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

Form 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2011
Or
¨ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File Number 1-32729

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

Delaware	82-0156045
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
601 West First Avenue, Suite 1600	
Spokane, Washington	99201
(Address of principal executive offices)	(Zip Code)

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

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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
The number of shares of common stock of the registrant outstanding as of October 20, 2011 was 40,187,407.

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Part I

ITEM 1.
Financial Statements

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

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

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

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

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

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

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

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

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

Certain 2010 amounts have been reclassified to conform to the 2011 presentation.
The accompanying notes are an integral part of these consolidated financial statements.

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

NOTE 1.
Basis of Presentation
For purposes of this report, any reference to “Potlatch,” “the company,” “we,” “us,” and “our” means Potlatch Corporation and all of its wholly owned subsidiaries, except where the context indicates otherwise.
The accompanying Consolidated Condensed Statements of Operations and Comprehensive Income for the quarters and nine months ended September 30, 2011 and 2010, the Consolidated Condensed Balance Sheets at September 30, 2011 and December 31, 2010, and the Consolidated Condensed Statements of Cash Flows for the nine months ended September 30, 2011 and 2010 have been prepared in conformity with accounting principles generally accepted in the United States of America. We believe that all adjustments necessary for a fair statement of the results of such interim periods have been included.
In September 2011, we recorded a pre-tax asset impairment charge of $1.2 million to reflect the markdown to fair value of a building that was listed for sale. In the third quarter of 2011, we recorded an adjustment to the cost basis of land sales that occurred in the first and second quarters of 2011 resulting in an increase in third quarter earnings from continuing operations and net earnings of $3.2 million pre-tax and $2.4 million after-tax, respectively. The adjustment had no effect on revenues or cash flows. In March 2010, we sold our Idaho particleboard manufacturing facility’s buildings and equipment. As a result of the sale, we recorded pre-tax charges totaling $0.4 million, primarily related to severance benefits. All other adjustments were of a normal recurring nature.
This Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2010, as filed with the Securities and Exchange Commission on February 23, 2011.

NOTE 2.
Recent Accounting Pronouncements
We did not adopt any new accounting standards during the nine months ended September 30, 2011. We reviewed all new accounting standards issued in the period and concluded that they did not have a material effect on our business.

NOTE 3.
Income Taxes
As a real estate investment trust, or REIT, if we meet certain requirements, we generally are not subject to federal and state corporate income taxes on our income from investments in real estate that we distribute to our shareholders. We are, however, subject to corporate taxes on built-in gains (the excess of fair market value at January 1, 2006 over tax basis on that date) with respect to the REIT's sale of any real property owned at such date within the first ten years following our conversion to a REIT, except for sales occurring in 2011. The Small Business Jobs Act of 2010 modifies the built-in gains provisions to exempt sales of real properties by a REIT in 2011, if five years of the recognition period has elapsed before January 1, 2011. If applicable, the built-in gains tax is eliminated or deferred if sale proceeds are reinvested in like-kind property in accordance with the like-kind exchange provisions of the Internal Revenue Code. The built-in gains tax is not applicable to the sale of timber pursuant to a stumpage sale agreement or timber deed.
For the quarters ended September 30, 2011 and 2010, we recorded income tax provisions related to our taxable REIT subsidiary, or Potlatch TRS, of $3.2 million and $1.6 million, respectively, due to pre-tax income. For the nine months ended September 30, 2011 and 2010, we recorded income tax provisions related to Potlatch TRS of $7.5 million and $5.1 million, respectively, due to pre-tax income.

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

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

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

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

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

NOTE 4.
Earnings per Common Share
The following table reconciles the number of common shares used in calculating the basic and diluted earnings per share from continuing operations for the quarters and nine months ended September 30:

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

NOTE 5.
Equity-Based Compensation
As of September 30, 2011, we had three stock incentive plans under which stock option, performance share or restricted stock unit, or RSU, grants were outstanding, with approximately 451,000 shares authorized for future use

under the 2005 Stock Incentive Plan.

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

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

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

STOCK OPTIONS

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

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

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

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

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

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

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PERFORMANCE SHARES

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

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

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

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

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

RESTRICTED STOCK UNITS

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

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

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

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

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NOTE 6.
Detail of Certain Balance Sheet Accounts
The following tables detail certain accounts as of the balance sheet dates:

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

NOTE 7.
Pension Plans and Other Postretirement Employee Benefits
The following table details the components of net periodic cost (benefit) of our pension plans and other postretirement employee benefits, or OPEB, for the quarters and nine months ended September 30:

Quarters ended September 30:

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

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Nine months ended September 30:

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

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

NOTE 8.
Comprehensive Income
The following table details the components of comprehensive income for the quarters and nine months ended September 30:

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

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NOTE 9.
Financial Instruments
The following table presents the estimated fair values of our financial instruments as of the balance sheet dates:

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

FAIR VALUE HEDGES OF INTEREST RATE RISK
As of September 30, 2011, we had eight separate interest rate swap agreements with notional amounts totaling $63.25 million, associated with our $22.5 million debentures and $40.75 million of our medium-term notes. The swaps convert interest payments with fixed rates between 6.95% and 8.89% to variable rates of three-month LIBOR plus spreads between 4.738% and 7.805%. The interest rate swaps terminate at various dates between January 2012 and February 2018.
As of September 30, 2011, we had a derivative asset within non-current other assets of $2.4 million, resulting in a cumulative net increase to the carrying amount of our debt of $2.4 million recorded on our Consolidated Condensed Balance Sheets.
For the quarter ended September 30, 2011 and 2010, we recognized a total of $1.9 million and $1.7 million, respectively, of net gains recorded in interest expense due to changes in fair value of the derivatives, which was offset by a cumulative net decrease to the carrying amount of debt of $1.9 million and $1.7 million, respectively. For the nine months ended September 30, 2011 and 2010 we recognized a total of $2.6 million and $1.5 million, respectively, of net gains recorded in interest expense due to changes in fair value of the derivatives, which was offset by a cumulative net decrease to the carrying amount of debt of $2.6 million and $1.5 million, respectively. Consequently, no net unrealized gain or loss was recognized in income for the quarter or nine months ended September 30, 2011. For the quarter ended September 30, 2011 and 2010, we recognized a net gain, resulting in a reduction in interest expense, of $0.3 million and $0.2 million, respectively, which includes realized net gains and losses from net cash settlements and interest accruals on the derivatives. For the nine months ended September 30, 2011 and 2010, we recognized a net gain, resulting in a reduction in interest expense, of $0.8 million and $0.2 million, respectively, which includes realized net gains and losses from net cash settlements and interest accruals on the derivatives. We recognized no hedge ineffectiveness during the quarter or nine months ended September 30, 2011 and 2010.
NON-DESIGNATED LUMBER HEDGE
In September 2011, we entered into a commodity swap contract for 31,200 mbf of southern yellow pine with an effective date of November 1, 2011 and a termination date of February 29, 2012. Under the contract, 7,800 mbf cash settles each month. On October 13, 2010, we entered into a commodity swap contract for 33,000 mbf (thousand board feet) of eastern spruce/pine with an effective date of April 1, 2011 and a termination date of September 30, 2011. Under the contract, 5,500 mbf cash settled each month. During the quarter ended September 30, 2011, the three monthly cash settlements resulted in a cash receipt of $0.3 million. Realized gains of $0.3 million and $0.6 million were recognized in the quarter and nine months ended September 30, 2011, respectively, as a reduction of cost of goods sold. In February 2011, the remaining 7,150 mbf of southern yellow pine from our commodity swap contract entered into on October 18, 2010 cash settled, resulting in a cash payment of $0.2 million. Changes in the fair value of

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

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

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

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

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

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

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NOTE 10.

Commitments and Contingencies

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

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NOTE 11.
Segment Information
The following table summarizes information by business segment for the quarters and nine months ended September 30:

(Dollars in thousands)	Quarter Ended September 30, 2011	2010	Nine Months Ended September 30, 2011	2010
Segment Revenues				
Resource	$86,770	$77,448	$172,587	$172,716
Real Estate	14,809	32,254	46,808	46,157
Wood Products	69,239	64,897	204,343	209,832
	170,818	174,599	423,738	428,705
Elimination of intersegment revenues - Resource	(17,927)	(15,722)	(36,244)	(35,432)
Total consolidated revenues	$152,891	$158,877	$387,494	$393,273
Operating Income				
Resource	$25,598	$24,336	$47,208	$49,283
Real Estate	9,929	9,788	29,295	16,803
Wood Products	2,896	(608)	8,548	10,576
Eliminations and adjustments	1,634	(895)	4,160	1,678
	40,057	32,621	89,211	