

Potlatch

POTLATCH CORPORATION -- SIX MONTHS REPORT, JUNE 30, 2003

HIGHLIGHTS

Unaudited (Dollars in thousands – except per-share amounts)

	Quarter Ended June 30 2003	June 30 2002	Six Months Ended June 30 2003	June 30 2002
Net Sales	\$ 368,094	\$ 336,273	\$ 702,896	\$ 654,948
Earnings (Loss) from Continuing Operations	6,822	(6,557)	(2,069)	(21,495)
Net Earnings (Loss)	6,649	(20,089)	(2,916)	(187,470)
Net Earnings (Loss) per Common Share from Continuing Operations:				
Basic	\$.24	\$ (.23)	\$ (.07)	\$ (.76)
Diluted	.24	(.23)	(.07)	(.76)
Net Earnings (Loss) per Common Share:				
Basic	.23	(.70)	(.10)	(6.60)
Diluted	.23	(.70)	(.10)	(6.60)
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 Corporation reported a profit for the second quarter of 2003. Improved results at the company's Resource, Wood Products and Pulp and Paperboard operating segments offset a loss in the Consumer Products segment during the quarter. Earnings were positively affected by significant interest income from a federal income tax settlement.

For the second quarter of 2003, the company reported earnings from continuing operations of \$6.8 million, or \$.24 per diluted common share, compared to a loss from continuing operations of \$6.6 million or \$.23 per diluted common share for the same period in 2002. Additionally, last year's second quarter results were adversely affected by debt retirement costs. Including discontinued operations, the company earned \$6.6 million or \$.23 per diluted common share for the second quarter of 2003, compared to a net loss of \$20.1 million or \$.70 per diluted common share for the second quarter of 2002. Net sales for the second quarter of 2003 were \$368.1 million, an improvement over the \$336.3 million recorded in the second quarter of 2002.

The company incurred a loss from continuing operations for the first half of 2003 totaling \$2.1 million or \$.07 per diluted common share. The loss from continuing operations for the first half of 2002 was \$21.5 million or \$.76 per diluted common share. Including discontinued operations, the net loss for the first half of 2003 totaled \$2.9 million or \$.10 per diluted common share, compared to a net loss of \$187.5 million or \$6.60 per diluted common share in 2002. Net sales for the first half of 2003 were \$702.9 million, compared with \$654.9 million for 2002's first half.

The Resource segment reported operating income of \$23.5 million for the second quarter of 2003, substantially higher than the \$12.5 million earned in the second quarter of 2002. The increase was primarily attributable to the previously announced sale of 15,300 acres of hardwood timberland in Arkansas.

Operating income for the Wood Products segment was \$2.3 million for the second quarter of 2003, an improvement compared to the \$0.9 million earned in the second quarter of 2002. Higher selling prices and increased shipments of oriented strand board were the primary reasons for the favorable comparison to the prior year. Wood products shipments from Canada continue to dampen domestic lumber prices, but the strong housing market has allowed us to increase shipments of lumber as well as our other panel products.

The Pulp and Paperboard segment reported an operating loss for the second quarter of \$1.2 million, versus a loss of \$7.3

million for 2002's second quarter. The favorable comparison was primarily due to increased paperboard shipments, compared to the second quarter of 2002, largely attributable to production improvements at the Lewiston, Idaho, pulp and paperboard facility. Although pulp net sales prices were higher relative to the second quarter of 2002, a greater percentage of production was used internally. As a result, external pulp shipments declined versus the prior year's second quarter.

The Consumer Products segment incurred an operating loss of \$5.0 million, compared to operating income of \$12.5 million earned in the second quarter of 2002. Markets for consumer tissue products continued to be very competitive during the quarter. As a result, net selling prices suffered, falling 10% compared to the second quarter of 2002. The segment also took downtime on numerous converting lines to reduce finished goods inventory levels.

The company incurred lower interest expense in the second quarter of 2003, compared to the same period last year. The reduction in interest expense was due to the repayment of debt during the second, third and fourth quarters of 2002. In the second quarter of 2002, the company also incurred \$5.9 million in debt repayment costs.

In June 2003, the company received \$24.9 million as a result of a settlement with the Internal Revenue Service for tax years 1989 through 1994. Of this amount, \$12.5 million was recognized as interest income.



L. Pendleton Siegel
Chairman and Chief Executive Officer



Richard L. Paulson
President and Chief Operating Officer

July 17, 2003

Statements of Operations

Unaudited (Dollars in thousands – except per-share amounts)

	Quarter Ended June 30		Six Months Ended June 30	
	2003	2002	2003	2002
Net sales	\$368,094	\$336,273	\$702,896	\$ 654,948
Costs and expenses:				
Depreciation, amortization and cost of fee timber harvested	25,202	27,244	52,061	57,728
Materials, labor and other operating expenses	311,124	277,863	602,802	550,414
Selling, general and administrative expenses	21,030	20,882	38,948	42,874
Restructuring charge	-	-	227	-
	357,356	325,989	694,038	651,016
Earnings from operations	10,738	10,284	8,858	3,932
Interest expense	(12,128)	(15,679)	(24,890)	(34,305)
Debt retirement costs	-	(5,898)	-	(5,898)
Interest income	12,573	544	12,640	1,034
Earnings (loss) before taxes on income	11,183	(10,749)	(3,392)	(35,237)
Provision (benefit) for taxes on income	4,361	(4,192)	(1,323)	(13,742)
Earnings (loss) from continuing operations	6,822	(6,557)	(2,069)	(21,495)
Discontinued operations:				
Loss from discontinued operations (including loss on disposal of \$0, \$9,397, \$45 and \$254,970)	(283)	(22,182)	(1,389)	(272,090)
Income tax benefit	(110)	(8,650)	(542)	(106,115)
Net earnings (loss)	\$ 6,649	\$(20,089)	\$ (2,916)	\$(187,470)
Net earnings (loss) per common share from continuing operations:				
Basic	\$.24	\$ (.23)	\$ (.07)	\$ (.76)
Diluted	.24	(.23)	(.07)	(.76)
Net earnings (loss) per common share:				
Basic	.23	(.70)	(.10)	(6.60)
Diluted	.23	(.70)	(.10)	(6.60)
Average shares outstanding (in thousands):				
Basic	28,679	28,441	28,648	28,397
Diluted	28,679	28,441	28,648	28,397

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

Condensed Balance Sheets

2003 amounts unaudited (Dollars in thousands – except per-share amounts)

	June 30, 2003	December 31, 2002
Assets		
Current assets:		
Cash and short-term investments	\$ 42,996	\$ 26,042
Receivables, net	109,300	117,919
Inventories	124,948	159,798
Prepaid expenses	42,810	39,005
Assets held for sale	-	5,000
Total current assets	320,054	347,764
Land, other than timberlands	8,911	8,750
Plant and equipment, at cost less accumulated depreciation	739,391	758,168
Timber, timberlands and related logging facilities	397,428	396,426
Other assets	112,055	105,218
	\$1,577,839	\$1,616,326
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable	\$ 35,000	\$ 40,000
Current installments on long-term debt	507	15,607
Accounts payable and accrued liabilities	171,117	189,452
Liabilities related to assets held for sale	-	12
Total current liabilities	206,624	245,071
Long-term debt	621,360	622,645
Other long-term obligations	273,036	261,165
Deferred taxes	54,789	56,654
Stockholders' equity	422,030	430,791
	\$1,577,839	\$1,616,326
Stockholders' equity per common share	\$ 14.71	\$ 15.07
Working capital	\$ 113,430	\$102,693
Current ratio	1.5:1	1.4:1

Condensed Statements of Cash Flows

Unaudited (Dollars in thousands)

	Six Months Ended June 30	
	2003	2002
CASH FLOWS FROM OPERATIONS		
Net loss	\$ (2,916)	\$ (187,470)
Adjustments to reconcile net loss to net operating cash flows:		
Loss from discontinued operations	820	10,443
Loss on disposal of discontinued operations	60	221,223
Depreciation, amortization and cost of fee timber harvested	52,061	57,728
Debt retirement costs	-	5,898
Deferred taxes	(1,865)	(104,004)
Working capital changes	21,072	(21,734)
Net cash provided by (used for) operating activities of continuing operations	69,232	(17,916)
CASH FLOWS FROM INVESTING		
Decrease in restricted cash	15,069	98,200
Increase in short-term investments	(24,924)	(146,157)
Additions to plant and properties	(29,450)	(13,520)
Other, net	(4,804)	(8,351)
Net cash used for investing activities of continuing operations	(44,109)	(69,828)
CASH FLOWS FROM FINANCING		
Change in book overdrafts	757	(7,572)
Decrease in notes payable	(5,000)	-
Retirement of long-term debt	(16,385)	(376,360)
Premiums and fees on debt retirement	-	(1,985)
Issuance of treasury stock	2,747	5,075
Dividends	(8,592)	(8,515)
Other, net	4,841	(5,727)
Net cash used for financing activities of continuing operations	(21,632)	(395,084)
Cash from continuing operations	3,491	(482,828)
Cash from discontinued operations	3,608	481,678
Increase (decrease) in cash	7,099	(1,150)
Balance at beginning of period	8,973	7,475
Balance at end of period	\$ 16,072	\$ 6,325

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

Segment Information

(Dollars in thousands)

	Quarter Ended June 30		Six Months Ended June 30	
	2003	2002	2003	2002
Net Sales				
Resource	\$ 61,829	\$ 91,210	\$ 106,800	\$ 211,319
Wood products				
Oriented strand board	62,410	46,840	114,643	93,505
Lumber	74,068	71,850	137,719	139,283
Plywood	9,808	8,862	19,117	18,176
Particleboard	3,901	4,575	7,196	7,751
Other	6,716	6,030	15,303	12,016
Total wood products net sales	156,903	138,157	293,978	270,731
Pulp and paperboard				
Paperboard	115,300	98,969	220,221	192,886
Pulp	13,382	11,538	26,522	22,300
Total pulp and paperboard net sales	128,682	110,507	246,743	215,186
Consumer products	67,414	81,326	145,478	162,360
	414,828	421,200	792,999	859,596
Intersegment sales	(46,734)	(84,927)	(90,103)	(204,648)
Total net sales	\$ 368,094	\$ 336,273	\$ 702,896	\$ 654,948
Operating Income (Loss)				
Resource	\$ 23,534	\$ 12,502	\$ 34,655	\$ 22,527
Wood products	2,343	853	(1,268)	(263)
Pulp and paperboard	(1,159)	(7,327)	(10,492)	(26,375)
Consumer products	(4,974)	12,493	1,828	25,801
Eliminations and adjustments	(1,400)	17	(1,330)	355
	18,344	18,538	23,393	22,045
Corporate	(7,161)	(29,287)	(26,785)	(57,282)
Earnings (loss) from continuing operations before taxes on income	\$ 11,183	\$ 10,749)	\$ (3,392)	\$ (35,237)

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

Shipment Information

	Quarter Ended June 30		Six Months Ended June 30	
	2003	2002	2003	2002
Wood products				
Oriented strand board (m. sq. ft., 3/8" basis)	344,290	313,460	666,983	626,583
Lumber (m. bd. ft.)	214,542	188,393	401,209	369,314
Plywood (m. sq. ft., 3/8" basis)	34,863	29,652	68,670	61,739
Particleboard (m. sq. ft., 3/4" basis)	18,784	17,208	35,257	33,778
Pulp and paperboard				
Paperboard (tons)	180,806	152,261	342,163	296,962
Pulp (tons)*	6,505	11,928	18,662	21,848
Consumer products				
Tissue (tons)	38,537	41,925	80,793	82,833

*Excludes pulp used internally.

Sales Price/Unit

	Quarter Ended June 30		Six Months Ended June 30	
	2003	2002	2003	2002
Wood products (\$ per unit)				
Oriented strand board (m. sq. ft., 3/8" basis)	\$ 181	\$ 149	\$ 172	\$ 149
Lumber (m. bd. ft.)	345	381	343	377
Plywood (m. sq. ft., 3/8" basis)	281	299	278	294
Particleboard (m. sq. ft., 3/4" basis)	208	266	204	229
Pulp and paperboard (\$ per ton)				
Paperboard	638	650	644	650
Pulp	361	351	375	338
Consumer products				
Tissue	1,749	1,939	1,800	1,960

Potlatch

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