

POTLATCH CORP
Form 10-K
March 02, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-K

(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, 2008
OR
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the transition period from _____ to _____.
Commission File Number 1-32729

POTLATCH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 82-0156045
(State or other jurisdiction of incorporation or organization) (IRS Employer Identification No.)
601 West 1st Ave., Suite 1600
Spokane, Washington 99201
(Address of principal executive offices) (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	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock (\$1 par value)	New York Stock Exchange 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

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark 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 voting stock held by non-affiliates of the registrant at June 30, 2008, was approximately \$1,730.0 million, based on the closing price of \$45.12, as reported on the New York Stock Exchange Composite Transactions.

The number of shares of common stock outstanding as of January 30, 2009: 39,740,898 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 2, 2009, with the Commission in connection with the 2009 annual meeting of stockholders are incorporated by reference in Part III hereof.

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

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Part I

ITEM 1.

Business

GENERAL

Potlatch Corporation is a real estate investment trust, or REIT, with approximately 1.6 million acres of timberlands in Arkansas, Idaho, Minnesota and Wisconsin. Through a wholly owned taxable subsidiary, which we refer to in this report as Potlatch TRS, we also operate a real estate sales and development business and six manufacturing facilities that produce lumber, plywood and particleboard.

Effective January 1, 2006, we restructured our operations to qualify for treatment as a REIT for federal income tax purposes. This restructuring primarily involved the creation of a new parent company that holds our timberlands, manufacturing facilities and other non-timberland assets through separate subsidiaries. Although the new parent company, Potlatch Corporation, was incorporated in September 2005, it is the successor to the business of Potlatch as originally structured, which was founded in 1903. For purposes of this report, any references to the company, us, we, and our include, where the context requires, both Potlatch Corporation and its predecessor as it existed prior to the restructuring, together with their respective subsidiaries.

On December 16, 2008, we distributed to our stockholders of record on December 9, 2008, the common stock of our subsidiary, Clearwater Paper Corporation, or Clearwater Paper, which holds our former pulp-based manufacturing businesses, consisting of our former pulp and paperboard and consumer products segments, as well as our wood products operations located in Lewiston, Idaho. In connection with this distribution, which we refer to in this report as the spin-off, each of our stockholders received one share of Clearwater Paper common stock for every 3.5 shares of our common stock that they held on the record date. Our results of operations, as presented in this Annual Report on Form 10-K, have been reclassified for all periods presented to report the businesses owned by Clearwater Paper as discontinued operations.

Following the spin-off of the pulp-based businesses, our businesses are organized into three reportable operating segments, as defined by Financial Accounting Standards Board, or FASB, Statement of Financial Accounting Standards, or SFAS, No. 131, Disclosures About Segments of an Enterprise and Related Information: Resource; Real Estate; and Wood Products. Our Resource segment manages our timberlands. Management activities include planting trees, harvesting trees, building and maintaining roads, development of management plans and recreation lease management. The activities of our Real Estate segment consist primarily of the sale of selected non-core real estate. The segment also negotiates timberland acquisitions and engages in real estate development activities through Potlatch TRS. Our Wood Products segment manufactures and markets lumber, plywood and particleboard.

We are focused on enhancing our position as a REIT and using our forestland investments to generate our income. Our primary objective is to maximize the long-term value of our assets by pursuing the following strategies:

Focusing on timberland ownership. We invest primarily in timberlands. We believe that timberland is a unique and attractive asset, due to the renewable nature of timber resources and timber's long-term history of price appreciation in excess of inflation. We also believe that timber prices generally have been less volatile than wood products prices.

Pursuing attractive acquisitions and dispositions. We actively pursue timberland acquisitions and dispositions that meet various financial and strategic criteria. The critical elements of our acquisition strategy include properties that complement our existing land base, are immediately cash flow accretive and have attractive timber values. Our disposition strategy focuses on opportunities to sell timberland where we believe pricing to be particularly

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attractive, to match a sale with a purchase of more desirable property in order to utilize like-kind exchange, or LKE, tax-deferred transactions, or to meet various financial and strategic objectives.

Managing our timberlands to improve their long-term sustainable yield. We manage our timberlands in a manner designed to optimize the balance among timber growth, prudent environmental management and current cash flow, in order to achieve increasing levels of sustainable yield and thereby maximize sustainable yield over the long term. We may choose to harvest timber from time to time at levels above or below our then-current estimate of sustainability for various reasons, including to improve the long-term productivity of certain timber stands.

Practicing sound environmental stewardship. We pursue a program of environmental stewardship and active involvement in federal, state and local policymaking to maximize our assets' long-term value. We manage our lands in a manner consistent with the principles set forth by the Forest Stewardship Council, or FSC, and the International Standardization Organization, or ISO, programs which prescribe minimum levels of reforestation and other best management practices, with the goal that 100% of our core lands will attain these certifications.

We derive most of our income from investments in real estate, including the sale of standing timber. As a REIT, we generally are not subject to federal corporate income taxes on our income and gain from investments in real estate that we distribute to our stockholders, including the income derived from the sale of timber, thereby reducing our corporate-level taxes and substantially eliminating the double taxation on income and gains that usually results in the case of a dividend distribution by a C corporation. 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) on sales of real property (other than timber) held by the REIT during the first ten years following the REIT conversion. We also continue to be required to pay federal corporate income taxes on earnings from our non-real estate investments, which, following the spin-off, principally consist of our wood products manufacturing and real estate and log sales operations, which are held by Potlatch TRS.

Discussion of each of our operating segments is included on pages 4-8. Information relating to the amounts of revenues, operating income (loss) and identifiable assets attributable to each of our operating segments for 2006-2008 is included in Note 15 to the consolidated financial statements of this report.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This report contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including without limitation, statements regarding future revenues, cash flows, the nature of our REIT income, dividend distributions, compliance with REIT tax rules, costs, manufacturing output, capital expenditures, timber harvest levels, the funding of our pension plans, tax refunds, Forest Stewardship Council certification of our timberlands, future land sales and acquisitions, like-kind exchanges and tax consequences, and other timber supply issues. Words such as anticipate, expect, will, intend, plan, target, project, believe, seek, schedule, estimate, could, can, may, intended to identify such forward-looking statements. These forward-looking statements reflect management's current views regarding future events based on estimates and assumptions, and are therefore subject to known and unknown risks and uncertainties and are not guarantees of future performance. Our actual results of operations could differ materially from those expressed or implied by forward-looking statements contained in this report. Important factors that could cause or contribute to such differences include those factors discussed in Item 1A of this report, as well as the following:

changes in timber harvest levels on our lands

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changes in timber prices

changes in timberland values

changes in policy regarding governmental timber sales

changes in the United States and international economies

changes in the level of commercial and residential construction and remodeling activity

changes in tariffs, quotas and trade agreements involving wood products

changes in demand for our products

changes in production and production capacity in the forest products industry

competitive pricing pressures for our products

unanticipated manufacturing disruptions

changes in general and industry-specific environmental laws and regulations

unforeseen environmental liabilities or expenditures

weather conditions

changes in raw material and other costs

collectability of amounts owed by customers

the ability to satisfy complex rules in order to remain qualified as a REIT

changes in tax laws that could reduce the benefits associated with REIT status.

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

RESOURCE SEGMENT

Industry Background

The demand for timber depends primarily upon the markets for wood products, including lumber, panel products, paper and other pulp-based products. The end uses for timber vary widely, depending on species, size and quality. Historically, timber demand has experienced cyclical fluctuations, although sometimes at different times and rates within the markets for sawlogs and pulpwood. The demand for sawlogs, lumber and other manufactured wood products is significantly dependent upon the level of new residential construction and remodeling activity, which, in turn, is affected by general economic and demographic factors, including population growth, interest rates for home mortgages and construction loans and credit availability. Reductions in residential construction and remodeling activities are generally followed by declining lumber prices, which are usually followed by declining log prices within a fairly short period of time. Locally, timber demand also fluctuates due to the expansion or closure of individual wood products manufacturing facilities. The demand for pulpwood is dependent on paper and pulp-based manufacturing industries, which are affected by domestic and international economic conditions, global population growth and other demographic factors, industry capacity and the value of the U.S. dollar in relation to foreign currencies.

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Over the past two decades, timber supplies have tightened relative to demand. Particularly in the western United States, the supply of timber has been significantly affected by reductions in timber sales by the United States government and by state governments. These reductions have been caused primarily by increasingly stringent environmental and endangered species laws and by a change in the emphasis of domestic governmental policy toward habitat preservation, conservation and recreation, and away from timber management. Because most timberlands in the southeastern United States are privately owned, changes in sales of publicly owned timber affect local timber supplies and prices in the Southeast less immediately than in the western United States and other regions with large proportions of public timber ownership. Timber supplies can fluctuate depending upon factors such as changes in weather conditions and harvest strategies of local forest products industry participants, as well as occasionally high timber salvage efforts due to storm damage, unusual pest infestations or fires. Local timber supplies also change in response to prevailing timber prices. Rising timber prices often lead to increased harvesting on private timberlands, including lands not previously made available for commercial timber operations.

Our Operations

Our Resource segment manages approximately 1.6 million acres of timberlands we own in two regions of the United States: the Northern region, consisting of our Idaho, Minnesota and Wisconsin timberlands; and the Southern region, consisting of our Arkansas timberlands.

Our timberlands include a wide diversity of softwood and hardwood species. We own approximately 838,000 acres of timberlands in the northern and central portions of the state of Idaho. Primary species on these lands include grand fir, Douglas fir, inland red cedar, ponderosa pine, western larch, Engelmann spruce and western white pine. We are the largest private landowner in Idaho. We own approximately 264,000 acres of timberlands in Minnesota, comprised primarily of aspen, pine and other mixed hardwoods. Our Wisconsin timberlands consist of approximately 72,000 acres of pine and hardwoods. In Arkansas we own approximately 439,000 acres of timberlands. Primary species on these lands include southern yellow pine, red oak, white oak and other hardwoods.

The primary business of the Resource segment is the management of our timberlands to optimize our revenue producing opportunities while at the same time adhering to our strict stewardship standards. Management activities include planting trees, harvesting trees, building and maintaining roads, development of management plans and recreation lease management.

Our strategic focus involves increasing harvest levels in ways that ensure long-term sustainability while maintaining high stewardship standards, increasing timber harvest levels in times of strong market demand and decreasing harvest levels in times of weak demand, and seeking accretive acquisitions that complement our existing timberland base. We also seek to increase our income from non-timber resources such as hunting leases, recreation permits, real estate related leasing activity and mineral leases.

Timber is a renewable resource, and our objective is to maximize cash flow over the long term by managing our timberlands on a sustainable yield basis, reflecting a balance between timber growth and harvesting. From time to time, however, we may choose, consistent with our environmental commitments, to harvest timber at levels above or below our estimate of sustainability for various reasons. To maximize our timberlands long-term value, we manage them intensively, based upon timber species and local growing conditions, and have created harvest plans that take into account changing market conditions, are designed to contribute to the growth of the remaining timber, and reflect our policy of environmental stewardship. We reforest our acreage in a timely fashion to enhance its long-term value. Several silvicultural techniques are employed to improve timber growth rates, including vegetation control, fertilization and thinning. In deciding whether to implement any silvicultural practice, we analyze the associated costs and long-term benefits, with the goal of achieving an attractive return over time.

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Our short-term and long-term harvest plans are critical factors in our long-term management process. Each year, we prepare a harvest plan designating the timber tracts and volumes to be harvested during that particular year. We also update our long-term harvest plan every year. Each harvest plan reflects our analysis of the age, size and species distribution of our timber, as well as our expectations about harvest methods, growth rates, the volume of each species to be harvested, anticipated acquisitions and dispositions, thinning operations, regulatory constraints and other relevant information. Among other things, the optimal harvest cycles, or rotations, for timber vary by location and species and tend to change over time as a result of biological advances, changes in the markets for different sizes and ages of timber and other factors. Since harvest plans are based on projections of weather, timber growth rates, regulatory constraints and other assumptions, many of which are beyond our control, there can be no assurance that we will be able to harvest the volumes projected or the specific timber stands designated in our harvest plans.

The following table presents our total 2008 fee timber harvest by region:

(In thousands)

	FEE TIMBER HARVESTED (TONS)		
	SAWLOGS	PULPWOOD	TOTAL
Northern region	2,081	597	2,678
Southern region	969	730	1,699
Total	3,050	1,327	4,377

In 2008, the overall harvest from our timberlands was 4.4 million tons, compared to 3.9 million tons harvested in 2007. Based on our current projections that take into consideration such factors as market conditions, the ages of our timber stands and recent timberland acquisitions and sales, we expect the overall timber harvest from our lands in 2009 to be between 4.2 million and 4.4 million tons, increasing to a range of 5.0 million to 5.3 million tons annually over the next few years, depending upon market conditions.

The volume and value of timber that can be harvested from our lands may be affected by natural disasters such as fire, insect infestation, disease, ice storms, hurricanes, wind storms, floods and other weather conditions and causes. We assume substantially all risk of loss to the standing timber we own from fire and other hazards, as do most owners of timber tracts in the United States, because insuring for such losses is not practicable.

The Resource segment sells a portion of its logs at market prices to our wood products manufacturing facilities. Intra-company sales to our wood products manufacturing facilities included in continuing operations were approximately 25% of our Northern region revenues and 22% of our Southern region revenues in 2008. In addition, in connection with the spin-off, we entered into a log supply agreement with Clearwater Paper under which we agreed to supply specified quantities of logs harvested from our Northern Idaho timberlands to Clearwater Paper's Lewiston, Idaho wood products facility. The agreement has an initial term of three years and pricing is determined based on fair market value in the local market. During 2008, we supplied \$44.2 million of sawlogs and \$10.3 million of pulpwood to Clearwater Paper businesses, the substantial majority of which was eliminated as intercompany sales prior to the spin-off. The segment also sells sawlogs and pulpwood to a variety of forest products companies located near our timberlands using marketing methodologies that are designed to maximize the value of the products being sold. The segment's customers range in size from small operators to multinational corporations. The segment competes with owners of timberlands that operate in areas near our timberlands, ranging from private owners of small tracts of land to some of the largest timberland companies in the United States. The segment competes principally on the basis of distance to market, price, log quality and customer service.

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The amount of timber harvested from company-owned lands is guided by our commitment to sustainable forest management. By continually improving silvicultural techniques, we have been able to increase the sustainable level of wood fiber produced per acre from our timberlands. We manage harvest levels on our timberlands in a manner that assures long-term sustainability. Our timberlands in Idaho, Arkansas, Minnesota and Wisconsin were audited in late 2008 by independent third parties for compliance with the Forest Stewardship Council, or FSC, program and the International Standardization Organization, or ISO, 14001 standard for environmental management systems. We were certified to be in compliance with the ISO 14001 standard on all of our timberlands. We have not yet received our audit reports from the FSC, but anticipate continued certification under the FSC program for our timberlands and initial certification under the FSC program for our Idaho lands acquired in late 2007 and early 2008. As a participant in these programs, we adhere to the collective principles of both of them. These principles include commitments to sustainable forestry, responsible practices, forest health and productivity, and protection of special sites.

These certifications aid us in marketing our logs and wood products to customers who require that products they purchase for resale come from sustainably managed forests. In 2008 and 2007, our sales of FSC certified products increased significantly over the previous year. Most of these sales were at prices higher than average market prices for these products.

Our operations are subject to numerous federal, state and local laws and regulations, including those relating to the environment, endangered species, our forestry activities, and health and safety. Due to the significance of regulation to our business, we integrate wildlife, habitat and watershed management into our resource management practices. We also take an active approach to regulatory developments by participating in standard-setting where possible. We work cooperatively with regulators to create voluntary conservation plans that address environmental concerns while preserving our ability to operate our timberlands efficiently. Despite our active participation in governmental policymaking and regulatory standard-setting, there can be no assurance that endangered species, environmental and other laws will not restrict our operations or impose significant costs, damages, penalties and liabilities on us. In particular, we anticipate that endangered species and environmental laws will generally become increasingly stringent.

REAL ESTATE SEGMENT

The activities of our Real Estate segment consist primarily of the sale of selected non-core timberland real estate, which falls into three categories. Higher and better use, or HBU, and development properties have characteristics that provide development potential, often with some type of superior location or other attractive amenities. These properties tend to have a much higher value than timberlands. Rural recreational properties also have a higher value than timberlands, but do not have the same qualities of HBU land. For example, these properties may be good for hunting or conservation. Other non-strategic properties often have locational or operational disadvantages for us. They typically are on the fringe of our ownership areas. The Real Estate segment also plays an active role in negotiations for all timberland acquisitions, and engages in real estate development activities through Potlatch TRS.

We seek acquisitions when properties complement our existing land base, are immediately cash flow accretive and have a blend of timber and real estate values. From time to time, we also take advantage of opportunities to sell timberland where we believe pricing to be particularly attractive, to match a sale with a purchase of more desirable property in order to utilize like-kind exchange, or LKE, tax-deferred transactions or to meet various financial and strategic objectives. Sales of conservation properties and conservation easements on our properties are also included in this segment. Results for the segment depend on the demand for our non-core timberlands, the timing of closing of sales of properties and our ability to match sales of property with acquisitions in LKE transactions. Consequently, revenues for the segment are seldom comparable or predictable between periods.

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A main focus of this segment is to continually assess the use of each of our lands to manage them proactively for the highest value. In December 2006, we completed an initial stratification assessment of all of our land. As new lands are acquired, we complete similar stratification assessments. The following tools were used in assessing our lands:

Electronic analysis, using geographic information systems;

On-the-ground analysis and verification of modeling assumptions;

Certain measured and ranked attributes, such as timber potential, recreational opportunities, accessibility, special features and population and demographic trends.

As a result of this continual assessment of our lands, we have identified 340,000 to 400,000 acres as having values that are potentially greater than timberland values. This includes approximately 140,000 to 160,000 acres of HBU property, 120,000 to 140,000 acres of rural recreational property and 80,000 to 100,000 acres of other non-strategic timberland. Sales of these lands are expected to occur over a 10-year period, with the goal of utilizing like-kind exchange transactions or other tax-advantaged methods.

Sales for the years ended December 31, 2008, 2007 and 2006 are summarized in the following table:

	2008		2007		2006	
	ACRES SOLD	AVERAGE PRICE/ACRE	ACRES SOLD	AVERAGE PRICE/ACRE	ACRES SOLD	AVERAGE PRICE/ACRE
HBU/development	3,562	\$ 2,598	3,009	\$ 2,639	853	\$ 3,555
Rural recreational	14,266	1,434	13,166	1,229	2,307	1,194
Other non-strategic timberland	42,841	379				
Conservation easements					17,572	446
Total	60,669	\$ 755	16,175	\$ 1,492	20,732	\$ 657

In January 2009, we sold approximately 24,800 acres of timberland in Arkansas for \$43.3 million.

In September 2007, we entered into agreements to acquire approximately 179,000 acres of attractive timberland in Idaho for approximately \$215 million. We acquired the timberland in two separate transactions, with the first closing in September 2007 and the second closing in January 2008. In January 2007, we acquired approximately 76,000 acres of prime timberland in Wisconsin for \$64.5 million.

We expect to use Internal Revenue Code section 1031 like-kind exchanges whenever possible to match sales of our land with acquisitions of land. For example, the Wisconsin timberland purchase discussed above allowed us to utilize a section 1031 like-kind exchange and not be subject to built-in-gains tax on an Arkansas conservation easement sale in December 2006 or the sale of our hybrid poplar tree farm in Boardman, Oregon in May 2007. The sale of the hybrid poplar tree farm is discussed in more detail under the heading, Discontinued Operations, below. We also matched much of the Idaho land purchase discussed above with sales of land in the second half of 2007 and first half of 2008.

WOOD PRODUCTS SEGMENT

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

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To produce these wood products, we own and operate six manufacturing facilities in Arkansas, Idaho, Michigan and Minnesota. A description of the locations and annual capacity and production of these facilities is included under Item 2 of this report.

Our share of the markets for lumber, plywood and particleboard is not significant compared to the total United States markets for these products. We believe that competitiveness in this industry is largely based on individual mill efficiency and on the availability of competitively priced raw materials on a facility-by-facility basis, rather than the number of mills operated. This is due to the fact that it is generally not economical to transfer wood between or among facilities, which might permit a greater degree of specialization and operating efficiencies. Instead, each facility must utilize the raw materials that are available to it in a relatively limited geographic area. For these reasons, we believe we are able to compete effectively with companies that have a larger number of mills. We compete based on product quality, customer service and price.

For our Wood Products operations, the principal raw material used is logs, which are obtained from our Resource segment or purchased on the open market. We generally do not maintain long-term supply contracts for a significant volume of timber.

The forest products industry in general and the lumber business in particular were adversely affected in 2008 by the national decline in home building and the subsequent weak demand and lower prices for wood products. As a result of these weak market conditions, we permanently closed our lumber mill at Prescott, Arkansas in May 2008. In addition, we were forced to temporarily halt or reduce production at many of our mills, particularly during the second half of 2008. During the first half of 2008, our mills in Michigan and Minnesota were each shut down for a few weeks, and the Michigan mill then operated on a reduced production level for a time due to weather-related log shortages. Our Idaho, Michigan and Minnesota mills were all shut down from two to four weeks each between mid-November and the end of the year due to poor market conditions. Five of our six mills have been running at 50% to 75% of normal production levels during the first two months of 2009. One of our Idaho mills was shut down for the month of January 2009, and since early February has been running at 50% capacity. We do not expect a meaningful recovery in the wood products markets in the near-term.

Our former lumber mill in Lewiston, Idaho, was part of the spin-off of Clearwater Paper operations, primarily due to its operational ties to our former pulp-based operations in Lewiston. In all discussions and financial results reported for our Wood Products segment, the results of the Lewiston lumber operations have been reclassified to discontinued operations.

DISCONTINUED OPERATIONS

On December 16, 2008, we completed the tax-free spin-off of Clearwater Paper, which includes our former pulp and paperboard and consumer products segments, as well as our former lumber mill in Lewiston, Idaho. Included in discontinued operations are after-tax transaction costs of \$9.6 million related to the spin-off.

In May 2008, our Prescott, Arkansas lumber mill permanently ceased operations due to poor market conditions. As a result of this closure, we recorded an after-tax charge of \$12.4 million in 2008. The charge represented estimated costs associated with the adjustment of assets to estimated fair market value, as well as severance benefits, the curtailment of the hourly defined benefit pension plan for the Prescott employees, and other costs associated with the closure.

In May 2007, we sold our hybrid poplar tree farm in Boardman, Oregon, for \$65 million in cash. We applied a large portion of the proceeds from this sale to our acquisition in the first quarter of 2007 of the Wisconsin timberlands through a tax-efficient section 1031 like-kind exchange. As a result of the sale, we recorded an after-tax charge of \$33.0 million in the first half of 2007. The charge represented estimated costs associated with the adjustment of the carrying value of the assets involved in the sale to fair market value, as well as severance benefits and other costs associated with the sale.

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SEASONALITY

Log and pulpwood sales volumes in our Resource segment are typically lower in the first half of each year, as winter rains in the Southern region and spring thaws in the Northern region limit timber harvesting operations due to softened roadbeds and wet logging conditions, which restrict access to logging sites. Demand for our wood products typically decreases in the winter months when construction activity is slower, and increases in the spring, summer and fall when construction activity is generally higher. Real Estate acquisitions and dispositions can be affected by seasonal changes when access to the properties is limited due to weather conditions.

GEOGRAPHIC AREAS

All of our wood products manufacturing facilities and other assets are located within the continental United States. Less than 2% of our revenues are derived from sales to Canada, with the remainder being domestic sales.

ENVIRONMENTAL

Our operations are subject to federal, state and local environmental laws and regulations relating to the protection of the environment and the protection of endangered species. These laws and regulations can change substantially and rapidly, and we anticipate them to become increasingly stringent. Although we believe that we are in substantial compliance with these requirements, there can be no assurance that these increasingly burdensome laws and regulations will not lead to significant costs, penalties and liabilities, including those related to claims for damages to property or natural resources, as well as restrictions on timber harvesting and other silvicultural activities.

Additional information regarding environmental matters is included under Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations of this report, and is incorporated herein by reference.

EMPLOYEES

As of December 31, 2008, we had approximately 990 employees. The workforce consisted of approximately 260 salaried, 710 hourly and 20 temporary or part-time employees. As of December 31, 2008, approximately 17% of the workforce was covered under one collective bargaining agreement, which expires in May 2011.

ITEM 1A.

Risk Factors

Investing in our common stock involves a significant degree of risk. Our business, financial condition, results of operations or liquidity could be materially adversely affected by any of the following risks and, as a result, the trading price of our common stock could decline. In addition to the risk factors discussed below, investors should carefully consider the risks and uncertainties presented under the following captions in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of Part II of this report: REIT Conversion and Factors Influencing Our Results of Operations and Cash Flows, both of which are incorporated herein by reference.

BUSINESS AND OPERATING RISKS

Our cash distributions are not guaranteed and may fluctuate.

Under the REIT rules, to remain qualified as a REIT, a REIT must distribute, within a certain period after the end of each year, 90% of its ordinary taxable income for such year. We anticipate that our REIT income in the foreseeable future will consist primarily of net capital gains resulting from payments to be received under timber cutting contracts with Potlatch TRS and third parties, and not ordinary taxable income. Therefore, unlike most REITs, we may not be required to distribute material amounts of cash to remain qualified as a REIT. If, after giving effect to our distributions, we have not distributed an amount equal to

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100% of our ordinary taxable income and net capital gains income, then we would be required to pay tax on the undistributed portion of such taxable income at regular corporate tax rates. In this case, our stockholders could be required to include their proportionate share of any undistributed capital gain in income and would receive a credit or refund for their share of the tax paid by us.

The IRS issued a ruling in December 2008 that provides temporary guidance allowing a publicly owned real estate investment trust to distribute up to 90% of its 2009 dividends in the form of company stock. Pursuant to the guidance, the total value of the cash and stock is considered to be a distribution of current year taxable income when computing the REIT's dividends paid deduction.

Our board of directors, in its sole discretion, will determine the actual amount of distributions to be made to stockholders based on consideration of a number of factors, including, but not limited to, our results of operations, cash flow and capital requirements, economic conditions in our industry and in the markets for our products, tax considerations, borrowing capacity, debt covenant restrictions, timber prices and harvest levels on our timberlands.

Our operating results and cash flows will be materially affected by the fluctuating nature of timber prices.

Our results of operations and cash flows will be materially affected by the fluctuating nature of timber prices. A variety of factors affect prices for timber, including factors affecting demand, such as changes in economic conditions, construction activity levels, interest rates, credit availability, population growth and weather conditions, as well as changes in timber supply and other factors. All of these factors can vary by region, timber type (saw logs or pulpwood logs) and species. In 2008, the overall price per ton for our timber was down approximately 8% from 2007.

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

The cyclical nature of our business could adversely affect our results of operations.

The financial performance of our operations is affected by the cyclical nature of our business. The markets for timber, real estate and manufactured wood products are influenced by a variety of factors beyond our control. The demand for our timber and wood products is affected by the level of new residential construction activity and, to a lesser extent, home repair and remodeling activity, which are subject to fluctuations due to changes in economic conditions, interest rates, credit availability, population growth, weather conditions and other factors. The demand for logs is also affected by the demand for wood chips in the pulp and paper markets. The supply of timber and logs has historically increased during favorable pricing environments, which then causes downward pressure on prices. The demand for real estate can be affected by changes in factors such as

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interest rates, credit availability and economic conditions, as well as by the impact of federal, state and local land use and environmental protection laws. Historical prices for our wood products have been volatile, and we, like others in the forest products industry, have limited direct influence over the timing and extent of price changes for our products.

Our ability to harvest and sell timber may be subject to limitations which could adversely affect our results of operations and cash flows.

Our timber harvest levels and sales may be limited due to weather conditions, timber growth cycles, restrictions on access, availability of contract loggers and regulatory requirements associated with the protection of wildlife and water resources, as well as by other factors, including damage by fire, insect infestation, disease and natural disasters such as ice storms, wind storms, hurricanes and floods. Although damage from such natural causes usually is localized, affecting only a limited percentage of our timber, there can be no assurance that any damage affecting our timberlands will be limited. Our financial results and cash flows are dependent to a significant extent on our continued ability to harvest timber at adequate levels.

Changes in harvest levels on our timberlands may have a significant impact on our results of operations, due in part to the low cost basis of much of our timber from timberlands that we acquired many years ago. Over the long term, we manage our timberlands on a sustainable yield basis to achieve a balance between timber growth and timber harvests. From time to time, however, we may choose, consistent with our environmental commitments, to harvest timber at levels above or below our estimate of sustainability for various reasons. In 2008, the overall harvest from our timberlands was 4.4 million tons, compared to 3.9 million tons harvested in 2007. Based on our current projections that take into consideration such factors as market conditions, the ages of our timber stands and recent timberland acquisitions and sales, we expect the overall timber harvest from our lands in 2009 to be between 4.2 million and 4.4 million tons, increasing to a range of 5.0 million to 5.3 million tons annually over the next few years, depending upon market conditions.

On a short-term basis, we may adjust our timber harvest levels in response to market conditions. For example, in 2006 we deferred a portion of our planned timber harvest in our Southern region due to weak markets. In 2007, however, due to rebounding prices, we significantly increased the harvest from our Southern region timberlands, offsetting the 2006 deferred harvest. We also experience seasonally lower harvest activity during the winter and early spring due to weather conditions. Longer term, our timber harvest levels will be affected by acquisitions of additional timberlands, such as the Idaho timberlands purchased in January 2008 and September 2007 and the Wisconsin timberlands purchased in January 2007, and sales of existing timberlands. In addition to timberland acquisitions and sales, future timber harvest levels may be affected by changes in estimates of long-term sustainable yield because of genetic improvements and other silvicultural advances, natural disasters, fires and other hazards, regulatory constraints and other factors beyond our control.

Our timberlands are concentrated in limited geographic areas.

We own approximately 1.6 million acres of timberland in two regions of the United States: the Northern region, consisting of our Idaho, Minnesota and Wisconsin timberlands; and the Southern region, consisting of our Arkansas timberlands. If the level of production from these regions substantially declines, or if the demand for timber in those regions declines, it could have a material adverse effect on our overall production levels and our revenues.

We do not insure against losses of timber from any causes.

The volume and value of timber that can be harvested from our lands may be affected by natural disasters such as fire, insect infestation, disease, ice storms, wind storms, hurricanes, floods and other weather conditions and causes beyond our control. We assume substantially all risk of loss to the standing timber we own from fire and other hazards because insuring for such losses is not practicable. Consequently, a reduction in our timber inventory could adversely affect our financial results and cash flows.

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Changes in demand for our real estate and delays in the timing of real estate transactions may affect our revenues and operating results.

A number of factors, including tightening of credit, a slowing of residential real estate development, population growth and changes in demographics could reduce the demand for our real estate and negatively affect our results of operations. In addition, changes in the interpretation or enforcement of current laws, or the enactment of new laws, regarding the use and development of real estate, or changes in the political composition of federal, state and local governmental bodies could lead to new or greater costs, delays and liabilities that could materially adversely affect our real estate business, profitability or financial condition. Also, there are inherent uncertainties in the timing of real estate transactions that could adversely affect our operating results. The timing of real estate sales is a function of many factors, including the general state of the economy, demand in local real estate markets, the number of properties listed for sale, the seasonal nature of sales, the plans of adjacent landowners and our expectations of future price appreciation. Delays in the completion of transactions or the termination of potential transactions may be beyond our control. These events could adversely affect our operating results.

We may be unsuccessful in carrying out our acquisition strategy.

We have pursued, and intend to continue to pursue, acquisitions of strategic timberland properties. Among the reasons for our REIT conversion is that we are better able to compete for acquisitions of timberlands against other entities that use tax-efficient structures. It is uncertain whether any timberland acquisitions we make will perform in accordance with our expectations. In addition, we anticipate using Internal Revenue Code section 1031 like-kind exchanges, and financing acquisitions through cash from operations, borrowings under our credit facilities, proceeds from equity or debt offerings or proceeds from asset dispositions, or any combination thereof. The failure to identify and complete acquisitions of suitable timberland properties, our inability to finance future acquisitions on favorable terms or our inability to complete like-kind exchanges, could adversely affect our operating results and cash flows.

The forest products industry is highly competitive.

The markets for our wood products are highly competitive, and companies that have substantially greater financial resources than we do compete with us in each of our lines of business. Our wood products are subject to competition from wood products manufacturers in North America, and to a lesser extent in Canada. Our wood products manufacturing facilities are relatively capital intensive, which leads to high fixed costs and generally results in continued production as long as prices are sufficient to cover variable costs. These conditions have contributed to substantial price competition, particularly during periods of reduced demand. Some of our wood products competitors may currently be lower-cost producers than we are, and accordingly these competitors may be less adversely affected than we are by price decreases. In addition, wood products are subject to significant competition from a variety of substitute products, including non-wood and engineered wood products. To the extent there is a significant increase in competitive pressure from substitute products or other domestic or foreign suppliers, our business could be adversely affected.

Our businesses are subject to extensive environmental laws and regulations.

Environmental laws and regulations are constantly changing, and are generally becoming more restrictive. Laws, regulations and related judicial decisions and administrative interpretations affecting our business are subject to change and new laws and regulations that may affect our business are frequently enacted. These changes may adversely affect our ability to harvest and sell timber, develop real estate and operate our manufacturing facilities. These laws and regulations may relate to, among other things, the protection of timberlands, endangered species, timber harvesting practices, recreation and aesthetics, protection and restoration of natural resources, air and water quality, and remedial standards for contaminated property and groundwater. Over time, the complexity and stringency of these laws and regulations have increased markedly and the

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enforcement of these laws and regulations has intensified. We believe that these laws and regulations will continue to become more restrictive and over time could adversely affect our operating results.

Existing regulatory restrictions on future harvesting activities may be significant. Federal, state and local laws and regulations, which are intended to protect threatened and endangered species, as well as waterways and wetlands, limit and may prevent timber harvesting, road building and other activities on our timberlands. The threatened and endangered species restrictions apply to activities that would adversely impact a protected species or significantly degrade its habitat. A number of species on our timberlands have been and in the future may be protected under these laws. If current or future regulations become more restrictive, the amount of our timberlands subject to harvest restrictions could increase.

Our manufacturing operations are subject to stringent environmental laws, regulations and permits covering air emissions, wastewater discharge, water usage, and waste handling and disposal that govern how we operate our facilities. These laws, regulations and permits, now and in the future, may restrict our current production and limit our ability to increase production, and impose significant costs on our operations with respect to environmental compliance. It is expected that, overall, these costs will likely increase over time as environmental laws and regulations and permit conditions become more stringent, and as the expectations of the communities in which we operate become more demanding.

We currently own, or formerly owned and operated, manufacturing facilities or may acquire timberlands and other properties that are subject to environmental liabilities, such as remediation of hazardous material contaminations and other existing or potential liabilities. The cost of investigations and remediation of contaminated properties could increase operating costs and adversely affect financial results. Although we believe we have adequate reserves recorded for the investigation and remediation of our current properties, there can be no assurance that actual expenditures will not exceed our expectations, or that other unknown liabilities will not be discovered in the future. Some environmental statutes impose strict liability, rendering an entity liable for environmental damage without regard to that entity's negligence or fault. These laws or future legislation or administrative or judicial action with respect to protection of the environment may adversely affect our business.

Environmental groups and interested individuals may intervene in the regulatory processes in the locations where we own timberlands and operate our wood products mills. Delays or restrictions on our operations due to the intervention of environmental groups or interested individuals could adversely affect our operating results. In addition to intervention in regulatory proceedings, interested parties may file or threaten to file lawsuits that seek to prevent us from obtaining permits or implementing capital improvements or pursuing operating plans. Any lawsuit, or even a threatened lawsuit, could delay harvesting on our timberlands or impact our ability to invest in our wood products mills.

Our defined benefit pension plans became underfunded at December 31, 2008.

As a result of the steep downturn in the stock market in the fourth quarter of 2008, our defined benefit pension plans went from being overfunded to underfunded. Our pension plan funding requirements are based in part on the performance of the assets in our pension plans, and that performance is highly correlated with stock market performance. Depending on the timing of a recovery in the stock market, we could be faced with increased funding requirements that could be substantial in future years.

We depend on external sources of capital for future growth.

Our ability to finance growth is dependent to a significant degree on external sources of capital. Our ability to access such capital on favorable terms could be hampered by a number of factors, many of which are outside of our control, including, without limitation, a decline in general market conditions, decreased market liquidity, a downgrade to our public debt rating, increases in interest rates, an unfavorable market perception of our growth potential, a decrease in our current or estimated future earnings or a decrease in the market price of our common stock. In addition, our ability to access additional capital may

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also be limited by the terms of our existing indebtedness, which, among other things, restricts our incurrence of debt and the payment of dividend distributions. Any of these factors, individually or in combination, could prevent us from being able to obtain the capital we require on terms that are acceptable to us, and the failure to obtain necessary capital could materially adversely affect our future growth.

REIT AND TAX-RELATED RISKS

If we fail to remain qualified as a REIT, income from our timberlands will be subject to taxation at regular corporate rates and we will have reduced funds available for distribution to our stockholders.

Qualification as a REIT involves the application of highly technical and complex provisions of the Internal Revenue Code to our operations, including satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements, on a continuing basis. Given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations and the possibility of future changes in our circumstances, no assurance can be given that we will remain qualified as a REIT.

In addition, the rules dealing with federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Department of the Treasury. Changes to the tax laws affecting REITs, which may have retroactive application, could adversely affect our stockholders or us. We cannot predict how changes in the tax laws might affect our stockholders or us. Accordingly, we cannot assure you that new legislation, Treasury regulations, administrative interpretations or court decisions will not significantly affect our ability to remain qualified as a REIT or the federal income tax consequences of such qualification.

If in any taxable year we fail to remain qualified as a REIT,

we will not be allowed a deduction for distributions to stockholders in computing our taxable income; and

we will be subject to federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates.

Any such corporate tax liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of our common stock. In addition, we would be disqualified from treatment as a REIT for the four taxable years following the year during which the qualification was lost, unless we are entitled to relief under certain statutory provisions. As a result, net income and the funds available for distribution to our stockholders could be reduced for up to five years or longer, which would have an adverse impact on the value of our common stock.

There are uncertainties relating to the estimate of our special E&P distribution, which could result in our disqualification as a REIT.

In order to qualify as a REIT, we were required to distribute to our stockholders all of our accumulated non-REIT tax earnings and profits, or E&P, prior to the end of our first taxable year as a REIT, which was December 31, 2006. In 2006, a special E&P distribution in the aggregate amount of approximately \$445 million was distributed to our stockholders. We believe that the amount of our special E&P distribution equaled or exceeded the amount required to be distributed in order to satisfy the requirements relating to the distribution of E&P. There are, however, uncertainties relating to the determination of the amount of our pre-REIT E&P, including the possibility that the IRS could, in any audits for tax years through 2005, successfully assert that our taxable income should be increased, which would increase our pre-REIT E&P. Thus, we might fail to satisfy the requirement that we distributed all of our pre-REIT E&P by the close of our first taxable year as a REIT. Moreover, although there are procedures available to cure a failure to distribute all of our pre-REIT E&P, we cannot now determine whether we would be able to take advantage of them or the economic impact on us of doing so.

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Certain of our business activities are potentially subject to prohibited transactions tax on 100% of our net income, which would reduce our cash flow and impair our ability to make distributions.

REITs are generally intended to be passive entities and can thus only engage in those activities permitted by the Internal Revenue Code, which for us generally include: owning and managing a timberland portfolio; growing timber; and selling standing timber. Accordingly, the manufacture and sale by us of wood products, certain types of timberlands sales, and the harvest and sale of logs are conducted through Potlatch TRS because such activities generate non-qualifying REIT income and could constitute prohibited transactions if such activities were engaged in directly by the REIT. In general, prohibited transactions are defined by the Internal Revenue Code to be sales or other dispositions of property held primarily for sale to customers in the ordinary course of a trade or business.

By conducting our business in this manner, we believe we will satisfy the REIT requirements of the Internal Revenue Code and avoid the 100% tax that could be imposed if a REIT were to conduct a prohibited transaction. We may not always be successful, however, in limiting such activit