

POTLATCH CORP
Form 10-Q
April 26, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2012

Or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number 1-32729

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

| | |
|--|---|
| Delaware (State or other jurisdiction of incorporation or organization) | 82-0156045 (I.R.S. Employer Identification No.) |
| 601 West First Avenue, Suite 1600 Spokane, Washington (Address of principal executive offices) | 99201 (Zip Code) |
| (509) 835-1500 (Registrant's telephone number, including area code) | |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 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 | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input type="checkbox"/> |

(Do not check if a smaller reporting company)

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

The number of shares of common stock of the registrant outstanding as of April 20, 2012 was 40,332,281.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES
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Part I

ITEM 1.
Financial Statements

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

| | Three Months Ended | |
|---|--------------------|-----------|
| | March 31, | |
| | 2012 | 2011 |
| Revenues | \$112,384 | \$122,233 |
| Costs and expenses: | | |
| Cost of goods sold | 88,975 | 93,148 |
| Selling, general and administrative expenses | 10,890 | 11,927 |
| | 99,865 | 105,075 |
| Operating income | 12,519 | 17,158 |
| Interest expense, net | (6,486 |) (7,879 |
| Income before income taxes | 6,033 | 9,279 |
| Income tax provision | (982 |) (1,583 |
| Net income | \$5,051 | \$7,696 |
| Net income per share: | | |
| Basic | \$0.13 | \$0.19 |
| Diluted | 0.13 | 0.19 |
| Distributions per share | \$0.31 | \$0.51 |
| Weighted-average shares outstanding (in thousands): | | |
| Basic | 40,261 | 40,078 |
| Diluted | 40,365 | 40,293 |

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

Potlatch Corporation and Consolidated Subsidiaries
 Consolidated Statements of Comprehensive Income
 Unaudited (Dollars in thousands)

| (Dollars in thousands) | Three Months Ended | |
|---|--------------------|----------|
| | March 31, 2012 | 2011 |
| Net income | \$5,051 | \$7,696 |
| Other comprehensive income, net of tax: | | |
| Defined benefit pension plans and other postretirement employee benefits: | | |
| Amortization of prior service credit included in net periodic cost, net of tax of \$(813) and \$(765) | (1,273 |) (1,198 |
| Amortization of actuarial loss included in net periodic cost, net of tax of \$1,827 and \$1,403 | 2,858 | 2,195 |
| Other comprehensive income, net of tax | 1,585 | 997 |
| Comprehensive income | \$6,636 | \$8,693 |

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

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

| | March 31, 2012 | December 31, 2011 |
|---|-------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$11,877 | \$7,819 |
| Short-term investments | 47,155 | 62,989 |
| Receivables, net | 13,058 | 13,533 |
| Inventories | 21,915 | 28,603 |
| Deferred tax assets | 11,909 | 11,909 |
| Other assets | 9,983 | 9,998 |
| Total current assets | 115,897 | 134,851 |
| Property, plant and equipment, net | 60,042 | 61,453 |
| Timber and timberlands, net | 458,360 | 459,687 |
| Deferred tax assets | 55,996 | 57,924 |
| Other assets | 10,739 | 32,305 |
| | \$701,034 | \$746,220 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current installments on long-term debt | \$5,162 | \$21,661 |
| Accounts payable and accrued liabilities | 57,167 | 55,948 |
| Total current liabilities | 62,329 | 77,609 |
| Long-term debt | 344,780 | 344,742 |
| Liability for pensions and other postretirement employee benefits | 139,554 | 163,116 |
| Other long-term obligations | 18,803 | 18,615 |
| Stockholders' equity | 135,568 | 142,138 |
| | \$701,034 | \$746,220 |
| Stockholders' equity per share | \$3.36 | \$3.54 |
| Working capital | \$53,568 | \$57,242 |
| Current ratio | 1.9 | 1.7 |

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

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

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2012 | 2011 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$5,051 | \$7,696 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, depletion and amortization | 5,788 | 8,666 |
| Basis of real estate sold | 444 | 3,615 |
| Change in deferred taxes | 915 | 1,589 |
| Gain on disposition of property, plant and equipment | (2 |) (34 |
| Employee benefit plans | 846 | 2,608 |
| Equity-based compensation expense | 947 | 950 |
| Proceeds from sales deposited with a like-kind exchange intermediary | (290 |) — |
| Funding of qualified pension plans | (21,630 |) (9,400 |
| Working capital changes | 9,603 | 4,531 |
| Net cash provided by operating activities | 1,672 | 20,221 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Decrease in short-term investments | 15,834 | 11,064 |
| Proceeds from company owned life insurance loan | 21,751 | — |
| Additions to property, plant and equipment | (989 |) (1,000 |
| Additions to timber and timberlands | (2,140 |) (2,131 |
| Proceeds from disposition of property, plant and equipment | 2 | 112 |
| Other, net | (246 |) 38 |
| Net cash provided by investing activities | 34,212 | 8,083 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Distributions to common stockholders | (12,503 |) (20,468 |
| Payments on long-term debt | (16,500 |) (5,000 |
| Issuance of common stock | 63 | 185 |
| Change in book overdrafts | (1,152 |) (19 |
| Deferred financing costs | (30 |) (325 |
| Employee tax withholdings on equity-based compensation | (1,713 |) (1,605 |
| Other, net | 9 | (76 |
| Net cash used for financing activities | (31,826 |) (27,308 |
| Increase in cash | 4,058 | 996 |
| Cash at beginning of period | 7,819 | 5,593 |
| Cash at end of period | \$11,877 | \$6,589 |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Cash paid (received) during the period for: | | |
| Interest, net of amount capitalized | \$1,264 | \$1,385 |
| Income taxes, net | (59 |) (1,052 |
| Non-cash investing activity: | | |
| Additions to timber and timberlands | — | 341 |

Certain 2011 amounts have been reclassified to conform to the 2012 presentation.

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

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

NOTE 1.

Basis of Presentation

For purposes of this report, any reference to “Potlatch,” “the company,” “we,” “us,” and “our” means Potlatch Corporation and all of its wholly owned subsidiaries, except where the context indicates otherwise.

The accompanying Consolidated Condensed Balance Sheets at March 31, 2012 and December 31, 2011 and the Consolidated Statements of Income, Consolidated Statements of Comprehensive Income and the Consolidated Condensed Statements of Cash Flows for the three months ended March 31, 2012 and 2011 have been prepared in conformity with accounting principles generally accepted in the United States of America. We believe that all adjustments necessary for a fair statement of the results of such interim periods have been included.

This Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission on February 17, 2012.

NOTE 2.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board, or FASB, issued Accounting Standard Update, or ASU, 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, to increase the prominence of other comprehensive income in the financial statements. An entity has the option to present the components of net income and comprehensive income in either one or two consecutive financial statements. The new guidance is effective for fiscal years and interim periods beginning after December 15, 2011. We adopted this guidance and presented the components of net income and comprehensive income in two consecutive statements. The adoption of ASU 2011-05 did not have a material effect on our consolidated financial condition or results of operations.

NOTE 3.

Income Taxes

As a real estate investment trust, or REIT, if we meet certain requirements we generally are not subject to federal and state corporate income taxes on our income from investments in real estate that we distribute to our shareholders. We are, however, subject to corporate taxes on built-in gains (the excess of fair market value at January 1, 2006 over tax basis on that date) with respect to the REIT's sale of any real property owned at such date within the first ten years following our conversion to a REIT, except for sales that occurred in 2011. 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 built-in gains tax is eliminated or deferred if sale proceeds are reinvested in like-kind property in accordance with the like-kind exchange provisions of the Internal Revenue Code. The built-in gains tax is not applicable to the sale of timber pursuant to a stumpage sale agreement or timber deed.

For the three months ended March 31, 2012 and 2011, we recorded income tax provisions related to Potlatch TRS of \$0.9 million and \$1.6 million, respectively, due to pre-tax income. For the three months ended March 31, 2012, we recorded income tax expense of \$0.1 million related to the sale of REIT properties that were not deferred in accordance with the like-kind exchange provisions of the Internal Revenue Code.

We reviewed our tax positions at March 31, 2012 and determined that no uncertain tax positions were taken during the first three months of 2012, and that no new information was available that would require derecognition of previously taken positions.

We reflect accrued interest related to tax obligations, as well as penalties, in our provision for income taxes. During the three months ended March 31, 2012 and 2011, amounts for interest and penalties included in our tax provision were insignificant. At March 31, 2012 and December 31, 2011, we had no accrued interest or penalties related to income taxes.

NOTE 4.

Earnings per Share

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

| (Dollars in thousands, except per-share amounts) | 2012 | 2011 |
|--|------------|------------|
| Net income | \$5,051 | \$7,696 |
| Basic weighted-average shares outstanding | 40,261,149 | 40,078,169 |
| Incremental shares due to: | | |
| Stock options | 34,404 | 84,199 |
| Performance shares | 51,554 | 103,565 |
| Restricted stock units | 17,885 | 26,796 |
| Diluted weighted-average shares outstanding | 40,364,992 | 40,292,729 |
| Basic net income per share | \$0.13 | \$0.19 |
| Diluted net income per share | \$0.13 | \$0.19 |
| Anti-dilutive shares excluded from the calculation: | | |
| Performance shares | 162,795 | 77,767 |
| Restricted stock units | 18,225 | 16,553 |
| Total anti-dilutive shares excluded from the calculation | 181,020 | 94,320 |

NOTE 5.

Equity-Based Compensation

As of March 31, 2012, we had three stock incentive plans under which stock option, performance share or restricted stock unit, or RSU, grants were outstanding, with approximately 362,000 shares authorized for future use under the 2005 Stock Incentive Plan.

The following table details our compensation expense for the three months ended March 31:

| (Dollars in thousands) | 2012 | 2011 |
|--|-------|---------|
| Employee equity-based compensation expense: | | |
| Performance shares | \$815 | \$823 |
| Restricted stock units | 132 | 127 |
| Total employee equity-based compensation expense | \$947 | \$950 |
| Related net income tax benefit | \$— | \$— |
| Director deferred compensation expense | \$243 | \$1,402 |

There were no realized tax benefits related to the excess of the deductible amount over the compensation cost recognized in the Consolidated Condensed Statements of Cash Flows during either period presented above.

STOCK OPTIONS

The following table summarizes outstanding stock options as of March 31, 2012, and changes during the three months ended March 31, 2012:

| (Dollars in thousands, except exercise prices) | Shares | Weighted Avg. Exercise Price | Aggregate Intrinsic Value |
|--|---------|------------------------------|---------------------------|
| Outstanding at January 1 | 144,684 | \$23.34 | |
| Shares exercised | (4,017 |) 15.85 | \$61 |
| Shares canceled or expired | — | — | |
| Outstanding and exercisable at March 31 | 140,667 | 23.55 | 1,096 |

There were no unvested stock options outstanding during the three months ended March 31, 2012. The aggregate intrinsic value of stock options exercised during the three months ended March 31, 2011 was \$0.2 million.

The following table summarizes outstanding stock options as of March 31, 2012:

| Range of Exercise Prices | Options Outstanding and Exercisable | | |
|--------------------------|-------------------------------------|--|------------------------------|
| | Outstanding | Weighted Avg. Remaining Contractual Life | Weighted Avg. Exercise Price |
| \$13.8594 to \$14.4398 | 33,001 | 0.69 years | \$14.29 |
| \$19.2569 | 41,821 | 1.67 years | 19.26 |
| \$30.9204 | 65,845 | 2.67 years | 30.92 |
| \$13.8594 to \$30.9204 | 140,667 | 1.91 years | 23.55 |

Cash received from stock option exercises for the three months ended March 31, 2012 and 2011 was \$0.1 million and \$0.2 million, respectively. No actual tax benefits were realized for tax deductions from options exercised during either period.

PERFORMANCE SHARES

The following table presents the key inputs used in the Monte Carlo simulation method to calculate the fair value of the performance share awards in 2012 and 2011, and the resulting fair values:

| | 2012 | 2011 | | |
|-----------------------------------|---------|---------|---|---|
| Shares granted | 85,028 | 77,767 | | |
| Stock price as of valuation date | \$31.11 | \$39.10 | | |
| Risk-free rate | 0.40 | % 1.26 | % | % |
| Fair value of a performance share | \$34.24 | \$55.84 | | |

The following table summarizes outstanding performance share awards as of March 31, 2012, and changes during the three months ended March 31, 2012:

| (Dollars in thousands, except grant date fair value) | Shares | Weighted Avg. Grant Date Fair Value | Aggregate Intrinsic Value |
|--|---------|-------------------------------------|---------------------------|
| Unvested shares outstanding at January 1 | 154,594 | \$50.54 | |
| Granted | 85,028 | 34.24 | |
| Forfeited | — | — | |
| Unvested shares outstanding at March 31 | 239,622 | 44.76 | \$7,260 |

As of March 31, 2012, there was \$6.0 million of unrecognized compensation cost related to non-vested performance share awards, which is expected to be recognized over a weighted average period of 1.8 years.

RESTRICTED STOCK UNITS

The following table summarizes outstanding RSU awards as of March 31, 2012, and changes during the three months ended March 31, 2012:

| (Dollars in thousands, except grant date fair value) | Shares | Weighted Avg. Grant Date Fair Value | Aggregate Intrinsic Value |
|--|--------|---|------------------------------|
| Unvested shares outstanding at January 1 | 36,359 | \$35.60 | |
| Granted | 18,225 | 31.09 | |
| Vested | (450 |) 30.17 | |
| Forfeited | (320 |) 32.36 | |
| Unvested shares outstanding at March 31 | 53,814 | 34.14 | \$1,687 |

For RSU awards granted during the period, the fair value of each share was determined on the date of grant using the grant date market price. The total fair value of RSU awards vested during the three months ended March 31, 2012 was less than \$0.1 million. As of March 31, 2012, there was \$1.1 million of total unrecognized compensation cost related to non-vested RSU awards, which is expected to be recognized over a weighted average period of 1.8 years.

NOTE 6.

Detail of Certain Balance Sheet Accounts

The following tables detail certain accounts as of the balance sheet dates:

| (Dollars in thousands) | March 31, 2012 | December 31, 2011 |
|---|----------------|----------------------|
| Inventories: | | |
| Lumber and other manufactured wood products | \$12,789 | \$12,002 |
| Logs | 4,722 | 12,400 |
| Material and supplies | 4,404 | 4,201 |
| | \$21,915 | \$28,603 |
| Current Other Assets: | | |
| Basis of real estate held for sale | 7,433 | 7,433 |
| Deferred charges | 1,453 | 1,437 |
| Prepaid expenses | 1,097 | 1,128 |
| | \$9,983 | \$9,998 |
| Noncurrent Other Assets: | | |
| Deferred charges | \$3,734 | \$4,129 |
| Developed land costs | 3,593 | 3,635 |
| Derivative asset associated with interest rate swap | 2,375 | 2,409 |
| Noncurrent investments | 659 | 22,043 |
| Restricted cash | 290 | — |
| Other | 88 | 89 |
| | \$10,739 | \$32,305 |

The decrease in Noncurrent Other Assets - Noncurrent investments as of March 31, 2012 from December 31, 2011 was due to borrowing against our company owned life insurance, or COLI, plan, based on the cash surrender value that had accumulated over the years, to make a pension contribution.

NOTE 7.

Pension Plans and Other Postretirement Employee Benefits

The following table details the components of net periodic cost (benefit) of our pension plans and other postretirement employee benefits, or OPEB, for the three months ended March 31:

| (Dollars in thousands) | Pension Plans | | Other Postretirement Employee Benefits | |
|---|---------------|---------|---|---------|
| | 2012 | 2011 | 2012 | 2011 |
| Service cost | \$1,282 | \$1,212 | \$123 | \$112 |
| Interest cost | 4,981 | 5,358 | 751 | 928 |
| Expected return on plan assets | (7,173) | (7,796) | — | — |
| Amortization of prior service cost (credit) | 193 | 171 | (2,279) | (2,134) |
| Amortization of actuarial loss | 3,703 | 2,513 | 982 | 1,085 |
| Net periodic cost (benefit) | \$2,986 | \$1,458 | \$(423) | \$(9) |

Our minimum funding requirement for 2012 was \$9.7 million. During the first quarter of 2012, we borrowed against our COLI 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 pension plan and \$5.5 million to our qualified non-represented pension plan, with \$11.9 million being discretionary funding. We do not anticipate additional contributions to any of our qualified pension plans in 2012. During the three months ended March 31, 2012, we made contributions of \$0.4 million to our non-qualified supplemental pension plan.

The following table details the components of "Other comprehensive income, net of tax" on our Consolidated Statements of Comprehensive Income of our pension plans and OPEB for the three months ended March 31:

| (Dollars in thousands) | 2012 | 2011 |
|---|---------|---------|
| Other comprehensive income, net of tax, related to: | | |
| Defined benefit pension plans | \$2,376 | \$1,637 |
| OPEB obligations | (791) | (640) |
| Other comprehensive income, net of tax | \$1,585 | \$997 |

NOTE 8.

Financial Instruments

The following table presents the estimated fair values of our financial instruments as of the balance sheet dates:

| (Dollars in thousands) | March 31, 2012 | | December 31, 2011 | |
|--|--------------------|---------------|--------------------|---------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash, restricted cash and short-term investments (Level 1) | \$59,322 | \$59,322 | \$70,808 | \$70,808 |
| Net derivative asset related to interest rate swaps (Level 2) | 2,375 | 2,375 | 2,409 | 2,409 |
| Derivative asset related to lumber swap (Level 2) | 185 | 185 | 480 | 480 |
| Long-term debt, including current installments on long-term debt (including fair value adjustments related to fair value hedges) (Level 2) | 349,942 | 362,894 | 366,403 | 373,791 |

FAIR VALUE HEDGES OF INTEREST RATE RISK

As of March 31, 2012, we had six separate interest rate swap agreements 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 between 6.95% and 8.89% to variable rates of three-month LIBOR plus spreads between 4.738% and 6.518%. The interest rate swaps terminate at various dates between December 2015 and

February 2018.

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As of March 31, 2012, we had a derivative asset within non-current other assets of \$2.4 million, resulting in a cumulative net increase to the carrying amount of our debt of \$2.4 million recorded on our Consolidated Condensed Balance Sheets.

For the three months ended March 31, 2012 and 2011, we recognized an unrealized loss of less than \$0.1 million and \$0.4 million, respectively, in interest expense due to changes in fair value of the derivatives, which were offset by an unrealized gain of less than \$0.1 million and \$0.4 million, respectively, recorded in interest expense due to the associated change in the carrying amount of hedged debt. Consequently, no net unrealized gain or loss was recognized in income for the three months ended March 31, 2012 and 2011 because we recognized no hedged ineffectiveness. For the three months ended March 31, 2012 and 2011, we recognized a net gain, resulting in a reduction in interest expense, of \$0.2 million and \$0.3 million, respectively, which represents realized net gains and losses from net cash settlements and interest accruals on the derivatives.

NON-DESIGNATED LUMBER SWAP

In February 2012, we entered into two commodity swap contracts for a total of 22,500 mbf (thousand board feet) of southern yellow pine. An equal amount will settle each month during the second quarter of 2012. In September 2011, we entered into a commodity swap contract for 31,200 mbf of southern yellow pine with an effective date of November 1, 2011 and a termination date of February 29, 2012, with an equal amount that cash settled each month. On October 18, 2010, we entered into a commodity swap contract for 14,300 mbf of southern yellow pine, which cash settled in January and February 2011.

A net realized gain of \$0.4 million was recognized as a reduction to Cost of Goods Sold resulting from net cash receipts and accruals for the three months ended March 31, 2012. A net realized loss of \$0.2 million was recognized as an increase to Cost of Goods Sold for the three months ended March 31, 2011. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly in net income. As such, an unrealized loss of \$0.3 million and an unrealized gain of \$0.8 million were recognized in the three months ended March 31, 2012 and 2011, respectively.

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

| (Dollars in thousands) | Balance Sheet Location | March 31, 2012 | December 31, 2011 |
|---|-------------------------------|-------------------|----------------------|
| Fair Value of Derivative Assets: | | | |
| Derivatives designated as hedging instruments: | | | |
| Interest rate contracts | Other assets (non-current) | \$2,375 | \$2,409 |
| Total derivatives designated as hedging instruments | | \$2,375 | \$2,409 |
| Derivatives not designated as hedging instruments: | | | |
| Lumber contracts | Receivables, net | \$185 | \$480 |
| Total derivatives not designated as hedging instruments | | \$185 | \$480 |

There were no derivatives recorded as liabilities as of March 31, 2012 or December 31, 2011.

The following table details the effect of derivatives on the Consolidated Statements of Income for the three months ended March 31:

| | Location of Gain (Loss) Recognized in Income | Gain (Loss) Recognized in Income | |
|--|---|-------------------------------------|---------|
| | | 2012 | 2011 |
| (Dollars in thousands) | | 2012 | 2011 |
| Derivatives designated in fair value hedging relationships: | | | |
| Interest rate contracts | | | |
| Realized gain on hedging instrument ⁽¹⁾ | Interest expense | \$215 | \$273 |
| Net gain recognized in income from fair value hedges | | \$215 | \$273 |
| Derivatives not designated as hedging instruments: | | | |
| Lumber contracts | | | |
| Unrealized gain (loss) on derivative | Cost of goods sold | \$(294 |) \$851 |
| Realized gain (loss) on derivative | Cost of goods sold | 351 | (227) |
| Net gain recognized in income from derivatives not designated as hedging instruments | | \$57 | \$624 |

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

NOTE 9.

Commitments and Contingencies

In January 2007, the Environmental Protection Agency, or EPA, notified us that we are a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, or CERCLA, and the Clean Water Act for clean-up of a site known as Avery Landing in northern Idaho. We own a portion of the land at the Avery Landing site, which we acquired in 1980 from the Milwaukee Railroad. The land we own at the site and adjacent properties were contaminated with petroleum as a result of the Milwaukee Railroad's operations at the site prior to 1980. We entered into a consent order with the EPA in August 2008 to conduct an Engineering Evaluation/Cost Analysis, or EE/CA, study to determine the best means of addressing the contamination at the site. In January 2010, we submitted our draft EE/CA report to the EPA outlining various alternatives for addressing the contamination at the entire site. Ultimately, the EPA published a draft EE/CA report on January 26, 2011 for public comment. The EPA's report focused on a limited number of remedial alternatives which range in cost from approximately \$7.9 million to \$10.5 million. The public comment period closed March 11, 2011. On July 5, 2011, the EPA issued an Action Memorandum for the Avery Landing Site selecting contaminant extraction and off-site disposal as the remedial alternative at an estimated cost of approximately \$9.5 million. On April 12, 2012, the EPA issued a unilateral administrative order requiring us to remediate the portion of the Avery Landing site that we own. As of March 31, 2012, we have accrued \$6.0 million for this matter based upon the estimated cost of remediating our property. We have reserved all of our rights to seek reimbursement for the costs of remediation from all parties potentially responsible.

NOTE 10.

Segment Information

The following table summarizes information by business segment for the three months ended March 31:

| (Dollars in thousands) | 2012 | 2011 |
|---|-----------|-----------|
| Revenues: | | |
| Resource | \$40,454 | \$51,552 |
| Real Estate | 8,164 | 12,981 |
| Wood Products | 73,924 | 68,472 |
| | 122,542 | 133,005 |
| Elimination of intersegment revenues - Resource | (10,158) | (10,772) |
| Total consolidated revenues | \$112,384 | \$122,233 |
| Operating income: | | |
| Resource | \$8,669 | \$14,061 |
| Real Estate | 6,312 | 8,366 |
| Wood Products | 5,044 | 2,894 |
| Eliminations and adjustments | 310 | 545 |
| | 20,335 | 25,866 |
| Corporate | (14,302) | (16,587) |
| Income before income taxes | \$6,033 | \$9,279 |
| Depreciation, depletion and amortization: | | |
| Resource | \$3,218 | \$4,818 |
| Real Estate | 9 | — |
| Wood Products | 1,860 | 1,984 |
| | 5,087 | 6,802 |
| Corporate | 701 | 1,864 |
| Total depreciation, depletion and amortization | \$5,788 | \$8,666 |
| Basis of real estate sold: | | |
| Real Estate | 495 | 3,615 |
| Eliminations and adjustments | (51) | — |
| Total basis of real estate sold | \$444 | \$3,615 |

ITEM 2.

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

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 recognition of compensation costs relating to our performance shares and RSUs, contributions to our qualified pension plans, U.S. housing market conditions and housing starts, North American log exports to China, domestic repair and remodel activities, harvest deferrals, harvest levels, log prices, lumber demand and prices, seasonal conditions, business conditions for our business segments, demand for our properties, Resource segment results, Wood Products segment results, Real Estate segment results, and similar matters. Words such as "anticipate," "expect," "will," "intend," "plan," "target," "project," "believe," "seek," "schedule," "estimate," "could," "can," "may," and similar expressions are intended to identify such forward-looking statements. These forward-looking statements reflect 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. For a nonexclusive listing of forward-looking statements and potential factors affecting our business, refer to "Cautionary Statement Regarding Forward-Looking Information" on page 1 and "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011.

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.

OVERVIEW

The operating results of our Resource, Real Estate and Wood Products business segments have been and will continue to be influenced by a variety of factors, including the cyclical nature of the forest products industry, which is largely dependent on the economy and U.S. housing starts, 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. The U.S. housing market remains weak and housing starts are expected to only show slight improvement through 2012. The business conditions for both our Resource and Wood Products segments remain challenging. Counterbalancing lower housing starts is the demand from China for North American logs and lumber, which helps support industry fundamentals, and in particular benefits the Northern region of our Resource segment, and an expected increase in domestic repair and remodel activities.

In late 2011 we announced a harvest deferral from 4.1 millions tons in 2011 to 3.5 million tons in 2012. In the first quarter of 2012, prices for logs held steady in our Northern region and logging conditions were fairly typical for the first quarter, which enabled us to harvest at our planned level, albeit a level that is lower than last year. Favorable logging conditions in Idaho and Arkansas during the first quarter of 2011 led to increased harvest levels in that period. Operating results from our Resource segment reflect this variance between the first quarters of 2012 and 2011. As a result of the decreased harvest levels, there were reductions in depletion and logging and hauling expenses, but these were partially offset by the increased cost of fuel. Our Wood Products segment benefited from improved lumber demand, and prices remained stable during the first quarter of 2012, which allowed us to increase production and lumber shipments. Our Real Estate segment had solid results for the first quarter of 2012, with a large number of higher and better use, or HBU, acres sold, along with a continued steady flow of other real estate sales.

While the 2012 first quarter results from our Resource and Real Estate segments were lower compared to the first quarter of 2011, they met our expectations. At this time we still expect our 2012 harvest to be approximately 3.5 million tons. Sawlog prices appear to have bottomed and are expected to improve in both our Northern and Southern regions into the second and third quarters. In our Wood Products business, we expect prices to remain firm as we

move through the year, resulting in continued strong performance. Our Real Estate segment is expected to have another good year as demand for our various properties remains strong, with the actual product-type mix and mix among regions being large factors in operating results.

RESULTS OF OPERATIONS

We are a real estate investment trust, or REIT, with approximately 1.44 million acres of timberlands in Arkansas, Idaho and Minnesota. Through wholly owned taxable subsidiaries, which we refer to in this report as Potlatch TRS, we operate a real estate sales and development business and five manufacturing facilities that produce lumber and plywood.

Our business is organized into three reporting segments: Resource; Real Estate; and Wood Products. Sales between segments are recorded as intersegment revenues based on prevailing market prices. Because our Resource segment supplies 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 discussion of our results of operations below, when we discuss our consolidated revenues, contributions by each of the segments to our revenues are reported after elimination of intersegment revenues. In the "Discussion of Business Segments" section below, segment revenues are presented before elimination of intersegment revenues.

Three Months Ended March 31, 2012 Compared to Three Months Ended March 31, 2011

The following table sets forth period-to-period changes in items included in our Consolidated Statements of Income for the three months ended March 31:

| (Dollars in thousands) | 2012 | 2011 | Increase (Decrease) |
|--|------------|------------|------------------------|
| Revenues | \$ 112,384 | \$ 122,233 | \$(9,849) |
| Costs and expenses: | | | |
| Cost of goods sold | 88,975 | 93,148 | (4,173) |
| Selling, general and administrative expenses | 10,890 | 11,927 | (1,037) |
| | 99,865 | 105,075 | (5,210) |
| Operating income | 12,519 | 17,158 | (4,639) |
| Interest expense, net | (6,486) | (7,879) | (1,393) |
| Income before income taxes | 6,033 | 9,279 | (3,246) |
| Income tax provision | (982) | (1,583) | (601) |
| Net income | \$5,051 | \$7,696 | \$(2,645) |

Revenues – Revenues decreased \$9.8 million, or 8%, in the first quarter of 2012 from the same period in 2011, as a result of decreased revenues from our Resource and Real Estate segments, primarily due to our planned harvest deferral and fewer acres of real estate sold, respectively, partially offset by increased sales in our Wood Products segment. A more detailed discussion of revenues follows in "Discussion of Business Segments."

Cost of goods sold – Cost of goods sold decreased \$4.2 million, or 4%, in the first quarter of 2012 from the same period in 2011, primarily due to lower logging and hauling costs and depletion resulting from the planned harvest deferral, partially offset by higher fuel costs, and a lower basis of real estate sold in the first quarter of 2012, partially offset by increased log usage in the Wood Products segment due to increased production.

Selling, general and administrative expenses – Selling, general and administrative expenses decreased \$1.0 million, or 9%, in the first quarter of 2012 from the same quarter in 2011, primarily due to a \$1.2 million non-cash charge for the mark to market adjustment for company stock in our deferred compensation plans in the first quarter of 2011.

Interest expense, net – Net interest expense decreased \$1.4 million, or 18%, in the quarter ended March 31, 2012, from the same period in 2011, primarily due to a \$1.2 million non-cash charge for deferred costs related to the reduction in our revolving credit facility in the first quarter of 2011 and reduced interest expense associated with the \$16.5 million medium-term note maturities in the first quarter of 2012.

Income tax provision – For the quarters ended March 31, 2012 and 2011, we recorded income tax provisions related to Potlatch TRS of \$0.9 million and \$1.6 million, respectively, due to pre-tax income. For the quarter ended March 31, 2012, we recorded income tax expense of \$0.1 million related to the sale of REIT properties that were not deferred in accordance with the like-kind exchange provisions of the Internal Revenue Code.

DISCUSSION OF BUSINESS SEGMENTS

| (Dollars in thousands) | Three Months Ended March 31, | | Increase (Decrease) |
|--|---------------------------------|-----------|------------------------|
| | 2012 | 2011 | |
| Segment Revenues: | | | |
| Resource | \$40,454 | \$51,552 | \$(11,098) |
| Real Estate | 8,164 | 12,981 | (4,817) |
| Wood Products | 73,924 | 68,472 | 5,452 |
| Total segment revenues, before eliminations | \$122,542 | \$133,005 | \$(10,463) |
| Segment Operating Income: | | | |
| Resource | \$8,669 | \$14,061 | \$(5,392) |
| Real Estate | 6,312 | 8,366 | (2,054) |
| Wood Products | 5,044 | 2,894 | 2,150 |
| Total segment operating income, before eliminations and adjustments, and corporate items | \$20,025 | \$25,321 | \$(5,296) |

Resource Segment – Revenues for the segment decreased \$11.1 million, or 22%, during the first quarter of 2012 from the same period in 2011. Total harvest volumes decreased 22% in the first quarter of 2012 compared to the same quarter in 2011, with the reduced volumes accounting for \$11.2 million of the variance. The major factors in the variance were the previously announced planned harvest deferral for 2012, combined with favorable logging conditions in the first quarter of 2011 that increased the harvest levels in that period. In our Northern region, total harvest volumes decreased 17% in the first quarter of 2012 from the same period in 2011. Sawlog volumes decreased 18%, primarily due to the favorable logging conditions in Idaho in the first quarter of 2011 and the planned harvest deferral in 2012. Sawlog prices increased 2%, primarily due to product mix as a general strengthening in demand for mixed sawlogs was partially offset by weaker demand for cedar sawlogs. Northern pulpwood volumes decreased 9%, but increased as a percentage of total production due to favorable market pricing. Pulpwood prices increased 11% due to continued steady demand for pulpwood in the Pacific Northwest resulting from a shortage of residual chips. In our Southern region, total harvest volumes decreased 30% in the first quarter of 2012 from the same period in 2011. Sawlog volumes and prices decreased 41% and 10%, respectively, primarily due to the planned harvest deferral and reduced demand in the first quarter of 2012, combined with favorable logging conditions in the first quarter of 2011. Southern pulpwood volumes decreased 12% due to the planned harvest deferral, and prices decreased 2%. Expenses for the segment decreased \$5.7 million, or 15%, during the first quarter of 2012 from the first quarter of 2011, primarily related to lower logging and hauling costs and depletion due to the decreased harvest levels, partially offset by the increased cost of fuel. Operating income for our Resource segment decreased \$5.4 million, or 38%, in the first quarter of 2012 from the same period of 2011.

Real Estate Segment – Revenues decreased \$4.8 million, expenses decreased \$2.7 million and operating income decreased \$2.1 million in the first quarter of 2012 compared to the same period in 2011 as a result of fewer acres sold and the mix of types of acres sold. In the first quarter of 2012, a large number of HBU acres were sold. The results for the first quarter of 2011 were primarily due to the sale of non-strategic timberland and rural real estate in the first of a three-phase land sale transaction in Idaho.

The following table summarizes our real estate sales for the three months ended March 31:

| | 2012 | | 2011 | |
|-----------------------------|------------|--------------------|------------|--------------------|
| | Acres Sold | Average Price/Acre | Acres Sold | Average Price/Acre |
| Higher and better use (HBU) | 3,028 | \$1,847 | 495 | \$1,901 |
| Rural real estate | 1,879 | 1,183 | 2,513 | 1,208 |

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| | | | | |
|--------------------------|-------|-----|-------|-------|
| Non-strategic timberland | 491 | 709 | 6,282 | 1,433 |
| Total | 5,398 | | 9,290 | |

Wood Products – Revenues for the segment increased \$5.5 million, or 8%, in the first quarter of 2012 over the same period in 2011 as a result of increased sales volumes. Lumber volumes increased 10% over the previous year due to improved demand in the first quarter of 2012, while lumber prices remained fairly level between the periods. Expenses for the segment increased \$3.4 million, or 5%, in the first quarter of 2012 over the same quarter of 2011, primarily as a result of increased log usage, slightly higher log prices, and additional wages and benefits costs associated with increased production volume. The net gain recognized in income related to our lumber hedge was \$0.1 million in the first quarter of 2012 compared to \$0.6 million in 2011. Operating income for the segment was \$5.0 million for the first quarter of 2012 compared to \$2.9 million in the first quarter of 2011.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2012, our financial position included long-term debt of \$349.9 million, including current installments on long-term debt of \$5.2 million, compared to \$366.4 million at December 31, 2011. Stockholders' equity for the first three months of 2012 decreased \$6.6 million primarily due to the payment of our quarterly cash distributions to common stockholders totaling \$12.5 million, partially offset by net income of \$5.1 million. The ratio of long-term debt to stockholders' equity was 2.6 to 1 at both March 31, 2012 and December 31, 2011.

Working capital totaled \$53.6 million at March 31, 2012, a decrease of \$3.6 million from the December 31, 2011 balance of \$57.2 million. The significant changes in the components of working capital are as follows:

- The current portion of long-term debt decreased \$16.5 million due to the maturity and redemption of medium-term notes in the first quarter of 2012.

- Cash and short-term investments decreased \$11.8 million primarily due to the payment of our quarterly cash distributions to common stockholders totaling \$12.5 million.

- Inventories decreased \$6.7 million primarily due to the increased production and sales of our manufactured wood products during the first quarter of 2012 that reduced our log inventory by \$7.7 million.

Cash Flows Summary

The following table presents information regarding our cash flows for the three months ended March 31:

| (Dollars in thousands) | 2012 | 2011 |
|---|----------|-----------|
| Net cash provided by operating activities | \$1,672 | \$20,221 |
| Net cash provided by investing activities | 34,212 | 8,083 |
| Net cash used for financing activities | (31,826 |) (27,308 |
| Increase in cash | 4,058 | 996 |
| Cash at beginning of period | 7,819 | 5,593 |
| Cash at end of period | \$11,877 | \$6,589 |

Net cash provided by operating activities for the first quarter of 2012 totaled \$1.7 million, compared to \$20.2 million for the same period in 2011. The decrease was primarily due to increased funding of our qualified pension plans, decreased net income and the decreased basis of real estate sold in the first quarter of 2012 compared to the same period in 2011.

Net cash provided by investing activities totaled \$34.2 million and \$8.1 million for the first three months of 2012 and 2011, respectively. During the first quarter of 2012, we borrowed \$21.8 million against our COLI plan, based on the cash surrender value that had accumulated over the years, to fund our 2012 pension contributions. In addition, a \$15.8 million net decrease in short-term investments was partially offset by \$3.1 million of capital expenditures. In the first three months of 2011, an \$11.1 million net decrease in short-term investments was partially offset by \$3.1 million of capital expenditures. Capital expenditures in both periods were primarily for reforestation activities and routine general replacement projects associated with our wood products manufacturing facilities.

Net cash used for financing activities totaled \$31.8 million and \$27.3 million for the first three months of 2012 and 2011, respectively. Net cash used for financing activities in the first quarter of 2012 was primarily for payment of our quarterly cash distributions to common stockholders of \$12.5 million and debt maturities and redemptions of \$16.5 million. Net cash used for financing activities in the first quarter of 2011 was primarily for payment of our quarterly cash distributions to common stockholders of \$20.5 million and a debt maturity and redemption of \$5.0 million.

As of March 31, 2012, there were no borrowings outstanding under the revolving line of credit, and approximately \$2.0 million of the letter of credit subfacility was being used to support several outstanding letters of credit. Available borrowing capacity at March 31, 2012 was \$148.0 million.

The following table sets forth the most restrictive covenants in the bank credit facility and our status with respect to these covenants as of March 31, 2012:

| | Covenant Requirement | Actual Ratio at March 31, 2012 |
|---|----------------------|--------------------------------|
| Minimum Interest Coverage Ratio | 2.00 to 1.00 | 3.80 to 1.00 |
| Minimum Collateral Coverage Ratio | 3.00 to 1.00 | 3.62 to 1.00 |
| Maximum Funded Indebtedness to Capitalization Ratio | 70.0% | 56.0% |
| Minimum Liquidity Requirement | \$60.0 million | \$207.0 million |

Our senior notes contain covenants that limit our ability to distribute cash to our shareholders, such as through the payment of dividends and repurchase of our capital stock, unless certain financial conditions are met. Our cumulative Funds Available for Distribution, or FAD, as defined in the covenant, less our dividends paid was \$23.8 million at March 31, 2012. The remaining balance available for the payment of future dividends pursuant to the covenant was \$90.1 million at March 31, 2012.

Contractual Obligations

There have been no material changes to our contractual obligations in the three months ended March 31, 2012 outside the ordinary course of business.

Off-Balance Sheet Arrangements

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

ITEM 3.

Quantitative and Qualitative Disclosures About Market Risk

In February 2012, we entered into two lumber swap contracts to mitigate commodity price risk related to sales by our Wood Products segment. These contracts will cash settle monthly during the second quarter of 2012. See Note 8 to the consolidated financial statements for additional information about the lumber commodity swaps.

Other than for the lumber commodity swaps above, our exposures to market risk have not changed materially since December 31, 2011. For quantitative and qualitative disclosures about market risk, see Item 7A – “Quantitative and Qualitative Disclosure about Market Risk” in our 2011 Annual Report on Form 10-K.

ITEM 4.

Disclosure Controls and Procedures

We conducted an evaluation (pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, or the Exchange Act), under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e)) as of March 31, 2012. 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 Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of March 31, 2012.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Internal Control Over Financial Reporting

In the three months ended March 31, 2012 there were no changes in our internal control over financial reporting that would materially affect or are reasonably likely to materially affect our internal control over financial reporting.

Part II

ITEM 1.

Legal Proceedings

Other than the environmental matter described in Note 9 to the consolidated financial statements included in this report, we believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

ITEM 1A.

Risk Factors

There have been no material changes in the risk factors previously disclosed in “Risk Factors” in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 6.

Exhibits

The exhibit index is located on page 21 of this Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

POTLATCH CORPORATION
(Registrant)

By /s/ Eric J. Cremers
Eric J. Cremers
Executive Vice President and Chief Financial Officer
(Duly Authorized; Principal Financial Officer)

By /s/ Terry L. Carter
Terry L. Carter
Controller and Treasurer
(Duly Authorized; Principal Accounting Officer)

Date: April 26, 2012

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES
EXHIBIT INDEX

| EXHIBIT NUMBER | DESCRIPTION |
|-------------------|--|
| (3)(a)* | Second Restated Certificate of Incorporation of the Registrant, effective February 3, 2006, filed as Exhibit 99.2 to the Current Report on Form 8-K filed by the Registrant on February 6, 2006. |
| (3)(b)* | Bylaws of the Registrant, as amended through February 18, 2009, filed as Exhibit (3)(b) to the Current Report on Form 8K filed by the Registrant on February 20, 2009. |
| (4) | Registrant undertakes to furnish to the Commission, upon request, any instrument defining the rights of holders of long-term debt. |
| (31) | Rule 13a-14(a)/15d-14(a) Certifications. |
| (32) | Furnished statements of the Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350. |
| 101 | The following financial information from Potlatch Corporation's Quarterly Report on Form 10-Q for the three months ended March 31, 2012, filed on April 26, 2012, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Income for the three months ended March 31, 2012 and 2011, (ii) the Consolidated Statements of Comprehensive Income for the three months ended March 31, 2012 and 2011, (iii) the Consolidated Condensed Balance Sheets at March 31, 2012 and December 31, 2011, (iv) the Consolidated Condensed Statements of Cash Flows for the three months ended March 31, 2012 and 2011, and (v) the Notes to Consolidated Financial Statements. |

* Incorporated by reference