

POTLATCH CORP  
Form 10-K  
February 13, 2015

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, 2014  
 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, 2014, was approximately \$1,680.5 million, based on the closing price of \$41.40.

As of January 31, 2015, 40,605,179 shares of the registrant's common stock, par value \$1 per share, were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive proxy statement for the 2014 annual meeting of stockholders expected to be filed with the Commission on or about April 1, 2015 are incorporated by reference in Part III hereof.

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## 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>17</u>      |
| ITEM 2. <u>Properties</u>   | <u>17</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 2015;
- 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 2015;
- expected increase in 2015 timber harvest volume of 800,000 tons from acquisition of Alabama and Mississippi timberlands;
- expected generation of \$1.5 million in annual revenues from recreational leases in Alabama and Mississippi;
- expected harvest level of between 4.0 million and 4.8 million tons each year over the next 15 years;
- expected 2015 overall timber harvest of 4.5 million tons;
- expected sale of 37% of Northern region timber volume under log supply agreements in 2015;
- expected volumes and value of timber to be sold in the Southern region in 2015 under log supply agreements;
- expected sales of 80,000 acres of higher and better use (HBU) property, 140,000 acres of rural real estate property and 80,000 acres of non-strategic timberland over the next decade or more;
- funding of our dividend distributions in 2015;
- compliance with REIT tax rules;
- FSC® and SFI® 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 2015;
- expectations regarding funding of our pension plans in 2015;
- expectations regarding supplemental pension plan payments in 2015:
- estimated future benefit payments;
- estimated future payments under operating leases;
- estimated future debt payments; and
- expected liquidity in 2015 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;

2014 FORM 10-K / 1

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- changes in requirements for FSC® or SFI® 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;
- 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) that owns approximately 1.6 million acres of timberlands in Alabama, Arkansas, Idaho, Minnesota and Mississippi. 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 activities such as hunting leases, recreation permits and leases, mineral rights leases, biomass production and carbon sequestration.

**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 16: 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 short periods of 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 and manage them proactively for the highest value. We have identified approximately 20% 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 Sustainable Forestry Initiative® (SFI®) or 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 Maine 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, with some exceptions, subject to corporate taxes on certain built-in gains (the excess of fair market value over tax basis at January 1, 2006) on sales of real property (other than timber) held by the REIT through December 31, 2015. We are required to pay federal corporate income taxes on income from our non-real estate investments, principally the operations of Potlatch TRS.

#### Available Information

We make available on or through our website, [www.potlatchcorp.com](http://www.potlatchcorp.com) (under “Investor Resources – Financial Information”), our periodic and current reports that we file with, or furnish to, the Securities and Exchange Commission (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 for products or geographic regions. 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. Increases in residential construction and remodeling activities are generally followed by higher lumber prices, which are usually followed by higher log prices. 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.

The supply of timber has been significantly affected by reductions in timber sales by the United States government and by state governments, particularly in the western United States. 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 with a much larger proportion of public timber ownership. Timber supplies can fluctuate depending upon factors such as changes in weather conditions and harvest strategies, as well 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. The supply of timber generally is adequate to meet demand, although this could tighten as a result of higher U.S. housing starts, the effect of the mountain pine beetle infestation in western Canada, the level of log and lumber exports to Asia from the U.S. and Canada, and the level of annual allowable cut in Canada.

**Timberland Acquisition.** On December 7, 2014, we acquired approximately 201,000 acres of timberland in Alabama and Mississippi for \$384 million. The acquisition complements our existing ownership in our Southern Region. The acquired timber consists of approximately 73% softwood and 27% hardwoods, and is expected to increase annual timber harvest volumes by approximately 800,000 tons in 2015. We bought the timberland subject to three supply agreements. In addition, we assumed recreational leases that cover approximately 90% of the timberlands acquired.

They are generally annual leases that are subject to renewal and are expected to generate approximately \$1.5 million in annual revenues.

Ownership. The Resource segment manages approximately 1.6 million acres of timberlands in the North, consisting of our Idaho and Minnesota timberlands, and the South, consisting of our Alabama, Arkansas and

Mississippi timberlands. This total includes approximately 17,000 acres under long-term leases. We are the largest private landowner in Idaho. The following table provides additional information about 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 | 791                  |
|                 | Minnesota   | Primarily aspen, pine and other mixed hardwoods  | 178                  |
|                 |             | Total Northern region  | 969                  |
| Southern region | Alabama     | Primarily southern yellow pine and other hardwoods   | 101                  |
|                 | Arkansas    | Primarily southern yellow pine and other hardwoods   | 410                  |
|                 | Mississippi | Primarily southern yellow pine and other hardwoods   | 100                  |
|                 |             | Total Southern region  | 611                  |
|                 |             | Total  | 1,580                |

Operation. 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 generates revenues from non-timber resources such as from hunting leases, recreation permits and leases, mineral rights leases, biomass production and carbon sequestration.

We strive to maximize cash flow while managing our timberlands sustainably over the long term. From time to time, we may choose, within the parameters of our environmental commitments, to harvest timber at levels above or below our estimate of sustainability for short periods in order to take advantage of strong demand or to adjust to weak demand. 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.

Inventory. As of the end of 2014, our estimated standing merchantable timber inventory was 68 million tons, including 37 million tons in the North and 31 million tons in the South. This estimate is derived using methods consistent with industry practice and is based on statistical methods and field sampling. The estimated inventory volume includes timber in environmentally sensitive areas where the timberlands are managed in a manner consistent with best management practices, state forest practice acts and the SFI® or FSC® forest management standards. The aggregate estimated volume of current standing merchantable timber inventory is updated annually to reflect increases due to reclassification of young growth to merchantable timber when the young growth meets defined diameter specifications, 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 generally completed on 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% in the North and 6%-9% in the South.

Harvest. 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. 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.

2014 FORM 10-K / 5

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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 2014 timber harvest by region.

| (in thousands)  | TIMBER HARVESTED (TONS) |          |          |       |
|-----------------|-------------------------|----------|----------|-------|
|                 | SAWLOGS                 | PULPWOOD | STUMPAGE | TOTAL |
| Northern region | 1,982                   | 202      | 16       | 2,200 |
| Southern region | 620                     | 817      | 22       | 1,459 |
| Total           | 2,602                   | 1,019    | 38       | 3,659 |

We expect our harvest level to range between 4.0 million and 4.8 million tons each year over the next 15 years, depending on market conditions and other factors. 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 to harvest approximately 4.5 million tons in 2015.

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 2014 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. Idaho Forest Group, LLC represented slightly more than 10% of our consolidated revenues in 2014, 2013 and 2012. 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 2014, approximately 37% of our Northern region's volume and 34% of our Southern region's volume were sold under log supply agreements. We expect approximately the same amount to be sold under log supply agreements in 2015 in our Northern region. In our Southern region, we added three more supply agreements when we acquired the Alabama and Mississippi timberlands with volume commitments that cease in 2016 or 2021. As a result, we expect contracted volumes to increase approximately 75% and revenues to increase approximately \$11 million. In general, our log supply contracts require a specified volume of timber to be delivered to defined 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 seven years.

Other. Our timberlands include a wide diversity of softwood and hardwood species and are certified to either the SFI® or FSC® standards. 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 some FSC®-certified logs at premium prices.

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. 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.

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

6 / POTLATCH CORPORATION

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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 2014 capacities and actual production, are as follows:

|                    | ANNUAL<br>CAPACITY <sup>1,2</sup> | PRODUCTION <sup>2</sup> |
|--------------------|-----------------------------------|-------------------------|
| Sawmills:          |                                   |                         |
| Warren, Arkansas   | 175 mmbf                          | 190 mmbf                |
| St. Maries, Idaho  | 160 mmbf                          | 170 mmbf                |
| Gwinn, Michigan    | 170 mmbf                          | 176 mmbf                |
| Bemidji, Minnesota | 120 mmbf                          | 128 mmbf                |
| Plywood Mill:      |                                   |                         |
| St. Maries, Idaho  | 150 mmsf                          | 159 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.

We are the ninth largest lumber manufacturer in the U.S. 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 logs 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 2014, 2013 and 2012, 38%, 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 while deferring 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:

- on-the-ground analysis and verification of modeling assumptions;
- electronic analysis, using geographic information systems; and
- certain measured and ranked attributes, such as timber potential, recreational opportunities, accessibility, special features and population and demographic trends.

We have identified approximately 300,000 acres of non-core timberland real estate. This includes approximately 80,000 acres of HBU property, 80,000 acres of non-strategic timberland and 140,000 acres of rural real estate property. Sales of these lands are expected to occur over a decade or more, 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 2014, 2013 and 2012, approximately 1%, 2% and 2%, 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 14: Commitments and Contingencies in the Notes to Consolidated Financial Statements contained in this report and incorporated herein by reference.

#### Employees

As of December 31, 2014, we had 887 employees. The workforce consisted of 219 salaried, 631 hourly and 37 temporary or part-time employees. As of December 31, 2014, 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.

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.

Our operating results and cash flows will be materially affected by supply and demand for timber.

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. 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 Alabama, Arkansas, Idaho, Minnesota and Mississippi. In Alabama, Arkansas, Minnesota and Mississippi, 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.

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 wood 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 softwood lumber imports, the United States and Canada signed a 7 year Softwood Lumber Agreement in 2006, which was subsequently extended to 2015. The agreement establishes a system of tiered taxes and volume restrictions relating to Canadian lumber imports to the United States. There is no assurance that this agreement will be renewed or renegotiated beyond 2015. If it is not renewed or renegotiated, the United States is subject to a one-year standstill on trade litigation upon expiration of the agreement and we would have little recourse to address the import of Canadian lumber into the United States that competes unfairly with our products. Even if the Softwood Lumber

Agreement is renewed or renegotiated, 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.

10 / POTLATCH CORPORATION

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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.

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 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, pest infestation, disease and natural disasters such as ice storms, wind storms, tornados, 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. Longer term, our timber harvest levels will be affected by acquisitions of additional timberlands, sales of existing timberlands and shifts in harvest from one region to another. 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, pests, insects and other hazards, regulatory constraints and other factors beyond our control.

We do not insure against losses of standing timber from fire or any other causes.

The volume and value of timber that can be harvested from our lands may be affected by natural disasters such as fire, pest infestation, disease, ice storms, wind storms, tornados, 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.





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, tornados, 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 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.

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 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.

12 / POTLATCH CORPORATION

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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. 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 Environmental Protection Agency (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 14: 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 timberlands and operate our wood products mills. Delays or restrictions on our operations due to the intervention of environmental groups or interested individuals could adversely affect our operating results. In addition to intervention in regulatory proceedings, interested parties may file or threaten to file lawsuits that seek to prevent us from obtaining permits, 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. Based on estimated year-end asset values and projections of plan liabilities, during 2015 we are not required to make a contribution to our qualified pension plans. However, 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. In addition, in 2014, the Society of Actuaries' Retirement Plans Experience Committee released new mortality tables. Adoption of these tables could result in increased funding requirements in future periods. 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

2014 FORM 10-K / 13

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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, 2014, 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 be certain 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, 2014, we had long-term debt of \$629.3 million, including \$22.9 million due in December 2015. 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;

- 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 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 8: 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, interest rates 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, changes in accounting principles and changes in tax laws and regulations.





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 14: 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

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## 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 2014 and 2013, were as follows:

| QUARTER | 2014    |         |                    | 2013    |         |                    |
|---------|---------|---------|--------------------|---------|---------|--------------------|
|         | HIGH    | LOW     | CASH DISTRIBUTIONS | HIGH    | LOW     | CASH DISTRIBUTIONS |
| 1st     | \$42.44 | \$37.52 | \$ 0.350           | \$46.01 | \$39.43 | \$ 0.31            |
| 2nd     | 41.80   | 37.04   | 0.350              | 51.48   | 39.66   | 0.31               |
| 3rd     | 43.20   | 39.83   | 0.350              | 44.93   | 37.59   | 0.31               |
| 4th     | 44.20   | 39.89   | 0.375              | 43.84   | 38.01   | 0.35               |

There were approximately 1,160 stockholders of record at January 31, 2015.

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 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, 2014. The total stockholder return assumes \$100 invested at December 31, 2009, with quarterly reinvestment of all dividends.

|                              | At December 31, |        |        |        |        |
|------------------------------|-----------------|--------|--------|--------|--------|
|                              | 2010            | 2011   | 2012   | 2013   | 2014   |
| Potlatch Corporation         | \$ 108          | \$ 109 | \$ 142 | \$ 156 | \$ 163 |
| NAREIT Equity Index          | 128             | 139    | 164    | 168    | 218    |
| S&P 500 Composite            | 115             | 117    | 136    | 180    | 205    |
| 2014 Peer Group <sup>1</sup> | 110             | 114    | 157    | 167    | 179    |

<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. Returns are weighted based on market capitalizations as of the beginning of each year.

## 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, 2014. 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, 2014.

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, 2014. 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 (2013).

Based on our assessment, management believes that, as of December 31, 2014, 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, 2014, 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, 2015.

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 13, 2015, and for at least the past five years concerning our executive officers is as follows:

Michael J. Covey (age 57), 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 51), 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 46), 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 48), 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 60), 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 58), has served as Vice President, Wood Products and Southern Resource since February 2012, and as Vice President, Wood Products from January 2009 to February 2012.

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, 2015, 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, 2015, is incorporated herein by reference.

**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, 2015, 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, 2015, 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 2014 and 2013" in our definitive Proxy Statement to be filed with the Commission on or about April 1, 2015, 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

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SIGNATURES

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

POTLATCH CORPORATION

(Registrant)

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

Date: February 13, 2015

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on February 13, 2015, 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>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, 2014, 2013 and 2012</u>               | <u>42</u>      |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012</u> | <u>43</u>      |
| <u>Consolidated Balance Sheets at December 31, 2014 and 2013</u>  | <u>44</u>      |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012</u>           | <u>45</u>      |
| <u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2014, 2013 and 2012</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)

|   | 2014        | 2013      | 2012      | 2011      | 2010      |
|---|-------------|-----------|-----------|-----------|-----------|
| Revenues  | \$606,950   | \$570,289 | \$525,134 | \$497,421 | \$539,447 |
| Net income  | 89,910      | 70,581    | 42,594    | 40,266    | 40,394    |
| Total assets  | \$1,035,421 | \$680,530 | \$718,897 | \$746,220 | \$781,711 |
| Working capital                                     | 21,469      | 80,051    | 74,510    | 57,242    | 95,762    |
| Long-term debt (including current portion)          | 629,343     | 320,092   | 357,576   | 366,403   | 368,496   |
| Stockholders' equity                                | 225,066     | 204,148   | 138,643   | 142,138   | 204,439   |
| Current ratio                                       | 1.3 to 1    | 2.6 to 1  | 2.2 to 1  | 1.7 to 1  | 2.5 to 1  |
| Long-term debt to stockholders' equity ratio        | 2.8 to 1    | 1.6 to 1  | 2.6 to 1  | 2.6 to 1  | 1.8 to 1  |
| Capital expenditures: <sup>1</sup>                  |             |           |           |           |           |
| Property, plant and equipment                       | \$13,261    | \$10,280  | \$5,636   | \$5,338   | \$5,215   |
| Timberlands reforestation and roads                 | 10,971      | 12,313    | 11,774    | 11,158    | 9,786     |
| Total capital expenditures                          | \$24,232    | \$22,593  | \$17,410  | \$16,496  | \$15,001  |
| Net income per share:                               |             |           |           |           |           |
| Basic   | \$2.21      | \$1.74    | \$1.06    | \$1.00    | \$1.01    |
| Diluted   | 2.20        | 1.73      | 1.05      | 1.00      | 1.00      |
| Weighted-average shares outstanding (in thousands): |             |           |           |           |           |
| Basic   | 40,749      | 40,503    | 40,333    | 40,159    | 39,971    |
| Diluted   | 40,894      | 40,709    | 40,553    | 40,383    | 40,219    |
| Distributions per share                             | \$1.425     | \$1.28    | \$1.24    | \$1.84    | \$2.04    |

<sup>1</sup> Excludes the acquisition of timber and timberlands.

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

### Overview

We delivered solid financial results in 2014, raised our dividend, completed a strategic acquisition of approximately 201,000 acres of timberlands in Alabama and Mississippi, and preserved our investment grade rating. Resource segment income increased approximately 16% in 2014, due largely to an increase in Northern sawlog prices. Lumber prices remained strong, which resulted in another strong year for our Wood Products segment. Real Estate activity included two large, opportunistic sales in 2014, which resulted in a 48% increase in the segment's earnings. According to industry forecasts, total demand for North American lumber is anticipated to increase an additional 4 billion board feet, or approximately 8%, over 2014 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 2015.

### 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

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. Approximately one-quarter of the Resource segment's sales have been to our Wood Products segment the last three years. 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 2014 WITH 2013

The following table sets forth year-to-year changes in items included in our Consolidated Statements of Income for the years ended December 31, 2014 and 2013.

| (Dollars in thousands)                       | YEARS ENDED<br>DECEMBER 31, |           | AMOUNT<br>OF<br>CHANGE | PERCENT<br>CHANGE |   |
|--|-----------------------------|-----------|------------------------|-------------------|---|
|  | 2014                        | 2013      |                        |                   |   |
| Revenues                                     | \$606,950                   | \$570,289 | \$36,661               | 6                 | % |
| Costs and expenses:                          |                             |           |                        |                   |   |
| Cost of goods sold                           | 429,789                     | 408,772   | 21,017                 | 5                 | % |
| Selling, general and administrative expenses | 44,655                      | 50,397    | (5,742)                | (11)              | % |
| Environmental remediation charge             | —                           | 3,522     | (3,522)                | n/m               |   |
|  | 474,444                     | 462,691   | 11,753                 | 3                 | % |
| Operating income                             | 132,506                     | 107,598   | 24,908                 | 23                | % |
| Interest expense, net                        | (22,909)                    | (23,132)  | 223                    | 1                 | % |
| Income before income taxes                   | 109,597                     | 84,466    | 25,131                 | 30                | % |
| Income taxes                                 | (19,687)                    | (13,885)  | (5,802)                | (42)              | % |
| Net income                                   | \$89,910                    | \$70,581  | \$19,329               | 27                | % |

**Revenues.** Revenues from all three business segments increased in 2014 over 2013. Higher Resource segment revenues were primarily due to increased prices. Our Real Estate segment had a much higher volume of acres sold in 2014 and our Wood Products segment experienced both higher prices and increased shipments for manufactured wood products. A more detailed discussion of revenues follows in the operating results by business segments.

**Cost of goods sold.** Cost of goods sold increased in 2014 over 2013 primarily due to higher log costs and labor-related expenses due to increased shipments by our Wood Products segment, increased acres sold by our Real Estate segment, and higher logging costs, forest management expenses and road costs in our Resource business.

**Selling, general and administrative expenses.** Selling, general and administrative expenses decreased in 2014 from 2013 primarily due to lower incentive plan expenses and non-cash mark-to-market adjustments related to our deferred compensation plans.

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

**Income taxes.** Our effective tax rate for 2014 was 18.0% compared to 16.4% in 2013. The increase resulted primarily from proportionately higher operating income in the TRS.

## BUSINESS SEGMENT RESULTS COMPARING 2014 WITH 2013

## Resource Segment

| (Dollars in thousands)                                 | YEARS ENDED<br>DECEMBER 31, |           | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|--|-----------------------------|-----------|------------------------|-------------------|---|
|  | 2014                        | 2013      |                        |                   |   |
| Revenues (before elimination of intersegment revenues) | \$252,581                   | \$238,228 | \$14,353               | 6                 | % |
| Operating income                                       | \$84,976                    | \$73,425  | \$11,551               | 16                | % |
| Harvest Volumes (in tons)                              |                             |           |                        |                   |   |
| Northern region  |                             |           |                        |                   |   |
| Sawlog   | 1,982,113                   | 2,031,637 | (49,524)               | (2)               | % |
| Pulpwood   | 201,926                     | 127,998   | 73,928                 | 58                | % |
| Stumpage   | 16,312                      | 25,397    | (9,085)                | (36)              | % |
| Total  | 2,200,351                   | 2,185,032 | 15,319                 | 1                 | % |
| Southern region  |                             |           |                        |                   |   |
| Sawlog   | 619,750                     | 694,147   | (74,397)               | (11)              | % |
| Pulpwood   | 817,408                     | 821,781   | (4,373)                | (1)               | % |
| Stumpage   | 21,798                      | 8,353     | 13,445                 | 161               | % |
| Total  | 1,458,956                   | 1,524,281 | (65,325)               | (4)               | % |
| Total harvest volume                                   | 3,659,307                   | 3,709,313 | (50,006)               | (1)               | % |
| Sales Price/Unit (\$ per ton)                          |                             |           |                        |                   |   |
| Northern region  |                             |           |                        |                   |   |
| Sawlog   | \$91                        | \$85      | \$6                    | 7                 | % |
| Pulpwood   | \$43                        | \$36      | \$7                    | 19                | % |
| Stumpage   | \$11                        | \$8       | \$3                    | 38                | % |
| Southern region  |                             |           |                        |                   |   |
| Sawlog   | \$46                        | \$43      | \$3                    | 7                 | % |
| Pulpwood   | \$34                        | \$32      | \$2                    | 6                 | % |
| Stumpage   | \$14                        | \$12      | \$2                    | 17                | % |

Revenues increased in 2014 over 2013 due to increased prices, primarily for sawlogs and pulpwood in Idaho, and the increased volume of pulpwood harvested in Idaho. Higher prices accounted for \$15.3 million of the revenue variance, while the decrease in total harvest volume accounted for a negative \$3.2 million impact on the variance.

In our Northern region, approximately two-thirds of our sawlog sales are indexed to the price of lumber. Sawlog prices increased due to improved lumber prices and stronger demand overall. However, sawlog harvest volumes were down slightly from 2013. Pulpwood volumes and prices increased substantially in 2014 primarily due to an oversupply of residuals and chips in the Northwest market in 2013 that resulted in lower pulpwood prices, which led us to minimize pulpwood production in 2013.

In our Southern region, sawlog volumes decreased as weather conditions negatively impacted production by limiting access to hardwood stands in 2014. 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 improved demand for hardwood pulpwood.

Expenses for the segment increased \$2.8 million, or 2%, in 2014 over 2013, primarily due to higher per-unit logging costs, increased forest management and road costs, and higher administrative expenses.



## Wood Products Segment

| (Dollars in thousands)           | YEARS ENDED<br>DECEMBER 31, |           | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|----------------------------------|-----------------------------|-----------|------------------------|-------------------|---|
|                                  | 2014                        | 2013      |                        |                   |   |
| Revenues                         | \$376,239                   | \$366,015 | \$10,224               | 3                 | % |
| Operating income                 | \$52,442                    | \$58,892  | \$(6,450)              | (11)              | % |
| Lumber shipments (MBF)           | 659,583                     | 641,217   | 18,366                 | 3                 | % |
| Lumber sales prices (\$ per MBF) | \$402                       | \$392     | \$10                   | 3                 | % |

Revenues for the segment increased in 2014 over 2013 due to both increased lumber prices and shipments. Expenses for the segment increased \$16.7 million, or 5%, due to the higher cost of logs consumed, primarily related to increased prices for sawlogs in Idaho and increased production, and labor-related expenses and other variable costs due to increased shipments.

## Real Estate Segment

| (Dollars in thousands) | YEARS ENDED<br>DECEMBER 31, |          | INCREASE<br>(DECREASE) | PERCENT<br>CHANGE |   |
|------------------------|-----------------------------|----------|------------------------|-------------------|---|
|                        | 2014                        | 2013     |                        |                   |   |
| Revenues               | \$40,460                    | \$26,160 | \$14,300               | 55                | % |
| Operating income       | \$26,945                    | \$18,266 | \$8,679                | 48                | % |

|                          | 2014       |                       | 2013       |                       |
|--------------------------|------------|-----------------------|------------|-----------------------|
|                          | ACRES SOLD | AVERAGE<br>PRICE/ACRE | ACRES SOLD | AVERAGE<br>PRICE/ACRE |
| HBU                      | 3,784      | \$2,129               | 4,799      | \$2,033               |
| Rural real estate        | 28,059     | \$1,112               | 9,494      | \$1,310               |
| Non-strategic timberland | 1,560      | \$779                 | 4,669      | \$849                 |
| Total                    | 33,403     | \$1,212               | 18,962     | \$1,380               |

Revenues increased \$14.3 million, expenses increased \$5.6 million and operating income increased \$8.7 million in 2014 compared to 2013, primarily due to increased acres sold in 2014 and product mix. In 2014, we had two large sales consisting of 9,400 acres in Minnesota and 11,000 acres in Idaho.



## 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<br>CHANGE | PERCENT<br>CHANGE |    |
|--|--------------------------|-----------|------------------------|-------------------|----|
|  | 2013                     | 2012      |                        |                   |    |
| Revenues                                     | \$570,289                | \$525,134 | \$45,155               | 9                 | %  |
| Costs and expenses:                          |                          |           |                        |                   |    |
| Cost of goods sold                           | 408,772                  | 390,773   | 17,999                 | 5                 | %  |
| Selling, general and administrative expenses | 50,397                   | 49,419    | 978                    | 2                 | %  |
| Environmental remediation charge             | 3,522                    | —         | 3,522                  | 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 taxes                                 | (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 for remediation costs related to our Avery Landing site in Idaho. Physical clean-up activities at the site were completed in 2013.

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 taxes. 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)              | % |
| Southern region  |                             |           |                        |                   |   |
| Sawlog   | \$43                        | \$42      | \$1                    | 2                 | % |
| Pulpwood   | \$32                        | \$31      | \$1                    | 3                 | % |
| Stumpage   | \$12                        | \$—       | \$12                   | n/m               |   |

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     | \$1,380               | 22,944     | \$1,667               |

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.

## Liquidity and Capital Resources

## Overview

At December 31, 2014, our financial position included long-term debt of \$629.3 million, including a current portion of \$22.9 million, compared to \$320.1 million at December 31, 2013. We incurred \$310.0 million of long-term debt in December 2014 for the acquisition of timberlands in Alabama and Mississippi. The ratio of long-term debt to stockholders' equity was 2.8 to 1 and 1.6 to 1 at December 31, 2014 and 2013, respectively. We increased our quarterly cash distributions in the fourth quarter of 2014 to \$0.375 per share from \$0.35 per share.

Cash and short-term investments totaled \$31.0 million at December 31, 2014. The available borrowing capacity under our credit agreement is \$248.6 million.

## Net Cash From Operations

Net cash provided from operating activities was:

\$131.4 million in 2014,  
 \$90.3 million in 2013 and  
 \$80.0 million in 2012.

Year ended December 31, 2014 compared to year ended December 31, 2013

Net cash from operating activities in 2014 increased \$41.1 million from 2013:

Cash received from customers increased \$49.6 million, primarily due to increased sales and cash received by the Resource, Wood Products and Real Estate segments. A more detailed discussion of revenues is included in the Business Segment Results section.

Net cash outflows related to income taxes decreased \$2.0 million. Net cash paid for taxes in 2014 was \$18.1 million compared to \$20.1 million in 2013.

Partially offsetting the increase was:

Cash paid to employees, suppliers and others increased \$8.2 million in 2014 from 2013 primarily due to higher log costs and labor-related expenses due to increased shipments by our Wood Products segment.

Cash contributions to our qualified pension plans increased \$3.6 million in 2014 from 2013, as we did not make a qualified pension plan contribution in 2013.

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 our Resource and Wood Products segments, partially offset by decreased sales and cash received from our Real Estate segment. A more detailed discussion of revenues is included in the Business Segment Results section.

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 increased cash from customers were:

Cash paid to employees, suppliers and others increased \$29.4 million in 2013 from 2012 primarily due to higher log costs in Wood Products and higher logging and hauling costs in our Resource segment as a result of higher harvest volumes.

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. The 2012 income tax liability was lower due primarily to use of net operating loss carryforwards.

Net Cash Flows from Investing Activities

Net cash used for investing activities was \$382.7 million in 2014, \$12.0 million in 2013 and \$8.6 million in 2012. In 2014, we used \$389.0 million for the acquisition of timber and timberlands and \$24.2 million for capital expenditures, partially offset by \$25.9 million provided by short-term investments. In 2013, we used \$22.6 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 and timberland acquisitions, which was partially offset by the \$21.8 million we borrowed against our COLI plan to fund our 2012 qualified pension contributions.

We anticipate that we will spend \$36 million for capital expenditures in 2015. Our capital spending is primarily related to reforestation expenditures, logging road construction, and high-return discretionary projects and routine general replacement projects for our wood products manufacturing facilities.

Net Cash Flow From Financing Activities

Net cash provided by financing activities was \$250.4 million in 2014. Net cash used in financing activities was \$89.6 million in 2013 and \$62.2 million in 2012. In 2014, proceeds from the borrowing of long-term debt provided \$310.0 million used to acquire timberlands, partially offset by distributions to stockholders of \$57.8 million. In 2013, net cash used for financing activities was primarily attributable to paying distributions to stockholders 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 distributions to stockholders of \$50.0 million and the redemption of \$21.7 million of debt, partially offset by the issuance of \$12.0 million of term loans.

Credit Agreement

On August 12, 2014, we entered into an amended and restated credit agreement with an expiration date of February 12, 2020, which supersedes our previous credit agreement dated as of December 11, 2012. This new credit agreement provides for a revolving line of credit with an initial aggregate principal amount not to exceed



\$250 million, which may be increased by up to an additional \$250 million, subject to certain conditions and agreement of the lenders. It also includes a sublimit of \$40 million for the issuance of standby letters of credit and a sublimit of \$15 million for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. As of December 31, 2014, there were no borrowings outstanding under the revolving line of credit, and approximately \$1.4 million of the letter of credit subfacility was being used to support several outstanding letters of credit. Available borrowing capacity at December 31, 2014 was \$248.6 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 including the maintenance of a minimum interest coverage ratio, a maximum leverage ratio and maximum allowable acres that may be sold. 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, 2014:

|  | COVENANT<br>REQUIREMENT | ACTUALS AT<br>DECEMBER 31, 2014 |
|--|-------------------------|---------------------------------|
| Minimum Interest Coverage Ratio          | 3.00 to 1.00            | 7.45 to 1.00                    |
| Maximum Leverage Ratio                   | 40%                     | 27%                             |
| Maximum Allowable Acres that may be sold | 433,051                 | 6,822                           |

The Interest Coverage Ratio is our twelve months ended EBITDDA, which is defined as net income adjusted for interest expense, 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 Leverage Ratio is our Total Funded Indebtedness divided by our Total Asset Value. Our Total Funded Indebtedness consists of our long-term debt, including any current portion of long-term debt, plus the total amount outstanding under the letter of credit subfacility. Our Total Asset Value per the credit agreement is defined as the value of our timberlands, the book basis of our wood products manufacturing facilities, cash and cash equivalents, short-term investments, the cash value of our company-owned life insurance (COLI), and the purchase price of timberlands acquired. The book basis of our Wood Products manufacturing facilities and the cash value of our COLI are each limited to 5% of Total Asset Value.

#### Term Loans

On December 5, 2014, we entered into an amended and restated term loan agreement totaling \$322 million, consisting of \$310 million of new term loans to fund the acquisition of timberlands in Alabama and Mississippi and \$12 million of term loans that we incurred in December 2012 to fund two timberland acquisitions in Arkansas. The new debt consists of six tranches of term loans, with \$40 million maturing each year from 2019 through 2023 and \$110 million maturing in 2024. The first three tranches are variable rate term loans based on 3-month LIBOR plus a spread between 1.65% and 1.90%. The last three tranches are fixed rate term loans with interest rates between 4.29% and 4.64%. Our original term loans from 2012 consist of two \$6 million tranches, with rates of 2.95% on the 2017 maturity and 3.70% on the 2020 maturity. The term loan agreement contains the same covenants and restrictions as those in our bank credit facility.

#### Senior Notes

In 2009, we sold \$150 million aggregate principal amount of 7.5% senior notes. The terms of these 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. Dividends and the repurchase of our capital stock, 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 \$95.7 million at December 31, 2014.

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, 2014.

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 2015 and taking into account planned harvest activities, we expect to fund a majority of our 2015 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, 2014. 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', and in December 2014 affirmed our Baa3 rating, 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 2014 affirmed our 'BB+' rating, with a negative outlook. The December 2014 affirmations occurred after our borrowing of \$310 million of term loans for our acquisition of timberlands in Alabama and Mississippi.

#### Contractual Obligations

The following table summarizes our contractual obligations as of December 31, 2014:

| (Dollars in thousands)                  | PAYMENTS DUE BY PERIOD |                  |           |           |                      |
|---|------------------------|------------------|-----------|-----------|----------------------|
|   | TOTAL                  | WITHIN<br>1 YEAR | 1-3 YEARS | 4-5 YEARS | MORE THAN<br>5 YEARS |
| Long-term debt <sup>1</sup>             | \$630,085              | \$22,500         | \$16,000  | \$204,250 | \$387,335            |
| Interest on long-term debt <sup>2</sup> | 212,440                | 33,179           | 56,311    | 50,931    | 72,019               |
| Operating leases <sup>3</sup>           | 12,193                 | 4,211            | 5,052     | 1,575     | 1,355                |
| Purchase obligations <sup>4</sup>       | 16,765                 | 3,316            | 10,881    | 2,568     | —                    |
| Other obligations <sup>5</sup>          | 181,013                | 50,022           | 15,659    | 26,984    | 88,348               |
| Total                                   | \$1,052,496            | \$113,228        | \$103,903 | \$286,308 | \$549,057            |

<sup>1</sup> See Note 9: Debt in the Notes to Consolidated Financial Statements.

Amounts presented for interest payments assume that all long-term debt outstanding as of December 31, 2014 will remain outstanding until maturity, and interest rates on variable debt in effect as of December 31, 2014 will remain in effect until maturity. Estimated cash flows related to interest rate swaps are also included in this category.

<sup>3</sup> See Note 14: 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.

Other obligations includes current liabilities, as well as qualified pension contributions, supplemental pension payments and payments for other postretirement employee benefit obligations. See Note 10: Accounts Payable and Accrued Liabilities and Note 13: 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)           | 2014     | 2013    | 2012    |
|-------------------------------|----------|---------|---------|
| Capital gain distributions    | \$ 1.425 | \$ 1.28 | \$ 0.71 |
| Non-taxable return of capital | —        | —       | 0.53    |
| Total distributions           | \$ 1.425 | \$ 1.28 | \$ 1.24 |

#### 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 expenses. Our depletion is determined based on costs capitalized and the related current estimated timber volume. The volume does not include anticipated future growth.

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 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

38 / POTLATCH CORPORATION

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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 \$59.1 million in benefits of these deductible differences and carryforwards at December 31, 2014. 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 or management is unable to implement one or more tax planning strategies.

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 14: 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 13: 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, 2014, as well as the funded status of our pension plans and OPEB obligations as of December 31, 2014 and 2013.

The discount rate used in the determination of pension and OPEB benefit obligations in 2014, 2013 and 2012 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, 2014, we calculated pension obligations using a 4.25% discount rate. We used a discount rate of 5.10% and 4.15% at December 31, 2013 and 2012, 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 7.50% for the year ended December 31, 2014, and 8.00% for the years ended December 31, 2013 and December 31, 2012. We reduced

the expected long-term rate of return to 6.75% for 2015 to reflect the change in the pension plan's investment portfolio.

Net periodic pension plan cost in 2014 was \$15.0 million. A decrease in the discount rate or the rate of expected return on plan assets, all other assumptions remaining the same, would increase net periodic cost. A 25 basis point

2014 FORM 10-K / 39

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decrease in the discount rate would increase net periodic cost by approximately \$0.7 million in 2015 and increase the projected benefit obligation by approximately \$11.6 million at December 31, 2014. 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 in 2015. 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 2014 was \$5.7 million. The discount rate used to calculate OPEB obligations, which was determined using the same methodology we used for our pension plans, was 3.90%, 4.45% and 3.70% at December 31, 2014, 2013 and 2012, respectively. The assumed health care cost trend rate used to calculate OPEB obligations as of December 31, 2014 was 0% for our salaried and non-represented plans and a certain group of participants over age 65 in our hourly plan; 5.70% for our Arkansas participants covered by a collective bargaining agreement, grading ratably to an assumption of 4.30% in 2094; and 5.70% for a certain group of participants under age 65 in our hourly plan, grading ratably to an assumption of 4.30% in 2094.

An decrease in the discount rate or increase in the health care cost trend rate assumption, all other assumptions remaining the same, would increase our OPEB liability. A 25 basis point decrease in the discount rate would increase net periodic cost by less than \$0.1 million. A 1% increase in the health care cost trend rate assumption would have affected our OPEB obligation by approximately \$0.1 million, as reported in Note 13: 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

See prospective accounting pronouncements in Note 1: Summary of Principal Accounting Policies in the Notes to Consolidated Financial Statements.

#### 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, term loans 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 under our bank credit facility at December 31, 2014.

Approximately two-thirds 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, in December 2014 we issued \$120 million of term loans at variable rates. In addition, we entered into interest rate swap agreements to effectively convert some of our fixed rate debt to variable rate. As of December 31, 2014, we had seven separate interest rate swaps with notional amounts totaling \$96.75 million. The swaps convert interest payments with fixed rates ranging between 6.95% and 8.89% to three-month LIBOR plus a spread between 4.738% and 6.518%. The interest rate swaps terminate at various dates between December 2015 and November 2019. See Note 12: Financial Instruments and Concentration of Risk in the Notes to Consolidated Financial Statements for additional information.

We have occasionally entered into lumber swap contracts to mitigate commodity price risk related to sales from our Wood Products segment. These contracts cash settled at various dates throughout the length of the contracts. Our last lumber swap settled in 2012; there were no lumber swaps outstanding at December 31, 2014 or 2013. See Note 12: Financial Instruments and Concentration of Risk in the Notes to Consolidated Financial Statements for additional information about our lumber swaps.





## Quantitative Information about Market Risks

The following table summarizes our outstanding debt, interest rate swaps and average interest rates as of December 31, 2014:

| (Dollars in thousands)             | EXPECTED MATURITY DATE |         |          |          |           |            | TOTAL      |
|------------------------------------|------------------------|---------|----------|----------|-----------|------------|------------|
|                                    | 2015                   | 2016    | 2017     | 2018     | 2019      | THEREAFTER |            |
| Variable rate debt:                |                        |         |          |          |           |            |            |
| Principal due                      | \$—                    | \$—     | \$—      | \$—      | \$40,000  | \$ 80,000  | \$ 120,000 |
| Average interest rate              |                        |         |          |          | 1.88      | % 2.13     | % 2.05 %   |
| Fair value at 12/31/14             |                        |         |          |          |           |            | \$ 120,000 |
| Fixed rate debt:                   |                        |         |          |          |           |            |            |
| Principal due                      | \$22,500               | \$5,000 | \$11,000 | \$14,250 | \$150,000 | \$ 307,335 | \$ 510,085 |
| Average interest rate              | 6.95                   | % 8.80  | % 5.64   | % 8.88   | % 7.50    | % 5.06     | % 6.02 %   |
| Fair value at 12/31/14             |                        |         |          |          |           |            | \$ 537,943 |
| Interest rate swaps <sup>1</sup> : |                        |         |          |          |           |            |            |
| Fixed to variable                  | \$372                  | \$92    | \$169    | \$551    | \$(391)   | ) \$—      | \$793      |
| Fair value at 12/31/14             |                        |         |          |          |           |            | \$793      |

<sup>1</sup> Interest rate swaps are included in long-term debt on the Consolidated Balance Sheets. The derivative assets are included in the other assets and current receivables on the Consolidated Balance Sheets.

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) | NOTIONAL AMOUNT | INTEREST RATE SWAP AGREEMENTS - FAIR VALUE <sup>1</sup> |         |          |          |          |
|------------------------|-----------------|---|---------|----------|----------|----------|
|                        |                 | Current   | +50 BPS | +100 BPS | -50 BPS  | -100 BPS |
| Maturing in:           |                 |   |         |          |          |          |
| 2015                   | \$22,500        | 389   | 302     | 216      | 460      | 470      |
| 2016                   | 5,000           | 99  | 76      | 52       | 119      | 124      |
| 2017                   | 5,000           | 178   | 121     | 66       | 239      | 296      |
| 2018                   | 14,250          | 579   | 369     | 163      | 797      | 1,019    |
| 2019                   | 50,000          | (399)   | )(1,537 | )(2,645  | )779     | 1,980    |
| Total                  | \$96,750        | \$846   | \$(669  | )(2,148  | )\$2,394 | \$3,889  |

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

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Income

(Dollars in thousands, except per-share amounts)

|  | FOR THE YEARS ENDED DECEMBER 31, |           |           |
|--|----------------------------------|-----------|-----------|
|  | 2014                             | 2013      | 2012      |
| Revenues                                     | \$606,950                        | \$570,289 | \$525,134 |
| Costs and expenses:                          |                                  |           |           |
| Cost of goods sold <sup>1</sup>              | 429,789                          | 408,772   | 390,773   |
| Selling, general and administrative expenses | 44,655                           | 50,397    | 49,419    |
| Environmental remediation charges            | —                                | 3,522     | —         |
|  | 474,444                          | 462,691   | 440,192   |
| Operating income                             | 132,506                          | 107,598   | 84,942    |
| Interest expense, net                        | (22,909)                         | (23,132)  | (25,539)  |
| Income before income taxes                   | 109,597                          | 84,466    | 59,403    |
| Income taxes                                 | (19,687)                         | (13,885)  | (16,809)  |
| Net income                                   | \$89,910                         | \$70,581  | \$42,594  |
| Net income per share:                        |                                  |           |           |
| Basic  | \$2.21                           | \$1.74    | \$1.06    |
| Diluted                                      | 2.20                             | 1.73      | 1.05      |
| Distributions per share                      | \$1.425                          | \$1.28    | \$1.24    |

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

<sup>1</sup> A 2012 asset impairment charge of \$107 was reclassified to cost of goods sold.

## POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

## Consolidated Statements of Comprehensive Income

(Dollars in thousands)

|  | FOR THE YEARS ENDED DECEMBER 31, |           |          |
|--|----------------------------------|-----------|----------|
|  | 2014                             | 2013      | 2012     |
| Net income   | \$89,910                         | \$70,581  | \$42,594 |
| 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 \$(15,598), \$21,424 and \$(5,968)                | (24,396                          | )33,510   | (9,334   |
| Prior service credit arising during the period, net of tax expense of \$0, \$0 and \$2,159                                   | —                                | —         | 3,273    |
| Amortization of actuarial loss included in net periodic cost, net of tax expense of \$6,488, \$9,024 and \$7,208             | 10,149                           | 14,114    | 11,275   |
| Amortization of prior service credit included in net periodic cost, net of tax benefit of \$(3,468), \$(3,482) and \$(3,343) | (5,425                           | )(5,446   | )(5,230  |
| Other comprehensive income (loss), net of tax  | (19,672                          | )42,178   | (16      |
| Comprehensive income   | \$70,238                         | \$112,759 | \$42,578 |

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 |           |
|---|----------------|-----------|
|   | 2014           | 2013      |
| <b>ASSETS</b>   |                |           |
| Current assets:   |                |           |
| Cash  | \$4,644        | \$5,586   |
| Short-term investments  | 26,368         | 52,251    |
| Receivables, net of allowance for doubtful accounts of \$450  | 9,928          | 16,572    |
| Inventories   | 31,490         | 36,275    |
| Deferred tax assets   | 6,168          | 7,724     |
| Other assets  | 15,065         | 11,961    |
| Total current assets  | 93,663         | 130,369   |
| Property, plant and equipment, net  | 65,749         | 59,976    |
| Timber and timberlands, net   | 828,420        | 455,871   |
| Deferred tax assets   | 37,228         | 21,576    |
| Other assets  | 10,361         | 12,738    |
| Total assets  | \$1,035,421    | \$680,530 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                |           |
| Current liabilities:  |                |           |
| Current portion of long-term debt   | \$22,870       | \$—       |
| Current liability for pensions and other postretirement employee benefits                           | 6,260          | 6,701     |
| Accounts payable and accrued liabilities  | 43,064         | 43,617    |
| Total current liabilities   | 72,194         | 50,318    |
| Long-term debt  | 606,473        | 320,092   |
| Liability for pensions and other postretirement employee benefits                                   | 115,936        | 83,619    |
| Other long-term obligations   | 15,752         | 22,353    |
| Total liabilities   | 810,355        | 476,382   |
| Stockholders' equity:   |                |           |
| Preferred stock, authorized 4,000,000 shares, no shares issued                                      | —              | —         |
| Common stock, \$1 par value, authorized 100,000,000 shares, issued 40,605,179 and 40,536,879 shares | 40,605         | 40,537    |
| Additional paid-in capital  | 346,441        | 337,887   |
| Accumulated deficit   | (43,588)       | (75,556)  |
| Accumulated other comprehensive loss, net of tax of \$(77,586) and \$(64,868)                       | (118,392)      | (98,720)  |
| Total stockholders' equity  | 225,066        | 204,148   |
| Total liabilities and stockholders' equity  | \$1,035,421    | \$680,530 |

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, |          |          |
|--|----------------------------------|----------|----------|
|  | 2014                             | 2013     | 2012     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                                |                                  |          |          |
| Net income   | \$89,910                         | \$70,581 | \$42,594 |
| Adjustments to reconcile net income to net cash from operating activities: |                                  |          |          |
| Depreciation, depletion and amortization                                   | 26,749                           | 26,962   | 26,247   |
| Basis of real estate sold  | 8,646                            | 2,904    | 5,048    |
| Change in deferred taxes   | (1,616)                          | (2,467)  | (15,992) |
| Employee benefit plans   | 2,122                            | 7,561    | 4,317    |
| Employee equity-based compensation expense                                 | 4,137                            | 4,377    | 4,067    |
| Other, net   | (2,191)                          | (1,972)  | (599)    |
| Change in:   |                                  |          |          |
| Receivables  | 7,016                            | (5,904)  | (2,865)  |
| Inventories  | 4,785                            | (7,347)  | (325)    |
| Other assets   | (1,421)                          | (1,668)  | (1,459)  |
| Accounts payable and accrued liabilities                                   | (2,388)                          | (3,468)  | (163)    |
| Funding of qualified pension plans   | (3,550)                          | —        | (21,630) |
| Timber deposits and cost share roads                                       | (827)                            | (2,643)  | (1,503)  |
| Net cash from operating activities   | 131,372                          | 90,252   | 79,981   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                                |                                  |          |          |
| Change in short-term investments   | 25,883                           | 10,826   | (88)     |
| Transfer from company owned life insurance (COLI)                          | 28,870                           | —        | 21,751   |
| Transfer to COLI   | (25,515)                         | —        | —        |
| Property, plant and equipment  | (13,261)                         | (10,280) | (5,636)  |
| Timberlands reforestation and roads <sup>1</sup>                           | (10,971)                         | (12,313) | (11,774) |
| Acquisition of timber and timberlands <sup>1</sup>                         | (388,952)                        | (1,060)  | (11,778) |
| Other, net   | 1,263                            | 823      | (1,122)  |
| Net cash from investing activities   | (382,683)                        | (12,004) | (8,647)  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                                |                                  |          |          |
| Distributions to common stockholders                                       | (57,848)                         | (51,868) | (50,041) |
| Repayment of long-term debt  | —                                | (36,663) | (21,662) |
| Proceeds from issuance of long-term debt                                   | 310,000                          | —        | 12,000   |
| Issuance of common stock   | 398                              | 1,904    | 1,075    |
| Change in book overdrafts  | 1,465                            | (955)    | (462)    |
| Deferred financing costs   | (2,388)                          | (25)     | (2,148)  |
| Employee tax withholdings on vested performance share awards               | (1,104)                          | (1,738)  | (1,714)  |
| Other, net   | (154)                            | (302)    | (140)    |
| Net cash from financing activities   | 250,369                          | (89,647) | (62,168) |
| Increase (decrease) in cash  | (942)                            | (11,399) | (9,166)  |
| Cash at beginning of year  | 5,586                            | 16,985   | 7,819    |
| Cash at end of year  | \$4,644                          | \$5,586  | \$16,985 |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION</b>                                  |                                  |          |          |
| Cash paid during the year for:   |                                  |          |          |
| Interest   | \$20,918                         | \$22,229 | \$23,884 |

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|                   |        |        |    |
|-------------------|--------|--------|----|
| Income taxes, net | 18,104 | 20,097 | 53 |
|-------------------|--------|--------|----|

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

<sup>1</sup> Acquisitions of timber and timberlands in 2013 and 2012 were reclassified in order to conform to the 2014 presentation.

2014 FORM 10-K / 45

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## 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, 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                        |
| Exercise of stock options and<br>stock awards         | 12,859                 | 13       | 385                              | —                      | —   | 398                              |
| Performance share and<br>restricted stock unit awards | 55,441                 | 55       | 2,974                            | (94)                   | —   | 2,935                            |
| Net income  | —                      | —        | —                                | 89,910                 | —   | 89,910                           |
| Director deferred stock<br>awards                     | —                      | —        | 5,195                            | —                      | —   | 5,195                            |
| Pension plans and OPEB<br>obligations                 | —                      | —        | —                                | —                      | (19,672)                                      | (19,672)                         |
| Common distributions, \$1.425<br>per share            | —                      | —        | —                                | (57,848)               | —   | (57,848)                         |
| Balance, December 31, 2014                            | 40,605,179             | \$40,605 | \$346,441                        | \$(43,588)             | \$(118,392)                                   | \$225,066                        |

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>Earnings per Share</u>   | <u>51</u>      |
| Note 3. <u>Short-Term Investments</u>   | <u>51</u>      |
| Note 4. <u>Inventories</u>  | <u>51</u>      |
| Note 5. <u>Property, Plant and Equipment</u>  | <u>52</u>      |
| Note 6. <u>Timber and Timberlands</u>   | <u>52</u>      |
| Note 7. <u>Other Assets</u>   | <u>52</u>      |
| Note 8. <u>Income Taxes</u>   | <u>53</u>      |
| Note 9. <u>Debt</u>   | <u>55</u>      |
| Note 10. <u>Accounts Payable and Accrued Liabilities</u>                                | <u>56</u>      |
| Note 11. <u>Other Long-Term Obligations</u>   | <u>56</u>      |
| Note 12. <u>Financial Instruments and Concentration of Risk</u>                         | <u>57</u>      |
| Note 13. <u>Savings Plans, Pension Plans and Other Postretirement Employee Benefits</u> | <u>59</u>      |
| Note 14. <u>Commitments and Contingencies</u>   | <u>65</u>      |
| Note 15. <u>Equity-Based Compensation Plans</u>   | <u>66</u>      |
| Note 16. <u>Segment Information</u>   | <u>69</u>      |
| Note 17. <u>Financial Results by Quarter (Unaudited)</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 1.6 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. We converted to a Real Estate Investment Trust (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 the Notes to Consolidated Financial Statements. Significant estimates include timber volumes, assumptions utilized for asset and disposal group impairment tests, income projections and tax planning strategies used to support realization of deferred tax assets, environmental liabilities, pension and postretirement obligation assumptions and fair value of derivative instruments.

### 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 15: 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, including costs of preparing the land for planting, cost of seeds or seedlings, and 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 acquisitions are capitalized and the cost is allocated to timberland, merchantable sawlogs, merchantable pulpwood, reproduction (young growth not merchantable), logging roads and other land improvements, generally based on relative appraised values. The aggregate estimated volume of current standing merchantable timber inventory is updated at least annually to reflect increases due to reclassification of young growth to merchantable timber when the young growth meets defined diameter specifications, the annual growth 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% in the North and 6%-9% in the South.

Depletion represents the amount charged to expense as fee timber is harvested. 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 remain 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.

#### 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 we intend to reinvest the the funds 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. The estimates are adjusted periodically to reflect changing business conditions. Impaired assets are written down to fair value. 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

2014 FORM 10-K / 49

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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 risk of loss transfers to the buyer and the quantity sold is determinable. These sales take the form of delivered logs, pay-as-cut contracts, timber deeds and lump sum contracts. On delivered log sales, revenue, which includes amounts billed for logging and hauling, is recognized at the point that logs are delivered and scaled. Revenue is recognized on timber deeds and lump sum contracts generally upon closing or when the contracts are effective, which is the point at which the buyer assumes risk of loss associated with the standing timber.

We receive cash consideration in full and recognize revenue at closing on substantially all our real estate sales.

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.

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.

#### PROSPECTIVE ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers. This update was issued as Accounting Standards Codification Topic 606. The core principle of this amendment is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, with earlier adoption not permitted. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. The adoption of this guidance is not expected to have a significant effect on our consolidated financial statements.

#### SHIPPING AND HANDLING COSTS

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

## NOTE 2. 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) | 2014       | 2013       | 2012       |
|--|------------|------------|------------|
| Net income                                       | \$89,910   | \$70,581   | \$42,594   |
| Basic weighted-average shares outstanding        | 40,748,924 | 40,502,878 | 40,333,333 |
| Incremental shares due to:                       |            |            |            |
| Performance shares                               | 117,830    | 133,766    | 134,079    |
| Restricted stock units                           | 27,628     | 69,076     | 70,217     |
| Stock options                                    | —          | 3,567      | 15,520     |
| Diluted weighted-average shares outstanding      | 40,894,382 | 40,709,287 | 40,553,149 |
| Basic net income per share                       | \$2.21     | \$1.74     | \$1.06     |
| Diluted net income per share                     | \$2.20     | \$1.73     | \$1.05     |

Anti-dilutive shares excluded from the calculation:

|  |       |       |     |
|--|-------|-------|-----|
| Performance shares                                       | —     | 3,441 | —   |
| Restricted stock units                                   | 1,216 | —     | 315 |
| Total anti-dilutive shares excluded from the calculation | 1,216 | 3,441 | 315 |

## NOTE 3. 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 4. INVENTORIES

| (Dollars in thousands)                      | 2014     | 2013     |
|---|----------|----------|
| Logs  | \$7,930  | \$14,975 |
| Lumber and other manufactured wood products | 17,286   | 15,967   |
| Materials and supplies                      | 6,274    | 5,333    |
|   | \$31,490 | \$36,275 |
| Valued at lower of cost or market:          |          |          |
| Last-in, first-out basis                    | \$16,874 | \$23,250 |
| Average cost basis                          | 14,616   | 13,025   |
| Total inventories                           | \$31,490 | \$36,275 |

If the last-in, first-out inventory had been carried at average cost, the values would have been approximately \$11.0 million, \$11.3 million, and \$10.6 million higher at December 31, 2014, 2013, and 2012, respectively.

## NOTE 5. PROPERTY, PLANT AND EQUIPMENT

| (Dollars in thousands)              | 2014       | 2013       |
|-------------------------------------|------------|------------|
| Land and land improvements          | \$18,374   | \$17,201   |
| Buildings and structures            | 36,174     | 33,985     |
| Machinery and equipment             | 176,085    | 171,385    |
| Construction in progress            | 5,878      | 1,225      |
|                                     | 236,511    | 223,796    |
| Less: accumulated depreciation      | (170,762 ) | (163,820 ) |
| Total property, plant and equipment | \$65,749   | \$59,976   |

Depreciation charged against operating income totaled \$8.1 million, \$8.2 million and \$8.8 million in 2014, 2013 and 2012, respectively.

## NOTE 6. TIMBER AND TIMBERLANDS

| (Dollars in thousands)       | 2014      | 2013      |
|------------------------------|-----------|-----------|
| Timber and timberlands       | \$760,431 | \$391,916 |
| Logging roads                | 67,989    | 63,955    |
| Total timber and timberlands | \$828,420 | \$455,871 |

Depletion from company-owned lands totaled \$14.5 million, \$14.6 million and \$12.9 million in 2014, 2013 and 2012, respectively. Amortization of logging roads totaled \$2.8 million, \$2.7 million and \$2.6 million in 2014, 2013 and 2012, respectively.

On December 7, 2014, we acquired approximately 201,000 acres of timberland in Alabama and Mississippi for a total purchase price of \$384 million. We borrowed \$310 million of new term loans and used cash on hand to pay for the acquisition. See Note 9: Debt in the Notes to Consolidated Financial Statements. The transaction was accounted for as an asset acquisition.

Payments due under timber cutting contracts total \$2.0 million, \$2.6 million, \$7.3 million and \$2.5 million in 2015, 2016, 2017 and 2018, respectively.

## NOTE 7. OTHER ASSETS

| Current Other Assets<br>(Dollars in thousands)       | 2014     | 2013     |
|--|----------|----------|
| Basis of real estate held for sale                   | \$11,529 | \$10,010 |
| Deferred charges                                     | 1,172    | 1,008    |
| Prepaid expenses                                     | 2,364    | 943      |
| Total current other assets                           | \$15,065 | \$11,961 |
| Noncurrent Other Assets<br>(Dollars in thousands)    | 2014     | 2013     |
| Deferred charges                                     | \$6,697  | \$5,668  |
| Noncurrent investments                               | 911      | 3,144    |
| Derivative asset associated with interest rate swaps | 421      | 1,830    |
| Developed land                                       | 1,733    | 1,733    |
| Other  | 599      | 363      |
| Total noncurrent other assets                        | \$10,361 | \$12,738 |

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

## NOTE 8. INCOME TAXES

As a REIT, 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 our 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 reduced five-year holding period was extended each year through 2014. Accordingly, the built-in gains tax did not apply to Potlatch sales of real property that occurred in 2011 through 2014.

We conduct certain activities through taxable REIT subsidiaries (TRS) that 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 sale.

We reflect accrued interest related to tax obligations, as well as penalties, in our provision for income taxes. For the years ended December 31, 2014, 2013 and 2012, we recognized insignificant amounts related to interest and penalties in our tax provision. At December 31, 2014 and 2013, we had no accrued interest related to tax obligations and no accrued interest receivable with respect to open tax refunds.

Income tax expense consists of the following for the years ended December 31:

| (Dollars in thousands)           | 2014     | 2013     | 2012     |
|----------------------------------|----------|----------|----------|
| Current                          | \$21,205 | \$16,352 | \$292    |
| Deferred                         | (2,143)  | (2,754)  | 8,197    |
| Net operating loss carryforwards | 625      | 287      | 8,320    |
| Income taxes                     | \$19,687 | \$13,885 | \$16,809 |

Income tax expense 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)                        | 2014     | 2013     | 2012     |
|---|----------|----------|----------|
| U.S. federal statutory income tax             | \$38,359 | \$29,563 | \$20,791 |
| REIT income not subject to federal income tax | (16,812) | (13,918) | (5,241)  |
| Change in valuation allowance                 | (1,818)  | (683)    | —        |
| State income taxes, net of federal income tax | 2,234    | 942      | 1,615    |
| Domestic production activities deduction      | (1,055)  | (1,579)  | —        |
| Permanent book-tax differences                | (1,073)  | (384)    | (413)    |
| All other items                               | (148)    | (56)     | 57       |
| Income taxes                                  | \$19,687 | \$13,885 | \$16,809 |
| Effective tax rate                            | 18.0     | % 16.4   | % 28.3   |



|  |          |          |
|--|----------|----------|
| The tax effects of significant temporary differences creating deferred tax assets and liabilities at December 31 were: |          |          |
| (Dollars in thousands)   | 2014     | 2013     |
| Deferred tax assets:   |          |          |
| Pensions   | \$31,527 | \$16,807 |
| Postretirement employee benefits   | 16,209   | 18,464   |
| Inventories  | 2,720    | 2,636    |
| Incentive compensation   | 2,544    | 2,807    |
| Nondeductible accruals   | 2,033    | 2,405    |
| Tax credits  | 1,904    | 2,135    |
| Employee benefits  | 1,839    | 1,586    |
| Net operating loss carryforwards   | 142      | 1,056    |
| Other  | 224      | 200      |
| Total deferred tax assets  | 59,142   | 48,096   |
| Valuation allowance  | —        | (2,184)  |
| Deferred tax assets, net of valuation allowance  | 59,142   | 45,912   |
| Deferred tax liabilities:  |          |          |
| Timber and timberlands   | (5,120)  | (5,871)  |
| Property, plant and equipment  | (10,626) | (10,741) |
| Total deferred tax liabilities   | (15,746) | (16,612) |
| Net deferred tax assets  | \$43,396 | \$29,300 |
| Net deferred tax assets and liabilities consist of:  |          |          |
| (Dollars in thousands)   | 2014     | 2013     |
| Current deferred tax assets  | \$6,168  | \$7,724  |
| Noncurrent deferred tax assets   | 37,228   | 21,576   |
| Net deferred tax assets  | \$43,396 | \$29,300 |

As of December 31, 2014 we believe it is more likely than not that we will have sufficient future taxable income to realize all of our deferred tax assets. During 2014, the valuation allowance decreased from \$2.2 million to zero, with \$1.8 million of the decrease due to the actual use and expected future use of Idaho Investment Tax Credits.

We have state net operating loss carryforwards of \$3.4 million at December 31, 2014 that expire from 2016 through 2017. We have Idaho Investment Tax Credits of \$2.9 million at December 31, 2014 that expire from 2016 through 2028.

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

|              |       |        |
|--------------|-------|--------|
| Jurisdiction | Years |        |
| Federal      | 2011  | - 2014 |
| Arkansas     | 2011  | - 2014 |
| Michigan     | 2010  | - 2014 |
| Minnesota    | 2010  | - 2014 |
| Idaho        | 2011  | - 2014 |

As of December 31, 2014 and 2013, we had no 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 9. DEBT

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

| (Dollars in thousands)   | 2014      | 2013      |
|--|-----------|-----------|
| Term loans, variable rate 1.88% to 2.13% due 2019 through 2021 and fixed rate 2.95% to 4.64% due 2017 through 2024 | \$322,000 | \$12,000  |
| Senior Notes, 7.50%, due 2019  | 150,000   | 150,000   |
| Revenue bonds, 5.90% to 6.95%, due 2024 and 2026   | 108,335   | 108,335   |
| 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    |
|  | 630,085   | 320,085   |
| Interest rate swaps  | 793       | 1,830     |
| Less unamortized discounts   | (1,535 )  | (1,823 )  |
|  | 629,343   | 320,092   |
| Less current portion   | (22,870 ) | —         |
| Long-term debt   | \$606,473 | \$320,092 |

## CREDIT AGREEMENT

On August 12, 2014, we entered into an amended and restated credit agreement with an expiration date of February 12, 2020, which supersedes our previous credit agreement dated as of December 11, 2012. This new credit agreement provides for a revolving line of credit with an initial aggregate principal amount not to exceed \$250 million, which may be increased by up to an additional \$250 million. It also includes a sublimit of \$40 million for the issuance of standby letters of credit and a sublimit of \$25 million for swing line loans. Usage under either or both subfacilities reduces availability under the revolving line of credit. As of December 31, 2014, there were no borrowings outstanding under the revolving line of credit, and approximately \$1.4 million of the letter of credit subfacility was being used to support several outstanding letters of credit. Available borrowing capacity at December 31, 2014 was \$248.6 million.

Pricing is set according to the type of borrowing. LIBOR 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 rate of interest in effect for such day as publicly announced from time to time by KeyBank as its “prime rate,” and (c) the sum of the LIBOR that would apply to a one month Interest Period plus 1.00%. The interest rates we pay for borrowings under either type of loan include an additional Applicable Rate, which can range from 0.875% to 1.70% for LIBOR loans and from 0% to 0.70% for Base Rate loans, depending on our current credit rating. As of December 31, 2014, we were able to borrow under the bank credit facility with the additional applicable rate of 1.30% for LIBOR Loans and 0.30% for Base Rate Loans, with facility fees of 0.2% on the \$250 million of the bank credit facility.

## TERM LOANS

On December 5, 2014, we entered into an amended and restated term loan agreement totaling \$322 million, consisting of \$310 million of new term loans to fund the acquisition of timberlands in Alabama and Mississippi and \$12 million of term loans that we incurred in December 2012 to fund two timberland acquisitions in Arkansas. The new debt consists of six tranches of term loans, with \$40.0 million maturing each year from 2019 through 2023 and \$110.0 million maturing in 2024. The first three tranches are variable rate term loans based on 3-month LIBOR plus a spread between 1.65% and 1.90%. The last three tranches are fixed rate term loans with interest rates between 4.29% and 4.64%. Our original 2012 term loans consist of two \$6 million tranches, with rates of 2.95% on the 2017 maturity and 3.70% on the 2020 maturity. The term loan agreement contains the same covenants and restrictions as those in our bank credit facility.

## DEBT MATURITIES

Scheduled principal payments due on long-term debt during each of the five years subsequent to December 31, 2014, are as follows:

(Dollars in thousands)

|      |          |
|------|----------|
| 2015 | \$22,500 |
| 2016 | 5,000    |
| 2017 | 11,000   |
| 2018 | 14,250   |
| 2019 | 190,000  |

## NOTE 10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

(Dollars in thousands)

|                                       | 2014     | 2013     |
|---------------------------------------|----------|----------|
| Wages, salaries and employee benefits | \$14,667 | \$15,908 |
| Trade accounts payable                | 5,656    | 7,702    |
| Taxes other than income taxes         | 5,663    | 6,247    |
| Interest                              | 4,811    | 4,018    |
| Logging related expenses              | 2,983    | 1,600    |
| Deferred recreational lease income    | 1,616    | 880      |
| Freight                               | 740      | 802      |
| Book overdrafts                       | 4,385    | 2,920    |
| Other                                 | 2,543    | 3,540    |
| Total                                 | \$43,064 | \$43,617 |

## NOTE 11. OTHER LONG-TERM OBLIGATIONS

(Dollars in thousands)

|   | 2014     | 2013     |
|---|----------|----------|
| Employee benefits and related liabilities | \$8,839  | \$15,423 |
| Cost share logging roads                  | 5,894    | 5,759    |
| Other                                     | 1,019    | 1,171    |
| Total                                     | \$15,752 | \$22,353 |

On May 8, 2014, our board approved changes to our director compensation program. This amendment states that upon a director's separation from the company, all deferred awards will be settled in company stock and no longer settled in cash. This resulted in a reclassification of the related \$4.3 million from employee benefits and related liabilities to stockholders' equity.

**NOTE 12. 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:

| (Dollars in thousands)  | 2014               |               | 2013               |               |
|---|--------------------|---------------|--------------------|---------------|
|   | CARRYING<br>AMOUNT | FAIR<br>VALUE | CARRYING<br>AMOUNT | FAIR<br>VALUE |
| Cash and short-term investments (Level 1)   | \$31,012           | \$31,012      | \$57,837           | \$57,837      |
| Net derivative asset related to interest rate swaps (Level 2)   | 793                | 793           | 1,830              | 1,830         |
| Long-term debt (including current portion of long-term debt and fair value adjustments related to fair value swaps) (Level 2) | 629,343            | 657,943       | 320,092            | 347,869       |
| Company owned life insurance (COLI) (Level 3)   | 877                | 877           | 3,110              | 3,110         |

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, or estimated based on average market prices for comparable debt when there is no quoted market price. Contract value of our COLI, the amount at which it could be redeemed, is used as a practical expedient to estimate fair value because market prices are not readily available.

**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, 2014, we had seven separate interest rate swaps with notional amounts totaling \$96.75 million associated with our \$22.5 million debentures, \$24.25 million of our medium-term notes and \$50.0 million of our



senior 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 November 2019.

#### NON-DESIGNATED LUMBER SWAP

Derivatives not designated as hedges were not speculative and have been used occasionally to manage our exposure to commodity price movements, but did 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 were recorded directly in net income. There were no outstanding lumber swap contracts at December 31, 2014 or 2013.

#### BALANCE SHEET AND INCOME EFFECTS OF DERIVATIVES

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

| (Dollars in thousands)                              | DERIVATIVE ASSETS       |                      |
|---|-------------------------|----------------------|
|   | 2014                    | 2013                 |
|   | BALANCE SHEET           | FAIR VALUE           |
|   | LOCATION                | FAIR VALUE           |
| Derivatives designated as hedging instruments:      |                         |                      |
| Interest rate contracts                             | Other noncurrent assets | \$ 793      \$ 1,830 |
| Total derivatives designated as hedging instruments |                         | \$ 793      \$ 1,830 |

The effect of derivatives on the Consolidated Statements of Income for the years ended December 31, 2014, 2013 and 2012 are as follows:

| (Dollars in thousands)   | LOCATION OF GAIN<br>(LOSS)<br>RECOGNIZED IN<br>INCOME | AMOUNT OF GAIN (LOSS)<br>RECOGNIZED IN INCOME |       |          |
|--|---|---|-------|----------|
|  |   | 2014  | 2013  | 2012     |
| Derivatives designated in fair value hedging relationships:                          |   |   |       |          |
| Interest rate contracts  |   |   |       |          |
| Realized gain on hedging instrument <sup>1</sup>                                     | Interest expense                                      | \$979   | \$960 | \$868    |
| Net gain recognized in income from fair value hedges                                 |   | \$979   | \$960 | \$868    |
| Derivatives not designated as hedging instruments:                                   |   |   |       |          |
| Lumber contracts   |   |   |       |          |
| Unrealized loss on derivative  | Cost of goods sold                                    | \$—   | \$—   | \$(480 ) |
| Realized loss on derivative  | Cost of goods sold                                    | —   | —     | (396 )   |
| Net loss recognized in income from derivatives not designated as hedging instruments |   | \$—   | \$—   | \$(876 ) |

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

#### CONCENTRATION OF RISK

One customer accounted for slightly more than 10% of our revenues in the years ended December 31, 2014, 2013 and 2012.

NOTE 13. 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 2014, 2013 and 2012, we made matching 401(k) contributions on behalf of employees of \$2.0 million, \$1.8 million and \$1.6 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 the 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<br>(OPEB) |            |
|--|---------------|-------------|--|------------|
| (Dollars in thousands)                                 | 2014          | 2013        | 2014   | 2013       |
| Benefit obligation at beginning of year                | \$(393,565)   | \$(445,535) | \$(47,343)   | \$(52,033) |
| Service cost   | (5,081)       | (5,318)     | (25)   | (94)       |
| Interest cost  | (19,184)      | (17,826)    | (1,741)  | (1,810)    |
| Plan amendments  | —             | —           | —  | —          |
| Actuarial loss (gain)                                  | (49,990)      | 41,178      | 3,229  | 2,692      |
| Benefits paid  | 50,126        | 33,936      | 4,319  | 3,902      |
| Benefit obligation at end of year                      | \$(417,694)   | \$(393,565) | \$(41,561)   | \$(47,343) |
| Fair value of plan assets at beginning of year         | \$350,588     | \$345,633   | \$—  | \$—        |
| Actual return on plan assets                           | 31,280        | 37,157      | —  | —          |
| Employer contributions and benefit payments            | 5,317         | 1,734       | 4,319  | 3,902      |
| Benefits paid  | (50,126)      | (33,936)    | (4,319)  | (3,902)    |
| Fair value of plan assets at end of year               | \$337,059     | \$350,588   | \$—  | \$—        |
| Amounts recognized in the consolidated balance sheets: |               |             |  |            |
| Current liabilities                                    | \$(1,774)     | \$(1,772)   | \$(4,486)  | \$(4,929)  |
| Noncurrent liabilities                                 | (78,861)      | (41,205)    | (37,075)   | (42,414)   |
| Funded status  | \$(80,635)    | \$(42,977)  | \$(41,561)   | \$(47,343) |

Changes in actuarial assumptions, primarily the decrease in the discount rate, and adoption of updated mortality tables used to calculate our pension liabilities resulted in a decrease to the funded status of our pension plans at the end of 2014.

The accumulated benefit obligation for all defined benefit pension plans was \$410.4 million and \$387.4 million at December 31, 2014 and 2013, respectively.

On January 1, 2011 we froze our pension plans to any new salaried and hourly non-represented employees hired after that date.





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

#### 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 | 24 | % - 48% |
| Fixed income securities             | 38 | % - 58% |
| Alternatives                        | 12 | % - 18% |
| Cash                                | 0  | % - 5%  |

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.

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

| ASSET CATEGORY                         | PENSION PLANS |       |   |
|--|---------------|-------|---|
|  | 2014          | 2013  |   |
| Domestic equity securities             | 14            | % 20  | % |
| Global/international equity securities | 22            | 27    |   |
| Fixed income securities                | 48            | 38    |   |
| Other                                  | 16            | 15    |   |
| Total                                  | 100           | % 100 | % |

The pension assets are stated at fair value. Refer to Note 12. Financial Instruments and Concentration of Risk for discussion of the framework used to measure 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, 2014:

(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            | \$ 6,586                                      | \$ —                        | \$ —                          | \$6,586   |
| Equity securities:              |   |                             |                               |           |
| U.S. small/mid cap <sup>1</sup> | 1,136   | —                           | —                             | 1,136     |
| International companies         | 13,782  | —                           | —                             | 13,782    |
| Mutual funds <sup>2</sup>       | 226,710                                       | —                           | —                             | 226,710   |
| Collective investments:         |   |                             |                               |           |
| U.S. large cap <sup>3</sup>     | —   | 30,005                      | —                             | 30,005    |
| Developed markets <sup>4</sup>  | —   | 29,879                      | —                             | 29,879    |
| Emerging markets <sup>5</sup>   | —   | 28,961                      | —                             | 28,961    |
| Total                           | \$ 248,214                                    | \$88,845                    | \$ —                          | \$337,059 |

<sup>1</sup> These are managed investments in US small/mid cap equities that track the Russell 2500 Growth index.

The mutual funds were 72% invested in high-quality intermediate and long-term investment grade securities, 22% 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, and 6% invested in US small/mid cap equities that track the Russell 2500 Growth index.

<sup>3</sup> These collective investments are invested in US large cap equities that track the S&P 500.

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



Fair value measurements at December 31, 2013:  
(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            | \$ 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.

<sup>3</sup> The mutual funds were 50% invested in high-quality intermediate and long-term investment grade securities and 50% invested in a diversified portfolio of fixed-income instruments of varying maturities, which may be represented by forwards or derivatives such as options, futures contracts or swap agreements and 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.

<sup>6</sup> The hedge funds are 37% invested in long/short and event-driven equity, 24% invested in long and short credit, 11% in relative value, 10% invested in distressed debt, 6% invested in convertible bond hedging, with the remaining 13% in other investments.

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 |          |
|---|-------------|----------|
|   | 2014        | 2013     |
| Balance, beginning of year  | \$10,579    | \$45,693 |
| Sales and settlements   | (10,579)    | (34,500) |
| Unrealized losses relating to assets still held at the reporting date | —           | (614)    |
| Balance, end of year  | \$—         | \$10,579 |

## 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 |           |           |
|---|---------------|----------|----------|---|-----------|-----------|
|   | 2014          | 2013     | 2012     | 2014                                      | 2013      | 2012      |
| Service cost                                | \$5,081       | \$5,318  | \$5,238  | \$25                                      | \$94      | \$284     |
| Interest cost                               | 19,184        | 17,826   | 19,986   | 1,741                                     | 1,810     | 2,478     |
| Expected return on plan assets              | (24,512)      | (26,092) | (28,755) | —   | —         | —         |
| Curtailement credit                         | —             | —        | —        | —   | —         | (103)     |
| Amortization of prior service cost (credit) | 748           | 779      | 770      | (9,641)                                   | (9,708)   | (9,343)   |
| Amortization of actuarial loss              | 14,451        | 19,929   | 15,356   | 2,186                                     | 3,209     | 3,127     |
| Net periodic cost (benefit)                 | \$14,952      | \$17,760 | \$12,595 | \$(5,689)                                 | \$(4,595) | \$(3,557) |

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

| (Dollars in thousands)                      | PENSION PLANS |           |           | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |            |            |
|---|---------------|-----------|-----------|---|------------|------------|
|   | 2014          | 2013      | 2012      | 2014                                      | 2013       | 2012       |
| Net amount at beginning of year             | \$117,167     | \$161,667 | \$158,883 | \$(18,447)                                | \$(20,769) | \$(18,001) |
| Amounts arising during the period:          |               |           |           |   |            |            |
| Net loss (gain)                             | 43,223        | (52,242)  | 20,180    | (3,229)                                   | (2,692)    | (4,878)    |
| Prior service cost (credit)                 | —             | —         | 510       | —   | —          | (5,942)    |
| Taxes                                       | (16,857)      | 20,374    | (8,069)   | 1,259                                     | 1,050      | 4,260      |
| Net amount arising during the period        | 26,366        | (31,868)  | 12,621    | (1,970)                                   | (1,642)    | (6,560)    |
| Amounts reclassified during the period:     |               |           |           |   |            |            |
| Amortization of prior service cost (credit) | (748)         | (779)     | (770)     | 9,641                                     | 9,708      | 9,343      |
| Amortization of actuarial loss              | (14,451)      | (19,929)  | (15,356)  | (2,186)                                   | (3,209)    | (3,127)    |
| Taxes                                       | 5,927         | 8,076     | 6,289     | (2,907)                                   | (2,535)    | (2,424)    |
| Net reclassifications during the period     | (9,272)       | (12,632)  | (9,837)   | 4,548                                     | 3,964      | 3,792      |
| Net amount at end of year                   | \$134,261     | \$117,167 | \$161,667 | \$(15,869)                                | \$(18,447) | \$(20,769) |

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 |             |
|-----------------------------|---------------|-----------|---|-------------|
|                             | 2014          | 2013      | 2014                                      | 2013        |
| Net loss                    | \$134,717     | \$115,404 | \$ (21,750)                               | \$ 16,490   |
| Prior service cost (credit) | (456)         | 1,763     | 5,881                                     | (34,937)    |
| Net amount recognized       | \$134,261     | \$117,167 | \$ (15,869)                               | \$ (18,447) |



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 \$17.6 million and \$0.6 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 \$2.2 million and \$9.3 million, respectively.

#### EXPECTED FUNDING AND BENEFIT PAYMENTS

We are not required to make a contribution to our qualified pension plan in 2015. 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 2015.

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 |        |
|------------------------|---------------|---------|--|--------|
| 2015                   | \$            | 29,566  | \$   | 4,486  |
| 2016                   |               | 29,342  |  | 4,293  |
| 2017                   |               | 29,167  |  | 4,044  |
| 2018                   |               | 29,049  |  | 3,789  |
| 2019                   |               | 29,031  |  | 3,541  |
| 2020 – 2024            |               | 143,681 |  | 14,600 |

#### ACTUARIAL ASSUMPTIONS

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

|  | PENSION PLANS |        |        | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |        |        |   |
|--|---------------|--------|--------|---|--------|--------|---|
|  | 2014          | 2013   | 2012   | 2014                                      | 2013   | 2012   |   |
| Discount rate                          | 4.25          | % 5.10 | % 4.15 | % 3.90                                    | % 4.45 | % 3.70 | % |
| Rate of salaried compensation increase | 3.00          | % 3.00 | % 3.50 | %—  | —      | —      |   |

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

|  | PENSION PLANS |        |        | OTHER POSTRETIREMENT<br>EMPLOYEE BENEFITS |        |        |   |
|--|---------------|--------|--------|---|--------|--------|---|
|  | 2014          | 2013   | 2012   | 2014                                      | 2013   | 2012   |   |
| Discount rate                          | 5.10          | % 4.15 | % 4.95 | % 4.45                                    | % 3.70 | % 4.85 | % |
| Expected return on plan assets         | 7.50          | % 8.00 | % 8.00 | %—  | —      | —      |   |
| Rate of salaried compensation increase | 3.00          | % 3.50 | % 3.50 | %—  | —      | —      |   |

The discount rate used in the determination of pension and other postretirement employee benefit obligations in 2014 and 2013 was calculated using hypothetical bond portfolios to match the expected benefit payments under each of our pension plans and other postretirement employee benefit obligations based on bonds available on December 31, 2014 with a rating of "AA" or better. The portfolios were well-diversified over corporate industrial, corporate financial, municipal, federal and foreign government issuers.

The expected return on plan assets assumption is based upon an analysis of historical long-term returns for various investment categories, as measured by appropriate indices. These indices are weighted based upon the extent to which plan assets are invested in the particular categories in arriving at our determination of a composite expected return. The expected rate of return assumption that will be used to determine net periodic cost for 2015 is 6.75%.

The assumed health care cost trend rate used to calculate other postretirement employee benefit obligations as of December 31, 2014 was 5.7% for a certain group of participants under age 65 in our hourly plan and our Arkansas participants covered by a collective bargaining agreement, grading ratably to an assumption of 4.3% in 2094.





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

December 31, 2014 Consolidated Financial Statements:

| (Dollars in thousands)                                  | 1% INCREASE | 1% DECREASE |
|---|-------------|-------------|
| Effect on total service cost plus interest cost         | \$5         | \$(5)       |
| Effect on accumulated postretirement benefit obligation | 112         | (112)       |

#### NOTE 14. COMMITMENTS AND CONTINGENCIES

We have operating leases covering office space, equipment, land and vehicles expiring at various dates through 2033. As leases expire, it can be expected that certain leases will be renewed or replaced in the normal course of business. As of December 31, 2014, the future minimum rental payments required under our operating leases are as follows:

(Dollars in thousands)

|                     |          |
|---------------------|----------|
| 2015                | \$4,211  |
| 2016                | 3,148    |
| 2017                | 1,904    |
| 2018                | 1,123    |
| 2019                | 452      |
| 2020 and thereafter | 1,355    |
| Total               | \$12,193 |

Operating lease expense was \$4.0 million, \$3.6 million and \$3.1 million for the years ended December 31, 2014, 2013 and 2012, respectively.

In January 2007, the Environmental Protection Agency (EPA) notified us that we are a potentially responsible party under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Clean Water Act for cleanup 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 (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 public comment period closed March 11, 2011, and 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. On May 23, 2012, we signed a consent order with the EPA pursuant to which we agreed to provide \$1.75 million in funding for EPA cleanup on a portion of our property (including the adjacent riverbank owned by the Idaho Department of Lands). On April 4, 2013, the EPA issued a unilateral administrative order requiring us to remediate the portion of the Avery Landing site that we own. During the first quarter of 2013, we increased our accrual by \$0.75 million. We began work on the site in May 2013 and discovered more contaminant on our property than had been expected based upon previous testing, and accordingly, during the second quarter of 2013 we increased our expense by an additional \$1.75 million. During the third quarter of 2013, we increased our accrual by approximately \$1.0 million to reflect the final work completed on the site in September 2013. On January 23, 2014, the EPA project manager informed us that he approved our Final Completion Report dated January 17, 2014 and our Final Natural Attenuation Performance Monitoring Plan dated January 17, 2014, and we have no further obligations with regard to our property other than fulfillment of the Monitoring Plan.

The following table details our Avery Landing environmental remediation reserve balance for the years ended December 31:

| (Dollars in thousands)           | 2014 | 2013    |
|----------------------------------|------|---------|
| Beginning reserve balance        | \$—  | \$4,250 |
| Environmental remediation charge | —    | 3,522   |
| Cash payments                    | —    | (7,772) |
| Ending reserve balance           | \$—  | \$—     |

Negotiations with the EPA continue regarding a final settlement and release of EPA claims against us regarding the site, and we cannot predict at this time what additional costs, if any, that we may incur on this matter. We have reserved all of our rights to seek reimbursement for the costs of remediation from all parties potentially responsible. We believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

#### NOTE 15. EQUITY-BASED COMPENSATION PLANS

As of December 31, 2014, we had two stock incentive plans under which performance shares, restricted stock units (RSUs), or deferred compensation stock equivalent units were outstanding. All of these plans have received shareholder approval. We were originally authorized to issue up to 1.6 million shares and 1.0 million shares under our 2005 Stock Incentive Plan and 2014 Stock Incentive Plan, respectively. At December 31, 2014, approximately 1.1 million shares were authorized for future use under the 2005 Stock Incentive Plan and 2014 Stock Incentive Plan. We issue new shares of common stock to settle performance shares, restricted stock units, and deferred compensation stock equivalent units.

The following table details our compensation expense and the related income tax benefit as of December 31:

| (Dollars in thousands)                                       | 2014    | 2013    | 2012    |
|--|---------|---------|---------|
| Employee equity-based compensation expense:                  |         |         |         |
| Performance shares   | 3,515   | 3,635   | 3,440   |
| Restricted stock units                                       | 622     | 742     | 627     |
| Total employee equity-based compensation expense             | \$4,137 | \$4,377 | \$4,067 |
| Deferred compensation stock equivalent units expense         | \$345   | \$1,265 | \$2,008 |
| Total tax benefit recognized for shared-based payment awards | \$280   | \$71    | \$525   |

#### PERFORMANCE SHARES

Performance share awards granted under the stock incentive plans have a three-year performance period and shares are issued at the end of the period if the performance measure is met. The performance measure is based on the percentile ranking of our total shareholder return relative to the total shareholder return performance of both a selected peer group of companies and a larger group of indexed companies over the three-year performance period. The number of shares actually issued, as a percentage of the amount subject to the performance share award, could range from 0% to 200%. Performance share awards granted under our stock incentive plans do not have voting rights unless and until shares are issued upon settlement. If shares are issued at the end of the three-year performance measurement period, the recipients will receive distribution equivalents in the form of additional shares at the time of payment equal to the distributions that would have been paid on the shares earned had the recipients owned the shares during the three-year period. Therefore, the shares are not considered participating securities.

A Monte Carlo simulation method is used to estimate the stock prices of Potlatch and the selected peer companies at the end of the three-year performance period. The expected volatility of each company's stock price and covariance of returns among the peer companies are key assumptions within the Monte Carlo simulation. Historical volatility over a term similar to the performance period is considered a reasonable proxy for forecasted volatility. Likewise, because the returns of Potlatch and the peer group companies are correlated, the covariance, a measure of how two variables tend to move together, is calculated over a historical term similar to the performance period.



and applied in the simulations. The simulations use the stock prices of Potlatch and the peer group of companies as of the award date as a starting point. Multiple simulations are generated, resulting in share prices and total shareholder return values for Potlatch and the peer group of companies. For each simulation, the total shareholder return of Potlatch is ranked against that of the peer group of companies. The future value of the performance share unit is calculated based on a multiplier for the percentile ranking and then discounted to present value. The discount rate is the risk-free rate as of the award date for a term consistent with the performance period. Awards are also credited with dividend equivalents at the end of the performance period, and as a result, award values are not adjusted for dividends. The following table presents the key inputs used in calculating the fair value of the performance share awards in 2014, 2013 and 2012, and the resulting fair values:

|                                   |         |         |         |   |
|-----------------------------------|---------|---------|---------|---|
|                                   | 2014    | 2013    | 2012    |   |
| Shares granted                    | 87,441  | 83,111  | 85,028  |   |
| Stock price as of valuation date  | \$39.76 | \$45.31 | \$31.11 |   |
| Risk-free rate                    | 0.72    | %0.40   | %0.40   | % |
| Fair value of a performance share | \$45.57 | \$62.78 | \$34.24 |   |

The following table summarizes outstanding performance share awards as of December 31, 2014, 2013 and 2012, and changes during those years:

|  | 2014     |                                     | 2013     |                                     | 2012     |                                     |
|--|----------|-------------------------------------|----------|-------------------------------------|----------|-------------------------------------|
| (Dollars in thousands, except per-share amounts)                   | SHARES   | WEIGHTED AVG. GRANT DATE FAIR VALUE | SHARES   | WEIGHTED AVG. GRANT DATE FAIR VALUE | SHARES   | WEIGHTED AVG. GRANT DATE FAIR VALUE |
| Unvested shares outstanding at January 1                           | 155,814  | \$ 48.73                            | 160,214  | \$ 44.50                            | 154,594  | \$ 50.54                            |
| Granted  | 87,441   | 45.57                               | 83,111   | 62.78                               | 85,028   | 34.24                               |
| Vested   | (76,202) | )34.24                              | (71,861) | )55.84                              | (76,812) | )45.30                              |
| Forfeited  | (6,820)  | )49.75                              | (15,650) | )47.32                              | (2,596)  | )44.99                              |
| Unvested shares outstanding at December 31                         | 160,233  | 53.86                               | 155,814  | 48.73                               | 160,214  | 44.50                               |
| Total grant date fair value of share awards vested during the year | \$2,609  |                                     | \$4,013  |                                     | \$3,480  |                                     |
| Aggregate intrinsic value of unvested share awards at December 31  | \$6,709  |                                     | \$6,504  |                                     | \$6,019  |                                     |

As of December 31, 2014, there was \$4.1 million of unrecognized compensation cost related to unvested performance share awards, which is expected to be recognized over a weighted average period of 1.6 years.

#### RESTRICTED STOCK UNITS

Our 2005 Stock Incentive Plan and 2014 Stock Incentive Plan also allow for awards to be issued in the form of RSU grants. During 2014, 2013 and 2012, certain officers and other select employees of the company were granted RSU awards that will accrue distribution equivalents based on distributions paid during the RSU vesting period. The distribution equivalents will be converted into additional RSUs that will vest in the same manner as the underlying RSUs to which they relate. Therefore, the shares are not considered participating securities. The terms of the awards state that the RSUs will vest in a given time period of one to three years, and the terms of certain awards follow a vesting schedule within the given time period.

A summary of the status of outstanding RSU awards as of December 31, 2014, 2013 and 2012, and changes during these years is presented below:

|   | 2014     |  | 2013     |  | 2012     |  |
|---|----------|--|----------|--|----------|--|
|   | SHARES   | WEIGHTED AVERAGE GRANT DATE FAIR VALUE | SHARES   | WEIGHTED AVERAGE GRANT DATE FAIR VALUE | SHARES   | WEIGHTED AVERAGE GRANT DATE FAIR VALUE |
| Unvested shares outstanding at January 1  | 37,461   | \$ 38.69                               | 40,219   | \$ 34.82                               | 36,359   | \$ 35.60                               |
| Granted   | 19,599   | 40.51                                  | 23,449   | 44.41                                  | 20,225   | 31.53                                  |
| Vested  | (21,333) | )34.46                                 | (19,796) | )38.19                                 | (14,861) | )32.41                                 |
| Forfeited   | (3,272)  | )42.06                                 | (6,411)  | )36.91                                 | (1,504)  | )33.36                                 |
| Unvested shares outstanding at December 31                                      | 32,455   | 42.24                                  | 37,461   | 38.69                                  | 40,219   | 34.82                                  |
| Total grant date fair value of RSU awards vested during the year (in thousands) | \$735    |  | \$756    |  | \$482    |  |
| Aggregate intrinsic value of unvested RSU awards at December 31 (in thousands)  | \$1,359  |  | \$2,511  |  | \$1,575  |  |

As of December 31, 2014, there was \$0.8 million of total unrecognized compensation cost related to outstanding RSU awards, which is expected to be recognized over a weighted average period of 1.5 years.

#### STOCK OPTIONS

All outstanding stock options were granted with an exercise price equal to the market price on the date of grant, were fully exercisable after two years and expire not later than 10 years from the date of grant. No new stock options were granted in 2014, 2013 or 2012.

A summary of the status of outstanding stock options as of December 31, 2014, 2013 and 2012 and changes during those years is presented below:

|   | 2014     |                              | 2013     |                              | 2012     |                              |
|---|----------|------------------------------|----------|------------------------------|----------|------------------------------|
|   | SHARES   | WEIGHTED AVG. EXERCISE PRICE | SHARES   | WEIGHTED AVG. EXERCISE PRICE | SHARES   | WEIGHTED AVG. EXERCISE PRICE |
| Outstanding at January 1  | 12,859   | \$ 30.92                     | 83,827   | \$ 27.46                     | 144,684  | \$ 23.34                     |
| Shares exercised  | (12,859) | )30.92                       | (70,968) | )26.25                       | (60,857) | )17.66                       |
| Outstanding and exercisable at December 31                                | —        |                              | 12,859   | 30.92                        | 83,827   | 27.46                        |
| Total intrinsic value of options exercised during the year (in thousands) | \$150    |                              | \$1,423  |                              | \$938    |                              |

Cash received from stock option exercises for the years ended December 31, 2014, 2013 and 2012 was \$0.4 million, \$1.9 million and \$1.1 million, respectively.

#### DEFERRED COMPENSATION STOCK EQUIVALENT UNITS

A long term incentive award is granted annually to our directors, and payable upon a director's separation from service. Directors may also elect to defer their annual retainers, payable in the form of stock. All stock unit equivalent accounts are credited with dividend equivalents. As of December 31, 2014, there were 122,782 shares outstanding that will be distributed in the future to directors as common stock.

#### NOTE 16. SEGMENT INFORMATION

Our businesses are organized into three reportable operating segments: Resource, Wood Products and Real Estate. The 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. The Wood Products segment manufactures and markets lumber and plywood. 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 subdivision and development activities through Potlatch TRS.

The reporting segments follow the same accounting policies used for our Consolidated Financial Statements, as described in the summary of principal accounting policies, with the exception of the valuation of inventories. All segment inventories are reported using the average cost method, while the LIFO reserve is recorded at the corporate level. Management evaluates a segment's performance based upon profit or loss from operations before income taxes. Intersegment revenues are recorded based on prevailing market prices.

The following table presents business segment information for each of the past three years. Corporate information is included to reconcile segment data to the Consolidated Financial Statements.

| (Dollars in thousands)                                       | 2014        | 2013      | 2012      |   |
|--|-------------|-----------|-----------|---|
| Revenues:  |             |           |           |   |
| Resource   | \$252,581   | \$238,228 | \$207,846 |   |
| Wood Products  | 376,239     | 366,015   | 329,404   |   |
| Real Estate  | 40,460      | 26,160    | 38,238    |   |
|  | 669,280     | 630,403   | 575,488   |   |
| Elimination of intersegment revenues - Resource <sup>1</sup> | (62,330)    | )(60,114  | )(50,354  | ) |
| Total consolidated revenues                                  | \$606,950   | \$570,289 | \$525,134 |   |
| Operating Income:  |             |           |           |   |
| Resource   | \$84,976    | \$73,425  | \$49,543  |   |
| Wood Products  | 52,442      | 58,892    | 45,456    |   |
| Real Estate  | 26,945      | 18,266    | 28,056    |   |
| Eliminations and adjustments                                 | (190)       | )(907     | )(1,061   | ) |
|  | 164,173     | 149,676   | 121,994   |   |
| Corporate  | (31,667)    | )(42,078  | )(37,052  | ) |
| Operating income   | 132,506     | 107,598   | 84,942    |   |
| Interest expense, net  | (22,909)    | )(23,132  | )(25,539  | ) |
| Income before income taxes                                   | \$109,597   | \$84,466  | \$59,403  |   |
| Depreciation, depletion and amortization:                    |             |           |           |   |
| Resource   | \$17,847    | \$18,103  | \$16,446  |   |
| Wood Products  | 6,176       | 6,194     | 6,538     |   |
| Real Estate  | 59          | 56        | 36        |   |
|  | 24,082      | 24,353    | 23,020    |   |
| Corporate  | 2,667       | 2,609     | 3,227     |   |
| Total depreciation, depletion and amortization               | \$26,749    | \$26,962  | \$26,247  |   |
| Basis of real estate sold:                                   |             |           |           |   |
| Real Estate  | \$9,355     | \$3,536   | \$5,413   |   |
| Elimination and adjustments                                  | (709)       | )(632     | )(365     | ) |
| Total basis of real estate sold                              | \$8,646     | \$2,904   | \$5,048   |   |
| Assets:  |             |           |           |   |
| Resource and Real Estate <sup>2</sup>                        | \$847,873   | \$476,628 | \$477,271 |   |
| Wood Products  | 118,674     | 115,664   | 100,190   |   |
|  | 966,547     | 592,292   | 577,461   |   |
| Corporate  | 68,874      | 88,238    | 141,436   |   |
| Total consolidated assets                                    | \$1,035,421 | \$680,530 | \$718,897 |   |
| Capital Expenditures: <sup>3</sup>                           |             |           |           |   |
| Resource and Real Estate                                     | \$11,116    | \$12,449  | \$12,138  |   |
| Wood Products  | 12,551      | 9,013     | 4,427     |   |
|  | 23,667      | 21,462    | 16,565    |   |
| Corporate  | 565         | 1,131     | 845       |   |
| Total capital expenditures                                   | \$24,232    | \$22,593  | \$17,410  |   |

<sup>1</sup> Intersegment revenues for 2012-2014, which were based on prevailing market prices, consisted of logs sold by our Resource segment to the Wood Products segment.

<sup>2</sup> Assets are shown on a combined basis for the Resource and Real Estate segments, as we do not produce information separately for those segments for internal purposes.

<sup>3</sup> Excludes acquisition of timber and timberlands.





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

| (Dollars in thousands)      | 2014      | 2013      | 2012      |
|-----------------------------|-----------|-----------|-----------|
| United States               | \$601,738 | \$558,138 | \$516,466 |
| Canada                      | 2,618     | 9,645     | 5,180     |
| Mexico                      | 2,594     | 2,506     | 3,488     |
| Total consolidated revenues | \$606,950 | \$570,289 | \$525,134 |

NOTE 17. FINANCIAL RESULTS BY QUARTER (UNAUDITED)

| (Dollars in thousands, except per-share amounts) | THREE MONTHS ENDED |           |           |           |              |           |             |           |
|--|--------------------|-----------|-----------|-----------|--------------|-----------|-------------|-----------|
|  | MARCH 31           |           | JUNE 30   |           | SEPTEMBER 30 |           | DECEMBER 31 |           |
|  | 2014               | 2013      | 2014      | 2013      | 2014         | 2013      | 2014        | 2013      |
| Revenues   | \$139,579          | \$139,253 | \$143,919 | \$133,212 | \$177,215    | \$157,869 | \$146,237   | \$139,955 |
| Operating income                                 | 31,309             | 26,608    | 29,725    | 29,441    | 44,869       | 30,904    | 26,603      | 20,645    |
| Net income                                       | 20,350             | 15,487    | 16,270    | 19,182    | 33,154       | 22,191    | 20,136      | 13,721    |
| Net income per share <sup>1</sup>                |                    |           |           |           |              |           |             |           |
| Basic  | \$0.50             | \$0.38    | \$0.40    | \$0.47    | \$0.81       | \$0.55    | \$0.49      | \$0.34    |
| Diluted  | 0.50               | 0.38      | 0.40      | 0.47      | 0.81         | 0.54      | 0.49        | 0.34      |

<sup>1</sup> Per-share amounts are computed independently for each of the quarters presented. Therefore, the sum of the quarterly per-share amounts may not equal the total computed for the year.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Potlatch Corporation:

We have audited the accompanying consolidated balance sheets of Potlatch Corporation and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for each of the years in the three year period ended December 31, 2014. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Potlatch Corporation and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Potlatch Corporation's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 13, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Seattle, Washington

February 13, 2015

72 / POTLATCH CORPORATION

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Potlatch Corporation:

We have audited Potlatch Corporation's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Potlatch Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Potlatch Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Potlatch Corporation and subsidiaries as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, cash flows, and stockholders' equity for each of the years in the three year period ended December 31, 2014, and our report dated February 13, 2015 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Seattle, Washington

February 13, 2015



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 8-K filed by the Registrant on February 20, 2009.
- (4) See Exhibits (3)(a) and (3)(b). The Registrant also undertakes to furnish to the Commission, upon request, any instrument defining the rights of holders of long-term debt.
- (4)(a)\* Indenture, dated as of November 3, 2009, between the Registrant and U.S. Bank National Association, as trustee, filed as Exhibit 4.1 to the Current Report on Form 8-K filed by the Registrant on November 9, 2009.
- (4)(a)(i)\* Form of 7 1/2% Senior Notes due 2019 (included as Exhibit A to the Indenture filed as Exhibit 4(a)).
- (4)(a)(ii)\* Registration Rights Agreement, dated as of November 3, 2009, between the Registrant and the parties named therein, filed as Exhibit 4.1 to the Current Report on Form 8-K filed by the Registrant on November 9, 2009.
- (4)(b)\* Indenture, dated as of December 18, 1995, between Potlatch Corporation, a Delaware corporation and the Registrant's former parent corporation ("Original Potlatch") (on February 3, 2006, Original Potlatch merged with and into Potlatch Operating Company, a Delaware corporation and a wholly owned subsidiary of the Registrant, the Registrant then changed its name to "Potlatch Corporation" and became the new, publicly traded parent corporation) and U.S. Bank, National Association (as successor to First Trust of California, National Association), as trustee, executed in connection with the 6.95% Debentures due 2015, filed as Exhibit 4(b) to the Annual Report on Form 10-K filed February 15, 2013. (SEC File No. 001-32729)
- (4)(b)(i)\* Form of 6.95% Debentures due 2015 (included as Exhibit 4(b)(i) to the Annual Report on Form 10-K) filed February 15, 2013. (SEC File No. 001-32729)
- (4)(c)\* Indenture, dated as of November 27, 1990, between Original Potlatch and Deutsche Bank National Trust Company (successor in interest to Bankers Trust Company of California, National Association), as trustee, filed as Exhibit (4)(a) to the Original Potlatch Annual Report on Form 10-K for the fiscal year ended December 31, 2000. (SEC File No. 001-05313)
- (4)(c)(i)\* Officer's Certificate, dated January 24, 1991, filed as Exhibit (4)(a)(i) to the Original Potlatch Annual Report on Form 10-K for the fiscal year ended December 31, 2000. (SEC File No. 001-05313)
- (4)(c)(ii)\* Officer's Certificate, dated December 12, 1991, filed as Exhibit (4)(a)(i) to the Original Potlatch Annual Report on Form 10-K for the fiscal year ended December 31, 1996. (SEC File No. 001-05313)

(10)(a)1\* Potlatch Corporation Management Performance Award Plan, as amended effective December 2, 2004, filed as Exhibit (10)(a) to the Annual Report on Form 10-K filed by Original Potlatch for the fiscal year ended December 31, 2004. (SEC File No. 001-05313)

74 / POTLATCH CORPORATION

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- (10)(a)(i)1\* Amendment to Potlatch Corporation Management Performance Award Plan, filed as Exhibit 10.6 to the Current Report on Form 8-K filed by the Registrant on December 11, 2008.
- (10)(b)1\* Potlatch Corporation Severance Program for Executive Employees, amended and restated effective February 14, 2014, filed as Exhibit (10)(b) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013.
- (10)(c)1\* Potlatch Corporation Salaried Employees' Supplemental Benefit Plan, as amended and restated effective January 1, 1989, and as amended through May 24, 2005, filed as Exhibit (10)(d) to the Quarterly Report on Form 10-Q filed by Original Potlatch for the quarter ended June 30, 2005.
- (10)(c)(i)1\* Amendment, effective as of January 1, 1998, to Plan described in Exhibit (10)(d), filed as Exhibit (10)(d)(i) to the Annual Report on Form 10-K filed by Original Potlatch for the fiscal year ended December 31, 2003. (SEC File No. 001-5313)
- (10)(c)(ii)1\* Amendment, effective as of December 5, 2008, to Plan described in Exhibit (10)(d), filed as Exhibit 10.5 to the Current Report on Form 8-K filed by the Registrant on December 11, 2008.
- (10)(d)1\* Potlatch Corporation Deferred Compensation Plan for Directors, as amended through May 24, 2005, filed as Exhibit (10)(g) to the Quarterly Report on Form 10-Q filed by Original Potlatch for the quarter ended June 30, 2005.
- (10)(e)1\* Potlatch Corporation Deferred Compensation Plan II for Directors, as amended and restated effective May 8, 2014, filed as Exhibit 10.2 to the Current Report on Form 8-K filed by the Registrant on May 13, 2014.
- (10)(f)1\* Potlatch Corporation Benefits Protection Trust Agreement, amended and restated effective February 14, 2014, filed as Exhibit (10)(h) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013.
- (10)(g)1\* Compensation of Outside Directors, effective as of January 1, 2008, filed as Exhibit (10)(i)(i) to the 2008 Form 10-K. (SEC File No. 001-32729)
- (10)(h)1\* Summary of Director Compensation, effective as of May 8, 2014, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on May 13, 2014.
- (10)(i)1\* Form of Indemnification Agreement with each director of the Registrant and with each executive officer of the Registrant, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on September 23, 2009.
- (10)(j)1\* Potlatch Corporation 2005 Stock Incentive Plan, as amended and restated May 19, 2006, filed as Exhibit (10)(r) to the Quarterly Report on Form 10-Q filed by the Registrant for the quarter ended June 30, 2006, and as further amended and restated effective September 16, 2006, filed as Exhibit (10)(e) to the Current Report on Form 8-K filed by the Registrant on September 21, 2006.
- (10)(j)(i)1\* Form of Restricted Stock Unit Agreement (2005 Stock Incentive Plan), as amended and restated May 19, 2006, to be used for restricted stock unit awards to be granted subsequent to May 19, 2006, filed as Exhibit (10)(r)(i) to the Quarterly Report on Form 10-Q filed by the Registrant for the quarter ended June 30, 2006.

(10)(j)(ii)1\* Form of Performance Share Agreement (2005 Stock Incentive Plan), as amended and restated May 19, 2006, to be used for performance share awards to be granted subsequent to May 19, 2006, filed as Exhibit (10)(r)(ii) to the Quarterly Report on Form 10-Q filed by the Registrant for the quarter ended June 30, 2006, and as further amended on January 17, 2007, filed as Exhibit (10)(r)(ii) to the Current Report on Form 8-K filed by the Registrant on January 19, 2007.



- (10)(k)1\* Potlatch Corporation 2014 Stock Incentive Plan, filed as Exhibit 10.C to the Quarterly Report on Form 10-Q filed by the Registrant for the quarter ended June 30, 2014.
- (10)(k)(i)1\* Form of 2014 Performance Share Award Notice and Agreement filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on May 9, 2014.
- (10)(k)(ii)1\* Form of 2014 RSU Award Notice and Award Agreement filed as Exhibit 10.3 to the Current Report on Form 8-K filed by the Registrant on May 9, 2014.
- (10)(l)(iv)1\* Potlatch Corporation Management Performance Award Plan II, as amended through February 20, 2008, filed as Exhibit (10)(r)(iv) to the Current Report on Form 8-K filed by the Registrant on February 26, 2008.
- (10)(l)(v)1\* Amendment to Potlatch Corporation Management Performance Award Plan II, effective June 1, 2008, filed as Exhibit (10)(r)(v) to the Current Report on Form 8-K filed by the Registrant on May 21, 2008.
- (10)(m)1\* Potlatch Corporation Salaried Supplemental Benefit Plan II, effective December 5, 2008, and amended and restated as of February 14, 2014, filed as Exhibit (10)(t) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013.
- (10)(n)(i)1\* Potlatch Corporation Annual Incentive Plan, amended and restated effective January 1, 2014, filed as Exhibit (10)(w)(i) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013.
- (10)(o)1\* Potlatch Corporation Management Deferred Compensation Plan, effective June 1, 2008, amended and restated on February 14, 2014, filed as Exhibit (10)(x) to the Annual Report on Form 10-K for the fiscal year ended December 31, 2013.
- (10)(p) \* Amended and Restated Credit Agreement, dated as of August 12, 2014, among the Registrant and its wholly owned subsidiaries, as borrowers, KeyBank National Association, as administrative agent, swing line lender and L/C issuer, the Guarantors from time to time party thereto and the Lenders from time to time party thereto, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on August 14, 2014.
- (10)(q) \* Amended and Restated Term Loan Agreement, dated as of December 5, 2014, by and among the Registrant and Potlatch Forest Holdings, Inc., as borrowers, Northwest Farm Credit Services, PCA as administrative agent, the Guarantors from time to time party thereto and the Lenders from time to time party thereto, filed as Exhibit 10.1 to the Current Report on Form 8-K filed by the Registrant on December 9, 2014.
- (10)(r) \* Purchase and Sale Agreement dated as of October 15, 2014 between Red Mountain Timberco I LLC, Red Mountain Timberco IV LLC, RMS Timberlands LLC and Springwood Timberlands LLC, and Potlatch Forest Holdings, Inc., as Purchaser filed as Exhibit 10.1 to the Current Report on Form 8-K filed October 20, 2014.
- (12) Computation of Ratio of Earnings to Fixed Charges.
- (21) Potlatch Corporation Subsidiaries.

- (23) Consent of Independent Registered Public Accounting Firm.
- (24) Powers of Attorney.

76 / POTLATCH CORPORATION

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(31) Rule 13a-14(a)/15d-14(a) Certifications.

(32) Furnished statements of the Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350.

101 The following financial information from Potlatch Corporation's Annual Report on Form 10-K for the year ended December 31, 2014, filed on February 13, 2015, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Income for the years ended December 31, 2014, 2013 and 2012, (ii) the Consolidated Statements of Comprehensive Income for the years ended December 31, 2014, 2013 and 2012, (iii) the Consolidated Balance Sheets at December 31, 2014 and 2013, (iv) the Consolidated Statements of Cash Flows for the years ended December 31, 2014, 2013 and 2012, (v) the Consolidated Statements of Stockholders' Equity for the years ended December 31, 2014, 2013 and 2012 and (vi) the Notes to Consolidated Financial Statements.

\*Incorporated by reference.

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

2014 FORM 10-K / 77