POTLATCH CORP
Form 10-Q
October 24, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2017

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	82-0156045
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

601 West First Avenue, Suite 1600	
Spokane, Washington	99201
(Address of principal executive offices)	(Zip Code)

(509) 835-1500

(Registrant's telephone number, including area code)

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth 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 an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act).

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange act).

Yes No

The number of shares of common stock of the registrant outstanding as of October 19, 2017 was 40,610,865.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

Table of Contents

Part I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Potlatch Corporation and Consolidated Subsidiaries

Consolidated Statements of Income (Loss)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share amount)	2017	2016	2017	2016
Revenues	$190,441	$174,027	$503,351	$443,418
Costs and expenses:				
Cost of goods sold	124,971	122,132	349,310	345,324
Selling, general and administrative expenses	14,619	12,901	41,773	38,712
Environmental charges for Avery Landing	4,978	—	4,978	1,022
Loss (gain) on lumber price swap	2,080	—	(1,185)	—
Loss on sale of central Idaho timber and timberlands	—	—	—	48,522
	146,648	135,033	394,876	433,580
Operating income	43,793	38,994	108,475	9,838
Interest expense, net	(7,336)	(7,786)	(19,654)	(22,017)
Income (loss) before income taxes	36,457	31,208	88,821	(12,179)
Income tax (provision) benefit	(2,757)	(3,562)	(13,956)	8,744
Net income (loss)	$33,700	$27,646	$74,865	$(3,435)
Net income (loss) per share:				
Basic	$0.83	$0.68	$1.83	$(0.08)
Diluted	$0.82	$0.68	$1.82	$(0.08)
Dividends per share	$0.375	$0.375	$1.125	$1.125
Weighted-average shares outstanding (in thousands):				
Basic	40,829	40,740	40,814	40,807
Diluted	41,250	40,933	41,183	40,807

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

Potlatch Corporation and Consolidated Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited)

(Dollars in thousands)	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2017	Nine Months Ended September 30, 2016
Net income (loss)	$33,700	$27,646	$74,865	$(3,435)
Other comprehensive income, net of tax:				
Pension and other postretirement employee benefits:				
Amortization of prior service credit included in net periodic cost, net of tax benefit of $(838), $(815), $(2,513) and $(2,445)	(1,309)	(1,275)	(3,929)	(3,824)
Amortization of actuarial loss included in net periodic cost, net of tax expense of $1,562, $1,760, $4,686 and $5,281	2,443	2,753	7,330	8,260
Cash flow hedge, net of tax of $0, $72, $(87) and $(297)	—	112	(137)	(465)
Other comprehensive income, net of tax	1,134	1,590	3,264	3,971
Comprehensive income	$34,834	$29,236	$78,129	$536

See Note 5: Derivative Instruments and Note 7: Pension and Other Postretirement Employee Benefits for additional information. Amortization of prior service credit and amortization of actuarial loss are included in the computation of net periodic cost (benefit).

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

Potlatch Corporation and Consolidated Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(Dollars in thousands)	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 116,803	$ 82,584
Receivables, net	23,461	17,284
Inventories	39,261	52,622
Other assets	8,820	11,155
Total current assets	188,345	163,645
Property, plant and equipment, net	76,138	72,820
Timber and timberlands, net	657,546	641,856
Deferred tax assets, net	40,889	42,051
Other assets	8,075	7,309
Total assets	$ 970,993	$ 927,681
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 20,304	$ 11,032
Accounts payable and accrued liabilities	60,741	43,710
Current portion of pension and other postretirement employee benefits	5,839	5,839
Total current liabilities	86,884	60,581
Long-term debt	559,019	572,956
Pension and other postretirement employee benefits	118,505	123,284
Other long-term obligations	15,395	14,586
Total liabilities	779,803	771,407
Commitments and contingencies		
Stockholders' equity:		
Common stock, $1 par value	40,611	40,519
Additional paid-in capital	357,736	355,274
Accumulated deficit	(99,677)	(128,775)
Accumulated other comprehensive loss	(107,480)	(110,744)
Total stockholders' equity	191,190	156,274
Total liabilities and stockholders' equity	$ 970,993	$ 927,681

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

4

Potlatch Corporation and Consolidated Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)	Nine Months Ended September 30, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$74,865	$(3,435)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation, depletion and amortization	21,908	25,723
Basis of real estate sold	6,351	6,686
Change in deferred taxes	(925)	1,375
Pension and other postretirement employee benefits	9,863	11,743
Equity-based compensation expense	3,536	3,290
Loss on sale of central Idaho timber and timberlands	—	48,522
Other, net	(1,467)	(1,141)
Funding of qualified pension plans	(5,275)	(1,300)
Change in working capital and operating-related activities, net	20,489	(17,073)
Net cash from operating activities	129,345	74,390
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(9,445)	(4,262)
Timberlands reforestation and roads	(11,577)	(10,421)
Acquisition of timber and timberlands	(22,033)	(1,180)
Net proceeds from sale of central Idaho timber and timberlands	—	111,460
Other, net	(106)	525
Net cash from investing activities	(43,161)	96,122
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends to common stockholders	(45,686)	(45,647)
Repayment of revolving line of credit borrowings	—	(30,000)
Repayment of long-term debt	(5,000)	(113,335)
Proceeds from issuance of long-term debt	—	93,235
Repurchase of common stock	—	(5,956)
Other, net	(1,279)	(3,879)
Net cash from financing activities	(51,965)	(105,582)
Change in cash and cash equivalents	34,219	64,930
Cash and cash equivalents at beginning of period	82,584	7,925
Cash and cash equivalents at end of period	$116,803	$72,855

SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid (received) during the period for:		
Interest, net of amounts capitalized	$17,381	$19,690
Income taxes, net	$13,923	$(1,828)

Certain 2016 amounts within cash flows from operating activities have been reclassified to conform to the 2017 presentation. There is no change to previously reported net cash from operating, investing or financing activities.

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

Notes to Condensed Consolidated Financial Statements

NOTE 1. BASIS OF PRESENTATION

For purposes of this report, any reference to “Potlatch,” “the company,” “we,” “us,” and “our” means Potlatch Corporation and all of its wholly-owned subsidiaries, except where the context indicates otherwise.

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission pertaining to interim financial statements; certain disclosures normally provided in accordance with generally accepted accounting principles in the United States have been omitted. This Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the Securities and Exchange Commission on February 17, 2017. We believe that all adjustments necessary for a fair statement of the results of such interim periods have been included and all such adjustments are of a normal recurring nature.

Certain 2016 amounts on the Condensed Consolidated Statements of Cash Flows within cash flows from operating activities have been reclassified to conform to the 2017 presentation. There is no change to previously reported net cash from operating, investing or financing activities.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which changes several aspects of the accounting for share-based payment award transactions, including accounting for income taxes, diluted shares outstanding, classification of excess tax benefits on the statement of cash flows, forfeitures and minimum statutory tax withholding requirements. We prospectively adopted the provisions of this ASU on January 1, 2017, which include recording the tax effects related to share-based payments through the income statement. As a Real Estate Investment Trust (REIT), we are generally not subject to federal and state corporate income taxes, except through our taxable REIT subsidiaries. Therefore, the adoption of this guidance was not material to our consolidated financial statements. We will continue to estimate forfeitures each period. We consider many factors when estimating expected forfeitures, including types of awards, employee class and historical experience.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers: Topic 606 (ASU No. 2014-09), which requires an entity to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 also included other guidance, including the presentation of a gain or loss recognized on the sale of a long-lived asset or a nonfinancial asset. Subsequent ASU’s have been issued that provide clarity, technical corrections and improvements to ASU No. 2014-09. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606), Deferral of the Effective Date, which deferred the effective date of ASU No. 2014-09 by one year. ASU No. 2014-09 is effective for us on January 1, 2018. For most of our sales, which consist of logs, manufactured wood products, residual by-products and real estate, we have identified no change to the timing or amount of revenue recognized because our contracts are legally enforceable, the transaction price is fixed and performance is completed at a point in time, typically when risk of loss and title pass. For our other sales, which include stumpage contracts, timber deeds, land use permits, and royalties, we have also identified no change to the timing or amount of revenue recognized. We will have minor refinements to our controls over financial reporting. Our expanded disclosures will disaggregate revenues along the lines of the sales categories mentioned above. The guidance permits a retrospective application of the new standard with certain practical expedients (contracts completed within the same annual reporting period need not be restated and other allowances for contracts with variable consideration) or retrospective application with a cumulative effect adjustment to the beginning balance of retained earnings. Upon adoption of this ASU on January 1, 2018, if there is a difference in the amount of revenue recorded for any of the prior reporting periods presented, while considering the practical expedients, we will restate that period to conform with the ASU. The adoption of this guidance is not expected to have a significant effect on our consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation – Retirement Benefits (Topic 715), Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires an entity to present service cost within compensation expense and the other components of net benefit cost outside of income from operations. This ASU is effective for us on January 1, 2018. The amendments in this update require retrospective presentation in the income statement. Changes to the capitalized portion of both service cost and the other components of net benefit cost within inventory will be applied prospectively. In 2016, net periodic pension and other postretirement employee benefit cost reported within operating income totaled $15.7 million of which $6.5 million represented service cost.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815), Targeted Improvements to Accounting for Hedging Activities, which is intended to better portray the economic results of an entity's risk management activities in its financial statements through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments expand and refine hedge accounting for certain nonfinancial and financial risk components and align the recognition and presentation of the effects in the financial statements, particularly in the areas of measuring hedge ineffectiveness. This ASU is effective for us on January 1, 2019, with early application permitted in any interim period. The presentation and disclosure guidance is required prospectively upon adoption. Our cash flow hedges currently have no ineffectiveness, but in the event they did, as of the beginning of the fiscal year that we adopt this ASU, a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness would be recorded to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings.

NOTE 3. EARNINGS PER SHARE

The following table reconciles the number of shares used in calculating basic and diluted earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands, except per share amounts)	2017	2016	2017	2016
Net income (loss)	$33,700	$27,646	$74,865	$(3,435)
Basic weighted-average shares outstanding	40,829,399	40,739,730	40,814,135	40,807,028
Incremental shares due to:				
Performance shares	378,149	157,145	331,082	—
Restricted stock units	42,909	36,476	37,578	—
Diluted weighted-average shares outstanding	41,250,457	40,933,351	41,182,795	40,807,028
Basic net income (loss) per share	$0.83	$0.68	$1.83	$(0.08)
Diluted net income (loss) per share	$0.82	$0.68	$1.82	$(0.08)

For the three months ended September 30, 2017, there were no stock based awards that were anti-dilutive. For the nine months ended September 30, 2017, there were 167 stock-based awards that were excluded from the calculation of diluted earnings per share because they were anti-dilutive. For the three months ended September 30, 2016, there were 12,139 stock-based awards that were excluded from the calculation of diluted earnings per share because they were anti-dilutive. For the nine months ended September 30, 2016, no dilutive potential shares were included in the computation of diluted net income (loss) per share due to the net loss. Anti-dilutive stock-based awards could be dilutive in future periods.

NOTE 4. CERTAIN BALANCE SHEET COMPONENTS

INVENTORIES

(Dollars in thousands)	September 30, 2017	December 31, 2016
Logs	$ 9,957	$ 23,342
Lumber, plywood and veneer	20,484	20,500
Materials and supplies	8,820	8,780
Total inventories	$ 39,261	$ 52,622

PROPERTY, PLANT AND EQUIPMENT

(Dollars in thousands)	September 30, 2017	December 31, 2016
Property, plant and equipment	$ 258,086	$ 250,913
Less: accumulated depreciation	(181,948)	(178,093)
Total property, plant and equipment, net	$ 76,138	$ 72,820

TIMBER AND TIMBERLANDS

(Dollars in thousands)	September 30, 2017	December 31, 2016
Timber and timberlands	$ 585,315	$ 572,273
Logging roads	72,231	69,583
Total timber and timberlands, net	$ 657,546	$ 641,856

In the nine months ended September 30, 2017, we purchased approximately $22.0 million of timber and timberlands adjacent to our current operations in northern Idaho, Arkansas and Alabama.

On April 21, 2016, we sold approximately 172,000 acres of timberlands located in central Idaho for $114 million. The company purchased the property in 2007 and 2008 for the purpose of growing and harvesting timber and selling rural recreation parcels. The sale freed up capital without having to wait for the rural recreation real estate market in central Idaho to recover. We recorded a loss of $48.5 million before taxes in our Real Estate segment in the second quarter of 2016. Historical earnings generated by the property were positive, but not material.

NOTE 5. DERIVATIVE INSTRUMENTS

From time to time, we enter into derivative financial instruments to manage certain cash flow and fair value risks.

Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset or liability to a particular risk, such as interest rate risk, are considered fair value hedges. We have five fair value interest rate swaps to convert interest payments on fixed-rate debt to variable-rate 3-month LIBOR plus a spread.

Derivatives designated and qualifying as a hedge of the exposure to variability in the cash flows of a specific asset or liability that is attributable to a particular risk, such as interest rate risk, are considered cash flow hedges. We have one interest rate swap to convert variable-rate debt, comprised of 3-month LIBOR plus a spread, to fixed-rate debt. Our cash flow hedge is expected to be highly effective in achieving offsetting cash flows attributable to the hedged interest rate risk through the term of the hedge. Therefore, changes in the fair value of the interest rate swap are recorded as a component of other comprehensive income and will be recognized in earnings when the hedged interest rate affects earnings. The amounts paid or received on this interest rate hedge will be recognized as adjustments to interest expense. As of September 30, 2017, the amount of net losses expected to be reclassified into earnings in the next 12 months is $0.1 million.

Derivatives not designated as hedges are not speculative and are used to manage our exposure to interest rate movements, commodity price movements or other identified risks, but do not meet the strict hedge accounting requirements. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly into income. In April 2017, we entered into a lumber price swap to fix the price on a total of 36 million board feet (mmbf) of southern yellow pine with an effective date of July 1, 2017 and a termination date of December 31, 2017. Under the contract, cash settlement on 6 mmbf occurs monthly.

The following table presents the gross fair values of derivative instruments on our Condensed Consolidated Balance Sheets:

	Asset Derivatives	Liability Derivatives

(Dollars in thousands)	Location	September 30, 2017	December 31, 2016	Location	September 30, 2017	December 31, 2016
Derivatives designated in fair value hedging relationships:						
Interest rate contracts	Other assets, current	$54	$ 32		$ —	$ —
Interest rate contracts	Other assets, non-current	—	215	Other long-term obligations	186	91
		$54	$ 247		$ 186	$ 91
Derivatives designated in cash flow hedging relationships:						
Interest rate contracts	Other assets, non-current	$925	$ 1,148		$ —	$ —
Derivatives not designated as hedging instruments:						
Lumber price swap	Other assets, current	$199	$ —		$ —	$ —

The following table details the effect of derivatives on our Consolidated Statements of Income (Loss):

(Dollars in thousands)	Location	Three Months Ended September 30, 2017	2016	Nine Months Ended September 30, 2017	2016
Derivatives designated in fair value hedging relationships:					
Interest rate contracts					
Realized gain on interest rate contracts[1]	Interest expense	$76	$186	$366	$642
Derivatives designated in cash flow hedging relationships:					
Interest rate contracts					
Gain (loss) recognized in other comprehensive income, net of tax (effective portion)		$(30)	$36	$(258)	$(618)
Loss reclassified from accumulated other comprehensive income (effective portion)[1]	Interest expense	$(30)	$(76)	$(121)	$(153)
Derivatives not designated as hedging instruments:					
Lumber price contracts					
Realized gain on lumber price swap		$986	$—	$986	$—
Unrealized gain (loss) on lumber price swap	Gain (loss) on lumber price swap	(3,067)	—	199	—
Net gain (loss) on lumber price contracts		$(2,081)	$—	$1,185	$—

[1] Realized gain on hedging instruments consists of net cash settlements and interest accruals on the fair value interest rate swaps during the periods. Net cash settlements are included in the supplemental cash flow information within interest, net of amounts capitalized in the Condensed Consolidated Statements of Cash Flows.

NOTE 6. FINANCIAL INSTRUMENTS

The following table presents the estimated fair values of our financial instruments:

(Dollars in thousands)	September 30, 2017 Carrying Amount	Fair Value	December 31, 2016 Carrying Amount	Fair Value
Cash and cash equivalents (Level 1)	$116,803	$116,803	$82,584	$82,584
Derivative assets related to interest rate swaps (Level 2)	$979	$979	$1,395	$1,395
Derivative liabilities related to interest rate swaps (Level 2)	$(186)	$(186)	$(91)	$(91)
Derivative asset related to lumber price swap (Level 2)	$199	$199	$—	$—
Long-term debt, including current portion (Level 2):				
Term loans	$(349,500)	$(353,856)	$(349,500)	$(350,909)

Senior notes	(149,464)	(163,500)	(149,271)	(164,250)
Revenue bonds	(65,735)	(62,954)	(65,735)	(62,205)
Medium-term notes	(17,250)	(18,476)	(22,250)	(23,926)
Total long-term debt[1]	$(581,949)	$(598,786)	$(586,756)	$(601,290)
Company owned life insurance asset (COLI) (Level 3)	$1,642	$1,642	$70	$70

[1] The carrying amount of long-term debt includes principal and unamortized discounts.

For cash and cash equivalents and any revolving line of credit borrowings, the carrying amount approximates fair value due to the short-term nature of these financial instruments.

The fair value of interest rate and lumber price swaps are 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 and commodity price forward curves.

The fair value of our long-term debt is estimated based upon quoted market prices for similar debt issues or estimated based on average market prices for comparable debt when there is no quoted market price.

The contract value of our COLI, the amount at which it could be redeemed, is used to estimate fair value because market prices are not readily available.

NOTE 7. PENSION AND OTHER POSTRETIREMENT EMPLOYEE BENEFITS

The following tables detail the components of net periodic cost (benefit) of our pension plans and other postretirement employee benefits (OPEB):

	Three Months Ended September 30,			
	Pension		OPEB	
(Dollars in thousands)	2017	2016	2017	2016
Service cost	$1,688	$1,627	$3	$3
Interest cost	4,024	4,255	316	355
Expected return on plan assets	(4,601)	(4,750)	—	—
Amortization of prior service cost (credit)	72	130	(2,219)	(2,220)
Amortization of actuarial loss	3,621	4,083	384	430
Net periodic cost (benefit)	$4,804	$5,345	$(1,516)	$(1,432)

	Nine Months Ended September 30,			
	Pension		OPEB	
(Dollars in thousands)	2017	2016	2017	2016
Service cost	$5,065	$4,881	$10	$10
Interest cost	12,072	12,765	947	1,065
Expected return on plan assets	(13,805)	(14,250)	—	—
Amortization of prior service cost (credit)	216	389	(6,658)	(6,658)
Amortization of actuarial loss	10,863	12,253	1,153	1,288
Net periodic cost (benefit)	$14,411	$16,038	$(4,548)	$(4,295)

During the nine months ended September 30, 2017 and 2016, we paid non-qualified supplemental pension benefits of $1.2 million and $1.3 million and OPEB benefits of $2.6 million and $2.6 million, respectively. During the nine months ended September 30, 2017 and 2016, we made voluntary contributions to our qualified pension plans of $5.3 million and $1.3 million, respectively.

The following tables detail the pension and OPEB changes in accumulated other comprehensive loss on our Condensed Consolidated Balance Sheets, net of tax:

	Three Months Ended September 30, 2017		
(Dollars in thousands)	Pension	OPEB	Total
Balance at June 30, 2017	$116,121	$(6,943)	$109,178
Amortization of defined benefit items, net of tax:[1]			
Prior service credit (cost)	(44)	1,353	1,309
Actuarial loss	(2,209)	(234)	(2,443)

Total reclassification for the period	(2,253)	1,119	(1,134)
Balance at September 30, 2017	$113,868	$(5,824)	$108,044

	Three Months Ended September 30, 2016		
(Dollars in thousands)	Pension	OPEB	Total
Balance at June 30, 2016	$123,103	$(11,558)	$111,545
Amortization of defined benefit items, net of tax:[1]			
Prior service credit (cost)	(79)	1,354	1,275
Actuarial loss	(2,492)	(261)	(2,753)
Total reclassification for the period	(2,571)	1,093	(1,478)
Balance at September 30, 2016	$120,532	$(10,465)	$110,067

(Dollars in thousands)	Nine Months Ended September 30, 2017 Pension	OPEB	Total
Balance at January 1, 2017	$120,627	$(9,182)	$111,445
Amortization of defined benefit items, net of tax:[1]			
Prior service credit (cost)	(132)	4,061	3,929
Actuarial loss	(6,627)	(703)	(7,330)
Total reclassification for the period	(6,759)	3,358	(3,401)
Balance at September 30, 2017	$113,868	$(5,824)	$108,044

(Dollars in thousands)	Nine Months Ended September 30, 2016 Pension	OPEB	Total
Balance at January 1, 2016	$128,244	$(13,741)	$114,503
Amortization of defined benefit items, net of tax:[1]			
Prior service credit (cost)	(237)	4,061	3,824
Actuarial loss	(7,475)	(785)	(8,260)
Total reclassification for the period	(7,712)	3,276	(4,436)
Balance at September 30, 2016	$120,532	$(10,465)	$110,067

[1] Amortization of prior service credit (cost) and amortization of actuarial loss are included in the computation of net periodic cost (benefit).

NOTE 8. COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table details the changes in our accumulated other comprehensive loss (AOCL) on our Condensed Consolidated Balance Sheets for the nine months ended September 30, 2017, net of tax.

(Dollars in thousands)	Gains and losses on cash flow hedge	Pension and other postretirement employee benefits	Total
Balance at January 1, 2017	$(701)	$ 111,445	$110,744
Other comprehensive (income) loss before reclassifications	258	(3,401)	(3,143)
Amounts reclassified from AOCL	(121)	-	(121)
Net current period other comprehensive (income) loss	137	(3,401)	(3,264)
Balance at September 30, 2017	$(564)	$ 108,044	$107,480

Amounts in parenthesis indicate credits.

See Note 5: Derivative Instruments and Note 7: Pension and Other Postretirement Employee Benefits for additional information.

NOTE 9. EQUITY-BASED COMPENSATION

As of September 30, 2017, we had two stock incentive plans under which performance shares, restricted stock units (RSUs) and deferred compensation stock equivalent units were outstanding. 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 September 30, 2017, approximately 1.0 million shares were authorized for future use. We issue new shares of common stock to settle performance shares, restricted stock units and deferred compensation stock equivalent units.

The following table details equity-based compensation expense and the related income tax benefit:

(Dollars in thousands)	Three Months Ended September 30, 2017	2016	Nine Months Ended September 30, 2017	2016
Employee equity-based compensation expense:				
Performance shares	$905	$866	$2,678	$2,571
Restricted stock units	283	248	858	719
Total employee equity-based compensation expense	$1,188	$1,114	$3,536	$3,290
Deferred compensation stock equivalent units expense	$166	$184	$488	$604
Total tax benefit recognized for share-based expense	$95	$81	$284	$236

PERFORMANCE SHARES

The following table presents the key inputs used in the Monte Carlo simulation to calculate the fair value of the performance share awards in 2017 and 2016:

	Nine Months Ended September 30, 2017	2016
Stock price as of valuation date	$43.60	$25.92
Risk-free rate	1.61 %	0.88 %
Expected volatility	24.22%	23.82%
Expected dividends	3.44 %	5.79 %
Expected term (years)	3.00	3.00
Fair value	$53.85	$30.02

The following table summarizes outstanding performance share awards as of September 30, 2017, and changes during the nine months ended September 30, 2017:

(Dollars in thousands, except grant date fair value)	Shares	Weighted-Avg. Grant Date Fair Value	Aggregate Intrinsic Value
Unvested shares outstanding at January 1, 2017	203,788	$ 32.59	
Granted	78,033	$ 53.85	

Forfeited	(2,187)	$ 39.15	
Unvested shares outstanding at September 30, 2017	279,634	$ 38.47	$ 14,261

As of September 30, 2017, there was $4.9 million of unrecognized compensation cost related to unvested performance share awards, which is expected to be recognized over a weighted-average period of 1.3 years.

RESTRICTED STOCK UNITS

The following table summarizes outstanding RSU awards as of September 30, 2017, and changes during the nine months ended September 30, 2017:

(Dollars in thousands, except grant date fair value)	Shares	Weighted-Avg. Grant Date Fair Value	Aggregate Intrinsic Value
Unvested shares outstanding at January 1, 2017	71,420	$ 31.61	
Granted	26,507	$ 43.64	
Vested	(2,000)	$ 32.85	
Forfeited	(728)	$ 32.70	
Unvested shares outstanding at September 30, 2017	95,199	$ 34.93	$ 4,855

The fair value of each RSU equaled our common share price on the date of grant. The total fair value of RSU awards that vested during the nine months ended September 30, 2017 was de minimis. As of September 30, 2017, there was $1.4 million of total unrecognized compensation cost related to unvested RSU awards, which is expected to be recognized over a weighted-average period of 1.2 years.

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 quarterly retainers, which may be payable in the form of stock. All stock unit equivalent accounts are credited with dividend equivalents. As of September 30, 2017, there were 137,606 shares outstanding that will be distributed in the future to directors as common stock.

Issuance of restricted stock units awarded to certain officers and select employees may also be deferred. All stock unit equivalent accounts are credited with dividend equivalents. As of September 30, 2017, there were 73,478 RSUs which had vested, but issuance of the related stock had been deferred.

NOTE 10. INCOME TAXES

As a real estate investment trust (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 conduct certain activities through our taxable REIT subsidiaries (TRS), which are subject to corporate level federal and state income taxes. These taxable activities are principally comprised of our wood products manufacturing operations and certain real estate investments. Therefore, income tax expense or benefit is primarily due to income or loss of the TRS, as well as permanent book versus tax differences.

NOTE 11. COMMITMENTS AND CONTINGENCIES

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. 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). The EPA cleanup was completed in October 2012. 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. Our remediation was completed in October 2013. In 2016, the EPA confirmed that Potlatch had completed the cleanup and subsequent monitoring required by the unilateral order. On September 25, 2015, the EPA sent us a letter asserting that the EPA and the Department of Transportation (the current owner of a portion of the adjacent property remediated by the EPA) (DOT) had incurred $9.8 million in unreimbursed response costs associated with the site and that we were liable for such costs. We executed a tolling agreement with the EPA and DOT suspending the statute of limitations on the claim until September 2016 in order to facilitate negotiations of a final settlement and release. In September 2016, the parties agreed to extend the tolling agreement through October 6, 2016. The tolling agreement was further extended through February 22, 2017; in January 2017, the tolling agreement was extended through May 22, 2017; in May 2017 the tolling agreement was extended through September 22, 2017, a further extension to October 23, 2017 was executed in September and an extension to December 31, 2017 was executed in October. Settlement negotiations continue. If settlement efforts prove to be unsuccessful, we believe we have meritorious defenses to this claim and we intend to defend ourselves vigorously. We accrued $0.2 million for this matter in the first quarter of 2016, an additional $0.8 million for this matter in the second quarter of 2016 and an additional $5.0 million in the third quarter of 2017. We have reserved all of our rights to seek reimbursement for the costs of remediation from all parties potentially responsible. We do not expect to make any further accruals in respect of this claim.

NOTE 12. SEGMENT INFORMATION

The following table summarizes information by business segment:

(Dollars in thousands)	Three Months Ended September 30, 2017	2016	Nine Months Ended September 30, 2017	2016
Revenues:				
Resource	$94,705	$85,822	$202,397	$189,358
Wood Products	116,487	97,620	326,608	271,782
Real Estate	3,282	8,426	25,922	23,946
	214,474	191,868	554,927	485,086
Intersegment Resource revenues[1]	(24,033)	(17,841)	(51,576)	(41,668)
Total consolidated revenues	$190,441	$174,027	$503,351	$443,418
Income (loss) before income taxes:				
Resource	$41,796	$33,303	$76,245	$59,182
Wood Products	19,281	10,657	52,670	16,308
Real Estate[2]	1,469	5,885	15,837	(35,469)
Eliminations and adjustments	(3,141)	(1,946)	(1,029)	(1,450)
	59,405	47,899	143,723	38,571
Corporate	(15,612)	(8,905)	(35,248)	(28,733)
Operating income	43,793	38,994	108,475	9,838
Interest expense, net	(7,336)	(7,786)	(19,654)	(22,017)
Income (loss) before income taxes	$36,457	$31,208	$88,821	$(12,179)
Depreciation, depletion and amortization:				
Resource	$6,207	$6,456	$14,865	$17,971
Wood Products	1,821	1,837	5,487	5,538
Real Estate	—	—	1	3
	8,028	8,293	20,353	23,512
Corporate	168	187	443	608
Bond discounts and deferred loan fees	369	769	1,112	1,603
Total depreciation, depletion and amortization	$8,565	$9,249	$21,908	$25,723
Basis of real estate sold:				
Real Estate	$618	$1,364	$6,474	$7,118
Eliminations and adjustments	(39)	(99)	(123)	(432)
Total basis of real estate sold	$579	$1,265	$6,351	$6,686

[1] Intersegment revenues are based on prevailing market prices of logs sold by our Resource segment to the Wood Products segment.

[2] In the second quarter of 2016, we sold approximately 172,000 acres of timberlands located in central Idaho for $114 million at a loss of $48.5 million before taxes.

NOTE 13. SUBSEQUENT EVENT

On October 22, 2017, Potlatch and Deltic Timber Corporation (Deltic) entered into an Agreement and Plan of Merger (“Merger Agreement”) pursuant to which Deltic will merge with and into a wholly-owned subsidiary of Potlatch. The combined company will be named PotlatchDeltic Corporation. Under the terms of the Merger Agreement, Deltic shareholders will receive 1.80 shares of Potlatch common shares for each share of Deltic common stock at the closing date. Deltic owns approximately 530,000 acres of timberland, operates two sawmills and a medium density fiberboard plant and is engaged in real estate development primarily in Arkansas and north Louisiana.

Because the exchange ratio was fixed at the time of the merger agreement and the market value of our common stock will continue to fluctuate, the total value of the consideration exchanged will not be determinable until the closing date. The number of shares to be issued with respect to Deltic stock awards will not be determinable until the closing of the transaction.

We have estimated the total consideration expected to be issued to Deltic shareholders in the merger to be approximately 22 million shares of our common stock based on the 1.80 exchange ratio and the number of shares of Deltic common stock issued and outstanding as of October 20, 2017.

Subsequent to the completion of the transaction, as part of the REIT conversion process, Deltic’s earnings and profits will be distributed to shareholders of the combined company through a dividend consisting of 80% stock and 20% cash.

The merger agreement has been approved by both companies' board of directors. The closing of the merger is subject to approval by the shareholders of Deltic and Potlatch, receipt of certain regulatory approvals and other conditions specified in the merger agreement. The merger is expected to close in the first half of 2018.

In addition, on October 22, 2017, Potlatch’s Board of Directors authorized an increase to the annual dividend from $1.50 per share to $1.60 per share, or $0.40 per share on a quarterly basis, commencing December 29, 2017.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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, fair value of hedging instruments and swaps, expected return on pension assets, recognition of compensation costs relating to our performance shares and RSUs, expectation of no further accruals relating to the Avery Landing matter, the pending merger with Deltic Timber Corporation (Deltic), the amount of Deltic's earnings and profits, 2017 capital spending and similar matters. Words such as "anticipate," "expect," "will," "intend," "plan," "target," "project," "believe," "seek," "schedule," "estimate," "c 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 the United States and international economies;
- changes in interest rates and discount rates;
- 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;
- our ability to close the pending merger with Deltic;
- finalization of the analysis and actions necessary to convert Deltic to a REIT;
- our ability to successfully realize the expected benefits from the merger with Deltic; and
- our ability to reach a settlement of the Avery Landing claim.

For a discussion of some of the factors that may affect our business, results and prospects, and a nonexclusive listing of forward-looking statements, refer to "Cautionary Statement Regarding Forward-Looking Information" on page 1 and "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016.

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.

Results of Operations

Our business is organized into three business segments: Resource, Wood Products and Real Estate. Our Resource segment supplies our Wood Products segment with a portion of its wood fiber needs. These intersegment revenues are based on prevailing market prices and typically represent a significant portion of the Resource segment's total revenues. Our other segments generally do not generate intersegment revenues.

In our discussions of consolidated results of operations, our revenues are reported after elimination of intersegment revenues. In our discussion by business segment, each segment's revenues are presented before the elimination of intersegment revenues.

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 cyclical fluctuations in the forest products industry, changes in timber prices and in harvest levels from our timberlands, weather conditions, competition, timberland valuations, demand for our non-strategic timberland for higher and better use purposes, changes in lumber prices, the efficiency and level of capacity utilization of our wood products manufacturing operations, changes in our principal expenses such as log costs, asset or business acquisitions or dispositions and other factors.

Overview

Increased lumber demand coupled with duties on Canadian exports to the United States and reduced lumber and plywood production due to wildfires in the western United States and Canada pushed lumber prices higher, which contributed to our strong results in our Wood Products and Resource segments.

In the nine months ended September 30, 2017, we purchased approximately $22.0 million of timber and timberlands adjacent to our current operations. In April 2016, we sold approximately 172,000 acres of non-strategic timberlands located in central Idaho for $114 million in our Real Estate segment.

Consolidated Results

The following table sets forth changes in our Consolidated Statements of Income (Loss). Our Business Segment Results provide a more detailed discussion of our segments.

(Dollars in thousands)	Three Months Ended September 30, 2017	2016	% Change	Nine Months Ended September 30, 2017	2016	% Change
Revenues	$190,441	$174,027	9%	$503,351	$443,418	14%
Costs and expenses:						
Cost of goods sold	124,971	122,132	2%	349,310	345,324	1%
Selling, general and administrative expenses	14,619	12,901	13%	41,773	38,712	8%
Environmental charges for Avery Landing	4,978	—	*	4,978	1,022	*
Loss (gain) on lumber price swap	2,080	—	*	(1,185)	—	*
Loss on sale of central Idaho timber and timberlands	—	—	*	—	48,522	*
	146,648	135,033	9%	394,876	433,580	(9%)
Operating income	43,793	38,994	12%	108,475	9,838	*
Interest expense, net	(7,336)	(7,786)	(6%)	(19,654)	(22,017)	(11%)
Income (loss) before income taxes	36,457	31,208	17%	88,821	(12,179)	*
Income tax (provision) benefit	(2,757)	(3,562)	(23%)	(13,956)	8,744	*
Net income (loss)	$33,700	$27,646	22%	$74,865	$(3,435)	*

* Percentage change not meaningful.

Revenues

Three months ended September 30, 2017 compared with three months ended September 30, 2016

Revenues increased $16.4 million primarily due to higher lumber prices and increased lumber shipments. Harvest volumes declined in the third quarter of 2017, compared with 2016, due to wet weather late in the quarter, which contributed to unfavorable hauling conditions in the Northern region. Lower Northern region harvest volumes were more than offset by higher sawlog prices.

Nine months ended September 30, 2017 compared with nine months ended September 30, 2016

Revenues increased $59.9 million primarily due to higher lumber prices and increased lumber shipments. Lower harvest volumes in both regions were more than offset by higher Northern region sawlog prices. Harvest volumes declined in the first nine months of 2017, compared with the same time in 2016 where we experienced a relatively mild winter and dry spring, as well as due to the sale of central Idaho timberlands in the second quarter of 2016.

Cost of goods sold

Three months ended September 30, 2017 compared with three months ended September 30, 2016

Cost of goods sold increased 2% due to higher lumber shipments.

Nine months ended September 30, 2017 compared with nine months ended September 30, 2016

Cost of goods sold increased 1% due to higher lumber shipments, partially offset by lower harvest volumes due to less favorable hauling conditions in 2017 and the sale of central Idaho timberlands in the second quarter of 2016.

Selling, general and administrative expenses

Three months ended September 30, 2017 compared with three months ended September 30, 2016

The 13% increase in selling, general and administrative expenses was the result of higher accrued annual incentive compensation expense and higher workers' compensation expense. Workers' compensation expense can fluctuate based on the timing of claims.

Nine months ended September 30, 2017 compared with nine months ended September 30, 2016

The 8% increase in selling, general and administrative expenses was the result of higher accrued annual incentive compensation expense and workers' compensation expenses, partially offset by lower pension expense in 2017 resulting from updated mortality tables.

Environmental charges for Avery Landing

During the third quarter of 2017, we accrued $5.0 million related to Avery Landing, compared with $1.0 million recorded in the first half of 2016. See Note 11: Commitments and Contingencies for a more detailed discussion of Avery Landing.

Lumber price swap

In April 2017, we entered into a lumber price swap to fix the price on a total of 36 million board feet (mmbf) of southern yellow pine with an effective date of July 1, 2017 and a termination date of December 31, 2017. Under the contract, beginning in July, cash settlement on 6 mmbf occurs each month. Changes in the fair value of derivatives not designated in hedging relationships are recorded directly into income. At June 30, 2017, the estimated fair value of the contract was $3.3 million, which was recognized as an unrealized gain in the Consolidated Statement of Income (Loss). During the third quarter of 2017, we realized $1.0 million in total monthly settlements. At September 30, 2017, the estimated fair value on the remaining term of the contract was $0.2 million, resulting in a $2.1 million change that was reflected as a loss on the lumber price swap in the three months ended September 30, 2017.

See Note 5: Derivative Instruments for a more detailed discussion of the lumber price swap.

Loss on sale of central Idaho timber and timberlands

In April 2016, we sold approximately 172,000 acres of non-strategic timberlands located in central Idaho for $114 million, less selling costs of $2.5 million. This divestiture resulted in a $48.5 million loss before income taxes.

Interest expense, net

Three months ended September 30, 2017 compared with three months ended September 30, 2016

Interest expense decreased due to the 2016 repayment of $42.6 million in Minnesota revenue bonds and the refinancing of $65.7 million in Idaho revenue bonds, as well as the 2017 repayment of $5.0 million of matured borrowings.

Nine months ended September 30, 2017 compared with nine months ended September 30, 2016

Interest expense decreased due to the 2016 repayment of $42.6 million in Minnesota revenue bonds and the refinancing of $65.7 million in Idaho revenue bonds, as well as the 2017 repayment of $5.0 million of matured borrowings.

Income tax provision

Three months ended September 30, 2017 compared with three months ended September 30, 2016

Income taxes are primarily due to income or loss from our taxable REIT subsidiaries (TRS). For the third quarter of 2017, the income tax provision of $2.8 million was the result of the TRS's income before income tax of $8.8 million, partially offset by permanent book versus tax differences. For the third quarter of 2016, the income tax provision of $3.6 million was the result of the TRS's income before income tax of $10.9 million, partially offset by discrete tax items.

Nine months ended September 30, 2017 compared with nine months ended September 30, 2016

For the first nine months of 2017, the income tax provision of $14.0 million was the result of the TRS's income before income tax of $40.4 million, partially offset by permanent book versus tax differences. For the first nine months of 2016, the income tax benefit of $8.7 million was the result of the TRS's loss before income tax of $22.3 million, partially offset by discrete tax items.

Business Segment Results

Resource Segment

	Three Months Ended September 30,			Nine Months Ended September 30,		
(Dollars in thousands)	2017	2016	% Change	2017	2016	% Change
Revenues[1]	$ 94,705	$ 85,822	10%	$ 202,397	$ 189,358	7%
Cost of goods sold:						
Logging and hauling	37,446	36,600	2%	85,918	86,373	(1%)
Depreciation, depletion and amortization	6,207	6,456	(4%)	14,865	17,971	(17%)
Other	7,337	7,354	—	20,267	20,811	(3%)
	50,990	50,410	1%	121,050	125,155	(3%)
Selling, general and administrative expenses	1,919	2,109	(9%)	5,102	5,021	2%
Operating income	$ 41,796	$ 33,303	26%	$ 76,245	$ 59,182	29%
Harvest Volumes (in tons)						
Northern region						
Sawlog	559,580	579,837	(3%)	1,247,610	1,335,264	(7%)
Pulpwood	33,742	62,138	(46%)	121,581	158,996	(24%)
Stumpage	1,434	1,261	14%	12,127	18,529	(35%)
Total	594,756	643,236	(8%)	1,381,318	1,512,789	(9%)
Southern region						
Sawlog	290,362	231,677	25%	698,850	592,226	18%
Pulpwood	334,399					