POTLATCH CORP
Form 10-K
February 23, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-K

(Mark One)	x	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2006
		OR
	¨	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the transition period from ______ to ______.

Commission File Number 1-32729

POTLATCH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	82-0156045 (IRS Employer Identification No.)
601 West Riverside Ave., Suite 1100 Spokane, Washington (Address of principal executive offices)	99201 (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock ($1 par value)	New York Stock Exchange Chicago Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. x 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 x 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. x Yes ¨ No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of the voting stock held by non-affiliates of the registrant at June 30, 2006, was approximately $1,418.6 million, based on the closing price of $37.75, as reported on the New York Stock Exchange Composite Transactions.

The number of shares of common stock outstanding as of January 31, 2007: 38,889,077 shares of Common Stock, par value of $1 per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement to be dated on or about April 2, 2007, with the Commission in connection with the 2007 annual meeting of stockholders are incorporated by reference in Part III hereof.

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POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

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Part I

ITEM 1.

Business

GENERAL

Potlatch Corporation is a real estate investment trust, or REIT, with approximately 1.5 million acres of timberlands in Arkansas, Idaho, Minnesota, Wisconsin and Oregon. Through a wholly-owned taxable subsidiary, Potlatch Forest Products Corporation, which we refer to in this report as Potlatch TRS, we also operate 13 manufacturing facilities that produce lumber and panel products and bleached pulp products, including paperboard and tissue products. Potlatch TRS also conducts a land sales and development business.

The company, as it exists today, is the result of two recent reorganization transactions. First, effective January 1, 2006, the predecessor to the company, or original Potlatch, restructured its operations to qualify for treatment as a REIT for federal income tax purposes. This restructuring primarily involved the transfer of our manufacturing and other non-timberland assets to Potlatch TRS. Second, on February 3, 2006, original Potlatch merged with and into another wholly-owned subsidiary, and as a result all of the stockholders of original Potlatch became stockholders of the company. Original Potlatch was incorporated in 1903. Although the company as currently constituted was incorporated in September 2005, it is the successor to the business of original Potlatch, and therefore we trace our origins to 1903 as well. For purposes of this report, any references to the company, us, we, and our include where the context requires both Potlatch Corporation and its predecessor, original Potlatch, as it existed prior to the merger, together with their respective subsidiaries.

As a REIT, we expect to derive most of our income from investments in real estate, including the sale of standing timber. Also as a REIT, we generally will not be subject to federal corporate income taxes on our income and gain from investments in real estate, including the revenue derived from the sale of timber that we distribute to our stockholders, thereby reducing our corporate-level taxes and substantially eliminating the double taxation on income and gain that usually results in the case of a distribution by a C corporation. We will, however, be subject to corporate taxes on 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 during the first ten years following the REIT conversion. We will continue to be required to pay federal corporate income taxes on earnings from our non-real estate investments, principally our manufacturing operations, which are now held by Potlatch TRS.

Prior to our REIT conversion on January 1, 2006, our businesses were organized into four reportable operating segments, as defined by Financial Accounting Standards Board, or FASB, Statement of Financial Accounting Standards, or SFAS, No. 131, Disclosures About Segments of an Enterprise and Related Information: Resource; Wood Products; Pulp and Paperboard; and Consumer Products. Beginning January 1, 2006, the Resource segment was separated into two reportable business segments: Resource and Land Sales and Development. The new Resource segment consists of substantially all of the timberlands owned by the company, as well as those assets that are necessary to manage these timberlands. The primary business of the new Resource segment is the management of our timberlands to optimize the value of all possible revenue producing opportunities while at the same time adhering to our strict standards of stewardship responsibilities. Management activities include, but are not limited to, planting trees, harvesting trees, building and maintaining roads, development of management plans, recreation lease management, and monitoring contract compliance. The new Land Sales and Development segment consists of the sale of selected non-strategic land parcels, including sales of land for higher and better use purposes. Results for this segment depend on the timing of closing of transactions for properties we identify as having higher and better use values. Discussion of each of our segments is included on pages 4-7.

Information relating to the amounts of revenues, operating income (loss) and identifiable assets attributable to each of our operating segments for 2004-2006 is included in Note 15 to the consolidated financial statements on pages 77-79 of this report.

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

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

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

- 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 exchange rates between the U.S. dollar and other currencies
- changes in the level of construction activity
- changes in tariffs, quotas and trade agreements involving wood products
- changes in worldwide demand for our products
- changes in worldwide 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, energy and other costs
- the ability to satisfy complex rules in order to remain qualified as a REIT
- changes in tax laws that could reduce the benefits associated with REIT status.

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

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RESOURCE SEGMENT

The Resource segment manages approximately 1.5 million acres of timberlands we own in Arkansas, Idaho, Minnesota, Wisconsin and Oregon. The timberlands include a wide diversity of softwood and hardwood species. In Arkansas we own approximately 470,000 acres of timberlands. Primary species on these lands include southern yellow pine, red oak, white oak and other hardwoods. We own approximately 665,000 acres of timberlands in the northern portion of the state of Idaho. Primary species on these lands include grand fir, inland red cedar, Douglas fir, ponderosa pine, western larch, Engelmann spruce and western white pine. We own approximately 312,000 acres of timberlands in Minnesota, comprised primarily of aspen and other mixed hardwoods and pine. We are the largest private landowner in Idaho and Minnesota. Our Wisconsin timberlands, which were purchased in January 2007, consist of approximately 76,000 acres of pine and hardwood, primarily aspen. In Oregon we own approximately 17,000 acres of land containing a hybrid poplar plantation.

The main focus of the segment is centered on three key areas: increasing harvest levels in ways that ensure long-term sustainability while maintaining the highest stewardship standards in the industry; increasing timber harvest levels in times of strong market demand or decreasing harvest levels in times of weak demand; and seeking acquisitions that complement our existing land base.

In 2006, the segment sold wood fiber at market prices to our manufacturing facilities. We believe the use of market prices as the internal transfer price maximizes our timber value and motivates management of our manufacturing segments to optimize operating efficiencies and identify profitable markets in which to compete. The amount of the segment s sales to our manufacturing facilities, which accounted for 61% of the Resource segment s total revenues in 2006, varied significantly among the segment s operations, from a low of approximately 24% of our Minnesota Resource revenues to approximately 72% of our Idaho Resource revenues. The Resource segment also provided fiber procurement services to some of our manufacturing facilities.

The segment also sold logs and pulpwood to a variety of forest products companies located near our timberlands using an assortment of marketing methodologies that maximized the value of the products being sold. The marketing methodologies included stumpage sales, delivered log sales and pay-as-cut sales. The segment s customers range in size from small operators to multinational corporations. The segment competes with owners of timberlands that operate in areas adjacent to or 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 log quality, distance to market, customer service and price.

Beginning in the fourth quarter of 2005, our 17,000 acre hybrid poplar plantation in Boardman, Oregon, transitioned from a development stage to an operating stage. As a result, we increased our harvest of wood fiber in 2006, and we expect to increase our harvest and sale of wood fiber over the next two to four years to a sustainable annual harvest level of approximately 340,000 tons in order to increase our cash flow from the plantation operations. Although our 2006 revenue from the operation consisted largely of the sale of wood chips, our strategy for the plantation is to produce high quality logs for conversion into higher value, non-structural lumber products, such as furniture and moldings. It is our belief that hybrid poplar lumber will serve as a cost-competitive alternative to other regional hardwood species, mainly red alder, which are in tight supply. We are in the process of seeking outside parties with hardwood manufacturing and marketing experience to match their capital and expertise with our sustainable poplar resource, which is capable of providing logs suitable for the manufacturing of high value clear lumber, veneer or engineered wood products. However, because there are no other producers of hybrid poplar sawlogs in the United States, it is uncertain whether we will be successful in developing an adequate market for hybrid poplar lumber.

The amount of timber harvested from company-owned lands is guided by our commitment to sustainable forest management. By continually improving silvicultural techniques, we have been able to increase the sustainable level of wood fiber produced per acre from our timberlands.

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We manage harvest levels on our timberlands in a manner that assures long-term sustainability. In 2006, all our timberlands were certified under three different environmental certification programs: Forest Stewardship Council, or FSC; International Standardization Organization, or ISO; and Sustainable Forestry Initiative, or SFI. As a participant in these programs, we adhere to the collective principles of all of them. These principles include, but are not limited to: commitments to sustainable forestry, responsible practices, forest health and productivity, and protection of special sites.

These certifications aid us in marketing our products to customers who require that products they purchase for resale come from sustainably managed forests. In 2006, our sales of FSC certified products increased significantly over 2005. Most of these sales were at significant margins over average market prices.

LAND SALES AND DEVELOPMENT SEGMENT

The Land Sales and Development segment consists of the sale of selected non-strategic land parcels, including sales of land for higher and better use purposes. Sales of conservation easements are also included in this segment. Results for the segment depend on the timing of closing of transactions for properties we identify as having higher and better use values. Any land development activities that may occur will be undertaken by Potlatch TRS. The Land Sales and Development segment also plays an active role in negotiations for major timberland acquisitions.

One of the main focuses of this segment is to continually assess the use of each of our lands to manage them proactively for the highest value. In December 2006, we completed an initial assessment of all of our 1.5 million acres of land. The following tools were used in assessing our lands:

- Electronic analysis, using Geographic Information Systems
- On-the-ground analysis and verification of modeling assumptions
- Certain measured and ranked attributes, such as timber potential, recreational influences, accessibility, special features and population and demographic trends

As a result of the assessment of our lands, we identified 250,000 to 300,000 acres, or approximately 17% to 20% of our land, as having values that are potentially greater than for timberland. Sales of these lands are expected to occur within the next 10 years, with the goal of utilizing like-kind exchange transactions for tax efficiency, thus maximizing cash flows. We expect to sell 15,000 to 20,000 acres in 2007.

In December 2006, we granted a conservation easement covering a small portion of our Arkansas timberlands to the Nature Conservancy. As a result, we recognized $6.7 million of Arkansas conservation easement revenue in 2006. We also finalized a conservation easement on a small portion of our Minnesota timberlands in 2006 and recognized conservation easement revenue of $1.1 million.

In December 2006, we entered into a definitive agreement to acquire 76,000 acres of prime timberland in Wisconsin for $64.5 million from Tomahawk Timberlands, LLC, and Tomahawk Highlands, LLC. The transaction closed in January 2007. This is our first significant purchase of timberland by us in more than a decade, and its location and high-value mature timber complement our existing timberland holdings in Minnesota. The timberland is located in the north-central part of the state, contains well-managed hardwoods and is made up of diverse age classes with significant amounts of mature timber. The timberland also has prime recreational values, and the majority of the land is concentrated in contiguous blocks located less than a five hour drive from Chicago and Minneapolis.

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As discussed above, we expect to use Internal Revenue Code section 1031 like-kind exchanges whenever possible to match sales of our land having values greater than for timberland with acquisitions of land that has strategic benefits to us. For example, the Wisconsin timberland purchase allowed us to utilize a section 1031 like-kind exchange and not be subject to built-in-gains tax on the Arkansas conservation easement sale in 2006. We also expect to use the Wisconsin land purchase for section 1031 like-kind exchanges of land we expect to sell in the first half of 2007.

WOOD PRODUCTS SEGMENT

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

To produce these solid wood products, we own and operate eight manufacturing facilities in Arkansas, Idaho, Michigan and Minnesota. A description of these facilities is included under Item 2 of this report.

Our share of the market for lumber, plywood and particleboard is not significant compared to the total United States market for these products. We believe that competitiveness in this industry is largely based on individual mill efficiency and on the availability of competitively priced resources on a facility-by-facility basis, rather than the number of mills operated. This is due to the fact that it is generally not economical to transfer wood between or among facilities, which would 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.

PULP AND PAPERBOARD SEGMENT

The Pulp and Paperboard segment produces and markets bleached paperboard and bleached pulp. A description of the facilities used to produce these products is included under Item 2 of this report.

We are a significant producer of bleached paperboard in the United States, where we compete with at least five other domestic pulp and paperboard producers. We have approximately 12% of the available domestic bleached paperboard capacity. The business is capital intensive, which leads to high fixed costs. As a result, production generally continues as long as selling prices cover variable costs.

Bleached paperboard is a product used in the high-end segment of the packaging industry due to its strength, brightness and favorable printing and graphic surface features. Our bleached paperboard is processed by our customers into a variety of end products, including packaging for liquids and other food products, pharmaceuticals, toiletries and other consumable goods, as well as paper cups and paper plates.

We also produce and sell bleached softwood market pulp, which is used as the basis for many paper products. We are not among the larger manufacturers of softwood market pulp in the United States.

We utilize various methods for the sale and distribution of our paperboard and softwood pulp. In general, we sell paperboard to packaging converters domestically through sales offices located throughout the United States. The majority of our international paperboard sales are made in Japan, China, Taiwan, Australia and other Southeast Asian countries through sales representative offices. The majority of softwood market pulp sales are made through agents. Our principal methods of competing are product quality, customer service and price.

CONSUMER PRODUCTS SEGMENT

The Consumer Products segment produces and markets household tissue products. A description of the facilities used to produce these products is included under Item 2 of this report.

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Our tissue products are manufactured on three machines at our facility in Lewiston, Idaho, as well as one machine at our facility in Las Vegas, Nevada. The tissue is then converted into packaged tissue products at three converting facilities in Lewiston, Las Vegas, and Elwood, Illinois. In 2006, approximately 60% of the pulp we used to make our tissue products was obtained from our Lewiston pulp mill. The remaining portion was purchased on the open market and consisted primarily of hardwood pulp, which enhances the quality of certain grades of tissue.

We are a significant producer of private label household tissue products in the United States. In 2006, we produced approximately 50% of the total private label tissue products sold in grocery stores in the United States. We compete with at least three companies that are much larger than us who sell national brand tissue products, as well as commercial, industrial and private label products. We also compete with other companies that sell regional brand products and commercial, industrial and private label products. Our household tissue products, comprised of facial and bathroom tissues, paper towels and napkins, are packaged to order for retail chains, wholesalers and cooperative buying organizations throughout the United States and, to a lesser extent, Canada. These products are sold to consumers under our customers own brand names. We sell a majority of our tissue products to three national grocery store chains. We do not have long-term supply contracts with any of these national chains and the loss of one or more of these customers could have a material adverse effect upon the operating results of the Consumer Products segment.

We sell tissue products to major retail outlets, primarily through brokers. Our principal methods of competing are product quality, customer service and price.

RAW MATERIALS

For our manufacturing operations, the principal raw material used is wood fiber, which is obtained from our Resource segment and purchased on the open market. Our Wood Products segment purchases a portion of its log needs from outside sources. Our Pulp and Paperboard segment purchases a substantial amount of wood chips and sawdust from third parties for use in the production of pulp. Our Consumer Products segment purchases several varieties of pulp from third parties, in addition to pulp provided by our Pulp and Paperboard segment, for use in manufacturing tissue products.

Information regarding 2006 fee harvests, purchases of wood fiber from third parties and sales of wood fiber to third parties are contained in the table below:

	FEE TIMBER HARVESTED (TONS)*	PURCHASED FIBER (TONS)	TOTAL	TONS SOLD TO THIRD PARTIES
Sawlogs	2,503,000	2,527,000	5,030,000	1,253,000
Pulpwood	963,000	917,000	1,880,000	836,000
Total	3,466,000	3,444,000	6,910,000	2,089,000

* The term Fee Timber Harvested refers to timber harvested on properties owned by Potlatch, as distinguished from Purchased Fiber, which is purchased from third parties.

In 2006, we harvested fee timber in two regions of the United States: the Northern region, consisting of our Idaho, Minnesota and Oregon timberlands; and the Southern region, consisting of our Arkansas timberlands. Beginning in 2007, due to the acquisition of the Wisconsin timberlands, the Northern region will also include our Wisconsin timberlands. The following table presents our total 2006 fee timber harvest by region:

	FEE TIMBER HARVESTED (TONS)		
	SAWLOGS	PULPWOOD	TOTAL
Northern region	1,940,000	626,000	2,566,000
Southern region	563,000	337,000	900,000
Total	2,503,000	963,000	3,466,000

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In 2006, approximately 551,000 tons of the total 3,444,000 tons of purchased sawlogs and pulpwood were acquired directly from timberlands owned by federal, state and local governments. Wood fiber acquisitions from these sources occur in market transactions at current market prices. We generally do not maintain long-term supply contracts for a significant volume of timber.

Timber from our lands, together with outside purchases, is presently adequate to support our manufacturing operations. Beginning in the early 1990s and continuing to the present, the timber supply from federal lands has diminished, largely due to environmental pressures. The resultant reduction in supply has increased the demand for logs from private timberlands. Although the supply of timber available from federal lands has recently stabilized, the future available supply cannot be predicted, and thus the long-term effect on our earnings cannot be predicted.

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

SEASONALITY

Our Resource segment log and pulpwood production is typically lower in the first and second quarters of each year, as winter rains in the Southern region and spring thaws in the Northern region limit timber harvesting operations due to softened roadbeds, which restrict access to logging sites. Demand for our wood products typically decreases in the winter months when construction activity is slower, and increases in the spring, summer and fall when construction activity is generally higher. Our pulp, paperboard and tissue products are generally not affected by seasonal changes, although a number of our paperboard contracts are renewed at the beginning of each year.

ENVIRONMENTAL

Information regarding environmental matters is included under Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations on pages 42-43 of this report.

EMPLOYEES

As of December 31, 2006, we had approximately 3,900 employees. The workforce consisted of approximately 900 salaried, 2,900 hourly and 100 temporary or part-time employees. As of December 31, 2006, approximately 53% of the workforce was covered under collective bargaining agreements.

Hourly union labor contracts expiring in 2007 are set forth below:

CONTRACT EXPIRATION DATE	LOCATION	UNION	APPROXIMATE NUMBER OF HOURLY EMPLOYEES
June 30	Resource Division, Greenhouse Lewiston, Idaho	United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union	16
September 1	Pulp and Paperboard Division,	United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial	12

Fire Department	and Service Workers International Union
Lewiston, Idaho	

As of the date of this report, we were still in the process of negotiating a new contract with the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union, covering approximately 980 hourly employees at our Pulp and Paperboard and Consumer Products operations in Lewiston, Idaho. Also as of the date of this report, we were still in the process of negotiating a new contract with the International Brotherhood of Electrical Workers,

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covering approximately 50 employees at our Pulp and Paperboard and Consumer Products operations in Lewiston. The previous contracts expired on September 1, 2006.

ITEM 1A.

Risk Factors

Investing in our common stock involves a significant degree of risk. Investors should carefully consider the risks and uncertainties presented under the following captions in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of Part II of this report: REIT Conversion, REIT-Related Risk Factors, and Factors Influencing Our Results of Operations and Cash Flows, all of which are incorporated herein by reference.

ITEM 1B.

Unresolved Staff Comments

Not applicable.

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ITEM 2.

Properties

For information regarding our timberlands, see the discussion under the heading Resource Segment on pages 4-5 of this report. Our principal manufacturing facilities at December 31, 2006, which are all owned by us except as noted, together with their respective 2006 annual capacities and production, are as follows:

	CAPACITY[A]	PRODUCTION[A]
WOOD PRODUCTS		
Sawmills:		
Prescott, Arkansas	225,000 mbf	198,000 mbf
Warren, Arkansas	200,000 mbf	158,000 mbf
Lewiston, Idaho	200,000 mbf	200,000 mbf
St. Maries, Idaho	120,000 mbf	116,000 mbf
Gwinn, Michigan	170,000 mbf	167,000 mbf
Bemidji, Minnesota	105,000 mbf	102,000 mbf
Plywood Mill[B]:		
St. Maries, Idaho	160,000 msf	157,000 msf
Particleboard Mill[C]:		
Post Falls, Idaho	70,000 msf	68,000 msf
PULP AND PAPERBOARD		
Pulp Mills:		
Cypress Bend, Arkansas	295,000 tons	288,000 tons
Lewiston, Idaho	545,000 tons	542,000 tons
Bleached Paperboard Mills:		
Cypress Bend, Arkansas	315,000 tons	310,000 tons
Lewiston, Idaho	425,000 tons	419,000 tons
CONSUMER PRODUCTS		
Tissue Mills:		
Lewiston, Idaho	180,000 tons	174,000 tons
Las Vegas, Nevada	33,000 tons	31,000 tons
Tissue Converting Facilities:		
Lewiston, Idaho	100,000 tons	98,000 tons
Elwood, Illinois[D]	43,000 tons	31,000 tons
Las Vegas, Nevada	50,000 tons	47,000 tons

[A] mbf stands for thousand board feet; msf stands for thousand square feet.

[B] 3/8 inch panel thickness basis.

[C] 3/4 inch panel thickness basis.

[D] The building located at this facility is leased by Potlatch, while the operating equipment located within the building is owned by Potlatch.

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ITEM 3.

Legal Proceedings

In March, April and May 2006, a series of private antitrust lawsuits were filed against us and seven other manufacturers of oriented strand board, or OSB, by plaintiffs who claim they purchased OSB at artificially high prices. The cases purport to be class actions brought on behalf of direct and indirect purchaser classes. The complaints allege that the defendant OSB manufacturers violated federal and state antitrust laws by purportedly conspiring from mid-2002 to the present to drive up the price of OSB. The indirect purchaser complaints also allege that defendants violated various states   unfair competition laws and common law. The cases generally have been consolidated into two Consolidated Amended Class Action Complaints in the United States District Court for the Eastern District of Pennsylvania under the caption In Re OSB Antitrust Litigation. Each consolidated complaint seeks an unspecified amount of monetary damages to be trebled as provided under the antitrust laws and other relief. We believe the claims are without merit, and we will defend ourselves accordingly. We sold our OSB manufacturing facilities to Ainsworth Lumber Co. Ltd. in September 2004.

On September 28, 2005, Ainsworth notified us by letter of its claims under the indemnification provisions of the asset purchase agreement between us and Ainsworth whereby Ainsworth purchased our OSB facilities. The claims involve alleged breaches of representations and warranties regarding the condition of certain of the assets sold to Ainsworth. On July 27, 2006, Ainsworth filed a complaint for breach of contract in the United States District Court for the Southern District of New York seeking an unspecified amount of monetary damages. The federal court case was subsequently dismissed voluntarily, and Ainsworth refiled its complaint in the Supreme Court of the State of New York for the County of New York on September 21, 2006. We believe the claim is without merit, and we will defend ourselves accordingly.

We believe there is no pending or threatened litigation that would have a material adverse effect on our financial position, operations or liquidity.

I TEM 4.

Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2006.

EXECUTIVE OFFICERS OF THE REGISTRANT

Information as of March 1, 2007, and for at least the past five years concerning the executive officers of the company is as follows:

Michael J. Covey (age 49), was elected President and Chief Executive Officer, and a director of the company, effective in February 2006, and has served as Chairman of the Board, President and Chief Executive Officer of the company since January 2007. Prior to February 2006, he was employed by Plum Creek Timber Company, Inc., for 23 years, where he had served most recently as Executive Vice President since August 2001.

William R. DeReu (age 40), has served as Vice President, Land Sales and Development, since May 2006. Prior to May 2006, he was employed by Plum Creek Timber Company, Inc., and served as Director, National Land Asset Management Services from February 2006 through April 2006. From December 2002 through February 2006, he was Senior Land Asset Manager, Lake States Region, at Plum Creek. From March 1997 through December 2002, he was Land Asset Manager, Montana, at Plum Creek.

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Robert P. DeVleming (age 54), has served as Vice President, Consumer Products, since October 2004. From May 2003 through October 2004, he was Vice President, Sales, Consumer Products Division. From August 2002 through May 2003, he was Vice President, Tissue Expansion, Consumer Products Division. From May 1999 through August 2002, he was Vice President, Marketing and Sales, Consumer Products Division. He has been with the company for 28 years.

Richard K. Kelly (age 59), has served as Vice President, Wood Products, since July 1999. He has been with the company for 31 years.

Pamela A. Mull (age 52), has served as Vice President, General Counsel and Corporate Secretary since July 2006. From March 2006 to July 2006, she was Vice President and General Counsel. Prior to March 2006, she served as Associate General Counsel. She has been with the company for 17 years.

Harry D. Seamans (age 53), has served as Vice President, Pulp and Paperboard, since January 2003. From March 2000 through December 2002, he was Arkansas Pulp and Paperboard Mill Manager. He has been with the company for 29 years.

Brent L. Stinnett (age 59), has served as Vice President, Resource Management, since August 2006. Prior to August 2006, he was employed by Plum Creek Timber Company, Inc., and served as Vice President and General Manager of the Gulf South region for Plum Creek from May 2002 through July 2006. From November 1997 through May 2002, he was General Manager of the Gulf South region for Plum Creek.

Gerald L. Zuehlke (age 58), has served as Vice President and Chief Financial Officer since June 2000. From June 1994 through March 2004, he served as Treasurer. He has been with the company for 35 years.

NOTE: 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.

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Part II

ITEM 5.

Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The company s common stock is traded on the New York and Chicago Stock Exchanges. The quarterly and yearly high and low sales price per share of our common stock, as reported in the New York Stock Exchange Composite Transactions for 2006 and 2005, as well as regular quarterly distribution payments per share for 2006 and 2005, were as follows:

	2006			2005		
QUARTER	HIGH	LOW	DISTRIBUTIONS	HIGH	LOW	DISTRIBUTIONS
1st	$54.26	$ 34.69	$ 15.80	$ 50.88	$ 45.03	$ 0.15
2nd	43.17	36.57	0.49	55.47	44.37	0.15
3rd	39.16	33.65	0.49	59.07	51.20	0.15
4th	44.94	36.67	0.49	52.88	43.45	0.15

The high share price for the first quarter of 2006 and all of the share prices for 2005 shown above do not reflect the effect of a $15.15 per common share special earnings and profit, or E&P, distribution that was paid on March 31, 2006. The high share price for the first quarter of 2006 and the high and low share prices for 2005 likely would have been lower had the special E&P distribution occurred at the beginning of all periods presented above. As an illustration, on February 9, the date prior to the ex-dividend date with respect to the special E&P distribution, the closing share price of our common stock was $50.35. On February 10, 2006, the ex-dividend date with respect to the special E&P distribution, the closing share price of our common stock was $36.78. A full discussion of our special E&P distribution is included in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of Part II of this report under the heading REIT Conversion.

There were approximately 1,310 stockholders of record at January 31, 2007.

The board of directors reviews and approves distributions by the company. The board considers a variety of factors in determining the distribution rate, including, but not limited to, our results of operations, cash flow and capital requirements, economic conditions, tax considerations and borrowing capacity. Consequently, the level of distributions to our stockholders may fluctuate and any reduction in the distribution rate may adversely affect our stock price.

In connection with the REIT conversion, we increased our regular quarterly distributions to stockholders to approximately $19.0 million, or $0.49 per common share, in 2006, compared with the regular quarterly dividends for 2005 of approximately $4.4 million, or $0.15 per common share.

Reference is made to the discussion in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, in Part II of this report, under the heading Liquidity and Capital Resources of (i) the covenants in our unsecured bank credit facility with which we must remain in compliance 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 the company may repurchase shares.

The table containing equity compensation plan information set forth in Item 12 of Part III of this report is incorporated herein by reference.

Table of Contents

I TEMS 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: