

POTLATCH CORP  
Form 10-K/A  
March 11, 2011  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**Form 10-K/A**

(Amendment No. 1)

(Mark One)  ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to \_\_\_\_\_ to \_\_\_\_\_.  
Commission File Number 1-32729

**POTLATCH CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

82-0156045  
(IRS 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

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

TITLE OF EACH CLASS  
Common Stock  
(\$1 par value)

NAME OF EACH EXCHANGE ON WHICH REGISTERED  
The Nasdaq Global Select Market  
Chicago Stock Exchange

*Securities registered pursuant to Section 12(g) of the Act: None*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act  Yes  No

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

## Edgar Filing: POTLATCH CORP - Form 10-K/A

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

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

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  (Do not check if a smaller reporting company) Smaller reporting company

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

The aggregate market value of the common stock held by non-affiliates of the registrant at June 30, 2010, was approximately \$1,428.7 million, based on the closing price of \$35.73.

The number of shares of common stock outstanding as of January 31, 2011: 40,033,182 shares of Common Stock, par value \$1 per share.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement expected to be filed on or about April 1, 2011, with the Commission in connection with the 2011 annual meeting of stockholders are incorporated by reference in Part III hereof.

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**EXPLANATORY NOTE**

On February 23, 2011, Potlatch Corporation filed its Form 10-K for the fiscal year ended December 31, 2010 (the 2010 Annual Report ). At the time the Company filed its 2010 Form 10-K, the Company was in possession of a signed Report of Independent Registered Public Accounting Firm relating to our internal controls over financial reporting as of December 31, 2010 from KPMG LLP ( KPMG ) and a signed Report of Independent Registered Public Accounting Firm relating to the company s 2010 consolidated financial statements (collectively, the Auditors Reports ). The 2010 Annual Report, however, inadvertently omitted KPMG s conformed electronic signatures to the Auditors Reports. This Amendment No. 1 is being filed solely for the purpose of inserting the conformed signatures of KPMG for the Auditors Reports.

As required by Rule 12b-15 promulgated under the Securities and Exchange Act of 1934, the Company is filing new Rule 13a-14(a) certifications as Exhibit 31 to this Form 10-K/A and is furnishing, but not filing, new statements pursuant to section 906 of the Sarbanes-Oxley Act of 2002 as Exhibit 32 to this Form 10-K/A.

The only changes to the original Form 10-K being made by this Form 10-K/A are those described above. This Form 10-K/A does not reflect events occurring after the filing of the original Form 10-K or modify or update any related disclosures. Information not affected by the amendment is unchanged and reflects the disclosure made at the time of the filing of the original Form 10-K. Accordingly, this Form 10-K/A should be read in conjunction with the original Form 10-K and our other filings with the Securities and Exchange Commission subsequent to filing of the Form 10-K.

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***Part II***

ITEM 8.

The information called for by Item 8 of Part II of this form is contained on pages 4-39 of this report.

***Part IV***

ITEM 15.

Exhibits and Financial Statement Schedules

**CONSOLIDATED FINANCIAL STATEMENTS**

Our consolidated financial statements are listed in the Index to Consolidated Financial Statements and Schedules on page 3 of this report.

**FINANCIAL STATEMENT SCHEDULES**

Our financial statement schedules are listed in the Index to Consolidated Financial Statements and Schedules on page 3 of this report.

**EXHIBITS**

Exhibits are listed in the Exhibit Index on pages 43-45 of this report.

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*SIGNATURES*

Pursuant to the requirements of Section 13 or 15(d) 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/ TERRY L. CARTER  
                 **Terry L. Carter**

Controller and Treasurer

(Principal Accounting Officer)

Date: March 11, 2011

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

***Index to Consolidated Financial Statements and Schedules***

The following documents are filed as part of this report:

|  | <b>PAGE<br/>NUMBER</b> |
|--|------------------------|
| Consolidated Financial Statements:   |                        |
| <u>Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008</u>                  | 4                      |
| <u>Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2010, 2009 and 2008</u> | 5                      |
| <u>Consolidated Balance Sheets at December 31, 2010 and 2009</u>   | 6                      |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008</u>                  | 7                      |
| <u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2010, 2009 and 2008</u>        | 9                      |
| <u>Summary of Principal Accounting Policies</u>  | 10-13                  |
| <u>Notes to Consolidated Financial Statements</u>  | 14-39                  |
| <u>Reports of Independent Registered Public Accounting Firm</u>  | 40-41                  |
| Schedules:   |                        |
| <u>II. Valuation and Qualifying Accounts</u>   | 42                     |

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

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## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

**Consolidated Statements of Operations**

(Dollars in thousands, except per-share amounts)

|  | <b>FOR THE YEARS ENDED DECEMBER 31</b> |             |             |
|--|--|-------------|-------------|
|  | <b>2010</b>                            | <b>2009</b> | <b>2008</b> |
| Revenues   | \$ 539,447                             | \$ 476,169  | \$ 439,957  |
| Costs and expenses:  |  |             |             |
| Cost of goods sold   | 423,353                                | 338,350     | 330,332     |
| Selling, general and administrative expenses   | 39,347                                 | 47,382      | 41,729      |
| Environmental remediation charge   | 4,096                                  | 739         |             |
| Asset impairment charge  |  | 2,994       |             |
|  | 466,796                                | 389,465     | 372,061     |
| Earnings from continuing operations before interest and taxes  | 72,651                                 | 86,704      | 67,896      |
| Interest expense, net  | (27,780)                               | (21,921)    | (20,154)    |
| Earnings from continuing operations before taxes   | 44,871                                 | 64,783      | 47,742      |
| Income tax benefit (provision)   | (4,596)                                | 16,648      | 25,195      |
| Earnings from continuing operations  | 40,275                                 | 81,431      | 72,937      |
| Discontinued operations:   |  |             |             |
| Gain (loss) from discontinued operations (including gain (loss) on disposal of \$922, \$ and \$(20,362)) | 182                                    | (6,788)     | (31,270)    |
| Income tax benefit (provision)   | (63)                                   | 2,685       | 10,970      |
|  | 119                                    | (4,103)     | (20,300)    |
| Net earnings   | \$ 40,394                              | \$ 77,328   | \$ 52,637   |
| Earnings per common share from continuing operations:  |  |             |             |
| Basic  | \$ 1.01                                | \$ 2.05     | \$ 1.85     |
| Diluted  | 1.00                                   | 2.04        | 1.83        |
| Loss per common share from discontinued operations:  |  |             |             |
| Basic  |  | (0.11)      | (0.52)      |
| Diluted  |  | (0.11)      | (0.51)      |
| Net earnings per common share:   |  |             |             |
| Basic  | 1.01                                   | 1.94        | 1.33        |
| Diluted  | 1.00                                   | 1.93        | 1.32        |

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

Certain 2009 amounts have been reclassified to conform to the 2010 presentation.

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## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

**Consolidated Statements of Comprehensive Income (Loss)**

(Dollars in thousands)

|   | <b>FOR THE YEARS ENDED DECEMBER 31</b> |             |             |
|---|--|-------------|-------------|
|   | <b>2010</b>                            | <b>2009</b> | <b>2008</b> |
| Net earnings  | \$ 40,394                              | \$ 77,328   | \$ 52,637   |
| Other comprehensive income (loss), net of tax:  |  |             |             |
| Defined benefit pension and other postretirement employee benefits:   |  |             |             |
| Net gain (loss) arising during the period, net of tax of \$5,132, \$(7,664) and \$(66,059)                          | 8,027                                  | (11,987)    | (103,323)   |
| Prior service (cost) credit arising during the period, net of tax of \$(279), \$29,712 and \$(559)                  | (436)                                  | 46,474      | (874)       |
| Amortization of actuarial loss included in net periodic cost, net of tax of \$4,994, \$3,251 and \$3,094            | 7,811                                  | 5,084       | 4,840       |
| Amortization of prior service cost (credit) included in net periodic cost, net of tax of \$(3,001), \$3 and \$(146) | (4,695)                                | 6           | (229)       |
| Recognition of deferred taxes related to actuarial gain on OPEB obligations   | 3,015                                  |             |             |
| Other comprehensive income (loss), net of tax   | 13,722                                 | 39,577      | (99,586)    |
| Comprehensive income (loss)   | \$ 54,116                              | \$ 116,905  | \$ (46,949) |

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



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## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

**Consolidated Balance Sheets**

(Dollars in thousands, except per-share amounts)

|  | AT DECEMBER 31    |                   |
|--|-------------------|-------------------|
|  | 2010              | 2009              |
| <b>ASSETS</b>  |                   |                   |
| Current assets:  |                   |                   |
| Cash   | \$ 5,593          | \$ 1,532          |
| Short-term investments   | 85,249            | 53,506            |
| Receivables, net of allowance for doubtful accounts of \$460 and \$1,670                                   | 21,278            | 18,161            |
| Inventories  | 24,375            | 24,493            |
| Deferred tax assets  | 13,346            | 8,872             |
| Other assets   | 11,953            | 15,134            |
| <b>Total current assets</b>  | <b>161,794</b>    | <b>121,698</b>    |
| Property, plant and equipment, at cost less accumulated depreciation of \$150,507 and \$158,123            | 67,174            | 75,839            |
| Timber and timberlands, net  | 475,578           | 533,173           |
| Deferred tax assets  | 49,054            | 64,873            |
| Other assets   | 28,111            | 27,982            |
|  | <b>\$ 781,711</b> | <b>\$ 823,565</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                   |                   |
| Current liabilities:   |                   |                   |
| Current installments on long-term debt   | \$ 5,011          | \$ 11             |
| Current liability for pensions and other postretirement employee benefits                                  | 9,517             | 13,961            |
| Accounts payable and accrued liabilities   | 51,504            | 44,501            |
| <b>Total current liabilities</b>   | <b>66,032</b>     | <b>58,473</b>     |
| Long-term debt   | 363,485           | 368,420           |
| Liability for pensions and other postretirement employee benefits  | 129,124           | 149,398           |
| Other long-term obligations  | 18,631            | 17,484            |
| Stockholders' equity:  |                   |                   |
| Preferred stock, Authorized 4,000,000 shares, no shares issued   |                   |                   |
| Common stock, \$1 par value, Authorized 100,000,000 shares, Issued 40,032,587 shares and 39,826,784 shares | 40,033            | 39,827            |
| Additional paid-in capital   | 330,894           | 328,989           |
| Retained earnings (accumulated deficit)  | (52,733)          | (11,549)          |
| Accumulated other comprehensive loss, net of tax of \$(74,547) and \$(81,479)                              | (113,755)         | (127,477)         |
| <b>Total stockholders' equity</b>  | <b>204,439</b>    | <b>229,790</b>    |
|  | <b>\$ 781,711</b> | <b>\$ 823,565</b> |

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

Certain 2009 amounts have been reclassified to conform to the 2010 presentation.



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## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

**Consolidated Statements of Cash Flows**

(Dollars in thousands)

|   | <b>FOR THE YEARS ENDED DECEMBER 31</b> |                 |                 |
|---|--|-----------------|-----------------|
|   | <b>2010</b>                            | <b>2009</b>     | <b>2008</b>     |
| <b>CASH FLOWS FROM CONTINUING OPERATIONS</b>  |  |                 |                 |
| Net earnings  | \$ 40,394                              | \$ 77,328       | \$ 52,637       |
| Adjustments to reconcile net earnings to net operating cash flows from continuing operations: |  |                 |                 |
| Depreciation, depletion and amortization  | 31,204                                 | 34,715          | 30,153          |
| Basis of real estate sold   | 48,670                                 | 10,696          | 9,109           |
| Change in deferred taxes  | 5,427                                  | (21,037)        | (17,894)        |
| Loss (gain) on disposition of property, plant and equipment                                   | 1,078                                  | (1,628)         | 592             |
| Loss (gain) from discontinued operations  | (119)                                  | 4,103           | 20,300          |
| Proceeds from land sales deposited with a like-kind exchange intermediary                     | (341)                                  | (2,030)         | (36,148)        |
| Equity-based compensation expense   | 3,952                                  | 3,829           | 4,320           |
| Employee benefit plans  | (6,241)                                | (138)           | (5,280)         |
| Asset impairment  |  | 2,994           |                 |
| Other, net  |  | 130             | (1,131)         |
| Decrease (increase) in receivables  | (3,117)                                | 4,601           | (3,920)         |
| Decrease (increase) in inventories  | (385)                                  | 5,223           | (10,215)        |
| Decrease in prepaid expenses  | 455                                    | 32              | 343             |
| Increase (decrease) in accounts payable and accrued liabilities                               | 5,096                                  | 1,096           | (3,950)         |
| Income tax benefit related to stock issued in conjunction with stock compensation plans       |  |                 | 1,085           |
| <b>Net cash provided by operating activities from continuing operations</b>                   | <b>126,073</b>                         | <b>119,914</b>  | <b>40,001</b>   |
| <b>CASH FLOWS FROM INVESTING</b>  |  |                 |                 |
| Decrease (increase) in short-term investments   | (31,743)                               | (31,843)        | 37,321          |
| Additions to property, plant and equipment  | (5,215)                                | (4,317)         | (10,345)        |
| Additions to timber and timberlands   | (9,786)                                | (11,380)        | (26,406)        |
| Deposits on timberlands   |  |                 | (27,328)        |
| Proceeds from disposition of property, plant and equipment                                    | 3,075                                  | 1,871           | 1,203           |
| Other, net  | (1,807)                                | (1,050)         | (802)           |
| <b>Net cash used for investing activities from continuing operations</b>                      | <b>(45,476)</b>                        | <b>(46,719)</b> | <b>(26,357)</b> |
| <b>CASH FLOWS FROM FINANCING</b>  |  |                 |                 |
| Change in book overdrafts   | 2,178                                  | 860             | (8,165)         |
| Increase (decrease) in notes payable  |  | (129,100)       | 18,800          |
| Issuance of common stock  | 2,156                                  | 1,839           | 3,902           |
| Change in long-term debt  | (11)                                   | 147,094         | (173)           |
| Distributions to common stockholders  | (81,578)                               | (81,132)        | (80,674)        |
| Deferred financing costs  | (249)                                  | (4,375)         | (4,292)         |

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|  | <b>FOR THE YEARS ENDED DECEMBER 31</b> |                 |                 |
|--|--|-----------------|-----------------|
|  | <b>2010</b>                            | <b>2009</b>     | <b>2008</b>     |
| Employee tax withholdings on vested performance share awards             | (2,075)                                | (77)            | (4,771)         |
| Other, net   | 41                                     | 212             | (714)           |
| <b>Net cash used for financing activities from continuing operations</b> | <b>(79,538)</b>                        | <b>(64,679)</b> | <b>(76,087)</b> |
| Cash from continuing operations  | 1,059                                  | 8,516           | (62,443)        |
| Cash flows provided by (used for) discontinued operations:               |  |                 |                 |
| Operating cash flows   | (829)                                  | (7,869)         | (4,770)         |
| Investing cash flows   | 3,831                                  |                 | (21,078)        |
| Financing cash flows   |  |                 | 80,129          |
| <b>Increase (decrease) in cash</b>                                       | <b>4,061</b>                           | <b>647</b>      | <b>(8,162)</b>  |
| Balance at beginning of year   | 1,532                                  | 885             | 9,047           |
| <b>Balance at end of year</b>  | <b>\$ 5,593</b>                        | <b>\$ 1,532</b> | <b>\$ 885</b>   |

**SUPPLEMENTAL CASH FLOW INFORMATION**

## Cash paid (received) during the year for:

|                                     |           |           |           |
|-------------------------------------|-----------|-----------|-----------|
| Interest, net of amount capitalized | \$ 26,135 | \$ 25,495 | \$ 33,644 |
| Income taxes                        | 255       | (540)     | (10,409)  |

## Non-cash investing activity:

|                                     |  |     |        |
|-------------------------------------|--|-----|--------|
| Additions to timber and timberlands |  | 202 | 40,862 |
|-------------------------------------|--|-----|--------|

## Non-cash financing activity:

|  |  |         |  |
|--|--|---------|--|
| Restricted cash payment from Clearwater Paper Corporation for the maturity of credit sensitive debentures (See Note 9) |  | 106,250 |  |
|--|--|---------|--|

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

Certain 2009 and 2008 amounts have been reclassified to conform to the 2010 presentation.

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## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

**Consolidated Statements of Stockholders Equity**

(Dollars in thousands, except per-share amounts)

|   | Common Stock Issued |                  | Additional Paid-In Capital | Retained Earnings (Accumulated Deficit) | Accumulated Other Comprehensive Loss | Total Stockholders Equity |
|---|---------------------|------------------|----------------------------|---|--------------------------------------|---------------------------|
|   | Shares              | Amount           |                            |   |                                      |                           |
| <b>Balance, December 31, 2007</b>   | <b>39,256,673</b>   | <b>\$ 39,257</b> | <b>\$ 530,949</b>          | <b>\$ 123,783</b>                       | <b>\$ (115,653)</b>                  | <b>\$ 578,336</b>         |
| Exercise of stock options and stock awards  | 148,327             | 148              | 3,754                      |   |                                      | 3,902                     |
| Income tax benefit related to stock issued in conjunction with stock compensation plans |                     |                  | 1,085                      |   |                                      | 1,085                     |
| Performance share and restricted stock unit awards                                      | 335,898             | 336              | 1,364                      |   |                                      | 1,700                     |
| Net earnings  |                     |                  |                            | 52,637                                  |                                      | 52,637                    |
| Pension plans and OPEB obligations  |                     |                  |                            |   | (99,586)                             | (99,586)                  |
| Spin-off of Clearwater Paper Corporation  |                     |                  | (203,860)                  | (103,491)                               | 48,185                               | (259,166)                 |
| Common distributions, \$2.04 per share  |                     |                  |                            | (80,674)                                |                                      | (80,674)                  |
| <b>Balance, December 31, 2008</b>   | <b>39,740,898</b>   | <b>\$ 39,741</b> | <b>\$ 333,292</b>          | <b>\$ (7,745)</b>                       | <b>\$ (167,054)</b>                  | <b>\$ 198,234</b>         |
| Exercise of stock options and stock awards  | 81,540              | 82               | 1,757                      |   |                                      | 1,839                     |
| Performance share and restricted stock unit awards                                      | 4,346               | 4                | 3,747                      |   |                                      | 3,751                     |
| Net earnings  |                     |                  |                            | 77,328                                  |                                      | 77,328                    |
| Pension plans and OPEB obligations  |                     |                  |                            |   | 39,577                               | 39,577                    |
| Transfer of assets from REIT to subsidiary  |                     |                  | (13,645)                   |   |                                      | (13,645)                  |
| Spin-off of Clearwater Paper Corporation  |                     |                  | 3,838                      |   |                                      | 3,838                     |
| Common distributions, \$2.04 per share  |                     |                  |                            | (81,132)                                |                                      | (81,132)                  |
| <b>Balance, December 31, 2009</b>   | <b>39,826,784</b>   | <b>\$ 39,827</b> | <b>\$ 328,989</b>          | <b>\$ (11,549)</b>                      | <b>\$ (127,477)</b>                  | <b>\$ 229,790</b>         |
| Exercise of stock options and stock awards  | 107,296             | 107              | 2,049                      |   |                                      | 2,156                     |
| Performance share and restricted stock unit awards                                      | 98,507              | 99               | 1,778                      |   |                                      | 1,877                     |
| Net earnings  |                     |                  |                            | 40,394                                  |                                      | 40,394                    |
| Pension plans and OPEB obligations  |                     |                  |                            |   | 13,722                               | 13,722                    |
| Transfer of assets from REIT to subsidiary  |                     |                  | (1,922)                    |   |                                      | (1,922)                   |
| Common distributions, \$2.04 per share  |                     |                  |                            | (81,578)                                |                                      | (81,578)                  |
| <b>Balance, December 31, 2010</b>   | <b>40,032,587</b>   | <b>\$ 40,033</b> | <b>\$ 330,894</b>          | <b>\$ (52,733)</b>                      | <b>\$ (113,755)</b>                  | <b>\$ 204,439</b>         |

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

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### POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

#### ***Summary of Principal Accounting Policies***

##### **CONSOLIDATION**

The consolidated financial statements include the accounts of Potlatch Corporation and its subsidiaries after elimination of significant intercompany transactions and accounts. There are no significant unconsolidated subsidiaries.

We are primarily engaged in activities associated with timberland management, including the sale of timber, the management of our approximately 1.5 million acres of timberlands and the purchase and sale of timberlands. We are also engaged in the manufacture and sale of wood products. Our timberlands and all of our wood products facilities are located within the continental United States. The primary market for our products is the United States. As discussed in Note 1, we converted to a Real Estate Investment Trust, or REIT, effective January 1, 2006.

##### **SIGNIFICANT ESTIMATES**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, which we refer to in this report as U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Significant estimates are described in further detail in this Summary of Principal Accounting Policies and the Notes to Consolidated Financial Statements. Significant estimates include timber volumes, pension and postretirement obligation assumptions, environmental liabilities, fair value of derivative instruments, assumptions utilized for asset and disposal group impairment tests, and liabilities associated with restructuring activities and discontinued operations.

##### **EQUITY-BASED COMPENSATION**

At December 31, 2010, we had three stock incentive plans under which stock option, performance share or restricted stock unit, or RSU, grants were outstanding. All of these plans have received shareholder 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 December 31, 2010, no shares were available for future use under the 1995 and 2000 Stock Incentive Plan, while approximately 524,000 shares were authorized for future use under the 2005 Stock Incentive Plan. We issue new shares of common stock to pay stock option exercises and to settle performance share awards and RSU awards.

Our outside directors are granted an annual award of common stock units that 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 stock unit account will be converted to cash based upon the then market price of the common stock and paid to the director.

Our outside directors can elect to defer compensation in the form of common 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 our common stock. See Note 15 for additional information related to our equity-based compensation plans.

##### **INVENTORIES**

Inventories are stated at the lower of cost or market. The last-in, first-out method is used to determine cost of logs, lumber and plywood for most of our operations. The average cost method is used to determine cost of all other inventories. Expenses associated with idle capacity or other curtailments of production are reflected in cost of goods sold in the periods incurred.

##### **PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment are valued at cost less accumulated depreciation. Depreciation of buildings, equipment and other depreciable assets is determined using the straight-line method of depreciation. Estimated useful lives range from 30 to 40 years for buildings and structures and 2 to 25 years for equipment.

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Major improvements and replacements of property are capitalized. Maintenance, repairs, and minor improvements and replacements are expensed. Upon retirement or other disposition of property, applicable cost and accumulated depreciation or amortization are removed from the accounts. Any gains or losses are included in earnings.

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**Table of Contents****TIMBER AND TIMBERLANDS**

Timber and timberlands are valued at cost less depletion and amortization. For fee timber, the capitalized cost includes costs related to stand establishment, such as site preparation, including all costs of preparing the land for planting, cost of seeds or seedlings, tree planting, including labor, materials, depreciation of company-owned equipment and the cost of contract services. Upon completion of planting activities and field inspection to assure the planting operation was successful, a plantation will be considered established. Subsequent expenditures made to maintain the integrity or enhance the growth of an established plantation or stand are expensed. Post-establishment expenses include release spray treatments, pest control activities, thinning operations and fertilization. Expenditures for forest management consist of regularly recurring items necessary to ownership and administration of timber producing property such as fire protection, property taxes and insurance, silviculture costs incurred subsequent to stand establishment, cruising (physical inventory), property maintenance and salaries, supplies, travel, record-keeping and other normal recurring administrative personnel costs. These expenditures are accounted for as current operating expenses. Timberland purchased on the open market is capitalized and the cost is allocated to the relative values of the component items as appraised, such as timberland, merchantable sawlogs, merchantable pulpwood, reproduction (young growth not merchantable), logging roads and other land improvements. The capitalized cost includes purchase price, title search and title recording, transfer taxes and fees, timber cruises, appraisals and running of boundary lines.

The aggregate estimated volume of current standing timber inventory is updated at least annually to reflect increases in merchantable timber due to reclassification of young growth stands to merchantable timber stands, the annual growth rates of merchantable timber and the acquisition of additional merchantable timber, and to reflect decreases due to timber harvests and land sales. Reproduction accounts are reviewed annually, and dollars and volumes are transferred from reproduction accounts to merchantable timber accounts on a reasonable and consistent basis. Volumes and the related accumulated costs are tracked and, as the timber is harvested, the cost is amortized to depletion. Total standing volume is estimated on an annual basis using inventory data and a forest growth projection model. Timber volumes are estimated from cruises of the timber tracts, which are completed on all of our timberlands on approximately a five to ten year cycle. Since the individual cruises collect field data at different times for specific sites, the growth model projects standing inventory from the cruise date to a common reporting date. Average annual growth rates for the merchantable inventory have historically been in the range of 2%-5%.

Depletion represents the amount chargeable to cost for logs cut from fee timber. Generally, rates at which timber is depleted are calculated annually for each of our Resource regions by dividing the beginning of year balance of the timber accounts by the forest inventory volume, after inventory updates for growth projection adjustments, new timber cruises, land purchases in existing operating regions and sales and harvested volume.

Logging roads on our land are presumed to become a part of our road system unless it is known at the time of construction that the road will be abandoned. Therefore, the base cost of the road, such as the clearing, grading, and ditching, is not amortized and remains a capitalized item until abandonment or other disposition, while other portions of the initial cost, such as bridges, culverts and gravel surfacing are amortized over their useful lives, which range from 10 to 20 years. Costs associated with temporary logging roads that will not become part of our road system are expensed as incurred.

Since timber and timberlands are generally considered to be long-term productive assets, we classify these expenditures as investing activities in our Consolidated Statements of Cash Flows. Depletion associated with timber and timberlands and amortization associated with logging roads are non-cash adjustments to net earnings in the operating activities section of the Consolidated Statements of Cash Flows.

**REAL ESTATE SALES**

Sales of non-core real estate are considered to be part of our normal operations. We therefore recognize revenue and costs associated with real estate sold in our Consolidated Statements of Operations. Certain cash receipts and payments associated with real estate have aspects of more than one class of cash flows. For example, cash generated from real estate sales is included as an operating activity in our Consolidated Statements of Cash Flows, and is adjusted for the basis of real estate sold. Acquisitions of timberlands, however, are reported as investing activities in our Consolidated Statements of Cash Flows.

**LIKE-KIND EXCHANGES AND RESTRICTED CASH**

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.





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We use a qualified intermediary to facilitate LKE transactions. Proceeds from forward transactions are held by the intermediary and are classified as restricted cash, within non-current other assets, 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 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 non-current asset and included in Timber and timberlands, net in our Consolidated Balance Sheets and as Deposits on timberlands in the investing activities section of our Consolidated Statements of Cash Flows. In the case of forward transactions, amounts from sales of company-owned land deposited with the intermediary that are not yet matched with LKE property purchased are included as restricted cash in non-current Other assets in our Consolidated Balance Sheets and as Proceeds from land sales deposited with a like-kind exchange intermediary in the operating activities section of our Consolidated Statements of Cash Flows.

At December 31, 2010, we had \$0.3 million of proceeds from land sales deposited with a qualified LKE intermediary classified as restricted cash, within non-current Other assets on our Consolidated Balance Sheets. At December 31, 2009, we had no proceeds from land sales deposited with a qualified LKE intermediary.

## **LONG-LIVED ASSETS**

Our long-lived assets are 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. Budget estimates are adjusted periodically to reflect changing business conditions, and operations are reviewed, as appropriate, for impairment using the most current data available.

Assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

## **INCOME TAXES**

The income tax provision or benefit is based on earnings or losses reported in the consolidated financial statements. Deferred income taxes are recorded under the asset and liability method for the temporary differences between reported earnings and taxable income using current tax laws and rates.

## **REVENUE RECOGNITION**

We recognize revenue from the sale of timber when legal ownership and the risk of loss transfers to the buyer and the quantity sold is determinable. The company sells timber under delivered log agreements as well as through sales of standing timber, or stumpage. For delivered sales, revenue, which includes amounts billed for shipping and handling (logging and hauling of timber), is recognized when the log is delivered to the customer. Stumpage is sold using pay-as-cut, timber deed or lump-sum sale agreements. Under a pay-as-cut sales contract, the purchaser acquires the right to harvest specified timber on a tract, at an agreed upon price per unit. The sale and any related advances are recognized as revenue as the purchaser harvests the timber on the tract. Under a timber deed sale, the buyer agrees to purchase and harvest specified timber on a tract of land over the term of the contract, the risk of loss and title to the trees transfer to the buyer when the contract is signed and the buyer pays the full purchase price when the contract is signed. Revenue from a timber deed sale is recognized when the contract is signed. Under a lump-sum sale, the parties agree to a purchase price for all the timber available for harvest on a tract of land. Generally the purchase price is paid when the contract is signed. Title to the timber and risk of loss transfers to the buyer as the timber is harvested. Therefore, revenue under a lump-sum sale is recognized over the term on the contract based on the timber harvested compared to the total estimated timber available to be harvested. An adjustment may be required to the extent the actual timber harvested is different than the estimate of timber available.

Substantially all of our real estate sales are considered cash sales, as we receive the entire consideration in cash at closing. Also at closing, all risks and rewards of ownership are transferred to the buyer, and we do not have a substantial continuing involvement in any of our properties after sales are consummated. We recognize revenue under the full accrual method for cash sales of real estate when the sale is consummated (i.e., at closing). Sales of properties that qualify for LKE tax-deferred treatment involve a third party intermediary that receives proceeds related to the property sold and holds the proceeds for reinvestment in like kind property. The proceeds are recorded as revenue when the third party intermediary receives them.

We recognize revenue from the sale of manufactured wood products and residual by-products when there is persuasive evidence of a sales agreement, the price to the customer is fixed and determinable, collection is reasonably assured, and title and the risk of loss passes to the

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customer. Shipping terms generally indicate when title and the risk of loss have passed. Revenue is recognized at shipment for sales when shipping terms are FOB (free on board) shipping point. For sales where shipping terms are FOB destination, revenue is recognized when the goods are received by the customer. Shipping terms for wood products and related by-products depend upon the sales agreement with the customer.

Revenue is recognized net of any sales taxes collected. Sales taxes, when collected, are recorded as a current liability and remitted to the appropriate governmental entities.

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**SHIPPING AND HANDLING COSTS**

Costs for shipping and handling of manufactured goods are included in cost of goods sold in our Consolidated Statements of Operations.

**ENVIRONMENTAL**

As part of our corporate policy, we have an ongoing process to monitor, report on and comply with environmental requirements. We record accruals for estimated environmental liabilities when such contingencies are probable and reasonably estimable. These estimates reflect assumptions and judgments, the specific nature of which varies in light of the particular facts and circumstances surrounding each environmental liability. These estimates typically reflect assumptions and judgments as to the probable nature, magnitude and timing of required investigation, remediation and monitoring activities and the probable cost of these activities, and in some cases reflect assumptions and judgments as to the obligation or willingness and ability of third parties to bear a proportionate or allocated share of the cost of these activities. Due to the numerous uncertainties and variables associated with these assumptions and judgments, and the effects of changes in governmental regulation and environmental technologies, both the precision and reliability of the resulting estimates of the related liabilities are subject to substantial uncertainties, and our actual costs could be materially more or less than the estimated amounts. We regularly monitor our estimated exposure to environmental liabilities and, as additional information becomes known, our estimates may change significantly. Our estimates of our environmental liabilities do not reflect potential future recoveries from insurance carriers except to the extent that recovery may from time to time be deemed probable as a result of a carrier's agreement to payment terms. In those instances in which our estimated exposure reflects actual or anticipated cost-sharing arrangements with third parties, we do not believe that we will be exposed to additional material liability as a result of non-performance by such third parties. We have accrued for specific environmental remediation costs that we have determined are probable and reasonably estimable, and currently we are not aware of any other material environmental liabilities.

Fees for professional services associated with environmental and legal issues are expensed as incurred.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In January 2010, the Financial Accounting Standards Board, or FASB, issued authoritative guidance for fair value measurements, which requires additional disclosures and clarifications to existing disclosures. This authoritative guidance requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and also to describe the reasons for these transfers. This authoritative guidance also requires enhanced disclosure of activity in Level 3 fair value measurements. The new disclosures and clarifications of existing disclosures for Level 1 and Level 2 fair value measurements became effective for the first interim reporting period after December 15, 2009. Disclosures regarding activity within Level 3 fair value measurements become effective for the first interim reporting period after December 15, 2010. Refer to Note 12 for information and related disclosures regarding our fair value measurements.

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## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

**Notes to Consolidated Financial Statements****NOTE 1.**

## REIT Conversion

Effective January 1, 2006, we restructured our operations to qualify for treatment as a REIT for federal income tax purposes. As a REIT, we generally are not subject to federal corporate income taxes on our income from investments in real estate that we distribute to our stockholders, including the income derived from the sale of standing timber. 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 our standing timber. Accordingly, we restructured to create a new parent company that holds our timberlands through a REIT subsidiary and substantially all of our non-timberland assets, consisting primarily of our manufacturing facilities, assets used for the harvesting of timber and the sale of logs, and selected land parcels that we expect to be sold or developed for higher and better use purposes through wholly owned taxable REIT subsidiaries, which we refer to collectively in this report as Potlatch TRS. Our use of Potlatch TRS, which is taxed as a C corporation, enables us to continue to engage in these non-REIT qualifying businesses without violating the REIT requirements.

**NOTE 2.**

## 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. The following table reconciles the number of common shares used in calculating the basic and diluted earnings per share from continuing operations for the years ended December 31:

|  | 2010       | 2009       | 2008       |
|--|------------|------------|------------|
| Basic average common shares outstanding                      | 39,971,073 | 39,763,090 | 39,473,879 |
| Incremental shares due to:                                   |            |            |            |
| Common stock options   | 81,942     | 83,799     | 76,543     |
| Performance shares   | 132,455    | 105,771    | 211,979    |
| Restricted stock units                                       | 33,859     | 20,953     | 41,012     |
| Diluted average common shares outstanding                    | 40,219,329 | 39,973,613 | 39,803,413 |
| Basic earnings per common share from continuing operations   | \$ 1.01    | \$ 2.05    | \$ 1.85    |
| Diluted earnings per common share from continuing operations | \$ 1.00    | \$ 2.04    | \$ 1.83    |

For the year ended December 31, 2010, 5,750 restricted stock units were excluded from the computation of diluted earnings per share because their effect was anti-dilutive. For the year ended December 31, 2009, options to purchase 85,391 shares of common stock were excluded from the computation of diluted earnings per share because the per share exercise prices of the stock options were greater than the average market price of our common stock during the period. For the year ended December 31, 2008, 2,500 restricted stock units and options to purchase 86,426 shares of common stock were excluded from the computation of diluted earnings per share because their effect was anti-dilutive.

**NOTE 3.**

## Short-term Investments

Our short-term investments are invested in time or demand deposits, certificates of deposit, U.S. Treasury and U.S. government agency obligations, money market funds, commercial paper and variable rate demand obligations, all of which have very short maturity periods and 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 made in compliance with the requirements of the Internal Revenue Code with respect to

qualifying REIT investments.

**Table of Contents****NOTE 4.**

Inventories

(Dollars in thousands)

|   | 2010      | 2009      |
|---|-----------|-----------|
| Lumber and other manufactured wood products | \$ 13,115 | \$ 14,057 |
| Logs  | 7,619     | 5,973     |
| Materials and supplies                      | 3,641     | 4,463     |
|   | \$ 24,375 | \$ 24,493 |
| Valued at lower of cost or market:          |           |           |
| Last-in, first-out basis                    | \$ 15,796 | \$ 15,079 |
| Average cost basis                          | 8,579     | 9,414     |
|   | \$ 24,375 | \$ 24,493 |

If the last-in, first-out inventory had been priced at lower of current average cost or market, the values would have been approximately \$8.5 million and \$9.3 million higher at December 31, 2010 and 2009, respectively. Reductions in quantities of LIFO inventories valued at higher costs prevailing in prior years had the effect of decreasing earnings, net of income taxes, by \$0.8 million in 2010. Reductions in quantities of LIFO inventories valued at lower costs prevailing in prior years had the effect of increasing earnings, net of income taxes, by \$0.2 million in 2009 and less than \$0.1 million in 2008.

**NOTE 5.**

Property, Plant and Equipment

(Dollars in thousands)

|                            | 2010       | 2009       |
|----------------------------|------------|------------|
| Land and land improvements | \$ 14,693  | \$ 15,461  |
| Buildings and structures   | 32,210     | 38,483     |
| Machinery and equipment    | 167,685    | 177,578    |
| Construction in progress   | 3,093      | 2,440      |
|                            | \$ 217,681 | \$ 233,962 |

Depreciation charged against income from continuing operations totaled \$9.8 million, \$11.0 million and \$11.0 million in each of the years ended December 31, 2010, 2009 and 2008, respectively.

**NOTE 6.**

Timber and Timberlands

(Dollars in thousands)

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|                        | 2010       | 2009       |
|------------------------|------------|------------|
| Timber and timberlands | \$ 415,401 | \$ 474,529 |
| Logging roads          | 60,177     | 58,644     |
|                        | \$ 475,578 | \$ 533,173 |

Depletion from company-owned lands totaled \$17.2 million, \$20.2 million and \$16.2 million in each of the years ended December 31, 2010, 2009 and 2008, respectively. Amortization of logging roads totaled \$2.4 million, \$2.4 million and \$2.3 million in each of the years ended December 31, 2010, 2009 and 2008, respectively.



**Table of Contents****NOTE 7.**

## Other Assets

(Dollars in thousands)

| <b>Current Other Assets:</b>                         | <b>2010</b> | <b>2009</b> |
|--|-------------|-------------|
| Basis of real estate held for sale                   | \$ 9,268    | \$ 8,905    |
| Deferred charges                                     | 1,567       | 1,521       |
| Prepaid expenses                                     | 1,118       | 1,573       |
| Assets held for sale                                 |             | 3,135       |
|  | \$ 11,953   | \$ 15,134   |
| <b>Noncurrent Other Assets:</b>                      |             |             |
| Noncurrent investments                               | \$ 21,292   | \$ 20,255   |
| Deferred charges                                     | 6,277       | 7,341       |
| Restricted cash                                      | 341         |             |
| Derivative asset associated with interest rate swaps | 62          |             |
| Other  | 139         | 386         |
|  | \$ 28,111   | \$ 27,982   |

Noncurrent investments primarily consist of company-owned life insurance stated at cash surrender value. Deferred charges primarily consist of deferred financing costs, which are being amortized over the life of the associated debt.

**NOTE 8.**

## Income Taxes

As a REIT, if we meet certain requirements, we generally are not subject to federal and state corporate income taxes on our income from investments in real estate that we distribute to our shareholders. We are, however, subject to corporate taxes on built-in gains (the excess of fair market value at January 1, 2006 over tax basis on that date) with respect to the REIT's sale of any real property owned at such date within the first ten years following our conversion to a REIT, except for sales occurring in 2011. The Small Business Jobs Act of 2010, enacted on September 27, 2010, modifies the built-in gains provisions to exempt sales of real properties by a REIT in 2011, if five years of the recognition period has elapsed before January 1, 2011. The built-in gains tax is eliminated or deferred if sale proceeds are reinvested in like-kind property in accordance with the like-kind exchange provisions of the Internal Revenue Code. The built-in gains tax is not applicable to the sale of timber pursuant to a stumpage sale agreement or timber deed. We are required to pay federal and state corporate income taxes on earnings of our Potlatch TRS operations, principally comprised of our wood products manufacturing operations and certain real estate investments held for development and resale.

Due to the varying tax treatments of our activities, such as REIT operations, built-in gains taxes applicable to property sales, like-kind exchanges and TRS activities, our effective tax rate and amount of taxes paid may vary significantly from year to year.

In association with our REIT conversion in 2006, we estimated the amount of REIT property that may be sold within the next ten years and retained a deferred tax liability at REIT conversion on the book-to-tax difference of approximately \$3.0 million. This estimate is periodically reviewed. As a result of the Small Business Jobs Act of 2010, which modified the built-in gains provisions for 2011, and our expected disposal of REIT property from 2012 through 2015, we reversed \$2.1 million of this deferred tax liability in 2010.

During 2010, we transferred some real estate properties from the REIT to Potlatch TRS that were identified for potential development and resale. As a result of these transfers, we recorded an additional deferred tax liability of \$1.9 million associated with the difference between the book and tax basis of the property, with the offset recorded as additional paid-in capital.

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The Patient Protection and Affordable Care Act, as amended by the Health Care and Reconciliation Act of 2010, was enacted in March 2010 and included a change in the deductibility of drug expenses reimbursed under the Medicare Part D retiree drug subsidy program beginning after 2012. As a result of this legislation, deferred taxes associated with our retiree health care liabilities based on prior law were required to be adjusted, resulting in a net charge to earnings of approximately \$1.4 million. We recorded income tax benefits related to continuing operations of Potlatch TRS of \$0.2 million attributable to the Part D reimbursements received during the year that were non-taxable.

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The income tax provision (benefit) allocated to continuing operations is comprised of the following for the years ended December 31:

(Dollars in thousands)

|   | 2010     | 2009        | 2008        |
|---|----------|-------------|-------------|
| Current*                                    | \$ (930) | \$ 4,389    | \$ (7,301)  |
| Deferred                                    | (10,619) | (1,351)     | (15,350)    |
| Benefit of net operating loss carryforwards | 16,145   | (19,686)    | (2,544)     |
| Income tax provision (benefit)              | \$ 4,596 | \$ (16,648) | \$ (25,195) |

\* The realized tax benefit related to stock issued in conjunction with our stock compensation plans that exceed any previously recognized deferred tax assets has been recorded as an increase to additional paid-in capital rather than a reduction to the provision for income taxes. The amount of this increase was \$0 for the years ended December 31, 2010 and 2009 and \$1.1 million for the year ended December 31, 2008.

The income tax provision (benefit) allocated to continuing operations differs from the amount computed by applying the statutory federal income tax rate of 35% to earnings before income taxes due to the following for the years ended December 31:

(Dollars in thousands)

|  | 2010      | 2009        | 2008        |
|--|-----------|-------------|-------------|
| Computed expected tax expense                    | \$ 15,705 | \$ 22,674   | \$ 16,710   |
| Built-in gains tax                               |           | 9,294       |             |
| REIT income not subject to federal income tax    | (9,481)   | (38,917)    | (38,895)    |
| Tax credits                                      |           | (6,504)     | (463)       |
| State and local taxes, net of federal income tax | 311       | (2,045)     | (2,981)     |
| Interest, net of federal income tax              |           | (1,416)     | (53)        |
| Adjustment of REIT deferred taxes                | (2,301)   |             |             |
| Deferred tax adjustment Retiree Health Care Act  | 1,441     |             |             |
| All other items                                  | (1,079)   | 266         | 487         |
| Income tax provision (benefit)                   | \$ 4,596  | \$ (16,648) | \$ (25,195) |
| Effective tax rate                               | 10.2%     | (25.7)%     | (52.8)%     |

Our effective tax rate for 2010 was 10.2%, compared to (25.7)% for 2009 and (52.8)% for 2008. The effective rate for 2010 differs from 2009 due to the impacts of the operating income earned by Potlatch TRS, the deferred tax adjustment caused by the Retiree Health Care Act and the adjustment of deferred tax liabilities established in 2006 for the book to tax difference on property expected to be sold that would result in a built-in gains tax. The effective rate for 2009 differs from 2008 due to the impacts of the operating loss incurred by Potlatch TRS, built-in gains tax incurred by the REIT and energy tax credits recognized in 2009.

Our accounts receivable balances included \$6.1 million and \$6.2 million of anticipated federal and state tax refunds at December 31, 2010 and 2009, respectively.

The tax effects of significant temporary differences creating deferred tax assets and liabilities at December 31 were:

(Dollars in thousands)

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|  | 2010             | 2009              |
|--|------------------|-------------------|
| Deferred tax assets:                                   |                  |                   |
| Postretirement employee benefits                       | \$ 28,771        | \$ 32,009         |
| Pensions   | 25,753           | 31,701            |
| Net operating loss carryforwards                       | 8,104            | 24,915            |
| Nondeductible accruals                                 | 5,226            |                   |
| Inventories  | 3,400            | 4,309             |
| Tax credits  | 2,871            | 2,542             |
| Incentive compensation                                 | 2,564            | 2,714             |
| Employee benefits                                      | 1,891            | 2,407             |
| Other  | 138              | 2,883             |
| <b>Total deferred tax assets</b>                       | <b>78,718</b>    | <b>103,480</b>    |
| Valuation allowance                                    | (1,919)          | (1,633)           |
| <b>Deferred tax assets, net of valuation allowance</b> | <b>\$ 76,799</b> | <b>\$ 101,847</b> |
| Deferred tax liabilities:                              |                  |                   |
| Timber and timberlands                                 | \$ (3,039)       | \$ (15,790)       |
| Property, plant and equipment                          | (11,360)         | (12,312)          |
| <b>Total deferred tax liabilities</b>                  | <b>(14,399)</b>  | <b>(28,102)</b>   |
| <b>Net deferred tax assets</b>                         | <b>\$ 62,400</b> | <b>\$ 73,745</b>  |

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Net deferred tax assets (liabilities) consist of:

(Dollars in thousands)

|                                     | 2010      | 2009      |
|-------------------------------------|-----------|-----------|
| Current deferred tax assets         | \$ 13,346 | \$ 8,872  |
| Noncurrent deferred tax assets      | 63,453    | 92,975    |
| Noncurrent deferred tax liabilities | (14,399)  | (28,102)  |
| Net noncurrent deferred tax assets  | 49,054    | 64,873    |
| Net deferred tax assets             | \$ 62,400 | \$ 73,745 |

At December 31, 2010, we had \$19.3 million of net operating loss carryforwards for federal and state income tax purposes available to offset future taxable income, if any, which expire in 2029.

A valuation allowance has been recognized for certain state tax credit carryforwards due to uncertainty of sufficient taxable income prior to expiration of available carryover periods. The valuation allowance increased \$0.3 million and \$0.4 million in 2010 and 2009, respectively, and decreased \$1.2 million in 2008. The increase in the valuation allowance in 2010 and 2009 was entirely related to continuing operations. The tax credits expire over the next 14 years.

With the exception of the valuation allowance discussed above, we believe it is more likely than not that we will have sufficient future taxable income to realize our deferred tax assets. In making this determination, we consider whether it is more likely than not that some or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which temporary differences are deductible. We consider the scheduled reversal of deferred tax liabilities (including the impact of available carryforward periods), projected taxable income and tax planning strategies in making this assessment. In order to fully realize the deferred tax assets, we will need to generate future taxable income before the expiration of the deferred tax assets governed by the tax code. Based on projected taxable income for Potlatch TRS, over the periods for which the deferred tax assets are deductible, as well as certain tax planning strategies that management has undertaken and expects to have the ability to undertake in the future, we believe that it is more likely than not that we will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2010. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced and management is unable to implement one or more of the tax planning strategies that it has identified. Such tax planning strategies include the potential transfer of income-producing timberlands from the REIT to Potlatch TRS to generate income sufficient to fund our pension and other postretirement employee benefit obligations, and thus realize our deferred tax assets.

Tax years subject to examination by major taxing jurisdictions are as follows:

| Jurisdiction | Years |      |
|--------------|-------|------|
| Federal      | 2007  | 2010 |
| Arkansas     | 2007  | 2010 |
| Michigan     | 2006  | 2010 |
| Minnesota    | 2006  | 2010 |
| Idaho        | 2007  | 2010 |

We reviewed our tax positions at December 31, 2010, and determined that no uncertain tax positions were taken during 2010, and that no new information was available at that time 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. For the years ended December 31, 2010, 2009 and 2008, we recognized a net benefit of approximately \$0.2 million, \$1.4 million and \$0.1 million, respectively, related to interest and penalties in our tax provision. At December 31, 2010 and 2009, we had less than \$0.1 million accrued for the payment of interest. At December 31, 2010, we had \$0.8 million accrued as a receivable for interest with respect to open tax refunds.

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In connection with the spin-off of Clearwater Paper, we entered into a tax sharing agreement that generally governs each party's rights, responsibilities and obligations with respect to taxes, including ordinary course of business taxes and taxes, if any, incurred as a result of any failure of the spin-off to be tax-free. Under the tax sharing agreement, we expect that, with certain exceptions, we will be responsible for the payment of all income and non-income taxes attributable to our operations, and the operations of our direct and indirect subsidiaries. The tax sharing agreement also sets forth our rights and responsibilities for tax obligations and refunds attributable to tax periods prior to the spin-off date of December 16, 2008.

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Under the tax sharing agreement, Clearwater Paper will be responsible for any taxes imposed on us that arise from the failure of the spin-off, together with certain related transactions, to qualify as a tax-free distribution for U.S. federal income tax purposes, including any tax that would result if we were to fail to qualify as a REIT as a result of income recognized by us if the spin-off were determined to be taxable, to the extent such failure to qualify is attributable to actions, events or transactions relating to Clearwater Paper's stock, assets or business, or a breach of the relevant representations or covenants made by Clearwater Paper in the tax sharing agreement. The tax sharing agreement imposes restrictions on Clearwater Paper's and our ability to engage in certain actions following the spin-off and sets forth the respective obligations of each party with respect to the filing of tax returns, the administration of tax contests, assistance and cooperation and other matters. Our tax provision, deferred tax balances, and tax refunds receivable have been determined to be in accordance with the tax sharing agreement.

**NOTE 9.**

## Debt

(Dollars in thousands)

|   | 2010              | 2009              |
|---|-------------------|-------------------|
| Revenue bonds, fixed rate 5.9% to 7.75%, due 2012 through 2026      | \$ 149,712        | \$ 149,679        |
| 7.5% Senior Notes due 2019  | 147,726           | 147,469           |
| Debentures, 6.95%, due 2015   | 22,488            | 22,486            |
| Medium-term notes, fixed rate 8.65% to 8.89%, due 2011 through 2022 | 48,750            | 48,750            |
| Interest rate swaps   | (216)             |                   |
| Other notes   | 36                | 47                |
|   | 368,496           | 368,431           |
| Less current installments on long-term debt                         | 5,011             | 11                |
| <b>Long-term debt</b>   | <b>\$ 363,485</b> | <b>\$ 368,420</b> |

We repaid \$0.4 million of revenue bonds on their maturity date in 2009. There were no maturities in 2010.

Our current secured bank credit facility, which expires on December 8, 2013, provides for a revolving line of credit of up to \$250 million, including a \$35 million subfacility for letters of credit and a \$20 million subfacility for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. Subject to certain conditions and agreement of the lenders, the bank credit facility may be increased by up to an additional \$100 million. As of December 31, 2010, there were no borrowings outstanding under the revolving line of credit, and approximately \$2.4 million of the letter of credit subfacility was being used to support several outstanding letters of credit. Available borrowing capacity at December 31, 2010 was \$247.6 million. Loans made under our bank credit facility can be either (1) Eurodollar loans, which bear interest at the one-month LIBOR or (2) Base Rate loans, which bear interest equal to the highest of (a) the current Federal Funds Rate plus 1/2 of 1%, (b) the one-month LIBOR, or (c) the rate effectively equal to the bank's prime rate. The interest rate we pay for borrowings under either type of loan includes an additional applicable rate of between 3.0% and 4.0%, based upon our Funded Indebtedness to Capitalization Ratio from the prior quarter. As of December 31, 2010, we were able to borrow under the bank credit facility with the additional applicable rate of 3.75%. We pay commitment fees of 0.5% on the unused balance of the bank credit facility. Pursuant to an amendment that became effective February 4, 2011, we reduced available borrowing capacity under our bank credit facility from \$250 million to \$150 million.

The bank credit facility contains financial maintenance covenants establishing a minimum interest coverage ratio, a minimum collateral coverage ratio and a maximum funded indebtedness to capitalization ratio. We will be permitted to pay distributions to our stockholders under the terms of the bank credit facility so long as we remain in pro forma compliance with the financial maintenance covenants.

The table below sets forth the most restrictive covenants in the bank credit facility and our status with respect to these covenants as of December 31, 2010:

**COVENANT REQUIREMENT**

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|  |                | <b>ACTUAL RATIO AT<br/>DECEMBER 31, 2010</b> |
|--|----------------|--|
| Minimum Interest Coverage Ratio                        | 2.75 to 1.00*  | 5.43 to 1.00                                 |
| Minimum Collateral Coverage Ratio                      | 2.25 to 1.00** | 3.56 to 1.00                                 |
| Maximum Funded Indebtedness To<br>Capitalization Ratio | 60.0%**        | 53.8%  |

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

\*\* Per an amendment to the credit agreement, the Minimum Collateral Coverage Ratio increased to 3.00 to 1.00 and the Maximum Funded Indebtedness to Capitalization Ratio increased to 70.0% effective as of February 4, 2011.



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On November 3, 2009, we sold \$150 million aggregate principal amount of senior notes. The notes are due on November 1, 2019, have an interest rate of 7.5% and were issued at a price equal to 98.284% of their face value. Approximately \$73.0 million of the net proceeds were used to repay the outstanding balance on our bank credit facility. The remainder was invested in short-term investments and has been or will be used for general corporate purposes.

These notes are general unsecured obligations and are therefore not secured by our assets. They are equal in right of payment with all existing and future unsecured senior debt and are senior in right of payment to all existing and future senior subordinated and subordinated debt. The notes are effectively subordinated to all of our existing and future secured debt to the extent of the value of the assets securing such debt, including borrowings under our secured bank credit facility and approximately \$71.3 million of other debt, which is secured by a pledge of the capital stock of our subsidiaries and by 640,900 acres of our timberlands in Idaho. The notes are unconditionally guaranteed by certain of our subsidiaries.

We have the option to redeem all or a portion of the notes at any time before maturity at a redemption price equal to 100% of the principal amount thereof plus a premium and accrued and unpaid interest. In addition, at any time prior to November 1, 2012, we have the option to redeem up to 35% of the principal amount of the notes with the net cash proceeds of certain equity offerings at a redemption price equal to 107.5% of the principal amount thereof plus accrued interest.

We filed a registration statement with the SEC, which was effective May 7, 2010, pursuant to which we offered to exchange the senior notes and related subsidiary guarantees for notes and subsidiary guarantees with substantially similar terms that are registered under the Securities Act. All of the original notes were tendered for the registered notes in June 2010.

In accordance with SEC rules, the registration of the notes does not result in a requirement to file periodically separate financial information with respect to an issuer, its guarantor subsidiaries and its non-guarantor subsidiaries where the parent entity has no independent assets or operations, the guarantees are full and unconditional and joint and several, and the non-guarantor subsidiaries are minor, all as defined by applicable SEC rules.

Separate financial information about Potlatch, Potlatch's guarantor subsidiaries and its non-guarantor subsidiaries is not presented because Potlatch holds all of its assets and conducts all of its operations through its subsidiaries and has no independent assets or operations. Potlatch's subsidiaries, other than the subsidiary guarantors, are minor in significance. The guarantees of our subsidiary guarantors are full and unconditional and joint and several. Except with respect to REIT tax rules, there are no significant restrictions on the ability of Potlatch or any of the subsidiary guarantors to obtain funds from any of our subsidiaries by dividend or loan. The tax rules with which we must comply to maintain our status as a REIT limit our ability to use dividends from Potlatch TRS to service our indebtedness. 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. This requirement may limit our ability to receive dividends from Potlatch TRS and may impact our ability to service our indebtedness using cash flows from Potlatch TRS.

The terms of the notes limit our ability and the ability of any subsidiary guarantors to borrow money, pay dividends, redeem or repurchase capital stock, enter into sale and leaseback transactions, and create liens. With respect to the limitation on dividends and the repurchase of our capital stock, these restricted payments are permitted as follows:

We may use 100% of our Funds Available for Distribution, or FAD, for the period January 1, 2010 through the end of the quarter preceding the payment date, less cumulative restricted payments previously made from FAD during that period, to make restricted payments.

If our cumulative FAD, less cumulative restricted payments previously made from FAD, is insufficient to cover a restricted payment, then we are permitted to make payments from a basket amount, which was approximately \$90.1 million at December 31, 2010.

If our cumulative FAD less our aggregate restricted payments made from FAD is insufficient to cover a restricted payment and we have depleted the basket, we may still make a restricted payment, so long as, after giving effect to the payment, our ratio of indebtedness to earnings before interest, taxes, depreciation, depletion, amortization and basis of real estate sold, or EBITDDA, from continuing operations for the preceding four full fiscal quarters does not exceed 4.25 to 1.00.

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FAD, as defined in the indenture governing the senior notes, is earnings from continuing operations, plus depreciation, depletion and amortization, plus basis of real estate sold, and minus capital expenditures. For purposes of this definition, capital expenditures exclude all expenditures relating to direct or indirect timberland purchases in excess of \$5 million. Under this definition, our FAD for 2010 was \$105.1 million and our distributions paid in 2010 were \$81.6 million.

In June 2009, our obligations under the indenture governing the \$100 million principal amount of 9-1/8% credit sensitive debentures, due December 1, 2009, were fully discharged. Prior to our spin-off of Clearwater Paper in December 2008, Clearwater Paper agreed to make all remaining payments to the debenture holders and, in June 2009, Clearwater Paper deposited with the indenture trustee a sum sufficient to satisfy all remaining principal and interest due on the credit sensitive debentures. The credit sensitive debentures matured and were redeemed on December 1, 2009.

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Scheduled payments due on long-term debt during each of the five years subsequent to December 31, 2010, are as follows:

(Dollars in thousands)

|      |          |
|------|----------|
| 2011 | \$ 5,011 |
| 2012 | 21,662   |
| 2013 | 8,413    |
| 2014 | 21,000   |
| 2015 | 22,500   |

**NOTE 10.**

Accounts Payable and Accrued Liabilities

(Dollars in thousands)

|                                       | 2010      | 2009      |
|---------------------------------------|-----------|-----------|
| Wages, salaries and employee benefits | \$ 13,766 | \$ 13,499 |
| Taxes other than income taxes         | 7,625     | 6,279     |
| Environmental remediation             | 4,800     | 739       |
| Interest                              | 4,726     | 4,732     |
| Logging related expenses              | 4,156     | 3,500     |
| Trade accounts payable                | 3,857     | 8,248     |
| Book overdrafts                       | 3,466     | 1,288     |
| Lumber hedge                          | 2,876     |           |
| Freight                               | 851       | 537       |
| Utilities                             | 279       | 319       |
| Income taxes                          | 72        | 1,400     |
| Other                                 | 5,030     | 3,960     |
|                                       | \$ 51,504 | \$ 44,501 |

**NOTE 11.**

Other Long-Term Obligations

(Dollars in thousands)

|   | 2010      | 2009      |
|---|-----------|-----------|
| Employee benefits and related liabilities | \$ 13,109 | \$ 12,328 |
| Other                                     | 5,522     | 5,156     |
|   | \$ 18,631 | \$ 17,484 |

**NOTE 12.**

Financial Instruments and Concentrations of Risk

**DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

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We record all derivatives on our balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether we have elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Derivatives designated and

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qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk in a fair value hedge.

We formally document all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedge transactions.

**FAIR VALUE OF FINANCIAL INSTRUMENTS**

Estimated fair values of our financial instruments are as follows:

(Dollars in thousands)

|   | 2010               |               | 2009               |               |
|---|--------------------|---------------|--------------------|---------------|
|   | CARRYING<br>AMOUNT | FAIR<br>VALUE | CARRYING<br>AMOUNT | FAIR<br>VALUE |
| Cash, restricted cash and short-term investments (Level 1)                                  | \$ 91,183          | \$ 91,183     | \$ 55,038          | \$ 55,038     |
| Net derivative liability related to interest rate swaps (Level 2)                           | 216                | 216           |                    |               |
| Derivative liability related to lumber hedge (Level 2)                                      | 2,876              | 2,876         |                    |               |
| Long-term debt (including fair value adjustments related to fair value hedges)<br>(Level 2) | 368,496            | 369,351       | 368,431            | 364,978       |

A framework has been established for measuring fair value, which provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below.

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets.

Level 2 Inputs to the valuation methodology include:

Quoted prices for similar assets or liabilities in active markets;

Quoted prices for identical or similar assets or liabilities in inactive markets;

Inputs other than quoted prices that are observable for the asset or liability;

Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observed for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

For cash, restricted cash and short-term investments, the carrying amount approximates fair value due to the short-term nature of these financial instruments. The fair value of the interest rate swaps has been determined based upon quoted market prices for similar assets and liabilities in active markets. The fair value of the non-designated lumber hedge has been determined primarily from observable data by correlation and other means. The fair value of our long-term debt is estimated based upon the quoted market prices for the same or similar debt issues. For long-term debt for which there is no quoted market price, fair value is estimated based on average market prices for comparable liquid revenue bonds.

**FAIR VALUE HEDGES OF INTEREST RATE RISK**

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On June 30, 2010, we entered into nine separate interest rate swap agreements with notional amounts totaling \$68.25 million, each effective July 1, 2010, associated with our \$22.5 million debentures and \$45.75 million of our medium-term notes. The swaps converted interest payments with fixed rates ranging between 6.95% and 8.89% to a variable rate of three-month LIBOR plus a spread between 4.738% and 7.8375%. The interest rate swaps terminate at various dates ranging from January 2011 to February 2018. Our risk management objective and strategy is to protect against the risk of adverse changes in fair value attributable to changes in the 3-month LIBOR swap rate, the designated benchmark interest rate being hedged, on \$68.25 million of fixed-rate debt.

All of the interest rate swaps qualify for and have been designated as fair value hedges under the short-cut method of FASB Accounting Standard Codification, or ASC, 815, *Derivatives and Hedging*. As such, the net changes in fair value of the derivatives and the net changes in fair value of the hedged items are each recorded within interest expense. As of December 31, 2010, we have a

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derivative asset within non-current other assets of \$0.1 million, derivative liabilities within other long-term obligations of \$0.3 million and a cumulative net decrease to the carrying amount of our debt of \$0.2 million recorded on our Consolidated Balance Sheets. We did not have any derivatives as of December 31, 2009.

For the year ended December 31, 2010, we recognized a total of \$0.2 million of net gains recorded in interest expense due to changes in fair value of the derivatives. This net gain was offset by a cumulative net decrease to the carrying amount of debt of \$0.2 million. Consequently, no net unrealized gain or loss was recognized in income. For the year ended December 31, 2010, we recognized a net gain, resulting in a reduction in interest expense, of \$0.5 million, which includes realized net gains and losses from net cash settlements and interest accruals on the derivatives. We recognized no hedge ineffectiveness during 2010.

**NON-DESIGNATED LUMBER HEDGE**

Derivatives not designated as hedges are not speculative and are used to manage our exposure to interest rate movements, commodity price movements or other identified risks, but do not meet the strict hedge accounting requirements. On October 13, 2010, we entered into a commodity swap contract for 33,000 mbf (thousand board feet) of eastern spruce/pine with an effective date of April 1, 2011 and a termination date of September 30, 2011. Under the contract, 5,500 mbf will cash settle per month. On October 18, 2010, we entered into a commodity swap contract for 14,300 mbf of southern yellow pine. In January 2011, 7,150 mbf cash settled, with the remaining 7,150 mbf to cash settle in February 2011. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in net earnings. As such, an unrealized loss of \$2.9 million was recognized for the year ended December 31, 2010.

The fair values of derivative instruments on our Consolidated Balance Sheets as of December 31 are as follows:

(Dollars in thousands)

|   | DERIVATIVE ASSETS          |                 |                 | DERIVATIVE LIABILITIES      |                 |                 |
|---|----------------------------|-----------------|-----------------|-----------------------------|-----------------|-----------------|
|   | BALANCE SHEET LOCATION     | 2010 FAIR VALUE | 2009 FAIR VALUE | BALANCE SHEET LOCATION      | 2010 FAIR VALUE | 2009 FAIR VALUE |
| Derivatives designated as hedging instruments:          |                            |                 |                 |                             |                 |                 |
| Interest rate contracts                                 |                            |                 |                 | Other long-term obligations |                 |                 |
|   | Other assets (non-current) | \$ 62           | \$              |                             | \$ 278          | \$              |
| Total derivatives designated as hedging instruments     |                            | \$ 62           | \$              |                             | \$ 278          | \$              |
| Derivatives not designated as hedging instruments:      |                            |                 |                 |                             |                 |                 |
| Lumber contracts  |                            |                 |                 | Accrued liabilities         |                 |                 |
|   |                            | \$              | \$              |                             | \$ 2,876        | \$              |
| Total derivatives not designated as hedging instruments |                            | \$              | \$              |                             | \$ 2,876        | \$              |

The effect of derivatives on the Consolidated Statements of Operations for the years ended December 31, 2010 and 2009 are as follows:

(Dollars in thousands)

LOCATION OF GAIN (LOSS) RECOGNIZED IN      AMOUNT OF GAIN (LOSS) RECOGNIZED IN

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|  | INCOME             | INCOME | 2010    | 2009 |
|--|--------------------|--------|---------|------|
| <b>Derivatives designated in fair value hedging relationships:</b>                   |                    |        |         |      |
| Interest rate contracts  |                    |        |         |      |
| Realized gain on hedging instrument <sup>(1)</sup>                                   | Interest expense   | \$     | 481     | \$   |
| Net gain recognized in income from fair value hedges                                 |                    | \$     | 481     | \$   |
| <b>Derivatives not designated as hedging instruments:</b>                            |                    |        |         |      |
| Lumber contracts   |                    |        |         |      |
| Unrealized loss on derivative  | Cost of goods sold | \$     | (2,876) | \$   |
| Net loss recognized in income from derivatives not designated as hedging instruments |                    | \$     | (2,876) | \$   |

<sup>(1)</sup> Realized gain on hedging instrument consists of net cash settlements and interest accruals on the interest rate swaps during the period.



**Table of Contents****CONCENTRATION RISK**

For the years ended December 31, 2010 and 2008, no customers accounted for 10% or more of our revenues. For the year ended December 31, 2009, we had one customer that accounted for approximately 10% of our revenues.

**NOTE 13.****Savings Plans, Pension Plans and Other Postretirement Employee Benefits**

Substantially all of our employees are eligible to participate in 401(k) savings plans and are covered by noncontributory defined benefit pension plans. In 2010, 2009 and 2008, we made matching 401(k) contributions on behalf of employees associated with continuing operations of \$1.2 million, \$1.3 million and \$1.6 million, respectively. We also provide benefits under company-sponsored defined benefit retiree health care plans, which cover certain salaried and hourly employees. Most of the retiree health care plans require retiree contributions and contain other cost-sharing features.

We recognized the underfunded status of our defined benefit pension plans and other postretirement employee benefit obligations on our Consolidated Balance Sheets at December 31, 2010 and 2009. We recognized the changes in that funded status, in the year in which changes occurred, through our Consolidated Statements of Comprehensive Income (Loss).

The net periodic cost or benefit related to pension and postretirement benefits applicable to the Clearwater Paper spin-off are shown in discontinued operations for 2008.

We use a December 31 measurement date for our benefit plans and obligations. The change in benefit obligation, change in plan assets and funded status for company-sponsored benefit plans and obligations are as follows:

(Dollars in thousands)

|  | PENSION BENEFIT PLANS |             | OTHER<br>POSTRETIREMENT<br>EMPLOYEE BENEFITS |             |
|--|-----------------------|-------------|--|-------------|
|  | 2010                  | 2009        | 2010   | 2009        |
| Benefit obligation at beginning of year        | \$ 399,875            | \$ 391,439  | \$ 82,074                                    | \$ 131,403  |
| Service cost                                   | 4,633                 | 4,289       | 415  | 980         |
| Interest cost                                  | 21,649                | 22,588      | 3,972  | 9,015       |
| Plan amendments                                |                       | 540         |  | (76,725)    |
| Actuarial loss (gain)                          | 106                   | 11,254      | (6,147)                                      | 27,540      |
| Closures and special termination benefits      | (432)                 |             | 65   |             |
| Medicare Part D subsidies received             |                       |             | 552  | 1,071       |
| Benefits paid                                  | (30,745)              | (30,235)    | (8,312)                                      | (11,210)    |
| Benefit obligation at end of year              | 395,086               | 399,875     | 72,619                                       | 82,074      |
| Fair value of plan assets at beginning of year | 318,590               | 292,645     |  | 13          |
| Actual return on plan assets                   | 38,863                | 57,489      |  |             |
| Employer contribution                          | 1,729                 | 1,714       |  |             |
| Benefits paid                                  | (30,745)              | (30,235)    |  |             |
| Spin-off of Clearwater Paper                   | 627                   | (3,023)     |  | (13)        |
| Fair value of plan assets at end of year       | 329,064               | 318,590     |  |             |
| Funded status at end of year                   | \$ (66,022)           | \$ (81,285) | \$ (72,619)                                  | \$ (82,074) |

Amounts recognized in the consolidated balance sheets:

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|                        |             |             |             |             |
|------------------------|-------------|-------------|-------------|-------------|
| Current liabilities    | \$ (1,708)  | \$ (1,708)  | \$ (7,809)  | \$ (12,253) |
| Noncurrent liabilities | (64,314)    | (79,577)    | (64,810)    | (69,821)    |
| Net amount recognized  | \$ (66,022) | \$ (81,285) | \$ (72,619) | \$ (82,074) |

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Amounts recognized (pre-tax) in Accumulated other comprehensive loss on our Consolidated Balance Sheets consist of:

(Dollars in thousands)

|                              | PENSION BENEFIT PLANS |                   | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |                    |
|------------------------------|-----------------------|-------------------|---|--------------------|
|                              | 2010                  | 2009              | 2010                                      | 2009               |
| Net loss                     | \$ 209,232            | \$ 224,089        | \$ 50,673                                 | \$ 61,780          |
| Prior service cost (credit)  | 4,613                 | 5,488             | (73,115)                                  | (82,401)           |
| <b>Net amount recognized</b> | <b>\$ 213,845</b>     | <b>\$ 229,577</b> | <b>\$ (22,442)</b>                        | <b>\$ (20,621)</b> |

The accumulated benefit obligation for all defined benefit pension plans was \$388.9 million and \$392.3 million at December 31, 2010 and 2009, respectively.

In late 2009, we restructured our health care and life insurance plans for the majority of our retirees, with the changes effective January 1, 2010. The level of subsidy was frozen for retirees so that all future increments in health care costs will be borne by the retirees. In addition, the retiree medical plans were redesigned for all retirees. For retirees under age 65, a high deductible medical plan was created and all other existing medical plans were terminated. These retirees were transferred to the new medical plan effective January 1, 2010. For retirees age 65 or over, the medical plan is divided into two components, with the company continuing to self-insure prescription drugs and providing a fully-insured medical supplemental plan through AARP/United Healthcare. Both medical plans require the retiree to contribute the amount in excess of the company subsidy in order to continue coverage. Finally, vision, dental and life insurance coverage for these retirees was terminated. The effect of these retiree plan changes was a reduction in the accumulated postretirement benefit obligation of \$76.7 million, which was recognized as of December 31, 2009. The retirees from our Arkansas wood products manufacturing facility are represented by a bargaining group and their retiree medical plan is covered by the collective bargaining agreement.

Information as of December 31 for our pension plans, all of which had accumulated benefit obligations in excess of plan assets, was as follows:

(Dollars in thousands)

|                                | 2010       | 2009       |
|--------------------------------|------------|------------|
| Projected benefit obligation   | \$ 395,086 | \$ 399,875 |
| Accumulated benefit obligation | 388,934    | 392,333    |
| Fair value of plan assets      | 329,064    | 318,590    |

Pre-tax components of net periodic cost (benefit) recognized in our Consolidated Statements of Operations were as follows:

(Dollars in thousands)

|   | PENSION BENEFIT PLANS |                   |                   | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |                  |                  |
|---|-----------------------|-------------------|-------------------|---|------------------|------------------|
|   | 2010                  | 2009              | 2008              | 2010                                      | 2009             | 2008             |
| Service cost                                | \$ 4,633              | \$ 4,289          | \$ 11,085         | \$ 415                                    | \$ 980           | \$ 2,546         |
| Interest cost                               | 21,649                | 22,588            | 37,144            | 3,972                                     | 9,015            | 15,676           |
| Expected return on plan assets              | (33,133)              | (35,309)          | (60,697)          |   |                  |                  |
| Amortization of prior service cost (credit) | 875                   | 993               | 3,276             | (8,891)                                   | (984)            | (3,651)          |
| Amortization of actuarial loss              | 8,174                 | 3,890             | 4,009             | 4,631                                     | 4,445            | 3,925            |
| Special termination benefits                |                       |                   | 200               |   |                  |                  |
| <b>Net periodic cost (benefit)</b>          | <b>\$ 2,198</b>       | <b>\$ (3,549)</b> | <b>\$ (4,983)</b> | <b>\$ 127</b>                             | <b>\$ 13,456</b> | <b>\$ 18,496</b> |



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Other amounts recognized in our Consolidated Statements of Comprehensive Income (Loss) were as follows:

(Dollars in thousands)

|  | PENSION BENEFIT PLANS |                    |                   | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |                    |                  |
|--|-----------------------|--------------------|-------------------|---|--------------------|------------------|
|  | 2010                  | 2009               | 2008              | 2010                                      | 2009               | 2008             |
| Net loss (gain)  | \$ (6,682)            | \$ (7,902)         | \$ 161,022        | \$ (6,477)                                | \$ 27,553          | \$ 8,360         |
| Prior service cost (credit)  |                       | 539                | 1,433             | 715                                       | (76,725)           |                  |
| Amortization of prior service (cost) credit  | (875)                 | (993)              | (3,276)           | 8,571                                     | 984                | 3,651            |
| Amortization of actuarial loss   | (8,174)               | (3,890)            | (4,009)           | (4,631)                                   | (4,445)            | (3,925)          |
| <b>Total recognized in other comprehensive loss (income)</b>                                 | <b>\$ (15,731)</b>    | <b>\$ (12,246)</b> | <b>\$ 155,170</b> | <b>\$ (1,822)</b>                         | <b>\$ (52,633)</b> | <b>\$ 8,086</b>  |
| <b>Total recognized in net periodic cost (benefit) and other comprehensive loss (income)</b> | <b>\$ (13,533)</b>    | <b>\$ (15,795)</b> | <b>\$ 150,187</b> | <b>\$ (1,695)</b>                         | <b>\$ (39,177)</b> | <b>\$ 26,582</b> |
| <b>Pre-tax net periodic benefit cost (benefit) related to continuing operations</b>          | <b>\$ 2,198</b>       | <b>\$ (3,549)</b>  | <b>\$ (5,411)</b> | <b>\$ 127</b>                             | <b>\$ 13,456</b>   | <b>\$ 10,275</b> |

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The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year are \$10.1 million and \$0.7 million, respectively. The estimated net loss and prior service credit for OPEB obligations that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year are \$4.3 million and \$(8.5) million, respectively.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 introduced a drug benefit under Medicare Part D and a federal subsidy to sponsors of retiree health care benefit plans that provide an equivalent benefit. Our actuaries determined that certain benefits provided under our plans are actuarially equivalent to the Medicare Part D standard plan and are eligible for the employer subsidy. During 2010 and 2009, we received subsidy payments totaling \$0.6 million and \$1.1 million, respectively, associated with continuing operations.

Weighted average assumptions used to determine the benefit obligation as of December 31 were:

|  | PENSION BENEFIT PLANS |       |       | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |       |       |
|--|-----------------------|-------|-------|---|-------|-------|
|  | 2010                  | 2009  | 2008  | 2010                                      | 2009  | 2008  |
| Discount rate                          | 5.65%                 | 5.65% | 6.15% | 5.40%                                     | 5.65% | 6.15% |
| Rate of salaried compensation increase | 4.00                  | 4.00  | 4.00  |   |       |       |

Weighted average assumptions used to determine the net periodic benefit (cost) for the years ended December 31 were:

|  | PENSION BENEFIT PLANS |       |       | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |       |       |
|--|-----------------------|-------|-------|---|-------|-------|
|  | 2010                  | 2009  | 2008  | 2010                                      | 2009  | 2008  |
| Discount rate                          | 5.65%                 | 6.15% | 6.40% | 5.65%                                     | 6.15% | 6.40% |
| Expected return on plan assets         | 8.50                  | 8.50  | 9.00  |   |       | 9.00  |
| Rate of salaried compensation increase | 4.00                  | 4.00  | 4.00  |   |       |       |

The discount rate used in the determination of pension and OPEB benefit obligations was a hypothetical bond portfolio consisting of AA or better rated securities which matches the expected monthly benefit payments under the pension plans and OPEB obligations. The portfolio consisted of approximately 50 bonds which were well-diversified over corporate industrial, corporate financial, municipal, federal and foreign government issuers. Prior to 2010, the discount rate used in the determination of pension and OPEB benefit obligations and net periodic benefit (cost) was 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.

The expected return on plan assets assumption is based upon an analysis of 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 health care cost trend rate used to calculate OPEB obligations as of December 31, 2010 was 0% for our salaried and non-represented plans and a certain group of participants over age 65 in our hourly plan; 7.5% for our Arkansas participants covered by a collective bargaining agreement, grading ratably to an assumption of 5.0% in 2070; and 6.0% for a certain group of participants under age 65 in our hourly plan, grading ratably to an assumption of 5.0% in 2070. The assumption of a 0% medical trend rate for several plans and groups of participants was due to the restructuring of our health care plans in late 2009 as previously discussed in this footnote.

A one percentage point change in the health care cost trend rates would have the following effects:

(Dollars in thousands)

|   | 1% INCREASE | 1% DECREASE |
|---|-------------|-------------|
| Effect on 2010 total service and interest cost components | \$ 79       | \$ (70)     |
| Effect on OPEB obligations as of December 31, 2010        | 817         | (749)       |

The weighted average asset allocations of the pension benefit plans assets at December 31 by asset category are as follows:

| ASSET CATEGORY                         | PENSION BENEFIT PLANS |             | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |      |
|--|-----------------------|-------------|---|------|
|  | 2010                  | 2009        | 2010                                      | 2009 |
| Domestic equity securities             | 22%                   | 50%         |   |      |
| Debt securities                        | 34                    | 26          |   |      |
| Global/international equity securities | 29                    | 21          |   |      |
| Other                                  | 15                    | 3           |   |      |
| <b>Total</b>                           | <b>100%</b>           | <b>100%</b> |   |      |

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We utilize formal investment policy guidelines for our company-sponsored pension plans. These guidelines are periodically reviewed by the board of directors. The board of directors has delegated its authority to management to insure that the investment policy and guidelines are adhered to and the investment objectives are met.

The general policy states that plan assets will be invested to seek the greatest return consistent with the fiduciary character of the pension funds and to allow the plans to meet the need for timely pension benefit payments. The specific investment guidelines stipulate that management will maintain adequate liquidity for meeting expected benefit payments by reviewing, on a timely basis, contribution and benefit payment levels and appropriately revise long-term and short-term asset allocations. Management takes reasonable and prudent steps to preserve the value of pension fund assets and to avoid the risk of large losses. Major steps taken to provide this protection include:

Assets are diversified among various asset classes, such as domestic equities, global equities, fixed income, convertible securities and liquid reserves. The long-term asset allocation ranges are as follows:

|   |         |
|---|---------|
| Domestic and global equities            | 36%-60% |
| Fixed income and convertible securities | 35%-40% |
| Liquid reserves                         | 9%-21%  |

The ranges are more heavily weighted toward equities since the liabilities of the pension plans are long-term in nature and equities historically have significantly outperformed other asset classes over long periods of time. Periodic reviews of allocations within these ranges are made to determine what adjustments should be made based on changing economic and market conditions and specific liquidity requirements.

Assets are managed by professional investment managers and may be invested in separately managed accounts or commingled funds. Assets are diversified by selecting different investment managers for each asset class and by limiting assets under each manager to no more than 25% of the total pension fund.

Assets are not invested in Potlatch stock.

The investment guidelines also provide that the individual investment managers are expected to achieve a reasonable rate of return over a market cycle. Emphasis will be placed on long-term performance versus short-term market aberrations. Factors to be considered in determining reasonable rates of return include performance achieved by a diverse cross section of other investment managers, performance of commonly used benchmarks (e.g., S&P 500 Index, Shearson Lehman Government/Corporate Intermediate Index, Morgan Stanley World Index, Merrill Lynch Investment Grade Convertibles Index, Russell Value Index), actuarial assumptions for return on plan investments and specific performance guidelines given to individual investment managers.

Fair Value Measurements at December 31, 2010:

(Dollars in thousands)

| ASSET CATEGORY                    | QUOTED PRICES IN<br>ACTIVE MARKETS FOR<br>IDENTICAL<br>ASSETS<br>(LEVEL 1) | SIGNIFICANT<br>OBSERVABLE<br>INPUTS<br>(LEVEL 2) | SIGNIFICANT<br>UNOBSERVABLE<br>INPUTS<br>(LEVEL 3) | TOTAL    |
|-----------------------------------|--|--|--|----------|
| Cash and equivalents              | \$ 5,700   | \$   | \$   | \$ 5,700 |
| Equity securities:                |  |  |  |          |
| U.S. large cap <sup>(a)</sup>     | 34,475   |  |  | 34,475   |
| U.S. small/mid cap <sup>(b)</sup> | 19,352   |  |  | 19,352   |
| U.S. small/mid cap <sup>(c)</sup> | 20,001   |  |  | 20,001   |
| International companies           | 10,303   |  |  | 10,303   |



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|   |            |           |           |            |
|---|------------|-----------|-----------|------------|
| Mutual funds <sup>(d)</sup>                                     | 112,648    |           |           | 112,648    |
| Collective investments:   |            |           |           |            |
| Developed markets <sup>(e)</sup>                                |            | 44,194    |           | 44,194     |
| Emerging markets <sup>(f)</sup>                                 |            | 40,195    |           | 40,195     |
| Hedge funds <sup>(g)</sup>                                      |            |           | 44,201    | 44,201     |
| Securities pledged to creditors:                                |            |           |           |            |
| Money market <sup>(h)</sup>                                     |            | 4,719     |           | 4,719      |
| Mortgage-backed securities <sup>(i)</sup>                       |            | 2,322     |           | 2,322      |
| Subtotal  | 202,479    | 91,430    | 44,201    | 338,110    |
| Payable held under securities lending agreements <sup>(i)</sup> | (9,046)    |           |           | (9,046)    |
| Total   | \$ 193,433 | \$ 91,430 | \$ 44,201 | \$ 329,064 |

(a) These are managed investments in US large cap equities that track Russell 1000 Value strategy.

(b) These are managed investments in US small/mid cap equities that track Russell 2500 Growth strategy.

(c) These are managed investments in US small/mid cap equities that track Russell 2500 Value strategy.

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- (d) The mutual funds were 50% invested in high-quality intermediate and long-term investment grade securities and 50% invested in a diversified portfolio of fixed-income instruments of varying maturities, which may be represented by forwards or derivatives such as options, futures contracts or swap agreements and high-yield securities that are rated B or higher.
- (e) These collective investments are invested in equity funds of developed markets outside of the US & Canada, that track the MSCI EAFE.
- (f) These collective investments are invested in equity funds of emerging markets outside of the US & Canada, that track the MSCI EAFE.
- (g) The hedge funds are 34% invested in long/short and event-driven equity, 27% invested in long and short credit, 10% invested in distressed debt, 10% invested in fixed income and 8% invested in convertible bonds, with the remaining 11% in other investments.
- (h) The money market holdings are invested in the Mount Vernon Securities Lending Trust Prime Portfolio.
- (i) The mortgage-backed securities are maintained in the U.S. Bank Illiquid Securities Liquidating Trust.
- (j) This category represents a payable under the securities lending agreements.

Fair Value Measurements at December 31, 2009:

(Dollars in thousands)

| ASSET CATEGORY  | QUOTED PRICES IN<br>ACTIVE MARKETS FOR<br>IDENTICAL<br>ASSETS<br>(LEVEL 1) | SIGNIFICANT<br>OBSERVABLE<br>INPUTS<br>(LEVEL 2) | SIGNIFICANT<br>UNOBSERVABLE<br>INPUTS<br>(LEVEL 3) | TOTAL      |
|---|--|--|--|------------|
| Cash and equivalents  | \$ 7,818   | \$   | \$   | \$ 7,818   |
| Equity securities:  |  |  |  |            |
| U.S. companies  | 72,594   |  |  | 72,594     |
| International companies   | 8,839  |  |  | 8,839      |
| Mutual funds <sup>(a)</sup>                                     | 84,190   |  |  | 84,190     |
| Collective investments:   |  |  |  |            |
| U.S. equity securities <sup>(b)</sup>                           |  | 88,012   |  | 88,012     |
| International securities <sup>(c)</sup>                         |  | 31,676   |  | 31,676     |
| Limited partnerships <sup>(d)</sup>                             |  | 27,999   |  | 27,999     |
| Securities pledged to creditors:                                |  |  |  |            |
| Money market  |  | 333  |  | 333        |
| Fixed income securities <sup>(e)</sup>                          |  | 5,324  |  | 5,324      |
| Mortgage-backed securities <sup>(f)</sup>                       |  | 2,269  |  | 2,269      |
| Subtotal  | 173,441  | 155,613  |  | 329,054    |
| Payable held under securities lending agreements <sup>(g)</sup> | (10,464)   |  |  | (10,464)   |
| Total   | \$ 162,977   | \$ 155,613                                       | \$   | \$ 318,590 |

- (a) The mutual funds were 50% invested in high-quality intermediate and long-term investment grade securities and 50% invested in a diversified portfolio of fixed-income instruments of varying maturities and assets in high-yield securities.
- (b) This collective investment was 47% invested in a low-cost equity index fund, not actively managed, that tracks the Russell 2500; 31% invested in an actively managed growth fund that tracks the Russell 1000; and 22% invested in a low-cost equity index fund, not actively managed, that tracks the S&P 500.
- (c) These are actively managed global funds that are invested in non-U.S. international and emerging market securities.
- (d) The limited partnerships hold investments in publicly traded U.S. and international equity securities.
- (e) These are liquidating trusts that maintain a diversified portfolio of fixed-income instruments with maturities exclusive to 2010.
- (f) This is a liquidating trust that maintains investments in mortgage-backed securities.
- (g) This category represents a payable under the securities lending agreements.

The table below sets forth a summary of changes in the fair value of the plans' Level 3 assets for the year ended December 31, 2010:

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|  | <b>Hedge Funds</b> |
|--|--------------------|
| Balance, beginning of year   | \$                 |
| Purchases, sales, issuances and settlements, net                     | 42,000             |
| Unrealized gains relating to assets still held at the reporting date | 2,201              |
| Balance, end of year   | \$ 44,201          |

Refer to Note 12 for discussion of the framework for measuring fair value.

Following is a description of the valuation methodologies used for assets measured at fair value:

Corporate common and preferred stocks are valued at quoted market prices of the issuers' stock.

Registered investment company funds are valued at the net asset value (NAV) of shares held by the plan at year-end and classified as Level 1.

Investments in common and collective trust funds (Vanguard Long-Term (VWESX) and PIMCO (PTCIX)) are valued on the basis of the unit value established for each fund at each valuation date. The unit value is supported by investment value based on quoted market prices in active markets. Investments that trade in markets that are not considered to be active, but whose values are based on quoted market prices, dealer quotations or valuations provided by alternative pricing sources supported by observable inputs are classified as Level 2. These may include U.S. government and sovereign obligations and less liquid listed equities. As investments whose values are classified as Level 2, prices include positions that are not traded in active markets and/or are subject to transfer restrictions, valuations may be adjusted to reflect illiquidity and/or non-transferability, which are generally based on available market information. The unit value of collective investment funds is calculated by dividing the fund's net asset value on the calculation date by the number of units of the fund that are outstanding.

Investments in hedge funds are based on valuations provided by the respective investment managers. These investments are based on inputs that are unobservable and significant to the fair value measurement and are not traded in an active market. These investments are classified as Level 3.

Investments in liquidating trusts that maintain investments in mortgage-backed securities are valued on the underlying net asset value of the securities and classified as Level 2.

At December 31, 2010, ten active investment managers managed substantially all of the pension funds, each of whom had responsibility for managing a specific portion of these assets. Plan assets were diversified among the various asset classes within the allocation ranges established by our investment policy.

As a result of the steep downturn in the stock market in late 2008 and early 2009, our company-sponsored pension plans were underfunded at December 31, 2010 and 2009. In April 2009, an Internal Revenue Service pronouncement provided significant funding relief to single-employer defined benefit plans sponsors. Consequently, we were not required to make contributions during 2009 to our defined benefit plans. We were also not required to make contributions during 2010 as a result of carry-forward credits that we earned from discretionary contributions made in prior periods. We estimate cash payments in 2011 will total approximately \$3.6 million to our non-represented pension plan and \$1.7 million to our non-qualified supplemental pension plan. Payments made for OPEB obligations represent benefit costs incurred during the year by eligible participants.

Estimated future benefit payments, which reflect expected future service and expected Medicare prescription subsidy receipts, are as follows for the years indicated:

(Dollars in thousands)

|      | <b>PENSION<br/>BENEFIT<br/>PLANS</b> | <b>OTHER<br/>POSTRETIREMENT<br/>EMPLOYEE<br/>BENEFITS</b> | <b>EXPECTED<br/>MEDICARE<br/>SUBSIDY</b> |
|------|--------------------------------------|---|--|
| 2011 | \$ 29,694                            | \$ 8,362  | \$ 553                                   |

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|           |         |        |       |
|-----------|---------|--------|-------|
| 2012      | 29,277  | 7,663  | 602   |
| 2013      | 29,123  | 7,268  | 647   |
| 2014      | 28,983  | 7,038  | 714   |
| 2015      | 28,909  | 6,870  | 762   |
| 2016 2020 | 144,046 | 30,222 | 4,453 |

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**NOTE 14.**

Commitments and Contingencies

We have operating leases covering office space, equipment, land and vehicles expiring at various dates through 2028. As leases expire, it can be expected that, in the normal course of business, certain leases will be renewed or replaced.

As of December 31, 2010, the future minimum rental payments required under our operating leases are as follows:

(Dollars in thousands)

|                      |                 |
|----------------------|-----------------|
| 2011                 | \$ 2,434        |
| 2012                 | 2,215           |
| 2013                 | 1,609           |
| 2014                 | 1,095           |
| 2015                 | 752             |
| 2016 and later years | 1,100           |
| <b>Total</b>         | <b>\$ 9,205</b> |

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Rent expense was \$2.0 million, \$1.9 million and \$2.2 million for the years ended December 31, 2010, 2009 and 2008, respectively.

In January 2007, the EPA notified us that we are a potentially responsible party under CERCLA and the Clean Water Act for clean-up of a site known as Avery Landing in northern Idaho. We own a portion of the land at the Avery Landing site, which we acquired in 1980 from the Milwaukee Railroad. The land we own at the site and adjacent properties were contaminated with petroleum as a result of the Milwaukee Railroad's operations at the site prior to 1980. We entered into a consent order with the EPA in August 2008 to conduct an Engineering Evaluation/Cost Analysis, or EE/CA, study to determine the best means of addressing the contamination at the site. In January 2010, we submitted our draft EE/CA report to the EPA outlining various alternatives for addressing the contamination at the entire site. The range of cost estimates for the various alternatives set forth in the report to address the contamination at the entire site was from \$0.7 million to \$8.2 million. In April 2010, we were notified by the EPA that they determined the EE/CA report submitted by us contained deficiencies and that the EPA would complete the EE/CA report for the Avery Landing site and produce the Biological Assessment and Cultural Resources Evaluation reports. The EPA published its draft report on January 26, 2011 for public comment. The EPA's report focuses on a more limited number of remedial alternatives which range in cost from approximately \$7.9 million to \$10.5 million. The EPA will select a remedy for the site and determine which potentially responsible parties should implement the remedy following public comment. Currently we are under no legal obligation to implement any remedy selected by the EPA. We believe we have valid defenses available to limit our potential liability for contamination at the site and we will pursue those defenses in either settlement negotiations with the EPA or in litigation to limit our liability. As of December 31, 2010, we have accrued \$4.8 million for this matter.

We believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

Under ASC Topic 410-20, the company must recognize a liability and an asset equal to the fair value of its legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. In accordance with the guidance of ASC Topic 410-20, we undertook a review of our wood products facilities and other assets to determine, if possible, amounts that should be recognized as asset retirement obligations. The review resulted in our recording additional assets and corresponding liabilities, which were not material to our financial position or results of operations. We also identified situations that would have resulted in the recognition of additional asset retirement obligations, except for an inability to reasonably estimate the fair value of the liability at this time. Most of these situations relate to asbestos located within our manufacturing facilities where a settlement date or range of settlement dates cannot be specified, so that we are unable at this time to apply present value calculations to appropriately value an obligation. Any additional obligations recognized in the future as more information becomes available are not expected to have a material effect on our financial position or results of operations.

**NOTE 15.**

**Equity-Based Compensation Plans**

We recorded total equity-based compensation expense of \$4.0 million in 2010, \$3.8 million in 2009 and \$6.5 million in 2008. Of these amounts, \$3.4 million and \$0.6 million related to performance shares and RSUs, respectively, in 2010; \$3.3 million and \$0.5 million related to performance shares and RSUs, respectively, in 2009; and \$5.2 million and \$1.3 million related to performance shares and RSUs, respectively, in 2008. All outstanding stock options were fully vested prior to January 1, 2006. The net income tax benefit associated with our equity-based compensation totaled \$0 in 2010 and 2009, and \$2.5 million in 2008.

For our continuing operations, we recorded equity-based compensation expense of \$4.0 million in 2010, \$3.8 million in 2009 and \$4.3 million in 2008. The net income tax benefit associated with our equity-based compensation for our continuing operations recognized in the Consolidated Statements of Operations totaled \$0 in 2010 and 2009, respectively, and \$1.7 million in 2008. We recorded director deferred compensation expense totaling \$0.9 million in 2010, \$1.5 million in 2009 and \$0.1 million in 2008.

For the year ended December 31, 2008, \$1.5 million of cash flows 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 from continuing operations in the Consolidated Statements of Cash Flows. There were no similar realized tax benefits recognized for the years ended December 31, 2010 and 2009.

**STOCK OPTIONS**

All outstanding stock options were granted with an exercise price equal to the market price on the date of grant, were fully exercisable after two years and expire not later than 10 years from the date of grant. No new stock options were granted in 2010, 2009 or 2008.

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On December 16, 2008, we completed the spin-off of Clearwater Paper. As part of the spin-off, we distributed 100% of the issued and outstanding shares of Clearwater Paper's common stock to the holders of record of our common stock as of the close of business on December 9, 2008. Each stockholder received one share of Clearwater Paper common stock for every 3.5 shares of our common stock held.

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In connection with the spin-off, in order to maintain the same intrinsic value to stock option holders immediately before and after the spin-off distribution was paid, the number of options granted and exercise prices of all outstanding stock options were adjusted after the distribution of the Clearwater Paper common stock. The adjustment is reflected in the activity for 2008 presented in the table below.

A summary of the status of outstanding stock options as of December 31, 2010, 2009 and 2008 and changes during those years is presented below:

|  | 2010      |                              | 2009     |                              | 2008      |                              |
|--|-----------|------------------------------|----------|------------------------------|-----------|------------------------------|
|  | SHARES    | WEIGHTED AVG. EXERCISE PRICE | SHARES   | WEIGHTED AVG. EXERCISE PRICE | SHARES    | WEIGHTED AVG. EXERCISE PRICE |
| Outstanding at January 1                                     | 329,426   | \$ 21.14                     | 412,001  | \$ 21.44                     | 509,284   | \$ 25.08                     |
| Adjustments associated with the spin-off of Clearwater Paper |           |                              |          |                              | 52,578    | 21.44                        |
| Shares exercised   | (107,296) | 20.10                        | (81,540) | 22.56                        | (148,327) | 26.30                        |
| Canceled or expired  |           |                              | (1,035)  | 30.92                        | (1,534)   | 25.31                        |
| Outstanding and exercisable at December 31                   | 222,130   | 21.64                        | 329,426  | 21.14                        | 412,001   | 21.44                        |

Total intrinsic value of options exercised during the year (in thousands) \$ 1,609 \$ 561 \$ 2,830

There were no unvested stock options outstanding during 2010, 2009 or 2008.

The following table summarizes information about stock options outstanding at December 31, 2010:

| RANGE OF EXERCISE PRICES | OPTIONS OUTSTANDING AND EXERCISABLE |  |                              |  |
|--------------------------|-------------------------------------|--|------------------------------|--|
|                          | NUMBER OUTSTANDING AT 12/31/10      | WEIGHTED AVG. REMAINING CONTRACTUAL LIFE | WEIGHTED AVG. EXERCISE PRICE | AGGREGATE INTRINSIC VALUE (IN THOUSANDS) |
| \$13.8594 to \$16.6452   | 64,365                              | 1.55 years                               | \$ 15.19                     |  |
| \$19.2569                | 89,949                              | 2.92 years                               | 19.26                        |  |
| \$30.9204                | 67,816                              | 3.92 years                               | 30.92                        |  |
| \$13.8594 to \$30.9204   | 222,130                             | 2.83 years                               | 21.64                        | \$ 2,423                                 |

Cash received from stock option exercises for the years ended December 31, 2010, 2009 and 2008 was \$2.2 million, \$1.8 million and \$3.9 million, respectively. The actual tax benefit realized for tax deductions from option exercises totaled \$0 for the years ended December 31, 2010 and 2009, and \$1.1 million for the year ended December 31, 2008.

**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 based on the percentile ranking of our total shareholder return relative to the total shareholder return performance of both a selected peer group of companies and a larger group of indexed companies over the three-year performance period. The number of shares actually issued, as a percentage of the amount subject to the performance share award, could range from 0% to 200%. Performance share awards granted under our stock incentive plans 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 distribution equivalents in the form of additional shares at the time of payment equal to the distributions that would have been paid on the shares earned had the recipients owned the shares during the three-year period.



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In connection with the spin-off of Clearwater Paper in the fourth quarter of 2008, the performance period for shares granted for the 36-month period ending December 31, 2008 was compressed to a 33-month performance period, and the shares were paid out prior to the spin-off on December 16, 2008. This acceleration of the performance period did not result in any additional compensation expense.

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A Monte Carlo simulation method is used to estimate the stock prices of Potlatch and the selected peer companies at the end of the three-year performance period. The expected volatility of each company's stock price and covariance of returns among the peer companies are key assumptions within the Monte Carlo simulation. Historical volatility over a term similar to the performance period is considered a reasonable proxy for forecasted volatility. Likewise, because the returns of Potlatch and the peer group companies are correlated, the covariance, a measure of how two variables tend to move together, is calculated over a historical term similar to the performance period and applied in the simulations. The simulations use the stock prices of Potlatch and the peer group of companies as of the award date as a starting point. Multiple simulations are generated, resulting in share prices and total shareholder return values for Potlatch and the peer group of companies. For each simulation, the total shareholder return of Potlatch is ranked against that of the peer group of companies. The future value of the performance share unit is calculated based on a multiplier for the percentile ranking and then discounted to present value. The discount rate is the risk-free rate as of the award date for a term consistent with the performance period. Awards are also credited with dividend equivalents at the end of the performance period, and as a result, award values are not adjusted for dividends.

The following table presents the key inputs used in calculating the fair value of the performance share awards in 2010, 2009 and 2008, and the resulting fair values:

|                                   | 2010     | 2009     | 2008     |
|-----------------------------------|----------|----------|----------|
| Shares granted                    | 81,162   | 112,269  | 91,491   |
| Stock price as of valuation date  | \$ 31.88 | \$ 24.30 | \$ 40.87 |
| Risk-free rate                    | 1.29%    | 1.18%    | 2.27%    |
| Fair value of a performance share | \$ 45.30 | \$ 33.32 | \$ 52.75 |

A summary of the status of outstanding performance share awards as of December 31, 2010, 2009 and 2008, and changes during those years is presented below:

(Dollars in thousands except per-share amounts)

|  | 2010<br>WEIGHTED AVG.<br>GRANT<br>DATE<br>FAIR<br>VALUE |          | 2009<br>WEIGHTED AVG.<br>GRANT<br>DATE<br>FAIR<br>VALUE |          | 2008<br>WEIGHTED AVG.<br>GRANT<br>DATE<br>FAIR<br>VALUE |          |
|--|---|----------|---|----------|---|----------|
|  | SHARES  |          | SHARES  |          | SHARES  |          |
| Unvested shares outstanding at January 1                           | 171,595   | \$ 40.04 | 131,108   | \$ 50.51 | 244,933   | \$ 50.80 |
| Granted  | 81,162  | 45.30    | 112,269   | 33.32    | 91,491  | 52.75    |
| Vested   | (57,291)  | 52.75    | (71,719)  | 48.66    | (100,615)   | 54.23    |
| Cancellations associated with the spin-off of Clearwater Paper     |   |          |   |          | (87,921)  | 49.45    |
| Forfeited  | (10,865)  | 39.24    | (63)  | 47.90    | (16,780)  | 50.22    |
| Unvested shares outstanding at December 31                         | 184,601   | 38.45    | 171,595   | 40.04    | 131,108   | 50.51    |
| Total grant date fair value of share awards vested during the year | \$ 3,022  |          | \$ 3,490  |          | \$ 5,457  |          |
| Aggregate intrinsic value of unvested share awards at December 31  | \$ 5,752  |          | \$ 4,890  |          | \$ 3,214  |          |

As of December 31, 2010, there was \$3.5 million of unrecognized compensation cost related to unvested performance share awards. The cost is expected to be recognized over a weighted average period of 1.5 years. The realized tax benefit that exceeds the previously recognized deferred tax asset for performance shares recognized as additional paid-in capital was \$0 for the years ended December 31, 2010 and 2009, and \$2.7 million for the year ended December 31, 2008.



**Table of Contents****RESTRICTED STOCK UNITS**

Our 2005 Stock Incentive Plan also allows for awards to be issued in the form of RSU grants. During 2010, 2009 and 2008, certain officers and other select employees of the company were granted RSU awards that will accrue distribution equivalents based on distributions paid during the RSU vesting period. The distribution 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 the awards state that the RSUs will vest in a given time period of one to three years, and the terms of certain awards follow a vesting schedule within the given time period.

A summary of the status of outstanding RSU awards as of December 31, 2010, 2009 and 2008, and changes during these years is presented below:

|   | 2010<br>WEIGHTED AVG.<br>GRANT<br>DATE |            | 2009<br>WEIGHTED AVG.<br>GRANT<br>DATE |            | 2008<br>WEIGHTED AVG.<br>GRANT<br>DATE |            |
|---|--|------------|--|------------|--|------------|
|   | SHARES                                 | FAIR VALUE | SHARES                                 | FAIR VALUE | SHARES                                 | FAIR VALUE |
| Unvested shares outstanding at January 1                          | 41,559                                 | \$ 32.57   | 39,711                                 | \$ 45.38   | 31,875                                 | \$ 48.84   |
| Granted   | 21,559                                 | 33.17      | 21,720                                 | 24.34      | 45,869                                 | 35.23      |
| Vested  | (16,639)                               | 42.23      | (19,872)                               | 49.18      | (25,411)                               | 34.72      |
| Cancellations associated with the spin-off<br>of Clearwater Paper |  |            |  |            | (10,835)                               | 41.31      |
| Forfeited   | (4,764)                                | 29.56      |  |            | (1,787)                                | 41.38      |

Unvested shares outstanding at December 31 41,715 29.37 41,559 32.57 39,711 45.38  
The aggregate intrinsic value of the RSU awards was \$1.4 million, \$1.3 million and \$1.0 million at December 31, 2010, 2009 and 2008, respectively.

For RSU awards granted during the period, the fair value of each share was determined on the date of grant using the grant date market price. The total fair value of RSU awards vested during 2010 was \$0.7 million.

As of December 31, 2010, there was \$0.6 million of total unrecognized compensation cost related to outstanding RSU awards. The cost is expected to be recognized over a weighted average period of 1.2 years.

**NOTE 16.****Segment Information**

As of December 31, 2010, our businesses are organized into three reportable operating segments: Resource; Real Estate; and Wood Products. Our Resource segment manages our timberlands to optimize revenue producing opportunities while at the same time adhering to our strict stewardship standards. Management activities include planting and harvesting trees and building and maintaining roads. The Resource segment also seeks to increase our revenues from non-timber resources such as from hunting leases, recreation permits and leases, biomass production, carbon sequestration, mineral rights leases and various other leasing opportunities. The activities of our Real Estate segment consist primarily of the sale of selected non-core timberland real estate. The Real Estate segment engages in real estate subdivision and development activities through Potlatch TRS and also plays an active role in negotiations for all timberland acquisitions. Our Wood Products segment manufactures and markets lumber and plywood.

Our former Lewiston, Idaho wood products operations were included in the spin-off of the Clearwater Paper businesses. Our Prescott, Arkansas lumber mill was permanently shut down in May 2008. The Wood Products segment information for the periods presented in the table below has been adjusted to reflect the results of the Lewiston wood products operations and the Prescott lumber mill as discontinued operations.

The reporting segments follow the same accounting policies used for our consolidated financial statements, as described in the summary of significant accounting policies, with the exception of the valuation of inventories. All segment inventories are reported using the average cost method and the LIFO reserve is recorded at the corporate level. Management evaluates a segment's performance based upon profit or loss from

operations before income taxes. Intersegment revenues are recorded based on prevailing market prices.

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Following is a tabulation of business segment information for each of the past three years. Corporate information is included to reconcile segment data to the consolidated financial statements.

(Dollars in thousands)

|   | 2010              | 2009              | 2008              |
|---|-------------------|-------------------|-------------------|
| <b>Segment Revenues:</b>                                |                   |                   |                   |
| Resource  | \$ 225,834        | \$ 234,411        | \$ 265,307        |
| Real Estate   | 85,226            | 65,353            | 46,077            |
| Wood Products   | 273,887           | 216,592           | 263,132           |
|   | 584,947           | 516,356           | 574,516           |
| Elimination of intersegment revenues                    | (45,500)          | (40,187)          | (134,559)         |
| <b>Total consolidated revenues</b>                      | <b>\$ 539,447</b> | <b>\$ 476,169</b> | <b>\$ 439,957</b> |
| <b>Intersegment Revenues<sup>1</sup> :</b>              |                   |                   |                   |
| Resource  | \$ 45,500         | \$ 40,187         | \$ 119,443        |
| Wood Products   |                   |                   | 15,116            |
| <b>Total</b>  | <b>\$ 45,500</b>  | <b>\$ 40,187</b>  | <b>\$ 134,559</b> |
| <b>Operating Income (Loss):</b>                         |                   |                   |                   |
| Resource  | \$ 62,107         | \$ 81,774         | \$ 76,008         |
| Real Estate <sup>2</sup>                                | 30,425            | 48,928            | 31,490            |
| Wood Products   | 7,140             | (20,484)          | (13,675)          |
| Eliminations and adjustments                            | 1,900             | 7,863             | (1,017)           |
|   | 101,572           | 118,081           | 92,806            |
| <b>Corporate Items:</b>                                 |                   |                   |                   |
| Administration expense                                  | (28,921)          | (31,377)          | (24,910)          |
| Interest expense, net                                   | (27,780)          | (21,921)          | (20,154)          |
| <b>Earnings from continuing operations before taxes</b> | <b>\$ 44,871</b>  | <b>\$ 64,783</b>  | <b>\$ 47,742</b>  |
| <b>Depreciation, depletion and amortization:</b>        |                   |                   |                   |
| Resource  | \$ 20,481         | \$ 23,366         | \$ 19,067         |
| Wood Products   | 8,188             | 9,675             | 10,162            |
|   | 28,669            | 33,041            | 29,229            |
| Corporate   | 2,535             | 1,674             | 924               |
| <b>Total</b>  | <b>\$ 31,204</b>  | <b>\$ 34,715</b>  | <b>\$ 30,153</b>  |
| <b>Assets:</b>  |                   |                   |                   |
| Resource and Real Estate <sup>3</sup>                   | \$ 495,780        | \$ 604,617        | \$ 580,603        |
| Wood Products   | 98,987            | 126,301           | 149,740           |
|   | 594,767           | 730,918           | 730,343           |



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|                                       | <b>2010</b> | <b>2009</b> | <b>2008</b> |
|---------------------------------------|-------------|-------------|-------------|
| Corporate                             | 186,944     | 92,647      | 207,978     |
| Total consolidated assets             | \$ 781,711  | \$ 823,565  | \$ 938,321  |
| <b>Capital Expenditures:</b>          |             |             |             |
| Resource and Real Estate <sup>3</sup> | \$ 11,534   | \$ 12,431   | \$ 55,167   |
| Wood Products                         | 1,896       | 1,466       | 6,709       |
|                                       | 13,430      | 13,897      | 61,876      |
| Corporate                             | 1,571       | 1,800       | 2,203       |
| Total                                 | \$ 15,001   | \$ 15,697   | \$ 64,079   |

<sup>1</sup> Intersegment revenues for 2008-2010, which were based on prevailing market prices, consisted primarily of logs and other fiber sales by our Resource segment to the Wood Products segment.

<sup>2</sup> Operating income for the Real Estate segment includes basis of real estate sold of \$48.7 million, \$10.7 million and \$9.1 million in 2010, 2009 and 2008, respectively.

<sup>3</sup> Assets and capital expenditures are shown on a combined basis for the Resource and Real Estate segments, as we do not produce such internal information separately for those segments. Capital expenditures for the Resource and Real Estate segments include capitalized reforestation costs, additions to timber and timberlands, deposits on timberlands for reverse LKE transactions, and additions to equipment. Not included in additions to timber and timberlands for 2010, 2009 and 2008 are non-cash transactions totaling \$0, \$0.2 million and \$40.8 million, respectively, for the purchase of timberlands.



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All of our wood products facilities and all other assets are located within the continental United States. However, we also sell and ship products to Canada and Mexico. Geographic information regarding our revenues is summarized as follows:

(Dollars in thousands)

|                             | 2010       | 2009       | 2008       |
|-----------------------------|------------|------------|------------|
| United States               | \$ 532,862 | \$ 471,016 | \$ 433,232 |
| Canada                      | 5,959      | 4,802      | 6,725      |
| Mexico                      | 626        | 351        |            |
| Total consolidated revenues | \$ 539,447 | \$ 476,169 | \$ 439,957 |

**NOTE 17.**

## Asset Impairment Charge

During the fourth quarter of 2009, due to a change in estimated future cash flows, we concluded that our particleboard manufacturing assets were impaired, and recorded a pre-tax asset impairment charge of \$3.0 million. The fair value of the impaired assets was estimated based on expected discounted future cash flows. For the year ended December 31, 2009, the impairment loss is reflected in the operating loss of our Wood Products segment and included in costs and expenses in our Consolidated Statement of Operations. In March 2010, we sold our particleboard manufacturing facility's buildings and equipment. There were no asset impairment charges in 2010 or 2008.

**NOTE 18.**

## Discontinued Operations

We sold our OSB manufacturing facilities to Ainsworth Lumber Co. Ltd., or Ainsworth, in 2004. In 2006, Ainsworth filed a complaint against us, which we settled in 2009. Also in 2006, a series of private antitrust lawsuits were filed against us and certain other OSB manufacturers, which were settled in 2008. The settlements and all related legal expenses were accounted for as discontinued operations.

On December 16, 2008, we completed the spin-off of the Clearwater Paper businesses. The results of these operations, plus other corporate and administrative costs directly attributable to the Clearwater Paper businesses, including interest expense on the credit sensitive debentures, have been reclassified to discontinued operations.

We entered into fiber supply agreements to sell logs and residual chips to Clearwater Paper at market prices. The log supply agreement is for Clearwater Paper's Idaho operations and has an initial term of three years. The agreement for the residual chips is also for Clearwater Paper's Idaho operations and has an initial term of five years. The historical eliminated revenues and similar expenses prior to the spin-off, related to sales from Potlatch to the Clearwater Paper operations, were \$69.6 million in 2008.

In May 2008, our lumber mill in Prescott, Arkansas was permanently shut down due to poor market conditions. As a result of this closure, we recorded an after-tax charge of \$12.4 million during 2008. The Prescott mill was sold in November 2010.

Revenues from discontinued operations were \$0 in both 2010 and 2009, and \$1.2 billion in 2008. The sale of our Prescott mill resulted in a \$0.9 million pre-tax gain in 2010. The operating loss from discontinued operations totaled \$6.8 million in 2009, primarily related to OSB settlements. In the Consolidated Statements of Cash Flows, we have separately disclosed the operating, investing and financing portions of the cash flows attributable to our discontinued operations.

**Table of Contents****NOTE 19.**

## Financial Results by Quarter (Unaudited)

(Dollars in thousands except per-share amounts)

|   | THREE MONTHS ENDED |            |            |           |              |            |             |            |
|---|--------------------|------------|------------|-----------|--------------|------------|-------------|------------|
|   | MARCH 31           |            | JUNE 30    |           | SEPTEMBER 30 |            | DECEMBER 31 |            |
|   | 2010               | 2009       | 2010       | 2009      | 2010         | 2009       | 2010        | 2009       |
| Revenues  | \$ 105,418         | \$ 129,593 | \$ 128,978 | \$ 78,782 | \$ 158,877   | \$ 163,716 | \$ 146,174  | \$ 104,078 |
| Costs and expenses:   |                    |            |            |           |              |            |             |            |
| Cost of goods sold  | 85,494             | 84,071     | 97,295     | 67,569    | 122,205      | 104,333    | 118,359     | 82,377     |
| Selling, general and administrative expenses                  | 8,445              | 9,611      | 9,401      | 10,589    | 10,062       | 14,560     | 11,439      | 12,622     |
| Environmental remediation charge                              |                    |            |            |           |              | 39         | 4,096       | 700        |
| Asset impairment  |                    |            |            |           |              |            |             | 2,994      |
|   | 93,939             | 93,682     | 106,696    | 78,158    | 132,267      | 118,932    | 133,894     | 98,693     |
| Earnings from continuing operations                           | 1,384              | 28,771     | 11,828     | 3,692     | 18,164       | 46,022     | 8,899       | 2,946      |
| Discontinued operations                                       | (189)              | (3,951)    | (85)       | 74        | (84)         | (183)      | 477         | (43)       |
| Net earnings  | \$ 1,195           | \$ 24,820  | \$ 11,743  | \$ 3,766  | \$ 18,080    | \$ 45,839  | \$ 9,376    | \$ 2,903   |
| Earnings per common share from continuing operations          |                    |            |            |           |              |            |             |            |
| Basic   | \$ 0.03            | \$ 0.72    | \$ 0.29    | \$ 0.09   | \$ 0.45      | \$ 1.16    | \$ 0.22     | \$ 0.07    |
| Diluted   | 0.03               | 0.72       | 0.29       | 0.09      | 0.45         | 1.15       | 0.22        | 0.07       |
| Earnings (loss) per common share from discontinued operations |                    |            |            |           |              |            |             |            |
| Basic   | \$                 | \$ (0.10)  | \$         | \$        | \$           | \$ (0.01)  | \$ 0.01     | \$         |
| Diluted   |                    | (0.10)     |            |           |              |            | 0.01        |            |
| Net earnings per common share                                 |                    |            |            |           |              |            |             |            |
| Basic   | \$ 0.03            | \$ 0.62    | \$ 0.29    | \$ 0.09   | \$ 0.45      | \$ 1.15    | \$ 0.23     | \$ 0.07    |
| Diluted   | 0.03               | 0.62       | 0.29       | 0.09      | 0.45         | 1.15       | 0.23        | 0.07       |

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***REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM***

The Board of Directors and Stockholders

Potlatch Corporation:

We have audited the accompanying balance sheets of Potlatch Corporation and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, comprehensive income (loss), cash flows and stockholders' equity for each of the years in the three-year period ended December 31, 2010. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule listed in Item 15. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Potlatch Corporation and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Potlatch Corporation's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 23, 2011 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Seattle, Washington

February 23, 2011

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***REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM***

The Board of Directors and Stockholders

Potlatch Corporation:

We have audited Potlatch Corporation's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Potlatch Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Potlatch Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Potlatch Corporation and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, comprehensive income (loss), cash flows and stockholders' equity for each of the years in the three-year period ended December 31, 2010, and our report dated February 23, 2011 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Seattle, Washington

February 23, 2011

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ITEM 15.

Schedule II

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

**Valuation and Qualifying Accounts****FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008**

(Dollars in thousands)

| <b>DESCRIPTION</b>                    | <b>BALANCE AT<br/>BEGINNING<br/>OF YEAR</b> | <b>AMOUNTS<br/>CHARGED<br/>(CREDITED)<br/>TO COSTS<br/>AND<br/>EXPENSES</b> | <b>DEDUCTIONS<sup>1</sup></b> | <b>BALANCE<br/>AT END<br/>OF YEAR</b> |
|---------------------------------------|---|---|-------------------------------|---------------------------------------|
| Reserve deducted from related assets: |   |   |                               |                                       |
| Doubtful accounts                     |   |   |                               |                                       |
| Accounts receivable                   |   |   |                               |                                       |
| Year ended December 31, 2010          | \$ 1,670                                    | \$ 54   | \$ (1,264)                    | \$ 460                                |
| Year ended December 31, 2009          | \$ 1,669                                    | \$ 7  | \$ (6)                        | \$ 1,670                              |
| Year ended December 31, 2008          | \$ 1,205                                    | \$ 1,270  | \$ (806)                      | \$ 1,669                              |

<sup>1</sup> Accounts written off, net of recoveries. The 2008 amount includes \$765 related to the Clearwater Paper businesses that were spun off in December 2008 and are included in discontinued operations.

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

***Exhibit Index***

| <b>EXHIBIT NUMBER</b>    | <b>DESCRIPTION</b>   |
|--------------------------|--|
| (2)(d)*                  | Asset Purchase Agreement, dated September 11, 2007, between Potlatch Forest Holdings, Inc., a Delaware corporation and wholly owned subsidiary of Potlatch Corporation, a Delaware corporation (the Registrant), as Buyer, and Western Pacific Timber, LLC, as Seller, regarding property located in Adams, Boise, and Valley counties, State of Idaho, filed as Exhibit (2)(d) to the Quarterly Report on Form 10-Q filed by the Registrant on October 29, 2007. (The Registrant agrees to furnish supplementally to the Securities and Exchange Commission (the Commission) upon request a copy of any omitted schedule.)                                  |
| (2)(e)*                  | Asset Purchase Agreement, dated September 11, 2007, between Potlatch Forest Holdings, Inc., a Delaware corporation and wholly owned subsidiary of the Registrant, as Buyer, and Western Pacific Timber, LLC, as Seller, regarding property located in Adams, Boise, Idaho, and Valley counties, State of Idaho, and the city of Cascade, Idaho, filed as Exhibit (2)(e) to the Quarterly Report on Form 10-Q filed by the Registrant on October 29, 2007. (The Registrant agrees to furnish supplementally to the Commission upon request a copy of any omitted schedule.)   |
| (2)(f)*                  | Separation and Distribution Agreement, dated December 15, 2008, between the Registrant and Clearwater Paper Corporation, filed as Exhibit 2.1 to the Current Report on Form 8-K filed by the Registrant on December 18, 2008.  |
| (3)(a)*                  | Second Restated Certificate of Incorporation of the Registrant, effective February 3, 2006, filed as Exhibit 99.2 to the Current Report on Form 8-K filed by the Registrant on February 6, 2006.   |
| (3)(b)*                  | Bylaws of the Registrant, as amended through February 18, 2009, filed as Exhibit (3)(b) to the Current Report on Form 8-K filed by the Registrant on February 20, 2009.  |
| (4)                      | See Exhibits (3)(a) and (3)(b). The Registrant also undertakes to furnish to the Commission, upon request, any instrument defining the rights of holders of long-term debt.  |
| (4)(a)*                  | Indenture, dated as of November 3, 2009, between the Registrant and U.S. Bank National Association, as trustee, filed as Exhibit 4.1 to the Current Report on Form 8-K filed by the Registrant on November 9, 2009.  |
| (4)(a)(i)*               | Form of 7 1/2% Senior Notes due 2019 (included as Exhibit A to the Indenture filed as Exhibit 4(a)).   |
| (4)(a)(ii)*              | Registration Rights Agreement, dated as of November 3, 2009, between the Registrant and the parties named therein, filed as Exhibit 4.1 to the Current Report on Form 8-K filed by the Registrant on November 9, 2009.   |
| (10)(a) <sup>1*</sup>    | Potlatch Corporation Management Performance Award Plan, as amended effective December 2, 2004, filed as Exhibit (10)(a) to the Annual Report on Form 10-K filed by Potlatch Corporation, a Delaware corporation and the Registrant's former parent corporation (Original Potlatch) (on February 3, 2006, Original Potlatch merged with and into Potlatch Operating Company, a Delaware corporation and a wholly owned subsidiary of the Registrant, the Registrant then changed its name to Potlatch Corporation and became the new, publicly traded parent corporation) for the fiscal year ended December 31, 2004 (2004 Form 10-K) (SEC File No. 1-5313). |
| (10)(a)(i) <sup>1*</sup> | Amendment to Potlatch Corporation Management Performance Award Plan, filed as Exhibit 10.6 to the Current Report on Form 8-K filed by the Registrant on December 11, 2008.   |
| (10)(b) <sup>1*</sup>    | Potlatch Corporation Severance Program for Executive Employees, filed as Exhibit 10.3 to the Current Report on Form 8-K filed by the Registrant on December 11, 2008.  |
| (10)(c) <sup>1*</sup>    | Potlatch Corporation 2000 Stock Incentive Plan, adopted December 2, 1999, as amended effective December 29, 2005, filed as Exhibit (10)(c) to the Current Report on Form 8-K filed by Original Potlatch on January 5, 2006, and as amended September 16, 2006, filed as Exhibit (10)(c) to the Current Report on Form 8-K filed by the Registrant on September 21, 2006.   |

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(10)(c)(ii)<sup>1\*</sup>

Form of employee Stock Option agreement for the Potlatch Corporation 2000 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 2000, 2001, 2002, 2003 and 2004, filed as Exhibit (10)(c)(i) to the Annual Report on Form 10-K filed by Original Potlatch for the fiscal year ended December 31, 2001 ( 2001 Form 10-K ) (SEC File No. 1-5313).

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|                            |   |
|----------------------------|---|
| (10)(c)(iii) <sup>1*</sup> | Form of outside director Stock Option agreement for the Potlatch Corporation 2000 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 2000, 2001, 2002 and 2003, filed as Exhibit (10)(c)(ii) to the 2001 Form 10-K (SEC File No. 1-5313).  |
| (10)(d) <sup>1*</sup>      | Potlatch Corporation Salaried Employees Supplemental Benefit Plan, as amended and restated effective January 1, 1989, and as amended through May 24, 2005, filed as Exhibit (10)(d) to the Quarterly Report on Form 10-Q filed by Original Potlatch for the quarter ended June 30, 2005.  |
| (10)(d)(i) <sup>1*</sup>   | Amendment, effective as of January 1, 1998, to Plan described in Exhibit (10)(d), filed as Exhibit (10)(d)(i) to the Annual Report on Form 10-K filed by Original Potlatch for the fiscal year ended December 31, 2003 (SEC File No. 1-5313).   |
| (10)(d)(ii) <sup>1*</sup>  | Amendment, effective as of December 5, 2008, to Plan described in Exhibit (10)(d), filed as Exhibit 10.5 to the Current Report on Form 8-K filed by the Registrant on December 11, 2008.  |
| (10)(g) <sup>1*</sup>      | Potlatch Corporation Deferred Compensation Plan for Directors, as amended through May 24, 2005, filed as Exhibit (10)(g) to the Quarterly Report on Form 10-Q filed by Original Potlatch for the quarter ended June 30, 2005.   |
| (10)(h) <sup>1*</sup>      | Potlatch Corporation Benefits Protection Trust Agreement, filed as Exhibit (10)(h) to the Annual Report on Form 10-K filed by the Registrant for the year ended December 31, 2008 (the 2008 Form 10-K ).  |
| (10)(i)(i) <sup>1*</sup>   | Compensation of Outside Directors, effective as of January 1, 2008, filed as Exhibit (10)(i)(i) to the 2008 Form 10-K.  |
| (10)(j) <sup>1*</sup>      | Form of Indemnification Agreement with each director of the Registrant and with each executive officer of the Registrant, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on September 23, 2009.  |
| (10)(n) <sup>1*</sup>      | Potlatch Corporation 1995 Stock Incentive Plan, adopted December 7, 1995, as amended effective December 29, 2005, filed as Exhibit (10)(n) to the Current Report on Form 8-K filed by Original Potlatch on January 5, 2006.   |
| (10)(n)(vi) <sup>1*</sup>  | Form of employee Stock Option Agreement for the Potlatch Corporation 1995 Stock Incentive Plan together with the Addendum thereto as used for options granted in December 2002, filed as Exhibit (10)(n)(vi) to the 2004 Form 10-K (SEC File No. 1-5313).   |
| (10)(o) <sup>*</sup>       | Credit Agreement, dated as of December 8, 2008, among the Registrant and its wholly owned subsidiaries, as borrowers, Bank of America, N.A., as administrative agent, swing line lender, L/C issuer and collateral agent, the Guarantors from time to time party thereto and the Lenders from time to time party thereto, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on December 10, 2008.                                   |
| (10)(o)(i) <sup>*</sup>    | First Amendment to Credit Agreement, dated November 19, 2009, by and among the Registrant, Potlatch Forest Holdings, Inc., Potlatch Land & Lumber, LLC, certain wholly-owned subsidiaries of the Registrant as Guarantors, the Lenders from time to time party thereto and Bank of America, N.A., as administrative agent for the Lenders, filed as Exhibit 10.1 to the Current Report of Form 8-K filed by the Registrant on November 24, 2009.                  |
| (10)(o)(ii) <sup>*</sup>   | Consent, dated June 23, 2009, to the Credit Agreement, dated December 8, 2008, by and among the Registrant and its wholly owned subsidiaries, as borrowers, Bank of America, N.A., as administrative agent, swing line lender, L/C issuer and collateral agent, the Guarantors from time to time party thereto and the Lenders from time to time party thereto, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on June 24, 2009. |
| (10)(o)(iii) <sup>*</sup>  | Second Amendment to Credit Agreement, dated February 4, 2011, by and among the Registrant, Potlatch Forest Holdings, Inc, Potlatch Land & Lumber, LLC, certain wholly owned subsidiaries of the Registrant as Guarantors, the Lenders from time to time party thereto and Bank of America, N. A. as administrative agent for the Lenders filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on February 8, 2011.                     |
| (10)(q)(iv) <sup>1*</sup>  | Amendment, dated October 21, 2008, to Employment Agreement effective February 6, 2006, between the Registrant and Michael J. Covey, filed as Exhibit (10)(q)(iv) to the 2008 Form 10-K.   |
| (10)(r) <sup>1*</sup>      | Potlatch Corporation 2005 Stock Incentive Plan, as amended and restated May 19, 2006, filed as Exhibit (10)(r) to the Quarterly Report on Form 10-Q filed by the Registrant for the quarter ended June 30, 2006, and as further amended and restated effective September 16, 2006, filed as Exhibit (10)(e) to the Current Report on Form 8-K   |



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filed by the Registrant on September 21, 2006.

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| (10)(r)(i) <sup>1*</sup>  | Form of Restricted Stock Unit Agreement (2005 Stock Incentive Plan), as amended and restated May 19, 2006, to be used for restricted stock unit awards to be granted subsequent to May 19, 2006, filed as Exhibit (10)(r)(i) to the Quarterly Report on Form 10-Q filed by the Registrant for the quarter ended June 30, 2006.  |
| (10)(r)(ii) <sup>1*</sup> | Form of Performance Share Agreement (2005 Stock Incentive Plan), as amended and restated May 19, 2006, to be used for performance share awards to be granted subsequent to May 19, 2006, filed as Exhibit (10)(r)(ii) to the Quarterly Report on Form 10-Q filed by the Registrant for the quarter ended June 30, 2006, and as further amended on January 17, 2007, filed as Exhibit (10)(r)(ii) to the Current Report on Form 8-K filed by the Registrant on January 19, 2007.   |
| (10)(r)(iv) <sup>1*</sup> | Potlatch Corporation Management Performance Award Plan II, as amended through February 20, 2008, filed as Exhibit (10)(r)(iv) to the Current Report on Form 8-K filed by the Registrant on February 26, 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>     | Potlatch Corporation Deferred Compensation Plan for Directors II, filed as Exhibit (10)(s) to the 2008 Form 10-K.   |
| (10)(t) <sup>1*</sup>     | Potlatch Corporation Salaried Supplemental Benefit Plan II, filed as Exhibit 10.4 to the Current Report on Form 8-K filed by the Registrant on December 11, 2008.   |
| (10)(w) <sup>1*</sup>     | Potlatch Corporation Annual Incentive Plan, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on December 11, 2008.   |
| (10)(x) <sup>1*</sup>     | Potlatch Corporation Management Deferred Compensation Plan, effective June 1, 2008, amended and restated as of May 1, 2009, filed as Exhibit 10.(x) on Form 10-K filed by the Registrant on February 18, 2010.  |
| (10)(aa)*                 | Employee Matters Agreement, dated December 15, 2008, between the Registrant and Clearwater Paper Corporation, filed as Exhibit 10.3 to the Current Report on Form 8-K filed by the Registrant on December 18, 2008.   |
| (10)(bb)*                 | Tax Sharing Agreement, dated December 15, 2008, among the Registrant, Potlatch Forest Holdings, Inc., a Delaware corporation and wholly owned subsidiary of the Registrant, Potlatch Land & Lumber, LLC, a Delaware limited liability company and wholly owned subsidiary of the Registrant, and Clearwater Paper Corporation, filed as Exhibit 10.4 to the Current Report on Form 8-K filed by the Registrant on December 18, 2008.  |
| (12)**                    | Computation of Ratio of Earnings to Fixed Charges.  |
| (21)**                    | Potlatch Corporation Subsidiaries.  |
| (23)**                    | Consent of Independent Registered Public Accounting Firm.   |
| (24)**                    | Powers of Attorney.   |
| (31)                      | Rule 13a-14(a)/15d-14(a) Certifications.  |
| (32)                      | Furnished statements of the Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350.   |
| 101**                     | The following financial information from Potlatch Corporation's Annual Report on Form 10-K for the year ended December 31, 2010, filed on February 23, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008, (ii) the Consolidated Statements of Comprehensive Income (Loss) for the years ended December 31, 2010, 2009 and 2008, (iii) the Consolidated Balance Sheets at December 31, 2010 and 2009, (iv) the Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008, (v) the Consolidated Statements of Stockholders' Equity for the years ended December 31, 2010, 2009 and 2008, (vi) the Notes to Consolidated Financial Statements, tagged as blocks of text, and (vii) Schedule II Valuation and Qualifying Accounts, tagged as a block of text. |

\* Incorporated by reference.

\*\* Filed as Exhibit to Potlatch Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

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

