

POTLATCH CORP  
Form 10-Q  
October 28, 2011  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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Form 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2011

Or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 1-32729

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POTLATCH CORPORATION  
(Exact name of registrant as specified in its charter)

|   |  |
|---|--|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization)<br>601 West First Avenue, Suite 1600<br>Spokane, Washington<br>(Address of principal executive offices)<br>(509) 835-1500<br>(Registrant's telephone number, including area code) | 82-0156045<br>(I.R.S. Employer<br>Identification No.)<br><br>99201<br>(Zip Code) |
|---|--|

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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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

|                         |                                     |                           |                          |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer         | <input type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/>            | Smaller reporting company | <input type="checkbox"/> |

(Do not check if a smaller reporting company)

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

The number of shares of common stock of the registrant outstanding as of October 20, 2011 was 40,187,407.



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## Part I

## ITEM 1.

## Financial Statements

## Potlatch Corporation and Consolidated Subsidiaries

## Consolidated Condensed Statements of Operations and Comprehensive Income

Unaudited (Dollars in thousands, except per-share amounts)

|   | Quarter Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|--------------------------------|-----------|------------------------------------|-----------|
|   | 2011                           | 2010      | 2011                               | 2010      |
| Revenues  | \$152,891                      | \$158,877 | \$387,494                          | \$393,273 |
| Costs and expenses:   |                                |           |                                    |           |
| Cost of goods sold  | 108,420                        | 122,205   | 287,473                            | 304,994   |
| Selling, general and administrative expenses                  | 7,837                          | 10,062    | 28,469                             | 27,908    |
| Asset impairment charge                                       | 1,180                          | —         | 1,180                              | —         |
|   | 117,437                        | 132,267   | 317,122                            | 332,902   |
| Earnings from continuing operations before interest and taxes | 35,454                         | 26,610    | 70,372                             | 60,371    |
| Interest expense, net   | (6,632)                        | (6,858)   | (21,123)                           | (21,035)  |
| Earnings from continuing operations before taxes              | 28,822                         | 19,752    | 49,249                             | 39,336    |
| Income tax provision  | (3,223)                        | (1,588)   | (7,505)                            | (7,960)   |
| Earnings from continuing operations                           | 25,599                         | 18,164    | 41,744                             | 31,376    |
| Discontinued operations, net of tax                           | —                              | (84)      | —                                  | (358)     |
| Net earnings  | \$25,599                       | \$18,080  | \$41,744                           | \$31,018  |
| Other comprehensive income, net of tax                        | 919                            | 657       | 2,759                              | 7,732     |
| Comprehensive income  | \$26,518                       | \$18,737  | \$44,503                           | \$38,750  |
| Earnings per common share from continuing operations:         |                                |           |                                    |           |
| Basic   | \$0.64                         | \$0.45    | \$1.04                             | \$0.79    |
| Diluted   | 0.63                           | 0.45      | 1.03                               | 0.78      |
| Loss per common share from discontinued operations:           |                                |           |                                    |           |
| Basic   | \$—                            | \$—       | \$—                                | \$(0.01)  |
| Diluted   | —                              | —         | —                                  | (0.01)    |
| Net earnings per common share:                                |                                |           |                                    |           |
| Basic   | \$0.64                         | \$0.45    | \$1.04                             | \$0.78    |
| Diluted   | 0.63                           | 0.45      | 1.03                               | 0.77      |
| Distributions per common share                                | \$0.51                         | \$0.51    | \$1.53                             | \$1.53    |
| Average shares outstanding (in thousands):                    |                                |           |                                    |           |
| Basic   | 40,187                         | 40,000    | 40,147                             | 39,954    |
| Diluted   | 40,380                         | 40,234    | 40,360                             | 40,194    |

The accompanying notes are an integral part of these consolidated financial statements.



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Potlatch Corporation and Consolidated Subsidiaries  
 Consolidated Condensed Balance Sheets  
 Unaudited (Dollars in thousands, except per-share amounts)

|   | September 30,<br>2011 | December 31,<br>2010 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash  | \$6,217               | \$5,593              |
| Short-term investments  | 74,690                | 85,249               |
| Receivables, net  | 26,880                | 21,278               |
| Inventories   | 26,369                | 24,375               |
| Other assets  | 24,335                | 25,299               |
| Total current assets  | 158,491               | 161,794              |
| Property, plant and equipment, net                                | 61,260                | 67,174               |
| Timber and timberlands, net                                       | 463,850               | 475,578              |
| Deferred tax assets   | 39,784                | 49,054               |
| Other assets  | 29,224                | 28,111               |
|   | \$752,609             | \$781,711            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                       |                       |                      |
| Current liabilities:  |                       |                      |
| Current installments on long-term debt                            | \$21,661              | \$5,011              |
| Accounts payable and accrued liabilities                          | 64,194                | 61,021               |
| Total current liabilities   | 85,855                | 66,032               |
| Long-term debt  | 344,676               | 363,485              |
| Liability for pensions and other postretirement employee benefits | 113,608               | 129,124              |
| Other long-term obligations                                       | 18,222                | 18,631               |
| Stockholders' equity  | 190,248               | 204,439              |
|   | \$752,609             | \$781,711            |
| Stockholders' equity per common share                             | \$4.73                | \$5.11               |
| Working capital   | \$72,636              | \$95,762             |
| Current ratio   | 1.8                   | 2.5                  |

The accompanying notes are an integral part of these consolidated financial statements.

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Potlatch Corporation and Consolidated Subsidiaries  
Consolidated Condensed Statements of Cash Flows  
Unaudited (Dollars in thousands)

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2011                               | 2010      |
| <b>CASH FLOWS FROM CONTINUING OPERATIONS</b>  |                                    |           |
| Net earnings  | \$41,744                           | \$31,018  |
| Adjustments to reconcile net earnings to net operating cash flows from continuing operations: |                                    |           |
| Depreciation, depletion and amortization  | 22,916                             | 23,857    |
| Basis of real estate sold   | 10,053                             | 25,492    |
| Change in deferred taxes  | 7,506                              | 8,801     |
| Loss (gain) on disposition of property, plant and equipment                                   | (106                               | ) 1,102   |
| Employee benefit plans  | (1,589                             | ) (4,326  |
| Equity-based compensation expense   | 3,144                              | 2,844     |
| Asset impairment  | 1,180                              | —         |
| Loss from discontinued operations   | —                                  | 358       |
| Proceeds from sales deposited with a like-kind exchange intermediary                          | —                                  | (260      |
| Funding of qualified pension plans  | (9,400                             | ) —       |
| Working capital changes   | (3,342                             | ) (4,876  |
| Net cash provided by operating activities from continuing operations                          | 72,106                             | 84,010    |
| <b>CASH FLOWS FROM INVESTING</b>  |                                    |           |
| Decrease (increase) in short-term investments   | 10,559                             | (12,160   |
| Additions to property, plant and equipment  | (4,163                             | ) (3,384  |
| Additions to timber and timberlands   | (7,915                             | ) (7,274  |
| Proceeds from disposition of property, plant and equipment                                    | 185                                | 3,110     |
| Other, net  | (1,564                             | ) (1,670  |
| Net cash used for investing activities from continuing operations                             | (2,898                             | ) (21,378 |
| <b>CASH FLOWS FROM FINANCING</b>  |                                    |           |
| Distributions to common stockholders  | (61,458                            | ) (61,161 |
| Payments on long-term debt  | (5,011                             | ) (10     |
| Issuance of common stock  | 1,230                              | 1,664     |
| Change in book overdrafts   | (1,377                             | ) 3,778   |
| Deferred financing costs  | (343                               | ) (194    |
| Employee tax withholdings on equity-based compensation  | (1,610                             | ) (2,075  |
| Other, net  | (15                                | ) 83      |
| Net cash used for financing activities from continuing operations                             | (68,584                            | ) (57,915 |
| Cash flows provided by continuing operations  | 624                                | 4,717     |
| Cash flows used for discontinued operations   | —                                  | (867      |
| Increase in cash  | 624                                | 3,850     |
| Cash at beginning of period   | 5,593                              | 1,532     |
| Cash at end of period   | \$6,217                            | \$5,382   |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b>   |                                    |           |
| Cash paid (received) during the period for:   |                                    |           |
| Interest, net of amount capitalized   | \$13,974                           | \$14,405  |

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|                                     |        |         |
|-------------------------------------|--------|---------|
| Income taxes, net                   | (5,977 | ) 1,434 |
| Non-cash investing activity:        |        |         |
| Additions to timber and timberlands | 341    | —       |

Certain 2010 amounts have been reclassified to conform to the 2011 presentation.

The accompanying notes are an integral part of these consolidated financial statements.

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Potlatch Corporation and Consolidated Subsidiaries  
Notes to Consolidated Condensed Financial Statements  
Unaudited (Dollars in thousands)

NOTE 1.

Basis of Presentation

For purposes of this report, any reference to “Potlatch,” “the company,” “we,” “us,” and “our” means Potlatch Corporation and all of its wholly owned subsidiaries, except where the context indicates otherwise.

The accompanying Consolidated Condensed Statements of Operations and Comprehensive Income for the quarters and nine months ended September 30, 2011 and 2010, the Consolidated Condensed Balance Sheets at September 30, 2011 and December 31, 2010, and the Consolidated Condensed Statements of Cash Flows for the nine months ended September 30, 2011 and 2010 have been prepared in conformity with accounting principles generally accepted in the United States of America. We believe that all adjustments necessary for a fair statement of the results of such interim periods have been included.

In September 2011, we recorded a pre-tax asset impairment charge of \$1.2 million to reflect the markdown to fair value of a building that was listed for sale. In the third quarter of 2011, we recorded an adjustment to the cost basis of land sales that occurred in the first and second quarters of 2011 resulting in an increase in third quarter earnings from continuing operations and net earnings of \$3.2 million pre-tax and \$2.4 million after-tax, respectively. The adjustment had no effect on revenues or cash flows. In March 2010, we sold our Idaho particleboard manufacturing facility’s buildings and equipment. As a result of the sale, we recorded pre-tax charges totaling \$0.4 million, primarily related to severance benefits. All other adjustments were of a normal recurring nature.

This Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission on February 23, 2011.

NOTE 2.

Recent Accounting Pronouncements

We did not adopt any new accounting standards during the nine months ended September 30, 2011. We reviewed all new accounting standards issued in the period and concluded that they did not have a material effect on our business.

NOTE 3.

Income Taxes

As a real estate investment trust, or REIT, if we meet certain requirements, we generally are not subject to federal and state corporate income taxes on our income from investments in real estate that we distribute to our shareholders. We are, however, subject to corporate taxes on built-in gains (the excess of fair market value at January 1, 2006 over tax basis on that date) with respect to the REIT's sale of any real property owned at such date within the first ten years following our conversion to a REIT, except for sales occurring in 2011. The Small Business Jobs Act of 2010 modifies the built-in gains provisions to exempt sales of real properties by a REIT in 2011, if five years of the recognition period has elapsed before January 1, 2011. If applicable, the built-in gains tax is eliminated or deferred if sale proceeds are reinvested in like-kind property in accordance with the like-kind exchange provisions of the Internal Revenue Code. The built-in gains tax is not applicable to the sale of timber pursuant to a stumpage sale agreement or timber deed.

For the quarters ended September 30, 2011 and 2010, we recorded income tax provisions related to our taxable REIT subsidiary, or Potlatch TRS, of \$3.2 million and \$1.6 million, respectively, due to pre-tax income. For the nine months ended September 30, 2011 and 2010, we recorded income tax provisions related to Potlatch TRS of \$7.5 million and \$5.1 million, respectively, due to pre-tax income.

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For the nine months ended September 30, 2011 and 2010, we recorded income tax expense of \$0 and \$0.4 million, respectively, related to the sale of REIT properties that were not deferred in accordance with the like-kind exchange provisions of the Internal Revenue Code.

The Patient Protection and Affordable Care Act, as amended by the Health Care and Reconciliation Act of 2010 included a change in the deductibility of drug expenses reimbursed under the Medicare Part D retiree drug subsidy program beginning after 2012. As a result of this legislation, deferred taxes associated with our retiree health care liabilities based on prior law

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were required to be adjusted, resulting in a \$3.0 million net charge to earnings in the first three months of 2010. During the nine months ended September 30, 2010, we recorded an income tax benefit related to continuing operations of Potlatch TRS of \$0.3 million attributable to the Part D reimbursements received during the period that were non-taxable.

We reviewed our tax positions at September 30, 2011 and determined that no uncertain tax positions were taken during the first nine months of 2011, and that no new information was available that would require derecognition of previously taken positions.

We reflect accrued interest related to tax obligations, as well as penalties, in our provision for income taxes. During the quarters and nine months ended September 30, 2011 and 2010, we recognized a net benefit of less than \$0.1 million related to interest and penalties in our tax provision. At September 30, 2011 and December 31, 2010, we had less than \$0.1 million accrued for the payment of interest. At September 30, 2011 and December 31, 2010, we had \$0 and \$0.8 million, respectively, accrued as a receivable for interest with respect to open tax refunds.

## NOTE 4.

## Earnings per Common Share

The following table reconciles the number of common shares used in calculating the basic and diluted earnings per share from continuing operations for the quarters and nine months ended September 30:

| (Dollars in thousands, except per-share amounts)             | Quarter Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|--------------------------------|------------|------------------------------------|------------|
|  | 2011                           | 2010       | 2011                               | 2010       |
| Earnings from continuing operations                          | \$25,599                       | \$18,164   | \$41,744                           | \$31,376   |
| Basic average common shares outstanding                      | 40,187,334                     | 40,000,396 | 40,147,133                         | 39,954,008 |
| Incremental shares due to:                                   |                                |            |                                    |            |
| Common stock options   | 44,147                         | 95,335     | 54,048                             | 95,595     |
| Performance shares   | 120,182                        | 108,097    | 129,691                            | 115,739    |
| Restricted stock units                                       | 28,639                         | 30,035     | 29,005                             | 29,128     |
| Diluted average common shares outstanding                    | 40,380,302                     | 40,233,863 | 40,359,877                         | 40,194,470 |
| Basic earnings per common share from continuing operations   | \$0.64                         | \$0.45     | \$1.04                             | \$0.79     |
| Diluted earnings per common share from continuing operations | \$0.63                         | \$0.45     | \$1.03                             | \$0.78     |
| Anti-dilutive shares excluded from the calculation:          |                                |            |                                    |            |
| Performance shares   | 77,767                         | 81,162     | 77,767                             | 81,162     |
| Restricted stock units                                       | —                              | 750        | 2,700                              | 4,550      |
| Total anti-dilutive shares excluded from the calculation     | 77,767                         | 81,912     | 80,467                             | 85,712     |

## NOTE 5.

## Equity-Based Compensation

As of September 30, 2011, we had three stock incentive plans under which stock option, performance share or restricted stock unit, or RSU, grants were outstanding, with approximately 451,000 shares authorized for future use

under the 2005 Stock Incentive Plan.

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The following table details our compensation expense for the quarters and nine months ended September 30:

| (Dollars in thousands)                           | Quarter Ended<br>September 30, |        | Nine Months Ended<br>September 30, |         |
|--|--------------------------------|--------|------------------------------------|---------|
|  | 2011                           | 2010   | 2011                               | 2010    |
| Employee equity-based compensation expense:      |                                |        |                                    |         |
| Performance shares                               | \$942                          | \$832  | \$2,707                            | \$2,393 |
| Restricted stock units                           | 155                            | 149    | 437                                | 451     |
| Total employee equity-based compensation expense | \$1,097                        | \$981  | \$3,144                            | \$2,844 |
| Related net income tax benefit                   | \$—                            | \$—    | \$—                                | \$—     |
| Director deferred compensation expense (income)  | \$(373)                        | \$(12) | \$484                              | \$917   |

For the nine months ended September 30, 2011 and 2010, there were no realized tax benefits related to the excess of the deductible amount over the compensation cost recognized in the Consolidated Condensed Statements of Cash Flows.

**STOCK OPTIONS**

The following table summarizes outstanding stock options as of September 30, 2011, and changes during the nine months ended September 30, 2011:

| (Dollars in thousands, except exercise prices) | Shares   | Weighted Avg.<br>Exercise Price | Aggregate<br>Intrinsic Value |
|--|----------|---------------------------------|------------------------------|
| Outstanding at January 1                       | 222,130  | \$21.64                         |                              |
| Shares exercised                               | (65,382) | 18.81                           | \$1,316                      |
| Shares canceled or expired                     | —        | —                               |                              |
| Outstanding and exercisable at September 30    | 156,748  | 22.82                           | 1,363                        |

There were no unvested stock options outstanding during the nine months ended September 30, 2011. The aggregate intrinsic value of stock options exercised during the nine months ended September 30, 2010 was \$1.2 million.

The following table summarizes outstanding stock options as of September 30, 2011:

| Range of Exercise Prices | Options Outstanding and Exercisable |  |                                 |
|--------------------------|-------------------------------------|--|---------------------------------|
|                          | Outstanding                         | Weighted Avg.<br>Remaining<br>Contractual Life | Weighted Avg.<br>Exercise Price |
| \$13.8594 to \$16.6452   | 47,908                              | 0.93 years                                     | \$14.89                         |
| \$19.2569                | 42,995                              | 2.17 years                                     | 19.26                           |
| \$30.9204                | 65,845                              | 3.17 years                                     | 30.92                           |
| \$13.8594 to \$30.9204   | 156,748                             | 2.21 years                                     | 22.82                           |

Cash received from stock option exercises for the nine months ended September 30, 2011 and 2010 was \$1.2 million and \$1.7 million, respectively. No actual tax benefits were realized for tax deductions from option exercises for the nine months ended September 30, 2011 and 2010.

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## PERFORMANCE SHARES

The following table presents the key inputs used in the Monte Carlo simulation method to calculate the fair value of the performance share awards in 2011 and 2010, and the resulting fair values:

|                                   |         |         |   |  |
|-----------------------------------|---------|---------|---|--|
|                                   | 2011    | 2010    |   |  |
| Shares granted                    | 77,767  | 81,162  |   |  |
| Stock price as of valuation date  | \$39.10 | \$31.88 |   |  |
| Risk-free rate                    | 1.26    | % 1.29  | % |  |
| Fair value of a performance share | \$55.84 | \$45.30 |   |  |

The following table summarizes outstanding performance share awards as of September 30, 2011, and changes during the nine months ended September 30, 2011:

| (Dollars in thousands, except grant date fair value) | Shares  | Weighted Avg.<br>Grant Date<br>Fair Value | Aggregate<br>Intrinsic Value |
|--|---------|---|------------------------------|
| Unvested shares outstanding at January 1             | 184,601 | \$38.45                                   |                              |
| Granted  | 77,767  | 55.84                                     |                              |
| Forfeited  | (3,814) | ) 42.77                                   |                              |
| Unvested shares outstanding at September 30          | 258,554 | 43.62                                     | \$7,923                      |

As of September 30, 2011, there was \$5.0 million of unrecognized compensation cost related to non-vested performance share awards, which is expected to be recognized over a weighted average period of 1.2 years.

## RESTRICTED STOCK UNITS

The following table summarizes outstanding RSU awards as of September 30, 2011, and changes during the nine months ended September 30, 2011:

| (Dollars in thousands, except grant date fair value) | Shares  | Weighted Avg.<br>Grant Date<br>Fair Value | Aggregate<br>Intrinsic Value |
|--|---------|---|------------------------------|
| Unvested shares outstanding at January 1             | 41,715  | \$29.37                                   |                              |
| Granted  | 18,053  | 38.57                                     |                              |
| Vested   | (1,404) | ) 39.17                                   |                              |
| Forfeited  | (1,619) | ) 32.00                                   |                              |
| Unvested shares outstanding at September 30          | 56,745  | 31.98                                     | \$1,789                      |

For RSU awards granted during the period, the fair value of each share was determined on the date of grant using the grant date market price. The total fair value of RSU awards vested during the nine months ended September 30, 2011 was less than \$0.1 million.

As of September 30, 2011, there was \$0.8 million of total unrecognized compensation cost related to non-vested RSU awards, which is expected to be recognized over a weighted average period of 1.3 years.

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## NOTE 6.

## Detail of Certain Balance Sheet Accounts

The following tables detail certain accounts as of the balance sheet dates:

| (Dollars in thousands)                      | September 30, 2011 | December 31, 2010 |
|---|--------------------|-------------------|
| Inventories:                                |                    |                   |
| Lumber and other manufactured wood products | \$12,534           | \$13,115          |
| Logs  | 9,732              | 7,619             |
| Material and supplies                       | 4,103              | 3,641             |
|   | \$26,369           | \$24,375          |
| Current Other Assets:                       |                    |                   |
| Deferred tax assets                         | \$13,346           | \$13,346          |
| Basis of real estate held for sale          | 6,667              | 9,268             |
| Assets held for sale                        | 1,700              | —                 |
| Prepaid expenses                            | 1,356              | 1,118             |
| Deferred charges                            | 1,266              | 1,567             |
|   | \$24,335           | \$25,299          |
| Noncurrent Other Assets:                    |                    |                   |
| Noncurrent investments                      | \$21,989           | \$21,292          |
| Deferred charges                            | 4,749              | 6,277             |
| Other                                       | 2,486              | 542               |
|   | \$29,224           | \$28,111          |

## NOTE 7.

## Pension Plans and Other Postretirement Employee Benefits

The following table details the components of net periodic cost (benefit) of our pension plans and other postretirement employee benefits, or OPEB, for the quarters and nine months ended September 30:

Quarters ended September 30:

| (Dollars in thousands)                      | Pension Plans |          | Other Postretirement<br>Employee Benefits |          |
|---|---------------|----------|---|----------|
|   | 2011          | 2010     | 2011                                      | 2010     |
| Service cost                                | \$1,114       | \$1,158  | \$112                                     | \$104    |
| Interest cost                               | 5,331         | 5,412    | 871                                       | 993      |
| Expected return on plan assets              | (7,951        | ) (8,283 | ) —                                       | —        |
| Amortization of prior service cost (credit) | 171           | 203      | (2,134                                    | ) (2,143 |
| Amortization of actuarial loss              | 2,479         | 2,043    | 992                                       | 1,158    |
| Net periodic cost (benefit)                 | \$1,144       | \$533    | \$(159                                    | ) \$112  |

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Nine months ended September 30:

| (Dollars in thousands)                      | Pension Plans |           | Other Postretirement<br>Employee Benefits |          |
|---|---------------|-----------|---|----------|
|   | 2011          | 2010      | 2011                                      | 2010     |
| Service cost                                | \$3,342       | \$3,474   | \$335                                     | \$312    |
| Interest cost                               | 15,994        | 16,237    | 2,614                                     | 2,979    |
| Expected return on plan assets              | (23,853       | ) (24,850 | ) —                                       | —        |
| Amortization of prior service cost (credit) | 513           | 609       | (6,402                                    | ) (6,429 |
| Amortization of actuarial loss              | 7,437         | 6,130     | 2,975                                     | 3,474    |
| Curtailment loss (gain)                     | —             | 64        | —   | (320     |
| Net periodic cost (benefit)                 | \$3,433       | \$1,664   | \$(478                                    | ) \$16   |

During the first quarter of 2011, we made contributions of \$5.0 million to our qualified salaried pension plan and \$4.4 million to our qualified non-represented pension plan, with \$5.8 million being discretionary funding. We do not anticipate additional contributions to any of our qualified pension plans in 2011. During the nine months ended September 30, 2011, we made contributions of \$1.3 million to our non-qualified supplemental pension plan.

## NOTE 8.

## Comprehensive Income

The following table details the components of comprehensive income for the quarters and nine months ended September 30:

| (Dollars in thousands)  | Quarter Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|--------------------------------|----------|------------------------------------|----------|
|   | 2011                           | 2010     | 2011                               | 2010     |
| Net earnings  | \$25,599                       | \$18,080 | \$41,744                           | \$31,018 |
| Other comprehensive income (loss), net of tax   |                                |          |                                    |          |
| Defined benefit pension plans and other<br>postretirement employee benefits:  |                                |          |                                    |          |
| Amortization of prior service credit included in net<br>periodic cost, net of tax of \$(765), \$(757), \$(2,297)<br>and \$(2,270) | (1,198                         | ) (1,183 | ) (3,592                           | ) (3,550 |
| Amortization of actuarial loss included in net<br>periodic cost, net of tax of \$1,354, \$1,248, \$4,061<br>and \$3,746           | 2,117                          | 1,953    | 6,351                              | 5,858    |
| Curtailment gain, net of tax of \$0, \$0, \$0 and \$(100)   | —                              | —        | —                                  | (156     |
| Recognition of deferred taxes related to actuarial<br>gain on OPEB obligations  | —                              | (113     | ) —                                | 5,580    |
| Other comprehensive income, net of tax  | 919                            | 657      | 2,759                              | 7,732    |
| Comprehensive income  | \$26,518                       | \$18,737 | \$44,503                           | \$38,750 |
| Other comprehensive income, net of tax, related to:   |                                |          |                                    |          |
| Defined benefit pension plans   | \$1,616                        | \$1,370  | \$4,849                            | \$4,149  |
| OPEB obligations  | (697                           | ) (713   | ) (2,090                           | ) 3,583  |
| Other comprehensive income, net of tax  | \$919                          | \$657    | \$2,759                            | \$7,732  |





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## NOTE 9.

## Financial Instruments

The following table presents the estimated fair values of our financial instruments as of the balance sheet dates:

| (Dollars in thousands)   | September 30, 2011 |            | December 31, 2010 |            |
|--|--------------------|------------|-------------------|------------|
|  | Carrying Amount    | Fair Value | Carrying Amount   | Fair Value |
| Cash, restricted cash and short-term investments (Level 1)   | \$80,907           | \$80,907   | \$91,183          | \$91,183   |
| Net derivative asset (liability) related to interest rate swaps (Level 2)  | 2,415              | 2,415      | (216)             | (216)      |
| Derivative asset (liability) related to lumber hedge (Level 2)   | 1,747              | 1,747      | (2,876)           | (2,876)    |
| Long-term debt, including current installments on long-term debt (including fair value adjustments related to fair value hedges) (Level 2) | 366,337            | 367,356    | 368,496           | 369,351    |

## FAIR VALUE HEDGES OF INTEREST RATE RISK

As of September 30, 2011, we had eight separate interest rate swap agreements with notional amounts totaling \$63.25 million, associated with our \$22.5 million debentures and \$40.75 million of our medium-term notes. The swaps convert interest payments with fixed rates between 6.95% and 8.89% to variable rates of three-month LIBOR plus spreads between 4.738% and 7.805%. The interest rate swaps terminate at various dates between January 2012 and February 2018.

As of September 30, 2011, we had a derivative asset within non-current other assets of \$2.4 million, resulting in a cumulative net increase to the carrying amount of our debt of \$2.4 million recorded on our Consolidated Condensed Balance Sheets.

For the quarter ended September 30, 2011 and 2010, we recognized a total of \$1.9 million and \$1.7 million, respectively, of net gains recorded in interest expense due to changes in fair value of the derivatives, which was offset by a cumulative net decrease to the carrying amount of debt of \$1.9 million and \$1.7 million, respectively. For the nine months ended September 30, 2011 and 2010 we recognized a total of \$2.6 million and \$1.5 million, respectively, of net gains recorded in interest expense due to changes in fair value of the derivatives, which was offset by a cumulative net decrease to the carrying amount of debt of \$2.6 million and \$1.5 million, respectively. Consequently, no net unrealized gain or loss was recognized in income for the quarter or nine months ended September 30, 2011. For the quarter ended September 30, 2011 and 2010, we recognized a net gain, resulting in a reduction in interest expense, of \$0.3 million and \$0.2 million, respectively, which includes realized net gains and losses from net cash settlements and interest accruals on the derivatives. For the nine months ended September 30, 2011 and 2010, we recognized a net gain, resulting in a reduction in interest expense, of \$0.8 million and \$0.2 million, respectively, which includes realized net gains and losses from net cash settlements and interest accruals on the derivatives. We recognized no hedge ineffectiveness during the quarter or nine months ended September 30, 2011 and 2010.

## NON-DESIGNATED LUMBER HEDGE

In September 2011, we entered into a commodity swap contract for 31,200 mbf of southern yellow pine with an effective date of November 1, 2011 and a termination date of February 29, 2012. Under the contract, 7,800 mbf cash settles each month. On October 13, 2010, we entered into a commodity swap contract for 33,000 mbf (thousand board feet) of eastern spruce/pine with an effective date of April 1, 2011 and a termination date of September 30, 2011. Under the contract, 5,500 mbf cash settled each month. During the quarter ended September 30, 2011, the three monthly cash settlements resulted in a cash receipt of \$0.3 million. Realized gains of \$0.3 million and \$0.6 million were recognized in the quarter and nine months ended September 30, 2011, respectively, as a reduction of cost of goods sold. In February 2011, the remaining 7,150 mbf of southern yellow pine from our commodity swap contract entered into on October 18, 2010 cash settled, resulting in a cash payment of \$0.2 million. Changes in the fair value of

derivatives not designated in hedging relationships are recorded directly in net earnings. As such, unrealized gains of \$1.7 million and \$4.4 million were recognized in the quarter and nine months ended September 30, 2011, respectively.

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The following table presents the fair values of derivative instruments as of the balance sheet dates:

| (Dollars in thousands)                                  | Balance Sheet<br>Location      | September 30,<br>2011 | December 31,<br>2010 |
|---|--------------------------------|-----------------------|----------------------|
| Fair Value of Derivative Assets:                        |                                |                       |                      |
| Derivatives designated as hedging instruments:          |                                |                       |                      |
| Interest rate contracts                                 | Other non-current<br>assets    | \$2,415               | \$62                 |
| Total derivatives designated as hedging instruments     |                                | \$2,415               | \$62                 |
| Derivatives not designated as hedging instruments:      |                                |                       |                      |
| Lumber contracts  | Receivables, net               | \$1,747               | \$—                  |
| Total derivatives not designated as hedging instruments |                                | \$1,747               | \$—                  |
| Fair Value of Derivative Liabilities:                   |                                |                       |                      |
| Derivatives designated as hedging instruments:          |                                |                       |                      |
| Interest rate contracts                                 | Other<br>long-term obligations | \$—                   | \$278                |
| Total derivatives designated as hedging instruments     |                                | \$—                   | \$278                |
| Derivatives not designated as hedging instruments:      |                                |                       |                      |
| Lumber contracts  | Accrued liabilities            | \$—                   | \$2,876              |
| Total derivatives not designated as hedging instruments |                                | \$—                   | \$2,876              |

The following table details the effect of derivatives on the Consolidated Condensed Statements of Operations and Comprehensive Income for the quarters and nine months ended September 30, 2011 and 2010:

| (Dollars in thousands)   | Location of Gain<br>Recognized in<br>Income | Gain Recognized in Income              |       |  |       |
|--|---|--|-------|--|-------|
|  |   | Quarter Ended<br>September 30,<br>2011 | 2010  | Nine Months Ended<br>September 30,<br>2011 | 2010  |
| Derivatives designated in fair value hedging relationships:                          |   |  |       |  |       |
| Interest rate contracts  |   |  |       |  |       |
| Realized gain on hedging instrument <sup>(1)</sup>                                   | Interest expense                            | \$255                                  | \$226 | \$791                                      | \$226 |
| Net gain recognized in income from fair value hedges                                 |   | \$255                                  | \$226 | \$791                                      | \$226 |
| Derivatives not designated as hedging instruments:                                   |   |  |       |  |       |
| Lumber contracts   |   |  |       |  |       |
| Unrealized gain on derivative  | Cost of goods sold                          | \$1,650                                | \$—   | \$4,401                                    | \$—   |
| Realized gain on derivative  | Cost of goods sold                          | 304                                    | —     | 553  | —     |
| Net gain recognized in income from derivatives not designated as hedging instruments |   | \$1,954                                | \$—   | \$4,954                                    | \$—   |

(1) Realized gain on hedging instrument consists of net cash settlements and interest accruals on the interest rate swaps during the periods.



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NOTE 10.

Commitments and Contingencies

In January 2007, the Environmental Protection Agency, or EPA, notified us that we are a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or CERCLA, and the Clean Water Act for clean-up of a site known as Avery Landing in northern Idaho. We own a portion of the land at the Avery Landing site, which we acquired in 1980 from the Milwaukee Railroad. The land we own at the site and adjacent properties were contaminated with petroleum as a result of the Milwaukee Railroad's operations at the site prior to 1980. We entered into a consent order with the EPA in August 2008 to conduct an Engineering Evaluation/Cost Analysis, or EE/CA, study to determine the best means of addressing the contamination at the site. In January 2010, we submitted our draft EE/CA report to the EPA outlining various alternatives for addressing the contamination at the entire site. The range of cost estimates for the various alternatives set forth in the report to address the contamination at the entire site was from \$0.7 million to \$8.2 million. In April 2010, we were notified by the EPA that they determined the EE/CA report submitted by us contained deficiencies and that the EPA would complete the EE/CA report for the Avery Landing site and produce the Biological Assessment and Cultural Resources Evaluation reports. The EPA published its draft report on January 26, 2011 for public comment. The EPA's report focused on a more limited number of remedial alternatives which range in cost from approximately \$7.9 million to \$10.5 million. The public comment period closed March 11, 2011. On July 5, 2011, the EPA issued an Action Memorandum for the Avery Landing Site selecting contaminant extraction and off-site disposal as the remedial alternative at an estimated cost of approximately \$9.5 million. Currently we are under no legal obligation to implement any remedy selected by the EPA. We believe we have valid defenses available to limit our potential liability for contamination at the site and we will pursue those defenses in either settlement negotiations with the EPA or in litigation to limit our liability. As of September 30, 2011, we have accrued \$4.8 million for this matter.

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## NOTE 11.

## Segment Information

The following table summarizes information by business segment for the quarters and nine months ended September 30:

| (Dollars in thousands)                           | Quarter Ended<br>September 30, |            | Nine Months Ended<br>September 30, |           |
|--|--------------------------------|------------|------------------------------------|-----------|
|  | 2011                           | 2010       | 2011                               | 2010      |
| Segment Revenues                                 |                                |            |                                    |           |
| Resource   | \$86,770                       | \$77,448   | \$172,587                          | \$172,716 |
| Real Estate                                      | 14,809                         | 32,254     | 46,808                             | 46,157    |
| Wood Products                                    | 69,239                         | 64,897     | 204,343                            | 209,832   |
|  | 170,818                        | 174,599    | 423,738                            | 428,705   |
| Elimination of intersegment revenues - Resource  | (17,927                        | ) (15,722  | ) (36,244                          | ) (35,432 |
| Total consolidated revenues                      | \$152,891                      | \$158,877  | \$387,494                          | \$393,273 |
| Operating Income                                 |                                |            |                                    |           |
| Resource   | \$25,598                       | \$24,336   | \$47,208                           | \$49,283  |
| Real Estate                                      | 9,929                          | 9,788      | 29,295                             | 16,803    |
| Wood Products                                    | 2,896                          | (608       | ) 8,548                            | 10,576    |
| Eliminations and adjustments                     | 1,634                          | (895       | ) 4,160                            | 1,678     |
|  | 40,057                         | 32,621     | 89,211                             | 78,340    |
| Corporate  | (11,235                        | ) (12,869  | ) (39,962                          | ) (39,004 |
| Earnings from continuing operations before taxes | \$28,822                       | \$19,752   | \$49,249                           | \$39,336  |
| Depreciation, depletion and amortization         |                                |            |                                    |           |
| Resource   | \$6,519                        | \$6,886    | \$13,851                           | \$15,889  |
| Real Estate*                                     | 21                             | —          | 21                                 | —         |
| Wood Products                                    | 1,925                          | 2,018      | 5,906                              | 6,188     |
|  | 8,465                          | 8,904      | 19,778                             | 22,077    |
| Corporate  | 627                            | 595        | 3,138                              | 1,780     |
| Total depreciation, depletion and amortization   | \$9,092                        | \$9,499    | \$22,916                           | \$23,857  |
| Basis of real estate sold                        |                                |            |                                    |           |
| Real Estate                                      | \$2,714                        | \$20,779   | \$13,287                           | \$25,492  |
| Eliminations and adjustments**                   | (3,234                         | ) —        | (3,234                             | ) —       |
| Total basis of real estate sold                  | \$(520                         | ) \$20,779 | \$10,053                           | \$25,492  |

\* Excludes \$1.2 million asset impairment charge.

\*\* See Note 1 to the consolidated condensed financial statements for additional information.

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ITEM 2.

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

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 recognition of compensation costs relating to our performance shares and RSUs, contributions to our qualified pension plans, U.S. housing market and housing starts, North American log exports to China, harvest deferrals, harvest levels, log and lumber prices, seasonal conditions, business conditions for our business segments, Resource segment results, Wood Products segment results, Real Estate segment results, and similar matters. Words such as "anticipate," "expect," "will," "intend," "plan," "target," "project," "believe," "seek," "schedule," "estimate," "could," "can," "may," and similar expressions identify such forward-looking statements. These forward-looking statements reflect our 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 our historical results or those expressed or implied by forward-looking statements contained in this report. For a nonexclusive listing of forward-looking statements and potential factors affecting our business, refer to "Cautionary Statement Regarding Forward-Looking Information" on page 1 and "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010.

Forward-looking statements contained in this report present our 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 our views to reflect events or circumstances occurring after the date of this report.

OVERVIEW

The operating results of our Resource, Real Estate and Wood Products business segments have been and will continue to be influenced by a variety of factors, including the cyclical nature of the forest products industry, which is largely dependent on the economy and U.S. housing starts, changes in timber prices and in harvest levels from our timberlands, competition, timberland valuations, demand for our non-strategic timberland for higher and better use purposes, the efficiency and level of capacity utilization of our wood products manufacturing operations, changes in our principal expenses such as log costs, asset dispositions or acquisitions, and other factors. Economic conditions remain difficult. The U.S. housing market remains weak and housing starts are expected to show little to no improvement during the remainder of the year. The business conditions for both our Resource and Wood Products segments continue to be challenging. Counterbalancing lower housing starts is the strong demand from China for North American logs and lumber, which helps support industry fundamentals, and in particular benefits the Northern region of our Resource segment.

Favorable logging conditions in Idaho during the first quarter of 2011 allowed our Resource segment to roll forward some of our planned harvest for the year in order to capture better than anticipated pricing that resulted from increased demand by West Coast customers as more of their traditional log supply was exported to China. However, in the second quarter of 2011, seasonal factors negatively affected our logging operations in Idaho. A late spring breakup delayed the start of logging operations by approximately three to four weeks compared to normal, which resulted in decreased harvest levels for the second quarter. However, we were able to harvest this deferred volume during the third quarter. In the South, extremely dry weather conditions in late 2010, that continued into 2011, resulted in favorable logging conditions which led to relatively high log inventories and less favorable pricing during the first nine months of 2011. For this reason, we deferred approximately 0.1 million tons of our planned quarterly sawlog harvest in the South during the second quarter. We were able to move this harvest volume to our Northern region during the third quarter to capture better pricing opportunities. In total, we expect our 2011 harvest to be approximately 4.1 million tons. In addition, wet weather in the South during the second quarter of 2010, combined with low inventory levels throughout the wood products supply chain, resulted in a sharp increase in prices for both logs and lumber in the second quarter of 2010, leading to unfavorable price comparisons in 2011 compared to 2010.



Our Wood Products segment benefited from relatively strong lumber prices in January and February, but prices were lower through the remainder of the first nine months of 2011. Our Real Estate segment had solid results for the first nine months of 2011, completing three phases of a non-strategic and rural real estate land sale transaction in Idaho and another non-strategic land sale in Idaho, along with a continued steady flow of other higher and better use, or HBU, and rural real estate sales.

Estimates for improvements in housing starts, the primary driver for our industry, continue to be pushed out further into the future. We expect a decrease in our Resource segment income in the fourth quarter, primarily due to seasonal factors in our Northern region and lower sawlog prices in our Southern region as a large customer in Arkansas recently idled its mill. We expect lumber prices to modestly decline during the fourth quarter due to typical seasonal factors. Consequently, our Wood Products segment will likely record a slight operating loss in the fourth quarter, though it is expected to be cash flow positive

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for the period. Results for our Real Estate segment are expected to remain steady, with continued demand for our non-strategic and rural real estate properties, although we expect to experience a seasonal drop in demand during the winter months.

**RESULTS OF OPERATIONS**

We are a real estate investment trust, or REIT, with approximately 1.45 million acres of timberlands in Arkansas, Idaho and Minnesota. Through wholly owned taxable subsidiaries, which we refer to in this report as Potlatch TRS, we operate a real estate sales and development business and five manufacturing facilities that produce lumber and plywood.

Our business is organized into three reporting segments: Resource; Real Estate; and Wood Products. Sales between segments are recorded as intersegment revenues based on prevailing market prices. Because our Resource segment supplies our Wood Products segment with a portion of its wood fiber needs, intersegment revenues can represent a significant portion of the Resource segment's total revenues. Our other segments generally do not generate intersegment revenues.

In the period-to-period discussion of our results of operations below, when we discuss our consolidated revenues, contributions by each of the segments to our revenues are reported after elimination of intersegment revenues. In the "Discussion of Business Segments" section below, segment revenues are presented before elimination of intersegment revenues.

Quarter Ended September 30, 2011 Compared to Quarter Ended September 30, 2010

The following table sets forth period-to-period changes in items included in our Consolidated Condensed Statements of Operations and Comprehensive Income for the quarters ended September 30:

| (Dollars in thousands)  | Quarter Ended<br>September 30, |           | Increase<br>(Decrease) |
|---|--------------------------------|-----------|------------------------|
|   | 2011                           | 2010      |                        |
| Revenues  | \$152,891                      | \$158,877 | \$(5,986)              |
| Costs and expenses  |                                |           |                        |
| Cost of goods sold  | 108,420                        | 122,205   | (13,785)               |
| Selling, general and administrative expenses                  | 7,837                          | 10,062    | (2,225)                |
| Asset impairment charge                                       | 1,180                          | —         | 1,180                  |
|   | 117,437                        | 132,267   | (14,830)               |
| Earnings from continuing operations before interest and taxes | 35,454                         | 26,610    | 8,844                  |
| Interest expense, net   | (6,632)                        | (6,858)   | (226)                  |
| Earnings from continuing operations before taxes              | 28,822                         | 19,752    | 9,070                  |
| Income tax provision  | (3,223)                        | (1,588)   | 1,635                  |
| Earnings from continuing operations                           | 25,599                         | 18,164    | 7,435                  |
| Discontinued operations, net of tax                           | —                              | (84)      | (84)                   |
| Net earnings  | \$25,599                       | \$18,080  | \$7,519                |

Revenues – Revenues decreased \$6.0 million, or 4%, in the quarter ended September 30, 2011 from the same period in 2010, as a result of decreased revenues from the Real Estate segment, primarily due to a large sale of non-strategic timberland in Wisconsin and Arkansas in 2010, partially offset by increased revenues due to seasonal factors that affected our Resource segment and increased sales by our Wood Products segment. A more detailed discussion of revenues follows in "Discussion of Business Segments."

Cost of goods sold – Cost of goods sold decreased \$13.8 million, or 11%, in the quarter ended September 30, 2011 from the same period in 2010, primarily due to a lower basis of real estate sold in the third quarter of 2011 as a result of decreased acreage sold in the current period, partially offset by increased logging and hauling costs and depletion expense in the Resource segment as a result of increased harvest levels and increased log and freight costs in the

Wood Products segment.

Selling, general and administrative expenses – Selling, general and administrative expenses decreased \$2.2 million, or 22%, in the third quarter of 2011 from the same quarter in 2010, primarily due to lower compensation-related expenses.

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Asset impairment charge – We recorded a \$1.2 million asset impairment charge to reflect the markdown to fair value of a building that was listed for sale during the quarter.

Interest expense, net – Net interest expense decreased \$0.2 million, or 3%, in the quarter ended September 30, 2011, from the same period in 2010, primarily due to a reduction in interest expense associated with the interest rate swaps entered into in June 2010 and the \$5.0 million medium-term note maturity in January 2011.

Income tax provision – We recorded income tax provisions related to our continuing operations of \$3.2 million and \$1.6 million for the quarters ended September 30, 2011 and 2010, respectively, primarily due to pre-tax income of Potlatch TRS.

Discontinued operations – The results of discontinued operations for the quarter ended September 30, 2010 included amounts associated with the Clearwater Paper businesses spun off in December 2008 and the Prescott mill closed in May 2008.

## DISCUSSION OF BUSINESS SEGMENTS

| (Dollars in thousands)   | Quarter Ended<br>September 30, |           | Increase<br>(Decrease) |
|--|--------------------------------|-----------|------------------------|
|  | 2011                           | 2010      |                        |
| Segment Revenues   |                                |           |                        |
| Resource   | \$86,770                       | \$77,448  | \$9,322                |
| Real Estate  | 14,809                         | 32,254    | (17,445 )              |
| Wood Products  | 69,239                         | 64,897    | 4,342                  |
| Total segment revenues, before eliminations  | \$170,818                      | \$174,599 | \$(3,781 )             |
| Segment Operating Income   |                                |           |                        |
| Resource   | \$25,598                       | \$24,336  | \$1,262                |
| Real Estate  | 9,929                          | 9,788     | 141                    |
| Wood Products  | 2,896                          | (608 )    | 3,504                  |
| Total segment operating income, before eliminations and adjustments, and corporate items | \$38,423                       | \$33,516  | \$4,907                |

Resource Segment – Revenues for the segment increased \$9.3 million, or 12%, during the third quarter of 2011 over the same period in 2010. Higher volumes and prices accounted for approximately \$8.0 million and \$2.2 million, respectively, of the variance, while a decrease in other revenues had a negative \$0.9 million impact on the variance. Total harvest volumes increased 11% in the third quarter of 2011 compared to the same quarter in 2010. The results for the third quarter of 2010 include volumes and prices from our Wisconsin and Arkansas properties that were sold in the third and fourth quarters of 2010. In our Northern region, total harvest volumes increased 15% in the third quarter of 2011 over the same period in 2010. Sawlog volumes increased 13%, primarily due to the shift of a portion of the harvest from our Southern region to capture better pricing opportunities in the Northern region, while sawlog prices increased 7%, primarily due to a general improvement in demand for sawlogs in the region. Northern pulpwood volumes and prices increased 41% and 13%, respectively, primarily due to increased demand for pulpwood in the Pacific Northwest due to a shortage of residual chips. Pulpwood prices also increased due to better market conditions and the higher valued pulp species harvested during the quarter in Minnesota. In our Southern region, total harvest volumes increased 2% in the third quarter of 2011 over the same period in 2010. Sawlog volumes and prices decreased 12% and 8%, respectively, primarily due to reduced demand. Southern pulpwood volumes increased 19%, due to thinning operations on our pine plantations, while prices decreased 18% due to the availability of fiber in the region. Expenses for the segment increased \$8.1 million, or 15%, during the third quarter of 2011 over the third quarter of 2010, primarily related to higher logging and hauling costs and depletion expense due to the increased harvest levels. Operating income for our Resource segment increased \$1.3 million, or 5%, in the third quarter of 2011

over the same period of 2010.

Real Estate Segment – Revenues decreased \$17.4 million, expenses decreased \$17.5 million and operating income increased \$0.1 million in the third quarter of 2011 compared to the same period in 2010 as a result of a decrease in non-strategic timberland acres sold. The results for the third quarter of 2011 primarily were due to the sale of 5,912 acres of non-strategic timberland and rural real estate in the third and final phase of a land sale transaction in Idaho for approximately \$9.1 million. In the third quarter of 2010 we sold approximately 41,700 acres of non-strategic timberlands in Wisconsin and Arkansas for \$28.7 million.

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The following table summarizes our real estate sales for the quarters ended September 30:

|                             | 2011       |                    | 2010       |                    |
|-----------------------------|------------|--------------------|------------|--------------------|
|                             | Acres Sold | Average Price/Acre | Acres Sold | Average Price/Acre |
| Higher and better use (HBU) | 966        | \$2,074            | 446        | \$2,000            |
| Rural real estate           | 3,663      | 1,221              | 1,370      | 1,261              |
| Non-strategic timberland    | 5,612      | 1,485              | 42,772     | 693                |
| Total                       | 10,241     |                    | 44,588     |                    |

Wood Products – Revenues for the segment increased \$4.3 million, or 7%, in the third quarter of 2011 over the same period in 2010 as a result of both increased prices and volumes. Lumber prices increased 10% over the previous year, while lumber volumes increased 2% over the previous year due to slightly improved demand in the third quarter of 2011. Expenses for the segment increased \$0.8 million, or 1%, in the third quarter of 2011 over the same quarter of 2010, primarily as a result of increased log costs, due to both prices and volumes, and higher freight costs, partially offset by a positive \$2.0 million adjustment related to our lumber hedge. The Wood Products segment reported operating income of \$2.9 million for the third quarter of 2011 compared to an operating loss of \$0.6 million in the same quarter of 2010.

Nine Months Ended September 30, 2011 Compared to Nine Months Ended September 30, 2010

The following table sets forth period-to-period changes in items included in our Consolidated Condensed Statements of Operations and Comprehensive Income for the nine months ended September 30:

| (Dollars in thousands)  | Nine Months Ended<br>September 30, |           |                        |
|---|------------------------------------|-----------|------------------------|
|   | 2011                               | 2010      | Increase<br>(Decrease) |
| Revenues  | \$387,494                          | \$393,273 | \$(5,779)              |
| Costs and expenses  |                                    |           |                        |
| Cost of goods sold  | 287,473                            | 304,994   | (17,521)               |
| Selling, general and administrative expenses                  | 28,469                             | 27,908    | 561                    |
| Asset impairment charge                                       | 1,180                              | —         | 1,180                  |
|   | 317,122                            | 332,902   | (15,780)               |
| Earnings from continuing operations before interest and taxes | 70,372                             | 60,371    | 10,001                 |
| Interest expense, net   | (21,123)                           | (21,035)  | 88                     |
| Earnings from continuing operations before taxes              | 49,249                             | 39,336    | 9,913                  |
| Income tax provision  | (7,505)                            | (7,960)   | (455)                  |
| Earnings from continuing operations                           | 41,744                             | 31,376    | 10,368                 |
| Discontinued operations, net of tax                           | —                                  | (358)     | (358)                  |
| Net earnings  | \$41,744                           | \$31,018  | \$10,726               |

Revenues – Revenues decreased \$5.8 million in the nine months ended September 30, 2011 from the same period in 2010, primarily due to decreased revenues from the Wood Products segment as a result of poor market conditions. A more detailed discussion of revenues follows in “Discussion of Business Segments.”

Cost of goods sold – Cost of goods sold decreased \$17.5 million, or 6%, in the nine months ended September 30, 2011 from the same period in 2010, primarily due to a lower basis of real estate sold as a result of decreased acreage sold and the positive impact of the lumber hedges, partially offset by increased logging and hauling costs as a result of increased harvest levels.



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Selling, general and administrative expenses – Selling, general and administrative expenses increased \$0.6 million, or 2%, in the nine months ended September 30, 2011 over the same period in 2010, primarily due to higher compensation-related expenses, attributable mainly to our deferred compensation and incentive plans.

Asset impairment charge – We recorded a \$1.2 million asset impairment charge to reflect the markdown to fair value of a building that was listed for sale during the third quarter of 2011.

Interest expense, net – Net interest expense increased \$0.1 million in the nine months ended September 30, 2011 over the same period in 2010, primarily due to a \$1.2 million non-cash charge for deferred costs related to the reduction in our revolving credit facility, offset by a reduction in interest expense associated with the interest rate swaps entered into in June 2010 and the \$5.0 million medium-term note maturity in January 2011.

Income tax provision – We recorded income tax provisions related to our continuing operations of \$7.5 million and \$8.0 million for the nine months ended September 30, 2011 and 2010, respectively. The income tax provision in 2011 resulted from pre-tax income of Potlatch TRS. The income tax provision in 2010 resulted from pre-tax income of Potlatch TRS, an adjustment of our deferred taxes associated with our retiree health care liability as a result of health care legislation, and built-in gains taxes on land sales.

Discontinued operations – The results of discontinued operations for the nine months ended September 30, 2010 included amounts associated with the Clearwater Paper businesses spun off in December 2008 and the Prescott mill closed in May 2008.

## DISCUSSION OF BUSINESS SEGMENTS

| (Dollars in thousands)   | Nine Months Ended<br>September 30, |           | Increase<br>(Decrease) |
|--|------------------------------------|-----------|------------------------|
|  | 2011                               | 2010      |                        |
| Segment Revenues   |                                    |           |                        |
| Resource   | \$172,587                          | \$172,716 | \$(129 )               |
| Real Estate  | 46,808                             | 46,157    | 651                    |
| Wood Products  | 204,343                            | 209,832   | (5,489 )               |
| Total segment revenues, before eliminations  | \$423,738                          | \$428,705 | \$(4,967 )             |
| Segment Operating Income   |                                    |           |                        |
| Resource   | \$47,208                           | \$49,283  | \$(2,075 )             |
| Real Estate  | 29,295                             | 16,803    | 12,492                 |
| Wood Products  | 8,548                              | 10,576    | (2,028 )               |
| Total segment operating income, before eliminations and adjustments, and corporate items | \$85,051                           | \$76,662  | \$8,389                |

Resource Segment – Revenues for the segment decreased \$0.1 million during the first nine months of 2011 from the same period in 2010. Higher prices contributed approximately \$2.8 million to the variance, but lower sales volumes and other revenues offset the variance by negative \$1.2 million and negative \$1.7 million, respectively. Total harvest volumes decreased 1% in the first nine months of 2011 compared to the same period in 2010. The results for the nine months ended September 30, 2010 include volumes and prices from our Wisconsin and certain Arkansas properties that were sold in the third and fourth quarters of 2010. In our Northern region, total harvest volumes were essentially level in the first nine months of 2011 compared to the same period in 2010. Sawlog volumes increased 1%, while prices increased 8%, primarily due to a general improvement in demand for all sawlog species. Northern pulpwood volumes decreased 6% in the first nine months of 2011 compared to the same period in 2010, primarily due to the late start of logging operations in Idaho in the second quarter of 2011 and the inclusion of Wisconsin harvests in the 2010 data, while pulpwood prices increased 8% due to increased customer demand and a shortage of residual chips in the Pacific Northwest. In our Southern region, total harvest volumes decreased 2% in the first nine months of 2011 from the same period in 2010. Sawlog volumes and prices decreased 13% and 7%, respectively, primarily due to fiber



availability and reduced demand. Southern pulpwood volumes increased 13%, due to thinning operations on our plantations, while prices decreased 17% due to fiber availability. Expenses for the segment increased \$1.9 million, or 2%, during the first nine months of 2011 over the same period in 2010, which was primarily related to higher logging and hauling costs due to higher fuel costs. Operating income for our Resource segment decreased \$2.1 million, or 4%, for the first nine months of 2011 from the same period in 2010.

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Real Estate Segment – Revenues increased \$0.7 million, expenses decreased \$11.8 million and operating income increased \$12.5 million in the first nine months of 2011 compared to the same period in 2010. The year-to-date results for 2011 are primarily due to four sales involving non-strategic timberland and rural real estate in Idaho that totaled 22,660 acres and resulted in revenues of \$32.4 million. The year-to-date results for 2010 primarily resulted from the approximately 41,700 acres of non-strategic timberlands sold in Wisconsin and Arkansas for \$28.7 million. The Wisconsin timberland, purchased in 2007, was carried at a higher basis in comparison to timberland sold from our other regions that we have held longer. The product type sale prices per acre were relatively consistent between the nine months ended September 30, 2011 and 2010, with the exception of the aforementioned non-strategic timberland and rural real estate sales.

The following table summarizes our real estate sales for the nine months ended September 30:

|                             | 2011       |                    | 2010       |                    |
|-----------------------------|------------|--------------------|------------|--------------------|
|                             | Acres Sold | Average Price/Acre | Acres Sold | Average Price/Acre |
| Higher and better use (HBU) | 2,126      | \$2,031            | 2,510      | \$2,003            |
| Rural real estate           | 8,294      | 1,244              | 7,099      | 1,187              |
| Non-strategic timberland    | 23,859     | 1,348              | 46,272     | 707                |
| Total                       | 34,279     |                    | 55,881     |                    |

Wood Products – Revenues for the segment decreased \$5.5 million, or 3%, in the nine months ended September 30, 2011 from the same period in 2010. Lumber sales prices decreased 1% in the first nine months of 2011 from the same period in 2010 primarily due to a sharp increase in prices that occurred in the second quarter of 2010. Sales volumes decreased 1% as a result of decreased demand in the first nine months of 2011. Expenses for the segment decreased \$3.5 million, or 2%, in the first nine months of 2011 from the same period in 2010, primarily due to a positive \$5.0 million adjustment related to our lumber hedges, partially offset by higher freight and log costs. The Wood Products segment reported operating income of \$8.5 million for the first nine months of 2011 compared to \$10.6 million in the same period in 2010.

**LIQUIDITY AND CAPITAL RESOURCES**

At September 30, 2011, our financial position included long-term debt of \$366.3 million, including current installments on long-term debt, compared to \$368.5 million at December 31, 2010. Stockholders' equity for the first nine months of 2011 decreased \$14.2 million primarily due to our regular quarterly cash distributions to common stockholders totaling \$61.5 million, partially offset by net earnings of \$41.7 million. The ratio of long-term debt to stockholders' equity was 1.9 to 1 at September 30, 2011, compared to 1.8 to 1 at December 31, 2010.

Working capital totaled \$72.6 million at September 30, 2011, a decrease of \$23.2 million from the December 31, 2010 balance of \$95.8 million. The significant changes in the components of working capital are as follows:

The current portion of long-term debt increased \$16.7 million due to the scheduled maturity of \$21.7 million of long-term debt in the first half of 2012, partially offset by the maturity of \$5.0 million of medium-term notes in January 2011.

Cash and short-term investments decreased \$9.9 million primarily due to the payment of the regular quarterly cash distributions to common stockholders totaling \$61.5 million and the contribution of \$9.4 million to our qualified pension plans, partially offset by earnings from real estate sales and other operating activities.

Receivables increased \$5.6 million primarily as a result of increased trade receivables due to the effects of seasonality on the Resource segment and increased Wood Products sales.

Accounts payable and accrued liabilities increased \$3.2 million, primarily as a result of an increase in trade payables due to increased logging activity.

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## Cash Flows Summary

The following table presents information regarding our cash flows for the nine months ended September 30:

| (Dollars in thousands)                       | 2011     | 2010      |
|--|----------|-----------|
| Cash flows from continuing operations        |          |           |
| Net cash provided by operations              | \$72,106 | \$84,010  |
| Net cash used for investing                  | (2,898   | ) (21,378 |
| Net cash used for financing                  | (68,584  | ) (57,915 |
| Cash flows provided by continuing operations | 624      | 4,717     |
| Cash flows used for discontinued operations  | —        | (867      |
| Increase in cash                             | 624      | 3,850     |
| Cash at beginning of period                  | 5,593    | 1,532     |
| Cash at end of period                        | \$6,217  | \$5,382   |

Net cash provided by operating activities from continuing operations for the first nine months of 2011 totaled \$72.1 million, compared to \$84.0 million for the same period in 2010. The decrease was due to a lower basis of real estate sold and the \$9.4 million contribution to our qualified pension plans, partially offset by increased earnings in the first nine months of 2011.

Net cash used for investing activities from continuing operations totaled \$2.9 million and \$21.4 million for the nine months ended September 30, 2011 and 2010, respectively. In the first nine months of 2011, a \$10.6 million net decrease in short-term investments was partially offset by \$12.1 million of capital expenditures. In the first nine months of 2010, a \$12.2 million net increase in short-term investments and \$10.7 million of capital expenditures was partially offset by \$3.1 million of proceeds from the disposition of property, plant and equipment. Capital expenditures in both periods were primarily for reforestation activities and routine general replacement projects associated with our wood products manufacturing facilities.

Net cash used for financing activities from continuing operations totaled \$68.6 million and \$57.9 million for the nine months ended September 30, 2011 and 2010, respectively. Net cash used for financing activities in the first nine months of 2011 was primarily for payment of our regular quarterly cash distributions to common stockholders of \$61.5 million and a debt maturity of \$5.0 million. Net cash used for financing activities in the first nine months of 2010 was primarily for payment of our regular quarterly cash distributions to common stockholders of \$61.2 million. Pursuant to an amendment effective February 4, 2011, we reduced the available borrowing capacity under our bank credit facility from \$250 million to \$150 million. As of September 30, 2011, there were no borrowings outstanding under the revolving line of credit, and approximately \$2.0 million of the letter of credit subfacility was being used to support several outstanding letters of credit. Available borrowing capacity at September 30, 2011 was \$148.0 million. Effective June 28, 2011, we reduced the amount of timberlands securing our bank credit facility from 640,900 acres to 351,900 acres, primarily due to the decrease in our bank credit facility from \$250 million to \$150 million.

The following table sets forth the most restrictive covenants in the bank credit facility and our status with respect to these covenants as of September 30, 2011:

|   | Covenant Requirement | Actual Ratio at September 30, 2011 |
|---|----------------------|------------------------------------|
| Minimum Interest Coverage Ratio                     | 2.75 to 1.00 *       | 5.17 to 1.00                       |
| Minimum Collateral Coverage Ratio                   | 3.00 to 1.00         | 3.27 to 1.00                       |
| Maximum Funded Indebtedness to Capitalization Ratio | 70.0%                | 54.9%                              |

\*Commencing October 1, 2011, the Minimum Interest Coverage Ratio will increase to 3.00 to 1.00.

Our senior notes contain covenants that limit certain of our abilities, such as the payment of dividends and repurchase of our capital stock, unless certain financial conditions are met. Our cumulative Funds Available for Distribution, or FAD, as defined in the covenant, less our dividends paid was \$39.2 million at September 30, 2011. The remaining

balance available for the payment of future dividends pursuant to the covenant was \$90.1 million at September 30, 2011.

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On July 22, 2011, Moody's upgraded our rating outlook to positive from stable, and affirmed our corporate and debt ratings of Ba1.

Contractual Obligations

There have been no material changes to our contractual obligations in the nine months ended September 30, 2011 outside the ordinary course of business.

Off-Balance Sheet Arrangements

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

ITEM 3.

Quantitative and Qualitative Disclosures About Market Risk

In September 2011 we entered into a commodity swap contract to mitigate commodity price risk related to sales by our Wood Products segment. These contracts will cash settle monthly from November 2011 through February 2012. See Note 9 to the consolidated condensed financial statements for additional information about the lumber commodity swap.

Other than for the lumber commodity swap above, our exposures to market risk have not changed materially since December 31, 2010. For quantitative and qualitative disclosures about market risk, see Item 7A – "Quantitative and Qualitative Disclosure about Market Risk" in our 2010 Annual Report on Form 10-K.

ITEM 4.

Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act). Based on that evaluation, our management, including our CEO and CFO, concluded that as of September 30, 2011, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Internal Control Over Financial Reporting

In the nine months ended September 30, 2011 there were no changes in our internal control over financial reporting that would materially affect or are reasonably likely to materially affect our internal control over financial reporting.

Part II

ITEM 1.

Legal Proceedings

Other than the potentially material environmental proceedings described in Note 10 to the consolidated condensed financial statements included in this report, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

ITEM 1A.

Risk Factors

There have been no material changes in the risk factors previously disclosed in "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 6.

Exhibits

The exhibit index is located on page 24 of this Form 10-Q.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

POTLATCH CORPORATION  
(Registrant)

By /s/ Eric J. Cremers  
Eric J. Cremers  
Vice President, Finance and Chief Financial Officer  
(Duly Authorized; Principal Financial Officer)

By /s/ Terry L. Carter  
Terry L. Carter  
Controller and Treasurer  
(Duly Authorized; Principal Accounting Officer)

Date: October 28, 2011

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES  
EXHIBIT INDEX

| EXHIBIT<br>NUMBER | DESCRIPTION  |
|-------------------|--|
| (3)(a)*           | Second Restated Certificate of Incorporation of the Registrant, effective February 3, 2006, filed as Exhibit 99.2 to the Current Report on Form 8-K filed by the Registrant on February 6, 2006.   |
| (3)(b)*           | Bylaws of the Registrant, as amended through February 18, 2009, filed as Exhibit (3)(b) to the Current Report on Form 8-K filed by the Registrant on February 20, 2009.  |
| (4)               | Registrant undertakes to furnish to the Commission, upon request, any instrument defining the rights of holders of long-term debt.   |
| (31)              | Rule 13a-14(a)/15d-14(a) Certifications.   |
| (32)              | Furnished statements of the Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350.  |
| 101               | The following financial information from Potlatch Corporation's Quarterly Report on Form 10-Q for the quarter and nine months ended September 30, 2011, filed on October 28, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Condensed Statements of Operations and Comprehensive Income for the quarters and nine months ended September 30, 2011 and 2010, (ii) the Consolidated Condensed Balance Sheets at September 30, 2011 and December 31, 2010, (iii) the Consolidated Condensed Statements of Cash Flows for the quarters and nine months ended September 30, 2011 and 2010, and (iv) the Notes to Consolidated Condensed Financial Statements. |

\* Incorporated by reference