

Potlatch

POTLATCH CORPORATION TWELVE MONTHS REPORT, DECEMBER 31, 2004 HIGHLIGHTS

(Dollars in thousands - except per-share amounts)

	Quarter Ended December 31		Twelve Months Ended December 31	
	2004	2003	2004	2003
Net sales	\$ 321,598	\$ 297,010	\$1,351,472	\$1,192,437
Earnings (loss) from continuing operations	(9,698)	2,538	15,330	(3,842)
Net earnings (loss)	(9,984)	31,487	271,249	50,727
Earnings (loss) per common share from continuing operations:				
Basic	\$ (.33)	\$.09	\$.52	\$ (.13)
Diluted	(.33)	.09	.52	(.13)
Earnings (loss) per common share from discontinued operations:				
Basic	(.01)	1.01	8.71	1.90
Diluted	(.01)	1.01	8.67	1.90
Net earnings (loss) per common share:				
Basic	(.34)	1.10	9.23	1.77
Diluted	(.34)	1.10	9.19	1.77
Dividends per common share (1) (annual rate)	3.10	.60	3.10	.60

(1) Cash dividends for 2004 included a special dividend of \$2.50 per common share.

TO OUR SHAREHOLDERS:

Potlatch's operating segments showed improved fourth quarter results compared to 2003's fourth quarter, but the company reported a loss for the fourth quarter of 2004 due primarily to \$25.2 million in one-time, net pre-tax costs associated with the early repayment of approximately \$282 million of debt.

The company reported a fourth quarter 2004 loss from continuing operations of \$9.7 million, or \$.33 per diluted common share, including debt repayment costs. Earnings from continuing operations for the fourth quarter of 2003 were \$2.5 million, or \$.09 per diluted common share. Including discontinued operations, the company lost \$10.0 million or \$.34 per diluted common share for the fourth quarter of 2004, compared to net earnings of \$31.5 million, or \$1.10 per diluted common share for the fourth quarter of 2003. Discontinued operations in 2004 consisted of our oriented strand board (OSB) operations, while 2003 included both the OSB operations and our printing papers mill in Brainerd, Minnesota. Net sales from continuing operations for the fourth quarter of 2004 were \$321.6 million, compared to \$297.0 million recorded in the fourth quarter of 2003.

Earnings from continuing operations for the year ended December 31, 2004, totaled \$15.3 million or \$.52 per diluted common share, compared to a loss from continuing operations for 2003 of \$3.8 million, or \$.13 per diluted common share. Including discontinued operations, net earnings for 2004 totaled \$271.2 million, or \$9.19 per diluted common share, compared to net earnings of \$50.7 million, or \$1.77 per diluted common share in 2003. Net sales from continuing operations for 2004 were \$1.4 billion, compared with \$1.2 billion for 2003.

The Resource segment reported operating income of \$20.9 million for the fourth quarter of 2004, compared to \$17.3 million earned in the fourth quarter of 2003. An increase in log sales and higher log sales prices in Idaho contributed significantly to the favorable comparison to the prior year quarter. The segment's lower land sales revenue partially offset the improved Idaho results. Income from land sales for the segment totaled \$5.3 million in the fourth quarter of 2004, versus \$9.1 million in 2003's fourth quarter.

Operating income for the Wood Products segment improved to \$6.4 million for the fourth quarter of 2004, versus \$4.8 million earned for the fourth quarter of 2003. Lumber markets remained relatively firm despite a normal seasonal decline in wood products markets during the fourth quarter of 2004, resulting in a favorable comparison to the fourth quarter of 2003. Selling prices for lumber and particleboard were higher compared to the fourth quarter of 2003, with plywood slightly below 2003 levels. Lumber shipments were negatively affected by downtime at the segment's Prescott, Arkansas, sawmill due to log shortages caused by exceptionally wet conditions. Particleboard shipments from the Post Falls, Idaho, mill declined 27 percent as a result of downtime to align inventories

with market conditions, although the decline was partially offset by higher particleboard sales prices.

The Pulp and Paperboard segment reported operating income for 2004's fourth quarter of \$0.7 million, versus a loss of \$1.3 million for the fourth quarter of 2003. Increased shipments and higher sales prices for both paperboard and pulp were responsible for the favorable comparison to the fourth quarter of 2003. Paperboard market conditions for this time of the year are as encouraging as we have seen them for some time. During the quarter, the segment's Lewiston, Idaho, facility continued to make production rate gains compared to the same period a year ago, and the resulting decrease in unit costs contributed to the positive results. However, the segment's costs and production were negatively affected by fourth quarter 2004 maintenance downtime at the Lewiston and Cypress Bend, Arkansas, pulp and paperboard mills, as well as extended downtime on one of Lewiston's two paperboard machines to install new equipment.

The Consumer Products segment incurred an operating loss of \$0.1 million, compared to a loss of \$0.7 million recorded in the fourth quarter of 2003. Markets for consumer tissue products continue to be competitive, although net selling prices improved over the fourth quarter of 2003, partially due to the addition of our new ultra towel product to the segment's product mix. Increased production costs and a decrease in shipments compared to the fourth quarter of 2003 partially offset the benefits from increased sales prices.

Energy costs for the entire company were approximately \$5 million higher for the fourth quarter of 2004 compared to the fourth quarter of 2003, with more than half the increase attributable to usage at the new Las Vegas tissue mill.

Proceeds from the sale of our OSB operations in the third quarter of 2004 allowed us to reduce outstanding debt – most of it paying a high interest rate — during the fourth quarter, thus strengthening our balance sheet. We have successfully brought our long-term debt to stockholders' equity ratio below our historically preferred range, which has been a priority. We also returned a portion of the OSB sale proceeds to our shareholders in the form of a \$2.50 per share special cash dividend and the repurchase of approximately 1.5 million



L. Pendleton Siegel
Chairman and Chief Executive Officer

February 7, 2005

Statements of Operations and Comprehensive Income

(Dollars in thousands - except per-share amounts)

	Quarter Ended		Twelve Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
Net sales	\$ 321,598	\$ 297,010	\$ 1,351,472	\$ 1,192,437
Costs and expenses:				
Depreciation, amortization and cost of fee timber harvested	21,523	23,066	88,319	88,987
Materials, labor and other operating expenses	261,922	243,215	1,083,660	1,006,786
Selling, general and administrative expenses	21,917	21,213	85,571	75,800
Restructuring charges	-	(703)	1,193	(476)
	305,362	286,791	1,258,743	1,171,097
Earnings from operations	16,236	10,219	92,729	21,340
Interest expense	(9,041)	(11,048)	(45,863)	(48,172)
Debt retirement costs	(25,186)	(248)	(25,186)	(248)
Interest income	1,920	935	3,617	14,090
Earnings (loss) before taxes	(16,071)	(142)	25,297	(12,990)
Provision (benefit) for taxes	(6,373)	(2,680)	9,967	(9,148)
Earnings (loss) from continuing operations	(9,698)	2,538	15,330	(3,842)
Discontinued operations:				
Earnings (loss) from discontinued operations (including gain (loss) on disposal of \$43, \$(2,700), \$269,587 and \$(2,745))	(1,463)	47,456	422,017	89,456
Income tax provision (benefit)	(1,177)	18,507	166,098	34,887
	(286)	28,949	255,919	54,569
Net earnings (loss)	(9,984)	31,487	271,249	50,727
Other comprehensive gain (loss), net of tax:				
Cash flow hedges:				
Net derivative gains (losses), net of income tax provision (benefit) of \$-, \$264, \$(44) and \$44	-	495	(68)	68
Minimum pension liability adjustment, net of income tax provision (benefit) of \$20,554, \$(239), \$20,554 and \$(239)	32,178	(374)	32,178	(374)
Comprehensive income	\$ 22,194	\$ 31,608	\$ 303,359	\$ 50,421
Earnings (loss) per common share from continuing operations:				
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Average shares outstanding (in thousands):				
Basic	29,206	28,795	29,397	28,706
Diluted	29,396	28,868	29,515	28,718

Certain 2003 amounts have been reclassified to conform to the 2004 presentation as a result of the divestiture of the OSB operations.

Condensed Balance Sheets

(Dollars in thousands - except per-share amounts)

	December 31,	December 31,
	2004	2003
Assets		
Current assets:		
Cash and short-term investments	\$ 120,621	\$ 47,281
Receivables, net	103,474	91,050
Inventories	167,015	140,351
Prepaid expenses	16,260	18,315
Assets held for sale	-	176,596
Total current assets	407,370	473,593
Land other than timberlands	8,351	7,850
Plant and equipment, at cost less accumulated depreciation	567,471	600,964
Timber, timberlands and related logging facilities	401,078	396,482
Other assets	210,402	118,488
	\$1,594,672	\$1,597,377
Liabilities and Stockholders' Equity		
Current liabilities:		
Current installments on long-term debt	\$ 1,107	\$ 507
Accounts payable and accrued liabilities	151,198	158,185
Liabilities related to assets held for sale	-	11,125
Total current liabilities	152,305	169,817
Long-term debt	335,415	618,278
Other long-term obligations	234,311	266,514
Deferred taxes	201,252	71,917
Stockholders' equity	671,389	470,851
	\$1,594,672	\$1,597,377
Stockholders' equity per common share	\$23.22	\$16.33
Working capital	\$255,065	\$303,776
Current ratio	2.7:1	2.8:1

Certain 2003 amounts have been reclassified to conform to the 2004 presentation as a result of the divestiture of the OSB operations.

Condensed Statements of Cash Flows

(Dollars in thousands)

	Twelve Months Ended December 31	
	2004	2003
CASH FLOWS FROM OPERATIONS		
Net earnings	\$ 271,249	\$ 50,727
Adjustments to reconcile net earnings to net operating cash flows:		
Earnings from discontinued operations	(92,819)	(56,243)
Loss (gain) on disposal of discontinued operations	(163,100)	60
Depreciation, amortization and cost of fee timber harvested	88,319	88,987
Debt retirement costs	25,186	248
Deferred taxes	30,289	(19,384)
Funding of qualified pension plans	(57,853)	(19,461)
Working capital changes	(126,043)	18,672
Other, net	1,875	1,514
Net cash provided by (used for) operating activities of continuing operations	(22,897)	65,120
CASH FLOWS FROM INVESTING		
Decrease in restricted cash	-	15,069
Increase in short-term investments	(71,884)	(38,091)
Additions to plant and properties	(48,900)	(76,090)
Other, net	(7,301)	(9,139)
Net cash used for investing activities of continuing operations	(128,085)	(108,251)
CASH FLOWS FROM FINANCING		
Change in book overdrafts	(5,582)	4,610
Decrease in notes payable	-	(40,000)
Retirement of long-term debt	(282,263)	(19,467)
Premiums and fees on debt retirement	(44,686)	(248)
Issuance of treasury stock	57,547	6,799
Purchase of treasury stock	(75,352)	-
Dividends	(92,426)	(17,217)
Other, net	10,160	8,656
Net cash used for financing activities of continuing operations	(432,602)	(56,867)
Cash from continuing operations	(583,584)	(99,998)
Cash from discontinued operations	585,040	98,215
Increase (decrease) in cash	1,456	(1,783)
Cash at beginning of period	7,190	8,973
Cash at end of period	\$ 8,646	\$ 7,190

Certain 2003 amounts have been reclassified to conform to the 2004 presentation as a result of the divestiture of the OSB operations.

Segment Information

(Dollars in thousands)

	Quarter Ended December 31		Twelve Months Ended December 31	
	2004	2003	2004	2003
Net Sales				
Resource	\$ 74,679	\$ 72,198	\$ 274,292	\$ 252,614
Wood products				
Lumber	76,471	66,570	345,800	279,192
Plywood	12,608	13,312	59,647	46,402
Particleboard	3,462	3,852	18,747	15,230
Other	6,138	6,228	26,810	28,063
Total wood products net sales	98,679	89,962	451,004	368,887
Pulp and paperboard				
Paperboard	109,913	98,617	463,608	420,805
Pulp	18,263	17,336	65,705	61,239
Total pulp and paperboard net sales	128,176	115,953	529,313	482,044
Consumer products	80,585	76,444	320,052	300,896
Intersegment sales	382,119	354,557	1,574,661	1,404,441
	(60,521)	(57,547)	(223,189)	(212,004)
Total net sales	\$ 321,598	\$ 297,010	\$ 1,351,472	\$ 1,192,437

	Quarter Ended December 31		Twelve Months Ended December 31	
	2004	2003	2004	2003
Operating income (loss)				
Resource	\$ 20,886	\$ 17,278	\$ 69,901	\$ 65,511
Wood products	6,355	4,802	68,330	4,078
Pulp and paperboard	689	(1,304)	11,012	(15,104)
Consumer products	(123)	(670)	(10,155)	1,266
Eliminations	(313)	1,059	(508)	(181)
	27,494	21,165	138,580	55,570
Corporate	(43,565)	(21,307)	(113,283)	(68,560)
Earnings (loss) from continuing operations before taxes	\$ (16,071)	\$ (142)	\$ 25,297	\$ (12,990)

Potlatch

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Shipment Information				
	Quarter Ended December 31		Twelve Months Ended December 31	
	2004	2003	2004	2003
Wood products				
Lumber (m. bd. ft.)	186,388	188,557	792,605	798,698
Plywood (m. sq. ft., 3/8" basis)	36,572	37,311	158,656	150,691
Particleboard (m. sq. ft., 3/4" basis)	11,844	16,184	63,578	70,303
Pulp and paperboard				
Paperboard (tons)	161,286	154,083	710,546	652,763
Pulp (tons)*	15,720	13,447	42,205	47,186
Consumer products				
Tissue (tons)	40,932	42,842	171,680	167,981

*Excludes pulp used internally

Sales Price/Unit				
	Quarter Ended December 31		Twelve Months Ended December 31	
	2004	2003	2004	2003
Wood products (\$ per unit)				
Lumber (m. bd. ft.)	\$ 410	\$ 353	\$ 436	\$ 350
Plywood (m. sq. ft., 3/8" basis)	345	357	376	308
Particleboard (m. sq. ft., 3/4" basis)	292	238	295	217
Pulp and paperboard (\$ per ton)				
Paperboard	681	640	652	645
Pulp	423	402	450	387
Consumer products (\$ per ton)				
Tissue	1,968	1,784	1,864	1,791

This report contains, in addition to historical information, certain forward-looking statements. These forward-looking statements are based on management's best estimates and assumptions regarding future events, and are therefore subject to known and unknown risks and uncertainties and are not guarantees of future performance. The company's actual results could differ materially from those expressed or implied by forward-looking statements. The company disclaims any intent or obligation to update these forward-looking statements.