



# **FORM 10-Q**

**POTLATCH CORP - PCH**

**Filed: July 28, 2008 (period: June 30, 2008)**

Quarterly report which provides a continuing view of a company's financial position

# Table of Contents

[10-Q - QUARTERLY REPORT ON FORM 10-Q](#)

## [PART I.](#)

---

[ITEM 1.](#)

[ITEM 2.](#)

[ITEM 3.](#)

[ITEM 4.](#)

## [Part II](#)

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[ITEM 1.](#)

[ITEM 1A.](#)

[ITEM 2.](#)

[ITEM 4.](#)

[ITEM 6.](#)

[SIGNATURES](#)

[EXHIBIT INDEX](#)

[EX-10.\(S\) \(AMENDED AND RESTATED DEFERRED COMPENSATION PLAN FOR DIRECTORS II\)](#)

[EX-31 \(RULE 13A-14\(A\)/15D-14\(A\) CERTIFICATIONS\)](#)

[EX-32 \(FURNISHED STATEMENTS OF THE CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER\)](#)

**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 June 30, 2008

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**  
(State or other jurisdiction of  
incorporation or organization)

**82-0156045**  
(I.R.S. Employer  
Identification No.)

**601 West 1st Ave., Suite 1600**  
**Spokane, Washington**  
(Address of principal executive offices)

**99201**  
(Zip Code)

Registrant's telephone number, including area code: **(509) 835-1500**

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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 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  Accelerated filer  Non-accelerated filer  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 June 30, 2008 was 39,504,018.

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[Table of Contents](#)

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

Index to Form 10-Q

	<u>Page Number</u>
<u>PART I. FINANCIAL INFORMATION</u>	
<u>ITEM 1. Financial Statements</u>	
<a href="#">Consolidated Statements of Operations and Comprehensive Income for the quarters and six months ended June 30, 2008 and 2007</a>	2
<a href="#">Consolidated Condensed Balance Sheets at June 30, 2008 and December 31, 2007</a>	3
<a href="#">Consolidated Condensed Statements of Cash Flows for the six months ended June 30, 2008 and 2007</a>	4
<a href="#">Notes to Consolidated Financial Statements</a>	5 - 14
<u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15 - 29
<u>ITEM 3. Quantitative and Qualitative Disclosures About Market Risk</u>	29 - 30
<u>ITEM 4. Controls and Procedures</u>	30 - 31
<u>PART II. OTHER INFORMATION</u>	
<u>ITEM 1. Legal Proceedings</u>	31
<u>ITEM 1A. Risk Factors</u>	31
<u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	32
<u>ITEM 4. Submission of Matters to a Vote of Security Holders</u>	32
<u>ITEM 6. Exhibits</u>	33
<u>SIGNATURES</u>	33
<u>EXHIBIT INDEX</u>	34

[Table of Contents](#)**Part I**

## ITEM 1.

**Financial Statements**

Potlatch Corporation and Consolidated Subsidiaries  
 Statements of Operations and Comprehensive Income  
 Unaudited (Dollars in thousands - except per-share amounts)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenues	\$415,404	\$398,489	\$832,801	\$768,792
Costs and expenses:				
Depreciation, depletion and amortization	16,906	18,734	36,135	37,468
Materials, labor and other operating expenses	346,367	310,219	694,138	630,134
Selling, general and administrative expenses	21,646	20,892	47,377	41,701
Restructuring charge	—	35	—	2,831
	<u>384,919</u>	<u>349,880</u>	<u>777,650</u>	<u>712,134</u>
Earnings from continuing operations before interest and taxes	30,485	48,609	55,151	56,658
Interest expense	(8,643)	(7,340)	(17,174)	(14,891)
Interest income	126	596	454	896
Earnings from continuing operations before taxes	21,968	41,865	38,431	42,663
Income tax provision (benefit)	(291)	6,336	(7,780)	1,314
Earnings from continuing operations	<u>22,259</u>	<u>35,529</u>	<u>46,211</u>	<u>41,349</u>
Discontinued operations:				
Loss from discontinued operations (including (losses) gain on disposal of \$(916), \$55, \$(20,016), and \$(35,774))	(1,278)	(1,618)	(23,727)	(40,292)
Income tax benefit	(498)	(39)	(9,253)	(3,117)
	<u>(780)</u>	<u>(1,579)</u>	<u>(14,474)</u>	<u>(37,175)</u>
Net earnings	<u>\$ 21,479</u>	<u>\$ 33,950</u>	<u>\$ 31,737</u>	<u>\$ 4,174</u>
Other comprehensive income (loss), net of tax				
Defined benefit pension and other postretirement benefit plans:				
Amortization of actuarial loss included in net periodic cost, net of tax of \$613, \$899, \$1,576, and \$2,015	\$ 957	\$ 1,407	\$ 2,464	\$ 3,153
Amortization of prior service credit included in net periodic cost, net of tax of \$(168), \$(230), \$(335), and \$(268)	(261)	(360)	(523)	(419)
Curtailment loss, net of tax of \$24, \$-, \$531, and \$-	37	—	830	—
Other comprehensive income, net of tax	<u>733</u>	<u>1,047</u>	<u>2,771</u>	<u>2,734</u>
Comprehensive income	<u>\$ 22,212</u>	<u>\$ 34,997</u>	<u>\$ 34,508</u>	<u>\$ 6,908</u>
Earnings per common share from continuing operations:				
Basic	\$ 0.56	\$ 0.91	\$ 1.17	\$ 1.06
Diluted	0.56	0.91	1.17	1.05
Loss per common share from discontinued operations:				
Basic	\$ (0.02)	\$ (0.04)	\$ (0.37)	\$ (0.95)
Diluted	(0.02)	(0.04)	(0.37)	(0.95)
Net earnings per common share:				
Basic	\$ 0.54	\$ 0.87	\$ 0.81	\$ 0.11
Diluted	0.54	0.87	0.80	0.11
Distributions per common share	\$ 0.51	\$ 0.49	\$ 1.02	\$ 0.98
Average shares outstanding (in thousands):				
Basic	39,459	39,027	39,389	38,989
Diluted	39,696	39,242	39,633	39,232

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

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

## Table of Contents

Potlatch Corporation and Consolidated Subsidiaries

Condensed Balance Sheets

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

	<u>June 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>
<b>ASSETS</b>		
Current assets:		
Cash	\$ 6,607	\$ 9,047
Short-term investments	26,000	22,289
Receivables, net	136,953	114,260
Inventories	151,378	169,396
Prepaid expenses	21,259	18,967
Assets held for sale	3,135	—
Total current assets	<u>345,332</u>	<u>333,959</u>
Land, other than timberlands	8,250	8,549
Plant and equipment, at cost less accumulated depreciation	475,284	510,776
Timber, timberlands and related deposits, net	569,798	534,513
Pension assets	115,347	108,435
Other assets	21,063	20,972
	<u>\$ 1,535,074</u>	<u>\$ 1,517,204</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current installments on long-term debt	\$ 410	\$ 209
Current notes payable	129,300	110,300
Accounts payable and accrued liabilities	178,142	174,198
Total current liabilities	<u>307,852</u>	<u>284,707</u>
Long-term debt	320,912	321,301
Liability for pensions and other postretirement employee benefits	262,258	261,956
Other long-term obligations	19,904	18,923
Deferred taxes	46,929	51,981
Stockholders' equity	<u>577,219</u>	<u>578,336</u>
	<u>\$ 1,535,074</u>	<u>\$ 1,517,204</u>
Stockholders' equity per common share	\$ 14.61	\$ 14.73
Working capital	\$ 37,480	\$ 49,252
Current ratio	1.1:1	1.2:1

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

## Table of Contents

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

	Six Months Ended	
	June 30,	
	2008	2007
<b>CASH FLOWS FROM CONTINUING OPERATIONS</b>		
Net earnings	\$ 31,737	\$ 4,174
Adjustments to reconcile net earnings to net operating cash flows from continuing operations:		
Loss from discontinued operations	2,264	4,192
Loss on disposal of discontinued operations	12,210	32,983
Depreciation, depletion and amortization	36,135	37,468
Proceeds from sales deposited with a like-kind exchange intermediary	(30,011)	(14,829)
Basis of real estate sold	5,793	403
Deferred taxes	(6,823)	(3,495)
Equity-based compensation expense	2,950	2,839
Employee benefit plans	(2,900)	(7,566)
Other	98	385
Working capital changes	(1,707)	16,553
Excess tax benefit from share-based payment arrangements	(2,011)	(2,192)
Income tax benefit related to stock issued in conjunction with stock compensation plans	946	958
Net cash provided by operating activities from continuing operations	<u>48,681</u>	<u>71,873</u>
<b>CASH FLOWS FROM INVESTING</b>		
Change in short-term investments	26,299	(9,830)
Additions to plant and properties	(31,889)	(32,855)
Deposits on timberlands	(27,328)	(54,021)
Other, net	970	(173)
Net cash used for investing activities from continuing operations	<u>(31,948)</u>	<u>(96,879)</u>
<b>CASH FLOWS FROM FINANCING</b>		
Change in book overdrafts	(3,067)	(3,319)
Increase in notes payable	19,000	—
Issuance of common stock	3,310	3,654
Repayment of long-term debt	(188)	(3,137)
Distributions to common stockholders	(40,252)	(38,244)
Excess tax benefit from share-based payment arrangements	2,011	2,192
Other, net	(2,844)	(1,654)
Net cash used for financing activities from continuing operations	<u>(22,030)</u>	<u>(40,508)</u>
Cash flows from continuing operations	(5,297)	(65,514)
Cash flows of discontinued operations:		
Operating cash flows	2,842	1,386
Investing cash flows	15	63,123
Financing cash flows	—	—
Decrease in cash	(2,440)	(1,005)
Cash at beginning of period	9,047	7,759
Cash at end of period	<u>\$ 6,607</u>	<u>\$ 6,754</u>

Net interest payments (net of amounts capitalized) for the six months ended June 30, 2008 and 2007 were \$17.1 million and \$14.9 million, respectively. Net income tax payments (refunds) for the six months ended June 30, 2008 and 2007 were \$(4.2) million and \$0.6 million, respectively.

Not included in additions to plant and properties for the six months ended June 30, 2008, are non-cash transactions totaling \$26.6 million for the purchase of timberlands.

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

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

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## [Table of Contents](#)

Potlatch Corporation and Consolidated Subsidiaries

Notes to Consolidated Financial Statements

Unaudited (Dollars in thousands)

NOTE 1.

### **General**

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.

Potlatch is a real estate investment trust, or REIT, for federal income tax purposes. The REIT tax rules require that we derive most of our income, other than income generated by a taxable REIT subsidiary, from investments in real estate, which for us primarily consists of income from the sale of standing timber. Our wholly owned taxable REIT subsidiary, Potlatch Forest Products Corporation, or Potlatch TRS, holds substantially all of our non-timberland assets, consisting primarily of our manufacturing facilities engaged in the production of wood products, pulp and paperboard and tissue products; assets used for the harvesting of timber and the sale of logs; and selected land parcels that we expect will be sold or developed for higher and better use purposes.

The accompanying Condensed Balance Sheets at June 30, 2008 and December 31, 2007 and the Statements of Operations and Comprehensive Income for the quarters and six months ended June 30, 2008 and 2007, and the Condensed Statements of Cash Flows for the six months ended June 30, 2008 and 2007 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.

On March 27, 2008, we announced the permanent closure of our Prescott, Arkansas lumber mill due to poor market conditions. The mill permanently ceased operations in May 2008. As a result, the Prescott operation has been classified as “discontinued operations” in the financial statements for the quarter and six months ended June 30, 2008. Comparative amounts for 2007 have been reclassified to conform to the 2008 presentation.

On March 30, 2007, we entered into a definitive agreement for the sale of our hybrid poplar tree farm in Boardman, Oregon. The sale was completed in May 2007. As a result, the Boardman operation was classified as “discontinued operations” in the financial statements for the quarter and six months ended June 30, 2007.

Except for adjustments to the carrying value of the Prescott and Boardman operations, made in conjunction with the closure and sale announcements, respectively, and pursuant to Financial Accounting Standards Board, or FASB, Statement of Financial Accounting Standards, or SFAS, No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” all adjustments were of a normal recurring nature. There were no material nonrecurring adjustments.

On April 17, 2008, we announced that our board of directors authorized management to evaluate a potential spin-off of our pulp-based manufacturing businesses, which would include our Consumer Products and our Pulp and Paperboard segments. Also included in the potential spin-off would be our Lewiston, Idaho lumber mill because it occupies the same site as our pulp-based operations in Lewiston. On July 17, 2008, our board of directors approved the plan to pursue this spin-off of our pulp-based businesses into a publicly-traded company called Clearwater Paper Corporation. We expect the transaction to be completed during the fourth quarter of 2008, subject to final board approval based on regulatory, market and other conditions.

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, 2007, as filed with the Securities and Exchange Commission on February 20, 2008.

NOTE 2.

### **Recent Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements.” This Statement defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. SFAS No. 157 (as amended by FASB Staff Position, or FSP, FAS No. 157-2) is effective for financial

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## **Table of Contents**

statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, for financial assets and liabilities, and nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In November 2007, the effective date was partially deferred by the FASB for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair market value in the financial statements on a nonrecurring basis. With the exception of the deferred portion of SFAS No. 157, we adopted this Statement effective January 1, 2008, which did not have a material effect on our financial condition and results of operations. We are currently reviewing the deferred portion of this Statement to determine what effect, if any, it will have on our financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51." This Statement requires all companies to report noncontrolling or minority interests in subsidiaries as equity in the consolidated financial statements. The intention of SFAS No. 160 is to eliminate the diversity in practice regarding the accounting for transactions between a company and noncontrolling interests. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We are currently reviewing this Statement to determine what effect, if any, it will have on our financial condition and results of operations.

In December 2007, the FASB also issued SFAS No. 141 (Revised 2007), "Business Combinations." This revised Statement, which we refer to as SFAS No. 141R, is intended to simplify existing guidance and converge rulemaking under U.S. GAAP with international accounting rules. SFAS No. 141R will significantly change the accounting for business combinations in a number of areas, including the treatment of contingent consideration, contingencies, acquisition costs and restructuring costs. Also under this Statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will have an impact on income tax expense. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008. Adoption of this Statement is not expected to have a material effect on our financial condition and results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of SFAS No. 133." This Statement amends and expands the disclosure requirements by requiring qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of, and gains and losses on, derivative instruments, and disclosures about credit risk-related contingent features in derivative agreements. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently reviewing this Statement to determine what effect, if any, it will have on our financial condition and results of operations.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*. It is not expected that this Statement will result in a change in current practice. However, transition provisions have been provided in case the application of the provisions of this Statement results in a change in practice.

### NOTE 3.

#### **Income Taxes**

As a REIT, if we meet certain requirements, we generally will not be subject to federal corporate income taxes on our ordinary and capital gains income from our real estate investments that we distribute to our shareholders. We will, however, be 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 sale of any real property owned at such date by the REIT within the first ten years following our conversion. 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 sales agreement.

We will continue to incur federal and state corporate income taxes on earnings from our manufacturing operations and real estate activities conducted by Potlatch TRS. For the quarter ended June 30, 2008, we recorded an income tax benefit of \$0.3 million, compared to an income tax provision of \$6.3 million for the quarter ended June 30, 2007, related to continuing operations. The income tax benefit for the second quarter of 2008 was due to operating losses of Potlatch TRS. The income tax provision for the second quarter of 2007 was largely due to operating income of Potlatch TRS.

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## [Table of Contents](#)

For the six months ended June 30, 2008, we recorded an income tax benefit of \$7.8 million, compared to an income tax provision of \$1.3 million for the same period in 2007, related to continuing operations. The income tax benefit for the first six months of 2008 was due to operating losses of Potlatch TRS. The income tax provision for the first half of 2007 was largely due to operating income of Potlatch TRS.

Our federal income tax returns from 1995 through 2004 have been examined by the Internal Revenue Service, and the resulting deficiency paid in 2007. Amended state tax returns reflecting the federal adjustments have been filed and associated taxes and interest paid.

A review of the company's tax positions at June 30, 2008, pursuant to the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," indicates that no uncertain tax positions were taken during the first six months of 2008, and no information came to light 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 ended June 30, 2008 and 2007, we reflected less than \$0.1 million and approximately \$0.2 million, respectively, in interest and penalties. For the six months ended June 30, 2008 and 2007, we reflected less than \$0.1 million and approximately \$0.4 million, respectively, in interest and penalties. At June 30, 2008 and December 31, 2007, we had less than \$0.1 million and approximately \$0.1 million, respectively, accrued for the payment of interest and penalties.

NOTE 4.

### **Restructuring Charge**

In January 2007, we recorded a pre-tax charge of \$2.8 million associated with a restructuring within our Resource segment. The charge represented estimated severance benefit costs for 35 employees. An additional charge of less than \$0.1 million related to this restructuring was recorded in the second quarter of 2007. There were no restructuring charges in the first six months of 2008.

NOTE 5.

### **Discontinued Operations**

On March 27, 2008, we announced the permanent closure of our Prescott, Arkansas lumber mill due to poor market conditions. The mill continued processing its remaining inventory of logs and permanently ceased operations in May 2008, affecting approximately 182 employees. As a result of this closure, we recorded an after-tax charge of \$12.2 million for the six months ended June 30, 2008. The charge represents estimated costs associated with the adjustment of assets to estimated fair market value, as well as approximately \$1.4 million in severance benefits, approximately \$0.8 million associated with the curtailment of the hourly defined benefit pension plan for the Prescott employees, and approximately \$0.3 million in other costs associated with the closure. For the quarter and six months ended June 30, 2008, after-tax operating losses of \$0.2 million and \$2.3 million, respectively, which were previously included in the operating results of our Wood Products segment, are classified as discontinued operations in the Statements of Operations and Comprehensive Income. For the quarter and six months ended June 30, 2007, we recorded after-tax operating losses of \$0.1 million and \$0.5 million, respectively. Revenues for the Prescott operation, which were previously included in our Wood Products segment revenues, were \$5.4 million and \$18.7 million for the quarter and six months ended June 30, 2008, respectively, and \$16.2 million and \$32.1 million for the quarter and six months ended June 30, 2007, respectively.

The assets of the Prescott lumber mill are presented in the Condensed Balance Sheets under the caption "Assets held for sale" at June 30, 2008. Included in the "Assets held for sale" amount are the estimated fair market values of storeroom inventories and property, plant and equipment. There are no liabilities associated with the Prescott assets held for sale.

In March 2007, we announced the sale of our hybrid poplar tree farm in Boardman, Oregon, for \$65 million in cash. The sale was completed in May 2007. We applied a large portion of the proceeds from this sale to our acquisition in the first quarter of 2007 of 76,000 acres of timberlands in Wisconsin through a tax-efficient Internal Revenue Code section 1031 like-kind exchange. As a result of the sale, we recorded an after-tax charge of \$33.0 million for the six months ended June 30, 2007. The charge represented estimated costs associated with the adjustment of the carrying value of the assets involved in the sale to fair market value, as well as approximately \$0.3 million in severance benefits and approximately \$0.2 million in transaction and other costs associated with the sale. For the quarter and six months ended June 30, 2007, after-tax operating losses of \$1.5 million and \$3.7 million,

## [Table of Contents](#)

respectively, which were previously included in the operating results of our Resource segment, are classified as discontinued operations in the Statements of Operations and Comprehensive Income. Revenues for the hybrid poplar tree farm, which were previously included in our Resource segment revenues, were \$0.8 million and \$2.5 million for the quarter and six months ended June 30, 2007, respectively.

### NOTE 6.

#### Like-Kind Exchanges

In order to acquire and sell assets, primarily timberlands, in a tax efficient manner, we enter into like-kind exchange, or LKE, tax-deferred transactions. There are two main types of LKE transactions: forward transactions, in which property is sold and the proceeds are reinvested by acquiring similar property; and reverse transactions, in which property is acquired and similar property is subsequently sold by us. Both forward and reverse transactions must be completed within prescribed time periods under Internal Revenue Code section 1031.

We use a qualified intermediary to facilitate LKE transactions. Proceeds from forward transactions are held by the intermediary and are classified as a restricted non-current asset because the funds must be reinvested in similar properties. If the acquisition of suitable LKE properties is not completed within 180 days of the sale of the company-owned property, the proceeds are distributed to us by the intermediary and are reclassified as available cash and applicable income taxes are determined. Proceeds from reverse transactions are not restricted because the funds are not subject to risk, earn interest and are available upon demand; therefore, these proceeds are included in short-term investments. In the case of reverse transactions in which we have not yet completed LKE sales of company-owned land to match with property purchased on our behalf by the intermediary, the amount associated with the property purchased on our behalf but not yet matched with LKE sales is classified as a long-term asset and included in "Timber, timberlands and related deposits, net" in our Condensed Balance Sheets and as "Deposits on timberlands" in the investing activities section of our Condensed Statements of Cash Flows. Amounts deposited with a third party towards the potential future purchase of property that are not matched with LKE sales are also included in "Timber, timberlands and related deposits, net" in our Condensed Balance Sheets and as "Deposits on timberlands" in our Condensed Statements of Cash Flows.

At June 30, 2008 and December 31, 2007, respectively, we had \$12.8 million and \$8.1 million of proceeds from land sales deposited with a qualified LKE intermediary and classified as short-term investments in the Condensed Balance Sheets. These proceeds, when received by the qualified intermediary, are included as non-cash adjustments to net earnings from continuing operations in the Condensed Statements of Cash Flows.

### NOTE 7.

#### Earnings per Common Share

Earnings per common share from continuing operations are computed by dividing earnings from continuing operations by the weighted average number of common shares outstanding in accordance with SFAS No. 128, "Earnings Per Share." The following table reconciles the number of common shares used in calculating the basic and diluted earnings per common share from continuing operations:

(Dollars in thousands - except share and per-share amounts)	Quarter Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Earnings from continuing operations	\$ 22,259	\$ 35,529	\$ 46,211	\$ 41,349
Basic average common shares outstanding	39,459,079	39,027,412	39,389,459	38,988,519
Incremental shares due to:				
Common stock options	63,512	86,125	57,688	92,175
Performance shares	144,166	117,772	158,970	139,048
Restricted stock units	29,722	11,144	27,076	12,734
Diluted average common shares outstanding	39,696,479	39,242,453	39,633,193	39,232,476
Basic earnings per common share from continuing operations	\$ 0.56	\$ 0.91	\$ 1.17	\$ 1.06
Diluted earnings per common share from continuing operations	\$ 0.56	\$ 0.91	\$ 1.17	\$ 1.05

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## [Table of Contents](#)

For the quarter ended June 30, 2008, 2,000 restricted stock units and options to purchase 83,447 shares of common stock were excluded from the computation of diluted earnings per common share because their effect was anti-dilutive. For the six months ended June 30, 2008, 76,243 performance shares and options to purchase 83,447 shares of common stock were excluded from the computation of diluted earnings per common share because their effect was anti-dilutive. For the quarter ended June 30, 2007, 3,000 performance shares and options to purchase 190,101 shares were excluded from the computation of diluted earnings per common share because their effect was anti-dilutive. For the six months ended June 30, 2007, options to purchase 190,101 shares of common stock were excluded from the computation of diluted earnings per common share because their effect was anti-dilutive.

NOTE 8.

### **Equity-Based Compensation**

At June 30, 2008, we had three stock incentive plans, the 1995, 2000 and 2005 plans, under which stock option, performance share or restricted stock unit, or RSU, grants were outstanding. All of these plans have received stockholder approval. We were originally authorized to issue up to 1.7 million shares, 1.4 million shares and 1.6 million shares under our 1995 Stock Incentive Plan, 2000 Stock Incentive Plan and 2005 Stock Incentive Plan, respectively. At June 30, 2008, no shares were available for future use under the 1995 Stock Incentive Plan, while approximately 115,700 and 832,500 shares were authorized for future use under the 2000 and 2005 Stock Incentive Plans, respectively. All exercises of stock options or distributions upon settlement of performance share awards or RSU awards are made through the issuance of new shares.

For the quarter ended June 30, 2008, we recorded equity-based compensation expense of \$1.5 million, of which \$1.3 million related to performance shares and \$0.2 million related to RSUs. For the quarter ended June 30, 2007, we recorded equity-based compensation expense of \$1.3 million, of which \$1.2 million related to performance shares and \$0.1 million related to RSUs. For the six months ended June 30, 2008, we recorded equity-based compensation expense of \$3.0 million, of which \$2.5 million related to performance shares and \$0.5 million related to RSUs. For the six months ended June 30, 2007, we recorded equity-based compensation expense of \$2.8 million, of which \$2.6 million related to performance shares and \$0.2 million related to RSUs. The net income tax benefit recognized in the Statements of Operations and Comprehensive Income for equity-based compensation expense totaled \$0.6 million and \$0.5 million for the quarters ended June 30, 2008 and 2007, respectively, and \$1.2 million and \$1.1 million for the six months ended June 30, 2008 and 2007, respectively.

Outside directors of the company are granted an annual award of common stock units, which are credited to an account established on behalf of each director. These accounts are then credited with additional common stock units equal in value to the distributions that are paid on the same amount of common stock. Upon separation from service as a director, the common stock units held by the director in his or her deferred account will be converted to cash based upon the then market price of the common stock and paid to the director.

Directors of the company can also each elect to defer compensation in the form of stock units. We record compensation expense or income during each reporting period based on the amount of compensation deferred during the period and the increase or decrease in the value of the company's common stock. We recorded director deferred expense totaling \$0.5 million and \$0.2 million for the quarters ended June 30, 2008 and 2007, respectively, and \$0.9 million and \$0.1 million for the six months ended June 30, 2008 and 2007, respectively.

As required by SFAS No. 123 (Revised 2004), "Share-Based Payment" (SFAS No. 123R), \$2.0 million and \$2.2 million of cash flows for the six months ended June 30, 2008 and 2007, respectively, representing the realized tax benefit related to the excess of the deductible amount over the compensation cost recognized, have been classified as a financing cash inflow and an operating cash outflow in the Condensed Statements of Cash Flows.

[Table of Contents](#)  
**STOCK OPTIONS**

All outstanding stock options were granted with an exercise price equal to the market price on the date of grant, vested over the two-year period from the grant date, and they expire not later than 10 years from the date of grant. No new stock options were granted in 2008 or 2007.

A summary of outstanding stock options and changes during the six months ended June 30, 2008, is presented below:

(Dollars in thousands, except exercise prices)	Shares	Weighted Avg. Exercise Price	Aggregate Intrinsic Value
Outstanding at January 1	509,284	\$ 25.08	
Shares exercised	<u>(126,348)</u>	26.20	\$ 2,432
Outstanding and exercisable at June 30	<u>382,936</u>	24.72	7,814

There were no unvested stock options outstanding during the six months ended June 30, 2008. The aggregate intrinsic value of stock options exercised during the six months ended June 30, 2007 was \$2.8 million.

The following table summarizes information about stock options outstanding at June 30, 2008:

<u>Range of Exercise Prices</u>	<u>Options Outstanding and Exercisable</u>		
	<u>Number Outstanding</u>	<u>Weighted Avg. Remaining Contractual Life</u>	<u>Weighted Avg. Exercise Price</u>
\$15.8849 to \$19.0779	81,256	4.05 years	\$ 17.45
\$21.3279 to \$25.1112	163,508	4.11 years	21.92
\$27.5226 to \$35.4393	<u>138,172</u>	4.44 years	32.30
\$15.8849 to \$35.4393	<u>382,936</u>	4.21 years	24.72

Cash received from stock option exercises for the six months ended June 30, 2008 and 2007 was \$3.3 million and \$3.7 million, respectively. The actual tax benefit realized for the tax deductions from option exercises totaled \$0.8 million and \$0.1 million for the quarters ended June 30, 2008 and 2007, respectively, and \$0.9 million and \$1.0 million for the six months ended June 30, 2008 and 2007, respectively.

**PERFORMANCE SHARES**

Performance share awards granted under the stock incentive plans have a three-year performance period, and shares are issued at the end of the period if the performance measure is met. The performance measure is a comparison of the percentile ranking of our total shareholder return compared to the total shareholder return performance of a selected peer group. The number of shares actually issued, as a percentage of the amount subject to the performance share award, could range from 0% – 200%. Performance share awards granted under our stock incentive plans do not represent common stock, and therefore the holders do not have voting rights unless and until shares are issued upon settlement. If shares are issued at the end of the three-year performance measurement period, the recipients will receive dividend equivalents at the time of payment equal to the distributions that would have been paid on the shares earned had the recipient owned the shares during the three-year period.

Due to the adoption of SFAS No. 123R, the fair value of all performance share awards after January 1, 2006, is estimated using a Monte Carlo simulation model. For the purpose of recognizing compensation expense, performance share awards granted prior to the adoption of SFAS No. 123R are valued at the market value of the company's stock at the date of grant.

## Table of Contents

A summary of outstanding performance share awards as of June 30, 2008, and changes during the six months ended June 30, 2008 is presented below:

(Dollars in thousands)	Shares	Weighted Avg. Grant Date Fair Value	Aggregate Intrinsic Value
Unvested shares outstanding at January 1	244,933	\$ 50.80	
Granted	91,491	52.75	
Forfeited	(12,548)	50.05	
Unvested shares outstanding at June 30	<u>323,876</u>	51.38	\$ 13,566

As of June 30, 2008, there was \$7.4 million of unrecognized compensation cost related to non-vested performance share awards. The cost is expected to be recognized over a weighted average period of 1.4 years.

### RESTRICTED STOCK UNITS

Our 2005 Stock Incentive Plan also allows for awards to be issued in the form of RSUs. During 2008 and 2007, certain officers and other select employees of the company were granted RSU awards that will accrue dividend equivalents based on distributions paid during the RSU vesting period. The dividend equivalents will be converted into additional RSUs that will vest in the same manner as the underlying RSUs to which they relate. The terms of certain of the awards state that 20% of the RSUs vest on each of the first and second anniversaries of the grant date of the awards, with the remaining 60% vesting on the third anniversary. The terms of certain other RSUs provide for vesting of such RSUs upon the expiration of a set period of approximately three years.

A summary of the status of outstanding RSU awards as of June 30, 2008, and changes during the six months ended June 30, 2008, is presented below:

(Dollars in thousands)	Shares	Weighted Avg. Grant Date Fair Value	Aggregate Intrinsic Value
Unvested shares outstanding at January 1	31,875	\$ 48.84	
Granted	27,369	41.50	
Vested	(5,780)	51.95	
Forfeited	(575)	41.38	
Unvested shares outstanding at June 30	<u>52,889</u>	44.78	\$ 2,239

For RSU awards granted during the period, the fair value of each share was estimated on the date of grant using the grant date market price of our common stock. The total fair value of share awards vested during the period was \$0.3 million, using the grant date market price of our common stock.

As of June 30, 2008, there was \$1.4 million of total unrecognized compensation cost related to non-vested RSU awards. The cost is expected to be recognized over a weighted average period of 1.9 years.

### NOTE 9.

#### Inventories

Inventories at the balance sheet dates consist of:

(Dollars in thousands)	June 30, 2008	December 31, 2007
Raw materials	\$ 62,334	\$ 65,517
Finished goods	89,044	103,879
	<u>\$ 151,378</u>	<u>\$ 169,396</u>

[Table of Contents](#)

NOTE 10.

**Pension and Other Postretirement Employee Benefit Plans**

The following table details the components of net periodic cost (benefit) of our pension and other postretirement employee benefit plans:

Quarters ended June 30:

(Dollars in thousands)	Pension Benefit Plans		Other Postretirement Employee Benefit Plans	
	2008	2007	2008	2007
Service cost	\$ 2,836	\$ 3,002	\$ 612	\$ 531
Interest cost	9,439	8,567	3,683	3,566
Expected return on plan assets	(15,427)	(15,605)	—	—
Amortization of prior service cost (credit)	513	548	(942)	(1,138)
Amortization of actuarial loss	1,017	1,304	554	1,002
Curtailements	268	—	—	—
Net periodic cost (benefit)	\$ (1,354)	\$ (2,184)	\$ 3,907	\$ 3,961

Six months ended June 30:

(Dollars in thousands)	Pension Benefit Plans		Other Postretirement Employee Benefit Plans	
	2008	2007	2008	2007
Service cost	\$ 5,672	\$ 6,004	\$ 1,296	\$ 1,247
Interest cost	18,878	17,134	8,008	7,645
Expected return on plan assets	(30,854)	(31,210)	—	—
Amortization of prior service cost (credit)	1,026	1,095	(1,884)	(1,782)
Amortization of actuarial loss	2,035	2,608	2,006	2,560
Curtailements	268	—	—	—
Net periodic cost (benefit)	\$ (2,975)	\$ (4,369)	\$ 9,426	\$ 9,670

The pension benefits presented above do not include a \$1.3 million pre-tax charge related to the closure of the Prescott lumber mill. The amount is included in "Loss from discontinued operations" in the Statements of Operations and Comprehensive Income for the six months ended June 30, 2008.

Of the \$0.7 million reported as "Other comprehensive income, net of tax," on our Statements of Operations and Comprehensive Income for the quarter ended June 30, 2008, \$0.9 million and \$(0.2) million related to our defined benefit pension and other postretirement employee benefit plans, respectively. Of the \$2.8 million reported as "Other comprehensive income, net of tax," on our Statements of Operations and Comprehensive Income for the six months ended June 30, 2008, \$1.9 million related to our defined benefit pension plans, \$0.1 million related to our other postretirement employee benefit plans and \$0.8 million related to the curtailment associated with the Prescott closure and the curtailment of our Lewiston, Idaho fire department hourly pension plan.

As discussed in the notes to our financial statements for the year ended December 31, 2007, no minimum contributions to our qualified pension plans are estimated for 2008 due to the funded status of those plans at December 31, 2007. However, we estimate contributions will total approximately \$1.7 million in 2008 for our non-qualified pension plan. As of June 30, 2008, \$0.8 million of contributions had been made. No change to the original estimate is anticipated. We do not anticipate funding our other postretirement employee benefit plans in 2008 except to pay benefit costs as incurred during the year by plan participants.

NOTE 11.

**Contingencies**

The following updates information included in the 2007 Annual Report on Form 10-K:

Beginning in February 2006, a series of private antitrust lawsuits were filed against us and certain other manufacturers of oriented strand board (OSB) by plaintiffs who claim they purchased OSB at artificially high prices. The cases were consolidated into two Consolidated Amended Class Action Complaints in the United States District Court for the Eastern District of Pennsylvania under the caption In Re OSB Antitrust Litigation, one on behalf of direct purchasers of OSB and the other on behalf of indirect purchasers. The complaints allege that the defendant

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## [Table of Contents](#)

OSB manufacturers violated federal and state antitrust laws by purportedly conspiring from mid-2002 to the present to drive up the price of OSB. The consolidated indirect purchaser complaint also alleges that defendants violated various states' unfair competition laws and common law. Each consolidated complaint seeks an unspecified amount of monetary damages to be trebled as provided under the antitrust laws and other relief. The court certified a nationwide class of direct purchasers who bought OSB structural panel products directly from one of the defendants during the period from June 1, 2002 to February 24, 2006. It also certified a nationwide class of indirect purchaser end users who purchased new OSB manufactured or sold by one of the defendants during the same time period; this class excludes persons who only bought OSB that was incorporated into a house or other structure. The claims of the nationwide indirect purchaser class are limited to injunctive relief. However, the court also certified a multistate class of indirect purchasers in 17 states whose members may recover compensation as allowed by state law. Although we vigorously deny any wrongdoing, on March 28, 2008, we tentatively settled the claims of the direct purchaser class for \$2.7 million, solely in order to avoid the further expense and burden of the ongoing litigation. On April 17, 2008, we tentatively settled the indirect purchaser class action claims for \$0.3 million. Both settlements remain subject to court approval. We sold our OSB manufacturing facilities to Ainsworth Lumber Co. Ltd. in September 2004.

[Table of Contents](#)

NOTE 12.

**Segment Information****(Dollars in thousands)**

	Quarter Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
<b>Segment Revenues</b>				
Resource	\$ 44,586	\$ 72,438	\$ 105,341	\$ 131,704
Real Estate	15,308	8,563	36,448	8,656
Wood Products				
Lumber	66,978	77,697	125,002	152,222
Plywood	13,923	14,080	28,008	27,716
Particleboard	5,293	5,676	9,721	10,592
Other	11,196	10,795	22,752	20,986
	<u>97,390</u>	<u>108,248</u>	<u>185,483</u>	<u>211,516</u>
Pulp and Paperboard				
Paperboard	162,491	142,711	313,193	273,487
Pulp	21,856	26,111	47,886	46,235
Other	96	318	394	580
	<u>184,443</u>	<u>169,140</u>	<u>361,473</u>	<u>320,302</u>
Consumer Products	<u>120,916</u>	<u>105,933</u>	<u>241,959</u>	<u>216,185</u>
	462,643	464,322	930,704	888,363
Elimination of intersegment revenues	<u>(47,239)</u>	<u>(65,833)</u>	<u>(97,903)</u>	<u>(119,571)</u>
Total consolidated revenues	<u>\$ 415,404</u>	<u>\$ 398,489</u>	<u>\$ 832,801</u>	<u>\$ 768,792</u>
<b>Intersegment revenues or transfers</b>				
Resource	\$ 23,129	\$ 45,881	\$ 54,230	\$ 78,300
Wood Products	7,231	5,273	13,231	10,685
Pulp and Paperboard	16,853	14,647	30,387	30,529
Consumer Products	26	32	55	57
Total	<u>\$ 47,239</u>	<u>\$ 65,833</u>	<u>\$ 97,903</u>	<u>\$ 119,571</u>
<b>Operating Income (Loss)</b>				
Resource	\$ 12,186	\$ 19,937	\$ 29,406	\$ 33,097
Real Estate	11,330	7,374	27,994	7,007
Wood Products	(227)	6,610	(10,308)	9,427
Pulp and Paperboard	6,212	17,005	17,246	10,976
Consumer Products	6,947	4,092	10,292	8,867
Eliminations	<u>5,416</u>	<u>4,026</u>	<u>6,411</u>	<u>8,973</u>
	41,864	59,044	81,041	78,347
Corporate	<u>(19,896)</u>	<u>(17,179)</u>	<u>(42,610)</u>	<u>(35,684)</u>
Earnings from continuing operations before taxes	<u>\$ 21,968</u>	<u>\$ 41,865</u>	<u>\$ 38,431</u>	<u>\$ 42,663</u>

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

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## [Table of Contents](#)

### ITEM 2.

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

##### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This report contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including without limitation, statements regarding future revenues, cash flows, distributions, compliance with REIT tax rules, costs, manufacturing output, capital expenditures, a potential spin-off of our pulp-based businesses, timber harvest levels, future land sales, like-kind exchanges and tax consequences, and other timber supply issues. Words such as "anticipate," "expect," "will," "intend," "plan," "target," "project," "believe," "seek," "schedule," "estimate," "could," "can," "may," and similar expressions are intended to identify such forward-looking statements. These forward-looking statements reflect management's current views regarding future events based on estimates and assumptions, and are therefore subject to known and unknown risks and uncertainties and are not guarantees of future performance. Our actual results of operations could differ materially from those expressed or implied by forward-looking statements contained in this report. Important factors that could cause or contribute to such differences include, but are not limited to:

- changes in timber harvest levels on our lands
- changes in timber prices
- changes in timberland values
- changes in policy regarding governmental timber sales
- changes in the United States and international economies
- changes in exchange rates between the U.S. dollar and other currencies
- changes in the level of construction activity
- changes in tariffs, quotas and trade agreements involving wood products
- changes in worldwide demand for our products
- changes in worldwide production and production capacity in the forest products industry
- competitive pricing pressures for our products
- unanticipated manufacturing disruptions
- changes in general and industry-specific environmental laws and regulations
- unforeseen environmental liabilities or expenditures
- weather conditions
- changes in raw material, energy and other costs
- the ability to satisfy complex rules in order to remain qualified as a REIT
- changes in tax laws that could reduce the benefits associated with REIT status

Forward-looking statements contained in this report present management's views only as of the date of this report. Except as required under applicable law, we do not intend to issue updates concerning any future revisions of management's views to reflect events or circumstances occurring after the date of this report.

##### OVERVIEW

Potlatch owns approximately 1.7 million acres of forestland in Arkansas, Idaho, Minnesota and Wisconsin, and operates 12 manufacturing facilities that produce lumber and panel products and bleached pulp products, including paperboard and tissue. We also conduct a real estate sales and development business.

On April 17, 2008, we announced that our board of directors authorized management to evaluate a potential spin-off of our pulp-based manufacturing businesses, which would include our Consumer Products and our Pulp and Paperboard segments. Also included in the potential spin-off would be our Lewiston, Idaho lumber mill because it occupies the same site as our pulp-based operations in Lewiston. On July 17, 2008, our board of directors approved the plan to pursue this spin-off of our pulp-based businesses into a publicly-traded company called Clearwater Paper Corporation. We expect the transaction to be completed during the fourth quarter of 2008, subject to final board approval based on regulatory, market and other conditions.

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## [Table of Contents](#)

As discussed in Note 5, on March 27, 2008, we announced the permanent closure of our Prescott, Arkansas, lumber mill due to poor market conditions. The mill permanently ceased operations in May 2008. In May 2007, we sold our hybrid poplar tree farm in Boardman, Oregon, for \$65.0 million in cash. These operations are classified as discontinued operations in the periods covered by this report.

As of June 30, 2008, our business was organized into five reporting segments:

- The Resource segment consists of substantially all of our timberlands, as well as those assets necessary to manage these timberlands. The primary business of the segment is the management of our timberlands to optimize the value of all possible revenue-producing opportunities while at the same time adhering to our strict stewardship standards. Management activities include, but are not limited to, planting trees, harvesting trees, building and maintaining roads, development of management plans and recreation lease management. For the first six months of 2008, Resource segment net revenues were \$105.3 million, representing approximately 11% of our net revenues from continuing operations, before elimination of intersegment revenues. Intersegment revenues were \$54.2 million for the period.

In September 2007, we entered into agreements to acquire approximately 179,000 acres of timberland in Idaho for approximately \$215 million. We completed the acquisition of the timberland in two separate transactions, with the first closing in September 2007 and the second closing, of approximately 34,000 acres for \$51.4 million, in January 2008. We matched a portion of the purchase of this Idaho timberland with sales of our own lands in the first half of 2008.

In January 2007, we completed the acquisition of 76,000 acres of prime timberland in Wisconsin for \$64.5 million. The purchase of the Wisconsin timberlands was matched with sales of our own lands, primarily the hybrid poplar tree farm in Boardman, Oregon, for section 1031 like-kind exchange purposes.

- The business of the Real Estate segment consists of the sale of selected non-strategic timberland real estate, including sales of land for higher and better use purposes, and the acquisition of timberlands. Results for this segment depend on the timing of closing of transactions for these non-strategic property sales. This segment also engages in land development activities through Potlatch TRS. Real Estate segment net revenues for the first six months of 2008 were \$36.4 million, which represented approximately 4% of our net revenues from continuing operations. The segment did not have intersegment revenues during the period.
- The Wood Products segment manufactures lumber, plywood and particleboard at seven mills located in Arkansas, Idaho, Michigan and Minnesota. The segment's products are largely commodity products, which are sold to wholesalers primarily for use in home building and other construction activity. Wood Products segment net revenues were \$185.5 million for the first six months of 2008, representing approximately 20% of our net revenues from continuing operations, before elimination of intersegment revenues. Intersegment revenues were \$13.2 million for the period.
- The Pulp and Paperboard segment manufactures bleached paperboard used in packaging and bleached softwood market pulp. The Pulp and Paperboard segment operates two pulp and paperboard mills located in Arkansas and Idaho. Pulp and Paperboard segment net revenues were \$361.5 million for the first six months of 2008, representing approximately 39% of our net revenues from continuing operations, before elimination of intersegment revenues. Intersegment revenues were \$30.4 million for the period.
- The Consumer Products segment manufactures tissue products primarily sold on a private label basis to major grocery store chains. The segment operates two tissue mills with related converting facilities in Idaho and Nevada, and one additional tissue converting facility located in Illinois. Consumer Products segment net revenues were \$242.0 million for the first six months of 2008, representing approximately 26% of our net revenues from continuing operations, before elimination of intersegment revenues. Intersegment revenues were \$0.1 million for the period.

## **FACTORS INFLUENCING OUR RESULTS OF OPERATIONS AND CASH FLOWS**

The operating results of our timberlands and manufacturing businesses have been and will continue to be influenced by a variety of factors, including the cyclical nature of the forest products industry, changes in timber prices and in harvest levels from our timberlands, competition, the efficiency and level of capacity utilization of our

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## [Table of Contents](#)

manufacturing operations, changes in our principal expenses such as wood fiber and energy costs, and changes in the production capacity of our manufacturing operations as a result of major capital spending projects, asset dispositions or acquisitions, and other factors.

Our results of operations and cash flows can be materially affected by the fluctuating nature of timber prices. A variety of factors affect prices for timber, including factors affecting demand, such as changes in economic conditions, construction activity levels, interest rates, population growth and weather conditions, as well as changes in timber supply and other factors. All of these factors can vary by region and by timber type, such as saw logs or pulpwood logs. In 2008, we expect overall average pricing for our timber to decline by approximately 10% compared to 2007.

Our results of operations and cash flows are also affected by changes in timber availability at the local and national level. Increases in timber supply could adversely affect the prices that we receive for timber. Our timberland ownership is currently concentrated in Arkansas, Idaho, Minnesota and Wisconsin. In Arkansas and Minnesota, most timberlands are privately owned. Historically, increases in timber prices have often resulted in substantial increases in harvesting on private timberlands, including lands not previously made available for commercial timber operations, causing a short-term increase in supply that has tended to moderate price increases. In Idaho, where a greater proportion of timberland is publicly owned, any substantial increase in timber harvesting from these lands could significantly reduce timber prices, which could harm our results of operations. For more than twenty years, environmental concerns and other factors have limited timber sales by federal agencies, which historically had been major suppliers of timber to the United States forest products industry, particularly in the West. Any reversal of policy that substantially increases public timber sales could have a materially adverse effect on our results of operations and cash flows. On a local level, timber supplies can fluctuate depending upon factors such as changes in weather conditions and harvest strategies of local forest products industry participants, as well as occasionally high timber salvage efforts due to unusual pest infestations or fires.

Changes in harvest levels on our timberlands also may have a significant impact on our results of operations, due in part to the low cost basis of much of our timber from timberlands that we acquired many years ago. Over the long term, we manage our timberlands on a sustainable yield basis to achieve a balance between timber growth and timber harvests. From time to time, however, we may choose, consistent with our environmental commitments, to harvest timber at levels above or below our estimate of sustainability for various reasons. In 2007, the overall harvest from our timberlands was 3.9 million tons. Based on our current projections that take into consideration such factors as market conditions, the ages of our timber stands and recent timberland acquisitions and sales, we expect the overall timber harvest from our lands in 2008 to be between 4.2 million and 4.4 million tons, increasing to a range of 4.9 million to 5.3 million tons by 2010.

On a short-term basis, our timber harvest levels may be impacted by factors such as demand for timber and harvesting capacity. In 2007, due to rebounding prices, we significantly increased the harvest from our Southern region timberlands, primarily to offset deferred harvest levels in 2006. We also experience seasonally lower harvest activity during the winter and early spring due to weather conditions. Longer term, our timber harvest levels will be affected by acquisitions of additional timberlands and sales of existing timberlands. In addition, future timber harvest levels may be affected by changes in estimates of long-term sustainable yield because of genetic improvements and other silvicultural advances, natural disasters, fires and other hazards, regulatory constraints and other factors beyond our control.

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

The markets for our products are highly competitive, and companies that have substantially greater financial resources than we do compete with us in each of our lines of business. Logs and other fiber from our timberlands, as well as our wood products, are subject to competition from timberland owners and wood products manufacturers in North America and to a lesser extent in South America, Europe, Australia and New Zealand. Our pulp-based products, other than tissue products, are globally traded commodity products. Because our competitors in these

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## Table of Contents

segments are located throughout the world, variations in exchange rates between the U.S. dollar and other currencies can significantly affect our competitive position compared to our international competitors. Since it is generally not profitable to sell tissue products overseas due to high transportation costs, and we do not sell a significant amount of tissue to Canada, currency exchange rates do not have a major effect on our ability to compete in our tissue business.

Our manufacturing businesses are capital intensive, which leads to high fixed costs and generally results in continued production as long as prices are sufficient to cover variable costs. These conditions have contributed to substantial price competition, particularly during periods of reduced demand. Some of our competitors may currently be lower-cost producers in some of the businesses in which we operate, and accordingly these competitors may be less adversely affected than we are by price decreases. In March 2008, our Gwinn, Michigan lumber mill was shut down for nine days due to a weather-related log shortage. Following the downtime, the lumber mill operated one shift a day until May 1, due to continuing weather-related log shortages, then returned to two shifts a day. Our Post Falls, Idaho particleboard plant was shut down for nearly three weeks in February 2008 and for fifteen days in May 2008 due to a fiber shortage caused by sawmill curtailments resulting from the depressed lumber market. The Lewiston, Idaho lumber mill was shut down for one week in June 2008 and the Bemidji, Minnesota lumber mill was shut down for eleven days in May 2008, both due to weather-related log shortages. For the periods presented in this Form 10-Q, no downtime was taken at any of our facilities associated with our continuing operations due to an inability to cover variable costs. The profitability of our manufacturing segments depends largely on our ability to operate our manufacturing facilities efficiently and at or near full capacity. Our operating results can be adversely affected if market demand does not justify operating at these levels or if our operations are inefficient or suffer significant interruption for any reason.

Energy costs, which have become one of our most volatile operating expenses over the past several years, have an impact on almost every aspect of our operations, from natural gas used at our manufacturing facilities to freight surcharges. In periods of high energy prices, market conditions may prevent us from passing higher energy costs on to our customers through price increases, and therefore such increased costs could adversely affect our operating results. We have taken steps through conservation and internal electrical production to reduce our exposure to both the volatile spot market for energy and to rate increases by regulated utilities. Our energy costs in future periods will depend principally on our ability to continue to produce a substantial portion of our electricity needs internally, on changes in market prices for natural gas and on reducing energy usage. To help mitigate the exposure to market risk for changes in natural gas commodity pricing, we occasionally use firm-price contracts to supply a portion of our natural gas requirements.

Another significant expense is the cost of wood fiber needed to supply our manufacturing facilities. The cost of various types of wood fiber that we purchase in the market has at times fluctuated greatly because of economic or industry conditions. The current high price of wood fiber is largely the result of limited supplies due to the slowdown of operations of many lumber mills that supply us with wood fiber as a result of the home construction downturn. Selling prices of our products have not always increased in response to wood fiber price increases, nor have wood fiber prices always decreased in conjunction with declining product prices. On occasion, our results of operations have been and may in the future be adversely affected if we are unable to pass cost increases through to our customers.

The disparity between the cost of wood fiber harvested from our timberlands and the cost of wood fiber purchased on the open market is due to the fact that the capitalized costs to establish most of our fee timber were expended many years ago. The initial stand establishment costs remain as a capitalized asset until the timber reaches maturity, which typically ranges from 30 to 60 years. Ongoing forest management costs include recurring items necessary to the ownership and administration of timber producing property and are expensed as incurred. The cost of purchased wood fiber is significantly higher due to the fact that the wood fiber being purchased from third parties is purchased at the current market price.

Changes in our timberland holdings and manufacturing capacity, primarily as a result of capital spending programs, asset purchases and dispositions, and facility closures, have affected our results of operations in recent periods. In January 2007, we purchased approximately 76,000 acres of timberlands in Wisconsin. In May 2007, we completed the sale of our hybrid poplar tree farm in Boardman, Oregon. In September 2007, we entered into agreements to acquire approximately 179,000 acres of timberland in Idaho. We completed the acquisition of the Idaho timberland in two separate transactions, with the first closing in September 2007 and the second closing in January 2008. In May 2008 we permanently closed our Prescott, Arkansas lumber mill due to poor market conditions. These changes have affected or will affect our levels of net revenues and expenses, as well as the comparability of our operating results from period to period.

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## Table of Contents

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

Among the reasons for our REIT conversion was that we are better able to compete for acquisitions of timberlands against other entities that use tax-efficient structures. It is uncertain whether any timberland acquisitions we make will perform in accordance with our expectations. In addition, we anticipate financing acquisitions through Internal Revenue Code section 1031 like-kind exchanges, cash from operations, borrowings under our credit facility, or proceeds from equity or debt offerings. Our inability to finance future acquisitions on favorable terms or the failure of any acquisition to perform as we expect could harm our results of operations.

### **CRITICAL ACCOUNTING POLICIES**

Our principal accounting policies are discussed on pages 50-56 of our Annual Report on Form 10-K for the year ended December 31, 2007. The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported financial position and operating results of the company. Management believes the accounting policies discussed below represent the most complex, difficult and subjective judgments it makes in this regard.

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

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

There are currently no authoritative accounting rules relating to costs to be capitalized in the timber and timberlands category. We have used relevant portions of current accounting rules, industry practices and our judgment in determining costs to be capitalized or expensed. Alternate interpretations and judgments could significantly affect the amounts capitalized. Additionally, models and observations used to estimate the current recoverable timber volume on our lands are subject to judgments that could significantly affect volume estimates. Following are examples of factors that add to the complexity of the assumptions we make regarding capitalized or expensed costs:

- harvest cycles can vary by geographic region and by species of timber;
- weather patterns can affect annual harvest levels;
- environmental regulations and restrictions may limit our ability to harvest certain timberlands;
- changes in harvest plans may occur;
- scientific advancement in seedlings and timber growing technology may affect future harvests;
- land sales and acquisitions affect volumes available for harvest; and
- major forest fire events or pest infestations can significantly affect future harvest levels.

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## [Table of Contents](#)

Different assumptions for either the cost or volume estimates, or both, could have a significant effect upon amounts reported in our statements of operations and financial condition. Because of the number of variables involved and the interrelationship between the variables, sensitivity analysis of individual variables is not practical.

**Restructuring charges and discontinued operations.** In January 2007, we recorded a charge for a restructuring of our Resource segment. On March 30, 2007, we entered into a definitive agreement to sell our hybrid poplar tree farm in Boardman, Oregon. The sale was completed in the second quarter of 2007. On March 27, 2008, we announced the permanent closure of our Prescott, Arkansas lumber mill due to poor market conditions. The mill ceased operations in May 2008. These events required us to record estimates of liabilities for employee benefits and other costs at the time of the events. In making these judgments, we considered contractual obligations, legal liabilities and possible incremental costs incurred as a result of restructuring transactions to determine liability. Our estimated liabilities could differ materially from actual costs incurred, with resulting adjustments to future period earnings for any differences.

**Environmental liabilities.** We record accruals for estimated environmental liabilities that are not within the scope of SFAS No. 143, "Accounting for Asset Retirement Obligations," and FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," in accordance with SFAS No. 5, "Accounting for Commitments and Contingencies." These estimates reflect assumptions and judgments as to the probable nature, magnitude and timing of required investigation, remediation and monitoring activities. In making these estimates, we consider, among other things, the activities we have conducted at any particular site, information obtained through consultation with applicable regulatory authorities and third parties, and our historical experience at other sites that are judged to be comparable. We must also consider the likelihood of changes in governmental regulations, advancements in environmental technologies, and changing legal standards regarding liability. Due to the numerous uncertainties and variables associated with these assumptions and judgments, and changes in governmental regulations and environmental technologies, our accruals are subject to substantial uncertainties, and our actual costs could be materially more or less than the estimated amounts.

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

Note 12 to our 2007 Form 10-K consolidated financial statements included information for the three years ended December 31, 2007, on the components of pension and OPEB expense and the underlying actuarial assumptions used to calculate periodic expense, as well as the funded status for our pension and OPEB plans as of December 31, 2007 and 2006. Note 10, "Pension and Other Postretirement Employee Benefit Plans," of this Form 10-Q, includes information on the components of pension and OPEB expense for the quarters and six months ended June 30, 2008 and 2007.

The discount rate used in the determination of pension benefit obligations and pension expense is a weighted average benchmark rate based on high-quality fixed income investment interest rates, as well as the amount and timing of expected benefit payments. At December 31, 2007 and 2006, we calculated obligations using discount rates of 6.40% and 5.85%, respectively. To determine the expected long-term rate of return on pension assets, we employ a process that analyzes historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return. The assumed long-term rates of return on pension plan assets used for the years ended December 31, 2007 and 2006 were 9.0% and 9.5%, respectively. Over the past 30 years, the period we have actively managed pension assets, our actual average annual return on pension plan assets has been approximately 11%.

Total periodic pension plan income in 2007 was \$8.3 million. An increase in the discount rate or the rate of expected return on plan assets, all other assumptions remaining the same, would increase pension plan income, and conversely, a decrease in either of these measures would decrease plan income. As an indication of the sensitivity that pension income has to the discount rate assumption, a 25 basis point change in the discount rate would affect annual plan income by approximately \$1.4 million. A 25 basis point change in the assumption for expected return on plan assets would affect annual plan income by approximately \$1.7 million. The actual rates on plan assets may vary significantly from the assumption used because of unanticipated changes in financial markets.

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## [Table of Contents](#)

No minimum contributions to our qualified pension plans are estimated for 2008 due to the funded status of those plans at December 31, 2007. However, we estimate contributions will total approximately \$1.7 million in 2008 to our non-qualified pension plan. We do not anticipate funding our postretirement employee benefit plans in 2008 except to pay benefit costs as incurred during the year by plan participants.

For our OPEB plans, expense for 2007 was \$19.3 million. The discount rate used to calculate OPEB obligations, which was determined using the same methodology we used for our pension plans, was 6.40% and 5.85% at December 31, 2007 and 2006, respectively. The assumed health care cost trend rate used to calculate OPEB obligations and expense for 2007 was a 10% increase over the previous year, with the rate of increase scheduled to decline one percent annually to a long-term ultimate rate increase assumption of 6% for 2011 and thereafter.

As an indication of the sensitivity that OPEB expense has to the discount rate assumption, a 25 basis point change in the discount rate would affect annual plan expense by approximately \$0.5 million. A 1% change in the assumption for health care cost trend rates would have affected 2007 plan expense by approximately \$1.6 – \$1.9 million and the total postretirement employee obligation by approximately \$21.4 – \$25.0 million. The actual rates of health care cost increases may vary significantly from the assumption used because of unanticipated changes in health care costs.

Periodic pension and OPEB expense are included in “Materials, labor and other operating expenses” and “Selling, general and administrative expenses” in the Statements of Operations and Comprehensive Income. The expense is allocated to all business segments. At June 30, 2008, and December 31, 2007, long-term assets are recorded for overfunded plans and liabilities are recorded for underfunded plans. The funded status of a benefit plan is measured as the difference between plan assets at fair value and the benefit obligation. For underfunded plans, the estimated liability to be payable in the next twelve months is recorded as a current liability, with the remaining portion recorded as long-term. See Note 12 to our 2007 Form 10-K consolidated financial statements for further discussion.

## **RESULTS OF OPERATIONS**

As noted above, our business is organized into five reporting segments: Resource; Real Estate; Wood Products; Pulp and Paperboard; and Consumer Products. Sales or transfers between segments are recorded as intersegment revenues based on prevailing market prices. Because of the role of the Resource segment in supplying our manufacturing segments with wood fiber, intersegment revenues represent a significant portion of the Resource segment’s total revenues. Intersegment revenues represent a substantially smaller percentage of revenues for our other segments.

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, each segment’s revenues are presented before elimination of intersegment revenues.

## Table of Contents

### Quarter Ended June 30, 2008 Compared to Quarter Ended June 30, 2007

The following table sets forth period-to-period changes in items included in our Statements of Operations and Comprehensive Income for the quarters ended June 30, 2008 and 2007.

(Dollars in thousands)	Quarters Ended June 30,		
	2008	2007	Increase (Decrease)
Revenues	\$ 415,404	\$ 398,489	\$ 16,915
Costs and expenses:			
Depreciation, depletion and amortization	16,906	18,734	(1,828)
Materials, labor and other operating expenses	346,367	310,219	36,148
Selling, general and administrative expenses	21,646	20,892	754
Restructuring charge	—	35	(35)
Earnings from continuing operations before interest and taxes	30,485	48,609	(18,124)
Interest expense	(8,643)	(7,340)	(1,303)
Interest income	126	596	(470)
Income tax provision (benefit)	(291)	6,336	6,627
Earnings from continuing operations	22,259	35,529	(13,270)
Discontinued operations, net of tax	(780)	(1,579)	799
Net earnings	\$ 21,479	\$ 33,950	\$ (12,471)
Other comprehensive income, net of tax	733	1,047	(314)
Comprehensive income	\$ 22,212	\$ 34,997	\$ (12,785)

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

**Revenues** – Total revenues from continuing operations of \$415.4 million for the quarter ended June 30, 2008, were \$16.9 million higher than the \$398.5 million recorded for the same period in 2007. Resource segment revenues decreased \$5.1 million to \$21.5 million for the second quarter of 2008, primarily due to decreased sales of logs to external customers and lower log selling prices. Real Estate revenues were \$15.3 million in the second quarter of 2008, \$6.7 million higher than in the second quarter of 2007 due to increased sales of land. Revenues from the Wood Products segment were \$90.2 million for the second quarter of 2008, compared to \$103.0 million for the same period in 2007. The decrease was due to lower selling prices and decreased shipments of lumber. Pulp and Paperboard revenues increased to \$167.6 million for the second quarter of 2008, compared to \$154.5 million for the second quarter of 2007, due primarily to increased paperboard shipments and higher paperboard and pulp selling prices. Consumer Products revenues were \$120.9 million for the second quarter of 2008, a \$15.0 million increase compared to second quarter 2007 revenues of \$105.9 million, due to increased shipments and higher selling prices.

**Depreciation, depletion and amortization** – For the quarter ended June 30, 2008, depreciation, depletion and amortization totaled \$16.9 million, compared to \$18.7 million recorded in the same period of 2007. The decrease was primarily due to lower depreciation expense for our Pulp and Paperboard segment.

**Materials, labor and other operating expenses** – Materials, labor and other operating expenses increased to \$346.4 million for the second quarter of 2008, compared to \$310.2 million recorded in the second quarter of 2007. The higher expenses in the second quarter of 2008 were primarily due to costs associated with increased shipments of paperboard and tissue, higher wood fiber, energy, chemical and freight costs for the Pulp and Paperboard segment, higher freight, pulp, energy and packaging costs for the Consumer Products segment, and costs associated with additional sales of land.

**Selling, general and administrative expenses** – Selling, general and administrative expenses were \$21.6 million for the second quarter of 2008, compared to \$20.9 million for the second quarter of 2007.

**Restructuring charge** – In January 2007, we recorded a pre-tax charge of \$2.8 million associated with a restructuring within our Resource segment. The charge represented estimated severance benefit costs for 35 employees. An additional charge of less than \$0.1 million related to this restructuring was recorded in the second quarter of 2007. There were no restructuring charges in the second quarter of 2008.

**Interest expense** – Interest expense totaled \$8.6 million in the second quarter of 2008 compared to \$7.3 million for the same period in 2007. The increase was due to increased borrowings outstanding under our unsecured bank

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## [Table of Contents](#)

credit facility to fund a portion of the purchase of 179,000 acres of Idaho timberlands in September 2007 and January 2008.

**Interest income** – We recorded interest income of \$0.1 million for the second quarter of 2008 compared to \$0.6 million in the second quarter of 2007.

**Income tax provision (benefit)** – For the quarter ended June 30, 2008, we recorded an income tax benefit related to our continuing operations of \$0.3 million due to Potlatch TRS losses. We recorded an income tax provision of \$6.3 million in the second quarter of 2007, which was largely due to Potlatch TRS income.

**Earnings from continuing operations** – We recorded earnings from continuing operations of \$22.3 million for the quarter ended June 30, 2008, compared to \$35.5 million for the same period in 2007. The decrease was primarily due to higher materials, labor, energy and other operating expenses in 2008, partially offset by an income tax benefit in 2008 compared to an income tax provision in 2007.

**Discontinued operations** – On March 27, 2008, we announced the permanent closure of our Prescott, Arkansas lumber mill due to poor market conditions. The mill processed its remaining inventory of logs in the second quarter and permanently ceased operations in May 2008, affecting approximately 182 employees. In the second quarter of 2008, we recorded an after-tax loss of \$0.8 million related to the Prescott mill closure. Of the after-tax charge, \$0.6 million was related to severance benefits and other costs, and \$0.2 million was related to net operating losses at the mill for the second quarter of 2008. For the second quarter of 2007, we recorded an operating loss of \$0.2 million for the Prescott mill.

The results for the quarter ended June 30, 2007 included an after-tax loss from discontinued operations of \$1.4 million associated with our hybrid poplar tree farm in Boardman, Oregon. The sale of the tree farm was announced in March 2007 and completed in May 2007.

**Other comprehensive income, net of tax** – We recorded other comprehensive income, net of tax, of \$0.7 million for the second quarter of 2008, compared to \$1.0 million for the second quarter of 2007.

## **DISCUSSION OF BUSINESS SEGMENTS**

The Resource segment reported operating income of \$12.2 million for the second quarter of 2008, a decrease of \$7.7 million compared to \$19.9 million reported for the same period of 2007. Segment revenues were \$44.6 million for the second quarter of 2008, compared to \$72.4 million for the second quarter of 2007. The decreased revenues were primarily due to decreased sales volumes and lower overall log selling prices. Expenses for the segment were \$32.4 million for the second quarter of 2008, compared to \$52.5 million in the second quarter of 2007. The decreased expenses in 2008 were primarily due to lower costs associated with decreased harvests of fee timber and fewer outside logs purchased in the second quarter of 2008.

The Real Estate segment reported operating income of \$11.3 million for the second quarter of 2008, compared to \$7.4 million for the second quarter of 2007. Revenues for the segment were \$15.3 million for the second quarter of 2008, compared to \$8.6 million for the same period in 2007. The higher revenues in the second quarter of 2008 were due to the sale of approximately 26,100 acres of land, compared to 7,472 acres sold in the second quarter of 2007. The majority of the land sold in the second quarter of 2008 was non-core land located in Minnesota. A large portion of this land was not included in the 18,000 to 22,000 acres of land we had previously announced that we expect to sell in 2008, but we were presented with an opportunity to sell this non-core land and were able to match it for section 1031 like-kind exchange purposes with land purchased in Idaho in 2007 and 2008. Real Estate segment expenses were \$4.0 million in the second quarter of 2008, compared to \$1.2 million for the second quarter of 2007. The increased expenses were due to costs associated with the additional sales of land in the second quarter of 2008. Results for the segment depend on the timing of closing of transactions for properties we identify as having higher and better use values. Our goal is to utilize like-kind exchange transactions for tax efficiency whenever possible, thus maximizing cash flows. Therefore, we attempt to schedule closings of both sales and acquisitions, if possible, to occur at times when they would be most tax-efficient.

The Wood Products segment reported an operating loss of \$0.2 million for the second quarter of 2008, compared to operating income of \$6.6 million recorded in the same period of 2007. Revenues for the segment for the second quarter of 2008 were \$97.4 million, compared to \$108.2 million for the second quarter of 2007. Lumber revenues were \$67.0 million in the second quarter of 2008, down from \$77.7 million for the same period in 2007. The lower revenues were due to decreased shipments and lower selling prices. In March 2008, our Gwinn, Michigan lumber mill was shut down for nine days due to a weather-related log shortage. Following the downtime, the lumber mill

## Table of Contents

operated one shift a day until May 1, due to continuing weather-related log shortages, then returned to two shifts a day. The Lewiston, Idaho lumber mill was shut down for one week in June 2008 and the Bemidji, Minnesota lumber mill was shut down for eleven days in May 2008, both due to weather-related log shortages. Plywood revenues totaled \$13.9 million for the second quarter of 2008, compared to \$14.1 million for the second quarter of 2007. Particleboard revenues were \$5.3 million for the second quarter of 2008, compared to \$5.7 million for the same period in 2007. The lower revenues for both plywood and particleboard were due to decreased shipments that were partially offset by higher selling prices. Our Post Falls, Idaho particleboard plant was shut down for nearly three weeks in February 2008 and for fifteen days in May 2008 due to a fiber shortage caused by sawmill curtailments resulting from the depressed lumber market. Other revenues for the segment, which consist primarily of sales of by-products such as chips and residual logs, were \$11.2 million for the second quarter of 2008, compared to \$10.8 million for the second quarter of 2007. The increase in other revenues was due primarily to the sale of residual logs in 2008, with no sales of residual logs by the segment in 2007. Segment expenses were \$97.6 million for the second quarter of 2008, compared to \$101.6 million for the second quarter of 2007. The decrease in expenses was primarily due to lower costs associated with decreased lumber shipments.

The Pulp and Paperboard segment reported operating income of \$6.2 million for the second quarter of 2008, compared to \$17.0 million for the second quarter of 2007. Revenues for the segment were \$184.4 million for the second quarter of 2008, an increase of \$15.3 million over the \$169.1 million in revenues for the second quarter of 2007. Paperboard revenues increased to \$162.5 million in the second quarter of 2008, from \$142.7 million in the second quarter of 2007. The higher revenues were primarily due to increased shipments and higher selling prices. Pulp revenues were \$21.9 million for the second quarter of 2008, \$4.2 million lower than revenues of \$26.1 million recorded in the same period of 2007 due primarily to decreased shipments, partially offset by higher selling prices. Expenses for the segment were \$178.2 million for the second quarter of 2008, compared to \$152.1 million for the same period in 2007. The increase in expenses was due primarily to costs associated with increased shipments of paperboard, and higher wood fiber, energy, chemical and freight costs in the second quarter of 2008.

The Consumer Products segment reported operating income of \$6.9 million for the second quarter of 2008, compared to \$4.1 million for the second quarter of 2007. Revenues for the segment were \$120.9 million in the second quarter of 2008, \$15.0 million higher than revenues of \$105.9 million recorded in the second quarter of 2007. The higher revenues were due to higher selling prices and increased shipments. Segment expenses were \$114.0 million for the second quarter of 2008, compared to \$101.8 million for the second quarter of 2007. Costs associated with increased tissue shipments, as well as higher freight, pulp, energy and packaging costs, were largely responsible for the higher segment expenses.

### *Six Months Ended June 30, 2008 Compared to Six Months Ended June 30, 2007*

The following table sets forth period-to-period changes in items included in our Statements of Operations and Comprehensive Income for the six months ended June 30, 2008 and 2007.

(Dollars in thousands)	Six Months Ended June 30,		
	2008	2007	Increase (Decrease)
Revenues	\$ 832,801	\$ 768,792	\$ 64,009
Costs and expenses:			
Depreciation, depletion and amortization	36,135	37,468	(1,333)
Materials, labor and other operating expenses	694,138	630,134	64,004
Selling, general and administrative expenses	47,377	41,701	5,676
Restructuring charge	—	2,831	(2,831)
Earnings from continuing operations before interest and taxes	55,151	56,658	(1,507)
Interest expense	(17,174)	(14,891)	(2,283)
Interest income	454	896	(442)
Income tax provision (benefit)	(7,780)	1,314	9,094
Earnings from continuing operations	46,211	41,349	4,862
Discontinued operations, net of tax	(14,474)	(37,175)	22,701
Net earnings	\$ 31,737	\$ 4,174	\$ 27,563
Other comprehensive income, net of tax	2,771	2,734	37
Comprehensive income	\$ 34,508	\$ 6,908	\$ 27,600

Certain 2007 amounts have been reclassified to conform to the 2008 presentation.

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## Table of Contents

**Revenues** – Total revenues from continuing operations of \$832.8 million for the six months ended June 30, 2008, were \$64.0 million higher than the \$768.8 million recorded for the same period in 2007. Resource segment revenues decreased \$2.3 million to \$51.1 million for the first six months of 2008, primarily due to decreased overall sales of logs to external customers and lower log selling prices in our Northern region, partially offset by higher selling prices for external log sales in our Southern region. Real Estate revenues were \$36.4 million in the first six months of 2008, \$27.8 million higher than in the first six months of 2007 due to significantly increased sales of land. Revenues from the Wood Products segment were \$172.3 million for the first six months of 2008, compared to \$200.8 million for the same period in 2007. The decrease was due to lower selling prices and decreased shipments of lumber. Pulp and Paperboard revenues increased to \$331.1 million for the first six months of 2008, compared to \$289.8 million for the same period in 2007, due primarily to increased paperboard and pulp shipments and higher selling prices for paperboard and pulp. Consumer Products revenues were \$242.0 million for the first six months of 2008, a \$25.8 million increase compared to revenues of \$216.2 million for the first six months of 2007, due to increased shipments and higher selling prices.

**Depreciation, depletion and amortization** – For the six months ended June 30, 2008, depreciation, depletion and amortization totaled \$36.1 million, compared to \$37.5 million recorded in the first six months of 2007. The decrease was due to lower depreciation expense for our Pulp and Paperboard segment, partially offset by higher depletion expense for our Northern Resource region.

**Materials, labor and other operating expenses** – Materials, labor and other operating expenses increased to \$694.1 million for the first six months of 2008, compared to \$630.1 million recorded in the first six months of 2007. The higher expenses in the first half of 2008 were primarily due to costs associated with increased shipments of paperboard and tissue, higher wood fiber, energy and chemical costs for the Pulp and Paperboard segment, higher freight, pulp and energy costs for the Consumer Products segment, and costs associated with additional sales of land.

**Selling, general and administrative expenses** – Selling, general and administrative expenses were \$47.4 million for the first six months of 2008, compared to \$41.7 million for the first six months of 2007. The increase was due primarily to \$2.7 million recorded in the first quarter of 2008 for our settlement with the direct purchaser plaintiffs in the OSB antitrust lawsuit, higher compensation-related expenses and higher legal expenses.

**Restructuring charge** – In January 2007, we recorded a pre-tax charge of \$2.8 million associated with a restructuring within our Resource segment. An additional charge of less than \$0.1 million related to this restructuring was recorded in the second quarter of 2007. The charge represented estimated severance benefit costs for 35 employees. There were no restructuring charges in the first half of 2008.

**Interest expense** – Interest expense totaled \$17.2 million in the first six months of 2008 compared to \$14.9 million for the same period in 2007. The increase was due to increased borrowings outstanding under our unsecured bank credit facility during the first half of 2008 to fund a portion of the purchase of 179,000 acres of Idaho timberlands in September 2007 and January 2008.

**Interest income** – For the six months ended June 30, 2008, interest income was \$0.5 million, compared to \$0.9 million recorded in the first six months of 2007.

**Income tax provision (benefit)** – For the six months ended June 30, 2008, we recorded an income tax benefit related to our continuing operations of \$7.8 million due to Potlatch TRS losses. We recorded an income tax provision of \$1.3 million in the same period of 2007, which was largely due to Potlatch TRS income.

**Earnings from continuing operations** – In the first half of 2008, we recorded earnings from continuing operations of \$46.2 million, compared to \$41.3 million for the first half of 2007. The favorable comparison was primarily due to the income tax benefit recorded in 2008 compared to the income tax provision recorded in 2007.

**Discontinued operations** – For the first six months of 2008, we recorded an after-tax loss of \$12.2 million related to the Prescott mill closure. The charge represents estimated costs associated with the adjustment of assets to estimated fair market value, as well as approximately \$1.4 million in severance benefits, approximately \$0.8 million associated with the curtailment of the hourly defined benefit pension plan for the Prescott employees, and approximately \$0.3 million in other costs associated with the closure. Excluding the loss on disposal, the Prescott operation recorded an after-tax operating loss of \$2.3 million for the first six months of 2008, compared to an after-tax operating loss of \$0.5 million for the first six months of 2007.

For the first six months of 2007, we recorded an after-tax loss of \$33.0 million related to the sale of our Boardman, Oregon, hybrid poplar tree farm, which was completed during the second quarter of 2007. Excluding the loss on

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## [Table of Contents](#)

disposal, the Boardman operation recorded an after-tax operating loss of \$3.7 million for the first six months of 2007.

**Other comprehensive income, net of tax** – We recorded other comprehensive income, net of tax, of \$2.8 million for the first six months of 2008, compared to \$2.7 million for the same period in 2007.

### **DISCUSSION OF BUSINESS SEGMENTS**

The Resource segment reported operating income of \$29.4 million for the first six months of 2008, a decrease of \$3.7 million compared to \$33.1 million reported for the first six months of 2007. Segment revenues were \$105.3 million for the first six months of 2008, compared to \$131.7 million for the same period in 2007. The lower revenues were primarily due to decreased sales volumes in 2008, combined with lower log selling prices in our Northern region. Expenses for the segment were \$75.9 million for the first half of 2008, compared to \$98.6 million for the first half of 2007. The lower expenses were due to fewer outside logs purchased in 2008 and decreased harvest of fee timber in the Southern region. The 2007 expenses included a pre-tax restructuring charge of \$2.8 million recorded in the first quarter of 2007.

The Real Estate segment reported operating income of \$28.0 million for the first six months of 2008, compared to \$7.0 million for the first six months of 2007. Revenues for the segment were \$36.4 million for the first six months of 2008, compared to \$8.7 million for the same period in 2007. The significantly higher revenues in the first half of 2008 were due to the sale of approximately 53,500 acres of land, compared to approximately 7,500 acres in the first half of 2007. The majority of the land sold in the first half of 2008 was non-core land located in Minnesota. A large portion of this land was not included in the 18,000 to 22,000 acres of land we had previously announced that we expect to sell in 2008, but we were presented with an opportunity to sell this non-core land and were able to match it for section 1031 like-kind exchange purposes with land purchased in Idaho in 2007 and early 2008. Real Estate segment expenses were \$8.5 million in the first six months of 2008, compared to \$1.6 million for the first six months of 2007. The increased expenses were due to costs associated with the additional sales of land in the first half of 2008.

The Wood Products segment reported an operating loss of \$10.3 million for the first six months of 2008, compared to operating income of \$9.4 million recorded in the same period of 2007. Revenues for the segment were \$185.5 million in the first six months of 2008, compared to \$211.5 million for the first six months of 2007. Lumber revenues were \$125.0 million in the first half of 2008, down from \$152.2 million for the same period in 2007. The lower revenues were due to lower selling prices and decreased shipments. In March 2008, our Gwinn, Michigan lumber mill was shut down for nine days due to a weather-related log shortage. Following the downtime, the lumber mill operated one shift a day until May 1, due to continuing weather-related log shortages, then returned to two shifts a day. The Lewiston, Idaho lumber mill was shut down for one week in June 2008 and the Bemidji, Minnesota lumber mill was shut down for eleven days in May 2008, both due to weather-related log shortages. Plywood revenues totaled \$28.0 million for the first six months of 2008, compared to \$27.7 million for the first six months of 2007. The increase was due to higher selling prices, partially offset by decreased shipments. Particleboard revenues were \$9.7 million for the first half of 2008, compared to \$10.6 million for the same period in 2007. The lower revenues were due to decreased shipments, partially offset by higher selling prices. Our Post Falls, Idaho particleboard plant was shut down for nearly three weeks in February 2008 and for fifteen days in May 2008 due to a fiber shortage caused by sawmill curtailments resulting from the depressed lumber market. Other revenues for the segment were \$22.8 million for the first six months of 2008, compared to \$21.0 million for the first six months of 2007. The increase in other revenues was due to the sale of residual logs in 2008, versus none sold by the segment in 2007. Segment expenses were \$195.8 million for the first six months of 2008, \$6.6 million lower than expenses of \$202.1 million for the first six months of 2007. The decrease in expenses was primarily due to lower costs associated with decreased lumber shipments.

The Pulp and Paperboard segment reported operating income of \$17.2 million for the first six months of 2008, compared to \$11.0 million for the first six months of 2007. Revenues for the segment were \$361.5 million for the first six months of 2008, an increase of \$41.2 million over the \$320.3 million in revenues for the first six months of 2007. Paperboard revenues increased to \$313.2 million in the first half of 2008, \$39.7 million higher than revenues of \$273.5 million in the first half of 2007. The higher revenues were primarily due to increased shipments and higher selling prices. Pulp revenues were \$47.9 million for the first six months of 2008, compared to \$46.2 million recorded in the same period of 2007 due primarily to increased shipments and slightly higher selling prices. Expenses for the segment were \$344.2 million for the first six months of 2008, compared to \$309.3 million for the same period in 2007. The increase in expenses was due primarily to costs associated with increased shipments of paperboard and pulp, and higher wood fiber, energy and chemical costs in the first half of 2008. These increased expenses were

## [Table of Contents](#)

partially offset by reduced maintenance costs in the first half of 2008 when compared to the first half of 2007. Maintenance costs for the first six months of 2007 included \$9.2 million for a planned major maintenance outage.

The Consumer Products segment reported operating income of \$10.3 million for the first six months of 2008, compared to \$8.9 million for the first six months of 2007. Revenues for the segment were \$242.0 million in the first six months of 2008, \$25.8 million higher than revenues of \$216.2 million recorded in the first six months of 2007. The higher revenues were due to increased shipments and higher selling prices. Segment expenses were \$231.7 million for the first half of 2008, compared to \$207.3 million for the first half of 2007. Costs associated with increased tissue shipments, as well as higher freight, pulp and energy costs, were largely responsible for the higher segment expenses.

## LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2008, our financial position included long-term debt of \$321.3 million, including current installments on long-term debt of \$0.4 million. Long-term debt at June 30, 2008 (including current installments) decreased \$0.2 million from the \$321.5 million balance at December 31, 2007. Stockholders' equity for the first six months of 2008 decreased by \$1.1 million due to a regular quarterly distribution to common stockholders of \$40.3 million, partially offset by net earnings of \$31.7 million and the issuance of \$3.3 million of common stock related to the exercise of stock options. The ratio of long-term debt (including current installments) to stockholders' equity was 0.56 to 1 at both June 30, 2008 and December 31, 2007.

Scheduled payments due on long-term debt during each of the five years subsequent to December 31, 2008, are as follows:

<b>(Dollars in thousands)</b>	
2009	\$100,410
2010	11
2011	5,011
2012	21,657
2013	8,413

Working capital totaled \$37.5 million at June 30, 2008, a decrease of \$11.8 million from the December 31, 2007 balance of \$49.3 million. The significant changes in the components of working capital are as follows:

- Notes payable totaled \$129.3 million at June 30, 2008, compared to \$110.3 million at December 31, 2007. The increase was primarily due to additional borrowings under our unsecured bank credit facility revolving line of credit in the first half of 2008 to partially fund the purchase of approximately 34,000 acres of timberland in Idaho for approximately \$51.4 million.
- Receivables increased by \$22.7 million due primarily to increases in income tax refunds receivable and trade receivables for our Pulp and Paperboard and Wood Products segments.
- Inventories decreased by \$18.0 million primarily due to lower log and tissue inventories.

Net cash provided by operating activities from continuing operations for the first six months of 2008 totaled \$48.7 million, compared to \$71.9 million for the same period in 2007. The decrease was largely due to a lower amount of cash provided from working capital changes in the first six months of 2008 compared to the same period in 2007.

For the six months ended June 30, 2008, net cash used for investing activities from continuing operations was \$31.9 million, compared to \$96.9 million for the first six months of 2007. In the first six months of 2008, we used \$27.3 million for deposits on timberlands, compared to \$54.0 million for the same period in 2007. The deposits on timberlands represent the portion of timberlands that were purchased on our behalf by a qualified like-kind exchange intermediary, and are held by the intermediary until they are either matched with sales of company-owned properties through our like-kind exchange process or the end of a 180-day period, whichever comes first. In accordance with section 1031 rules, title to any portion of timberlands held by the intermediary that is not matched with sales of company-owned properties within 180 days of the purchase of these timberlands will be transferred to us at the end of the 180-day period. In addition to the change in deposits on timberlands, we had a net cash inflow of \$26.3 million in the first six months of 2008 from a change in our short-term investments compared to a net cash outflow of \$9.8 million for the same period in 2007. The \$26.3 million net cash inflow from the change in short-term investments for the first half of 2008 included \$25.3 million in proceeds received as a result of the settlement of short-term investments originally obtained through non-cash like-kind exchange transactions.

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## Table of Contents

Capital expenditures in the first six months of 2008 included \$16.4 million in cash for the acquisition of timberlands in Idaho. Capital expenditures in the first six months of 2007 included \$14.5 million in cash for our Wisconsin timberland purchase. The balance of capital expenditures in both periods was for forestland activities and various smaller projects designed to improve product quality and manufacturing efficiency.

Net cash used for financing activities totaled \$22.0 million for the six months ended June 30, 2008, compared to \$40.5 million during the same period in 2007. The cash used for financing activities in the first six months of 2008 was primarily due to the regular quarterly cash distributions to common stockholders of \$40.3 million, which were partially offset by an increase of \$19.0 million in notes payable, as discussed above. The cash used by financing activities in the first six months of 2007 was primarily due to the regular quarterly cash distributions to common stockholders of \$38.2 million.

Our regular quarterly distributions increased to approximately \$40.3 million in the first six months of 2008 from approximately \$38.2 million in the same period in 2007. Based on historical operating results and taking into account planned harvest activities, we expect to fund a substantial majority of future annual distributions using the cash flows from our REIT-qualifying timberland operations. Any shortfall between cash available for distribution from REIT operations and anticipated future annual distributions to stockholders is expected to be funded through cash on hand, bank borrowings, or a combination thereof. Our ability to fund distributions through bank borrowings is subject to our continued compliance with debt covenants, as well as the availability of borrowing capacity under our lending arrangements. If our operations do not generate sufficient cash flows and we are unable to borrow, we may be required to reduce our quarterly distributions. In addition, even if cash available for distribution from our REIT operations is sufficient on an annual basis to fund the entire distribution to stockholders, we anticipate that it may be necessary to utilize some short-term borrowing to fully fund distributions in the first half of each year as a result of the lower harvest activity during winter and early spring. Significant decreases in timber prices or other factors that have a materially adverse effect on the cash flows from our REIT operations could result in our inability to maintain our current distribution rate.

In addition, the rules with which we must comply to maintain our status as a REIT limit our ability to use dividends from our manufacturing businesses for the payment of stockholder distributions. In particular, at least 75% of our gross income for each taxable year as a REIT must be derived from sales of our standing timber and other types of real estate income. No more than 25% of our gross income may consist of dividends from Potlatch TRS and other non-qualifying types of income. Our board of directors, in its sole discretion, will determine the actual amount of distributions to be made to stockholders based on consideration of a number of factors, including, but not limited to, our results of operations, cash flow and capital requirements, economic conditions, tax considerations and borrowing capacity.

Our current unsecured bank credit facility, which expires on December 22, 2008, provides for a revolving line of credit of up to \$250 million, including a \$35 million subfacility for letters of credit and a \$10 million subfacility for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. As of June 30, 2008, there were \$129.3 million of borrowings outstanding under the revolving line of credit, and \$10.0 million of the letter of credit subfacility was being used to support several outstanding letters of credit. The \$129.3 million in borrowings were used to fund a portion of the acquisition of 145,000 acres of timberland in Idaho costing approximately \$163.0 million in September 2007 and 34,000 acres purchased for approximately \$51.4 million in January 2008. Loans under the credit facility bear interest at LIBOR plus between 0.625% and 1.625% for LIBOR loans, and a base rate effectively equal to the bank's prime rate plus up to 0.625% for other loans. As of June 30, 2008, the weighted average interest rate on the \$129.3 million of borrowings outstanding under the revolving line of credit was approximately 3.58%, and we are eligible to borrow under the credit facility at LIBOR plus 1.125%.

The agreement governing our credit facility contains covenants that, among other things, limit to a certain degree our ability and that of our subsidiaries to create liens, merge or consolidate, dispose of assets, incur indebtedness and guarantees, repurchase or redeem capital stock and indebtedness, make certain investments or acquisitions, enter into certain transactions with affiliates or change the nature of our business. The credit facility also contains financial maintenance covenants establishing a maximum funded indebtedness to capitalization ratio, a minimum consolidated net worth requirement, and a minimum interest coverage ratio. We will be permitted to pay distributions under the terms of the credit facility so long as we remain in pro forma compliance with the financial covenants.

## [Table of Contents](#)

The table below sets forth the most restrictive covenants in the credit facility and our status with respect to these covenants as of June 30, 2008.

	<b>Covenant Requirement</b>	<b>Actual Ratio at June 30, 2008</b>
Maximum Funded Indebtedness To Capitalization Ratio	55%	40.0%
Minimum Net Worth	80% of consolidated net worth at March 31, 2006 (1)	124.5%
Minimum Interest Coverage Ratio	2.75 to 1.00	5.18 to 1.00

- (1) The minimum requirement is 80% of consolidated net worth as of March 31, 2006, with an adjustment to the minimum requirement for the net cash proceeds, on a cumulative basis, of all equity issuances.

Events of default under the credit facility include, but are not limited to, payment defaults, covenant defaults, breaches of representations and warranties, cross defaults to certain other material agreements and indebtedness, bankruptcy and other insolvency events, material adverse judgments, actual or asserted invalidity of security interests or loan documentation, and certain change of control events.

We and several of our subsidiaries are parties to the credit agreement and eligible to borrow thereunder, subject to the \$250 million aggregate credit limit and continued compliance with debt covenants. Any borrowings by one of these entities under the credit facility reduce the credit available for all the entities. As a result, borrowings by Potlatch TRS under the credit facility will, until repaid, reduce the amount of borrowings otherwise available to us for purposes such as the funding of quarterly distributions.

We believe that our cash, cash flows from continuing operations and available borrowings under our current credit facility, which we expect to replace or extend prior to its expiration in December 2008, will be sufficient to fund our operations, stockholder distributions, capital expenditures and debt service obligations for the next twelve months. We cannot assure, however, that our business will generate sufficient cash flow from operations or that we will be in compliance with the financial covenants in our credit facility so that future borrowings thereunder will be available to us. Thus, our ability to fund our operations and stockholder distributions will be dependent upon our future financial performance, which will be affected by general economic, competitive and other factors, including those discussed above under the heading "Factors Influencing our Results of Operations and Cash Flows," many of which are beyond our control.

Since October 2005, Standard & Poor's Ratings Services, or S&P, has rated our senior unsecured debt at BB. Since the first quarter of 2003, Fitch, Inc. has rated our senior unsecured debt at BB+. Fitch affirmed its rating in January 2008, with a positive outlook. Moody's Investors Service Inc. has rated our senior unsecured debt at Ba1 and our senior secured subordinated debt at Ba2 since October 2004. Moody's affirmed its rating, with a stable outlook, in December 2007. The interest rate we pay on some of our debt is influenced by our credit ratings. See Item 3, "Quantitative and Qualitative Disclosures About Market Risk" below for additional information.

### ITEM 3.

#### **Quantitative and Qualitative Disclosures About Market Risk**

Our exposure to market risks on financial instruments includes interest rate risk on our short-term investments and unsecured bank credit facility, and credit rate risk on our credit sensitive debentures.

Our short-term investments are invested in time or demand deposits, certificates of deposit and U.S. Treasury and U.S. government agency obligations, all of which have very short maturity periods, and they therefore earn an interest rate commensurate with low-risk instruments. We do not attempt to hedge our exposure to interest rate risk for our short-term investments. All short-term investments are intended to be made in compliance with the requirements of the Internal Revenue Code with respect to qualifying REIT investments.

## Table of Contents

As of June 30, 2008, there were \$129.3 million of borrowings outstanding under our unsecured bank credit facility. The interest rates applied to borrowings under the credit facility are adjusted often and therefore react quickly to any movement in the general trend of market interest rates. For example, a 1% increase or decrease in interest rates, based on our current outstanding credit facility borrowings of \$129.3 million, would have a \$1.3 million annual effect on interest expense. We do not attempt to mitigate the effects of short-term interest rate fluctuations on our credit facility borrowings through the use of derivative financial instruments.

All of our long-term debt is fixed rate and therefore changes in market interest rates do not expose us to interest rate risk for these financial instruments.

We currently have \$100.0 million of credit sensitive debentures outstanding that pay interest to the debt holder based upon our credit ratings as established by S&P or Moody's. The following table denotes the interest rate applicable based on various credit ratings:

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

In October 2005, S&P lowered our senior unsecured debt rating to BB stable from BB+. The rating downgrade caused the interest rate on our credit sensitive debentures to increase from 12.5% to 13.0%. Since October 2004, Moody's has rated our senior unsecured debt at Ba1. Moody's affirmed this rating, with a stable outlook, in December 2007.

## QUANTITATIVE INFORMATION ABOUT MARKET RISKS (Dollars in thousands)

	Expected Maturity Date (as of June 30, 2008)						Total
	2008	2009	2010	2011	2012	Thereafter	
Long-term debt:							
Fixed rate	\$ 3	\$ 100,410	\$ 11	\$ 5,011	\$ 21,657	\$ 194,230	\$ 321,322
Average interest rate	6.5%	13.0%	6.5%	8.6%	5.7%	6.8%	8.7%
Fair value at 6/30/08							\$ 338,318

## ITEM 4.

### Controls and Procedures

We maintain "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) under the Securities and Exchange Act of 1934 (the Exchange Act), which are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, we recognize that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

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## [Table of Contents](#)

Subject to the limitations noted above, our management, with the participation of our CEO and CFO, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the fiscal quarter covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the CEO and CFO have concluded that, as of such date, our disclosure controls and procedures are effective to meet the objective for which they were designed and operate at the reasonable assurance level.

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

## **Part II**

### ITEM 1.

#### **Legal Proceedings**

Beginning in February 2006, a series of private antitrust lawsuits were filed against us and certain other manufacturers of oriented strand board (OSB) by plaintiffs who claim they purchased OSB at artificially high prices. The cases were consolidated into two Consolidated Amended Class Action Complaints in the United States District Court for the Eastern District of Pennsylvania under the caption In Re OSB Antitrust Litigation, one on behalf of direct purchasers of OSB and the other on behalf of indirect purchasers. The complaints allege that the defendant OSB manufacturers violated federal and state antitrust laws by purportedly conspiring from mid-2002 to the present to drive up the price of OSB. The consolidated indirect purchaser complaint also alleges that defendants violated various states' unfair competition laws and common law. Each consolidated complaint seeks an unspecified amount of monetary damages to be trebled as provided under the antitrust laws and other relief. The court certified a nationwide class of direct purchasers who bought OSB structural panel products directly from one of the defendants during the period from June 1, 2002 to February 24, 2006. It also certified a nationwide class of indirect purchaser end users who purchased new OSB manufactured or sold by one of the defendants during the same time period; this class excludes persons who only bought OSB that was incorporated into a house or other structure. The claims of the nationwide indirect purchaser class are limited to injunctive relief. However, the court also certified a multistate class of indirect purchasers in 17 states whose members may recover compensation as allowed by state law. Although we vigorously deny any wrongdoing, on March 28, 2008, we tentatively settled the claims of the direct purchaser class for \$2.7 million, solely in order to avoid the further expense and burden of the ongoing litigation. On April 17, 2008, we tentatively settled the indirect purchaser class action claims for \$0.3 million. Both settlements remain subject to court approval. We sold our OSB manufacturing facilities to Ainsworth Lumber Co. Ltd. in September 2004.

On September 28, 2005, Ainsworth notified us by letter of its claims under the indemnification provisions of the asset purchase agreement between us and Ainsworth whereby Ainsworth purchased our OSB facilities. The claims involve alleged breaches of representations and warranties regarding the condition of certain of the assets sold to Ainsworth. In July 2006, Ainsworth filed a complaint for breach of contract in the United States District Court for the Southern District of New York seeking an unspecified amount of monetary damages. The federal court case was subsequently dismissed voluntarily, and Ainsworth refiled its complaint in the Supreme Court of the State of New York for the County of New York on September 21, 2006. We believe we have meritorious defenses to the claim, and we are defending ourselves accordingly.

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 are no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2007. See Part I, Item 1A, "Risk Factors."

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**Table of Contents**

ITEM 2.

**Unregistered Sales of Equity Securities and Use of Proceeds**

<b>Period</b>	<b>Total Number of Shares Purchased</b>	<b>Average Price Paid per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs</b>
June 1 – June 30, 2008	287(1)	\$ 49.84	—(2)	—(2)
Total	287	\$ 49.84	—	—

(1) Represents shares of the company's common stock purchased on behalf of the company in an open-market transaction occurring on June 16, 2008.

(2) There are currently no authorized repurchase programs in effect under which the company may repurchase shares.

ITEM 4.

**Submission of Matters to a Vote of Security Holders**

At the annual meeting of stockholders of the company held on May 5, 2008, the company's stockholders voted on three proposals as follows:

**Proposal 1**

Election of Directors

	<u>For</u>	<u>Against</u>	<u>Abstain</u>
Jerome C. Knoll	35,707,208	813,237	106,928
John S. Moody	35,664,141	839,957	123,275
Lawrence S. Peiros	35,709,655	798,228	119,490
William T. Weyerhaeuser	35,280,358	1,257,403	89,612

Directors whose terms of office also continued after the annual meeting are Michael J. Covey, Boh A. Dickey, William L. Driscoll, Ruth Ann M. Gillis, Gregory L. Quesnel, Michael T. Riordan and Judith M. Runstad.

**Proposal 2**

Approval of Annual Incentive Plan

For	34,491,150
Against	1,356,191
Abstain	780,032

**Proposal 3**

Ratification of the Appointment of Independent Auditor

For	34,886,440
Against	1,669,794
Abstain	71,139

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[Table of Contents](#)

ITEM 6.

**Exhibits**

The exhibit index is located on page 34 of this Form 10-Q.

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  
(Duly Authorized; Principal Accounting Officer)

Date: July 28, 2008

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**Table of Contents**

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

EXHIBIT INDEX

<b>EXHIBIT NUMBER</b>	<b>DESCRIPTION</b>
(4)	Registrant undertakes to furnish to the Commission, upon request, any instrument defining the rights of holders of long-term debt.
(10)(h)(i) <sup>1</sup> *	Amendment to Potlatch Corporation Benefits Protection Trust Agreement, effective June 1, 2008, filed as Exhibit (10)(h)(i) to the Current Report on Form 8-K filed by the Registrant on May 21, 2008.
(10)(r)(v) <sup>1</sup> *	Amendment to Potlatch Corporation Management Performance Award Plan II, effective June 1, 2008, filed as Exhibit (10)(r)(v) to the Current Report on Form 8-K filed by the Registrant on May 21, 2008.
(10)(s) <sup>1</sup>	Amended and Restated Deferred Compensation Plan For Directors II, effective May 15, 2008.
(10)(w) <sup>1</sup> *	Potlatch Corporation Annual Incentive Plan, effective January 1, 2009, filed as Exhibit (10)(w) to the Current Report on Form 8-K filed by the Registrant on May 8, 2008.
(10)(x) <sup>1</sup> *	Potlatch Corporation Management Deferred Compensation Plan, effective June 1, 2008, filed as Exhibit (10)(x) to the Current Report on Form 8-K filed by the Registrant on May 21, 2008.
(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.

\* Incorporated by reference.

<sup>1</sup> Management contract or compensatory plan, contract or arrangement.

POTLATCH CORPORATION  
DEFERRED COMPENSATION PLAN FOR DIRECTORS II

Effective January 1, 2005

Amended and Restated Effective May 15, 2008

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POTLATCH CORPORATION  
DEFERRED COMPENSATION PLAN FOR DIRECTORS II

Effective January 1, 2005

As Amended and Restated Effective May 15, 2008

1. ESTABLISHMENT AND PURPOSE.

(a) The Potlatch Corporation Deferred Compensation Plan for Directors II was adopted effective January 1, 2005, by the Board of Directors of Potlatch Corporation to provide Directors of Potlatch Corporation an opportunity to defer payment of their Director's Fees. The Plan is also intended to establish a method of paying Director's Fees, which will assist the Corporation in attracting and retaining persons of outstanding achievement and ability as members of the Board of Directors of the Corporation.

(b) The Plan is the successor plan to the Potlatch Corporation Deferred Compensation Plan for Directors (the "Prior Plan"). Effective December 31, 2004, the Prior Plan was frozen and no new contributions will be made to it; provided, however, that any deferrals made under the Prior Plan before January 1, 2005 continue to be governed by the terms and conditions of the Prior Plan as in effect on December 31, 2004 or on the date of any later amendment, provided that such amendment is not a material modification of the Prior Plan under Section 409A of the Code and regulations promulgated thereunder.

(c) Any deferrals made under the Prior Plan after December 31, 2004 are deemed to have been made under the Plan and all such deferrals are governed by the terms and conditions of the Plan as it may be amended from time to time.

(d) The Plan is intended to comply with the requirements of Section 409A of the Code.

2. DEFINITIONS.

(a) "Affiliate" means any other entity which would be treated as a single employer with the Corporation under Section 414(b) or (c) of the Code.

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- (b) "Beneficiary" means the person or persons designated by the Director to receive payment of the Director's Deferred Compensation Account in the event of the death of the Director.
- (c) "Board" and "Board of Directors" means the board of directors of the Corporation.
- (d) "Code" means the Internal Revenue Code of 1986, as amended.
- (e) "Committee" means the Nominating and Corporate Governance Committee of the Board.
- (f) "Corporation" means Potlatch Corporation, a Delaware corporation.
- (g) "Deferred Compensation Account" means the bookkeeping account established pursuant to section 6 on behalf of each Director who elects to participate in the Plan.
- (h) "Director" means a member of the Board of Directors who is not an employee of the Corporation or any subsidiary thereof.
- (i) "Director's Fees" means the amount of compensation paid by the Corporation to a Director for his or her services as a Director, including an annual retainer and any amount payable for attendance at a Board meeting or any Board committee meeting. "Director's Fees" shall not include any reimbursement by the Corporation of expenses incurred by a Director incidental to attendance at a Board meeting or a Board committee meeting or of any other expense incurred on behalf of the Corporation.
- (j) A Director shall be considered "Disabled" if the Director is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve months.
- (k) "Dividend Equivalent" means an amount equal to the cash dividend paid on an outstanding share of the Corporation's common stock. Dividend Equivalents shall be credited to Stock Units as if each Stock Unit were an outstanding share of the Corporation's common stock, except that Dividend Equivalents shall also be credited to fractional Stock Units.

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- (l) "Plan" means the Potlatch Corporation Deferred Compensation Plan for Directors II.
- (m) "Prior Plan" means the Potlatch Corporation Deferred Compensation Plan for Directors.
- (n) "Separation from Service" means termination of a Director's service as a non-employee member of the Board consistent with Code Section 409A and the regulations promulgated thereunder. The Plan is intended to be a Plan provided to directors, and in accordance with applicable regulations, a Director shall be treated as having Separation from Service for purposes of this Plan on the later of the date that the Director ceases to serve on the Board of Directors of the Corporation or an Affiliate and the Director is not an independent contractor to the Corporation or an Affiliate. Continued service as an employee of the Corporation or an Affiliate shall not affect whether a Director has incurred a Separation from Service under this Plan.
- (o) "Stock Units" means the deferred portion of Director's Fees, which is converted into a unit denominated in shares of the Corporation's common stock.
- (p) "Value" means the closing price of the Corporation's common stock as reported in the New York Stock Exchange, Inc., composite transactions reports for the Valuation Date.
- (q) "Valuation Date" means, for the purpose of Section 6 or 7, the date on which Director's Fees or Dividend Equivalents are converted into Stock Units pursuant to Section 6 or 7 and, for purposes of Section 8, the last trading day of the month preceding the month in which Stock Units are converted into cash for purposes of Section 8.
- (r) "Year" shall mean the calendar year.

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3. ELIGIBILITY.

Each Director who receives Director's Fees for service on the Board of Directors shall be eligible to participate in the Plan.

4. PARTICIPATION.

In order to participate in the Plan for a particular Year, a Director must file a deferral election with the Secretary of the Corporation prior to January 1 of such Year; provided, however, that in the case of a newly elected or appointed Director an election to participate shall be effective for the Year in which the Director is first elected or appointed if it is filed no later than thirty days following the date of the Director's election or appointment to the Board. Any initial election filed by a newly elected or appointed Director shall apply only to Director's Fees earned after the effective date of the election. A new Director who does not elect to make deferrals of Director's Fees during the initial thirty-day election period may not later elect to make deferrals of Director's Fees for the calendar year of his or her initial eligibility. If a payment of Director's Fees (such as annual retainer fees or fees for serving as Chairman of a Committee) are due for services performed over a period of time which includes the period both before and the period after the date of the election, the election will apply to an amount equal to the total amount of the Director's Fee paid for such performance period multiplied by the ratio of the number of days remaining in the performance period after the election over the total number of days in the performance period.

5. DEFERRAL ELECTION.

A Director who elects to participate in the Plan shall file a deferral election on a form, which shall indicate:

(a) The amount or percentage of Director's Fees that such Director elects to defer pursuant to the terms of the Plan. This election shall apply to amounts deferred under the Plan until modified by the Director. The Director shall notify the Secretary of the Corporation in writing of any such modification, which shall apply solely to amounts deferred with respect to Years following the Year in which the modification is made;

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(b) The Year in which payment of the Director's Deferred Compensation Account and/or Stock Units shall commence; provided however, that payments shall commence no later than the Year following the Year in which the Director attains age 72 and, in the case of Stock Unit payments, to the extent that Committee reasonably determines that earlier payment would result in a violation of Federal securities laws, payment shall be made no earlier than six months after the last date on which Director's Fees have been converted into Stock Units on behalf of the Director (except in the case of payments made following the Director's death, Disability or Separation from Service);

(c) Whether the payment of such Director's Deferred Compensation Account is to be made in a single lump sum or in a series of approximately equal installments over a period of years specified by the Director (but in no event more than fifteen years). For purposes of the Plan, installment payments shall be treated as a single distribution under Section 409A of the Code;

(d) Whether the percentage deferral election shall be effective only with respect to Director's Fees paid for the Year in which the Director's participation in the Plan is to commence as determined pursuant to Section 4 above or shall apply with respect to Director's Fees paid for that Year and all subsequent Years until revoked or modified by the Director, it being intended that a Director shall have only one election in effect with respect to the Year during which payment is to commence and the form of the payment for all amounts deferred under the Plan. Notwithstanding the preceding intention that a Director have only one election in effect with respect to the time and form of payment, (i) any elections in effect as of January 1, 2008, shall remain in effect unless changed in accordance with the terms of Sections 5(f) or (g) of the Plan and (ii) a Director whose existing election provides for benefits to commence in the next Year or who has already begun receiving payments, may elect a new time and form of payment for amounts to be deferred in subsequent Years. Changes to the Year of commencement and form of payment may be made only in accordance with the rules of Sections 5(f) or (g), below. The Director shall notify the Secretary of the Corporation in writing of any such revocation or modification of a deferral election or permitted new election with respect to the time or form of payment, which elections shall apply solely to amounts deferred with respect

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to Years following the Year in which the revocation, modification or new payment election is made; and

(e) The percentage of the Director's Fees deferred pursuant to the election, which is to be converted into Stock Units. This election shall apply to the Year in which the Director's participation in the Plan commences and to all subsequent Years until modified by the Director. The Director shall notify the Secretary of the Corporation in writing of any such modification, which shall apply solely to amounts deferred with respect to years following the Year in which the modification is made.

(f) Notwithstanding any provision herein to the contrary, a Director or former Director may revoke a previous election and make a new election as to the time and form of distribution under the Plan. Such new election shall take effect 12 months after it is filed with the Secretary of the Corporation and shall apply only to that portion of the Director's or former Director's Deferred Compensation Account and/or Stock Units scheduled to be paid more than 12 months after the date the election is filed with the Secretary of the Corporation; provided, however, that the newly scheduled distribution date must be at least five years later than the originally scheduled distribution date.

(g) Directors may make a special distribution election to change the time and form of the distribution of their Deferred Compensation Accounts and Stock Units, provided that the distribution election is made at least twelve months in advance of the newly elected distribution date and the previously scheduled distribution date and the election is made no later than December 31, 2008. No election under this Section 5(g) shall (i) change the payment date of any distribution otherwise scheduled to be paid in 2008 or cause a payment to be paid in 2008, or (ii) be permitted after December 31, 2008.

#### 6. TREATMENT OF DEFERRED ACCOUNTS.

Upon receipt of a duly filed deferral election, the Corporation shall establish a Deferred Compensation Account to which shall be credited an amount equal to that portion of the Director's Fees which would have been payable currently to the Director but for the terms of the deferral election and which is not converted into Stock Units. If the deferral election includes an

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election to convert a percentage of the Director's Fees deferred pursuant to the election into Stock Units, the number of full and fractional Stock Units shall be determined by dividing the amount subject to such an election by the Value of the Corporation's common stock on the Valuation Date.

Director's Fees shall be credited to Director's Deferred Compensation Account or converted into Stock Units on a quarterly basis as follows:

- (a) The deferred portion of one-fourth of the annual retainer fee (other than the portion to be credited to Stock Units) shall be credited to a Director's Deferred Compensation Account as of the first day of each calendar quarter;
- (b) The deferred portion of the fee for any meeting of the Board or any committee thereof (other than the portion to be credited to Stock Units) shall be credited to a Director's Deferred Compensation Account as of the first day of the month following the date of such meeting;
- (c) The deferred portion of one-fourth of the annual retainer fee which is to be credited as Stock Units shall be credited to the Director's Account as of the first trading day of the calendar quarter; and
- (d) The deferred portion of the fees for any meetings of the Board or any committee thereof which are to be credited as Stock Units shall be accumulated in the Participant's Deferred Compensation Account and credited as Stock Units on the first trading day of the next calendar quarter.

7. TREATMENT OF DEFERRED COMPENSATION ACCOUNT AND STOCK UNITS DURING DEFERRAL PERIOD.

(a) Deferred Compensation Account. Interest shall be credited on the balance of each Director's Deferred Compensation Account commencing with the date as of which any amount is credited to the Deferred Compensation Account and continuing up to the last day of the quarter preceding the month in which payment of the amounts deferred pursuant to the Plan is made. Such interest shall become a part of the Deferred Compensation Account and shall be

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paid at the same time or times as the balance of the Deferred Compensation Account. For periods prior to July 1, 2008, such interest for each calendar quarter during the deferral period shall be computed at 70% of the higher of the following averages: (i) the prime rate charged by the major commercial banks as of the first business day of each calendar month (as reported in an official publication of the Federal Reserve System), or (ii) the average monthly long-term rate of A rated corporate bonds (as published in Moody's Bond Record). For periods on and after July 1, 2008, interest shall be credited at 120% of the long-term applicable federal rate, with quarterly compounding, as published under Section 1274(d) of the Code for the first month of the calendar quarter. Such interest shall be compounded quarterly.

(b) Stock Units. Dividend Equivalents shall be credited with respect to each Stock Unit credited to a Director on each dividend record date. Such Dividend Equivalents shall themselves be converted into Stock Units as of the dividend payment by dividing the amount of the Dividend Equivalents by the Value of the Corporation's Common Stock as of the dividend payment date.

(c) Effect of Certain Transactions. In the event of a change in the number of outstanding shares of the Corporation's common stock by reason of a stock split, stock dividend, or other changes in capitalization, an appropriate adjustment shall be made in the number of each Director's Stock Units determined as of the date of such occurrence.

#### 8. FORM AND TIME OF PAYMENT OF DEFERRED COMPENSATION ACCOUNT.

Payment of a Director's Deferred Compensation Account shall be made or commence to be made in cash prior to January 31 in each year in which a payment is to be made in accordance with the Director's deferral election. Payment of a Director's Stock Units shall also be made at such time except that, if the applicable January 31 occurs within the six-month period beginning on the last date on which Director's Fees have been converted into Stock Units on behalf of the Director and to the extent the Committee reasonably determines that earlier payment would result in a violation of Federal securities laws, then payment of the Director's Stock Units shall be made on the last day of the month in which such six-month period expires. Notwithstanding the previous sentence, Stock Unit payments shall be made following the Director's death, Disability or the date the Director Separates from Service, without regard to whether such six-

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month period has expired. A Director shall continue to be credited with Dividend Equivalents during any such delay in payment. For the purpose of payment, Stock Units shall be converted to cash based on the Value of the Corporation's common stock on the applicable Valuation Date.

In the case of a Director who has both a Deferred Compensation Account and Stock Units, if a partial distribution of a deferred portion of Director's Fees is to be made and if the Director's Stock Units are immediately payable in accordance with the previous paragraph, payment shall be made partially from the Director's Deferred Compensation Account and partially from Stock Units, in proportion to the relative size of the Deferred Compensation Account and the Stock Units. If the Director's Stock Units are not immediately payable in accordance with the previous paragraph, the partial payment shall be made entirely from the Director's Deferred Compensation Account.

Notwithstanding any other provision of the Plan to the contrary:

(a) No distribution shall be made from the Plan that would constitute an impermissible acceleration of payment as defined in Section 409A(a)(3) of the Code and regulations promulgated thereunder; and

(b) To the extent Code Section 409A(a)(2)(B), which applies to certain "specified employees," is applicable to distributions to Directors under this Plan, no payment shall be made by reason of a Separation of Service before the date which, is six (6) months and one day following the Director's Separation of Service or the Director's death, if earlier. Any payments which would otherwise have been payable to a Director during the period of delay shall be made in a lump sum following the end of such delay. A Director's Accounts shall continue to be credited with interest and Dividend Equivalents during the period of such delay.

#### 9. EFFECT OF DEATH OF PARTICIPANT.

Upon the death of a participating Director, all amounts, if any, remaining in his or her Deferred Compensation Account and all Stock Units shall be distributed to the Beneficiary designated by the Director. Such distribution shall be made at the time or times specified in the Director's deferral election. If the designated Beneficiary does not survive the Director or dies before receiving payment in full of the Director's Deferred Compensation Account and Stock

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Units, payment shall be made to the estate of the last to die of the Director or the designated Beneficiary.

10. PARTICIPANT'S RIGHTS UNSECURED.

The interest under the Plan of any participating Director and such Director's right to receive a distribution of his or her Deferred Compensation Account and Stock Units shall be an unsecured claim against the general assets of the Corporation. The Deferred Compensation Account and Stock Units shall be bookkeeping entries only and no Director shall have an interest in or claim against any specific asset of the Corporation pursuant to the Plan.

11. STATEMENT OF DEFERRED COMPENSATION ACCOUNT AND STOCK UNITS.

The Secretary of the Corporation shall provide an annual statement of each participating Director's Deferred Compensation Account and Stock Units no later than January 31 each year.

12. NONASSIGNABILITY OF INTERESTS.

The interest and property rights of any Director under the Plan shall not be subject to option nor be assignable either by voluntary or involuntary assignment or by operation of law, including (without limitation) bankruptcy, garnishment, attachment or other creditor's process, and any act in violation of this Section 12 shall be void.

13. ADMINISTRATION OF THE PLAN.

The Plan shall be administered by the Committee. In addition to the powers and duties otherwise set forth in the Plan, the Committee shall have full power and authority to administer and interpret the Plan, to establish procedures for administering the Plan and to take any and all necessary action in connection therewith. The Committee's interpretation and construction of the Plan shall be conclusive and binding on all persons.

Within 30 days after a Change of Control (as defined in Section 16), the Committee shall appoint an independent committee consisting of at least three current (as of the effective date of the Change of Control) or former Corporation officers and directors, which shall thereafter

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administer all claims for benefits under the Plan. Upon such appointment the Committee shall cease to have any responsibility for claims administration under the Plan.

14. AMENDMENT OR TERMINATION OF THE PLAN.

(a) The Board may amend, suspend or terminate the Plan at any time. The foregoing notwithstanding, the Plan may not be amended (including any amendment to this Section 14) or terminated by the Board if such amendment or termination would alter the provisions of this Section 14 or adversely affect or impair the Director's rights to receive payment with respect to the Director's Deferred Compensation Account or Stock Units.

(b) Except as provided in Section 14(c) or as otherwise permitted under Section 409A of the Code, in the event of termination of the Plan, the Directors' Deferred Compensation Accounts and Stock Units may, in the Board's discretion, be distributed within the period beginning twelve months after the date the Plan was terminated and ending twenty-four months after the date the Plan was terminated, or pursuant to Section 8, if earlier. If the Plan is terminated and Deferred Compensation Accounts and Stock Units are distributed, the Board shall terminate all account balance non-qualified deferred compensation plans with respect to all Directors and shall not adopt a new account balance non-qualified deferred compensation plan for at least three years after the date the Plan was terminated. A termination and liquidation of the Plan under this Section 14(b) shall be made only in compliance with Treasury Regulation Section 1.409A-3(j)(4)(ix)(c).

(c) The Board may terminate the Plan upon a corporate dissolution of the Corporation that is taxed under Section 331 of the Code or with the approval of a bankruptcy court pursuant to 11 U.S.C. Section 503(b)(1)(A), provided that the Directors' Deferred Compensation Accounts and Stock Units are distributed and included in the gross income of the Directors by the latest of (i) the Year in which the Plan terminates or (ii) the first Year in which payment of the Deferred Compensation Accounts and Stock Units is administratively practicable.

15. SUCCESSORS AND ASSIGNS.

The Plan shall be binding upon the Corporation, its successors and assigns, and any parent corporation of the Corporation's successors or assigns. Notwithstanding that the Plan

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may be binding upon a successor or assign by operation of law, the Corporation shall require any successor or assign to expressly assume and agree to be bound by the Plan in the same manner and to the same extent that the Corporation would be if no succession or assignment had taken place.

16. CHANGE IN CONTROL.

For purposes of the Plan, "Change of Control" shall mean

i) Upon consummation of a reorganization, merger or consolidation involving the Corporation (a "Business Combination"), in each case, unless, following such Business Combination, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the then outstanding shares of common stock of the Corporation (the "Outstanding Common Stock") and the then outstanding voting securities of the Corporation entitled to vote generally in the election of directors (the "Outstanding Voting Securities") immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of, respectively, the then outstanding shares of common stock and the combined voting power of the then outstanding voting securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Corporation either directly or through one or more subsidiaries), (B) no individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended) (excluding any corporation resulting from such Business Combination or any employee benefit plan (or related trust) sponsored or maintained by the Corporation or such other corporation resulting from such Business Combination) beneficially owns, directly or indirectly, 30% or more of, respectively, the then outstanding shares of common stock of the corporation resulting from such Business Combination or the combined voting power of the then outstanding voting securities of such corporation except to the extent that such ownership is based on the beneficial ownership, directly or indirectly, of Outstanding Common Stock or Outstanding Voting Securities immediately prior to the Business Combination and (C) at least a majority of the members of the board of directors of the corporation resulting from such Business Combination

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were members of the Board at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination; or

ii) On the date that individuals who, as of May 19, 2006 constitute the Board of Directors (the "Incumbent Board") cease for any reason to constitute at least a majority of the Board of Directors; provided, however, that any individual becoming a director subsequent to May 19, 2006 whose election, or nomination for election by the Corporation's stockholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result of an actual or threatened election contest with respect to the election or removal of directors, an actual or threatened solicitation of proxies or consents or any other actual or threatened action by, or on behalf of any Person other than the Board of Directors; or

iii) Upon the acquisition after May 19, 2006 by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) (a "Person") of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 30% or more of either (A) the then Outstanding Common Stock or (B) the combined voting power of the Outstanding Voting Securities; provided, however, that the following acquisitions shall not be deemed to be covered by this Section (iii): (x) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by the Corporation, (y) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or (z) any acquisition of Outstanding Common Stock or Outstanding Voting Securities by any corporation pursuant to a transaction which complies with clauses (A), (B) and (C) of Section (i); or

iv) Upon the consummation of the sale of all or substantially all of the assets of the Corporation or approval by the stockholders of the Corporation of a complete liquidation or dissolution of the Corporation.

**CERTIFICATIONS**

I, Michael J. Covey, certify that:

1. I have reviewed this report on Form 10-Q of Potlatch Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 28, 2008

/s/ MICHAEL J. COVEY

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**Michael J. Covey**  
Chief Executive Officer

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**CERTIFICATIONS**

I, Eric J. Cremers, certify that:

1. I have reviewed this report on Form 10-Q of Potlatch Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: July 28, 2008

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/s/ ERIC J. CREMERS

**Eric J. Cremers**  
Vice President, Finance and Chief Financial Officer



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**STATEMENT OF CHIEF FINANCIAL OFFICER UNDER 18 U.S.C. § 1350**

I, Eric J. Cremers, Vice President, Finance and Chief Financial Officer of Potlatch Corporation (the "Company"), certify pursuant to section 1350 of Chapter 63 of Title 18 of the United States Code that, to my knowledge:

- (1) the Quarterly Report of the Company on Form 10-Q for the period ended June 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ ERIC J. CREMERS

**Eric J. Cremers**  
Vice President, Finance and  
Chief Financial Officer  
July 28, 2008

**A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.**

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