

Potlatch

POTLATCH CORPORATION -- TWELVE MONTHS REPORT, DECEMBER 31, 2003

HIGHLIGHTS

Unaudited for the fourth quarter(Dollars in thousands - except per-share amounts)

	Quarter Ended December 31		Twelve Months Ended December 31	
	2003	2002	2003	2002
Net Sales	\$ 403,479	\$ 312,054	\$1,506,634	\$1,293,546
Earnings (loss) from continuing operations	33,134	(19,056)	53,221	(50,933)
Net earnings (loss)	31,487	(34,478)	50,727	(234,381)
Net earnings (loss) per common share from continuing operations:				
Basic	\$1.15	\$(.67)	\$1.85	\$(1.79)
Diluted	1.15	(.67)	1.85	(1.79)
Net earnings (loss) per common share:				
Basic	1.10	(1.20)	1.77	(8.23)
Diluted	1.10	(1.20)	1.77	(8.23)
Dividends per common share (annual rate)	.60	.60	.60	.60

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.

TO OUR SHAREHOLDERS

Potlatch reported earnings for both the fourth quarter and the year 2003, compared to losses in 2002, due to significantly higher earnings for the company's Wood Products segment and improved results for its Pulp and Paperboard segment.

Lower fourth quarter 2003 earnings for the Consumer Products and Resource segments partially offset the positive Wood Products and Pulp and Paperboard results. A \$9.0 million pre-tax charge related to the elimination of over 100 salaried positions adversely affected 2002 fourth quarter results. A portion of that charge was reversed in the fourth quarter of 2003.

For the fourth quarter of 2003, the company reported earnings from continuing operations of \$33.1 million or \$1.15 per diluted common share, compared to a loss from continuing operations of \$19.1 million or \$.67 per diluted common share for the same period in 2002. Including discontinued operations, the company reported net earnings of \$31.5 million or \$1.10 per diluted common share versus a net loss of \$34.5 million or \$1.20 per diluted common share for the fourth quarter of 2002. An additional \$2.7 million pre-tax charge related to a contractual obligation for the Brainerd facility was recorded in discontinued operations in the fourth quarter of 2003. The charge should represent the final costs incurred for the company's printing papers operations. The fourth quarter of 2002 included a \$21.2 million pre-tax charge for adjustments to disposal costs related to discontinued operations. Net sales were \$403.5 million for the fourth quarter of 2003, a substantial increase over the \$312.1 million recorded in the fourth quarter of 2002.

The company reported earnings totaling \$53.2 million or \$1.85 per diluted common share from continuing operations for the year ended December 31, 2003, compared to a loss from continuing operations for 2002 of \$50.9 million or \$1.79 per diluted common share. Net earnings for 2003, including discontinued operations, totaled \$50.7 million or \$1.77 per diluted common share, compared to a net loss of \$234.4 million or \$8.23 per diluted common share in 2002. Net sales for 2003 were \$1.51 billion, compared with \$1.29 billion in 2002.

The Resource segment reported operating income of \$17.3 million for the fourth quarter of 2003 versus income of \$20.3 million in the fourth quarter of 2002. Lower log sales prices and higher costs for purchased logs in Idaho were partially offset by increased income from land sales in Arkansas, Idaho and Minnesota. Segment results for the fourth quarter of 2002

include income from the sale of surplus land and associated water rights and irrigation equipment at the Boardman, Oregon, hybrid poplar plantation.

Operating income for the Wood Products segment was \$55.0 million in the fourth quarter of 2003, a significant improvement compared to the \$17.6 million loss recorded in the fourth quarter of 2002. The favorable comparison was primarily due to significantly higher oriented strand board selling prices and increased shipments for the fourth quarter of 2003 versus the fourth quarter of 2002. Increased shipments as well as higher prices for all other panel and lumber products also contributed to the improved income for the segment.

The Pulp and Paperboard segment reported a fourth quarter operating loss of \$1.3 million, a notable improvement over 2002's fourth quarter loss of \$9.9 million. Productivity improvements at the Lewiston, Idaho, pulp and paperboard facility have decreased per-ton production costs and are primarily responsible for the favorable comparison. Increased shipments and higher sales prices for pulp also positively affected the results, but were partially offset by lower paperboard sales prices.

The Consumer Products segment reported an operating loss of \$0.7 million, down from income of \$7.6 million earned in the fourth quarter of 2002. Continued competitive markets resulted in an approximate 5 percent decline in sales prices for consumer tissue products compared to the fourth quarter of 2002. A slight increase in fourth quarter product shipments was more than offset by the lower sales prices and slightly higher production costs.



L. Pendleton Siegel
Chairman and Chief Executive Officer



Richard L. Paulson
President and Chief Operating Officer

January 23, 2004

Statements of Operations and Comprehensive Income

Unaudited for the fourth quarter (Dollars in thousands - except per-share amounts)

	Quarter Ended		Twelve Months Ended	
	2003	2002	2003	2002
Net sales	\$ 403,479	\$ 312,054	\$ 1,506,634	\$ 1,293,546
Costs and expenses:				
Depreciation, amortization and cost of fee timber harvested	27,019	28,674	104,859	115,469
Materials, labor and other operating expenses	294,358	275,243	1,207,086	1,099,690
Selling, general and administrative expenses	22,430	18,747	80,280	79,618
Restructuring charges	(703)	8,963	(476)	8,963
	343,104	331,627	1,391,749	1,303,740
Earnings (loss) from operations	60,375	(19,573)	114,885	(10,194)
Interest expense	(11,048)	(11,593)	(48,172)	(59,882)
Debt retirement costs	(248)	(206)	(248)	(15,360)
Interest income	935	133	14,090	1,939
Earnings (loss) before taxes on income	50,014	(31,239)	80,555	(83,497)
Provision (benefit) for taxes on income	16,880	(12,183)	27,334	(32,564)
Earnings (loss) from continuing operations	33,134	(19,056)	53,221	(50,933)
Discontinued operations:				
Loss from discontinued operations (including loss on disposal)	(2,700)	(25,283)	(4,089)	(300,734)
Income tax benefit	(1,053)	(9,861)	(1,595)	(117,286)
Net earnings (loss)	31,487	(34,478)	50,727	(234,381)
Other comprehensive income (loss), net of tax:				
Cash flow hedges:				
Net derivative gains, net of income tax provision of \$264, \$0, \$44 and \$0	495	-	68	-
Minimum pension liability adjustment, net of income tax benefit of \$239, \$21,231, \$239 and \$21,231	(374)	(33,207)	(374)	(33,207)
Comprehensive income (loss)	\$ 31,608	\$ (67,685)	\$ 50,421	\$ (267,588)
Net earnings (loss) per common share from continuing operations:				
Basic	\$ 1.15	\$ (.67)	\$ 1.85	\$ (1.79)
Diluted	1.15	(.67)	1.85	(1.79)
Net earnings (loss) per common share:				
Basic	1.10	(1.20)	1.77	(8.23)
Diluted	1.10	(1.20)	1.77	(8.23)
Average shares outstanding (in thousands):				
Basic	28,795	28,556	28,706	28,462
Diluted	28,868	28,556	28,718	28,462

The effective tax rates for 2003 and 2002 are 34% and 39%, respectively.
Certain 2002 amounts have been reclassified to conform to the 2003 presentation.

Condensed Balance Sheets

(Dollars in thousands - except per-share amounts)

	December 31, 2003	December 31, 2002
Assets		
Current assets:		
Cash and short-term investments	\$ 47,281	\$ 26,042
Receivables, net	105,345	119,964
Inventories	159,678	159,798
Prepaid expenses	18,315	39,005
Assets held for sale	-	5,000
Total current assets	330,619	349,809
Land other than timberlands	8,831	8,750
Plant and equipment, at cost less accumulated depreciation	740,342	758,168
Timber, timberlands and related logging facilities	398,899	396,426
Other assets	118,686	111,664
	\$1,597,377	\$ 1,624,817
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable	\$ -	\$ 40,000
Current installments on long-term debt	507	15,607
Accounts payable and accrued liabilities	169,310	191,497
Liabilities related to assets held for sale	-	12
Total current liabilities	169,817	247,116
Long-term debt	618,278	622,645
Other long-term obligations	266,514	267,611
Deferred taxes	71,917	56,654
Stockholders' equity	470,851	430,791
	\$ 1,597,377	\$ 1,624,817
Stockholders' equity per common share	\$ 16.33	\$ 15.07
Working capital	\$ 160,802	\$ 102,693
Current ratio	1.9:1	1.4:1

Certain 2002 amounts have been reclassified to conform to the 2003 presentation.

Condensed Statements of Cash Flows

(Dollars in thousands)

	Twelve Months Ended December 31	
	2003	2002
CASH FLOWS FROM OPERATIONS		
Net earnings (loss)	\$ 50,727	\$ (234,381)
Adjustments to reconcile net earnings (loss) to net operating cash flows:		
Loss from discontinued operations	820	14,955
Loss on disposal of discontinued operations	60	229,023
Depreciation, amortization and cost of fee timber harvested	104,859	115,469
Debt retirement costs	248	15,360
Deferred taxes	15,503	(132,725)
Working capital changes	9,132	(49,615)
Net cash provided by (used for) operating activities of continuing operations	181,349	(41,914)
CASH FLOWS FROM INVESTING		
Decrease in restricted cash	15,069	83,131
Decrease (increase) in short-term investments	(38,091)	28,500
Funding of qualified pension plans	(19,461)	-
Additions to plant and properties	(79,686)	(51,614)
Other, net	(9,218)	(13,530)
Net cash provided by (used for) investing activities of continuing operations	(131,387)	46,487
CASH FLOWS FROM FINANCING		
Change in book overdrafts	4,610	(9,952)
Increase (decrease) in notes payable	(40,000)	40,000
Retirement of long-term debt	(19,467)	(511,873)
Premiums and fees on debt retirement	(248)	(10,584)
Issuance of treasury stock	6,856	8,146
Dividends	(17,217)	(17,071)
Other, net	10,113	9,349
Net cash used for financing activities of continuing operations	(55,353)	(491,985)
Cash from continuing operations	(5,391)	(487,412)
Cash from discontinued operations	3,608	488,910
Increase (decrease) in cash	(1,783)	1,498
Balance at beginning of period	8,973	7,475
Balance at end of period	\$ 7,190	\$ 8,973

Certain 2002 amounts have been reclassified to conform to the 2003 presentation.

Segment Information

(Dollars in thousands)

	Quarter Ended		Twelve Months Ended	
	December 31	December 31	December 31	December 31
	2003	2002	2003	2002
Net Sales				
Resource	\$ 72,198	\$ 91,729	\$ 252,614	\$ 411,833
Wood products				
Oriented strand board	106,469	46,250	314,197	187,293
Lumber	66,570	51,641	279,192	249,790
Plywood	13,312	8,041	46,402	34,915
Particleboard	3,852	2,281	15,230	14,083
Other	6,228	5,921	28,063	23,077
Total wood products net sales	196,431	114,134	683,084	509,158
Pulp and paperboard				
Paperboard	98,617	101,944	420,805	395,085
Pulp	17,336	12,718	61,239	48,483
Total pulp and paperboard net sales	115,953	114,662	482,044	443,568
Consumer products	76,444	78,630	300,896	315,708
	461,026	399,155	1,718,638	1,680,267
Intersegment sales	(57,547)	(87,101)	(212,004)	(386,721)
Total net sales	\$ 403,479	\$ 312,054	\$1,506,634	\$1,293,546
Operating income (loss)				
Resource	\$ 17,278	\$ 20,285	\$ 65,511	\$ 62,554
Wood products	54,958	(17,642)	97,623	(27,031)
Pulp and paperboard	(1,304)	(9,940)	(15,104)	(42,821)
Consumer products	(670)	7,628	1,266	42,806
Eliminations	1,059	(4,053)	(181)	(3,389)
	71,321	(3,722)	149,115	32,119
Corporate	(21,307)	(27,517)	(68,560)	(115,616)
Earnings (loss) from continuing operations before taxes on income	\$ 50,014	\$ (31,239)	\$ 80,555	\$ (83,497)

The effective tax rates for 2003 and 2002 are 34% and 39%, respectively.
 Certain 2002 amounts have been reclassified to conform to the 2003 presentation.



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Spokane, WA 99201

Sales Price/Unit	Quarter Ended December 31		Twelve Months Ended December 31	
	2003	2002	2003	2002
Wood products (\$ per unit)				
Oriented strand board (m. sq. ft., 3/8" basis)	\$ 327	\$ 145	\$ 236	\$ 147
Lumber (m. bd. ft.)	353	335	350	367
Plywood (m. sq. ft., 3/8" basis)	357	288	308	294
Particleboard (m. sq. ft., 3/4" basis)	238	226	217	229
Pulp and paperboard (\$ per ton)				
Paperboard	640	662	645	659
Pulp	402	338	387	347
Consumer products (\$ per ton)				
Tissue	1,784	1,883	1,791	1,922

Shipment Information	Quarter Ended December 31		Twelve Months Ended December 31	
	2003	2002	2003	2002
Wood products				
Oriented strand board (m. sq. ft., 3/8" basis)	325,878	319,143	1,330,000	1,276,897
Lumber (m. bd. ft.)	188,557	154,256	798,698	679,772
Plywood (m. sq. ft., 3/8" basis)	37,311	27,941	150,691	118,820
Particleboard (m. sq. ft., 3/4" basis)	16,184	10,093	70,303	61,427
Pulp and paperboard				
Paperboard (tons)	154,083	153,258	652,763	597,968
Pulp (tons)*	13,447	11,124	47,186	42,232
Consumer products				
Tissue (tons)	42,842	41,746	167,981	164,229

*Excludes pulp used internally.