

POTLATCH CORP  
Form 10-K  
February 14, 2014

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, 2013  
 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 (IRS Employer Identification No.)  
organization)  
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<br>(\$1 par value) | The Nasdaq Global Select Market           |

Securities registered pursuant to Section 12(g) of the Act: None  
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant at June 30, 2013, was approximately \$1,638.9 million, based on the closing price of \$40.44.

As of January 31, 2014, 40,536,879 shares of the registrant's common stock, par value \$1 per share, were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive proxy statement expected to be filed on or about April 1, 2014, with the Commission in connection with the 2014 annual meeting of stockholders are incorporated by reference in Part III hereof.

---

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Table of Contents

|   | PAGE<br>NUMBER |
|---|----------------|
| <u>PART I</u>   |                |
| ITEM 1. <u>Business</u>   | <u>3</u>       |
| ITEM 1A. <u>Risk Factors</u>  | <u>9</u>       |
| ITEM 1B. <u>Unresolved Staff Comments</u>   | <u>18</u>      |
| ITEM 2. <u>Properties</u>   | <u>18</u>      |
| ITEM 3. <u>Legal Proceedings</u>  | <u>18</u>      |
| ITEM 4. <u>Mine Safety Disclosures</u>  | <u>18</u>      |
| <u>PART II</u>  |                |
| ITEM 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | <u>19</u>      |
| ITEM 6. <u>Selected Financial Data</u>  | <u>20</u>      |
| ITEM 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>                        | <u>20</u>      |
| ITEM 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | <u>20</u>      |
| ITEM 8. <u>Financial Statements and Supplementary Data</u>  | <u>20</u>      |
| ITEM 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | <u>21</u>      |
| ITEM 9A. <u>Controls and Procedures</u>   | <u>21</u>      |
| ITEM 9B. <u>Other Information</u>   | <u>21</u>      |
| <u>PART III</u>   |                |
| ITEM 10. <u>Directors, Executive Officers and Corporate Governance</u>  | <u>22</u>      |
| ITEM 11. <u>Executive Compensation</u>  | <u>22</u>      |
| ITEM 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>              | <u>23</u>      |
| ITEM 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>                                   | <u>23</u>      |
| ITEM 14. <u>Principal Accounting Fees and Services</u>  | <u>23</u>      |
| <u>PART IV</u>  |                |
| ITEM 15. <u>Exhibits and Financial Statement Schedules</u>  | <u>24</u>      |
| <u>SIGNATURES</u>   | <u>25</u>      |
| <u>INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULES</u>   | <u>26</u>      |
| <u>EXHIBIT INDEX</u>  | <u>74</u>      |

## EXPLANATORY NOTE

For purposes of this report, any references to "the company," "us," "we," and "our" include Potlatch Corporation and its consolidated subsidiaries.

## 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:

- timber inventory;
- payments under timber cutting contracts;
- increasing lumber demand and pricing in North America in 2014;
- increased North American housing starts and repair and remodel activity;
- the expected positive effect on timber prices of increased lumber demand and higher lumber prices;
- expected sawlog prices in 2014;
- expected 2014 overall timber harvest of 4.8 million tons;
- expected sales of 110,000 to 120,000 acres of HBU property, 80,000 to 90,000 acres of rural real estate property and 10,000 to 20,000 acres of non-strategic timberland over the next 10 years;
- funding of our dividend distributions in 2014;
- compliance with REIT tax rules;
- FSC certification of our timberlands;
- expectations regarding premium prices for FSC-certified logs and FSC-certified lumber;
- realization of deferred tax assets;
- expected capital expenditures in 2014;
- expectations regarding funding of our pension plans in 2014;
- estimated future benefit payments;
- estimated future payments under operating leases; and
- expected liquidity in 2014 to fund our operations, regular stockholder distributions, capital expenditures and debt service obligations and related matters.

Words such as "anticipate," "expect," "will," "intend," "plan," "target," "project," "believe," "seek," "schedule," "estimate," "and similar expressions are intended to identify such forward-looking statements. These forward-looking statements reflect our current views regarding future events based on estimates and assumptions, and are therefore subject to known and unknown risks and uncertainties and are not guarantees of future performance.

Our actual results of operations could differ materially from our historical results or those expressed or implied by forward-looking statements contained in this report. Important factors that could cause or contribute to such differences include, but are not limited to, the following:

- changes in timber growth rates;
- changes in silviculture;
- timber cruising variables;
- changes in state forest acts or best management practices;
- changes in timber harvest levels on our lands;
- changes in timber prices;
- changes in timberland values;
- changes in policy regarding governmental timber sales;
- changes in the United States and international economies;
- changes in interest rates and discount rates;
- changes in requirements for FSC certification;
- changes in the level of residential and commercial 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;

2013 FORM 10-K / 1

---

- unforeseen environmental liabilities or expenditures;
- weather conditions;
- changes in raw material and other costs;
- collectability of amounts owed by customers;
- changes in federal and state tax laws;
- the ability to satisfy complex rules in order to remain qualified as a REIT; and
- changes in tax laws that could reduce the benefits associated with REIT status.

For a discussion of some of the factors that may affect our business, results and prospects, see Part 1 - Item 1A. Risk Factors.

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

Part I

ITEM 1. BUSINESS

General

Potlatch Corporation is a real estate investment trust (REIT) with approximately 1.4 million acres of timberlands in Arkansas, Idaho and Minnesota. We derive much of our income from investments in real estate, including the sale of standing timber. Through wholly owned taxable REIT subsidiaries, which we refer to collectively in this report as Potlatch TRS, we operate a real estate sales and development business and five wood products manufacturing facilities that produce lumber and plywood.

Our businesses are organized into three operating segments:

**Resource:** Our Resource segment manages our timberlands to optimize revenue producing opportunities while adhering to our strict stewardship standards. Management activities include planting and harvesting trees and building and maintaining roads. The Resource segment also generates revenues from non-timber resources such as hunting leases, recreation permits and leases, mineral rights leases, biomass production, carbon sequestration and other leasing opportunities.

- **Wood Products:** Our Wood Products segment manufactures and markets lumber and plywood.

**Real Estate:** The business of our Real Estate segment consists primarily of the sale of land holdings deemed non-strategic or identified as having higher and better use alternatives. The Real Estate segment engages in real estate sales, subdivision and development activities through Potlatch TRS.

Additional information regarding each of our operating segments is included in this section, as well as in Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 17: Segment Information in the Notes to Consolidated Financial Statements.

We are focused on the ownership of timberland, which we view as 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. Our primary objectives include using our timberland investments to generate income and maximizing the long-term value of our assets. We pursue these objectives by adhering to the following strategies:

- 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 over the long term. We may choose to harvest timber at levels above or below our then-current estimate of sustainability for various reasons from time to time, including improving the long-term productivity of certain timber stands or in response to market conditions. In addition, we focus on optimizing timber returns by continually improving productivity and yields through advanced silvicultural practices that take into account soil, climate and biological considerations.

Pursuing attractive acquisitions. We actively pursue timberland acquisitions that meet our financial and strategic criteria. The critical elements of our acquisition strategy generally include acquiring properties that complement our existing land base, are immediately cash flow accretive and have attractive timber or higher and better use (HBU) values.

Maximizing the value of our non-core timberland real estate. A portion of our acreage is more valuable for development or recreational purposes than for growing timber. We continually assess the potential uses of our lands to manage them proactively for the highest value. We have identified approximately 15% of our timberlands as having values that are potentially greater than timberland values.

- 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 timberlands in a manner consistent with the principles set forth by the Forest Stewardship Council (FSC).

Potlatch Corporation, formerly known as Potlatch Holdings, Inc., was incorporated in Delaware in September 2005 to facilitate a restructuring to qualify for treatment as a REIT for federal income tax purposes. It is the successor to the business of the original Potlatch Corporation, which was incorporated in Delaware in 1903.





Effective January 1, 2006, we restructured our operations to qualify for treatment as a REIT for federal income tax purposes. As a REIT, if we meet certain requirements we generally are not subject to federal and state corporate income taxes on our income from investments in real estate that we distribute to our stockholders, including the income derived from the sale of standing timber. We are, however, subject to corporate taxes on certain 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 our conversion to a REIT, except for sales that occurred in 2011, 2012 and 2013. The Small Business Jobs Act of 2010 modified the built-in gains provisions to exempt sales of real properties by a REIT in 2011, if five years of the recognition period had elapsed before January 1, 2011. The American Taxpayer Relief Act of 2012, enacted on January 2, 2013, extended the reduced five-year holding period for sales that occurred in 2012 and 2013. If applicable, the built-in gains tax is eliminated or deferred if sale proceeds are reinvested in accordance with the like-kind exchange provisions of the Internal Revenue Code. The built-in gains tax is not applicable to the sale of timber pursuant to a stumpage sale agreement or timber deed. We are required to pay federal corporate income taxes on income from our non-real estate investments, principally the operations of Potlatch TRS.

The REIT tax rules require that we derive most of our income, other than income generated by a taxable REIT subsidiary, from investments in real estate, which for us primarily consists of income from the sale of our standing timber. Accordingly, we restructured to create a new parent company that holds our timberlands through a REIT subsidiary and substantially all of our non-timberland assets, consisting primarily of our manufacturing facilities, assets used for the harvesting of timber and the sale of logs, and selected land parcels that we expect to be sold or developed for higher and better use purposes, through Potlatch TRS. Our use of Potlatch TRS, which is taxed as a C corporation, enables us to continue to engage in these non-REIT qualifying businesses while complying with the REIT requirements.

#### Available Information

We make available on or through our website, [www.potlatchcorp.com](http://www.potlatchcorp.com) (under “Investor Resources – SEC Filings”), our periodic and current reports that we file with, or furnish to, the Securities and Exchange Commission, or SEC, at no charge as soon as reasonably practicable after we electronically file the information with, or furnish it to, the SEC. Information on our website is not part of this report. In addition, the reports and materials that we file with the SEC are available at the SEC’s website (<http://www.sec.gov>) and at the SEC’s Public Reference Room at 100 F Street N.E., Washington DC 20549. Interested parties may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

#### Business Segments

##### Resource Segment

**Industry Background.** The demand for timber depends primarily upon the markets for wood related 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, new household formations, 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. The demand for pulpwood is dependent on the 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. Locally, timber demand also fluctuates due to the expansion or closure of individual wood products and pulp-based manufacturing facilities.

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

4 / POTLATCH CORPORATION

---

as occasionally high timber salvage efforts due to storm damage, unusual pest infestations such as the mountain pine beetle, 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. Currently, the supply of timber generally is adequate to meet demand.

Operations. The Resource segment manages approximately 1.4 million acres of timberlands we own in two regions of the United States: the Northern region, consisting of our Idaho and Minnesota timberlands; and the Southern region, consisting of our Arkansas timberlands. We are the largest private landowner in Idaho. The following table provides additional information on our timberlands.

| REGION          | STATE     | DESCRIPTION  | ACRES<br>(thousands) |
|-----------------|-----------|--|----------------------|
| Northern region | Idaho     | Variety of commercially viable softwood species, such as grand fir, Douglas fir, inland red cedar and other associated softwoods | 805                  |
|                 | Minnesota | Primarily aspen, pine and other mixed hardwoods  | 197                  |
|                 |           | Total Northern region  | 1,002                |
| Southern region | Arkansas  | Primarily southern yellow pine and other hardwoods   | 410                  |
|                 |           | Total  | 1,412                |

Our timberlands include a wide diversity of softwood and hardwood species and are certified by the FSC. As a participant in this program, we adhere to principles that include commitments to sustainable forestry, responsible practices, forest health and productivity, and protection of special sites. We are generally able to sell FSC-certified logs at premium prices.

As of the end of 2013, our estimated standing timber inventory is approximately 56 million tons. This estimate is derived using methods consistent with industry practice and is based on statistical methods and field sampling. Efforts are made to periodically update this estimate for growth, harvest, acquisitions and disposals. The estimated inventory volume includes timber from environmentally sensitive areas where the timberlands are managed in a manner consistent with best management practices, state forest practice acts and the FSC forest management standard.

The aggregate estimated volume of current standing timber inventory is updated at least annually to reflect increases in merchantable timber due to reclassification of young growth to merchantable timber, the annual growth rates of merchantable timber and the acquisition of additional merchantable timber, and to reflect decreases due to timber harvests and land sales. Timber volumes are estimated from cruises of the timber tracts, which are completed on our timberlands on approximately a five to ten year cycle. Since the individual cruises collect field data at different times for specific sites, the growth model projects standing inventory from the cruise date to a common reporting date.

Annual growth rates for the merchantable inventory have historically been in the range of 2%-5%.

The primary business of the Resource segment is the management of our timberlands to optimize the value of all possible revenue producing opportunities while adhering to our strict stewardship standards. Management activities include planting and harvesting trees and building and maintaining roads. The segment also seeks to increase our revenues from non-timber resources such as from hunting leases, recreation permits and leases, mineral rights leases, biomass production, carbon sequestration and various other leasing opportunities.

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. Because timber is a renewable resource, 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. Our harvest plans 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. We employ silvicultural techniques 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.

2013 FORM 10-K / 5

---

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 annually. 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 silvicultural 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. Detailed harvest information by region and product is presented in Management's Discussion and Analysis of Financial Condition and Results of Operations. The following table presents a summary of our total 2013 fee timber harvest by region.

| (in thousands)  | FEE TIMBER HARVESTED (TONS) |          |          |       |
|-----------------|-----------------------------|----------|----------|-------|
|                 | SAWLOGS                     | PULPWOOD | STUMPAGE | TOTAL |
| Northern region | 2,032                       | 128      | 25       | 2,185 |
| Southern region | 694                         | 822      | 8        | 1,524 |
| Total           | 2,726                       | 950      | 33       | 3,709 |

Based on our current projections that take into consideration such factors as market conditions, the ages of our timber stands and recent timberland sales and acquisitions, we expect the overall timber harvest from our lands in 2014 to total approximately 3.8 million tons.

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, consistent with industry practice 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. Intersegment sales to our wood products manufacturing facilities in 2013 were approximately 25% of our total Resource segment revenues. The segment also sells sawlogs and pulpwood to a variety of forest products companies located near our timberlands. 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.

In 2013, approximately 36% of our Northern region's volume and 37% of our Southern region's volume was sold under log supply agreements. We expect approximately the same amount to be sold under log supply agreements in 2014. In general, our log supply contracts require a specified volume of timber to be delivered to certain customer facilities at prices that are adjusted periodically to reflect market conditions. Prices in our Northern region contracts are adjusted periodically by species to prevailing market prices for logs, lumber, wood chips and other residuals. Prices in our Southern region contracts are adjusted every three months for pine and hardwood logs based on prevailing market prices for logs. Currently our log supply agreements are in place for two to three years. Idaho Forest Group, LLC represented slightly more than 10% of our consolidated revenues in 2013 and 2012.

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.



### Wood Products Segment

Our Wood Products segment manufactures and markets lumber and plywood at five mills located in Arkansas, Idaho, Michigan and Minnesota. The segment's products are largely commodity products, which are sold through our sales offices to end users, retailers or wholesalers for nationwide distribution primarily for use in home building, industrial products and other construction activity.

A description of our wood products manufacturing facilities, which are all owned by us, together with their respective 2013 capacities and actual production, are as follows:

|                    | ANNUAL<br>CAPACITY <sup>1,2</sup> | PRODUCTION <sup>2</sup> |
|--------------------|-----------------------------------|-------------------------|
| Sawmills:          |                                   |                         |
| Warren, Arkansas   | 175 mmbf                          | 191 mmbf                |
| St. Maries, Idaho  | 160 mmbf                          | 168 mmbf                |
| Gwinn, Michigan    | 170 mmbf                          | 173 mmbf                |
| Bemidji, Minnesota | 120 mmbf                          | 123 mmbf                |
| Plywood Mill:      |                                   |                         |
| St. Maries, Idaho  | 150 mmsf                          | 161 mmsf                |

Capacity represents the proven annual production capabilities of the facility under normal operating conditions and producing a normal product mix. Normal operating conditions are based on the configuration, efficiency and the number of shifts worked at each individual facility. In general, the definition includes two shifts for five days (two 40-hour shifts) per week at each facility, which is consistent with industry-wide recognized measures. Production can exceed capacity due to efficiency gains and overtime.

<sup>2</sup> mmbf stands for million board feet; mmsf stands for million square feet, 3/8 inch panel thickness basis.

Our share of the markets for lumber and plywood 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.

Our manufacturing facilities can produce and sell FSC-certified products that generally command premium pricing. 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 logs. During 2013 and 2012, 39% and 36% of our log purchases, respectively, were provided by our Resource segment.

### Real Estate Segment

The activities of our Real Estate segment consist primarily of the sale of selected non-core timberland real estate, which consist of three categories of property: HBU, rural real estate and non-strategic.

HBU properties have characteristics that provide development potential as a result of superior location or other attractive amenities. These properties tend to have a much higher value than timberlands.

Rural real estate properties also have a higher value than timberlands, but do not have the same developmental potential as HBU properties. For example, these properties may be appropriate for hunting, conservation or secondary rural housing.

Non-strategic properties often have locational or operational disadvantages for us, and are typically on the fringe of our ownership areas.

The Real Estate segment engages in real estate sales, subdivision and development activities through Potlatch TRS.

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 defer taxes in a like-kind exchange (LKE) transaction, or to meet various other financial or 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 types of properties sold, the basis of these properties and the timing of closings of property sales. Although large sales of non-strategic properties can cause results that are not comparable or predictable between periods, we have maintained a relatively consistent level of rural real estate and HBU sales. A main focus of this segment is to continually assess the highest value use of our lands. We conduct periodic stratification assessments on our lands and as new lands are acquired. The following tools are used in assessing our lands:

- electronic analysis, using geographic information systems;
- on-the-ground analysis and verification of modeling assumptions; and
- 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 currently have identified 200,000 to 230,000 acres of non-core timberland real estate. This includes approximately 110,000 to 120,000 acres of HBU property, 80,000 to 90,000 acres of rural real estate property and 10,000 to 20,000 acres of non-strategic timberland. Sales of these lands are expected to occur over a 10-year period, with the goal of utilizing LKE transactions or other tax-advantaged methods when it is appropriate.

#### 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 thaw in the Northern region limit timber harvesting operations due to softened roadbeds and wet logging conditions that restrict access to logging sites. The third quarter is typically our Resource segment's strongest production quarter. Real Estate dispositions and acquisitions can be adversely affected when access to any properties to be sold or considered for acquisition is limited due to adverse weather conditions. Demand for our manufactured 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.

#### Geographic Areas

All of our timberlands, wood products manufacturing facilities and other real estate and assets are located within the continental United States. In 2013, 2012 and 2011, approximately 2%, 2% and 1%, of the respective year's revenues were derived from sales of manufactured wood products to Canada and Mexico, with the remainder of our revenues resulting from domestic sales.

#### Environmental Regulation

We are subject to extensive federal and state environmental regulation of our wood products manufacturing facilities and timberlands, particularly with respect to air emissions, wastewater discharges, solid and hazardous waste management, site remediation, forestry operations, and threatened and endangered species. We are also subject to the requirements of the Federal Occupational Safety and Health Act and comparable state statutes relating to the health and safety of our employees. We maintain environmental and safety compliance programs and conduct regular internal and independent third-party audits of our facilities and timberlands to monitor compliance with these laws and regulations. Compliance with environmental regulations is a significant factor in our business and requires capital expenditures as well as additional operating costs.

We believe that our manufacturing facilities and timberland operations are currently in substantial compliance with applicable environmental laws and regulations. We cannot be certain, however, that situations that give rise to material environmental liabilities will not be discovered.

Enactment of new environmental laws or regulations, or changes in existing laws or regulations, particularly relating to air and water quality, or their enforcement, may require significant expenditures by us or may adversely affect our timberland management and harvesting activities.





Similarly, a number of species indigenous to our timberlands have been listed as threatened or endangered or have been proposed for one or the other status under the Endangered Species Act. As a result, our activities in or adjacent to the habitat of these species may be subject to restrictions on the harvesting of timber, reforestation activities and the construction and use of roads.

We expect legislative and regulatory developments in the area of climate change to address carbon dioxide emissions and renewable energy and fuel standards. It is unclear as of this date how any such developments will affect our business.

At this time, we believe that federal and state laws and regulations related to the protection of endangered species and air and water quality will not have a material adverse effect on our financial position, results of operations or liquidity. We anticipate, however, that increasingly strict laws and regulations relating to the environment, natural resources and forestry operations, as well as increased social concern over environmental issues, may result in additional restrictions on us leading to increased costs, additional capital expenditures and reduced operating flexibility.

Information regarding potentially material environmental proceedings is included in Note 15: Commitments and Contingencies in the Notes to Consolidated Financial Statements contained in this report and incorporated herein by reference.

#### Employees

As of December 31, 2013, we had approximately 880 employees. The workforce consisted of approximately 220 salaried, 630 hourly and 30 temporary or part-time employees. As of December 31, 2013, 18% of the workforce was covered under one collective bargaining agreement, which expires in May 2016.

#### 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. The risks described below are not the only ones we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business, financial condition, results of operations or liquidity. In addition to the risk factors discussed below, investors should carefully consider the risks and uncertainties presented in Part 1 - Item 1. Business.

##### Business and Operating Risks

Our cash distributions are not guaranteed and may fluctuate, which could adversely affect our stock price.

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. Our REIT income, however, consists primarily of net capital gains resulting from payments received under timber cutting contracts with Potlatch TRS and third parties, rather than ordinary taxable income. Therefore, unlike most REITs, we are not 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 100% of our REIT 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 and our stockholders would 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.

Our Board of Directors, in its sole discretion, determines 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, harvest levels on our timberlands, market demand for timberlands, including timberland properties we have identified as potentially having a higher and better use, and future acquisitions and dispositions. For a description of debt covenants that could limit our ability to make distributions to stockholders in the future, see Liquidity and Capital Resources in Management's Discussion and Analysis of Financial Condition and Results of Operations. Consequently, the level of future distributions to our stockholders may fluctuate, and any reduction in the distribution rate may adversely affect our stock price.



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, the level of domestic new construction and remodeling activity, foreign demand, interest rates, credit availability, population growth, weather conditions and pest infestation, as well as changes in timber supply and other factors. All of these factors can vary by region, timber type (sawlogs or pulpwood logs) and species.

Timber prices are affected by changes in demand on a local, national or international level. The closure of a mill in the regions where we own timber can have a material adverse effect on demand and therefore pricing. In 2011, due to continuing poor market conditions and the resulting closure of a significant customer's mill in Arkansas, we saw a substantial decline in log prices in the region. As the demand for paper nationwide continues to decline, closures of pulp mills have adversely affected the demand for pulpwood and wood chips in certain of the regions in which we operate. Also, demand in other parts of the world may affect timber prices in the markets in which we compete. For example, during the past few years, demand from Asia has remained steady, and although we do not sell into the Asian markets, Asian demand has affected supply and demand in the markets in which we participate. A decrease in Asian demand may have a negative impact on lumber and timber prices in the markets in which we compete.

Timber prices are also affected by changes in timber availability at the local, national and international level. Our timberland ownership is currently concentrated in Arkansas, Idaho and Minnesota. 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 harvest levels, causing short-term decreases in supply that have 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 land could significantly reduce timber prices, which would harm our results of operations. For more than 20 years, environmental concerns and other factors have limited timber sales by federal agencies, which historically had been major suppliers of timber to the U.S. forest products industry, particularly in the West. Any reversal of policy that substantially increases timber sales from government-owned land could have a material 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 timberland owners, 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, manufactured wood products and real estate are influenced by a variety of factors beyond our control. The demand for our timber and manufactured 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.

Historical prices for our manufactured wood products have been volatile, and we have limited direct influence over the timing and extent of price changes for our manufactured wood products. The demand for real estate can be affected by changes in factors such as interest rates, credit availability and economic conditions, as well as by the impact of federal, state and local land use and environmental protection laws.

We may be unable to harvest timber or we may elect to reduce harvest levels due to market conditions, either of 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. Changes in global climate conditions could intensify one or more of these factors. 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. We typically experience seasonally lower harvest activity during the winter and early spring due to weather conditions. Severe weather conditions and other natural disasters can also reduce the productivity of

timberlands and disrupt the harvesting and delivery of logs. Our financial results and cash flows are dependent to a significant extent on our continued ability to harvest timber at adequate levels.

On a short-term basis, we may adjust our timber harvest levels in response to market conditions. For example, in 2011, in response to weak demand and low prices, we shifted a portion of our harvest from our Southern region to our Northern region to capture better pricing opportunities. Following the closure of a significant customer's mill in Arkansas, in 2012 we reduced our overall timber harvest to 3.6 million tons from 4.1 million tons in 2011.

Longer term, our timber harvest levels will be affected by acquisitions of additional timberlands 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 silvicultural advances, natural disasters, fires and other hazards, regulatory constraints and other factors beyond our control.

We do not insure against losses of standing 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. As is typical in the forest industry, 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.

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 availability of credit, a slowing of residential real estate development, population shifts and changes in demographics could reduce the demand for our real estate and negatively affect our results of operations. Changes in investor interest in purchasing timberlands could reduce our ability to execute sales of non-strategic timberlands and could also 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.

In addition, there are inherent uncertainties in the timing of real estate transactions that could adversely affect our operating results in any particular quarter. 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 and other forest products assets. We compete with buyers that have substantially greater financial resources than we have for acquisition opportunities. We intend to finance acquisitions through cash from operations, borrowings under our credit facility, proceeds from equity or debt offerings, or proceeds from asset dispositions, or any combination thereof. In addition, it is uncertain whether any acquisitions we make will perform in accordance with our expectations. The failure to identify and complete acquisitions of suitable 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.

Our wood products are commodities that are widely available from other producers.

Because commodity products have few distinguishing properties from producer to producer, competition for these products is based primarily on price, which is determined by supply relative to demand and competition from substitute products. Prices for our products are affected by many factors outside of our control, and we have no influence over the timing and extent of price changes, which often are volatile. Our profitability with respect to these products depends, in part, on managing our costs, particularly raw material and energy costs, which represent significant components of our operating costs and can fluctuate based upon factors beyond our control.



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 the United States, and to a lesser extent in Canada. After years of trade disputes over Canadian lumber imports, the United States and Canada signed an agreement, which has been extended to 2015, establishing a system of tiered taxes and volume restrictions relating to Canadian lumber imports to the United States. Notwithstanding the signing of this agreement, there can be no assurance that it will at all times, or at any time, effectively create a fair trade environment. The London Court of International Arbitration has twice ruled that Canada has violated the Softwood Lumber Agreement. In addition, 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. Wood products also 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 affected by transportation availability and costs.

Our business depends on the availability of logging contractors and providers of transportation of wood products, and is materially affected by the cost of these service providers. Therefore, increases in the cost of fuel could negatively impact our financial results by increasing the cost associated with logging activities and transportation services, and could also result in an overall reduction in the availability of these services.

A material disruption at one of our manufacturing facilities could prevent us from meeting customer demand, reduce our sales or negatively affect our results of operations and financial condition.

Any of our manufacturing facilities, or any of our machines within an otherwise operational facility, could cease operations unexpectedly due to a number of events, including unscheduled maintenance outages, prolonged power failures, equipment failures, labor difficulties, disruptions in the transportation infrastructure, such as roads, bridges, railroad tracks and tunnels, fire, ice storms, floods, windstorms, hurricanes or other catastrophes, terrorism or threats of terrorism, governmental regulations and other operational problems.

Any such downtime or facility damage could prevent us from meeting customer demand for our products and/or require us to make unplanned capital expenditures. If one of these machines or facilities were to incur significant downtime, our ability to meet our production targets and satisfy customer requirements could be impaired, resulting in lower sales and income.

Our businesses are subject to extensive environmental laws and regulations.

Our operations are subject to a variety of federal, state and local laws and regulations regarding protection of the environment, including those relating to 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 soil, sediments and groundwater. Failure to comply with these requirements can result in significant fines or penalties, as well as liabilities for remediation of contaminated sites, natural resource damages, or alleged personal injury or property damage claims.

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 and operate our manufacturing facilities and may adversely affect the ability of others to develop property we intend to sell for higher and better use purposes. Over time, the complexity and stringency of these laws and regulations have increased markedly and the 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.



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. For example, the Clean Water Act and comparable state laws, regulations and best management practices programs protect water quality. As a result, our resource management activities adjacent to rivers and streams as well as the point source discharges from our manufacturing facilities are subject to strict regulation and there can be no assurance that our forest management and manufacturing activities will not be subject to increased regulation under the Clean Water Act in the future. Similarly, 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 or their enforcement become more restrictive, the amount of our timberlands subject to harvest restrictions could increase.

We anticipate that increasingly strict laws and regulations relating to the environment, natural resources and forestry operations, as well as increased social concern over environmental issues, may result in additional restrictions on us leading to increased costs, additional capital expenditures and reduced operating flexibility.

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. For example, in December 2012, the Environmental Protection Agency (EPA) issued new Major Source Boiler Maximum Achievable Control Technology, or Boiler MACT, rules that could require capital investments at our Wood Products manufacturing facilities. These rules are effective in early 2016. We are unable at this time to estimate the cost of compliance with these new rules because we are still in the process of reviewing the new rules as they apply to our wood products manufacturing facilities, however, the capital investments required to comply with the new rules could be significant. Overall, it is expected that environmental compliance costs will likely increase over time as environmental requirements become more stringent, and as the expectations of the communities in which we operate become more demanding.

Certain environmental laws, including the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) impose strict, and under certain circumstances joint and several, liability on responsible parties, including current and former owners and operators of contaminated sites, for costs of investigation and remediation of contamination. They also impose liability for related damages to natural resources. We have in the past been identified by the EPA as a potentially responsible party under CERCLA at various locations, and we are currently identified as a potentially responsible party in connection with one of our properties. Additional information regarding this matter is included in Note 15: Commitments and Contingencies in the Notes to Consolidated Financial Statements included in this report, and that information is incorporated herein by reference. It is possible that other facilities we own or operate, or formerly owned or operated, or timberlands we now own or acquire, could also become subject to liabilities under these laws. The cost of investigation and remediation of contaminated properties could increase operating costs and adversely affect our financial results. Although we believe we have appropriate reserves recorded for the investigation and remediation of known matters, there can be no assurance that actual expenditures will not exceed our expectations, that reserves will not be increased, or that other unknown liabilities will not be discovered in the future.

Environmental groups and interested individuals may intervene in the regulatory processes in the locations where we own timberland 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, implementing capital improvements or pursuing operating plans or to require us to obtain permits before pursuing operating plans. Any lawsuit, or even a threatened lawsuit, could delay harvesting on our timberlands or impact our ability to operate or invest in our wood products mills.

Our defined benefit pension plans are currently underfunded.

As a result of the steep downturn in the stock market in the fourth quarter of 2008 and the resulting effects on long-term interest rates and discount rates, our defined benefit pension plans have been underfunded since December 31, 2008, as the projected benefit obligation exceeds the aggregate fair value of plan assets. As a result of the underfunding, we may be required to make contributions to our qualified pension plans. We did not make a contribution in 2013, however, we contributed \$21.6 million and \$9.4 million, respectively, in 2012 and 2011. We funded the 2012 contribution by taking a loan against our company owned life insurance plan, or COLI, based on

2013 FORM 10-K / 13

---

the cash surrender value that has accumulated in the plan over the years. Based on estimated year-end asset values and projections of plan liabilities, during 2014 we expect to be required to make a contribution of \$1.7 million to our qualified pension plans. In addition, we will be making payments of approximately \$1.8 million for our non-qualified pension plan.

The determination of pension plan expense and the requirements for funding our pension plans are based on a number of actuarial assumptions. Two critical assumptions are the expected rate of return on plan assets and the discount rate applied to pension plan obligations. Pension plan assets primarily consist of equity and fixed income investments, so fluctuations in actual equity market returns and changes in long-term interest rates may result in increased pension costs in future periods. Changes in assumptions regarding discount rates and expected rates of return on plan assets could also increase future pension costs. Changes in any of these factors may significantly impact future contribution requirements.

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 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 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.

A strike or other work stoppage, or our inability to renew collective bargaining agreements on favorable terms, could adversely affect our financial results.

As of December 31, 2013, approximately 18% of our workforce was covered by one collective bargaining agreement, which expires in May 2016. While we believe our relations with our employees are satisfactory, we cannot assure you that we will be able to negotiate a new collective bargaining agreement on favorable terms. If we are unable to negotiate an acceptable new agreement with the union upon expiration of the existing contract, we could experience a strike or work stoppage. Even if we are successful in negotiating a new agreement, the new agreement could call for higher wages or benefits paid to union members, which would increase our operating costs and could adversely affect our profitability. If our unionized workers were to engage in a strike or other work stoppage, or other non-unionized operations were to become unionized, we could experience a significant disruption of operations at our facilities or higher ongoing labor costs. A strike or other work stoppage in the facilities of any of our major customers or suppliers could also have similar effects on us.

#### Risks Related to Our Indebtedness

Our indebtedness could materially adversely affect our ability to generate sufficient cash to make distributions to stockholders and fulfill our debt obligations, our ability to react to changes in our business and our ability to incur additional indebtedness to fund future needs.

Our debt requires interest and principal payments. As of December 31, 2013, we had long-term debt of \$320.1 million, with no installments due in 2014. Subject to the limits contained in our debt instruments, we may be able to incur additional debt from time to time to finance working capital, capital expenditures, investments or acquisitions, or for other purposes. If we do so, the risks related to our indebtedness could intensify.

Our indebtedness increases the possibility that we may be unable to generate cash sufficient to pay, when due, the principal of, interest on or other amounts due in respect of our indebtedness or to make distributions to our stockholders. Our indebtedness, combined with our other financial obligations and contractual commitments, could have important consequences for stockholders. For example, it could:

- make it more difficult for us to satisfy our obligations with respect to our indebtedness, and any failure to comply with the obligations under any of our debt instruments, including restrictive covenants, could result in an event of default under the agreements governing such indebtedness;

require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing funds available for distributions to stockholders, working capital, capital expenditures, acquisitions and other purposes;

14 / POTLATCH CORPORATION

---

increase our vulnerability to adverse economic and industry conditions, which could place us at a competitive disadvantage compared to our competitors that have relatively less indebtedness; limit our flexibility in planning for, or reacting to, changes in our business and the industries in which we operate; and limit our ability to borrow additional funds, or to dispose of assets to raise funds, if needed, for distributions to stockholders, working capital, capital expenditures, acquisitions and other corporate purposes.

Changes in credit ratings issued by nationally recognized statistical rating organizations could adversely affect our cost of financing and have an adverse effect on the market price of our securities.

Credit rating agencies rate our debt securities on factors that include our operating results, actions that we take, their view of the general outlook for our industry and their view of the general outlook for the economy. Actions taken by the rating agencies can include maintaining, upgrading or downgrading the current rating or placing the company on a watch list for possible future downgrading. Downgrading the credit rating of our debt securities or placing us on a watch list for possible future downgrading could limit our access to the credit markets, increase our cost of financing, and have an adverse effect on the market price of our securities.

#### 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 (Treasury). Changes to the tax laws affecting REITs or taxable REIT subsidiaries, 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 provide assurance that new legislation, Treasury regulations, administrative interpretations or court decisions will not significantly affect our ability to remain qualified as a REIT, the federal income tax consequences of such qualification, the determination of the amount of REIT taxable income or the amount of tax paid by the TRS. If in any taxable year we fail to remain qualified as a REIT:

- we would not be allowed a deduction for distributions to stockholders in computing our taxable income; and
- we would be subject to federal income tax on our taxable income at regular corporate rates, including any applicable alternative minimum tax.

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, which would have an adverse impact on the value of our common stock.

Certain of our business activities are potentially subject to a prohibited transactions tax on 100% of our net income derived from such activities, 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 of wood products, certain types of timberland 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 thus 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 activities to Potlatch TRS. Therefore, we could be subject to the 100% prohibited transactions tax if such instances were to occur, which would adversely affect our cash flow and impair our ability to make quarterly distributions.

Our REIT structure may limit our ability to invest in our non-REIT qualifying operations.

Our use of Potlatch TRS enables us to continue to engage in non-REIT qualifying business activities consisting primarily of our manufacturing facilities, assets used for the harvesting of timber and the sale of logs, and selected land parcels that we expect to be sold or developed for higher and better use purposes. However, under the Internal Revenue Code, no more than 25% of the value of the assets of a REIT may be represented by securities of our taxable REIT subsidiaries. This may limit our ability to make investments in our wood products manufacturing operations or in other non-REIT qualifying operations.

Our ability to fund distributions and service our indebtedness using cash generated through our taxable REIT subsidiary may be limited.

The rules with which we must comply to maintain our status as a REIT limit our ability to use dividends from Potlatch TRS for the payment of stockholder distributions and to service our indebtedness. In particular, at least 75% of our gross income for each taxable year as a REIT must be derived from sales of our standing timber and other types of real estate income. No more than 25% of our gross income may consist of dividends from Potlatch TRS and other non-qualifying types of income. This requirement may limit our ability to receive dividends from Potlatch TRS and may impact our ability to fund distributions to stockholders and service the REIT's indebtedness using cash from Potlatch TRS.

We may not be able to complete desired like-kind exchange transactions for property we sell.

We sometimes seek to match sales and acquisitions of properties, which allows us to use Internal Revenue Code section 1031 like-kind exchange tax-deferred treatment. The matching of sales and purchases provides us with significant tax benefits, primarily the deferral of any gain on the property sold until the ultimate disposition or harvest of the replacement property. While we may attempt to complete like-kind exchanges when it is appropriate, it is unlikely that we will be able to do so in all instances due to various factors, including the lack of availability of suitable replacement property on acceptable terms and the inability to complete a qualifying like-kind exchange transaction within the time frames required by the Internal Revenue Code. The inability to obtain like-kind exchange treatment could result in the payment of taxes with respect to REIT property sold in 2014 and 2015, and a corresponding reduction in income and cash available for distribution to stockholders.

We may not be able to realize our deferred tax assets.

We may not have sufficient future taxable income to realize all our deferred tax assets. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which our temporary differences are deductible as governed by the tax code. The amount of our deferred tax assets could be reduced in the near term if future taxable income does not materialize or management is unable to implement one or more strategies that it has identified to generate taxable income. See Note 9: Income Taxes in the Notes to Consolidated Financial Statements contained in this report for additional information about our deferred tax assets.

### Risks Related to Ownership of Our Common Stock

The price of our common stock may be volatile.

The market price of our common stock may be influenced by many factors, some of which are beyond our control, including those described above under "Business and Operating Risks" and the following: actual or anticipated fluctuations in our operating results or our competitors' operating results, announcements by us or our competitors of capacity changes, acquisitions or strategic investments, our growth rate and our competitors' growth rates, the financial markets and general economic conditions, changes in stock market analyst recommendations regarding us, our competitors or the forest products industry generally, or lack of analyst coverage of our common stock, failure to pay cash dividends or the amount of cash dividends paid, sales of our common stock by our executive officers, directors and significant stockholders or sales of substantial amounts of common stock, and changes in accounting principles. In addition, there has been significant volatility in the market price and trading volume of securities of companies operating in the forest products industry that often has been unrelated to the operating performance of particular companies.

Certain provisions of our certificate of incorporation and bylaws and of Delaware law may make it difficult for stockholders to change the composition of our board of directors and may discourage hostile take over attempts that some of our stockholders may consider to be beneficial.

Certain provisions of our certificate of incorporation and bylaws and Delaware law may have the effect of delaying or preventing changes in control if our board of directors determines that such changes in control are not in the best interest of us and our stockholders. The provisions in our certificate of incorporation and bylaws include, among other things, the following:

- a classified board of directors with three-year staggered terms;
- the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms, including preferences and voting rights, of those shares without stockholder approval;
- stockholder action can only be taken at a special or regular meeting and not by written consent and stockholders cannot call a special meeting except upon the written request of stockholders entitled to cast not less than a majority of all of the votes entitled to be cast at the meeting;
- advance notice procedures for nominating candidates to our board of directors or presenting matters at stockholder meetings;
- removal of directors only for cause;
- allowing only our board of directors to fill vacancies on our board of directors;
- in order to facilitate the preservation of our status as a REIT under the Internal Revenue Code, a prohibition on any single stockholder, or any group of affiliated stockholders, from beneficially owning more than 9.8% of our outstanding common or preferred stock, unless our board waives or modifies this ownership limitation;
  - unless approved by the vote of at least 80% of our outstanding shares, we may not engage in business combinations, including mergers, dispositions of assets, certain issuances of shares of stock and other specified transactions, with a person owning or controlling, directly or indirectly, 5% or more of the voting power of our outstanding common stock; and
- supermajority voting requirements to amend our bylaws and certain provisions of our certificate of incorporation.

While these provisions have the effect of encouraging persons seeking to acquire control of our company to negotiate with our board of directors, they could enable the board of directors to hinder or frustrate a transaction that stockholders might believe to be in their best interests and, in that case, may prevent or discourage attempts to remove and replace incumbent directors. We are also subject to Delaware laws that could have similar effects. One of these laws prohibits us from engaging in a business combination with a significant stockholder unless specific conditions are met.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Information on our locations and facilities is included in Part I - Item 1. Business under each of the respective segment headers.

ITEM 3. LEGAL PROCEEDINGS

Other than the environmental proceedings described in Note 15: Commitments and Contingencies in the Notes to Consolidated Financial Statements, which is incorporated herein by reference, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

18 / POTLATCH CORPORATION

---



## Part II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on The Nasdaq Global Select Market (NASDAQ). The quarterly high and low sales price per share of our common stock and the quarterly cash distribution payments per share for 2013 and 2012, were as follows:

| QUARTER | 2013    |         |                    | 2012    |         |                    |
|---------|---------|---------|--------------------|---------|---------|--------------------|
|         | HIGH    | LOW     | CASH DISTRIBUTIONS | HIGH    | LOW     | CASH DISTRIBUTIONS |
| 1st     | \$46.01 | \$39.43 | \$ 0.31            | \$34.45 | \$29.73 | \$ 0.31            |
| 2nd     | 51.48   | 39.66   | 0.31               | 32.13   | 28.02   | 0.31               |
| 3rd     | 44.93   | 37.59   | 0.31               | 38.49   | 31.12   | 0.31               |
| 4th     | 43.84   | 38.01   | 0.35               | 39.21   | 36.65   | 0.31               |

There were approximately 1,172 stockholders of record at January 31, 2014.

Our Board of Directors, in its sole discretion, determines 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, harvest levels on our timberlands, market demand for timberlands, including timberland properties we have identified as potentially having a higher and better use, and future acquisitions and dispositions. Consequently, the level of distributions to our stockholders may fluctuate and any reduction in the distribution rate may adversely affect our stock price.

Reference is made to the discussion in Liquidity and Capital Resources in Management's Discussion and Analysis of Financial Condition and Results of Operations, of (i) the covenants in our bank credit facility and term loan and the indenture governing our senior notes with which we must comply in order to make cash distributions and (ii) the REIT tax rules, which under certain circumstances may restrict our ability to receive dividends from Potlatch TRS, our taxable REIT subsidiary.

There are currently no authorized repurchase programs in effect under which we may repurchase shares.

See Part III - Item 12. Security Ownerships of Certain Beneficial Owners and Management and Related Stockholder Matters of this report for a tabular summary of shares authorized for issuance under our equity compensation plans, which information is incorporated herein by this reference.

## Company Stock Price Performance

The following graph and table show a five-year comparison of cumulative total stockholder returns for the company, the NAREIT Equity Index, the Standard & Poor's 500 Composite Index and a group of six companies that we refer to as our Peer Group for the period ended December 31, 2013. The total stockholder return assumes \$100 invested at December 31, 2008, with quarterly reinvestment of all dividends.

|                              | At December 31, |        |        |        |        |
|------------------------------|-----------------|--------|--------|--------|--------|
|                              | 2009            | 2010   | 2011   | 2012   | 2013   |
| Potlatch Corporation         | \$ 132          | \$ 143 | \$ 144 | \$ 188 | \$ 207 |
| NAREIT Equity Index          | 128             | 164    | 177    | 209    | 215    |
| S&P 500 Composite            | 126             | 146    | 149    | 172    | 228    |
| 2013 Peer Group <sup>1</sup> | 130             | 142    | 148    | 203    | 216    |

<sup>1</sup> Our Peer Group companies are Deltic Timber Corp., Plum Creek Timber Co., Inc., Rayonier Inc., St. Joe Co., Universal Forest Products Inc. and Weyerhaeuser Co.

ITEMS 6, 7, 7A and 8.

The information called for by Items 6, 7, 7A and 8, inclusive, of Part II of this form is contained in the following sections of this report at the pages indicated below:

|   | PAGE<br>NUMBER |
|---|----------------|
| ITEM 6 <u>Selected Financial Data</u>   | <u>27</u>      |
| ITEM 7 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>28</u>      |
| ITEM 7A <u>Quantitative and Qualitative Disclosures About Market Risk</u>                           | <u>40</u>      |
| ITEM 8 <u>Financial Statements and Supplementary Data</u>   | <u>42</u>      |

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

We conducted an evaluation (pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act)), under the supervision and with the participation of management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) as of December 31, 2013. These disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports that are filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Our disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that this information is accumulated and communicated to management, including the principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. Based on the evaluation, the CEO and CFO have concluded that these disclosure controls and procedures were effective as of December 31, 2013.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Exchange Act of 1934.

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

Our management, with the participation of our CEO and CFO, assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (1992).

Based on our assessment, management believes that, as of December 31, 2013, our internal control over financial reporting is effective based on those criteria.

The effectiveness of our internal control over financial reporting as of December 31, 2013, has been audited by KPMG LLP, an independent registered public accounting firm. The audit report is included in the Reports of Independent Registered Public Accountants section of this document.

Changes in Internal Control Over Financial Reporting

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

ITEM 9B. OTHER INFORMATION

None.

Part III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Certain of the information required by this item is incorporated by reference to the information appearing under the headings "Board of Directors," "Corporate Governance" and "Security Ownership of Certain Beneficial Owners and Management – Section 16(a) Beneficial Ownership Reporting Compliance" from our definitive Proxy Statement to be filed with the Commission on or about April 1, 2014.

Our Corporate Conduct and Ethics Code, which is applicable to all directors, officers and employees, can be found on our website at [www.potlatchcorp.com](http://www.potlatchcorp.com). We post any amendments to or waivers from our Corporate Conduct and Ethics Code on our website.

Executive Officers of the Registrant

Information as of February 14, 2014, and for at least the past five years concerning our executive officers is as follows:

Michael J. Covey (age 56), has served as Chief Executive Officer since February 2006 and served as President and Chief Executive Officer from 2006 to March 2013. He has been a director of the company since February 2006, and has served as Chairman of the Board of the company since January 2007.

Eric J. Cremers (age 50), has served as President and Chief Operating Officer, and a director of the company, since March 2013, as Executive Vice President and Chief Financial Officer from March 2012 to March 2013, and as Vice President, Finance and Chief Financial Officer from July 2007 to March 2012.

Jerald W. Richards (age 45), has served as Vice President and Chief Financial Officer since September 2013. He was employed by Weyerhaeuser Company and served as Chief Accounting Officer from October 2010 to August 2013 and corporate segment controller from 2008 to October 2010.

William R. DeReu (age 47), has served as Vice President, Real Estate and Lake States Resource since February 2012 and as Vice President, Real Estate from May 2006 to February 2012.

Lorrie D. Scott (age 59), has served as Vice President, General Counsel and Corporate Secretary since July 2010. Prior to July 2010, she was employed by Weyerhaeuser Realty Investors, Inc., and served as Senior Vice President and General Counsel from October 2007 to July 2010.

Thomas J. Temple (age 57), has served as Vice President, Wood Products and Arkansas Resource since February 2012, as Vice President, Wood Products from January 2009 to February 2012, and as Vice President from November 2008 to January 2009.

The term of office of the officers of the company expires at the annual meeting of our board, and each officer holds office until the officer's successor is duly elected and qualified or until the earlier of the officer's death, resignation, retirement, removal by the board or as otherwise provided in our bylaws.

ITEM 11. EXECUTIVE COMPENSATION

Information set forth under the headings "Report of the Executive Compensation Personnel Policies Committee," "Compensation Discussion and Analysis" and "Corporate Governance - Compensation Committee Interlocks and Insider Participation" in our definitive Proxy Statement to be filed with the Commission on or about April 1, 2014, is incorporated herein by reference.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information regarding any person or group known by us to be the beneficial owner of more than five percent of our common stock as well as the security ownership of management set forth under the heading "Security Ownership of Certain Beneficial Owners and Management" in our definitive Proxy Statement to be filed with the Commission on or about April 1, 2014, is incorporated herein by reference.

The following table provides certain information as of December 31, 2013, with respect to our equity compensation plans:

### EQUITY COMPENSATION PLAN INFORMATION

| PLAN CATEGORY  | NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS OR RIGHTS <sup>1</sup> | WEIGHTED AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS OR RIGHTS <sup>2</sup> | NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE UNDER EQUITY COMPENSATION PLANS |
|--|---|---|--|
| Equity compensation plans approved by security holders     | 557,943   | \$ 30.92  | 269,358  |
| Equity compensation plans not approved by security holders | —   | —   | —  |
| Total  | 557,943   | \$ 30.92  | 269,358  |

Includes 455,350 performance shares and 89,734 restricted stock units, or RSUs, which are the maximum number of <sup>1</sup> shares that can be awarded under the performance share and RSU programs, not including future dividend equivalents.

<sup>2</sup> Performance shares and RSUs do not have exercise prices and are therefore not included in the weighted average exercise price calculation.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item regarding certain relationships and related transactions is included under the heading "Corporate Governance - Transactions with Related Persons" in our definitive Proxy Statement to be filed with the Commission on or about April 1, 2014, and is incorporated herein by reference.

The information required by this item regarding director independence is included under the headings "Board of Directors" and "Corporate Governance - Director Independence" in our definitive Proxy Statement to be filed with the Commission on or about April 1, 2014, and is incorporated herein by reference.

## ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item regarding principal accounting fees and services is included under the heading "Fees Paid to Independent Registered Public Accounting Firm in 2013 and 2012" in our definitive Proxy Statement to be filed with the Commission on or about April 1, 2014, and is incorporated herein by reference.

Part IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Consolidated Financial Statements

Our consolidated financial statements are listed in the [Index to Consolidated Financial Statements and Schedules](#).

Financial Statement Schedules

None.

Exhibits

Exhibits are listed in the [Exhibit Index](#).

24 / POTLATCH CORPORATION

---

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

POTLATCH CORPORATION

(Registrant)

By /S/ MICHAEL J. COVEY  
Michael J. Covey  
Chairman of the Board and Chief Executive Officer

Date: February 14, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on February 14, 2014, by the following persons on behalf of the registrant in the capacities indicated.

|   |  |
|---|--|
| BY /S/ MICHAEL J. COVEY<br>Michael J. Covey     | Director, Chairman of the Board, and Chief Executive Officer<br>(Principal Executive Officer)                |
| BY /S/ ERIC J. CREMERS<br>Eric J. Cremers       | Director, President and Chief Operating Officer  |
| BY /S/ JERALD W. RICHARDS<br>Jerald W. Richards | Vice President and Chief Financial Officer (Principal Financial Officer<br>and Principal Accounting Officer) |
| *<br>Boh A. Dickey                              | Director   |
| *<br>William L. Driscoll                        | Director   |
| *<br>Charles P. Grenier                         | Director   |
| *<br>Jerome C. Knoll                            | Director   |
| *<br>John S. Moody                              | Director   |
| *<br>Lawrence S. Peiros                         | Director   |
| *<br>Gregory L. Quesnel                         | Director   |

\*By /S/ LORRIE D. SCOTT  
Lorrie D. Scott  
(Attorney-in-fact)





POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

Index to Consolidated Financial Statements and Schedules

The following documents are filed as part of this report:

|   | PAGE<br>NUMBER |
|---|----------------|
| <u>Selected Financial Data</u>  | <u>27</u>      |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                | <u>28</u>      |
| Consolidated Financial Statements:  |                |
| <u>Consolidated Statements of Income for the years ended December 31, 2013, 2012 and 2011</u>               | <u>42</u>      |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011</u> | <u>43</u>      |
| <u>Consolidated Balance Sheets at December 31, 2013 and 2012</u>  | <u>44</u>      |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011</u>           | <u>45</u>      |
| <u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2013, 2012 and 2011</u> | <u>46</u>      |
| <u>Notes to Consolidated Financial Statements</u>   | <u>47</u>      |
| <u>Reports of Independent Registered Public Accounting Firm</u>   | <u>72</u>      |

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Selected Financial Data

(Dollars in thousands – except per-share amounts)

|   | 2013      | 2012      | 2011      | 2010      | 2009      |
|---|-----------|-----------|-----------|-----------|-----------|
| Revenues  | \$570,289 | \$525,134 | \$497,421 | \$539,447 | \$476,169 |
| Income from continuing operations                   | 70,581    | 42,594    | 40,266    | 40,275    | 81,431    |
| Net income  | 70,581    | 42,594    | 40,266    | 40,394    | 77,328    |
| Total assets  | \$680,530 | \$718,897 | \$746,220 | \$781,711 | \$823,565 |
| Working capital                                     | 80,051    | 74,510    | 57,242    | 95,762    | 63,225    |
| Long-term debt (including current portion)          | 320,092   | 357,576   | 366,403   | 368,496   | 368,431   |
| Stockholders' equity                                | 204,148   | 138,643   | 142,138   | 204,439   | 229,790   |
| Current ratio                                       | 2.6 to 1  | 2.2 to 1  | 1.7 to 1  | 2.5 to 1  | 2.1 to 1  |
| Long-term debt to stockholders' equity ratio        | 1.6 to 1  | 2.6 to 1  | 2.6 to 1  | 1.8 to 1  | 1.6 to 1  |
| Capital expenditures:                               |           |           |           |           |           |
| Property, plant and equipment                       | \$10,280  | \$5,636   | \$5,338   | \$5,215   | \$4,317   |
| Timber and timberlands, net                         | 13,373    | 23,552    | 11,548    | 9,786     | 11,380    |
| Total capital expenditures                          | \$23,653  | \$29,188  | \$16,886  | \$15,001  | \$15,697  |
| Net income per share from continuing operations:    |           |           |           |           |           |
| Basic   | \$1.74    | \$1.06    | \$1.00    | \$1.01    | \$2.05    |
| Diluted   | 1.73      | 1.05      | 1.00      | 1.00      | 2.04      |
| Net income per share:                               |           |           |           |           |           |
| Basic   | \$1.74    | \$1.06    | \$1.00    | \$1.01    | \$1.94    |
| Diluted   | 1.73      | 1.05      | 1.00      | 1.00      | 1.93      |
| Weighted-average shares outstanding (in thousands): |           |           |           |           |           |
| Basic   | 40,503    | 40,333    | 40,159    | 39,971    | 39,763    |
| Diluted   | 40,709    | 40,553    | 40,383    | 40,219    | 39,974    |
| Distributions per share                             | \$1.28    | \$1.24    | \$1.84    | \$2.04    | \$2.04    |

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

### Overview

Our 2013 performance demonstrated a strong year, marked by the improvement in lumber prices and higher log prices in Idaho. The Resource segment income increased 48% year over year, or \$23.9 million, on flat harvest levels. The Wood Products segment operated well and posted its highest level of earnings in nearly a decade. Results for our Real Estate segment were strong and it continues to be a stable earnings contributor based on steady demand for our HBU and rural recreational properties.

According to industry forecasts, total demand for North American lumber is anticipated to increase an additional 4 billion board feet, or approximately 7%, from 2013 levels. The majority of the growth is expected in the new home construction market segment as the U.S. housing market continues its gradual recovery. Factors such as home price increases, the cost of new mortgages, the mortgage approval process and the availability of desirable building lots will continue to play into the pace of the housing recovery. Participation by first-time homebuyers has been low to this point in the recovery by historical standards, and would provide an additional boost to demand. We anticipate southern pine sawlog prices will remain flat in 2014.

### Factors Influencing Our Results of Operations and Cash Flows

The operating results of our Resource, Wood Products and Real Estate business segments have been and will continue to be influenced by a variety of factors, including the cyclical nature of the forest products industry, changes in timber prices and in harvest levels from our timberlands, competition, timberland valuations, demand for our non-strategic timberland for higher and better use purposes, the efficiency and level of capacity utilization of our wood products manufacturing operations, changes in our principal expenses such as log costs, asset dispositions or acquisitions, and other factors. See Part I - Item 1. Business for additional information.

### Results of Operations

As of December 31, 2013, our business is organized into three reporting segments: Resource, Wood Products and Real Estate. Sales between segments are recorded as intersegment revenues based on prevailing market prices.

Because of the role of the Resource segment in supplying our Wood Products segment with a portion of its wood fiber needs, intersegment revenues can represent a significant portion of the Resource segment's total revenues. Our other segments generally do not generate intersegment revenues.

In the period-to-period discussions of our consolidated results of operations, our revenues are reported after elimination of intersegment revenues. In the discussions by business segments, each segment's revenues are presented before elimination of intersegment revenues.

## CONSOLIDATED RESULTS COMPARING 2013 WITH 2012

The following table sets forth year-to-year changes in items included in our Consolidated Statements of Income for the years ended December 31, 2013 and 2012.

| (Dollars in thousands)                       | YEARS ENDED DECEMBER 31, |           | AMOUNT<br>OF CHANGE | PERCENT<br>CHANGE |   |
|--|--------------------------|-----------|---------------------|-------------------|---|
|  | 2013                     | 2012      |                     |                   |   |
| Revenues                                     | \$570,289                | \$525,134 | \$45,155            | 9                 | % |
| Costs and expenses:                          |                          |           |                     |                   |   |
| Cost of goods sold                           | 408,772                  | 390,666   | 18,106              | 5                 | % |
| Selling, general and administrative expenses | 50,397                   | 49,419    | 978                 | 2                 | % |
| Environmental remediation charge             | 3,522                    | —         | 3,522               | n/m               |   |
| Asset impairment charge                      | —                        | 107       | (107)               | n/m               |   |
|  | 462,691                  | 440,192   | 22,499              | 5                 | % |
| Operating income                             | 107,598                  | 84,942    | 22,656              | 27                | % |
| Interest expense, net                        | (23,132)                 | (25,539)  | 2,407               | 9                 | % |
| Income before income taxes                   | 84,466                   | 59,403    | 25,063              | 42                | % |
| Income tax provision                         | (13,885)                 | (16,809)  | 2,924               | 17                | % |
| Net income                                   | \$70,581                 | \$42,594  | \$27,987            | 66                | % |

**Revenues.** Revenues increased in 2013 over 2012 from the Resource segment, primarily from higher log prices in Idaho, and the Wood Products segment, due to higher prices for manufactured wood products, partially offset by decreased revenues from our Real Estate segment due to fewer acres sold in 2013. A more detailed discussion of revenues follows in the operating results by business segments.

**Cost of goods sold.** Cost of goods sold increased in 2013 over 2012, primarily due to higher log costs in Wood Products and higher logging and hauling costs and depletion expense in our Resource segment as a result of higher harvest volumes.

**Environmental remediation charge.** In 2013, we recorded pre-tax charges of \$3.5 million to reflect increased remediation costs associated with liabilities related to our Avery Landing site in Idaho. Physical clean-up activities at the site were completed in 2013.

**Asset impairment charge.** In 2012, we recorded a \$0.1 million charge related to write-downs of two of our real estate development projects.

**Interest expense, net.** Net interest expense decreased in 2013 from 2012 primarily due to the early redemption of \$36.7 million of debt in 2013.

**Income tax provision.** Our effective tax rate for 2013 was 16.4% compared to 28.3% in 2012. The decrease resulted primarily from proportionately higher operating income in the REIT.

## BUSINESS SEGMENT RESULTS COMPARING 2013 WITH 2012

## Resource Segment

| (Dollars in thousands)                                 | YEARS ENDED<br>DECEMBER 31, |           | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|--|-----------------------------|-----------|------------------------|-------------------|---|
|  | 2013                        | 2012      |                        |                   |   |
| Revenues (before elimination of intersegment revenues) | \$238,228                   | \$207,846 | \$30,382               | 15                | % |
| Operating income                                       | \$73,425                    | \$49,543  | \$23,882               | 48                | % |
| Harvest Volumes (in tons)                              |                             |           |                        |                   |   |
| Northern region  |                             |           |                        |                   |   |
| Sawlog   | 2,031,637                   | 1,946,138 | 85,499                 | 4                 | % |
| Pulpwood   | 127,998                     | 299,934   | (171,936)              | (57)              | % |
| Stumpage   | 25,397                      | 34,049    | (8,652)                | (25)              | % |
| Total  | 2,185,032                   | 2,280,121 | (95,089)               | (4)               | % |
| Southern region  |                             |           |                        |                   |   |
| Sawlog   | 694,147                     | 586,658   | 107,489                | 18                | % |
| Pulpwood   | 821,781                     | 691,411   | 130,370                | 19                | % |
| Stumpage   | 8,353                       | —         | 8,353                  | n/m               |   |
| Total  | 1,524,281                   | 1,278,069 | 246,212                | 19                | % |
| Total harvest volume                                   | 3,709,313                   | 3,558,190 | 151,123                | 4                 | % |
| Sales Price/Unit (\$ per ton)                          |                             |           |                        |                   |   |
| Northern region  |                             |           |                        |                   |   |
| Sawlog   | \$85                        | \$75      | \$10                   | 13                | % |
| Pulpwood   | \$36                        | \$40      | \$(4)                  | (10)              | % |
| Stumpage   | \$8                         | \$10      | \$(2)                  | (20)              | % |
| Weighted Average                                       | \$81                        | \$69      | \$12                   | 17                | % |
| Southern region  |                             |           |                        |                   |   |
| Sawlog   | \$43                        | \$42      | \$1                    | 2                 | % |
| Pulpwood   | \$32                        | \$31      | \$1                    | 3                 | % |
| Stumpage   | \$12                        | \$—       | \$12                   | n/m               |   |
| Weighted Average                                       | \$37                        | \$36      | \$1                    | 3                 | % |

Revenues increased in 2013 over 2012 due to increased prices, primarily for sawlogs in Idaho, and the incremental harvest volumes provided by land acquisitions in Arkansas in late 2012. Increased prices accounted for \$22.0 million of the revenue variance, while the increase in total harvest volume accounted for \$8.6 million of the variance.

In our Northern region, sawlog prices and volume increased due to stronger demand. An oversupply of residuals and chips in the Northwest market resulted in lower pulpwood prices, which led us to minimize pulpwood production.

In our Southern region, both sawlog and pulpwood volumes increased. Sawlog prices increased due primarily to a shift in product mix related to increased demand for higher priced hardwoods. Pulpwood prices increased as a result of slightly improved demand for both pine and hardwood pulpwood.

Expenses for the segment increased \$6.5 million, or 4%, in 2013 over 2012, primarily due to higher logging and hauling costs, from increased per-unit costs as well as volume, and higher depletion expense from increased harvest volumes.



## Wood Products Segment

| (Dollars in thousands)           | YEARS ENDED<br>DECEMBER 31, |           | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|----------------------------------|-----------------------------|-----------|------------------------|-------------------|---|
|                                  | 2013                        | 2012      |                        |                   |   |
| Revenues                         | \$366,015                   | \$329,404 | \$36,611               | 11                | % |
| Operating income                 | \$58,892                    | \$45,456  | \$13,436               | 30                | % |
| Lumber shipments (MBF)           | 641,217                     | 649,119   | (7,902)                | (1)               | % |
| Lumber sales prices (\$ per MBF) | \$392                       | \$342     | \$50                   | 15                | % |

Revenues for the segment increased in 2013 over 2012 as lumber prices increased, but were partially offset by a small decrease in shipments. Expenses for the segment increased \$23.2 million, or 8%, due to the higher cost of logs consumed, primarily related to increased prices for sawlogs in Idaho, and increased logging and hauling expenses, primarily due to a higher volume of logs sourced from third party timberlands in Idaho, and labor-related expenses.

## Real Estate Segment

| (Dollars in thousands) | YEARS ENDED<br>DECEMBER 31, |          | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|------------------------|-----------------------------|----------|------------------------|-------------------|---|
|                        | 2013                        | 2012     |                        |                   |   |
| Revenues               | \$26,160                    | \$38,238 | \$(12,078)             | (32)              | % |
| Operating income       | \$18,266                    | \$28,056 | \$(9,790)              | (35)              | % |

|                          | 2013       |                       | 2012       |                       |
|--------------------------|------------|-----------------------|------------|-----------------------|
|                          | ACRES SOLD | AVERAGE<br>PRICE/ACRE | ACRES SOLD | AVERAGE<br>PRICE/ACRE |
| HBU                      | 4,799      | \$2,033               | 7,080      | \$2,969               |
| Rural real estate        | 9,494      | \$1,310               | 11,724     | \$1,218               |
| Non-strategic timberland | 4,669      | \$849                 | 4,140      | \$711                 |
| Total                    | 18,962     |                       | 22,944     |                       |

Revenues decreased \$12.1 million, expenses decreased \$2.3 million and operating income decreased \$9.8 million in 2013 compared to 2012, all primarily due to the sale of fewer acres of land in 2013 and product mix.





## CONSOLIDATED RESULTS COMPARING 2012 WITH 2011

The following table sets forth year-to-year changes in items included in our Consolidated Statements of Income for the years ended December 31, 2012 and 2011.

| (Dollars in thousands)                       | YEARS ENDED DECEMBER 31, |           | AMOUNT<br>OF<br>CHANGE | PERCENT<br>CHANGE |    |
|--|--------------------------|-----------|------------------------|-------------------|----|
|  | 2012                     | 2011      |                        |                   |    |
| Revenues                                     | \$525,134                | \$497,421 | \$27,713               | 6                 | %  |
| Costs and expenses:                          |                          |           |                        |                   |    |
| Cost of goods sold                           | 390,666                  | 382,252   | 8,414                  | 2                 | %  |
| Selling, general and administrative expenses | 49,419                   | 40,549    | 8,870                  | 22                | %  |
| Environmental remediation charge             | —                        | 1,200     | (1,200)                | ) n/m             |    |
| Asset impairment charge                      | 107                      | 1,180     | (1,073)                | ) (91)            | )% |
|  | 440,192                  | 425,181   | 15,011                 | 4                 | %  |
| Operating income                             | 84,942                   | 72,240    | 12,702                 | 18                | %  |
| Interest expense, net                        | (25,539)                 | (27,829)  | 2,290                  | 8                 | %  |
| Income before income taxes                   | 59,403                   | 44,411    | 14,992                 | 34                | %  |
| Income tax provision                         | (16,809)                 | (4,145)   | (12,664)               | ) n/m             |    |
| Net income                                   | \$42,594                 | \$40,266  | \$2,328                | 6                 | %  |

Revenues. Revenues increased in 2012 compared to 2011 due to increased revenues from our Wood Products segment, partially offset by decreased revenues from our Resource and Real Estate segments. A more detailed discussion of revenues follows in the operating results by business segments.

Cost of goods sold. Cost of goods sold increased in 2012 over 2011, primarily due to the increased cost of logs consumed, customer freight, and wages and benefits that resulted from increased production and operating hours at our wood products manufacturing facilities, partially offset by reduced logging and hauling costs from our Resource segment due to the harvest deferral and lower basis of acres sold by our Real Estate segment.

Selling, general and administrative expenses. Selling, general and administrative expenses increased in 2012 over 2011, primarily due to higher pension expense related to our legacy plans, increased compensation expenses and mark to market adjustments related to deferred compensation plans.

Environmental remediation charge. In 2011, we recorded a pre-tax charge of \$1.2 million to reflect increased remediation cost estimates associated with estimated liabilities related to our Avery Landing site in Idaho.

Asset impairment charge. In 2012, we recorded a \$0.1 million charge related to write-downs of two of our real estate development projects. In 2011, we recorded a charge of \$1.2 million that resulted from a change in the intended use of a warehouse.

Interest expense, net. Net interest expense decreased in 2012 from 2011 due to the maturity and redemption of \$21.7 million of debt in 2012 and the lower interest rates associated with our interest rate swaps in 2012. In addition, a \$1.2 million non-cash charge was recorded in 2011 for deferred costs related to the reduction in the available borrowing capacity in our previous bank credit facility.

Income tax provision. Our effective tax rate for 2012 was 28.3% compared to 9.3% in 2011. The increase resulted from increased operating income earned by Potlatch TRS in 2012.



## BUSINESS SEGMENT RESULTS COMPARING 2012 WITH 2011

## Resource Segment

| (Dollars in thousands)                                 | YEARS ENDED<br>DECEMBER 31, |           | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|--|-----------------------------|-----------|------------------------|-------------------|---|
|  | 2012                        | 2011      |                        |                   |   |
| Revenues (before elimination of intersegment revenues) | \$207,846                   | \$226,969 | \$(19,123)             | (8)               | % |
| Operating income                                       | \$49,543                    | \$59,792  | \$(10,249)             | (17)              | % |
| Harvest Volumes (in tons)                              |                             |           |                        |                   |   |
| Northern region  |                             |           |                        |                   |   |
| Sawlog   | 1,946,138                   | 2,034,465 | (88,327)               | (4)               | % |
| Pulpwood   | 299,934                     | 360,391   | (60,457)               | (17)              | % |
| Stumpage   | 34,049                      | 41,008    | (6,959)                | (17)              | % |
| Total  | 2,280,121                   | 2,435,864 | (155,743)              | (6)               | % |
| Southern region  |                             |           |                        |                   |   |
| Sawlog   | 586,658                     | 875,933   | (289,275)              | (33)              | % |
| Pulpwood   | 691,411                     | 812,577   | (121,166)              | (15)              | % |
| Stumpage   | —                           | 15,006    | (15,006)               | n/m               |   |
| Total  | 1,278,069                   | 1,703,516 | (425,447)              | (25)              | % |
| Total harvest volume                                   | 3,558,190                   | 4,139,380 | (581,190)              | (14)              | % |
| Sales Price/Unit (\$ per ton)                          |                             |           |                        |                   |   |
| Northern region  |                             |           |                        |                   |   |
| Sawlog   | \$75                        | \$73      | \$2                    | 3                 | % |
| Pulpwood   | \$40                        | \$38      | \$2                    | 5                 | % |
| Stumpage   | \$10                        | \$10      | \$—                    | —                 |   |
| Weighted Average                                       | \$69                        | \$66      | \$3                    | 5                 | % |
| Southern region  |                             |           |                        |                   |   |
| Sawlog   | \$42                        | \$42      | \$—                    | —                 |   |
| Pulpwood   | \$31                        | \$29      | \$2                    | 7                 | % |
| Stumpage   | \$—                         | \$6       | \$(6)                  | n/m               |   |
| Weighted Average                                       | \$36                        | \$36      | \$—                    | —                 |   |

Resource revenues decreased in 2012 from 2011 due to our planned harvest deferral, primarily in Arkansas, partially offset by higher sales prices, primarily in Idaho, due to improving market conditions. The decline in total harvest volume accounted for a negative \$31.2 million revenue variance, which was partially offset by a positive pricing variance of \$12.3 million.

In our Northern region, sawlog volume decreased, while sawlog prices increased as a result of strengthening demand for cedar and mixed sawlogs, partially offset by a change in product mix that contained less cedar. Northern pulpwood volume decreased as a result of reduced pulpwood production in Idaho in 2012 due to lower prices, and pulp and paper mill curtailments and closures in the Lake States in 2012. Pulpwood prices increased in 2012 over 2011 due to very low prices in the first half of 2011.

In our Southern region, sawlog volume and prices decreased. Southern pulpwood volume decreased due to the harvest deferral in 2012, combined with increased production of pulpwood in 2011 resulting from pine plantation thinnings

and favorable weather conditions in the latter part of 2011. Pulpwood prices increased due to stronger demand that resulted from decreased pine availability, and a shift in product mix to higher-priced hardwoods.

2013 FORM 10-K / 33

---

Expenses for the segment decreased \$8.9 million, or 5%, in 2012 from 2011, primarily due to decreased logging and hauling costs and lower depletion expense as a result of the reduced harvest volume, partially offset by higher per-unit logging and hauling expenses, increased forest management costs due to catching up on deferred road maintenance, pre-commercial thinning and replanting, and increased commercial thinning.

#### Wood Products Segment

| (Dollars in thousands)           | YEARS ENDED<br>DECEMBER 31, |           | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|----------------------------------|-----------------------------|-----------|------------------------|-------------------|---|
|                                  | 2012                        | 2011      |                        |                   |   |
| Revenues                         | \$329,404                   | \$271,580 | \$57,824               | 21                | % |
| Operating income                 | \$45,456                    | \$7,267   | \$38,189               | n/m               |   |
| Lumber shipments (MBF)           | 649,119                     | 602,510   | 46,609                 | 8                 | % |
| Lumber sales prices (\$ per MBF) | \$342                       | \$297     | \$45                   | 15                | % |

Wood Products revenues increased due to improved market conditions, as both lumber prices and volumes increased in 2012 over 2011. Expenses for the segment increased \$19.6 million, or 7%. The cost of logs consumed, customer freight, and wages and benefits all increased as a result of increased production and operating hours. We recognized a \$0.9 million charge to income related to our lumber hedge in 2012 compared to a benefit of \$4.5 million in 2011.

#### Real Estate Segment

| (Dollars in thousands) | YEARS ENDED<br>DECEMBER 31, |          | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|------------------------|-----------------------------|----------|------------------------|-------------------|---|
|                        | 2012                        | 2011     |                        |                   |   |
| Revenues               | \$38,238                    | \$50,029 | \$(11,791)             | (24)              | % |
| Operating income       | \$28,056                    | \$31,384 | \$(3,328)              | (11)              | % |

|                          | 2012       |                       | 2011       |                       |
|--------------------------|------------|-----------------------|------------|-----------------------|
|                          | ACRES SOLD | AVERAGE<br>PRICE/ACRE | ACRES SOLD | AVERAGE<br>PRICE/ACRE |
| HBU                      | 7,080      | \$2,969               | 2,592      | \$2,054               |
| Rural real estate        | 11,724     | 1,218                 | 9,851      | 1,259                 |
| Non-strategic timberland | 4,140      | 711                   | 24,015     | 1,345                 |
| Total                    | 22,944     |                       | 36,458     |                       |

Revenues decreased \$11.8 million, expenses decreased \$8.5 million and operating income decreased \$3.3 million in 2012 compared to 2011, all primarily due to the sale of fewer acres of land in 2012.

#### Liquidity and Capital Resources

##### Overview

At December 31, 2013, our financial position included long-term debt of \$320.1 million, compared to \$357.6 million at December 31, 2012, due to the redemption in 2013 of \$36.7 million of revenue bonds before their stated maturity dates. The ratio of long-term debt to stockholders' equity was 1.6 to 1 and 2.6 to 1 at December 31, 2013 and 2012, respectively. We increased our quarterly cash distributions in the fourth quarter of 2013 to \$0.35 per share from \$0.31 per share.

Cash and short-term investments totaled \$57.8 million at December 31, 2013. The available borrowing capacity under our credit agreement is \$248.1 million. We have no scheduled debt maturities until December 2015.

#### Net Cash From Operations

Net cash provided from operating activities was:

\$90.3 million in 2013,  
\$80.0 million in 2012 and  
\$77.4 million in 2011.

Year ended December 31, 2013 compared to year ended December 31, 2012

Net cash from operating activities in 2013 increased \$10.3 million from 2012:

Cash received from customers increased \$36.4 million, primarily due to increased sales and cash received by Resource and Wood Products, partially offset by decreased sales and cash received from our Real Estate Segment. Qualified pension plan contributions decreased \$21.6 million in 2013 from 2012, as we did not make a qualified pension plan contribution in 2013.

Partially offsetting these increases were:

Cash paid to employees, suppliers and others increased \$29.4 million in 2013 from 2012.

Net cash outflows related to income taxes increased \$20.0 million. Net cash paid in taxes in 2013 was \$20.1 million compared to \$0.1 million in 2012.

Year ended December 31, 2012 compared to year ended December 31, 2011

Net cash from operating activities in 2012 increased \$2.6 million from 2011:

Cash received from customers increased \$22.8 million, primarily due to increased sales and cash received by Wood Products, partially offset by decreased sales and cash received in our Resource and Real Estate segments.

Partially offsetting increased cash from customers were:

Cash contributions to our qualified pension plans increased \$12.2 million in 2012 from 2011. The qualified pension plan contribution in 2013 was \$21.6 million compared to \$9.4 million in 2011.

Net cash outflows related to income taxes in 2012 was \$0.1 million compared to a net cash inflow in 2011 of \$6.0 million.

Cash paid to employees, suppliers and others increased \$3.4 million in 2012 from 2011.

#### Net Cash Flows from Investing Activities

Net cash used for investing activities was \$12.0 million in 2013, compared to \$8.6 million in 2012. Net cash provided by investing activities was \$4.5 million in 2011. In 2013, we used \$23.7 million for capital expenditures partially offset by \$10.8 million provided by short-term investments. In 2012, we used \$29.2 million for capital expenditures, which was partially offset by the \$21.8 million we borrowed against our COLI plan to fund our 2012 qualified pension contributions. In 2011, the decrease in short-term investments of \$22.3 million was partially offset by \$16.9 million used for capital expenditures.

We anticipate that we will spend \$28 million for capital expenditures in 2014. Our capital spending is primarily related to reforestation expenditures, logging road construction, high-return discretionary projects and routine general replacement projects for our wood products manufacturing facilities.

#### Net Cash Flow From Financing Activities

Net cash used for financing activities was \$89.6 million in 2013, \$62.2 million in 2012 and \$79.7 million in 2011. In 2013, net cash used for financing activities was primarily attributable to paying our quarterly distribution to shareholders of \$51.9 million and the redemption of \$36.7 million of debt. Net cash used for financing activities in 2012 was primarily attributable to paying our quarterly cash distributions to stockholders of \$50.0 million and the maturity and redemption of \$21.7 million of debt, partially offset by the issuance of \$12.0 million of term loans. Net cash used for financing activities in 2011 was primarily attributable to paying our quarterly cash distributions to stockholders of \$73.9 million and the maturity and redemption of \$5.0 million of medium-term notes.

### Unsecured Credit Agreement

Our current unsecured credit agreement, which expires on December 11, 2017, provides for a revolving line of credit of up to \$250 million, including a \$40 million subfacility for letters of credit and a \$15 million subfacility for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. Subject to certain conditions and agreement of the lenders, the bank credit facility may be increased by up to an additional \$100 million. As of December 31, 2013, there were no borrowings outstanding under the revolving line of credit, and approximately \$1.9 million of the letter of credit subfacility was being used to support several outstanding letters of credit. Available borrowing capacity at December 31, 2013 was \$248.1 million.

We may use the funds borrowed under the credit agreement, among other things, to refinance existing indebtedness, fund working capital needs and capital expenditures, and for other general corporate purposes, including acquisitions. The agreement governing our bank credit facility contains certain covenants that limit our ability and that of our subsidiaries to create liens, merge or consolidate, dispose of assets, incur indebtedness and guarantees, repurchase or redeem capital stock and indebtedness, make certain investments or acquisitions, enter into certain transactions with affiliates or change the nature of our business. The bank credit facility also contains financial maintenance covenants establishing a minimum interest coverage ratio, a minimum timberland coverage ratio and a maximum leverage ratio. We will be permitted to pay distributions to our stockholders under the terms of the bank credit facility so long as we remain in pro forma compliance with the financial maintenance covenants.

The table below sets forth the financial covenants in the bank credit facility and our status with respect to these covenants as of December 31, 2013:

|                                   | COVENANT<br>REQUIREMENT | ACTUAL RATIO AT<br>DECEMBER 31, 2013 |
|-----------------------------------|-------------------------|--------------------------------------|
| Minimum Interest Coverage Ratio   | 3.00 to 1.00            | 6.09 to 1.00                         |
| Minimum Timberland Coverage Ratio | 3.00 to 1.00            | 5.94 to 1.00                         |
| Maximum Leverage Ratio            | 5.00 to 1.00 *          | 2.29 to 1.00                         |

\* Commencing January 1, 2015, the Maximum Leverage Ratio will decrease to 4.50 to 1.00.

The Interest Coverage Ratio is our twelve months ended EBITDDA, which we define as net income adjusted for interest expense, provision for income taxes, depreciation, depletion and amortization, the basis of real estate sold and non-cash equity compensation expense, divided by interest expense for the same period.

The Timberland Coverage Ratio is the value of our timberlands divided by our total funded indebtedness, which consists of our long-term debt, including current installments on long-term debt, plus the total amount outstanding under the letter of credit subfacility.

The Leverage Ratio is our total funded indebtedness divided by our twelve months ended EBITDDA, both as computed in the other covenant calculations above.

### Term Loans

In December 2012, we entered into a \$12 million term loan to fund two timberland acquisitions. The term loan consists of two \$6 million tranches, with rates of 2.95% on the 2017 maturity and 3.70% on the 2020 maturity. The term loan contains the same covenants and restrictions as those in our unsecured credit agreement.

### Senior Notes

In 2009, we sold \$150 million aggregate principal amount of 7.5% senior notes. The terms of the notes limit our ability and the ability of any subsidiary guarantors to borrow money, pay dividends, redeem or repurchase capital stock, enter into sale and leaseback transactions, and create liens. With respect to the limitation on dividends and the repurchase of our capital stock, these restricted payments are permitted as follows:

We may use 100% of our Funds Available for Distribution, or FAD, for the period January 1, 2010 through the end of the quarter preceding the payment date, less cumulative restricted payments previously made from FAD during that period, to make restricted payments. Our cumulative FAD less our dividends paid was \$55.7 million at December 31, 2013.

If our cumulative FAD, less cumulative restricted payments previously made from FAD, is insufficient to cover a restricted payment, then we are permitted to make payments from a basket amount, which was approximately \$90.1 million at December 31, 2013.





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

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

#### Future Cash Requirements

Based on our outlook for 2014 and taking into account planned harvest activities, we expect to fund a majority of our 2014 annual cash distributions using the cash flows from our REIT-qualifying timberland operations and from cash and short-term investments on hand at December 31, 2013. The rules with which we must comply to maintain our status as a REIT limit our ability to use dividends from Potlatch TRS for the payment of stockholder distributions. In particular, at least 75% of our gross income for each taxable year as a REIT must be derived from sales of our standing timber and other types of real estate income. No more than 25% of our gross income may consist of dividends from Potlatch TRS and other non-qualifying types of income. This requirement may limit our ability to receive dividends from Potlatch TRS and may impact our ability to fund distributions to stockholders using cash flows from Potlatch TRS.

#### Credit Ratings

The major debt rating agencies routinely evaluate our debt and our access to capital, and our cost of borrowing can increase or decrease depending on our credit rating. In April 2013, Moody's upgraded our debt rating to investment grade 'Baa3' from 'Ba1', with a stable outlook. In April 2013, Standard & Poor's upgraded our corporate credit and senior unsecured ratings to 'BB+' from 'BB', and in December 2013 affirmed our 'BB+' rating, with a stable outlook.

#### Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2013:

| (Dollars in thousands)                  | PAYMENTS DUE BY PERIOD |                  |           |           |                      |
|---|------------------------|------------------|-----------|-----------|----------------------|
|   | TOTAL                  | WITHIN<br>1 YEAR | 1-3 YEARS | 3-5 YEARS | MORE THAN<br>5 YEARS |
| Long-term debt <sup>1</sup>             | \$320,085              | \$—              | \$27,500  | \$25,250  | \$267,335            |
| Interest on long-term debt <sup>2</sup> | 153,048                | 21,241           | 41,097    | 37,955    | 52,755               |
| Operating leases <sup>3</sup>           | 9,985                  | 3,335            | 5,028     | 1,491     | 131                  |
| Purchase obligations <sup>4</sup>       | 13,284                 | 1,599            | 6,867     | 4,818     | —                    |
| Other obligations <sup>5</sup>          | 192,316                | 51,524           | 39,549    | 36,206    | 65,037               |
| Total                                   | \$688,718              | \$77,699         | \$120,041 | \$105,720 | \$385,258            |

<sup>1</sup> See Note 10: Debt in the Notes to Consolidated Financial Statements.

<sup>2</sup> Amounts presented for interest payments assume that all long-term debt outstanding as of December 31, 2013 will remain outstanding until maturity.

<sup>3</sup> See Note 15: Commitments and Contingencies in the Notes to Consolidated Financial Statements.

<sup>4</sup> Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on the company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude arrangements that the company can cancel without penalty.

<sup>5</sup> Other obligations includes current liabilities, as well as qualified pension contributions, supplemental pension payments and payments for other postretirement employee benefit obligations. See Note 11: Accounts Payable and Accrued Liabilities and Note 14: Savings Plans, Pension Plans and Other Postretirement Employee Benefits in the Notes to Consolidated Financial Statements for additional detail.



#### Off-Balance Sheet Arrangements

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

#### Distributions to Shareholders

The following table summarizes the historical tax characteristics of distributions to shareholders for the years ended December 31:

| (Amounts per share)           | 2013    | 2012    | 2011    |
|-------------------------------|---------|---------|---------|
| Capital gain distributions    | \$ 1.28 | \$0.71  | \$0.83  |
| Non-taxable return of capital | —       | 0.53    | 1.01    |
| Total distributions           | \$ 1.28 | \$ 1.24 | \$ 1.84 |

#### Critical Accounting Policies and Estimates

Our accompanying Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States, which require management to make estimates that affect the amounts of revenues, expenses, assets and liabilities reported. The following are critical accounting policies which are both very important to the portrayal of our financial condition and results of operations and which require some of management's most difficult, subjective and complex judgments. The accounting for these matters involves forming estimates based on current facts, circumstances and assumptions which, in management's judgment, could change in a manner that would materially affect management's future estimates with respect to such matters and, accordingly, could cause our future reported financial condition and results of operations to differ materially from financial results reported based on management's current estimates.

**Timber and timberlands.** Timber and timberlands are recorded at cost, net of depletion. Expenditures for reforestation, including all costs related to stand establishment, such as site preparation, costs of seeds or seedlings and tree planting, are capitalized. Expenditures for forest management, consisting of regularly recurring items necessary to the ownership and administration of our timber and timberlands, are accounted for as current operating expense. Our depletion is determined based on costs capitalized and the related current estimated recoverable timber volume.

Recoverable volume does not include anticipated future growth, nor are anticipated future costs considered.

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

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

**Long-lived assets.** A significant portion of our total assets are invested in our timber and timberlands and our wood products manufacturing facilities. The cyclical patterns of our businesses cause cash flows to fluctuate by varying degrees from period to period. As a result, long-lived assets are a material component of our financial position with the potential for material change in valuation if assets are determined to be impaired.

Our long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as measured by its undiscounted estimated future cash flows. We use our operational budgets to estimate future cash flows. Budgets are inherently uncertain estimates of future performance due to the fact that all inputs, including revenues, costs and capital spending, are subject to frequent change for many different reasons, including the reasons previously described above under "Factors Influencing our Results of Operations and Cash Flows." Because of the number of variables involved, the interrelationship between the variables and the long-term nature of the impairment measurement, sensitivity analysis of individual variables is not practical.



Income taxes. We believe it is more likely than not that we will have sufficient future taxable income to realize our deferred tax assets. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which temporary differences are deductible. In making this assessment, we consider the scheduled reversal of deferred tax liabilities (including the impact of available carryforward periods), projected taxable income and tax planning strategies. Based on projected taxable income for Potlatch TRS over the periods for which the deferred tax assets are deductible, as well as certain tax planning strategies that management has undertaken and expects to have the ability to undertake in the future, we believe that it is more likely than not that we will realize the \$45.9 million in benefits of these deductible differences and carryforwards, net of the existing \$2.2 million in valuation allowances at December 31, 2013. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced and management is unable to implement one or more of the tax planning strategies that it has identified.

Contingent liabilities. We are subject to lawsuits, investigations and other claims related to environmental, product and other matters, and are required to assess the likelihood of any adverse judgments or outcomes to these matters, as well as potential ranges of probable losses. We record contingent liabilities when it becomes probable that we will have to make payments and the amount of loss can be reasonably estimated. Assessing probability of loss and estimating probable losses requires analysis of multiple factors, including historical experience, judgments about the potential actions of third party claimants and courts, and recommendations of legal counsel. In addition to contingent liabilities recorded for probable losses, we disclose contingent liabilities when there is a reasonable possibility that an ultimate loss may occur.

While we do our best in developing our projections, recorded contingent liabilities are based on the best information available and actual losses in any future period are inherently uncertain. If estimated probable future losses or actual losses exceed our recorded liability for such claims, we would record additional charges. These exposures and proceedings can be significant and the ultimate negative outcomes could be material to our operating results or cash flow in any given quarter or year. See Note 15: Commitments and Contingencies in the Notes to Consolidated Financial Statements for more information.

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

Note 14: Savings Plans, Pension Plans and Other Postretirement Employee Benefits in the Notes to Consolidated Financial Statements includes information on the components of pension and OPEB expense and the underlying actuarial assumptions used to calculate periodic expense for the three years ended December 31, 2013, as well as the funded status of our pension plans and OPEB obligations as of December 31, 2013 and 2012.

The discount rate used in the determination of pension and OPEB benefit obligations in 2013, 2012 and 2011 was calculated using hypothetical bond portfolios consisting of "AA" or better rated securities that match the expected monthly benefit payments under our pension plans and OPEB obligations. The portfolios were well-diversified over corporate industrial, corporate financial, municipal, federal and foreign government issuers. At December 31, 2013, we calculated pension obligations using a 5.10% discount rate. We used a discount rate of 4.15% and 4.95% at December 31, 2012 and 2011, respectively.

To determine the expected long-term rate of return on pension assets, we employ a process that analyzes historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return. The expected long-term rates of return on pension plan assets was 8.0% for the years ended December 31, 2013 and December 31, 2012, and 8.5% for the year ended December 31, 2011. We reduced the expected long-term rate of return to 7.5% for 2014 to reflect the change in the pension plan's investment portfolio.



Net periodic pension plan cost in 2013 was \$17.8 million. An increase in the discount rate or the rate of expected return on plan assets, all other assumptions remaining the same, would decrease net periodic cost. A 25 basis point increase in the discount rate would increase net periodic cost by approximately \$0.6 million in 2014 and decrease the projected benefit obligation by approximately \$10.1 million at December 31, 2013. A 25 basis point decrease in the assumption for the expected return on plan assets would increase net periodic cost by approximately \$0.8 million. The actual rates of return on plan assets may vary significantly from the assumption used because of unanticipated changes in financial markets.

For our OPEB obligations, the net periodic benefit for 2013 was \$4.6 million. The discount rate used to calculate OPEB obligations, which was determined using the same methodology we used for our pension plans, was 4.45%, 3.70% and 4.85% at December 31, 2013, 2012 and 2011, respectively. The assumed health care cost trend rate used to calculate OPEB obligations as of December 31, 2013 was 0% for our salaried and non-represented plans and a certain group of participants over age 65 in our hourly plan; 6.3% for our Arkansas participants covered by a collective bargaining agreement, grading ratably to an assumption of 5.0% in 2083; and 7.7% for a certain group of participants under age 65 in our hourly plan, grading ratably to an assumption of 5.0% in 2083.

An increase in the discount rate or decrease in the health care cost trend rate assumption, all other assumptions remaining the same would decrease our OPEB liability. A 25 bases point increase in the discount rate would decrease the OPEB liability approximately \$0.9 million. A 1% increase in the health care cost trend rate assumption would have affected our OPEB obligation by approximately \$0.5 million, as reported in Note 14: Savings Plans, Pension Plans and Other Postretirement Employee Benefits in the Notes to Consolidated Financial Statements. The actual rates of health care cost increases may vary significantly from the assumption used because of unanticipated changes in health care costs.

#### PROSPECTIVE ACCOUNTING PRONOUNCEMENTS

Currently there are no significant prospective accounting pronouncements that are expected to have a material impact on us.

#### Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risks on financial instruments includes interest rate risk on our short-term investments, bank credit facility and interest rate swap agreements. All market risk sensitive instruments were entered into for purposes other than trading purposes.

Our short-term investments consist of diversified depository accounts, money market funds and variable rate demand obligations, all of which have very short maturity periods, and therefore earn an interest rate commensurate with low-risk instruments. We do not attempt to hedge our exposure to interest rate risk for our short-term investments.

The interest rates applied to borrowings under our bank credit facility adjust often and therefore react quickly to any movement in the general trend of market interest rates. We do not attempt to mitigate the effects of short-term interest rate fluctuations on our bank credit facility borrowings through the use of derivative financial instruments. There were no outstanding borrowings at December 31, 2013.

All of our long-term debt is fixed rate and therefore changes in market interest rates do not expose us to interest rate risk for these financial instruments. However, we entered into interest rate swap agreements to effectively convert some of our debt to variable rate. As of December 31, 2013, we had six separate interest rate swaps with notional amounts totaling \$46.75 million. The swaps convert interest payments with fixed rates ranging between 6.95% and 8.89% to a three-month LIBOR plus a spread between 4.738% and 6.518%. The interest rate swaps terminate at various dates between December 2015 and February 2018. See Note 13: Financial Instruments and Concentration of Risk in the Notes to Consolidated Financial Statements for additional information.

We occasionally enter into lumber hedging contracts to mitigate commodity price risk related to sales by the Wood Products segment. These contracts normally cash settle at various dates throughout the length of the contracts. Our last lumber hedge settled in 2012; there were no lumber hedges outstanding at December 31, 2013 or 2012. See Note 13: Financial Instruments and Concentration of Risk in the Notes to Consolidated Financial Statements for additional information about our lumber hedges.





## Quantitative Information about Market Risks

The following table summarizes our outstanding debt, interest rate swaps and average interest rates as of December 31, 2013:

| (Dollars in thousands)             | EXPECTED MATURITY DATE |          |         |          |          |           | THEREAFTER | TOTAL |
|------------------------------------|------------------------|----------|---------|----------|----------|-----------|------------|-------|
|                                    | 2014                   | 2015     | 2016    | 2017     | 2018     |           |            |       |
| Fixed rate debt:                   |                        |          |         |          |          |           |            |       |
| Principal due                      | \$—                    | \$22,500 | \$5,000 | \$11,000 | \$14,250 | \$267,335 | \$320,085  |       |
| Average interest rate              | —                      | 6.95     | %8.80   | %5.64    | %8.88    | %6.80     | %6.90      | %     |
| Fair value at 12/31/13             |                        |          |         |          |          |           | \$347,869  |       |
| Interest rate swaps <sup>1</sup> : |                        |          |         |          |          |           |            |       |
| Fixed to variable                  | \$—                    | \$727    | \$171   | \$238    | \$694    | \$—       | \$1,830    |       |
| Fair value at 12/31/13             |                        |          |         |          |          |           | \$1,830    |       |

<sup>1</sup> Interest rate swaps are included in the long-term debt line on the Consolidated Balance Sheets.

We are not subject to interest rate risk on our fixed rate obligations. We are subject to interest rate risk on our interest rate swap agreements. A hypothetical increase or decrease of 50 and 100 basis points (BPS) related to our interest rate swap agreements would have the following effects on fair value:

| (Dollars in thousands) | LONG-TERM INTEREST RATE SWAP AGREEMENTS - FAIR VALUE <sup>1</sup> |         |         |          |         |          |
|------------------------|---|---------|---------|----------|---------|----------|
|                        | DEBT  |         |         |          |         |          |
|                        | PRINCIPAL AMOUNT  | Current | +50 BPS | +100 BPS | -50 BPS | -100 BPS |
| Maturing in:           |   |         |         |          |         |          |
| 2014                   | \$—   | \$—     | \$—     | \$—      | \$—     | \$—      |
| 2015                   | 22,500  | 747     | 546     | 349      | 952     | 956      |
| 2016                   | 5,000   | 179     | 131     | 82       | 231     | 235      |
| 2017                   | 5,000   | 249     | 166     | 85       | 334     | 412      |
| 2018                   | 14,250  | 723     | 441     | 166      | 1,016   | 1,305    |
| Total                  | \$46,750  | \$1,898 | \$1,284 | \$682    | \$2,533 | \$2,908  |

<sup>1</sup> Fair value for purpose of this table is calculated on a termination value basis. Accrued interest is included and a credit value adjustment, which is used for GAAP purpose, is excluded.

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Income

(Dollars in thousands, except per-share amounts)

|  | FOR THE YEARS ENDED DECEMBER 31, |           |           |
|--|----------------------------------|-----------|-----------|
|  | 2013                             | 2012      | 2011      |
| Revenues                                     | \$570,289                        | \$525,134 | \$497,421 |
| Costs and expenses:                          |                                  |           |           |
| Cost of goods sold                           | 408,772                          | 390,666   | 382,252   |
| Selling, general and administrative expenses | 50,397                           | 49,419    | 40,549    |
| Environmental remediation charges            | 3,522                            | —         | 1,200     |
| Asset impairment charges                     | —                                | 107       | 1,180     |
|  | 462,691                          | 440,192   | 425,181   |
| Operating income                             | 107,598                          | 84,942    | 72,240    |
| Interest expense, net                        | (23,132)                         | (25,539)  | (27,829)  |
| Income before income taxes                   | 84,466                           | 59,403    | 44,411    |
| Income tax provision                         | (13,885)                         | (16,809)  | (4,145)   |
| Net income                                   | \$70,581                         | \$42,594  | \$40,266  |
| Net income per share:                        |                                  |           |           |
| Basic  | \$1.74                           | \$1.06    | \$1.00    |
| Diluted                                      | 1.73                             | 1.05      | 1.00      |
| Distributions per share                      | \$1.28                           | \$1.24    | \$1.84    |

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

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

(Dollars in thousands)

|  | FOR THE YEARS ENDED DECEMBER 31, |          |            |
|--|----------------------------------|----------|------------|
|  | 2013                             | 2012     | 2011       |
| Net income   | \$70,581                         | \$42,594 | \$40,266   |
| Other comprehensive income (loss), net of tax:   |                                  |          |            |
| Defined benefit pension plans and other postretirement employee benefits (OPEB):   |                                  |          |            |
| Net gain (loss) arising during the period, net of tax expense (benefit) of \$21,424, \$(5,968) and \$(21,960)                | 33,510                           | (9,334   | )(34,347 ) |
| Prior service credit arising during the period, net of tax expense of \$0, \$2,159 and \$2,264                               | —                                | 3,273    | 3,541      |
| Amortization of actuarial loss included in net periodic cost, net of tax expense of \$9,024, \$7,208 and \$5,414             | 14,114                           | 11,275   | 8,469      |
| Amortization of prior service credit included in net periodic cost, net of tax benefit of \$(3,482), \$(3,343) and \$(3,062) | (5,446                           | )(5,230  | )(4,790 )  |
| Other comprehensive income (loss), net of tax  | 42,178                           | (16      | )(27,127 ) |
| Comprehensive income   | \$112,759                        | \$42,578 | \$13,139   |

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

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Consolidated Balance Sheets

(Dollars in thousands, except per-share amounts)

|   | AT DECEMBER 31 |           |
|---|----------------|-----------|
|   | 2013           | 2012      |
| <b>ASSETS</b>   |                |           |
| Current assets:   |                |           |
| Cash  | \$5,586        | \$16,985  |
| Short-term investments  | 52,251         | 63,077    |
| Receivables, net of allowance for doubtful accounts of \$450  | 16,572         | 10,668    |
| Inventories   | 36,275         | 28,928    |
| Deferred tax assets   | 7,724          | 10,507    |
| Other assets  | 11,961         | 7,932     |
| Total current assets  | 130,369        | 138,097   |
| Property, plant and equipment, net  | 59,976         | 58,050    |
| Timber and timberlands, net   | 455,871        | 464,467   |
| Deferred tax assets   | 21,576         | 43,292    |
| Other assets  | 12,738         | 14,991    |
| Total assets  | \$680,530      | \$718,897 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                |           |
| Current liabilities:  |                |           |
| Current installments on long-term debt  | \$—            | \$8,413   |
| Current liability for pensions and other postretirement employee benefits                           | 6,701          | 6,888     |
| Accounts payable and accrued liabilities  | 43,617         | 48,286    |
| Total current liabilities   | 50,318         | 63,587    |
| Long-term debt  | 320,092        | 349,163   |
| Liability for pensions and other postretirement employee benefits                                   | 83,619         | 145,047   |
| Other long-term obligations   | 22,353         | 22,457    |
| Total liabilities   | 476,382        | 580,254   |
| Stockholders' equity:   |                |           |
| Preferred stock, authorized 4,000,000 shares, no shares issued                                      | —              | —         |
| Common stock, \$1 par value, authorized 100,000,000 shares, issued 40,536,879 and 40,389,180 shares | 40,537         | 40,389    |
| Additional paid-in capital  | 337,887        | 333,348   |
| Accumulated deficit   | (75,556)       | (94,196)  |
| Accumulated other comprehensive loss, net of tax of \$(64,868) and \$(91,834)                       | (98,720)       | (140,898) |
| Total stockholders' equity  | 204,148        | 138,643   |
| Total liabilities and stockholders' equity  | \$680,530      | \$718,897 |

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

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES  
Consolidated Statements of Cash Flows

(Dollars in thousands)

|  | FOR THE YEARS ENDED DECEMBER |            |            |
|--|------------------------------|------------|------------|
|  | 31,                          |            |            |
|  | 2013                         | 2012       | 2011       |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                |                              |            |            |
| Net income   | \$70,581                     | \$42,594   | \$40,266   |
| Adjustments to reconcile net income to net cash from operating activities: |                              |            |            |
| Depreciation, depletion and amortization                                   | 26,962                       | 26,247     | 29,092     |
| Basis of real estate sold  | 2,904                        | 5,048      | 10,219     |
| Deferred income taxes  | (2,467)                      | ) 15,992   | 4,218      |
| Employee benefit plans   | 7,561                        | 4,317      | (2,181)    |
| Equity-based compensation expense  | 4,377                        | 4,067      | 4,404      |
| Other, net   | (1,972)                      | ) 599      | 1,104      |
| Change in:   |                              |            |            |
| Receivables  | (5,904)                      | ) 2,865    | 7,745      |
| Inventories  | (7,347)                      | ) (325)    | ) (4,228)  |
| Prepaid expenses and other assets  | 1,668                        | (1,459)    | ) (8)      |
| Accounts payable and accrued liabilities                                   | (3,468)                      | ) 163      | (4,116)    |
| Funding of qualified pension plans   | —                            | (21,630)   | ) (9,400)  |
| Operating related activities   | (2,643)                      | ) 1,503    | 310        |
| Net cash from operating activities   | 90,252                       | 79,981     | 77,425     |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                |                              |            |            |
| Change in short-term investments   | 10,826                       | (88)       | ) 22,260   |
| Proceeds from company owned life insurance (COLI) loan                     | —                            | 21,751     | —          |
| Additions to property, plant and equipment                                 | (10,280)                     | ) (5,636)  | ) (5,338)  |
| Additions to timber and timberlands  | (13,373)                     | ) (23,552) | ) (11,548) |
| Other, net   | 823                          | (1,122)    | ) (871)    |
| Net cash from investing activities   | (12,004)                     | ) (8,647)  | ) 4,503    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                |                              |            |            |
| Distributions to common stockholders                                       | (51,868)                     | ) (50,041) | ) (73,921) |
| Repayment of long-term debt  | (36,663)                     | ) (21,662) | ) (5,011)  |
| Proceeds from issuance of long-term debt                                   | —                            | 12,000     | —          |
| Issuance of common stock   | 1,904                        | 1,075      | 1,430      |
| Change in book overdrafts  | (955)                        | ) 462      | 157        |
| Deferred financing costs   | (25)                         | ) (2,148)  | ) (698)    |
| Employee tax withholdings on vested performance share awards               | (1,738)                      | ) (1,714)  | ) (1,641)  |
| Other, net   | (302)                        | ) (140)    | ) (18)     |
| Net cash from financing activities   | (89,647)                     | ) (62,168) | ) (79,702) |
| Increase (decrease) in cash  | (11,399)                     | ) 9,166    | 2,226      |
| Cash at beginning of year  | 16,985                       | 7,819      | 5,593      |
| Cash at end of year  | \$5,586                      | \$16,985   | \$7,819    |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b>                                  |                              |            |            |
| Cash paid (received) during the year for:                                  |                              |            |            |
| Interest   | \$22,229                     | \$23,884   | \$25,241   |
| Income taxes, net  | 20,097                       | 53         | (5,984)    |

The accompanying notes are an integral part of these consolidated financial statements.  
Certain 2012 and 2011 amounts have been reclassified to conform to the 2013 presentation.

2013 FORM 10-K / 45

---

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Stockholders' Equity

(Dollars in thousands, except per-share amounts)

|   | Common Stock<br>Issued |          | Additional<br>Paid-In<br>Capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity |
|---|------------------------|----------|----------------------------------|------------------------|---|----------------------------------|
|   | Shares                 | Amount   |                                  |                        |   |                                  |
| Balance, December 31, 2010                            | 40,032,587             | \$40,033 | \$330,894                        | \$(52,733)             | \$(113,755)                                   | \$204,439                        |
| Exercise of stock options and<br>stock awards         | 77,446                 | 77       | 1,261                            | —                      | —   | 1,338                            |
| Performance share and<br>restricted stock unit awards | 92,137                 | 92       | 2,744                            | —                      | —   | 2,836                            |
| Net income  | —                      | —        | —                                | 40,266                 | —   | 40,266                           |
| Pension plans and OPEB<br>obligations                 | —                      | —        | —                                | —                      | (27,127)                                      | (27,127)                         |
| Transfer of assets from REIT<br>to subsidiary         | —                      | —        | (5,693)                          | —                      | —   | (5,693)                          |
| Common distributions, \$1.84<br>per share             | —                      | —        | —                                | (73,921)               | —   | (73,921)                         |
| Balance, December 31, 2011                            | 40,202,170             | \$40,202 | \$329,206                        | \$(86,388)             | \$(140,882)                                   | \$142,138                        |
| Exercise of stock options and<br>stock awards         | 60,857                 | 61       | 1,031                            | —                      | —   | 1,092                            |
| Performance share and<br>restricted stock unit awards | 126,153                | 126      | 3,096                            | (361)                  | —   | 2,861                            |
| Net income  | —                      | —        | —                                | 42,594                 | —   | 42,594                           |
| Pension plans and OPEB<br>obligations                 | —                      | —        | —                                | —                      | (16)  | (16)                             |
| Transfer of assets from REIT<br>to subsidiary         | —                      | —        | 15                               | —                      | —   | 15                               |
| Common distributions, \$1.24<br>per share             | —                      | —        | —                                | (50,041)               | —   | (50,041)                         |
| Balance, December 31, 2012                            | 40,389,180             | \$40,389 | \$333,348                        | \$(94,196)             | \$(140,898)                                   | \$138,643                        |
| Exercise of stock options and<br>stock awards         | 70,968                 | 71       | 1,833                            | —                      | —   | 1,904                            |
| Performance share and<br>restricted stock unit awards | 76,731                 | 77       | 2,706                            | (73)                   | —   | 2,710                            |
| Net income  | —                      | —        | —                                | 70,581                 | —   | 70,581                           |
| Pension plans and OPEB<br>obligations                 | —                      | —        | —                                | —                      | 42,178  | 42,178                           |
| Common distributions, \$1.28<br>per share             | —                      | —        | —                                | (51,868)               | —   | (51,868)                         |
| Balance, December 31, 2013                            | 40,536,879             | \$40,537 | \$337,887                        | \$(75,556)             | \$(98,720)                                    | \$204,148                        |

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

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES  
INDEX FOR NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

|   | PAGE<br>NUMBER |
|---|----------------|
| Note 1. <u>Summary of Principal Accounting Policies</u>                                 | <u>48</u>      |
| Note 2. <u>REIT Conversion</u>  | <u>51</u>      |
| Note 3. <u>Earnings per Share</u>   | <u>51</u>      |
| Note 4. <u>Short-Term Investments</u>   | <u>52</u>      |
| Note 5. <u>Inventories</u>  | <u>52</u>      |
| Note 6. <u>Property, Plant and Equipment</u>  | <u>52</u>      |
| Note 7. <u>Timber and Timberlands</u>   | <u>53</u>      |
| Note 8. <u>Other Assets</u>   | <u>53</u>      |
| Note 9. <u>Income Taxes</u>   | <u>53</u>      |
| Note 10. <u>Debt</u>  | <u>55</u>      |
| Note 11. <u>Accounts Payable and Accrued Liabilities</u>                                | <u>56</u>      |
| Note 12. <u>Other Long-Term Obligations</u>   | <u>57</u>      |
| Note 13. <u>Financial Instruments and Concentration of Risk</u>                         | <u>57</u>      |
| Note 14. <u>Savings Plans, Pension Plans and Other Postretirement Employee Benefits</u> | <u>59</u>      |
| Note 15. <u>Commitments and Contingencies</u>   | <u>65</u>      |
| Note 16. <u>Equity-Based Compensation Plans</u>   | <u>66</u>      |
| Note 17. <u>Segment Information</u>   | <u>69</u>      |
| Note 18. <u>Asset Impairment Charges</u>  | <u>71</u>      |
| Note 19. <u>Financial Results by Quarter</u>  | <u>71</u>      |



## NOTE 1. SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

### CONSOLIDATION

The Consolidated Financial Statements include the accounts of Potlatch Corporation and its subsidiaries after elimination of significant intercompany transactions and accounts. There are no significant unconsolidated subsidiaries.

We are primarily engaged in activities associated with timberland management, including the sale of timber, the management of approximately 1.4 million acres of timberlands and the purchase and sale of timberlands. We are also engaged in the manufacture and sale of wood products. Our timberlands and all of our wood products facilities are located within the continental United States. The primary market for our products is the United States. As discussed in Note 2: REIT Conversion, we converted to a Real Estate Investment Trust, or REIT, effective January 1, 2006.

### SIGNIFICANT ESTIMATES

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

Significant estimates are described in further detail in this section and the following Notes to Consolidated Financial Statements. Significant estimates include timber volumes, pension and postretirement obligation assumptions, environmental liabilities, fair value of derivative instruments and assumptions utilized for asset and disposal group impairment tests.

### EQUITY-BASED COMPENSATION

Equity-based awards are measured at fair value on the dates they are granted or modified. These measurements establish the cost of the equity-based awards for accounting purposes. The cost of the equity-based award is then recognized in the Consolidated Statements of Income over each employee's required service period. See Note 16: Equity-Based Compensation Plans for more information about our equity-based compensation.

### INVENTORIES

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

### PROPERTY, PLANT AND EQUIPMENT

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

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

### TIMBER AND TIMBERLANDS

Timber and timberlands are valued at cost less accumulated depletion and amortization. For fee timber, the capitalized cost includes costs related to stand establishment, such as site preparation, including all costs of preparing the land for planting, cost of seeds or seedlings, tree planting, including labor, materials, depreciation of company-owned equipment and the cost of contract services. Upon completion of planting activities and field inspection to assure the planting operation was successful, a plantation will be considered "established." Subsequent expenditures made to maintain the integrity or enhance the growth of an established plantation or stand are expensed. Post-establishment expenses include release spray treatments, pest control activities, thinning operations, fertilization and replanting seedlings lost through mortality. Expenditures for forest management consist

of regularly recurring items necessary for ownership and administration of timber producing property such as fire protection, property taxes and insurance, silviculture costs incurred subsequent to stand establishment, cruising (physical inventory), property maintenance and salaries, supplies, travel, record-keeping and other normal recurring administrative personnel costs. These expenditures are accounted for as current operating expenses. Timberland purchased on the open market is capitalized and the cost is allocated to the relative values of the component items as appraised, such as timberland, merchantable sawlogs, merchantable pulpwood, reproduction (young growth not merchantable), logging roads and other land improvements. The capitalized cost includes purchase price, title search and title recording, transfer taxes and fees, timber cruises, appraisals and running of boundary lines.

The aggregate estimated volume of current standing timber inventory is updated at least annually to reflect increases in merchantable timber due to reclassification of young growth to merchantable timber, the annual growth rates of merchantable timber and the acquisition of additional merchantable timber, and to reflect decreases due to timber harvests and land sales. Timber volumes are estimated from cruises of the timber tracts, which are completed on our timberlands on approximately a five to ten year cycle. Since the individual cruises collect field data at different times for specific sites, the growth model projects standing inventory from the cruise date to a common reporting date. Annual growth rates for the merchantable inventory have historically been in the range of 2%-5%.

Reproduction accounts are reviewed annually, and dollars are transferred from reproduction accounts to merchantable timber accounts on a reasonable and consistent basis. Volumes and the related accumulated costs are tracked and, as the timber is harvested, the cost is amortized to depletion.

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

The base cost of logging roads, such as the clearing, grading, and ditching, is not amortized and remains a capitalized item until obliteration or other disposition, while other portions of the initial cost, such as bridges, culverts and gravel surfacing are amortized over their useful lives, which range from 5 to 20 years. Costs associated with temporary logging roads that will not become part of our road system are expensed as incurred.

#### REAL ESTATE SALES

Sales of non-core timberland are considered to be part of our normal operations. We therefore classify revenue and costs associated with real estate sold in revenues and cost of goods sold, respectively, in our Consolidated Statements of Income. Cash generated from real estate sales is included as an operating activity in our Consolidated Statements of Cash Flows, and is adjusted for the basis of real estate sold.

#### LIKE-KIND EXCHANGES AND RESTRICTED CASH

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

We use a qualified intermediary to facilitate LKE transactions. Proceeds from forward transactions are held by the intermediary and are classified as restricted cash, within non-current other assets, because the funds must be reinvested in similar properties. If the acquisition of suitable LKE properties is not completed within 180 days of the sale of the company-owned property, the proceeds are distributed to us by the intermediary and are reclassified as available cash and applicable income taxes are determined. In the case of reverse transactions in which we have not yet completed LKE sales of company-owned land to match with property purchased on our behalf by the intermediary, the amount associated with the property purchased on our behalf but not yet matched with LKE sales is classified as a non-current asset and included in "Timber and timberlands, net" in our Consolidated Balance Sheets and as "Additions to timber and timberlands" in the investing activities section of our Consolidated Statements of Cash Flows.



## LONG-LIVED ASSETS

Our long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as measured by its undiscounted estimated future cash flows. We use our operational budgets to estimate future cash flows. Budget estimates are adjusted periodically to reflect changing business conditions, and operations are reviewed, as appropriate, for impairment using the most current data available. In certain circumstances we may also use fair market value to determine the carrying value of certain assets. Assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

We recognize a liability and an asset equal to the fair value of our legal obligations to perform asset retirement activities if the amount can be reasonably estimated. Our primary obligations relate to asbestos located within our manufacturing facilities and a landfill site. We have recorded assets and corresponding liabilities that are not material to our financial position or results of operations. We have also identified situations that would have resulted in the recognition of additional asset retirement obligations, except for an inability to reasonably estimate the fair value of the liability. Most of these situations relate to asbestos located within our manufacturing facilities where a settlement date or range of settlement dates cannot be specified. We review these obligations annually and do not expect them to have a material effect on our financial position, results of operations or cash flows.

## INCOME TAXES

We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases, operating loss carryforwards and tax credit carryforwards. Deferred tax assets and liabilities are measured pursuant to tax laws using rates expected to apply to taxable income in the years in which the temporary differences are expected to be recovered or settled. We recognize the effect of a change in income tax rates on deferred tax assets and liabilities in the Consolidated Statements of Income and Consolidated Statements of Comprehensive Income in the period that includes the enactment date of the rate change. We record a valuation allowance to reduce the carrying amounts of deferred tax assets if it is more likely than not that such deferred tax assets will not be realized.

## REVENUE RECOGNITION

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

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



We recognize revenue from the sale of manufactured wood products and residual by-products when there is persuasive evidence of a sales agreement, the price to the customer is fixed and determinable, collection is reasonably assured, and title and the risk of loss passes to the customer. Shipping terms generally indicate when title and the risk of loss have passed. Revenue is recognized at shipment for sales when shipping terms are FOB (free on board) shipping point. For sales where shipping terms are FOB destination, revenue is recognized when the goods are received by the customer. Shipping terms for wood products and related by-products depend upon the sales agreement with the customer.

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

#### SHIPPING AND HANDLING COSTS

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

#### NOTE 2. REIT CONVERSION

Effective January 1, 2006, we restructured our operations to qualify for treatment as a Real Estate Investment Trust (REIT) for federal income tax purposes. As a REIT, we generally are not subject to federal corporate income taxes on our income from investments in real estate that we distribute to our stockholders, including the income derived from the sale of standing timber. The REIT tax rules require that we derive most of our income, other than income generated by a taxable REIT subsidiary, from investments in real estate, which for us primarily consists of income from the sale of our standing timber. Accordingly, we restructured to create a new parent company that holds our timberlands through a REIT subsidiary and substantially all of our non-timberland assets, consisting primarily of our manufacturing facilities, assets used for the harvesting of timber and the sale of logs, and selected land parcels that we expect to be sold or developed for higher and better use purposes through wholly owned taxable REIT subsidiaries, which we refer to collectively in this report as Potlatch TRS. Our use of Potlatch TRS, which is taxed as a C corporation, enables us to continue to engage in these non-REIT qualifying businesses and comply with the REIT requirements.

#### NOTE 3. EARNINGS PER SHARE

The following table reconciles the number of shares used in calculating the basic and diluted earnings per share for the years ended December 31:

| (Dollars in thousands, except per-share amounts)         | 2013       | 2012       | 2011       |
|--|------------|------------|------------|
| Net income   | \$70,581   | \$42,594   | \$40,266   |
| Basic weighted-average shares outstanding                | 40,502,878 | 40,333,333 | 40,159,141 |
| Incremental shares due to:                               |            |            |            |
| Performance shares                                       | 133,766    | 134,079    | 146,157    |
| Restricted stock units                                   | 69,076     | 70,217     | 32,455     |
| Stock options  | 3,567      | 15,520     | 45,232     |
| Diluted weighted-average shares outstanding              | 40,709,287 | 40,553,149 | 40,382,985 |
| Basic net income per share                               | \$1.74     | \$1.06     | \$1.00     |
| Diluted net income per share                             | \$1.73     | \$1.05     | \$1.00     |
| Anti-dilutive shares excluded from the calculation:      |            |            |            |
| Performance shares                                       | 3,441      | —          | 77,767     |
| Restricted stock units                                   | —          | 315        | 1,500      |
| Total anti-dilutive shares excluded from the calculation | 3,441      | 315        | 79,267     |



## NOTE 4. SHORT-TERM INVESTMENTS

Our short-term investments consist of diversified depository accounts, money market funds and variable rate demand obligations, all of which have very short maturity periods and therefore earn an interest rate commensurate with low-risk instruments. We classify our short-term investments as "available for sale" and there is no significant difference between cost and fair value. We do not attempt to hedge our exposure to interest rate risk for our short-term investments. All short-term investments of REIT funds are made in compliance with the requirements of the Internal Revenue Code with respect to qualifying REIT investments.

## NOTE 5. INVENTORIES

| (Dollars in thousands)                      | 2013     | 2012     |
|---|----------|----------|
| Logs  | \$14,975 | \$12,493 |
| Lumber and other manufactured wood products | 15,967   | 11,761   |
| Materials and supplies                      | 5,333    | 4,674    |
|   | \$36,275 | \$28,928 |
| Valued at lower of cost or market:          |          |          |
| Last-in, first-out basis                    | \$23,250 | \$14,636 |
| Average cost basis                          | 13,025   | 14,292   |
| Total inventories                           | \$36,275 | \$28,928 |

If the last-in, first-out inventory had been carried at average cost, the values would have been approximately \$11.3 million, \$10.6 million, and \$9.7 million higher at December 31, 2013, 2012, and 2011, respectively. LIFO inventories valued at higher costs prevailing in prior years decreased net income by \$0.9 million, \$1.2 million and \$0.8 million in 2013, 2012 and 2011, respectively.

## NOTE 6. PROPERTY, PLANT AND EQUIPMENT

| (Dollars in thousands)              | 2013       | 2012       |
|-------------------------------------|------------|------------|
| Land and land improvements          | \$17,201   | \$16,448   |
| Buildings and structures            | 33,985     | 32,908     |
| Machinery and equipment             | 171,385    | 165,369    |
| Construction in progress            | 1,225      | 3,188      |
|                                     | 223,796    | 217,913    |
| Less: accumulated depreciation      | (163,820 ) | (159,863 ) |
| Total property, plant and equipment | \$59,976   | \$58,050   |

Depreciation charged against operating income totaled \$8.2 million, \$8.8 million and \$9.8 million in 2013, 2012 and 2011, respectively.





## NOTE 7. TIMBER AND TIMBERLANDS

| (Dollars in thousands)       | 2013      | 2012      |
|------------------------------|-----------|-----------|
| Timber and timberlands       | \$391,916 | \$394,913 |
| Deposits on timberlands      | —         | 7,871     |
| Logging roads                | 63,955    | 61,683    |
| Total timber and timberlands | \$455,871 | \$464,467 |

Depletion from company-owned lands totaled \$14.6 million, \$12.9 million and \$14.1 million in 2013, 2012 and 2011, respectively. Amortization of logging roads totaled \$2.7 million, \$2.6 million and \$2.4 million in 2013, 2012 and 2011, respectively.

In 2012, we made two timberland acquisitions in and around our existing ownership in Arkansas. One acquisition was 2,981 acres for approximately \$3.9 million, and the other was 6,304 acres for approximately \$7.9 million. The deposits on timberland balance of \$7.9 million at December 31, 2012 is related to amounts associated with the Arkansas timberland purchased on our behalf by a qualified LKE intermediary.

Payments due under timber cutting contracts total \$2.1 million, \$4.5 million, \$1.5 million and \$4.2 million in 2014, 2015, 2016 and 2017, respectively.

## NOTE 8. OTHER ASSETS

| Current Other Assets<br>(Dollars in thousands) | 2013     | 2012    |
|--|----------|---------|
| Basis of real estate held for sale             | \$10,010 | \$5,871 |
| Deferred charges                               | 1,008    | 1,066   |
| Prepaid expenses                               | 943      | 995     |
| Total current other assets                     | \$11,961 | \$7,932 |

| Noncurrent Other Assets<br>(Dollars in thousands)    | 2013     | 2012     |
|--|----------|----------|
| Deferred charges                                     | \$5,668  | \$6,837  |
| Noncurrent investments                               | 3,144    | 1,754    |
| Derivative asset associated with interest rate swaps | 1,830    | 2,952    |
| Developed land held for sale                         | 1,733    | 1,733    |
| Other  | 363      | 123      |
| Long-term note receivable                            | —        | 1,592    |
| Total noncurrent other assets                        | \$12,738 | \$14,991 |

Deferred charges primarily consist of deferred financing costs, which are being amortized over the life of the associated debt.

## NOTE 9. INCOME TAXES

As a REIT, we generally are not subject to federal and state corporate income taxes on income of the REIT that we distribute to our shareholders. We are, however, subject to corporate taxes on built-in gains (the excess of fair market value over tax basis on January 1, 2006) on sales of real property held by the REIT during the first ten years following the REIT conversion. The sale of standing timber is not subject to built-in gains tax. The Small Business Jobs Act of 2010 modified the built-in gains provisions to exempt sales of real properties in 2011, if five years of the recognition period had elapsed before January 1, 2011. The American Taxpayer Relief Act of 2012 extended the reduced five-year holding period for sales occurring in 2012 and 2013. Accordingly, the built-in gains tax does not apply to sales of real property that occurred in 2011, 2012 and 2013.

We conduct certain activities through taxable REIT subsidiaries (TRS), which are subject to corporate-level federal and state income taxes. These activities are principally comprised of our wood products manufacturing operations and certain real estate investments held for development and resale.

We reflect accrued interest related to tax obligations, as well as penalties, in our provision for income taxes. For the years ended December 31, 2013, 2012 and 2011, we recognized insignificant amounts related to interest and penalties in our tax provision. At December 31, 2013 and 2012, we had no accrued interest related to tax obligations and insignificant accrued interest receivable with respect to open tax refunds.

The income tax provision consists of the following for the years ended December 31:

| (Dollars in thousands)           | 2013     | 2012     | 2011    |
|----------------------------------|----------|----------|---------|
| Current                          | \$16,352 | \$292    | \$(73)  |
| Deferred                         | (2,754)  | 8,197    | 4,990   |
| Net operating loss carryforwards | 287      | 8,320    | (772)   |
| Income tax provision             | \$13,885 | \$16,809 | \$4,145 |

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

| (Dollars in thousands)                        | 2013     | 2012     | 2011     |
|---|----------|----------|----------|
| U.S. federal statutory income tax             | \$29,563 | \$20,791 | \$15,544 |
| REIT income not subject to federal income tax | (13,918) | (5,241)  | (11,739) |
| Change in valuation allowance                 | (683)    | —        | 897      |
| State income taxes, net of federal income tax | 942      | 1,615    | 54       |
| Domestic production activities deduction      | (1,579)  | —        | —        |
| All other items                               | (440)    | (356)    | (611)    |
| Income tax provision                          | \$13,885 | \$16,809 | \$4,145  |
| Effective tax rate                            | 16.4     | %28.3    | %9.3     |

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

| (Dollars in thousands)                          | 2013     | 2012     |
|---|----------|----------|
| Deferred tax assets:                            |          |          |
| Pensions  | \$16,807 | \$38,986 |
| Postretirement employee benefits                | 18,464   | 20,293   |
| Nondeductible accruals                          | 2,405    | 3,841    |
| Inventories                                     | 2,636    | 3,126    |
| Incentive compensation                          | 2,807    | 2,843    |
| Tax credits                                     | 2,135    | 2,678    |
| Employee benefits                               | 1,586    | 1,795    |
| Net operating loss carryforwards                | 1,056    | 1,346    |
| Other   | 200      | 124      |
| Total deferred tax assets                       | 48,096   | 75,032   |
| Valuation allowance                             | (2,184)  | (2,867)  |
| Deferred tax assets, net of valuation allowance | 45,912   | 72,165   |
| Deferred tax liabilities:                       |          |          |
| Timber and timberlands                          | (5,871)  | (6,006)  |
| Property, plant and equipment                   | (10,741) | (12,360) |
| Total deferred tax liabilities                  | (16,612) | (18,366) |
| Net deferred tax assets                         | \$29,300 | \$53,799 |

Net deferred tax assets and liabilities consist of:

| (Dollars in thousands)         | 2013     | 2012     |
|--------------------------------|----------|----------|
| Current deferred tax assets    | \$7,724  | \$10,507 |
| Noncurrent deferred tax assets | 21,576   | 43,292   |
| Net deferred tax assets        | \$29,300 | \$53,799 |

With the exception of the valuation allowances discussed below, we believe it is more likely than not that we will have sufficient future taxable income to realize our deferred tax assets.

Our valuation allowance on deferred taxes was \$2.2 million at the end of 2013; which related to state net operating loss and tax credit carryforwards. The valuation allowance decreased \$0.7 million in 2013 due to the change in actual use and expected future use of state net operating loss carryforwards and state credits.

We have state net operating loss carryforwards of \$24.0 million at December 31, 2013 which expire from 2014 through 2031. We have state investment tax credits of \$3.2 million at December 31, 2013 which expire from 2016 through 2027.

The following table summarizes the tax years subject to examination by major taxing jurisdictions:

| Jurisdiction | Years       |
|--------------|-------------|
| Federal      | 2008 - 2013 |
| Arkansas     | 2010 - 2013 |
| Michigan     | 2009 - 2013 |
| Minnesota    | 2009 - 2013 |
| Idaho        | 2010 - 2013 |

During the fourth quarter of 2013 the IRS closed our federal income tax exams for 2009. As of December 31, 2013 our 2008 TRS federal income tax return is under exam. We do not expect the outcome of the exam to have a material effect on our Consolidated Financial Statements.

As of December 31, 2013 and December 31, 2012, we did not have any liabilities for unrecognized tax benefits. We do not currently believe there is a reasonable possibility of recording a liability for unrecognized tax benefits within the next twelve months.

#### NOTE 10. DEBT

The following table presents our long-term debt as of December 31:

| (Dollars in thousands)  | 2013      | 2012      |
|---|-----------|-----------|
| Senior Notes, 7.50%, due 2019                                     | \$150,000 | \$150,000 |
| Revenue bonds, 5.90% to 7.75%, due 2014 through 2026 <sup>1</sup> | 108,335   | 144,985   |
| Debentures, 6.95%, due 2015                                       | 22,500    | 22,500    |
| Medium-term notes, 8.75% to 8.89%, due 2016 through 2022          | 27,250    | 27,250    |
| Term loans, 2.95% due 2017 and 3.70% due 2020                     | 12,000    | 12,000    |
| Other notes   | —         | 13        |
|   | 320,085   | 356,748   |
| Interest rate swaps   | 1,830     | 2,952     |
| Less unamortized discounts  | (1,823 )  | (2,124 )  |
|   | 320,092   | 357,576   |
| Less current installments on long-term debt                       | —         | (8,413 )  |
| Long-term debt  | \$320,092 | \$349,163 |

<sup>1</sup> In 2013, \$36.7 million of long-term debt was redeemed prior to its scheduled maturities. This included \$8.4 million that was due later in 2013 and \$21.0 million that was the total amount due in 2014.



**UNSECURED CREDIT AGREEMENT**

Our current unsecured credit agreement, which expires on December 11, 2017, provides for a revolving line of credit of up to \$250 million, including a \$40 million subfacility for letters of credit and a \$15 million subfacility for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. Subject to certain conditions and agreement of the lenders, the bank credit facility may be increased by up to an additional \$100 million. As of December 31, 2013, there were no borrowings outstanding under the revolving line of credit, and approximately \$1.9 million of the letter of credit subfacility was being used to support several outstanding letters of credit. Available borrowing capacity at December 31, 2013 was \$248.1 million.

Pricing is set according to the type of borrowing. Eurodollar Rate Loans are issued at a rate equal to the British Bankers Association LIBOR Rate, while Base Rate Loans are issued at a rate equal to the Base Rate, which is a fluctuating rate per annum equal to the highest of (a) the Federal Funds Rate plus 1/2 of 1.00%, (b) the British Bankers Association LIBOR Rate that would then be applicable to a new Eurodollar Rate Loan with a one month Interest Period plus 1.00%, and (c) the rate of interest in effect for such day as publicly announced from time to time by Bank of America as its "prime rate." The interest rates we pay for borrowings under either type of loan include an additional Applicable Rate, which can range from 1.25% to 2.50% for Eurodollar loans and from 0.25% to 1.50% for Base Rate loans, depending on the current Leverage Ratio, as defined below. As of December 31, 2013, we were able to borrow under the bank credit facility with the additional applicable rate of 1.50% for Eurodollar Rate Loans and 0.50% for Base Rate Loans, with commitment fees of 0.25% on the unused balance of the bank credit facility.

**TERM LOANS**

In December 2012, we entered into a \$12 million term loan to fund two timberland acquisitions. The term loan consists of two \$6 million tranches, with rates of 2.95% on the 2017 maturity and 3.70% on the 2020 maturity. The term loans contain the same covenants as those in the unsecured credit agreement.

**DEBT MATURITIES**

Scheduled payments due on long-term debt during each of the five years subsequent to December 31, 2013, are as follows:

(Dollars in thousands)

|      |        |
|------|--------|
| 2014 | \$—    |
| 2015 | 22,500 |
| 2016 | 5,000  |
| 2017 | 11,000 |
| 2018 | 14,250 |

**NOTE 11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

(Dollars in thousands)

|                                       | 2013     | 2012     |
|---------------------------------------|----------|----------|
| Wages, salaries and employee benefits | \$15,908 | \$14,992 |
| Trade accounts payable                | 7,702    | 6,599    |
| Taxes other than income taxes         | 6,247    | 6,363    |
| Interest                              | 4,018    | 4,250    |
| Logging related expenses              | 1,600    | 3,456    |
| Deferred recreational lease income    | 880      | 899      |
| Freight                               | 802      | 426      |
| Environmental remediation             | —        | 4,250    |
| Book overdrafts                       | 2,920    | 3,875    |
| Other                                 | 3,540    | 3,176    |
| Total                                 | \$43,617 | \$48,286 |



## NOTE 12. OTHER LONG-TERM OBLIGATIONS

|   |          |          |
|---|----------|----------|
| (Dollars in thousands)                    | 2013     | 2012     |
| Employee benefits and related liabilities | \$15,423 | \$15,215 |
| Other                                     | 6,930    | 7,242    |
| Total                                     | \$22,353 | \$22,457 |

## NOTE 13. FINANCIAL INSTRUMENTS AND CONCENTRATION OF RISK

## FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair values of our financial instruments as of December 31 are as follows:

|  |               |          |               |          |
|--|---------------|----------|---------------|----------|
|  | 2013          |          | 2012          |          |
| (Dollars in thousands)   | CARRYING FAIR |          | CARRYING FAIR |          |
|  | AMOUNT        | VALUE    | AMOUNT        | VALUE    |
| Cash and short-term investments (Level 1)  | \$57,837      | \$57,837 | \$80,062      | \$80,062 |
| Net derivative asset related to interest rate swaps (Level 2)  | 1,830         | 1,830    | 2,952         | 2,952    |
| Long-term debt (including current installments on long-term debt and fair value adjustments related to fair value swaps) (Level 2) | 320,092       | 347,869  | 357,576       | 379,048  |

A framework has been established for measuring fair value, which provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The three levels of the fair value hierarchy are described below.

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

Level 2 Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
  - Quoted prices for identical or similar assets or liabilities in inactive markets;
  - Inputs other than quoted prices that are observable for the asset or liability; and
  - Inputs that are derived principally from or corroborated by observable market data by correlation or other means.
- If the asset or liability has a specified (contractual) term, the Level 2 input must be observed for substantially the full term of the asset or liability.

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

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

For cash and short-term investments, the carrying amount approximates fair value due to the short-term nature of these financial instruments. The fair value of the interest rate swaps was determined using discounted cash flow analysis on the expected cash flows of each derivative. The analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate forward curves. The fair value of our long-term debt is estimated based upon the quoted market prices for the same or similar debt issues. Long-term debt for which there is no quoted market price, fair value is estimated based on average market prices for comparable liquid revenue bonds.

## DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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



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

#### FAIR VALUE HEDGES OF INTEREST RATE RISK

As of December 31, 2013, we had six separate interest rate swaps with notional amounts totaling \$46.75 million associated with our \$22.5 million debentures and \$24.25 million of our medium-term notes. The swaps convert interest payments with fixed rates ranging between 6.95% and 8.89% to a variable rate of 3-month LIBOR plus a spread between 4.738% and 6.518%. The interest rate swaps terminate at various dates between December 2015 and February 2018.

#### NON-DESIGNATED LUMBER SWAP

Derivatives not designated as hedges are not speculative and are used to manage our exposure to interest rate movements, commodity price movements or other identified risks, but do not meet the strict hedge accounting requirements. In February 2012, we entered into two commodity swap contracts that settled during the second quarter of 2012. In September 2011, we entered into two commodity swap contracts that settled in February 2012. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in net income. There were no outstanding lumber swap contracts at December 31, 2013 or 2012.

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

| (Dollars in thousands)                              | DERIVATIVE ASSETS<br>BALANCE SHEET<br>LOCATION | 2013       | 2012       |
|---|--|------------|------------|
|   |  | FAIR VALUE | FAIR VALUE |
| Derivatives designated as hedging instruments:      |  |            |            |
| Interest rate contracts                             | Other noncurrent assets                        | \$ 1,830   | \$ 2,952   |
| Total derivatives designated as hedging instruments |  | \$ 1,830   | \$ 2,952   |

The effect of derivatives on the Consolidated Statements of Income for the years ended December 31, 2013, 2012 and 2011 are as follows:

| (Dollars in thousands)                                      | LOCATION OF GAIN<br>(LOSS)<br>RECOGNIZED IN<br>INCOME | AMOUNT OF GAIN (LOSS)<br>RECOGNIZED IN INCOME |       |         |
|---|---|---|-------|---------|
|   |   | 2013  | 2012  | 2011    |
| Derivatives designated in fair value hedging relationships: |   |   |       |         |
| Interest rate contracts                                     |   |   |       |         |
| Realized gain on hedging instrument <sup>1</sup>            | Interest expense                                      | \$960   | \$868 | \$1,027 |
| Net gain recognized in income from fair value hedges        |   | \$960   | \$868 | \$1,027 |

Derivatives not designated as hedging instruments:

|   |                    |     |         |         |
|---|--------------------|-----|---------|---------|
| Lumber contracts  |                    |     |         |         |
| Unrealized gain (loss) on derivative  | Cost of goods sold | \$— | \$(480) | \$3,356 |
| Realized gain (loss) on derivative  | Cost of goods sold | —   | (396)   | 1,164   |
| Net gain (loss) recognized in income from derivatives not designated as hedging instruments |                    | \$— | \$(876) | \$4,520 |

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

#### CONCENTRATION OF RISK

One customer accounted for slightly more than 10% of our revenues in the years ended December 31, 2013 and December 31, 2012.



NOTE 14. SAVINGS PLANS, PENSION PLANS AND OTHER POSTRETIREMENT EMPLOYEE BENEFITS  
SAVINGS PLANS

Substantially all of our employees are eligible to participate in 401(k) savings plans. In 2013, 2012 and 2011, we made matching 401(k) contributions on behalf of employees of \$1.8 million, \$1.6 million and \$1.4 million, respectively. Effective January 1, 2011, we closed our defined benefit pension plans to any new salaried and hourly non-represented entrants. In connection with these closures, additional company 401(k) contributions are made for employees hired after that date.

PENSION PLANS AND OTHER POSTRETIREMENT BENEFITS

We also provide benefits under company-sponsored defined benefit retiree health care plans, which cover certain salaried and hourly employees. Most of the retiree health care plans require retiree contributions and contain other cost-sharing features.

We recognize the underfunded status of our defined benefit pension plans and other postretirement employee benefit obligations on our Consolidated Balance Sheets. We recognize the changes in that funded status, in the year in which changes occur, through our Consolidated Statements of Comprehensive Income.

We use a December 31 measurement date for our benefit plans and obligations.

The change in benefit obligation, change in plan assets and funded status for company-sponsored benefit plans and obligations are as follows:

|  | PENSION PLANS |           | OTHER<br>POSTRETIREMENT<br>EMPLOYEE BENEFITS |          |
|--|---------------|-----------|--|----------|
|  | 2013          | 2012      | 2013   | 2012     |
| (Dollars in thousands)                         |               |           |  |          |
| Benefit obligation at beginning of year        | \$445,535     | \$418,251 | \$52,033                                     | \$65,195 |
| Service cost                                   | 5,318         | 5,238     | 94   | 284      |
| Interest cost                                  | 17,826        | 19,986    | 1,810  | 2,478    |
| Plan amendments                                | —             | 510       | —  | (6,045)  |
| Actuarial loss (gain)                          | (41,178)      | )38,329   | (2,692)                                      | )(4,878) |
| Benefits paid                                  | (33,936)      | )(36,779  | )(3,902)                                     | )(5,001) |
| Benefit obligation at end of year              | 393,565       | 445,535   | 47,343                                       | 52,033   |
| Fair value of plan assets at beginning of year | 345,633       | 312,158   | —  | —        |
| Actual return on plan assets                   | 37,157        | 46,905    | —  | —        |
| Employer contributions and benefit payments    | 1,734         | 23,349    | 3,902  | 5,001    |
| Benefits paid                                  | (33,936)      | )(36,779  | )(3,902)                                     | )(5,001) |
| Fair value of plan assets at end of year       | 350,588       | 345,633   | —  | —        |

Amounts recognized in the consolidated balance sheets:

|                        |            |           |           |           |
|------------------------|------------|-----------|-----------|-----------|
| Current liabilities    | \$(1,772)  | )(1,775)  | )(4,929)  | )(5,113)  |
| Noncurrent liabilities | (41,205)   | )(98,127) | )(42,414) | )(46,920) |
| Funded status          | \$(42,977) | )(99,902) | )(47,343) | )(52,033) |

Changes in actuarial assumptions, primarily the increase in the discount rate, used to calculate our pension liabilities resulted in an increase to the funded status of our pension plans at the end of 2013.

Our company-sponsored pension plans were underfunded at December 31, 2013 and 2012. In 2012, we borrowed against our company owned life insurance plan, based on the cash surrender value that had accumulated over the years, to make a \$21.6 million pension contribution. We contributed \$9.3 million to our qualified salaried pension plan, \$6.8 million to our qualified hourly plan and \$5.5 million to our qualified non-represented pension plan, with \$11.9 million being discretionary funding. We were not required to make contributions to our qualified defined benefit plans during 2013.



The accumulated benefit obligation for all defined benefit pension plans was \$387.4 million and \$438.6 million at December 31, 2013 and 2012, respectively.

#### PENSION ASSETS

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

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

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

|                                     |    |         |
|-------------------------------------|----|---------|
| Domestic and international equities | 15 | % - 60% |
| Fixed income securities             | 35 | % - 60% |
| Alternatives                        | 5  | % - 15% |
| Cash                                | 0  | % - 5%  |

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

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

• Assets are not invested in Potlatch stock.

The investment guidelines also provide that the individual investment managers are expected to achieve a reasonable rate of return over a market cycle. Emphasis will be placed on long-term performance versus short-term market aberrations. Factors to be considered in determining reasonable rates of return include performance achieved by a diverse cross section of other investment managers, performance of commonly used benchmarks (e.g., Russell 3000 Index, Barclays US Long Credit Index, Morgan Stanley Capital International All Country World Index ex US), actuarial assumptions for return on plan investments and specific performance guidelines given to individual investment managers.

At December 31, 2013, eleven active investment managers managed substantially all of the pension funds, each of whom had responsibility for managing a specific portion of these assets. Plan assets were diversified among the various asset classes within the allocation ranges established by our investment policy.

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

| ASSET CATEGORY                         | PENSION PLANS |       |   |
|--|---------------|-------|---|
|  | 2013          | 2012  | % |
| Domestic equity securities             | 20            | % 22  | % |
| Debt securities                        | 38            | 36    |   |
| Global/international equity securities | 27            | 28    |   |
| Other                                  | 15            | 14    |   |
| Total                                  | 100           | % 100 | % |

The pension assets are stated at fair value. Refer to Note 13. Financial Instruments and Concentration of Risk for discussion of the framework for measuring fair value.

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

Corporate common and preferred stocks are valued at quoted market prices reported on the major securities markets, and are classified in Level 1. Investments in registered investment company funds for which market quotations are generally readily available are valued at the last reported sale price, official closing price or publicly available net asset value, or NAV, (or its equivalent) on the primary market or exchange on which they are traded, and are classified in Level 1.

Investments in common and collective trust funds, hedge funds and liquidating trusts that maintain investments in mortgage-backed securities, are generally valued based on their respective NAV (or its equivalent), as a practical expedient to estimate fair value due to the absence of readily available market prices. Investments that may be fully redeemed at NAV in the near-term are generally classified in Level 2.

Investments in funds that may not be fully redeemed at NAV in the near-term are generally classified in Level 3.

Fair Value Measurements at December 31, 2013:

(Dollars in thousands)

| ASSET CATEGORY                  | QUOTED PRICES IN<br>ACTIVE MARKETS FOR<br>IDENTICAL ASSETS<br>(LEVEL 1) | SIGNIFICANT<br>OBSERVABLE<br>INPUTS<br>(LEVEL 2) | SIGNIFICANT<br>UNOBSERVABLE<br>INPUTS<br>(LEVEL 3) | TOTAL     |
|---------------------------------|---|--|--|-----------|
| Cash and equivalents            | \$ 9,673  | \$—  | \$ —   | \$9,673   |
| Equity securities:              |   |  |  |           |
| U.S. large cap <sup>1</sup>     | 32,304  | —  | —  | 32,304    |
| U.S. small/mid cap <sup>2</sup> | 19,053  | —  | —  | 19,053    |
| International companies         | 34,773  | —  | —  | 34,773    |
| Mutual funds <sup>3</sup>       | 185,505   | —  | —  | 185,505   |
| Collective investments:         |   |  |  |           |
| Developed markets <sup>4</sup>  | —   | 17,401   | —  | 17,401    |
| Emerging markets <sup>5</sup>   | —   | 41,300   | —  | 41,300    |
| Hedge funds <sup>6</sup>        | —   | —  | 10,579   | 10,579    |
| Total                           | \$ 281,308  | \$58,701   | \$ 10,579  | \$350,588 |

<sup>1</sup> These are managed investments in US large cap equities that track the Russell 1000 Value index.

<sup>2</sup> These are managed investments in US small/mid cap equities that track the Russell 2500 Growth index.

The mutual funds were 50% invested in high-quality intermediate and long-term investment grade securities and

<sup>3</sup> 50% invested in a diversified portfolio of fixed-income instruments of varying maturities, which may be represented by forwards or derivatives such as options, futures contracts or swap agreements and debt securities.

<sup>4</sup> These collective investments are invested in equity funds of developed markets outside of the US & Canada, that track the MSCI EAFE index.

<sup>5</sup> These collective investments are invested in equity funds of emerging markets outside of the US & Canada, that track the MSCI Emerging Markets index.

The hedge funds are 37% invested in long/short and event-driven equity, 24% invested in long and short credit, 11%

<sup>6</sup> in relative value, 10% invested in distressed debt, 6% invested in convertible bond hedging, with the remaining 12% in other investments.

## Fair Value Measurements at December 31, 2012:

(Dollars in thousands)

| ASSET CATEGORY   | QUOTED PRICES IN                              | SIGNIFICANT                 | SIGNIFICANT                   | TOTAL      |
|--|---|-----------------------------|-------------------------------|------------|
|  | ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1) | OBSERVABLE INPUTS (LEVEL 2) | UNOBSERVABLE INPUTS (LEVEL 3) |            |
| Cash and equivalents   | \$ 2,085                                      | \$—                         | \$ —                          | \$2,085    |
| Equity securities:   |   |                             |                               |            |
| U.S. large cap <sup>1</sup>                                    | 35,099  | —                           | —                             | 35,099     |
| U.S. small/mid cap <sup>2</sup>                                | 21,516  | —                           | —                             | 21,516     |
| International companies  | 9,400   | —                           | —                             | 9,400      |
| Mutual funds <sup>3</sup>                                      | 124,453                                       | —                           | —                             | 124,453    |
| Collective investments:  |   |                             |                               |            |
| U.S. small/mid cap <sup>4</sup>                                | —   | 19,803                      | —                             | 19,803     |
| Developed markets <sup>5</sup>                                 | —   | 47,916                      | —                             | 47,916     |
| Emerging markets <sup>6</sup>                                  | —   | 40,983                      | —                             | 40,983     |
| Hedge funds <sup>7</sup>                                       | —   | —                           | 45,693                        | 45,693     |
| Securities pledged to creditors:                               |   |                             |                               |            |
| Money market <sup>8</sup>                                      | —   | 1,499                       | —                             | 1,499      |
| Mortgage-backed securities <sup>9</sup>                        | —   | 1,992                       | —                             | 1,992      |
| Subtotal   | 192,553                                       | 112,193                     | 45,693                        | 350,439    |
| Payable held under securities lending agreements <sup>10</sup> | (4,806  | ) —                         | —                             | (4,806 )   |
| Total  | \$ 187,747                                    | \$ 112,193                  | \$ 45,693                     | \$ 345,633 |

<sup>1</sup> These are managed investments in US large cap equities that track the Russell 1000 Value index.

<sup>2</sup> These are managed investments in US small/mid cap equities that track the Russell 2500 Growth index.

The mutual funds were 50% invested in high-quality intermediate and long-term investment grade securities and

<sup>3</sup> 50% invested in a diversified portfolio of fixed-income instruments of varying maturities, which may be represented by forwards or derivatives such as options, futures contracts or swap agreements and debt securities.

<sup>4</sup> These are managed investments in US small/mid cap equities that track the Russell 2500 Value index.

<sup>5</sup> These collective investments are invested in equity funds of developed markets outside of the US & Canada, that track the MSCI EAFE index.

<sup>6</sup> These collective investments are invested in equity funds of emerging markets outside of the US & Canada, that track the MSCI Emerging Markets index.

The hedge funds are 53% invested in long/short and event-driven equity, 11% invested in long and short credit, 14%

<sup>7</sup> in relative value, 5% invested in fixed income relative value, 4% invested in distressed debt, with the remaining 13% in other investments.

<sup>8</sup> The money market holdings are invested in the Mount Vernon Securities Lending Trust Prime Portfolio.

<sup>9</sup> The mortgage-backed securities are maintained in the U.S. Bank Illiquid Securities Liquidating Trust.

<sup>10</sup> This category represents a payable under the securities lending agreements.

The following table sets forth a summary of changes in the fair value of the plans' Level 3 assets for the years ended December 31:

| (Dollars in thousands)  | Hedge Funds |          |
|---|-------------|----------|
|   | 2013        | 2012     |
| Balance, beginning of year  | \$45,693    | \$42,940 |
| Sales and settlements   | (34,500     | )—       |
| Unrealized gains (losses) relating to assets still held at the reporting date | (614        | )2,753   |

|                      |          |          |
|----------------------|----------|----------|
| Balance, end of year | \$10,579 | \$45,693 |
|----------------------|----------|----------|

62 / POTLATCH CORPORATION

---



## PLAN ACTIVITY

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

| (Dollars in thousands)                      | PENSION PLANS |          |          | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |           |         |
|---|---------------|----------|----------|---|-----------|---------|
|   | 2013          | 2012     | 2011     | 2013                                      | 2012      | 2011    |
| Service cost                                | \$5,318       | \$5,238  | \$4,456  | \$94                                      | \$284     | \$446   |
| Interest cost                               | 17,826        | 19,986   | 21,325   | 1,810                                     | 2,478     | 3,486   |
| Expected return on plan assets              | (26,092)      | (28,755) | (31,804) | —   | —         | —       |
| Curtailment credit                          | —             | —        | —        | —   | (103)     | —       |
| Amortization of prior service cost (credit) | 779           | 770      | 684      | (9,708)                                   | (9,343)   | (8,536) |
| Amortization of actuarial loss              | 19,929        | 15,356   | 9,916    | 3,209                                     | 3,127     | 3,967   |
| Net periodic cost (benefit)                 | \$17,760      | \$12,595 | \$4,577  | \$(4,595)                                 | \$(3,557) | \$(637) |

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

| (Dollars in thousands)                           | PENSION PLANS |           |           | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |            |            |
|--|---------------|-----------|-----------|---|------------|------------|
|  | 2013          | 2012      | 2011      | 2013                                      | 2012       | 2011       |
| Net amount at beginning of year                  | \$161,667     | \$158,883 | \$130,445 | \$(20,769)                                | \$(18,001) | \$(16,690) |
| Amounts arising during the period:               |               |           |           |   |            |            |
| Net loss (gain)                                  | (52,242)      | )20,180   | 57,220    | (2,692)                                   | (4,878)    | (913)      |
| Prior service cost (credit)                      | —             | 510       | —         | —   | (5,942)    | (5,805)    |
| Taxes  | 20,374        | (8,069)   | (22,316)  | )1,050                                    | 4,260      | 2,620      |
| Net amount arising during the period             | (31,868)      | )12,621   | 34,904    | (1,642)                                   | (6,560)    | (4,098)    |
| Amounts reclassified during the period:          |               |           |           |   |            |            |
| Amortization of prior service cost (cost) credit | (779)         | (770)     | (684)     | )9,708                                    | 9,343      | 8,536      |
| Amortization of actuarial loss                   | (19,929)      | (15,356)  | (9,916)   | (3,209)                                   | (3,127)    | (3,967)    |
| Taxes  | 8,076         | 6,289     | 4,134     | (2,535)                                   | (2,424)    | (1,782)    |
| Net reclassifications during the period          | (12,632)      | (9,837)   | (6,466)   | )3,964                                    | 3,792      | 2,787      |
| Net amount at end of year                        | \$117,167     | \$161,667 | \$158,883 | \$(18,447)                                | \$(20,769) | \$(18,001) |

Amounts recognized in accumulated other comprehensive loss on our Consolidated Balance Sheets, net of tax, consist of:

| (Dollars in thousands)      | PENSION PLANS |           | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |            |
|-----------------------------|---------------|-----------|---|------------|
|                             | 2013          | 2012      | 2013                                      | 2012       |
| Net loss                    | \$115,404     | \$159,429 | \$16,490                                  | \$20,090   |
| Prior service cost (credit) | 1,763         | 2,238     | (34,937)                                  | (40,859)   |
| Net amount recognized       | \$117,167     | \$161,667 | \$(18,447)                                | \$(20,769) |



The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year are \$14.5 million and \$0.7 million, respectively. The estimated net loss and prior service credit for OPEB obligations that will be amortized from accumulated other comprehensive loss into net periodic benefit over the next fiscal year are \$2.7 million and \$9.6 million, respectively.

**EXPECTED FUNDING AND BENEFIT PAYMENTS**

We are required to make a minimum contribution of approximately \$1.7 million to our qualified pension plan in 2014. Our non-qualified pension plan is unfunded and benefit payments are paid from our general assets. We estimate approximately \$1.8 million in supplemental pension plan payments in 2014.

Our other postretirement employee benefit plans are unfunded and benefit payments are paid from our general assets they come due. Estimated future benefit payments represent benefit costs incurred during the year by eligible participants.

Estimated future benefit payments, which reflect expected future service are as follows for the years indicated:

| (Dollars in thousands) | PENSION PLANS | OTHER<br>POSTRETIREMENT<br>EMPLOYEE BENEFITS |
|------------------------|---------------|--|
| 2014                   | \$ 30,033     | \$ 4,929                                     |
| 2015                   | 29,836        | 4,835  |
| 2016                   | 29,566        | 4,699  |
| 2017                   | 29,287        | 4,490  |
| 2018                   | 29,064        | 4,248  |