



## Deltic Timber Corporation 2008 Annual Report



**SUSTAINABLE.  
FOCUSED.  
BALANCED.**



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# OPERATIONAL HIGHLIGHTS

## Financial

(Thousands of dollars, except per share amounts)

| For the Year              | 2008       | 2007    | 2006    |
|---------------------------|------------|---------|---------|
| Net sales                 | \$ 129,524 | 128,255 | 153,112 |
| Operating income          | \$ 7,505   | 19,959  | 18,721  |
| Net income                | \$ 4,384   | 11,111  | 11,323  |
| Earnings per common share | \$ 0.35    | 0.89    | 0.91    |
| Net cash provided by      |            |         |         |
| operating activities      | \$ 21,683  | 28,243  | 39,148  |
| Capital expenditures      | \$ 29,654  | 20,568  | 27,767  |

## At Year-End

|                         |            |         |         |
|-------------------------|------------|---------|---------|
| Working capital         | \$ 4,807   | 7,285   | 12,710  |
| Total assets            | \$ 334,733 | 328,744 | 324,266 |
| Long-term debt          | \$ 75,833  | 66,667  | 70,000  |
| Stockholders' equity    | \$ 213,164 | 218,086 | 207,126 |
| Common shares           |            |         |         |
| outstanding (thousands) | 12,402     | 12,388  | 12,425  |

## Operating

|                              |         |         |         |
|------------------------------|---------|---------|---------|
| Pine sawtimber harvested     |         |         |         |
| from fee land (tons)         | 579,770 | 575,637 | 580,316 |
| Pine sawtimber               |         |         |         |
| sales price (per ton)        | \$ 33   | 40      | 45      |
| Lumber sales (MBF)           | 254,590 | 218,188 | 262,726 |
| Lumber sales price (per MBF) | \$ 277  | 293     | 324     |

Deltic Timber Corporation is a natural resources company focused on the efficient and environmentally responsible management of its land holdings. The Company owns 438,600 acres of timberland, operates two sawmills, and is engaged in real estate development.

Headquartered in

El Dorado, Arkansas, the

Company's operations are

located primarily in Arkansas and north Louisiana.

# TO OUR SHAREHOLDERS

Despite a harsh operating environment of historic proportions in the forest products industry during the year 2008, Deltic Timber Corporation achieved positive financial results, earning net income of \$4.4 million, \$.35 per share for the year, compared to \$11.1 million, \$.89 per share in 2007. We again benefitted, albeit modestly, from having a well-balanced group of operating assets that created profitability for Deltic, despite the “perfect storm” of unwinding credit excesses. Weak markets for two of Deltic’s key business drivers, dimension lumber and residential real estate, continued to soften throughout the year; U.S. housing starts fell below one million for the first time since 1945, pressuring lumber prices downward; while the uncertainty in financial markets led to credit deadlock, particularly for potential buyers of commercial real estate. Deltic’s operating response to these economic forces beyond our control experienced in 2008, was to become even more focused on efficiency in every aspect of each business line.

Our Woodlands segment’s 438,600 acres of well-stocked Southern pine timberlands continued their trend of providing strong operating income and cash flow, even though the weak lumber market exerted more downward pressure on sawtimber prices in this extended cycle than is normally seen. Our strategy of maintaining the harvest of

pine sawtimber at a level that is indefinitely sustainable, contributed to the stability of this segment’s financial results. As such, the Woodlands segment reported operating income of \$27.8 million for the year. This was actually a 12% increase over the prior year, despite the drop in timber prices, and we did not increase the harvest volume of pine sawtimber to generate the additional revenues. During 2008, we did sell about 5,100 acres of non-strategic, recreational-use hardwood bottomland for some \$ 8.9 million, an attractive \$1,752 per acre. Our plan is for all of the sales proceeds to be invested in acquisitions of pine timberland to grow our land base. Royalty income from production in the acreage that we have leased, especially in the Fayetteville Shale Play area, also increased for 2008, as we saw this revenue source grow to \$1.6 million for the year compared to \$300,000 in 2007. For 2009, we will again maintain a disciplined, sustainable level for the harvest of our timber, while continuing our plans to sell potential recreational-use lands that are not strategic to our core timberland management operations.

The financial results for Deltic’s Mills segment were negatively impacted by the weak demand for dimension lumber caused by the further drop in housing starts in the United States, and the resulting decrease in lumber prices to levels reaching historic lows for portions of 2008. As such, this segment reported a loss of \$4.8 million for this year compared to \$3 million in 2007. Intensely focused management of our sawmills allowed them to continue to make significant strides in increasing hourly productivity rates and improving other operating efficiencies during 2008, while achieving lower manufacturing cost per MBF of lumber



From left, Ray C. Dillon, Robert C. Nolan



*Sustainable Woodlands segment operating results stem from disciplined harvests and a commitment to reforestation.*



*Focused management of the Mills segment has resulted in increased productivity rates and improved operating efficiencies.*



*Balanced development of residential neighborhoods and commercial properties by the Real Estate segment adds value.*

produced, aided by lower log input cost resulting from lower stumpage prices. These efforts allowed our Mills segment to return to profitability during the third quarter before lumber markets retreated in the fourth quarter. For 2009, we will continue to be focused on being very efficient producers, while balancing production with market demands.

Arkansas was not immune to the slowdown in housing starts that was seen in the United States, or the credit crunch that greatly impacted developers of commercial property, especially during the last four months of the year. As a result, Deltic's lot closings dropped to the lowest annual level since we entered the real estate development business. However, the average price received for the lots sold was consistent with the Company's historical average, as we did not reduce the listed prices in order to try to generate additional sales activity. We continued to see interest in our commercial real estate properties, especially acreage zoned for multi-family development. However, potential developers were hindered by the availability of funding for their projects during the tight-credit environment that existed. The focus of our efforts in our Real Estate segment for 2009 will be on achieving sales of commercial property, as we wait for the residential housing market to recover.

Del-Tin Fiber again reported positive financial results, with income of \$3 million. The medium density fiberboard (MDF) market remained in balance for most of

2008. Therefore, sales realizations were fairly stable, but producers continued to see high costs for the wood fiber and resin glue utilized in the manufacture of their product. As we entered 2009, MDF markets had begun to soften, but we were also seeing decreases in resin glue costs and we anticipate that wood fiber cost will also recede during the year, as reduced paper demand has eased the availability of residual pine wood chips.

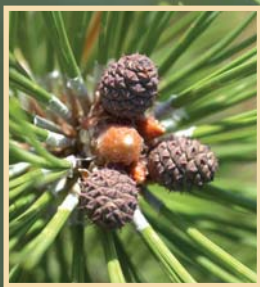
While conditions for the year were far from ideal, Deltic weathered the storm of 2008 as well as could be expected. Deltic's stock price held up versus the indexes that we use to measure our stock's performance, but was down as was the rest of the market. We took advantage of this by utilizing \$6.2 million of our approved share repurchase program. We view this activity as the purchase of more of the timberland we know the best, our own, at attractive prices. Your Company's strong balance sheet allowed us to maintain our dividend, with the added bonus of repurchasing our shares at attractive prices. Finally, the low cost basis of our timberlands and real estate developments combined with the lack of leverage on our balance sheet allowed the Company to not be forced to liquidate its land holdings in order to meet immediate cash needs. As we enter 2009, we are extremely cautious about the economic environment that exists, but believe we are well positioned to be successful, while being hopeful that we can grow our assets should these difficult times make such available at attractive prices. Your continued interest and support is appreciated.

*Robert C. Nolan, Chairman*

*Ray C. Dillon, President and Chief Executive Officer*



SUSTAINABLE.



# WOODLANDS

Maintaining a sustainable harvest level of pine sawtimber is a strategic focus of the Company's Woodlands segment. The measurable outcome of this strategy is stable financial performance, as each year's yield approximates actual growth. Consequently, Deltic's most valuable asset has not been reduced over time. This responsible management practice, combined with strategic acquisitions of Southern pine timberland, has resulted in a significant and consistent increase in the Company's inventory of pine sawtimber.

Using the proceeds from the sale of non-strategic, hardwood bottomland acreage for recreational uses, allows Deltic to increase strategically located acreage more suitable to Southern pine growth. In time, this practice, along with the maturity of some of the Company's pine plantations into sawtimber-bearing status, will allow the sustainable annual harvest level to increase.

Deltic protects its timberlands through disciplined reforestation efforts, in many cases planting seedlings grown from seeds produced at the Company's own seed orchard. Water quality and wildlife habitat are protected, as well, through strict adherence to the forestry practices required as a participant in the Sustainable Forestry Initiative program. In addition, a balanced approach to timber management that maintains both all-aged timber stands and even-aged plantations, increases the flexibility to achieve optimum log quality, growth rates, and carrying volumes in Deltic's forests.

Focused management of timberlands ensures a proper balance of financial and environmental stewardship, while achieving sustainable positive performance in the Woodlands segment.



## **The Arkansas Wildlife Federation Award for Corporate Conservation.**

*Deltic Timber was recognized by the Arkansas Wildlife Federation for its sustainable, focused and balanced approach to timber management with the 2008 Corporate Conservationist of the Year Award*



**Sustainable Forestry Initiative certification validates Deltic Timber's conservation practices.**

*As a Certified Participant in the Sustainable Forestry Initiative (SFI) program, Deltic Timber's practices provide a continuous inventory of raw timber through the managing, nurturing, and planned harvesting of trees for useful products.*

## MILLS

As a vertically integrated forest products company, Deltic is committed to the strategy that efficient sawmills add value to the Company's core timberland assets and that, over time, skillful lumber manufacturers will be rewarded for their production efforts. Being a proficient mill operator requires an intense effort focused on achieving maximum productivity rates and uptime percentages, while minimizing every manageable component of manufacturing cost.

The decline in housing starts and the reduced need for dimension lumber will result in continued difficult market conditions until the housing market recovers. This environment will require the Company to further improve the productivity and operating efficiencies of the mills, while maintaining production levels consistent with what the market can absorb.

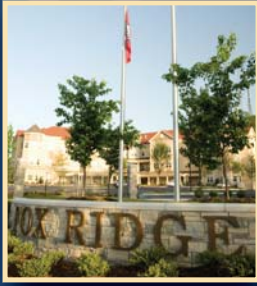
Targeted capital investment has been made for state-of-the-art equipment at both of Deltic's sawmills. The resulting enhancements to these operations have facilitated a critical reduction in labor hour requirements. This investment has also improved the ratio of lumber produced from each ton of logs processed and the final grade mix for the lumber manufactured.

Deltic is focused on managing its Mills segment's assets with the goal of achieving a sustainable level of operating excellence, while accomplishing an output of lumber volume balanced with market conditions.



# FOCUSED.





# BALANCED.



## REAL ESTATE

The balanced mix of residential lots and commercial sites in Deltic's real estate developments contributes to the diversity of the Company's assets. The low-cost basis in these former timberland holdings has allowed Deltic to add value to this well-located acreage, thus ensuring its highest and best use.

While the real estate markets have continued to soften in Arkansas and throughout the United States, the Company is committed to achieving optimum sales prices for all real estate assets sold. Until residential housing recovers, management's attention will continue to be on potential commercial sales, a primary focus of the Real Estate segment's activities.

Long-range planning, diversification, and balance are some of the keys to sustainable success in real estate development. At the Company's flagship Little Rock development, Chenal Valley, and its adjacent community, Chenal Downs, as well as at Red Oak Ridge in Hot Springs, the infrastructure and amenities are in place, and the appeal to a wide variety of interests is growing.

Deltic's management is focused on utilizing the balanced diversification that its real estate holdings offer, and has well positioned these assets to achieve a sustainable positive impact on the Company's future performance.



### **Chenal golf course designated as a Certified Audubon Cooperative Sanctuary.**

*Chenal Country Club is an important amenity to Deltic Timber's Chenal Valley development. As such, it is important to note the Club's golf courses have been designated since 2000 as a Certified Audubon Cooperative Sanctuary. This distinction makes Chenal the only country club golf course in Arkansas, and one of only 535 courses in the world, to receive the honor.*

# FINANCIAL REVIEW

## Selected Financial Information

|                                                         | 2008        | 2007     | 2006     | 2005     | 2004     |
|---------------------------------------------------------|-------------|----------|----------|----------|----------|
| <i>(Thousands of dollars, except per share amounts)</i> |             |          |          |          |          |
| <b>Results of Operations for the Year</b>               |             |          |          |          |          |
| Net sales                                               | \$ 129,524  | 128,255  | 153,112  | 168,350  | 142,017  |
| Operating income                                        | \$ 7,505    | 19,959   | 18,721   | 26,257   | 23,155   |
| Net income                                              | \$ 4,384    | 11,111   | 11,323   | 14,518   | 11,093   |
| Comprehensive income                                    | \$ (915)    | 14,638   | 11,621   | 14,128   | 11,205   |
| Earnings per common share                               |             |          |          |          |          |
| Basic                                                   | \$ 0.35     | 0.89     | 0.91     | 1.18     | 0.92     |
| Assuming dilution                                       | \$ 0.35     | 0.89     | 0.89     | 1.17     | 0.91     |
| Cash dividends declared per common share                | \$ 0.30     | 0.30     | 0.30     | 0.275    | 0.25     |
| Net cash provided/(required) by                         |             |          |          |          |          |
| Operating activities                                    | \$ 21,683   | 28,243   | 39,148   | 43,125   | 42,147   |
| Investing activities                                    | \$ (30,778) | (21,023) | (24,234) | (29,015) | (15,723) |
| Financing activities                                    | \$ 835      | (7,906)  | (5,192)  | (13,332) | (27,252) |
| Percentage return on                                    |             |          |          |          |          |
| Average stockholders' equity                            | 2.0         | 5.2      | 5.5      | 7.6      | 6.3      |
| Average borrowed and invested capital                   | 3.4         | 5.7      | 5.6      | 7.4      | 6.2      |
| Average total assets                                    | 1.3         | 3.4      | 3.5      | 4.6      | 3.6      |
| <b>Capital Expenditures for the Year</b>                |             |          |          |          |          |
| Woodlands                                               | \$ 11,436   | 4,978    | 3,333    | 7,062    | 6,686    |
| Mills                                                   | 6,874       | 5,345    | 8,763    | 10,732   | 4,797    |
| Real Estate                                             | 11,222      | 10,171   | 15,612   | 15,379   | 12,519   |
| Corporate                                               | 122         | 74       | 59       | 74       | 165      |
|                                                         | \$ 29,654   | 20,568   | 27,767   | 33,247   | 24,167   |

## Financial Condition at Year-End

|                                        |            |           |           |           |           |
|----------------------------------------|------------|-----------|-----------|-----------|-----------|
| Working capital                        | \$ 4,807   | 7,285     | 12,710    | 7,027     | 6,481     |
| Current ratio                          | 1.42 to 1  | 1.46 to 1 | 2.15 to 1 | 1.57 to 1 | 1.73 to 1 |
| Total assets                           | \$ 334,733 | 328,744   | 324,266   | 316,327   | 307,580   |
| Long-term debt                         | \$ 75,833  | 66,667    | 70,000    | 74,500    | 85,724    |
| Stockholders' equity                   | \$ 213,164 | 218,086   | 207,481   | 198,244   | 184,091   |
| Long-term debt to stockholders' equity | .356 to 1  | .306 to 1 | .337 to 1 | .376 to 1 | .466 to 1 |

# STATISTICAL SUMMARY

## Selected Statistical Data

|                                                         | 2008       | 2007       | 2006       | 2005       | 2004       |
|---------------------------------------------------------|------------|------------|------------|------------|------------|
| <b>Operating</b>                                        |            |            |            |            |            |
| Acres owned <sup>1</sup>                                |            |            |            |            |            |
| Woodlands                                               | 438,600    | 438,600    | 438,200    | 437,700    | 436,300    |
| Real Estate                                             | 6,500      | 6,400      | 6,300      | 6,400      | 6,700      |
| Woodlands                                               |            |            |            |            |            |
| Estimated standing pine timber inventories <sup>1</sup> |            |            |            |            |            |
| Sawtimber ( <i>tons</i> )                               | 11,567,300 | 11,389,300 | 10,977,600 | 10,833,700 | 11,355,500 |
| Pulpwood ( <i>tons</i> )                                | 4,568,400  | 4,770,000  | 5,180,900  | 5,403,700  | 5,622,000  |
| Company-owned pine timber harvested <sup>2</sup>        |            |            |            |            |            |
| Sawtimber ( <i>tons</i> )                               | 579,770    | 575,637    | 580,316    | 581,242    | 578,224    |
| Average sales price ( <i>per ton</i> )                  | \$ 33      | 40         | 45         | 45         | 40         |
| Pulpwood ( <i>tons</i> )                                | 390,200    | 458,938    | 416,390    | 297,694    | 235,365    |
| Average sales price ( <i>per ton</i> )                  | \$ 15      | 13         | 8          | 9          | 7          |
| Timberland sales                                        |            |            |            |            |            |
| Acres sold                                              | 5,062      | 893        | 200        | 45         | 1,150      |
| Average sales price ( <i>per acre</i> )                 | \$ 1,800   | 1,700      | 1,400      | 5,300      | 1,200      |
| Mills                                                   |            |            |            |            |            |
| Production                                              |            |            |            |            |            |
| Annual capacity ( <i>MBF</i> ) <sup>1</sup>             | 390,000    | 390,000    | 390,000    | 350,000    | 300,000    |
| Finished lumber ( <i>MBF</i> )                          | 245,858    | 212,888    | 253,135    | 265,429    | 223,612    |
| Pine chips ( <i>tons</i> )                              | 341,296    | 271,725    | 324,220    | 381,835    | 326,315    |
| Lumber sales ( <i>MBF</i> )                             | 254,590    | 218,188    | 262,726    | 276,048    | 229,407    |
| Average sales price ( <i>per MBF</i> )                  | \$ 277     | 293        | 324        | 369        | 365        |
| Mill margin ( <i>per MBF</i> )                          | \$ (19)    | (14)       | (20)       | 23         | 29         |
| Real Estate                                             |            |            |            |            |            |
| Residential lots sold                                   | 39         | 81         | 116        | 249        | 290        |
| Average sales price ( <i>per lot</i> )                  | \$ 77,800  | 89,500     | 103,800    | 78,600     | 72,900     |
| Commercial acres sold                                   | –          | 26.0       | 54.9       | 5.7        | 4.2        |
| Average sales price ( <i>per acre</i> )                 | \$ –       | 240,600    | 248,400    | 945,800    | 226,200    |
| Undeveloped acres sold                                  | –          | 680.1      | –          | 6.7        | 94.0       |
| Average sales price ( <i>per acre</i> )                 | \$ –       | 12,000     | –          | 64,000     | 27,700     |

## Stockholder and Employee Data<sup>1</sup>

|                                                |        |        |        |        |        |
|------------------------------------------------|--------|--------|--------|--------|--------|
| Common shares outstanding ( <i>thousands</i> ) | 12,402 | 12,388 | 12,425 | 12,315 | 12,208 |
| Number of stockholders of record               | 1,080  | 1,163  | 1,215  | 1,303  | 1,539  |
| Number of employees                            | 469    | 464    | 466    | 479    | 515    |

<sup>1</sup> At December 31

<sup>2</sup> Includes intersegment transfers at market prices

# DIRECTORS AND OFFICERS

## Board of Directors



**Robert C. Nolan (1)**  
*Chairman*  
Deltic Timber Corporation  
El Dorado, AR / Director since 1996



**Ray C. Dillon (1)**  
*President and Chief Executive Officer*  
Deltic Timber Corporation  
El Dorado, AR / Director since 2003



**Randolph C. Coley (2) (3)**  
*Partner*  
King & Spalding, LLP  
Houston, TX / Director since 2007



**The Reverend Cannon  
Christoph Keller, III (3) (4)**  
*Episcopal Priest*  
Little Rock, AR / Director since 1996



**David L. Lemmon (2) (4)**  
*President and Chief Executive Officer, Retired*  
Colonial Pipeline  
Las Vegas, NV / Director since 2007



**R. Madison Murphy (1) (3) (4)**  
*Managing Member*  
Murphy Family Management, LLC  
El Dorado, AR / Director since 1996



**R. Hunter Pierson, Jr. (2) (4)**  
*Private Investor*  
Timberland, commercial real estate,  
and securities  
New Orleans, LA / Director since 1999



**J. Thurston Roach (1) (2) (3)**  
*Retired Executive and Private Investor*  
Seattle, WA / Director since 2000



**Robert Tudor, III (4)**  
*Managing Partner*  
Tudor, Pickering & Company  
Houston, TX / Director since 2007

### Committees of the Board

- (1) Member of the Executive Committee  
*Chaired by Mr. Nolan*
- (2) Member of the Audit Committee  
*Chaired by Mr. Roach*
- (3) Member of the Nominating and Corporate Governance Committee  
*Chaired by Reverend Keller*
- (4) Member of the Executive Compensation Committee  
*Chaired by Mr. Murphy*

## Company Officers

### **Ray C. Dillon**

President and Chief Executive Officer

### **Kenneth D. Mann**

Vice President, Treasurer, and Chief Financial Officer

### **Phillip A. Pesek**

Vice President, General Counsel, and Secretary

### **Kent L. Streeter**

Vice President, Operations

### **David V. Meghreblian**

Vice President, Real Estate

### **Byrom L. Walker**

Controller



UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

**FORM 10-K**

(Mark One)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the fiscal year ended **December 31, 2008**

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

Commission file number **1-12147**

**DELTIC TIMBER CORPORATION**

(Exact name of registrant as specified in its charter)

|                                                                                                      |                                                       |
|------------------------------------------------------------------------------------------------------|-------------------------------------------------------|
| Delaware<br>(State or other jurisdiction of incorporation or organization)                           | 71-0795870<br>(I.R.S. Employer Identification Number) |
| 210 East Elm Street, P. O. Box 7200, El Dorado, Arkansas<br>(Address of principal executive offices) | 71731-7200<br>(Zip Code)                              |

Registrant's telephone number, including area code: (870) 881-9400

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

| Title of each class                                                  | Name of each exchange on which registered |
|----------------------------------------------------------------------|-------------------------------------------|
| Common Stock, \$.01 Par Value                                        | New York Stock Exchange, Inc.             |
| Series A Participating Cumulative<br>Preferred Stock Purchase Rights | New York Stock Exchange, Inc.             |

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

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

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

|                         |                                                                      |                           |                                     |
|-------------------------|----------------------------------------------------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/>                                             | Accelerated filer         | <input checked="" type="checkbox"/> |
| Non-accelerated filer   | <input type="checkbox"/> (Do not check if a small reporting company) | Smaller reporting company | <input type="checkbox"/>            |

Indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based on the closing price of the Common Stock on the New York Stock Exchange as of June 30, 2008, was \$256,713,208. For purposes of this computation, all officers, directors, and 5% beneficial owners of the registrant (as indicated in Item 12) are deemed to be affiliates. Such determination should not be deemed an admission that such directors, officers, or 5% beneficial owners are, in fact, affiliates of the registrant.

Number of shares of Common Stock, \$.01 Par Value, outstanding at February 13, 2009, was 12,395,913.

Documents incorporated by reference:

The Registrant's definitive Proxy Statement relating to the Annual Meeting of Stockholders on April 23, 2009.

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## PART I

### Item 1. Business

#### Introduction

Deltic Timber Corporation (“Deltic” or the “Company”) is a natural resources company engaged primarily in the growing and harvesting of timber and the manufacture and marketing of lumber. Deltic owns approximately 438,600 acres of timberland, primarily in Arkansas and north Louisiana. The Company's sawmill operations are located at Ola in central Arkansas (the “Ola Mill”) and at Waldo in south Arkansas (the “Waldo Mill”). In addition to its timber and lumber operations, the Company is engaged in real estate development in central Arkansas. The Company also holds a 50 percent interest in Del-Tin Fiber L.L.C. (“Del-Tin Fiber”), a joint venture to manufacture and market medium density fiberboard (“MDF”). Deltic is a calendar-year company for both financial and income tax reporting.

The Company is organized into four segments: (1) Woodlands, which manages all aspects of the Company's timberlands including harvesting and sale of timber, timberland sales and acquisitions, oil and gas mineral revenue, and hunting land leases; (2) Mills, which consists of Deltic's two sawmills that manufacture a variety of softwood lumber products; (3) Real Estate, which includes the Company's three active real estate developments and a related country club operation; and (4) Corporate, which consists of executive management, accounting, information systems, human resources, purchasing, treasury, income tax, and legal staff functions that provide support services to the operating business units. The Company currently does not allocate the cost of maintaining these support functions to its operating units.

The Company's timberlands consist primarily of Southern Pine, known in the industry as a type of “softwood”. Deltic considers its timberlands to be the Company's most valuable asset and the harvest of stumpage to be its most significant source of income; accordingly, Deltic actively manages its timberlands to increase productivity and maximize the long-term value of these timber assets. The Company harvests timber from the timberlands in accordance with its harvest plans and sells such timber in the domestic market or converts it to lumber in its sawmills. Stumpage supplied to the Company's sawmills is transferred at prices that approximate market in its operating area. The Company implemented a timberland acquisition program in late 1996. Thus far, the Company has focused its acquisition program on timberland in its current operating area. The Company also initiated a program in 1999 to identify, for possible sale, non-strategic timberland and higher and better use lands.

The Company's two sawmills employ modern technology in order to improve efficiency, reduce labor costs, maximize utilization of the timber resource, and maintain high standards for production quality with safety being one of the highest priorities. In addition, each mill is strategically located near significant portions of the Company's timberlands. The mills can produce a variety of lumber products, including dimension lumber, boards, and timbers. These lumber products are sold primarily to wholesale distributors, lumber treaters, and truss manufacturers in the South and Midwest and are used mainly in residential construction, roof trusses, and laminated beams. Combined annual permitted capacity of the two mills at December 31, 2008, was 390 million board feet (“MMBF”). The Company's total finished lumber production was 246 MMBF in 2008 compared to 213 MMBF in 2007 and 253 MMBF in 2006.

The Company's real estate operations were started in 1985 to add value to higher and better use timberland strategically located in the growth corridor of west Little Rock, Arkansas. Since that time, the Company has been developing Chenal Valley, a premier planned community consisting of 4,700 acres of residential and commercial properties. The property is being developed in stages, and real estate sales to-date have consisted primarily of residential lots, which are sold to builders or individuals, and commercial sites. In addition to Chenal Valley, Deltic has developed Chenal Downs, a 400-acre development located just outside Chenal Valley, and is developing Red Oak Ridge, an 800-acre development in Hot Springs, Arkansas. During 2007, the Company and Central Arkansas Water entered into a full and complete settlement of a pending condemnation litigation involving 680 acres of undeveloped real estate within the watershed of Lake

Maumelle in western Pulaski County, Arkansas. Approximately 640 acres were part of a planned development of the Company, which has since been suspended. (For additional information, See Note 21 – Commitments and Contingencies.)

The Del-Tin Fiber plant is located near El Dorado, Arkansas. Construction of the plant was completed, and initial production began, in 1998. The plant is designed to have an annual capacity of 150 million square feet (“MMSF”) on a 3/4 inch basis, making it one of the largest plants of its type in North America. MDF, which is used primarily in the furniture, flooring, store fixture, and molding industries, is manufactured from sawmill residuals such as chips, shavings, and sawdust, pressed and held together by an adhesive bond.

From the time production began at Del-Tin Fiber in 1998 until the fourth quarter of 2003, both operating and financial performance were below the expectations established at the time the decision to construct the plant was made. As a result, on April 25, 2002, Deltic announced that Banc One Capital Markets, Inc. had been retained as financial advisor to assist in the evaluation of strategic alternatives for the Company's investment in Del-Tin Fiber. Subsequently, Deltic's management and Board of Directors completed its review of these strategic alternatives and announced the Company intended to exit the MDF business upon the earliest and most reasonable opportunity provided by the market. As a result of this decision, the Company's evaluation of possible impairment of the carrying value of its investment in the joint-venture was based primarily upon the estimated cash flows from a sale of the Company's interest during 2003 and resulted in a determination that the Company's investment was impaired as of December 31, 2002. The investment was written off to zero.

Due to the Company's commitment to fund its share of any of the facility's operating working capital needs until the facility was able to consistently generate sufficient funds to meet its cash requirements or Deltic's ownership was sold, the Company recognized losses in Del-Tin Fiber equal to the extent of these advances during 2003. For the year of 2003, such advances approximated the Company's equity share of losses for the plant; accordingly, the investment in Del-Tin Fiber at December 31, 2003, was zero. The Company also continued to utilize its management resources to work with Del-Tin's management and the joint-venture partner to improve operating performance at the plant. As a result of these improvements, on December 11, 2003, Deltic's Board of Directors revised its intent regarding the Company's investment in Del-Tin Fiber and ceased efforts to sell the Company's interest in the joint venture, while continuing to focus on improving operating and financial results of the plant. Due to this decision, the 2003 evaluation of fair value for the investment was based primarily upon the future net cash flows from Del-Tin Fiber's operations over the remaining life of the plant. From 2004 through 2008, the Company has recorded its equity share of the operating results of the joint venture.

## **Forest Products Industry**

Deltic is primarily a wood products producer operating in a commodity-based business environment, with a major diversification in real estate development. This environment is affected by a number of factors, including general economic conditions, interest rates, availability and costs of credit, imports, foreign exchange rates, housing starts, unsold new and existing home inventories, home foreclosures, residential repair and remodeling, commercial construction, industry capacity and production levels, the availability of raw material, fuel cost, and weather conditions. The Mills segments have been affected by the decreased number of housing starts in the U.S., which declined to its lowest level in 50 years. Several factors influencing the decrease were stricter lending practices brought about by subprime loan failures, construction loan delinquencies that are causing lenders to tighten credit for new developments, increased new and existing home inventory levels, and economic concerns with the U.S. economy and overall weakness in the banking industry. Consequently, the demand and pricing level for softwood lumber products have steadily declined for the past three years.

Lumber prices have historically been, and will remain, volatile. Sawtimber prices have generally been more stable than lumber prices, but have seen price reductions due to the closure of several mills in Deltic's operating area.

The southern U.S., in which all of the Company's operations are located, is a major timber and lumber producing region. There are an estimated 215 million acres of forestland in the region, of which approximately 97 million acres contain softwood, predominately Southern Pine. Unlike other major timber-producing areas in North America, most of this acreage is privately held. The estimated breakdown of ownership of softwood timberland in the southern U.S. is 88 percent private, six percent national forest, and six percent other public. Although there can be no assurance, management anticipates that the southern U.S. timber resource will be subject to strong demand for the foreseeable future and also believes that the South will have a strategic advantage over other U.S. timber-producing regions due to regulatory, geographic, and other factors.

## Woodlands

The Company owns approximately 438,600 acres of timberland, primarily in Arkansas and north Louisiana, stocked principally with Southern Pine. Management considers the timberlands to be Deltic's most valuable asset and the harvest of this stumpage to be the Company's most significant source of income.

The approximate breakdown of the Company's timberland acreage at year-end 2008 consisted of the following:

|                       | <u>Acres</u>   |
|-----------------------|----------------|
| Pine forest.....      | 184,000        |
| Pine plantation ..... | 191,000        |
| Hardwood forest.....  | 20,000         |
| Other .....           | <u>43,600</u>  |
| Total .....           | <u>438,600</u> |

The Company's timberlands are well diversified by age class. The timberland classified as pine forest is primarily managed on an all-aged basis and contains mature timber that is ready to be harvested over the next several years and includes stream-management zones. Pine plantations are primarily less than 30 years old, with the majority ranging in age from 5 to 25 years. At the approximate age of 20 years, pine plantations begin building a significant amount of pine sawtimber tonnage.

*Timber Inventory.* The Company's estimated standing timber inventory is calculated for each tract by utilizing growth formulas based on representative sample tracts and tree counts for various diameter classifications. The calculation of pine inventory is subject to periodic adjustments based on sample cruises and actual volumes harvested. The hardwood inventory shown in the following table is only an approximation; therefore, the physical quantity of such timber may vary significantly from this approximation. Estimated inventory of standing timber as of December 31, 2008, consisted of the following:

|                 | <u>Estimated<br/>Volume<br/>(Tons)</u> |
|-----------------|----------------------------------------|
| Pine timber     |                                        |
| Sawtimber ..... | 11,567,000                             |
| Pulpwood .....  | 4,568,000                              |
| Hardwood timber |                                        |
| Sawtimber ..... | 1,682,000                              |
| Pulpwood .....  | 994,000                                |

The Company's pine sawtimber is either used in its sawmills or sold to third parties. Over the past few years, the annual harvest has been used primarily in the Company's Mills segment. Products that can be manufactured from this resource include dimension lumber, boards, timbers, and decking, used primarily in residential construction. Deltic's hardwood sawtimber is sold to third parties and is primarily used in the production of railroad ties, flooring, and pallets. Pulpwood consists of logs with a diameter of less than nine inches. Both pine and hardwood pulpwood are sold to third parties for use primarily in the manufacture of paper.

*Timber Growth.* Timber growth rate is an important variable for forest products companies since it ultimately determines how much timber can be harvested on a sustainable basis. A higher growth rate permits larger annual harvests as replacement timber regenerates. Growth rates vary depending on species, location, age, and forestry management practices. The growth rate, net of mortality, for Deltic's Southern Pine averages five to six percent of standing inventory per annum. The Company considers a 30 to 35 year rotation optimal for most pine plantations.

*Timberland Management.* Forestry practices vary by geographic region and depend on factors such as soil productivity, weather, terrain, and timber species, size, age, and stocking. The Company actively manages its timberlands based on these factors and other relevant information to increase productivity and maximize the long-term value of its timber assets. In general, the Company's timberland management involves harvesting and thinning operations, reforestation, cull timber removal programs, and the introduction of genetically improved seedlings.

Deltic has developed and operates its own seed orchard. Seeds from the orchard are grown by third parties to produce genetically improved seedlings for planting. These seedlings are developed through selective cross-pollination to produce trees with preferred characteristics, including higher growth rates, fewer limbs, straighter trunks, and greater resistance to disease. However, this process does not involve genetic engineering. The seedlings are planted in all-aged stands, or a site is completely replanted in the case of a final harvest of mature stands. During 2008, about 17,000 acres were planted, primarily using seedlings grown from seeds produced at the orchard facility, with another approximately 6,500 acres scheduled to be planted in 2009 as the Company continues to reforest understocked tracts. The Company meets or exceeds, in all material respects, the reforestation recommendations of the Arkansas Forestry Commission's Best Management Practices. In addition, the Company has been certified under the Sustainable Forestry Initiative ("SFI") program with regards to its timberland management practices.

The Company actively utilizes commercial thinning practices. Thinning operations consist of the selective removal of trees within a stand, usually a plantation, and improve overall productivity by enhancing the growth of the remaining trees while generating revenues.

The Company's silviculture program is designed to control undesirable, competitive vegetation in its forests and to increase pine growth rates and reproduction. Deltic treated about 18,000 acres, 13,400 acres, and 13,000 acres under this program in 2008, 2007, and 2006, respectively.

*Harvest Plans.* Management views the timberlands as assets with substantial inherent value apart from the sawmills and intends to manage the timberlands on a basis that permits regeneration of the timberlands over time. The Company intends to continue to manage the timberlands on a sustainable-yield basis and has no plans to harvest timber on an ongoing basis at levels that would diminish its timber inventory. In 2008, the Company harvested 579,770 tons of pine sawtimber from its timberlands. Under the current plan, Deltic intends to harvest approximately 575,000 tons of pine sawtimber in 2009.

The Company's harvest plans are generally designed to project multi-year harvest schedules. In addition, harvest plans are updated at least annually and reviewed on a monthly basis to monitor performance and to make any necessary modifications to the plans in response to changing forestry conditions, market conditions, contractual obligations, regulatory limitations, and other relevant factors.

Since harvest plans are based on projections of demand, price, availability of timber from other sources, and other factors that may be outside of the Company's control, actual harvesting levels may vary.

Management believes that the Company's harvest plans are sufficiently flexible to permit modification in response to fluctuations in the markets for logs and lumber.

*Access.* Substantially all of the timberlands are accessible by a system of low impact and low maintenance roads. Deltic generally uses third-party road crews to conduct construction and maintenance of these roads, and the Company regularly exchanges access easements and cooperates with other area forest products companies and the U.S. Forest Service.

*Wildlife Management.* The Company has an active wildlife management program for its properties. Deltic leased approximately 427,000, 420,000, and 422,000 acres to hunting clubs in 2008, 2007, and 2006, respectively. The Company's wildlife biologist conducts white-tail deer management clinics throughout Arkansas. In addition, Deltic cooperates with federal, state, and private agencies in various wildlife studies.

*Client-Land Management.* In addition to managing its own timberlands, Deltic also manages timberlands owned by others under management contracts with one-year renewable terms. This program provided harvest planning, silvicultural improvements, and maintenance work for approximately 67,600 acres in 2008.

*Timberland Acquisitions.* The Company implemented a timberland acquisition program in late 1996. This ongoing program is designed to enable the Company to continue to increase harvest levels, while expanding its timber inventory. In addition, it will allow the Company to maintain or increase the volume of logs supplied to its sawmills from its own timberlands, when economically feasible.

The Company intends to continue to focus its acquisition program on timberlands that range from fully-stocked to cutover tracts. Unlike other timber-producing areas of North America, most of the timberland in the southern U.S. is privately held, making it potentially available for acquisition. There can be no assurance that timber properties suitable for acquisition will be identified by the Company, or that once identified, such properties will ultimately be acquired by the Company.

Deltic formed an acquisition team to implement its timberland acquisition program. Lands considered for purchase are evaluated based on location, site index, timber stocking, and growth potential. Approximately 130,000 acres of strategically located pine timberlands have been added since the inception of the program. Individual land purchases have ranged from three acres to 21,700 acres.

*Land Sales.* In 1999, the Company initiated a program to identify for possible sale non-strategic timberlands and higher and better use lands. Sales totaled 3,315 acres in 2001; 3,418 acres in 2002; 4,130 acres in 2003; 1,150 acres in 2004; 45 acres in 2005; 40 acres in 2006; 893 acres in 2007; and 5,062 acres in 2008.

*Leasing.* The Company also generates revenue from the leasing of hunting, oil and gas, and other rights on its timberlands. For the years ended 2008, 2007, and 2006, the Company had hunting lease revenues totaling \$1,782,000, \$1,695,000, and \$1,599,000, respectively. During 2008, 2007, and 2006, the Company had leased net mineral acres of approximately 39,500, 37,600, and 30,700 acres, respectively, and recorded oil and gas lease revenues of \$1,977,000, \$1,352,000, and \$918,000, respectively.

*Royalty Income.* The Company receives royalty income from oil and gas leases once production begins on leased mineral acres. For the years ended 2008, 2007, and 2006, Deltic earned \$1,566,000, \$260,000, and \$196,000, respectively from oil and gas royalties.

## **Mills**

The Company's two sawmills are located at Ola in central Arkansas and at Waldo in south Arkansas, near significant portions of the timberlands. The mills employ modern technology in order to improve efficiency, reduce labor costs, maximize utilization of the timber resource, and maintain high quality standards of production with safety being one of the highest priorities. Logs processed into lumber are obtained from the

Company's timberlands and from public and private landowners. The Company selects logs for processing in its mills based on size, grade, and the prevailing market price. The Ola Mill is equipped for maximum utilization of smaller diameter logs, while the Waldo Mill can process both smaller and larger diameter logs. The mills produce a variety of softwood lumber products, including dimension lumber, boards, and timbers. The lumber is sold primarily to wholesale distributors, lumber treaters, and truss manufacturers in the South and Midwest and is used in residential construction, roof trusses, and laminated beams.

Combined permitted annual production capacity of the two mills is 390 MMBF at year-end 2008 following the completion of upgrades at both mills. The Company's lumber output increased during 2008, with production totaling 246 MMBF compared to 213 MMBF in 2007. The low volume in 2007 was due primarily to a fire that occurred in the planer section at the Company's Waldo Mill on August 9, 2007. The mill was shut down while repairs were made, but was fully operational in late October 2007. (For additional information, see Note 20 – Business Interruption and Involuntary Conversion.) With the softwood lumber market on the decline since 2006, the Company has closely managed production, focusing on increasing efficiencies, and reducing controllable manufacturing cost.

*Capital Projects.* Deltic has invested significant capital in its sawmills in recent years to increase production capacity and efficiency, decrease costs, and expand the product mix. Major capital projects completed at the Ola Mill over the past several years include: (1) installation of a curve-sawing gang and double-length infeed to improve log recovery, increase hourly output, and expand product mix; (2) the installation of an optimized edger system to increase lumber recovery; (3) replacement of the planer mill with a high-speed planer mill and automated sorting system to increase mill output; (4) construction of a small log processing system which allows for the efficient usage of small diameter logs, thus reducing average log costs; (5) addition of a boiler system and steam dry kilns to increase mill capacity and provide the capability to produce higher value lumber; (6) expansion of log storage capacity; (7) redesign and rebuild of the sawmill primary breakdown processing equipment to improve the infeed of logs and overall flow of green lumber; (8) installation of a stick laying stacker to improve lumber drying quality and reduce labor cost; (9) gang control upgrade to improve operating efficiencies; (10) safety improvements including upgrades to the planer blow system; and (11) installation of a new log bucking deck to improve log recovery and increase throughput capacity.

At the Waldo Mill, major capital projects completed over the past several years include: (1) installation of a curve-sawing gang to improve log recovery, increase hourly output, and expand product mix; (2) installation of a new edger and optimizer to improve recovery; (3) installation of a log optimization system to improve lumber recovery; (4) extension of the green lumber sorter to increase sawmill throughput; (5) replacement of the planer that was destroyed by fire in August 2007; (6) installation of a second log debarker in order to further improve hourly throughput capability; (7) addition of a boiler and an upgrade of the lumber drying kilns to increase the mill's lumber drying capacity; (8) addition of an automatic stick-laying system and stacker/package maker; (9) installation of a new planer hog system to move scrap material away from the planer mill more efficiently and to allow for increased throughput of finished lumber; and (10) various safety improvements including upgrades to planer blow system.

*Raw Materials.* In 2008, the Company's two sawmills processed 1,105,944 tons of logs, either obtained from the timberlands or purchased from public and private landowners. The timberlands supplied 54 percent, or 597,721 tons, of the mills' raw material receipt requirements, while the mills obtained 99 percent of the 579,770 tons of pine sawtimber harvested from the timberlands.

Various factors, including environmental and endangered species concerns, have limited, and will likely continue to limit, the amount of timber offered for sale by U.S. government agencies. Because of this reduced availability of federal timber for harvesting, the Company believes that its supply of timber from the timberlands is a significant competitive advantage. Deltic has historically supplied a significant portion of the timber processed in the sawmills from its timberlands.

In order to operate its sawmills economically, the Company relies on purchases of timber from third parties to supplement timber harvests from its own timberlands. The Company has an active timber procurement function for each of its sawmills. As of December 31, 2008, the Company had under contract

107,207 tons of timber on land owned by other parties, including the U.S. Forest Service, which is expected to be harvested over the next three years. During 2008, the Company harvested third-party stumpage and purchased logs from third parties totaling 539,020 tons. Of this volume, purchases from the U.S. Forest Service represented 12 percent. The balance of such purchased volume was acquired from private lands.

Due to the closure of several mills which were in close proximity to the Company's mills, there has been a higher availability of privately owned pine timber at lower stumpage prices due to the decreased demand. As a result, Deltic's sources of private timber are many and diverse. The key factors in a landowner's determination of whether to sell timber to the Company are price, the Company's relationships with logging contractors, and the ability of the Company to demonstrate the quality of its logging practices to landowners. As a result, a landowner will be more likely to sell timber to a forest products company whose own land has been responsibly managed and harvested. There is a substantial amount of other private timber acreage in proximity to each of Deltic's sawmills.

*Residual Wood Products.* The Company pursues waste minimization practices at both of its sawmills. Wood chips are usually sold to paper mills, wood shavings and chips are usually sold to Del-Tin Fiber, and bark is frequently sold for use as fuel. Bark, sawdust, shavings, and wood chips that cannot be sold are used as "hog fuel" to fire the boilers that heat the drying kilns. The Company expects to continue to sell a significant portion of its Waldo Mill's residual wood shavings and chip production to Del-Tin Fiber pursuant to a fiber supply agreement which is renegotiated annually.

*Transportation.* Each mill facility has the capability to ship its lumber by truck or rail.

*Cyclical Market.* While the cyclical nature of the lumber market may occasionally require the interruption of operations at one or both of the Company's sawmills, suspension of milling activities is unusual. Management is not currently anticipating any interruption of operations at either of Deltic's sawmills, but no assurance can be given that market conditions or other factors will not render such an action economically advisable in the future.

## **Real Estate**

The Company's real estate operations were started in 1985 to add value to former timberland strategically located in the growth corridor of west Little Rock, Arkansas. Development activities began with the construction of Chenal Ridge, the initial, 85-lot neighborhood in Chenal Valley on the western edge of the Little Rock city limits in 1985. Since that time the Company has been developing the remainder of Chenal Valley, a premier planned community, centered around two Robert Trent Jones, Jr. designed championship golf courses with approximately 4,700 acres of residential and commercial properties. The first golf course was completed in 1990. Construction of the second course began in 2001, and was opened for play in the summer of 2003. The property has been developed in stages, and real estate sales to date have consisted primarily of residential lots sold to builders or individuals and commercial tracts. In addition to Chenal Valley, Deltic has developed Chenal Downs, located just outside of Chenal Valley, and is developing Red Oak Ridge, in Hot Springs, Arkansas. Chenal Downs is a 400-acre equestrian development with controlled access, featuring secluded, five-acre lots. Red Oak Ridge, Deltic's first development outside the Little Rock area, is an 800-acre upscale community designed for residential, resort, or retirement living. During 2007, the Company and Central Arkansas Water entered into a full and complete settlement of a pending condemnation litigation involving 680 acres of undeveloped real estate within the watershed of Lake Maumelle in western Pulaski County, Arkansas. Approximately 640 acres were part of a planned development of the Company that has since been suspended. (For additional information See Note 21 – Commitments and Contingencies.)

Chenal Valley is a premier upscale residential and commercial development in the Little Rock real estate market. All developed acreage in Chenal Valley has been annexed by the City of Little Rock. Red Oak Ridge has been similarly annexed by the City of Hot Springs. Chenal Downs is located just outside the Little Rock city limits.

*Residential Development.* Lots were offered for sale in Chenal Valley during the second half of 1986 with closings beginning in 1987. As of December 31, 2008, 2,676 lots have been developed in 32 neighborhoods and 2,501 lots have been sold, with about 2,282 residences constructed or under construction. When fully developed, Chenal Valley will include approximately 4,600 single-family residences. However, the actual number of residences in Chenal Valley will depend on final land usages and lot densities. The Company has developed lots in a wide variety of market segments. Lot size has ranged from 0.2 acres to 2.25 acres, and lot price has ranged from \$25,000 per lot to over \$335,000 per lot.

The first phase of Chenal Downs was opened in December 1997, followed by a second phase in November 2000. By the end of 2008, 63 of the 76 developed lots were sold. Lot prices in Chenal Downs range from \$89,000 to approximately \$187,000. In Red Oak Ridge, the first two neighborhoods were offered for sale in 1998, with a third neighborhood offered in late 2005. These neighborhoods offer a choice of either estate-sized homesites, many of which overlook one of two Deltic-constructed lakes, or garden-home lots. As of the end of 2008, 81 of the 135 lots offered have been sold, and prices for lots currently offered range from about \$30,000 to almost \$183,000.

*Commercial Development.* Commercial development in Chenal Valley began with the construction of a Company-owned, 50,000-square-foot office building, which was sold during 2000. Commercial activity to-date has consisted of the sale of approximately 300 acres, including 55 acres in 2006, 26 acres in 2007, and no acres in 2008. Commercial property sales to-date have consisted of retail store locations, an office building constructed by the Company on a nine-acre site, multi-family residence sites, convenience store locations, a bank office building site, a site for a 38-acre open-air shopping center, and outparcels surrounding a retail center constructed and owned by the Company. Under current development plans, Chenal Valley will include approximately 900 acres of commercial property when fully developed.

In 2006, the Company sold approximately 38 acres to RED Development LLC for the development of "The Promenade at Chenal", an upscale lifestyle shopping center. Construction of "The Promenade at Chenal" began in 2007 and was completed in May 2008. This project is expected to further increase interest in the Company's additional 135 acres of commercially-zoned property adjacent to the site.

The 1998 completion of construction of the initial section of Rahling Road, a major connector street to Chenal Parkway, provided greater access to Chenal Valley's commercial acreage. Located at the center of this commercial property is a Company-owned 35,000-square-foot retail center. The retail center was completed in early 2000 and offers retail space for lease. The center is surrounded by 16 outparcels, ranging in size from 0.2 to 1.8 acres. To-date, 11 of these outparcels have been sold.

No commercial acreage is included in Chenal Downs and Red Oak Ridge is planned to include a small amount of commercial property. The Company will begin to develop and offer commercial sites as population density increases.

*Infrastructure.* Infrastructure and other improvements to support the development and sale of residential and commercial property are funded directly by the Company and/or through real property improvement districts. Such properties are developed only when sufficient demand exists and substantially all infrastructure is completed. Future infrastructure investments are primarily for the development and sale of additional property.

*Development Amenities.* In connection with its Chenal Valley development, the Company developed Chenal Country Club, consisting of the earlier-described golf courses, a clubhouse, and related facilities for use by club members. Since its original construction, Deltic has undertaken substantial remodeling and expansion of the clubhouse as the club membership level has increased. In addition, the Company has built three community parks within the Chenal Valley development for the benefit of the residents of the developed residential areas.

Chenal Downs has been developed around an equestrian center, consisting of stables and a training facility, and also includes bridle trails throughout the development. Red Oak Ridge's primary amenities currently consist of two lakes and a community park constructed by the Company.

*Home Construction.* Historically, the Company's focus with regards to residential real estate development has been on lot development only. However, Deltic has constructed a limited number of speculative homes within its Red Oak Ridge development located in Hot Springs, Arkansas.

*Future Development.* A number of factors have added significant value to the undeveloped portion of Chenal Valley. Such factors include: (1) the overall success of Chenal Valley as a residential development and its image as one of the premier developments in central Arkansas, (2) the continued westward growth of Little Rock, (3) the Company's investment in infrastructure in the area, and (4) the established residential base which is now large enough to support commercial development. Management expects the undeveloped portion of Chenal Valley to provide growth and development opportunities in the future.

Chenal Downs has been fully developed, but development of Red Oak Ridge is in the early stages, currently consisting of two man-made lakes as the core amenity, initial infrastructure placement, and the first three of several planned neighborhoods.

Continued development in the Highway 10 growth corridor of west Little Rock has significantly affected land values in the area, and is expected to create real estate development opportunities for the Company's approximately 57,000 mostly contiguous acres located two miles west of Chenal Valley.

*Undeveloped Acreage.* The success of Chenal Valley has increased the value of the Company's undeveloped real estate surrounding and within the development. Sales of undeveloped real estate amounted to no acres in 2006, 680 acres in 2007, and no acres in 2008.

## **Del-Tin Fiber**

Deltic owns 50 percent of the membership interest of Del-Tin Fiber, a joint venture to manufacture and market MDF. The Del-Tin Fiber plant is located near El Dorado, Arkansas. Construction of the plant was completed, and initial production began, in 1998. The plant is designed to have an annual capacity of 150 million square feet ("MMSF"), on a 3/4-inch basis, making it one of the largest plants of its type in North America.

From the time production began at Del-Tin Fiber in 1998 until the fourth quarter of 2003, both operating and financial performances were below the expectations established at the time that the decision to construct the plant was made. As a result, on April 25, 2002, Deltic announced that Banc One Capital Markets, Inc. had been retained as financial advisor to assist in the evaluation of strategic alternatives for the Company's investment in Del-Tin Fiber. Subsequently, Deltic's management and Board of Directors completed its review of these strategic alternatives and announced the Company intended to exit the MDF business upon the earliest and most reasonable opportunity provided by the market. As a result of this decision, the Company's evaluation of possible impairment of the carrying value of its investment in the joint-venture was based primarily upon the estimated cash flows from a sale of the Company's interest during 2003 and resulted in a determination that the Company's investment was impaired as of December 31, 2002. The investment was written off to zero.

Due to the Company's commitment to fund its share of any of the facility's operating working capital needs until the facility was able to consistently generate sufficient funds to meet its cash requirements or Deltic's ownership was sold, the Company recognized losses in Del-Tin Fiber equal to the extent of these advances during 2003. For the year of 2003, such advances approximated the Company's equity share of losses for the plant; accordingly, the investment in Del-Tin Fiber at December 31, 2003, was zero. The Company also continued to utilize its management resources to work with Del-Tin's management and the joint-venture partner to improve operating performance at the plant. As a result of these improvements, on December 11, 2003, Deltic's Board of Directors revised its intent regarding the Company's investment in Del-Tin Fiber and ceased efforts to sell the Company's interest in the joint venture, while continuing to focus on improving operating and financial results of the plant. Due to this decision, the 2003 evaluation of fair value for the investment was based primarily upon the future net cash flows from Del-Tin Fiber's operations over the

remaining life of the plant. Since 2004, the Company has recorded its equity share of the operating results of the joint venture.

*Medium Density Fiberboard.* MDF, which is used primarily in the furniture, laminate flooring, store fixture, and molding industries, is manufactured from sawmill residuals such as chips, shavings, and sawdust, pressed and held together by an adhesive bond. Although the technology has existed for decades, continued improvements in the manufacture of MDF have increased both the quality and market acceptance of the product. MDF, with its “real wood” appearance and the ability to be finely milled and accept a variety of finishes, competes primarily with lumber.

*Production.* The plant produced 115 MMSF of MDF in 2008 versus 117 MMSF of MDF in 2007 and 147 MMSF of MDF in 2006. Due to market conditions in 2008, plant production was reduced. Prior to 2003, start-up difficulties and operational problems with the plant's press and heat energy system limited production to levels significantly below capacity. The problems with the press were corrected in mid-1999. As natural gas prices escalated during the last half of 2000, the decision was made in late January 2001 to temporarily suspend operations until the heat energy system could be modified. Following completion of a capital project to modify this system, the plant resumed operations in June 2001. Rectification of the heat energy system has enabled the plant's operations to increase production levels closer to the plant's capacity of 150 MMSF per year, as market conditions improved. In addition, manufacturing cost per thousand square feet has decreased, as certain variable costs of manufacturing have been lowered and fixed costs for the facility are being allocated to the increased production.

*Raw Materials.* The Del-Tin plant provides an additional outlet for wood chip production from the Waldo Mill. Pursuant to a fiber supply agreement which is renegotiated annually, the Company has agreed to sell, and Del-Tin Fiber to buy, a substantial amount of residual shavings and wood chips from the Waldo Mill. In addition, Del-Tin Fiber has an option to purchase residual wood chips from the Ola Mill. During 2008, 2007, and 2006, Deltic sold approximately \$4,593,000, \$3,772,000, and \$3,939,000, respectively, of these lumber manufacturing by-products to Del-Tin Fiber.

## **Products and Competition**

The Company's principal forest products are timber, timberland, softwood lumber products (primarily finished lumber), residual wood products, and real estate.

*Timber.* Timber harvested from the timberlands is utilized by the Company's sawmills or sold to third parties. The Company's timber sales to third parties accounted for approximately five percent of consolidated net sales in 2008, eight percent in 2007, and six percent in 2006.

The Company competes in the domestic timber market with numerous private industrial and non-industrial land and timber owners. Competitive factors with respect to the domestic timber market generally include price, species and grade, proximity to wood manufacturing facilities, and accessibility.

*Land Sales.* Timberland sold by the Company to third parties consists of both non-strategic timberland, including hardwood bottomland suitable for recreational use, and lands with potential for higher and better use, and amounted to three percent of consolidated net sales in 2008, one percent in 2007, and less than one percent in 2006.

*Lumber Products.* The Company's sawmills produce a wide variety of products, including dimension lumber, boards, and timbers. Lumber is sold primarily to wholesaler distributors, lumber treaters, and truss manufacturers in the South and Midwest and is used in residential construction, roof trusses, and laminated beams. During 2008, 2007, and 2006 lumber sales as a percentage of consolidated net sales were approximately 54 percent, 50 percent, and 56 percent, respectively.

The forest products market is highly competitive with respect to price and quality of products. In particular, competition in the commodity-grade lumber market in which the Company competes is primarily

based on price. Deltic competes with other publicly held forest products companies operating in the U.S., many of which have significantly greater financial resources than the Company, as well as privately held lumber producers. The Company also competes with producers in Canada and overseas. In addition, Deltic's management expects the Company's products to experience additional increased competition from engineered wood products and other substitute products. Due to the geographic location of Deltic's timberlands and its high-quality timber, in addition to the Company's active timber management program, strategically located and efficient sawmill operations, and highly motivated workforce, Deltic has been able to compete effectively.

*Residual Wood Products.* The Company's sawmills produce wood chips, shavings, sawdust, and bark as by-products of the conversion process. During 2008, 2007, and 2006, sales of these residual products accounted for 13 percent, nine percent, and eight percent, respectively, of Deltic's consolidated net sales. Wood chips are the primary source of residual sales and are typically sold to Del-Tin Fiber or to paper mills. In 2008, Deltic's sawmills produced 341,296 tons of wood chips. The Company expects to continue to sell a significant portion of its wood chip production to Del-Tin Fiber for use in the production of MDF.

*Real Estate.* The Company develops and markets residential lots and commercial sites. Deltic generally provides the supporting infrastructure. Residential lots are sold to homebuilders and individuals, while commercial sites are sold to developers and businesses. The Company also sells undeveloped acreage. During 2008, 2007, and 2006, the sales of residential lots, commercial sites, and undeveloped acreage as a percentage of consolidated net sales were two percent, 17 percent, and 17 percent, respectively. The sale of commercial property can have a significant impact on the Company's sales, but is unpredictable and irregular.

## **Seasonality**

The Company's operating segments are subject to variances in financial results due to several seasonal factors. The majority of timber sales are typically generated in the first half of the year due primarily to weather conditions and historically stronger timber prices. Increased housing starts during the spring usually push lumber prices up. Forestry operations generally incur expenses related to silvicultural treatments, which are applied during the fall season to achieve maximum effectiveness.

## **Business Segment Data**

Information concerning net sales, operating income, and identifiable assets attributable to each of the Company's business segments is set forth in Item 7, "Management's Discussion and Analysis"; and Note 22 to the consolidated financial statements in Item 8, "Financial Statements and Supplementary Data," of Part II of this report.

## **Environmental Matters**

The Company is subject to extensive and changing federal, state, and local environmental laws and regulations relating to the protection of human health and the environment, including laws relating to air and water emissions, the use of herbicides on timberlands, regulation of "wetlands", and the protection of endangered species. Environmental legislation and regulations, and the interpretation and enforcement thereof, are expected to become increasingly stringent. The Company has made, and will continue to make, expenditures to comply with such requirements in the ordinary course of its operations. Historically, these expenditures have not been material and the Company expects that this will continue to be the case. Liability under certain environmental regulations may be imposed without regard to fault or the legality of the original actions, and may be joint and several with other responsible parties. As a result, in addition to ongoing compliance costs, the Company may be subject to liability for activities undertaken on its properties prior to its ownership or operation and by third parties, including tenants. The Company is not involved with any such sites as of this time. The Company leases the rights to drill for oil and gas on some of its lands to third parties.

Pursuant to these leases, the lessee indemnifies the Company from environmental liability relating to the lessee's operations. Based on its present knowledge, including the fact the Company is not currently aware of any facts that indicate the Company will be required to incur any material costs relating to environmental matters, and currently applicable laws and regulations, the Company believes environmental matters are not likely to have a material adverse effect on the Company's financial condition, results of operations, or liquidity.

In addition, the federal "Endangered Species Act" protects species threatened with possible extinction and restricts timber harvesting activities on private and federal lands. Certain of the Company's timberlands are subject to such restrictions due to the presence on the lands of the red-cockaded woodpecker, a species protected under the Act. There can be no assurance that the presence of this species or the discovery of other protected species will not subject the Company to future harvesting restrictions. However, based on the Company's knowledge of its timberlands, the Company does not believe that its ability to harvest its timberlands will be materially adversely effected by the protection of endangered species.

### **Access to SEC Filings**

The Company maintains an internet website at [www.deltic.com](http://www.deltic.com). The Company makes available free of charge under the Investor Relations section of its website its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to any of those reports and other filings, as soon as reasonably practicable after providing such reports to the Securities and Exchange Commission.

### **Employees**

As of January 31, 2009, the Company had 466 employees.

## Item 1A. Risk Factors

### *Cyclical nature of Forest Products Industry*

The Company's results of operations are, and will continue to be, affected by the cyclical nature of the forest products industry. Prices and demand for logs and manufactured wood products have been, and in the future can be expected to be, subject to cyclical fluctuations. The demand for logs and lumber is primarily affected by the level of new residential construction activity, which activity is subject to fluctuations due to changes in economic conditions, availability and cost of financing for developers, mortgage interest rates, new and existing housing inventory levels, population growth, weather conditions and other factors. Decreases in the level of residential construction activity usually will be reflected in reduced demand for logs and lumber resulting in lower prices for the Company's products and lower revenues, profits, and cash flows. In addition to housing starts, demand for wood products is also significantly affected by repair and remodeling activities and industrial uses, demand for which has historically been less cyclical. Furthermore, changes in industry supply of timber have an effect on prices. Although the Company believes sales of timber by United States government agencies will remain at relatively low levels for the foreseeable future, any reversal of policy that substantially increase such sales could significantly reduce prices for logs and lumber, which could have a material adverse effect on the Company. Furthermore, increased imports from Canada and other foreign countries could reduce the prices the Company receives for its products.

### *Limitations on the Company's Ability to Harvest Timber*

Revenues from the Company's future operations will depend to a significant extent on its ability to harvest timber pursuant to its harvest plans from its 438,600 acres of timberlands (the "Timberlands"). Harvesting of the Timberlands may be affected by various natural factors, including damage by fire, insect infestation, disease, prolonged drought, severe weather conditions including ice storms and other causes. The effects of such natural disasters may be particularly damaging to young timber. To the extent possible, the Company implements measures to limit the risk of damage from such natural causes. The Company is a participant with state agencies and other timberland owners in cooperative fire fighting and fire surveillance programs. In addition, the Timberlands' extensive system of access roads and the physical separation of various tracts provide some protection against fire damage. Nonetheless, one or more major fires on the Timberlands could adversely affect Deltic's operating results. In addition, the Timberlands may also be affected by insect infestation, particularly by the southern pine beetle, and disease. Additionally, the Timberlands may be affected by severe weather conditions, especially ice storms, tornados, and heavy winds. Although damage from such natural causes usually is localized and affects only a limited percentage of the timber, there can be no assurance that any damage affecting the Timberlands will, in fact, be so limited. As is typical in the forest products industry, the Company does not maintain insurance coverage with respect to damage to the Timberlands. The Company does, however, maintain insurance for loss of logs due to fire and other occurrences following their receipt at the Company's sawmills.

### *Operation of Sawmills*

The Company's sawmills are located at Ola in central Arkansas and Waldo in southern Arkansas. The operations of the sawmills are dependent on various factors and there can be no assurance that the Company will be able to continue such operations at current levels of production or that suspension of such operations may not be required in the future. One such factor is the ability of the Company to procure sufficient logs at suitable prices. The Company obtains logs for its sawmills from the Timberlands, other private sources, and federal lands. As discussed above, prices for logs are cyclical and affected primarily by demand for lumber and other products produced from logs. Another such factor is the ability of the Company to find an outlet for the large volume of residual wood products that result from the milling process. The company currently markets such products to third parties for the production of paper and other uses. The Company sells a significant portion of its residual wood chips to Del-Tin Fiber L.L.C. ("Del-Tin"), a joint venture medium density fiberboard plant near El Dorado, Arkansas, in which the Company owns a 50-percent interest. In addition, the continued operation of the sawmills is subject generally to the risk of business interruption in the event of a fire or other natural disaster, regulatory actions, or other causes. The Company mitigates this risk through the procurement of casualty and business interruption insurance.

### *Del-Tin Fiber*

Deltic owns 50 percent of the membership interest of Del-Tin Fiber, a joint venture to manufacture and market MDF. The Del-Tin Fiber plant is located near El Dorado, Arkansas. Construction of the plant was completed, and initial production began, in 1998. From the time production began at Del-Tin Fiber until the fourth quarter of 2003, both operating and financial performances were below the expectations established at the time the decision to construct the plant was made. Contributions to Del-Tin Fiber by the Company through the third quarter of 2003 amounted to \$60.7 million. The operating and financial performance of the joint venture has improved significantly since 2004, when compared to prior years. These advances were the result of price improvements in the MDF market, product mix, and the Company's utilization of its management resources to work with Del-Tin's management and the joint-venture partner to improve operating performance at the plant. As a result, the impact of Del-Tin Fiber on the Company's results of operations and cash flows was significantly reduced during the years of 2004 through 2008. Although the Company remains focused on the efficient operations of the facility, changes in MDF prices or disruptions in manufacturing operations at the plant could impact the Company's results of operations and cash flows in future periods, as well as Deltic's ability to exit the MDF business if desired in the future.

### *Competition*

The forest products industry is highly competitive in terms of price and quality. The products of the Company are subject to increasing competition from a variety of non-wood and engineered wood products. In addition, the Company is subject to a potential increase in competition from lumber products and logs imported from foreign sources. Any significant increase in competitive pressures from substitute products or other domestic or foreign suppliers could have a material adverse effect on the Company.

### *Federal and State Environmental Regulations*

The Company is subject to extensive and changing federal, state, and local environmental laws and regulations relating to the protection of human health and the environment, the provisions and enforcement of which are expected to become more stringent in the future. The Company has made and will continue to make non-material expenditures to comply with such provisions. Based on currently available information, including the fact that the Company is not presently aware of any facts that indicate the Company will be required to incur any material costs relating to environmental matters, the Company believes environmental regulation will not materially adversely effect the Company, but there can be no assurances that environmental regulation will not have a material adverse effect on the financial condition, results of operations, or liquidity of the Company in the future.

### *Geographic Concentration and Risk Associated with Real Estate Development*

The Company's real estate development projects are located in central Arkansas, specifically, in and west of, Little Rock, Arkansas, and in Hot Springs, Arkansas. Accordingly, the Company's real estate operations are particularly vulnerable to any economic downturns or other adverse events that may occur in this region and to competition from nearby residential housing developments. The Company's results of operations may be affected by the cyclicity of the homebuilding and real estate industries generally. Factors include changes in general and local economic conditions, such as employment levels, consumer confidence and income, housing demand, new and existing housing inventory levels, availability and cost of financing, mortgage interest rates, and changes in government regulation regarding the environment, zoning, real estate taxes, and other local government fees.

### *Reliance on Key Personnel*

The Company believes that its continued success will depend in large part on its ability to attract and retain highly skilled and qualified personnel. The Company offers management incentives in a manner that are directly linked to the Company's performance, which the Company believes will facilitate the attraction, retention, and motivation of highly skilled and qualified personnel. In this regard, the Company has taken steps to retain its key personnel, including the provision of competitive employee benefit programs. Although the Company will seek to employ qualified individuals in the event that officers or other key employees of the Company cease to be associated with the Company, there can be no assurance that such individuals could be engaged by the Company.

### *Dividend Policy*

The Company currently intends to pay modest quarterly cash dividends. However, the Company anticipates that future earnings will, for the most part, be used to support operations and finance growth of the business. The payment of any dividends will be at the discretion of the Company's Board of Directors (the "Company Board"). The declaration of dividends and the amount thereof will depend on a number of factors, including the Company's financial condition, capital requirements, funds from operations, future business prospects, and such other factors as the Company Board may deem relevant, and no assurance can be given as to the timing or amount of any dividend payments.

### *Anti-Takeover Effects of Certain Statutory, Charter, Bylaw and Contractual Provisions*

Several provisions of the Company's Certificate of Incorporation and Bylaws and of the Delaware General Corporation Law could discourage potential acquisition proposals and could deter or delay unsolicited changes in control of the Company, including provisions creating a classified Board of Directors, limiting the stockholders' powers to remove directors, and prohibiting the taking of action by written consent in lieu of a stockholders' meeting. The preferred stock purchase rights attached to the Company's common stock could have similar anti-takeover effects. In addition, the Company's Board has the authority, without further action by the stockholders, to fix the rights and preferences of and to issue preferred stock. The issuance of preferred stock could adversely affect the voting power of the owners of Company's common stock, including the loss of voting control to others. Transactions subject to these restrictions will include, among other things, the liquidation of the Company, the merger, consolidation or other combination or affiliation of the Company with another company, discontinuance of or material change in the conduct of a material portion of its businesses independently and with its own employees, redemption or other reacquisition of Company's common stock, and the sale, distribution, or other disposition of assets of the Company out of the ordinary course of business.

These provisions and others that could be adopted in the future could discourage unsolicited acquisition proposals or delay or prevent changes in control or management of the Company, including transactions in which stockholders might otherwise receive a premium for their shares over then current market prices. In addition, these provisions could limit the ability of stockholders to approve transactions that they may deem to be in their best interests.

### *General Economic Conditions*

The recent deterioration of the global credit markets and general economic conditions could adversely affect the Company's access to capital. Financial and credit markets have been experiencing a period of turmoil that has included the failure, restructuring, or sale of various financial institutions and has led to an unprecedented level of intervention from the United States government. While it is difficult to predict the ultimate results of these events, they may impair the Company's ability to borrow money. Similarly, the Company's customers and suppliers ability to obtain financing could adversely affect its business if their ability to operate or fund transactions is impaired.

## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

The Company's properties, primarily located in Arkansas and north Louisiana, consist principally of fee timber and timberlands, purchased stumpage inventory, two sawmills, and residential and commercial real estate held for development and sale. As of December 31, 2008, the Company's gross investment in timber and timberlands; gross property, plant, and equipment; and investment in real estate held for development and sale consisted of the following:

|                                           |                   |
|-------------------------------------------|-------------------|
| (Thousands of dollars)                    |                   |
| Timberlands                               | \$ 85,524         |
| Fee timber and logging facilities         | 213,327           |
| Purchased stumpage inventory              | 2,277             |
| Real estate held for development and sale | 54,081            |
| Land and land improvements                | 5,319             |
| Buildings and structures                  | 10,722            |
| Machinery and equipment                   | <u>95,226</u>     |
|                                           | \$ <u>466,476</u> |

"Timberlands" consist of the historical cost of land on which fee timber is grown and related land acquisitions stated at acquisition cost. "Fee timber" consists of the historical cost of company standing timber inventory, including capitalized reforestation costs, and related timber acquisitions stated at acquisition cost. "Logging facilities" consist primarily of the costs of roads constructed and other land improvements. "Purchased stumpage inventory" consists of the purchase price paid for third-party timber, net of amounts harvested. "Real estate held for development and sale" consist primarily of the unamortized costs, including amenities, incurred to develop the real estate for sale and a retail center held for sale. "Land and land improvements" consist primarily of improvements at the Company's two sawmill locations. "Buildings and structures" and "Machinery and equipment" primarily consist of the sawmill buildings and equipment and the Company's two real estate sales offices.

The Company owns all of the properties discussed above. The Company's properties are not subject to mortgages or other forms of debt financing. (For further information on the location and type of the Company's properties, see the descriptions of the Company's operations in Item 1.)

## Item 3. Legal Proceedings

From time to time, the Company is involved in litigation incidental to its business. Currently, there are no material legal proceedings.

## Item 4. Submission of Matters to a Vote of Security Holders

None.

## **Executive Officers of the Registrant**

The age (at January 1, 2009), present corporate office, and length of service in office of each of the Company's executive officers and persons chosen to become officers are reported in the following listing. Executive officers are elected annually but may be removed from office at any time by the Board of Directors.

Ray C. Dillon - Age 53; President and Chief Executive Officer and a director of the Company effective July 1, 2003. Prior to joining the Company, Mr. Dillon was employed at Gaylord Container Corporation, where from April, 2000 through December, 2002, he was Executive Vice President, and preceding his election as Executive Vice President, he was Vice President, Primary Product Operations from April 1997.

Kenneth D. Mann - Age 49; Vice President, Treasurer, and Chief Financial Officer, effective May 1, 2007. From September 1, 2004 to April 30, 2007, Mr. Mann was Controller. From September 1, 2002, to September 2004, Mr. Mann was Manager of Corporate Governance and Investor Relations. From January 1997 to September 2002, Mr. Mann was Assistant Controller.

Phillip A. Pesek - Age 52; Vice President, General Counsel, and Secretary effective October 22, 2007. Prior to joining the Company, Mr. Pesek was Vice President, General Counsel, and Secretary of Anthony Forest Products Company, and before that, worked in various legal roles for The Home Depot, Inc., Wal-Mart Stores, Inc., and Dillard's, Inc.

Kent L. Streeter - Age 48; Vice President of Operations effective November 16, 2003. Prior to joining the Company, Mr. Streeter was Operations Manager of a large paper mill located in the Southeastern United States from January 1997, which has been owned since April 2002, by Temple-Inland, Inc. and prior to that by Gaylord Container Corporation.

David V. Meghreblian - Age 50; Vice President of Real Estate effective November 16, 2003. From May 2000 to November 2003, Mr. Meghreblian was Vice President of Operations for the Company. From November 1996 to April 2000, Mr. Meghreblian was General Manager of Planning and Investor Relations for Deltic. Prior to such time, Mr. Meghreblian was General Manager of Project Development, a position he held beginning in November 1995.

Byrom L. Walker - Age 47; Controller effective May 1, 2007. Mr. Walker had been Manager of Financial Reporting since he joined the Company in early 2006. Prior to joining the Company, Mr. Walker was Corporate Controller from 2004 for Teris, L.L.C., a division of Suez S.A.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Common stock of Deltic Timber Corporation is traded on the New York Stock Exchange under the symbol DEL. The following table sets forth the high, low, and closing prices, along with the quarterly dividends declared, for each of the quarters indicated:

|                |    | Sales Prices <sup>1</sup> |            |                          | Dividend per        |
|----------------|----|---------------------------|------------|--------------------------|---------------------|
|                |    | <u>High</u>               | <u>Low</u> | <u>Close<sup>2</sup></u> | <u>Common Share</u> |
| <b>2008</b>    |    |                           |            |                          |                     |
| First Quarter  | \$ | 56.13                     | 47.54      | 55.70                    | .075                |
| Second Quarter | \$ | 59.46                     | 50.01      | 53.51                    | .075                |
| Third Quarter  | \$ | 69.28                     | 52.97      | 63.64                    | .075                |
| Fourth Quarter | \$ | 63.27                     | 40.35      | 45.75                    | .075                |
| <b>2007</b>    |    |                           |            |                          |                     |
| First Quarter  | \$ | 56.60                     | 46.15      | 47.96                    | .075                |
| Second Quarter | \$ | 57.87                     | 47.03      | 54.82                    | .075                |
| Third Quarter  | \$ | 62.83                     | 50.91      | 56.92                    | .075                |
| Fourth Quarter | \$ | 59.83                     | 45.46      | 51.49                    | .075                |

<sup>1</sup> Daily closing price.

<sup>2</sup> At period end.

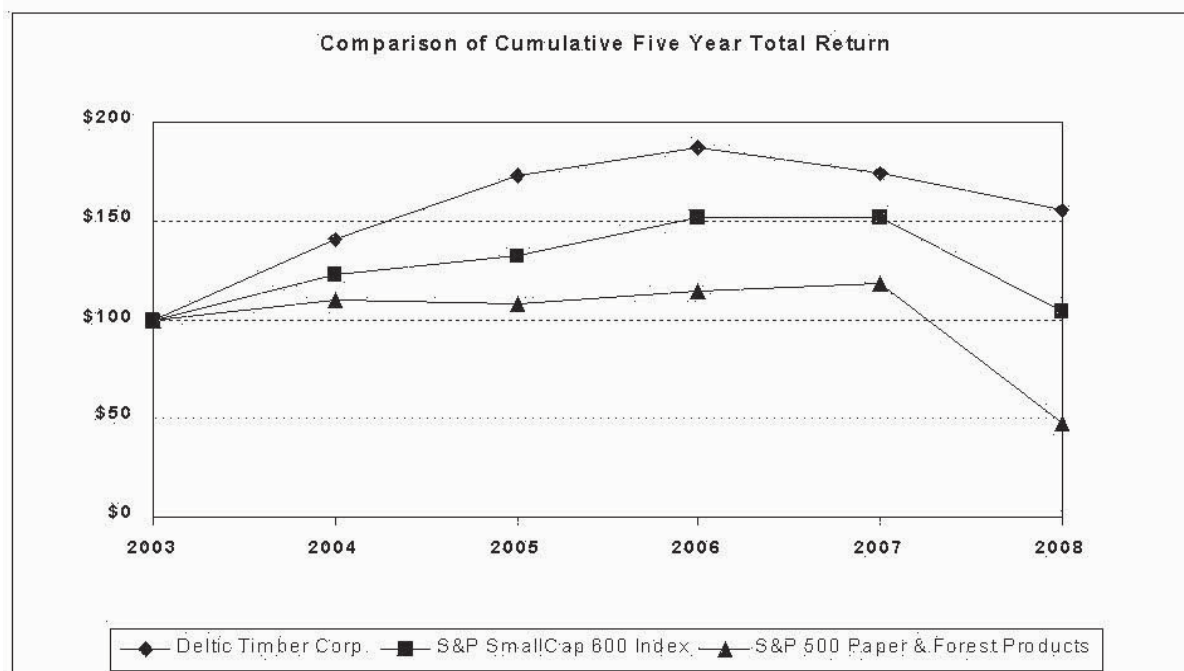
Common stock dividends were declared to be paid for each quarter during 2008 and 2007. As of February 13, 2009, there were approximately 1,076 stockholders of record of Deltic's common stock.

In December 2000, the Company's Board of Directors authorized a stock repurchase plan of up to \$10 million of Deltic common stock. There is no stated expiration date regarding this authorization. There were no repurchases under the program for the first nine months of 2008. Information pertaining to this plan for the fourth quarter of 2008 is presented in the table below. On December 13, 2007, Deltic announced an expansion of its repurchase program by \$25 million.

| Period                                  | Total Number<br>of Shares<br>Purchased | Average<br>Price Paid<br>Per Share | Total Number of Shares<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs | Maximum Approximate Dollar<br>Value of Shares that May Yet<br>Be Purchased Under the<br>Plans or Programs |
|-----------------------------------------|----------------------------------------|------------------------------------|-------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|
| October 1 through<br>October 31, 2008   | 103,081                                | 48.51                              | 103,081                                                                                   | \$ 22,685,314                                                                                             |
| November 1 through<br>November 30, 2008 | 26,696                                 | 43.82                              | 26,696                                                                                    | \$ 21,515,453                                                                                             |
| December 1 through<br>December 31, 2008 | -                                      | -                                  | -                                                                                         | \$ 21,515,453                                                                                             |

Information regarding securities authorized for issuance under equity compensation plans required by this Item is contained in Item 12 of this Form 10-K and is incorporated herein by reference.

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities (cont.)**



The graphed stock performance represents the cumulative total return for the Company's common stock compared to issuers with similar capitalization, and to peer industry issuers for the period December 31, 2003, through December 31, 2008. The calculated returns assume an investment of \$100 on December 31, 2003, and that all dividends were reinvested.

## Item 6. Selected Financial Data

The following table presents certain selected consolidated financial data for each of the years in the five-year period ended December 31, 2008:

| (Thousands of dollars, except per share amounts) | <u>2008</u>      | <u>2007</u>   | <u>2006</u>   | <u>2005</u>   | <u>2004</u>   |
|--------------------------------------------------|------------------|---------------|---------------|---------------|---------------|
| <b>Results of Operations for the Year</b>        |                  |               |               |               |               |
| Net sales .....                                  | \$ 129,524       | 128,255       | 153,112       | 168,350       | 142,017       |
| Operating income .....                           | \$ 7,505         | 19,959        | 18,721        | 26,257        | 23,155        |
| Net income .....                                 | \$ 4,384         | 11,111        | 11,323        | 14,518        | 11,093        |
| Comprehensive income/(loss) .....                | \$ (915)         | 14,638        | 11,621        | 14,128        | 11,205        |
| Earnings per common share                        |                  |               |               |               |               |
| Basic .....                                      | \$ .35           | .89           | .91           | 1.18          | .92           |
| Assuming dilution .....                          | \$ .35           | .89           | .89           | 1.17          | .91           |
| Cash dividends declared per common share .....   | \$ .30           | .30           | .30           | .275          | .25           |
| Net cash provided/ (required) by                 |                  |               |               |               |               |
| Operating activities .....                       | \$ 21,683        | 28,243        | 39,148        | 43,125        | 42,147        |
| Investing activities .....                       | \$ (30,778)      | (21,023)      | (24,234)      | (29,015)      | (15,723)      |
| Financing activities .....                       | \$ 835           | (7,906)       | (5,192)       | (13,332)      | (27,252)      |
| Percentage return on                             |                  |               |               |               |               |
| Average stockholders' equity .....               | 2.0              | 5.1           | 5.5           | 7.6           | 6.3           |
| Average borrowed and invested capital .....      | 3.4              | 5.7           | 5.6           | 7.4           | 6.2           |
| Average total assets .....                       | 1.3              | 3.3           | 3.5           | 4.6           | 3.6           |
| <b>Capital Expenditures for the Year</b>         |                  |               |               |               |               |
| Woodlands .....                                  | \$ 11,436        | 4,978         | 3,333         | 7,062         | 6,686         |
| Mills .....                                      | 6,874            | 5,345         | 8,763         | 10,732        | 4,797         |
| Real Estate .....                                | 11,222           | 10,171        | 15,612        | 15,379        | 12,519        |
| Corporate .....                                  | 122              | 74            | 59            | 74            | 165           |
|                                                  | <u>\$ 29,654</u> | <u>20,568</u> | <u>27,767</u> | <u>33,247</u> | <u>24,167</u> |

## Financial Condition at Year-End

|                                                    |            |           |           |           |           |
|----------------------------------------------------|------------|-----------|-----------|-----------|-----------|
| Working capital .....                              | \$ 4,807   | 7,285     | 12,710    | 7,027     | 6,481     |
| Current ratio .....                                | 1.42 to 1  | 1.46 to 1 | 2.15 to 1 | 1.57 to 1 | 1.73 to 1 |
| Total assets .....                                 | \$ 334,733 | 328,744   | 324,266   | 316,327   | 307,580   |
| Long-term debt .....                               | \$ 75,833  | 66,667    | 70,000    | 74,500    | 85,724    |
| Stockholders' equity .....                         | \$ 213,164 | 218,086   | 207,481   | 198,244   | 184,091   |
| Long-term debt to stockholders' equity ratio ..... | .356 to 1  | .306 to 1 | .337 to 1 | .376 to 1 | .466 to 1 |

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### ***Introduction***

Deltic Timber Corporation ("Deltic" or the "Company") is a natural resources company engaged primarily in the growing and harvesting of timber and the manufacture and marketing of lumber. Deltic owns approximately 438,600 acres of timberland, primarily in Arkansas and north Louisiana. The Company's sawmill operations are located at Ola in central Arkansas (the "Ola Mill") and at Waldo in south Arkansas (the "Waldo Mill"). In addition to its timber and lumber operations, the Company is engaged in real estate development in central Arkansas. The Company also holds a 50 percent interest in Del-Tin Fiber L.L.C. ("Del-Tin Fiber"), a joint venture to manufacture and market medium density fiberboard ("MDF"). Deltic is a calendar-year company for both financial and income tax reporting.

The Company is organized into four segments: (1) Woodlands, which manages all aspects of the timberlands including harvesting and sale of timber, timberland sales and acquisitions, oil and gas mineral revenues, and hunting land leases; (2) Mills, which consists of Deltic's two sawmills that manufacture a variety of softwood lumber products; (3) Real Estate, which includes the Company's real estate developments and a related country club operation; and (4) Corporate, which consists of executive management, accounting, information systems, human resources, purchasing, treasury, income tax, and legal staff functions that provide support services to the operating business units. (The Company currently does not allocate the cost of maintaining these support functions to its operating units.)

The Company's timberlands consist primarily of Southern Pine, known in the industry as a type of "softwood". Deltic considers its timberlands to be the Company's most valuable asset and the harvest of stumpage to be its most significant and consistent source of income; accordingly, Deltic actively manages its timberlands to increase productivity and maximize the long-term value of these timber assets. The Company harvests timber from the timberlands in accordance with its harvest plans and sells such timber in the domestic market or converts it to lumber in its sawmills. Stumpage supplied to the Company's sawmills is transferred at prices that approximate market in its operating regions. Deltic derives additional revenues from its timberlands in the form of hunting leases, mineral lease bonuses, mineral royalties, and land easements. In late 1996, the Company implemented a timberland acquisition program to enable it, when desired, to increase harvest levels, while expanding its timber inventory. The Company continues to focus its acquisition program on timberland within its current operating area. Additionally, as market conditions allow, Deltic will sell tracts of land where market values exceed that of the tracts' worth as a timber growing platform. During 2008, and especially in the fourth quarter, Deltic was able to significantly increase its sales of non-strategic recreational-use hardwood bottomland. The Company looks to continue these sales in coming years as it seeks to replace the non-strategic acres with strategic southern yellow pine sawtimber producing acres.

The Company's two sawmills employ modern technology in order to improve efficiency, reduce labor costs, maximize utilization of the timber resource, and maintain high standards for production quality, with safety being one of its highest priorities. In addition, each mill is strategically located near significant portions of the Company's timberlands. The mills produce a variety of lumber products, including dimension lumber, timbers, and boards. These lumber products are sold primarily to wholesale distributors, lumber treaters, and truss manufacturers in the Southern and mid-western United States and are used mainly in residential construction, roof trusses, and laminated beams.

The Company's real estate operations were started in 1985 to maximize the value of former timberland strategically located in the growth corridor of west Little Rock, Arkansas. Since that time, the Company has been developing Chenal Valley, a premier planned community consisting of 4,700 acres of residential and commercial properties. The property is being developed in stages, and real estate sales to date have consisted primarily of residential lots, which are sold to builders or individuals, and commercial sites. In addition to Chenal Valley, Deltic has developed Chenal Downs, a 400-acre development located just outside Chenal Valley, and is developing Red Oak Ridge, an 800-acre development in Hot Springs, Arkansas.

The Del-Tin Fiber plant is located near El Dorado, Arkansas. Construction of the plant was completed, and initial production began in 1998. The plant is designed to have a rated annual production capacity of 150 million square feet ("MMSF") of 3/4 inch MDF, making it one of the largest plants of its type in North America. MDF, which is used primarily in the furniture, store fixture, laminate flooring, and molding industries, is manufactured from sawmill residuals such as chips, shavings, and sawdust, pressed and held together by an adhesive bond.

## ***Executive Overview***

Deltic is primarily a wood products producer operating in a commodity-based business environment, with a major diversification in real estate development. This environment is affected by a number of factors, including general economic conditions, interest rates, availability and costs of credit, imports, foreign exchange rates, housing starts, new and existing home inventories, home foreclosures, residential repair and remodeling, commercial construction, industry capacity and production levels, the availability of raw materials, cost of fuel, and weather conditions. Given its relative size and the nature of most commodity markets, the Company has little or no influence over the market's pricing levels for its wood products. Accordingly, the Company will continually seek to reduce controllable costs and expenses from its manufacturing processes. Sales of real estate are affected by general economic conditions, interest rates, home foreclosures, new and existing home inventories, and the availability and cost of credit; specifically as such factors are manifested in the Company's operating area of central Arkansas.

Significant accomplishments for the Company's operating segments during the year of 2008 include: (1) the Woodlands segment capitalized on the strong demand for pulpwood and achieved a 15 percent higher average sales price per ton for pine pulpwood and a 22 percent higher average sales price per ton for hardwood pulpwood; (2) the sale of approximately 5,100 acres of non-strategic, recreational-use, hardwood bottomland and the utilization of the proceeds to enhance Deltic's core timberland holdings; (3) the Mills segment achieved positive cash flow in the current year due to continued improvements in operating efficiencies and the benefits from reduced unit manufacturing cost, primarily through lower log supply cost; and (4) the Real Estate segment's Red Oak Ridge development reported its second best level of annual residential sales activity.

The Woodlands segment maintained its position as the Company's established core operation. The 2008 pine sawtimber harvest volume increased slightly to 580,000 tons when compared to 2007's volume of 576,000 tons, but the average sales price decreased 18 percent to \$33 per ton. Despite the decline in the average pine sawtimber sales price, the segment's 2008 overall operating income increased by \$3 million, or 12 percent. The improvement was due to increased sales of non-strategic hardwood bottomland; higher revenues from hunting and oil and gas lease rentals and royalties, and easements and rights-of-way; and increased other revenues resulting from the natural gas drilling activity occurring on the Company's fee lands, including damages for acreage taken out of timber production for wellsite locations, and fees for allowing seismic testing. Since Deltic expects the markets for residential housing and lumber to remain depressed through 2009, prices received for pine sawtimber harvested for this period are not expected to improve from current levels.

While lumber production levels within a region can influence pine sawtimber prices, lumber prices typically do not. Over the long-term, there is a fundamental correlation between the level of lumber prices and pine sawtimber prices. However, in the short-term, the geographical size differential between the lumber and pine sawtimber markets results in the two acting somewhat independently of each other. Pine sawtimber markets operate primarily within local or regional areas with sales being mainly to sawmills. These mills are subject to a relatively fixed level of demand for raw materials that is driven by the facilities' required production levels. Changes in pricing levels within the lumber market typically do not have an immediate effect on the existing demand for raw materials in the short-term; therefore, the resulting impact on pine sawtimber prices will usually lag in timing and be less volatile than the market for lumber. This trend would typically also be true in the short-term during times of a depressed lumber market. Ultimately, the Company's ability to sell pine sawtimber at acceptable prices in the future will be dependent upon the size or existence of markets for manufactured lumber and other wood products. The Company continues to manage the harvest level of its forests on a sustainable-yield basis.

Timberland designated as higher and better use consists of tracts with market values that exceed the land's worth as a timber growing platform. Deltic's approximately 57,000-acre timberland holdings in the expanding westward growth corridor of Little Rock, Arkansas, is an example of such land. Non-strategic timberland is composed primarily of hardwood bottomland acreage not suitable for the growing of pine timber for which the demand by recreational users for hunting, etc. has increased in recent years, tracts too small to allow efficient timber management, those geographically isolated from other Company fee lands, or any other acreage not deemed strategic to Deltic's operations or growth. Approximately 5,100 acres of non-strategic hardwood bottomland was sold during 2008. Additional sales of these acres will continue in 2009 and beyond as market conditions allow. The sales of the non-strategic hardwood bottomland were accomplished in conjunction with acquiring 5,000 acres of pine timberland. By utilizing the tax-deferring, like-kind exchange method, Deltic was able to minimize the tax consequences and invested or will invest timberland sale proceeds into pine timberland.

In addition to pine and hardwood timber sales, the Company receives additional values of land ownership, such as revenues from hunting leases, mineral lease rentals and royalties, and land easements, that have historically provided additional income to Deltic's Woodlands segment. Recent advances in technology and increased pricing levels have resulted in the economic viability of expanded natural gas exploration within the state of Arkansas. One current area of activity, known as the "Fayetteville Shale Play", is an unconventional natural gas reservoir, ranging in depth from 1,300 feet to 6,500 feet, and is spread across multiple Arkansas counties. Deltic has leased approximately 32,100 acres in this area to various exploration enterprises and received applicable lease rental payments, with the possibility of future royalty income should production be established. The Company continues to evaluate additional leasing requests within the currently defined boundary of the Fayetteville Shale Play, although future leasing will probably not be significant within this boundary. Production has begun in a few areas and Deltic received over \$1.3 million in royalty payments from this area in 2008. The ultimate benefit to Deltic from these mineral leases remains speculative and unknown to the Company and is contingent on the level of natural gas prices and the successful extraction and sale of natural gas from the area.

For the Mills segment, the status of the lumber market and the resulting pricing for the Company's commodity softwood lumber products will continue to impact operating strategies and financial results. By the end of 2008, the seasonally adjusted annual rate of housing starts had reached its lowest level in 50 years. Factors affecting this decline were the U.S. economic recession, falling home prices, stricter mortgage lending practices brought about by sub-prime loan failures, construction loan delinquencies that are causing lenders to tighten credit for new developments, increased home foreclosure rates, and increased new and existing home inventory levels. The segment's 2008 average lumber sales price declined six percent when compared to 2007. Lumber sales volume increased 17 percent compared to 2007 due mainly to the three-month suspension of production at the Waldo Mill while undergoing fire related repairs in 2007 combined with improved hourly production rates throughout 2008. As with any commodity market, the Company expects the historical volatility of lumber prices to continue in the future. Other factors impacting future lumber prices include the level of production capacity utilized, inventory levels, and the level of repair and remodeling activity. Many industry analysts are projecting that the market for new housing will not improve during 2009. That, along with excess production capacity and high inventory levels, could have a negative impact on lumber sales prices. As in the past, Deltic will make timely management decisions to take advantage of supply and demand situations.

Since commodity-based markets rarely benefit from real price growth, after inflation, Deltic has concentrated management's attention, in regard to its manufacturing operations, on improving sales realizations through product and customer mix enhancements and improving production efficiencies and the cost structure at its lumber mills. The Company has achieved improved production efficiencies at both of its sawmills, largely as a result of an intensive capital upgrade program over the past four years. This improvement has been more significant at the Ola Mill, as the upgrade program there has focused on maximizing hourly productivity rates with the smaller log size available as raw material for the mill. In 2008, Deltic installed a new log bucking system at this sawmill, improving the log-to-lumber yield ratio there. Deltic will continue to seek opportunities that will enable it to increase operating efficiencies, while reducing controllable cost.

Sales activity levels for the Company's real estate developments have been affected by economic conditions that influence the level of housing starts in the central Arkansas region, including general economic conditions, new and existing housing inventories, home foreclosure rates, and stricter lending requirements for homebuyers and builders. These conditions contributed to a decrease in the overall demand for residential lots in Chenal Valley, the largest of the Company's three active developments, as evidenced by Chenal Valley's 25 residential lot closings. This was a reduction of 48 lots from 2007's level of 73 residential lot closings. As of December 31, 2008, there were 174 developed lots in Chenal Valley uncommitted. The Company opened 32 new lots during 2008 to maintain a specific mix of lot offerings. Ultimately, the impact to Deltic's overall real estate business model from fluctuations, both positive and negative, in the annual volumes of residential lot sales is deemed minimal in light of the Company's continued focus on the long-term financial returns from the ultimate build-out of the Chenal Valley development. In Deltic's other two active developments, Red Oak Ridge had sales of 12 lots and Chenal Downs had two lot sales. Deltic has 61 developed lots in Red Oak Ridge and 13 in Chenal Downs uncommitted as of year-end 2008. While Chenal Downs is fully developed, Deltic plans to develop additional lots within Red Oak Ridge as demanded by market conditions. Actual future annual lot development levels will be dependent upon the demand for the Company's residential lots.

The Real Estate segment's average sales price for residential lots sold in 2008 was \$78,000, which was a decrease of 13 percent when compared to 2007, due to the current-year sales mix. The Company has not nor does it plan to reduce the sales price of its residential lots. Deltic's lot development plans provide for a mix of lot offerings that represent all real estate market segments for a planned community. Neighborhoods adjoining Chenal Country Club's second 18-hole, championship golf course designed by Robert Trent Jones, Jr. represent the highest priced market segment in the Chenal Valley development. Average prices for non-golf course lots are lower and vary between neighborhoods depending on other factors such as lot size and location. The mix of lot offerings for any given year will be driven by lot inventory and expected demand.

Commercial real estate sales activity is by nature less predictable than residential activity. With the number of residents and past growth in West Little Rock, specifically Chenal Valley, the Company continues to receive interest in multi-family housing sites and commercial real estate in and around the vicinity of "The Promenade at Chenal," an upscale shopping center within Chenal Valley that opened in 2008, though economic uncertainties and stricter lending requirements has had an impact on commercial acreage closings. There were no sales of commercial real estate acreage in 2008 compared to 26 acres in 2007. Future pricing trends for commercial real estate sales are difficult to predict and are influenced by multiple factors, which include intended use of the site, and property location and access. No commercial acreage is included in the Chenal Downs development. Red Oak Ridge includes a small amount of commercial property, depending on actual final land usages. The Company will begin to develop and offer commercial sites as this development's population density increases. There were no sales of undeveloped acreage during 2008, while the Company sold approximately 680 acres in 2007.

Operating results for Del-Tin Fiber are affected primarily by the overall MDF market and plant operating performance. Del-Tin was able to operate at a profitable level during 2008 by passing through the higher raw material costs, in the form of price increases, and improved production efficiencies. The demand for thin board, used in store fixtures and laminate flooring, remained strong through the first nine months of 2008, but with the reduction in housing starts along with the current recession, the market began weakening in the fourth quarter. Del-Tin has continued to maximize earnings potential of the thin board production by developing a strategy to grow market share for this product.

Operationally, Del-Tin Fiber maintained its uptime percentage and premium grade production levels. The facility was able to push through increased raw material costs to its customers; however, Del-Tin will continue to be affected by decreased supply and increased costs for wood fiber used in the manufacturing process. The wood fiber supply and cost issues are due largely to a shortage of softwood residual wood chips as area lumber mills curtailed production in reaction to lumber market conditions. With reduced mill production levels, the volume of residual by-product chips produced decreases proportionally. During 2007 and 2008, the resin glue utilized to bond MDF in the manufacturing process increased significantly in price due to substantial price increases in methanol, which is a raw material used in the manufacture of the resin glue. Due to decreases in the cost of methanol in late 2008 and curtailments by wood product manufacturing

facilities that use the resin glue, there is currently an increased supply of resin glue. With this reduction in cost to manufacture resin glue and increased supply, Del-Tin's cost for resin is starting to decrease.

For 2009, wood fiber cost is expected to remain near current levels, while resin glue prices are projected to decrease. Manufacturers have been able to recover a portion of their raw materials cost through price increases, though it may slip some with the decreased cost for resin glue. Del-Tin Fiber's efforts will be concentrated on further improvements in its hourly productivity level and other plant operating efficiencies, while making additional reductions in the plant's manufacturing cost structure where possible.

On May 22, 2008, the Food, Conservation, and Energy Act of 2008 was enacted. Within this Act was the TREE Act, which included a provision for a reduced federal tax rate on qualified timber gains for one year. Gains on qualified timber sales beginning May 23, 2008, through May 22, 2009, will be taxed at a 15 percent alternate tax rate for corporations. Efforts are ongoing to extend this provision for another year or to make this legislation permanent, but law changes are not certain until passed by both houses of Congress and signed into law by the President. Due to the lack of taxable income for Deltic in 2008, the effects of this act were inconsequential for the year, but could provide a lower effective tax rate in 2009. Deltic has benefited from various discrete tax items in 2008 that combined to provide a lower effective tax rate.

### ***Significant Events***

On October 29, 2008, Deltic delivered a notice of voluntary prepayment to all participants in the \$30 million Note Purchase Agreement dated December 20, 2002, as amended. In the agreement, the Company requested that the Note Purchasers waive any prepayment penalty or other requirement to pay any "make whole" fees. All participants except Modern Woodmen of America accepted the terms on October 30, 2008. As a result, \$25 million of the \$30 million notes were paid in full on November 4, 2008, and cancelled.

On June 30, 2008, the Company entered into an agreement with Metropolitan Life and a group of other domestic insurance companies to amend the existing note agreement of the \$30,000,000 private placement senior notes. The amendment changed the minimum fixed charge coverage and other ratios applicable to the Company's business to be the same as those contained in the Company's Series A Senior Notes placed with the American AgCredit PCA.

On August 7, 2007, Deltic amended its revolving credit agreement with SunTrust Bank and other banks whereby the unsecured and committed revolving credit facility was increased from \$260 million to \$300 million. An option to request an increase in the amount of aggregate revolving commitments from \$300 million to \$350 million was reinstated. The agreement, which was set to expire on September 9, 2010, was extended to September 9, 2012. The funds available through this agreement will enable the Company to take full advantage of value-added growth opportunities as they present themselves.

On March 30, 2007, the Company entered into an agreement with American AgCredit PCA to amend and restate the terms of the Company's series A Senior Notes ("Notes") in the principal amount of \$40 million. Under the new agreement, the Notes are due and payable December 18, 2016. Prior to the agreement, the Notes would have become due on December 18, 2008, pursuant to a Note Purchase Agreement effective December 19, 1998. The interest rate for the Notes remains the same as under the 1998 agreement (6.66 percent) through December 18, 2008, and after that date, the rate was reduced to 6.10 percent for the balance of the term of the Notes.

On April 6, 2004, RED Development LLC announced that it planned to purchase from Deltic a site within Chenal Valley for "The Promenade at Chenal," an upscale lifestyle shopping center. After extensive efforts by both parties, the sale of 38 acres of commercial property was closed on September 27, 2006. Construction began on the shopping center in 2007 and was completed in May 2008. The development of "The Promenade at Chenal" is strategic to Chenal Valley in that it is expected to further increase interest in the Company's additional 135 acres of commercially-zoned property adjacent to the site.

From the time production began at Del-Tin Fiber in 1998 until the fourth quarter of 2003, both operating and financial performance was below the expectations established at the time that the decision to construct the plant was made. As a result, on April 25, 2002, Deltic announced that Banc One Capital Markets, Inc. had been retained as financial advisor to assist in the evaluation of strategic alternatives for the Company's investment in Del-Tin Fiber. Subsequently, Deltic's management and Board of Directors completed its review of these strategic alternatives and announced the Company intended to exit the MDF business upon the earliest, reasonable opportunity provided by the market. As a result of this decision, the Company's evaluation of possible impairment of the carrying value of its investment in the joint-venture was based primarily upon the estimated cash flows from a possible sale of the Company's interest during 2003 and resulted in a determination that the Company's investment was impaired as of December 31, 2002. The investment was written off, to zero, and the write-off amounted to \$18.7 million before income taxes.

Due to the Company's commitment to fund its share of any of the facility's operating working capital needs until the facility was able to consistently generate sufficient funds to meet its cash requirements or Deltic's ownership was sold, the Company recognized equity in Del-Tin Fiber equal to the extent of these advances during 2003. For the year of 2003, such advances approximated the Company's equity share of losses for the plant. Accordingly, the investment in Del-Tin Fiber at December 31, 2003 was zero. The Company also continued to utilize its management resources to work with Del-Tin's management and the joint-venture partner to improve operating performance at the plant. As a result of these improvements, on December 11, 2003, Deltic's Board of Directors revised its intent regarding the Company's investment in Del-Tin Fiber and ceased efforts to sell the Company's interest in the joint venture, while continuing to focus on improving operating and financial results of the plant. Due to this decision, the 2003 evaluation of fair value for the investment was based primarily upon the future net cash flows from Del-Tin Fiber's operations over the remaining life of the plant. In 2004, the Company began recording its equity share of the operating results of the joint venture.

### ***Results of Operations***

In the following tables, Deltic's net sales and results of operations are presented for the three years ended December 31, 2008. Explanations of significant variances and additional analyses for the Company's consolidated and segmental operations follow the tables.

| (Millions of dollars, except per share amounts) | Years Ended December 31, |               |               |
|-------------------------------------------------|--------------------------|---------------|---------------|
|                                                 | 2008                     | 2007          | 2006          |
| Net sales                                       |                          |               |               |
| Woodlands                                       | \$ 46.0                  | 39.6          | 37.6          |
| Mills                                           | 91.4                     | 79.3          | 101.9         |
| Real Estate                                     | 11.4                     | 30.3          | 35.5          |
| Eliminations                                    | <u>(19.3)</u>            | <u>(20.9)</u> | <u>(21.9)</u> |
| Net sales                                       | \$ <u>129.5</u>          | <u>128.3</u>  | <u>153.1</u>  |
| Operating income                                |                          |               |               |
| Woodlands                                       | \$ 27.8                  | 24.8          | 22.5          |
| Mills                                           | (4.8)                    | (3.0)         | (5.3)         |
| Real Estate                                     | (1.9)                    | 13.1          | 13.9          |
| Corporate                                       | (13.1)                   | (14.3)        | (13.1)        |
| Eliminations                                    | <u>(.5)</u>              | <u>(.6)</u>   | <u>.7</u>     |
| Operating income                                | 7.5                      | 20.0          | 18.7          |

| (Millions of dollars, except per share amounts) | Years Ended December 31, |             |             |
|-------------------------------------------------|--------------------------|-------------|-------------|
|                                                 | 2008                     | 2007        | 2006        |
| Equity in Del-Tin Fiber                         | 2.3                      | 1.7         | 2.9         |
| Interest income                                 | .3                       | .8          | .5          |
| Interest and other debt expense                 | (5.2)                    | (5.1)       | (5.4)       |
| Interest capitalized                            | .5                       | .7          | 1.2         |
| Other income                                    | -                        | .3          | .3          |
| Income taxes                                    | (1.0)                    | (7.3)       | (6.9)       |
| Net income                                      | \$ <u>4.4</u>            | <u>11.1</u> | <u>11.3</u> |
| Earnings per common share                       | \$ .35                   | .89         | .91         |

### *Consolidated*

Net income for 2008 was \$4.4 million, a decrease of \$6.7 million when compared to 2007 due primarily to deteriorating real estate and forest products markets. The decline in operating income for the Company's Real Estate and Mills segments was partially offset by improved operating income from the Woodlands segment, decreased Corporate expense, increased equity income from Del-Tin Fiber, and a lower effective tax rate due to discrete items. The net income for 2007 was relatively flat when compared to 2006. Improved results for the Company's Woodlands and Mills segments were essentially offset by lower results from the Real Estate segment, increased Corporate expense, increased eliminations of intercompany profit on pine stumpage from fee timber in inventory at the Mills, and decreased equity income in Del-Tin Fiber.

Operating income for 2008 decreased \$12.5 million or 63 percent when compared to 2007. The Woodlands segment increased \$3 million due primarily to additional sales of non-strategic, recreational-use hardwood bottomland, increased oil and gas rental and royalty and hunting lease income, and higher pulpwood prices, partially offset by a lower average per-ton sales prices for pine sawtimber and a lower pine pulpwood harvest level. Operating results for the Mills segment in 2008 decreased \$1.8 million when compared to 2007 results, which included property and business interruption insurance claims related to the fire at the Waldo Mill. Lower lumber sales prices per MBF were partially offset by lower average production cost per MBF and improved operating efficiencies. Real Estate operating income decreased by \$15 million due to reduced sales of commercial and undeveloped real estate acreage and residential lots. Corporate operating expense decreased \$1.2 million mainly due to lower general and administrative expense.

Operating income for 2007 increased \$1.3 million, or seven percent, when compared to 2006. The Woodlands segment increased \$2.3 million due primarily to increases in pulpwood revenues, sales of non-strategic hardwood bottomland, and oil and gas lease rental income, partially offset by lower average per-ton sales price for pine sawtimber. Operating results for the Mills segment improved \$2.3 million mainly due to proceeds from insurance settlements on property damaged in the fire at the Waldo Mill and related business interruption insurance claims and a lower average production cost per MBF, partially offset by decreases in both average lumber sales price and lumber sales volume. Real Estate operating income decreased \$.8 million due to reduced sales of residential lots and commercial acreage, partially offset by sales of undeveloped real estate acreage. Corporate operating expenses increased \$1.2 million mainly due to higher general and administrative expenses.

## Woodlands

Selected financial and statistical data for the Woodlands segment is shown in the following table.

|                                  | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|----------------------------------|-------------|-------------|-------------|
| Net sales (millions of dollars)  |             |             |             |
| Pine sawtimber                   | \$ 19.0     | 23.2        | 26.1        |
| Pine pulpwood                    | 5.8         | 6.1         | 3.5         |
| Hardwood sawtimber               | .3          | .4          | .5          |
| Hardwood pulpwood                | 1.0         | .8          | .5          |
| Oil and gas lease rentals        | 2.0         | 1.4         | .9          |
| Oil and gas royalties (net)      | 1.6         | .3          | .2          |
| Hunting leases                   | 1.8         | 1.7         | 1.6         |
| Sales volume (thousands of tons) |             |             |             |
| Pine sawtimber                   | 580         | 576         | 580         |
| Pine pulpwood                    | 390         | 459         | 416         |
| Hardwood sawtimber               | 9           | 13          | 17          |
| Hardwood pulpwood                | 93          | 80          | 107         |
| Sales price (per ton)            |             |             |             |
| Pine sawtimber                   | \$ 33       | 40          | 45          |
| Pine pulpwood                    | 15          | 13          | 8           |
| Hardwood sawtimber               | 34          | 32          | 30          |
| Hardwood pulpwood                | 11          | 9           | 5           |
| Timberland                       |             |             |             |
| Net sales (millions of dollars)  | \$ 6.2      | 1.2         | .2          |
| Sales volume (acres)             | 5,062       | 893         | 200         |
| Sales price (per acre)           | \$ 1,800    | 1,700       | 1,400       |

Total net sales in 2008 increased \$6.4 million, or 16 percent, when compared to 2007. During 2008, sales of timberland increased \$7.3 million due to an increase in the number of acres sold and the average per-acre sales price. Sales of hardwood pulpwood increased \$.3 million due to increases in both the per-ton average sales price and the volume harvested. Other items contributing to the increase in total net sales were a \$1.3 million increase in oil and gas royalty income, a \$.7 million increase in hunting lease and oil and gas lease rental income, and a \$1 million increase in freight revenue. Sales of pine sawtimber decreased \$4.2 million due to a lower per-ton average sales price. Pine pulpwood revenues decreased \$.3 million due to a lower harvest volume partially offset by a higher per-ton average sales price.

Total net sales in 2007 increased \$2 million, or five percent, when compared to 2006. Sales of pine pulpwood increased \$2.6 million due to increases in harvest levels and a higher per-ton average sales price. Other items contributing to the increase in total net sales were a \$.5 million increase in hunting lease and oil and gas lease rental income, a \$.2 million increase in easements and rights-of-way, and a \$.4 million increase in other income related to seismic permits, wellsite damages, and water usage. Sales of pine sawtimber decreased by \$2.9 million due to a lower per-ton average sales price, and freight revenue decreased \$.5 million.

The Woodlands segment's operating income for 2008 was \$3 million more than 2007 due to the increase in net sales, partially offset by increases in the cost of timberland sales due to the increase in acres sold. The Woodlands segment's operating income for 2007 was \$2.2 million more than 2006 due to the increase in net sales and a reduction in silviculture and freight expense, partially offset by increases in the cost of timberland sales due to the increase in acres sold.

## Mills

Selected financial and statistical data for the Mills segment is shown in the following table.

|                                 | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---------------------------------|-------------|-------------|-------------|
| Net sales (millions of dollars) |             |             |             |
| Lumber                          | \$ 70.5     | 64.0        | 85.1        |
| Residual products               | 16.6        | 11.9        | 12.8        |
| Lumber                          |             |             |             |
| Finished production (MMBF)      | 246         | 213         | 253         |
| Sales volume (MMBF)             | 255         | 218         | 263         |
| Sales price (per MBF)           | \$ 277      | 293         | 324         |

Total sales in 2008 increased \$12 million, or 15 percent, when compared to 2007. The increase was primarily a result of higher lumber and residual product sales volumes due to increased production because the Waldo Mill was shut down approximately three months for fire related repairs in 2007, combined with improved year-over-year operating efficiencies.

Total sales in 2007 decreased \$22.6 million, or 22 percent, when compared to 2006. The decrease was mainly due to a lower lumber sales volume, reduced residual sales volumes as a result of decreased lumber production and decreased freight revenue. This decrease was because the Waldo Mill was shut down approximately three months for repairs due to a fire at the facility in the third quarter, combined with a lower average lumber sales price.

The decrease in the Mills segment's operating income for 2008 was due primarily to a lower average sales price per MBF, which was partially offset by lower production and log costs, and to the benefit of property and business interruption insurance claims realized in 2007.

The increase in the Mills segment's operating income for 2007 was mainly due to the settlement of property and business interruption claims for the Waldo Mill. Included in the reported results was a \$1.9 million gain on involuntary conversion of damaged assets and \$1.2 million in other operating income from business interruption insurance claims. This benefit, along with a reduction in the average production cost per MBF, was partially offset by the same factors that caused a decline in net sales.

## Real Estate

Selected financial and statistical data for the Real Estate segment is shown in the following table.

|                                            | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--------------------------------------------|-------------|-------------|-------------|
| Net sales (millions of dollars)            |             |             |             |
| Residential lots                           | \$ 3.0      | 7.3         | 12.0        |
| Commercial sites                           | -           | 6.3         | 13.6        |
| Undeveloped acreage                        | -           | 8.2         | -           |
| Sales volume                               |             |             |             |
| Residential lots                           | 39          | 81          | 116         |
| Commercial acres                           | -           | 26          | 55          |
| Undeveloped acres                          | -           | 680         | -           |
| Average sales price (thousands of dollars) |             |             |             |
| Residential lots                           | \$ 78       | 90          | 104         |
| Commercial acres                           | -           | 241         | 248         |
| Undeveloped acres                          | -           | 12          | -           |

Total net sales for 2008 decreased \$18.8 million, or 62 percent, versus 2007 due primarily to decreased revenue from the sales of commercial and undeveloped real estate acreage and residential lots. The reduction in the average lot sales price was due to mix of lots sold. Chenal Country Club, Inc. produced net sales of \$7.7 million for 2008, an increase of \$.2 million.

Total net sales for 2007 decreased \$5.2 million, or 15 percent, versus 2006 due primarily to decreased revenues from sales of residential lots and commercial acreage, partially offset by increased sales of undeveloped real estate acreage. The reduction in the average lot sales price was due to the mix of lots sold. Chenal Country Club, Inc. produced net sales of \$7.5 million for 2007, an increase of \$.8 million.

The changes in the Real Estate segment's operating income were due primarily to the same factors impacting net sales.

#### *Corporate*

The decrease in operating expense for Corporate functions of \$1.2 million in 2008 was due primarily to decreased incentive plan expenses, salaries and benefits expenses, and legal fees, which were partially offset by increased acquisition-related professional fees that were deferred from prior periods.

The increase in operating expense for Corporate functions of \$1.1 million in 2007 was due primarily to higher incentive plan expenses, partially offset by lower legal fees.

#### *Eliminations*

Intersegment sales of timber from Deltic's Woodlands segment to the Mills segment were \$19.3 million in 2008, \$20.9 million in 2007, and \$21.9 million in 2006. The \$1.6 million decrease during 2008 and the \$1 million decrease during 2007 was due primarily to a lower average transfer price that approximates market.

#### *Equity in Del-Tin Fiber*

For the year ended December 31, 2008, equity in Del-Tin Fiber recorded by the Company was \$2.3 million compared to \$1.7 million in 2007 and \$2.9 million in 2006.

Additional selected financial and statistical data for Del-Tin Fiber is shown in the following table.

|                                 | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---------------------------------|-------------|-------------|-------------|
| Net sales (millions of dollars) | \$ 66.5     | 64.0        | 73.7        |
| Finished production (MMSF)      | 115.4       | 116.7       | 147.0       |
| Board sales (MMSF)              | 113.0       | 118.5       | 144.9       |
| Sales price (per MSF)           | \$ 538      | 487         | 456         |

Average prices for 2008 increased due to an increase in premium-grade production and to the fact that Del-Tin was able to pass along increases in wood fiber, resin glue, and wax cost in its average sales price.

Average sales price for 2007 increased when compared to 2006 due to a change in product mix to include a greater percentage of thin board, an increase in premium-grade production, and a price increase due to producers attempting to recover a portion of their higher resin glue cost. The decrease in finished production was planned due to market conditions.

### *Interest Income/Expense*

Interest expense for 2008 was relatively unchanged from 2007. When compared to 2006, interest expense for 2007 decreased \$.3 million due primarily to reduction in outstanding debt.

### *Income Taxes*

The effective income tax rate was 18 percent, 40 percent, and 37 percent in 2008, 2007, and 2006, respectively. The decrease in the effective income tax rate for 2008 was due primarily to discrete tax items related to the lapse of applicable statutes of limitations on the 2004 return and other adjustments from the 2007 tax return true-up. The increase in the effective income tax rate for 2007 was due primarily to a higher effective rate for federal income taxes.

## ***Liquidity and Capital Resources***

### *Cash Flows and Capital Expenditures*

Net cash provided by operating activities totaled \$21.7 million for the year ended December 31, 2008, which compares to \$28.2 million for 2007 and \$39.1 million for 2006. Changes in operating working capital other than cash and cash equivalents, required cash of \$2.7 million in 2008, provided cash of \$1.3 million and \$4.5 million in 2007 and 2006, respectively. Net cash provided/(required) by other operating activities included changes in long-term deferred mineral lease bonus of \$.5 million in 2007, and \$2.4 million in 2006. The Company's accompanying Consolidated Statements of Cash Flows identify other differences between income and cash provided by operating activities for each reported year.

Capital expenditures required cash of \$29.3 million in 2008, \$20.6 million in 2007, and \$27.6 million in 2006. Total capital expenditures, by segment, for the years ended December 31, 2008, 2007, 2006, are presented in the following table.

| (Millions of dollars)                     | <u>2008</u>    | <u>2007</u> | <u>2006</u> |
|-------------------------------------------|----------------|-------------|-------------|
| Woodlands                                 | \$ 11.5        | 5.0         | 3.3         |
| Mills                                     | 6.9            | 5.3         | 8.8         |
| Real Estate                               | 11.2           | 10.2        | 15.6        |
| Corporate                                 | <u>.1</u>      | <u>.1</u>   | <u>.1</u>   |
| Total capital expenditures                | 29.7           | 20.6        | 27.8        |
| Non-cash land exchange                    | <u>(.4)</u>    | <u>-</u>    | <u>(.2)</u> |
| Total capital expenditures requiring cash | \$ <u>29.3</u> | <u>20.6</u> | <u>27.6</u> |

Woodlands capital expenditures included timberland acquisitions of approximately 5,000 acres at a cost of \$7.5 million in 2008, 1,200 acres at a cost of \$2.2 million in 2007, and 400 acres at a cost of \$1.1 million in 2006. Reforestation site preparation and planting required expenditures of \$3.3 million in 2008, \$2 million in 2007, and \$1.5 million in 2006, and were the result of expansion of the Company's planting program due to final harvests of mature stands, necessitating regeneration, and to recent acquisitions of timberland.

Significant capital expenditures for the Mills segments during 2008 included \$3.3 million for a log bucking system, \$.3 million for saw filing automation, and \$.2 million for a planer blow system upgrade at the Ola Mill. At the Waldo Mill, 2008 expenditures included \$.5 million for new forklifts and a log loader, \$.4 million for a gang control and hydraulic valve upgrade, \$.2 million for a planer hog, and \$.2 million for a planer blow system upgrade.

During 2007, significant capital expenditures for the Mills segment included \$2.6 million for a planer machine and related system enhancements at the Waldo Mill, to replace the existing machine that was destroyed by fire. Also, at the Waldo Mill, \$.3 million was expended on hard surfacing and \$.1 million on a

forklift. The Ola Mill expended \$.4 million to complete the stick laying stacker project, \$.4 million on a gang saw control upgrade, \$.2 million on a strapping system upgrade, and \$.2 million on hard surfacing. During 2006, significant capital expenditures for the Mills segment included \$1.7 million to make improvements to the primary breakdown and automatic log rotation system at the Ola Mill, which increased shift uptime and reduced recovery losses associated with cants mis-manufactured due to poor rotation. The Ola Mill also installed a stick laying stacker at a cost of \$.7 million which improved uptime, efficiencies, and productivity. Also at the Ola Mill, \$.4 million was expended on sawmill modifications, \$.3 million on a log loader, \$.3 million on compressed air system improvements, and \$.2 million on edger upgrades. The Waldo Mill expended \$1.7 million on sawmill modifications to improve efficiencies and productivity, \$.6 million was for an automatic stick-laying system for the existing lumber stacker, and \$.4 million was expended on a reman/re-entry system.

Capital expenditures for Real Estate operations related to the cost of residential lot development totaled \$1 million in 2008, \$.7 million in 2007, and \$2.4 million in 2006. Land acquisitions required \$5.9 million in 2008, \$.8 million in 2007, and \$.6 million in 2006. Infrastructure related cost required \$.2 million in 2008, \$.1 million in 2007, and \$.3 million in 2006. Expenditures related to golf operations at the two courses at Chenal Country Club totaled \$.1 million in 2008 and 2006, respectively, for course maintenance equipment and golf carts, with no such expenditures in 2007. The Company expended \$.3 million in 2008, \$1.8 million in 2007, and \$6.1 million in 2006 on clubhouse renovations, the addition of a fitness center, and additional locker room and dining facilities. In addition, \$.6 million was expended in 2008, \$1.7 million in 2007, and \$1.4 million in 2006 for the construction of a limited number of speculative homes within the Company's Red Oak Ridge development located in Hot Springs, Arkansas. During 2007 and 2006, \$1.3 million and \$.2 million, respectively, was expended to construct, furnish, and decorate one of three Southern Living Idea Homes in the United States to be used as a model home in the Red Oak Ridge development and to gain national exposure for the development. Other expenditures were primarily for various amenity and infrastructure improvements.

Deltic had commitments of \$5.5 million for capital projects in progress at December 31, 2008. This total commitment includes \$.7 million for reforestation site preparation and road construction, \$3.3 million for land acquisitions, and \$.2 million for the completion of various projects at both the Ola Mill and Waldo Mill. Also, \$1.3 million was committed for residential and commercial site development, new home construction, and amenity improvements at the Company's real estate developments.

The net change in purchase stumpage inventory provided cash of \$1.2 million in 2008 and \$.3 million in 2006, but required cash of \$2.6 million in 2007. Advances to Del-Tin Fiber by the Company amounted to \$6.5 million, \$4.7 million, and \$2.8 million, in 2008, 2007 and 2006, respectively. The Company received cash repayments from Del-Tin Fiber of \$6.2 million in 2008, \$3.9 million in 2007, and \$4 million in 2006. Funds held by trustees to be used to acquire timberland designated as "replacement property" for income tax purposes, as required for tax-deferred exchanges, amounted to \$3.5 million in 2008, \$.7 million in 2007, and \$.1 million in 2006. Initiation fees received from members joining Chenal Country Club, accounted for as a reduction in cost basis of the club rather than net sales, amounted to \$.7 million in 2008, \$1.1 million in 2007, and \$.9 million in 2006. In 2007, other net cash provided by investing activities included \$1.9 million due to insurance proceeds for an involuntary conversion of assets related to a fire at the Waldo Mill.

During 2008, Deltic borrowed \$35 million under its revolving credit facility and repaid \$28 million of debt. During 2007, Deltic borrowed \$19 million and repaid \$19 million under its revolving credit facility. During 2006, Deltic borrowed \$20 million and repaid \$24.5 million under its revolving credit facility.

The Company purchased 129,996 shares of treasury stock in 2008 for \$6.2 million and 101,914 shares of treasury stock in 2007 for \$4.9 million. During 2006, only seven treasury shares were purchased. Cash required to pay common stock dividends totaled \$3.7 million in 2008, 2007, and 2006. Proceeds from stock option exercises amounted to \$3.4 million, \$1 million, and \$2.5 million, in 2008, 2007, and 2006, respectively. Costs of \$.6 million related to Deltic's revolving credit facility were paid in 2008 and 2007. Tax benefits from stock option exercises were \$.7 million in 2008, \$.3 million in 2007, and \$.6 million in 2006.

### *Financial Condition*

Working capital at year-end totaled \$4.8 million in 2008 and \$7.3 million in 2007. Deltic's working capital ratio at December 31, 2008, was 1.42 to 1 compared to 1.46 to 1 at the end of 2007. Cash and cash equivalents at the end of 2008 were \$2.4 million compared to \$10.7 million at the end of 2007. The total indebtedness of the Company at year-end 2008 was \$77 million and 2007 was \$70 million. Deltic's long-term debt to stockholders' equity ratio was .356 to 1 at December 31, 2008, compared to .306 to 1 at the end of 2007.

### *Liquidity*

The primary sources of the Company's liquidity are internally generated funds, access to outside financing, and working capital. The Company's current strategy for growth continues to emphasize its timberland acquisition program, in addition to expanding lumber production as market conditions allow and developing residential and/or commercial properties at Chenal Valley and Red Oak Ridge.

To facilitate these growth plans, the Company has an agreement with a group of banks which provides an unsecured and committed revolving credit facility totaling \$300 million, inclusive of a \$50 million letter of credit feature. The agreement will expire on September 9, 2012. As of December 31, 2008, \$267 million was available. The credit agreement contains restrictive covenants, including limitations on the incurrence of debt and requirements to maintain certain financial ratios. (For additional information about the Company's current financing arrangements, refer to Note 9 to the consolidated financial statements.)

In December 2000, the Company's Board of Directors authorized a stock repurchase program of up to \$10 million of Deltic common stock. In December 2007, the Company's Board of Directors expanded the program by \$25 million. As of December 31, 2008, the Company had expended \$13.5 million under this program, with the purchase of 335,178 shares at an average cost of \$40.23 per share; 129,996 shares were purchased in 2008, 101,914 shares were purchased under this program in 2007 and seven shares in 2006. In its two previous repurchase programs, Deltic purchased 479,601 shares at an average cost of \$20.89 and 419,542 shares at a \$24.68 per share average cost, respectively.

### *Off-Balance Sheet Arrangements, Contractual Obligations, and Commitments*

On August 26, 2004, Del-Tin Fiber refinanced its existing long-term debt by entering into a credit agreement consisting of a letter of credit and term loan with multiple lending institutions. The funds provided from this credit agreement were used, together with the existing balance in Del-Tin Fiber's debt service reserve and bond sinking fund accounts, to redeem \$60 million of its \$89 million industrial revenue bonds. Under the new credit agreement, the lenders, on September 1, 2004, loaned Del-Tin Fiber \$30 million which is repayable over five years in equal quarterly installments, that began December 31, 2004, and issued on Del-Tin Fiber's behalf, a letter of credit in the amount of \$29.7 million to support the remaining industrial revenue bonds originally issued in 1998 by Union County, Arkansas. Concurrent with this event, on August 26, 2004, Deltic executed a guarantee agreement in connection with the refinancing of the debt of Del-Tin Fiber. Under Deltic's guarantee agreement, Deltic unconditionally guarantees the due and punctual payment of 50 percent (\$16.8 million at December 31, 2008) of Del-Tin Fiber's obligations under its credit agreement.

The Company has adopted the provisions of FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34." In accordance with FIN 45, Deltic initially estimated the fair value of its guarantee of Del-Tin Fiber's credit agreement to be \$3.5 million and included this non-cash amount in the Company's Consolidated Balance Sheet as a long-term liability with an offsetting increase in the Company's investment in Del-Tin Fiber. Deltic is reducing this liability systematically over the life of the credit agreement, as the Company is released from risk under the guarantee. At December 31, 2008, Deltic's remaining liability regarding the guarantee was \$.5 million. Deltic considers the current status of the payment/performance risk of this guarantee to be low based on history and the length of time remaining on the guarantee.

The Company has both funded and unfunded noncontributory defined benefit retirement plans that cover the majority of its employees. The plans provide defined benefits based on years of service and final average salary. Deltic also has other postretirement benefit plans covering substantially all of its employees. The health care plan is contributory with participants' contributions adjusted as needed; the life insurance plan is noncontributory. With regards to all of the Company's employee and retiree benefit plans, Deltic is unaware of any trends, demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the Company's liquidity increasing or decreasing in any material way, or which would cause the 2008 reported plan information not to be necessarily indicative of future operating performance or future financial condition. (For information about material assumptions underlying the accounting for these plans and other components of the plans, refer to Note 15 to the consolidated financial statements.)

Tabular summaries of the Company's contractual cash payment obligations and other commercial commitment expirations, by period, are presented in the following tables.

| (Millions of dollars)                                    | <u>Total</u>    | <u>During<br/>2009</u> | <u>2010<br/>to 2011</u> | <u>2012<br/>to 2013</u> | <u>After<br/>2013</u> |
|----------------------------------------------------------|-----------------|------------------------|-------------------------|-------------------------|-----------------------|
| Contractual cash<br>payment obligations                  |                 |                        |                         |                         |                       |
| Real estate development<br>committed capital cost        | \$ 5.0          | .5                     | 4.5                     | -                       | -                     |
| Woodlands land acquisition<br>and committed capital cost | 2.7             | 2.7                    | -                       | -                       | -                     |
| Mills committed capital cost                             | .2              | .2                     | -                       | -                       | -                     |
| Long-term debt                                           | 76.9            | 1.1                    | 2.2                     | 33.6                    | 40.0                  |
| Interest on debt <sup>1</sup>                            | 23.4            | 3.6                    | 7.0                     | 5.6                     | 7.2                   |
| Retirement plans                                         | 14.4            | 1.0                    | 2.3                     | 2.7                     | 8.4                   |
| Other postretirement<br>benefits                         | 5.6             | .5                     | 1.1                     | 1.1                     | 2.9                   |
| Other long-term liabilities                              | 9.2             | 4.0                    | 4.4                     | .8                      | -                     |
| Unrecognized tax benefits                                | 1.5             | -                      | 1.3                     | .2                      | -                     |
|                                                          | <u>\$ 138.9</u> | <u>13.6</u>            | <u>22.8</u>             | <u>44.0</u>             | <u>58.5</u>           |
| Other commercial<br>commitment expirations               |                 |                        |                         |                         |                       |
| Guarantee of indebtedness<br>of Del-Tin Fiber            | \$ 16.8         | 2.3                    | 14.5                    | -                       | -                     |
| Timber cutting agreements                                | .6              | .5                     | .1                      | -                       | -                     |
| Operating leases                                         | -               | -                      | -                       | -                       | -                     |
| Letters of credit                                        | .5              | -                      | .2                      | .3                      | -                     |
|                                                          | <u>\$ 17.9</u>  | <u>2.8</u>             | <u>14.8</u>             | <u>.3</u>               | <u>-</u>              |

<sup>1</sup> Interest commitments are estimated using the Company's current interest rates for the respective debt agreements over their remaining terms to expiration.

### Outlook

Deltic's management believes that cash provided from its operations, the remaining amount available under its credit facility, and its ability to access the credit markets, will be sufficient to meet its expected cash needs and planned expenditures, including those of the Company's continued timberland acquisition and stock repurchase programs, and capital expenditures, for the foreseeable future.

The preceding discussion of the Company's liquidity and capital resources contains "forward-looking statements" which were made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements reflect the Company's current expectations and involve risks and uncertainties. Actual results could differ materially from those included in such forward-looking statements.

## ***Other Matters***

### *Impact of Inflation*

General inflation has not had a significant effect on the Company's operating results during the three years ended December 31, 2008. The Company's timber operations are more significantly impacted by the forces of supply and demand in the southern United States than by changes in inflation. Lumber manufacturing operations are affected by the supply of lumber available in the North American market and by the demand for lumber by both the North American and foreign export markets. Sales of real estate are affected by changes in the general economy and long-term interest rates, specifically as such may manifest themselves in the central Arkansas region.

### *Market Risk*

Market risk represents the potential loss resulting from adverse changes in the value of financial instruments, either derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates, commodity prices, and equity security prices. The Company handles market risks in accordance with its established policies; however, Deltic does not enter into derivatives or other financial instruments for trading or speculative purposes. The Company does, on occasion, consider the need to enter into financial instruments to manage and reduce the impact of changes in interest rates; however, the Company entered into no such instruments during the three-year period ended December 31, 2008. Deltic held various financial instruments at December 31, 2008 and 2007, consisting of financial assets and liabilities reported in the Company's Consolidated Balance Sheets and off-balance sheet exposures resulting from contractual debt guarantees and letters of credit issued for the benefit of Deltic, primarily in connection with its purchased stumpage procurement and real estate operations. (For additional information regarding these financial instruments, refer to the previous tabular summary of the Company's other commercial commitment expirations and to Note 13 to the consolidated financial statements.)

*Interest Rate Risk* - The Company is subject to interest rate risk from the utilization of financial instruments, such as term debt and other borrowings. The fair market value of long-term, fixed-interest rate debt is subject to interest rate risk. Generally, the fair value of fixed-interest rate debt will increase as interest rates fall and will decrease as interest rates rise. Conversely, for floating rate debt, interest rate changes generally do not affect the instruments' fair value, but do impact future earnings and cash flows, assuming other factors are held constant. The estimated fair values of the Company's long-term debt, including current maturities, contractual guarantees of debt, and letters of credit at December 31, 2008, were \$1.1 million, \$.5 million, and \$.5 million, respectively.

A one percentage-point increase in prevailing interest rates would result in decreases in the estimated fair value of long-term debt of \$6.1 million, while the fair value of contractual guarantees and the Company's letters of credit would be unchanged. Fair values were determined using the current rates at which the Company could enter into comparable financial instruments with similar remaining maturities. There was no impact for 2008 resulting from a one percentage-point increase in interest rates on the estimated pretax earnings and cash flows, holding other variables constant.

*Foreign-Exchange Rate Risk* - The Company currently has no exposure to foreign-exchange rate risk because all of its financial instruments are denominated in U.S. dollars.

*Commodity Price Risk* - The Company has no financial instruments subject to commodity price risk.

*Equity Security Price Risk* - None of the Company's financial instruments have potential exposure to equity security price risk.

The preceding discussion of the Company's estimated fair value of its financial instruments and the sensitivity analyses resulting from hypothetical changes in interest rates are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements reflect the Company's current expectations and involve uncertainties. These forward-looking market risk disclosures are selective in nature and only address the potential impact from financial instruments. They do not include other potential effects which could impact Deltic's business as a result of changes in interest rates, foreign-exchange rates, commodity prices, or equity security prices.

#### *Critical Accounting Policies and Estimates*

The Company has identified seven of its current accounting policies as being, in management's view, critical to the portrayal of the Company's financial condition and results of operations. Additionally, six of these policies require significant assumptions and/or estimates on the part of management as it pertains to certain factors inherent in the policies. The Company's senior management has discussed the development and selection of its critical accounting policies and estimates with the Company's Audit Committee. Deltic has not made any material changes to its critical accounting estimates in the last three years. These policies, along with explanations of the key assumptions and/or estimates considered by management, are described below. (For a listing of all significant accounting policies of the Company, refer to Note 1 to the consolidated financial statements.)

- 1) *Investment in Real Estate Held for Development and Sale* — Real estate held for development and sale is stated at the lower of cost or net realizable value, and includes direct costs of land and land development and indirect costs, including amenities. Indirect and amenity costs are allocated to individual lots or acreage sold based on relative sales value. Direct costs are allocated on a specific neighborhood basis, while indirect costs for the Company's three development areas — Chenal Valley, Chenal Downs, and Red Oak Ridge — are allocated to neighborhoods over the entire respective development area based on relative retail values.

The key factors involved in determining the Investment in Real Estate Held for Development and Sale are: (1) the treatment of the clubhouse and golf course at Chenal Country Club, the amenity around which the Chenal Valley development is centered, as an amenity rather than an operating fixed asset and (2) the management estimates required to estimate the future indirect development costs and sales values of the areas of Chenal Valley yet to be developed. Due to accounting for Chenal Country Club as an amenity, the cost of the clubhouse and golf course, including the estimated cost of planned future improvements, are charged against income as real estate is sold rather than depreciating this cost. This amenity treatment also records the initiation fees received from members joining the club as a reduction in the cost basis of the club rather than as net sales. In addition, the Company's model for allocating the indirect cost to be expensed against each piece of real estate sold requires management to estimate the future indirect costs to be incurred for the entire development, primarily infrastructure costs and future improvements at Chenal Country Club (net of estimated future initiation fees to be received), as well as the potential market value of each tract of undeveloped property within the Chenal Valley development. In determining future indirect development costs, management relies on cost projections for its development plans provided by independent professional engineering consultants. Independent appraisers are utilized to provide the potential market value for unsold acreage.

- 2) *Investment in Del-Tin Fiber* — Investment in Del-Tin Fiber L.L.C. ("Del-Tin Fiber"), a 50 percent-owned limited liability company, is carried at cost and is adjusted for the Company's proportionate share of Del-Tin Fiber's undistributed earnings or losses. The Company's equity-method-basis carrying value for its investment in Del-Tin Fiber is evaluated for possible impairment, as

applicable under the requirements of Accounting Principles Board Opinion ("APB") 18, The Equity Method of Accounting for Investments in Common Stock". This evaluation as of December 31, 2002, based on the intent of the Company's Board of Directors to exit the business, resulted in a determination that the Company's investment was impaired as of December 31, 2002, and the carrying amount of the investment was written off, to zero, for the 2002 Consolidated Balance Sheet. On December 11, 2003, the Company's Board of Directors revised its intent in regard to selling Deltic's interest in the joint venture. The resulting evaluation of fair value for the related investment indicated that fair value exceeded carrying value, which was zero as of December 31, 2003, and the Company resumed recording its equity share of the operating results of Del-Tin Fiber. Likewise, cash advances to the joint venture are recorded as increases in the Company's investment in the facility, while cash distributions received from the joint venture are reflected as reductions in its investment.

For Deltic's investment in Del-Tin Fiber, the key determinations by management are (1) the accounting treatment for this investment under the equity method of accounting rather than as a consolidated subsidiary since the joint venture is 50 percent owned by both owners, (2) the factors used in evaluating the impairment of the investment's carrying value, and (3) the estimate of the fair value of the Company's guarantee of Del-Tin Fiber's credit agreement. Deltic management has determined that there is no control by either company due to having a Board of Managers with equal representation. As such, the assets and liabilities of Del-Tin Fiber are not included in the amounts reported on the Company's balance sheet for any period. In evaluating the possibility of the existence of an impairment for the Company's carrying value for its investment in Del-Tin Fiber under APB 18, management must estimate future net cash flows from the possible courses of action available for its investment, such as continuing to maintain or sell its investment, to determine both recoverability of the carrying amount and fair value of the investment. More specifically, management must determine the possible courses of action and estimate the probability of each potential action, as well as the related future net cash flows. Then, if estimated fair value is less than the carrying amount, management must determine if this impairment is other than temporary. If so, then an impairment write-down is required. In estimating the fair value of the guarantee of Del-Tin Fiber's credit agreement, Deltic's management must first assess how the same debt instrument would have been structured without the guarantees of the joint venture partners, in order to estimate the benefit resulting from Deltic's guarantee. A range of probabilities of estimated future cash outflows under the benefit previously determined are then assembled. A probability-weighted present value of the estimated future cash outflows is then calculated. The resulting balance represents the fair value of the obligation, which is the estimate of the value of assets required currently to settle the liability in the future. (For additional information about the Company's investment in Del-Tin Fiber, refer to Note 4 to the consolidated financial statements.)

- 3) *Timber and Timberlands* — Timber and timberlands, which includes timberland, fee timber, purchased stumpage inventory and logging facilities, are stated at cost less cost of fee timber harvested and accumulated depreciation of logging facilities and includes no estimated future reforestation cost. The cost of timber consists of fee timber acquired and reforestation costs, which includes site preparation, seedlings, and labor. The cost of fee timber harvested is based on the volume of timber harvested in relation to the estimated volume of timber recoverable. Logging facilities, which consist primarily of roads constructed and other land improvements, are depreciated using the straight-line method over a ten-year estimated life. The Company estimates its fee timber inventory using statistical information and data obtained from physical measurements and other information gathering techniques. Fee timber carrying costs, commercial thinning, silviculture and timberland management costs are expensed as incurred.

The Company classifies its timberlands and fee timber as either strategic or non-strategic. Strategic timberland including pine forest and pine plantations are prime pine sawtimber growing platforms located within or immediately adjacent to the Company sawmill's operating regions. Deltic manages these acres using modern silviculture methods to achieve optimal volume and quality of its pine sawtimber. The Company harvests sawtimber and pulpwood in accordance with

its harvest plans and generally converts sawtimber into lumber in its own sawmills and sells pulpwood in the market. Upon harvest, strategic timberlands are reforested. The Company's timberland acquisition program is focused on the acquisition of timberland in its current operating regions. The Company considers the acquisition and the occasional sale of strategic timberlands as investing activities. The Company has legacy hardwood and other acreage which can not be harvested for conversion in Company sawmills, reforested as pine plantations, or both. These legacy timberlands have been identified as non-strategic and or higher and better use timberlands and are expected to be sold over time. The Woodlands segment manages an annual program to sell a portion of these non-strategic timberlands and or harvest hardwoods for the sale to third parties. The Company considers this program as an operating activity of its Woodlands segment.

In order to acquire and sell assets, primarily timberlands, in a tax efficient manner, the Company enters into like-kind exchange ("LKE") tax-deferred transactions. The Company generally enters into forward transactions, in which property is sold and the proceeds are reinvested by acquiring similar property; and reverse transactions, in which property is acquired and similar property is subsequently sold. A qualified LKE intermediary is used to facilitate LKE transactions. Proceeds from forward LKE transactions are held by the intermediary and are classified as restricted cash because the funds must be reinvested in similar properties. If the acquisition of suitable LKE properties is not completed within 180 days of the sale of the company-owned property, the proceeds are distributed to us by the intermediary and are reclassified as available cash and applicable income taxes are determined. Amounts deposited with a third party towards the potential future purchase of property are included in other investments and non-current receivables in the consolidated balance sheets and as an investing activity in funds held by trustee in the consolidated statements of cash flow. At December 31, 2008 and 2007, the Company had \$4.3 million and \$.8 million, respectively, of proceeds from land sales deposited with a LKE intermediary.

The key components of the Timber and Timberlands policy are: (1) management's decision to maintain separate timber cost pools for each legal entity within the Deltic consolidated group and (2) the required estimation of timber inventory volume, by species, for each of these companies in order to calculate the cost of fee timber harvested per ton. Management has elected to maintain a separate cost pool for the timber owned by each company, thus resulting in a different cost per ton for fee timber harvested for each. The mix of harvest by company for any period can significantly affect the amount of cost of fee timber harvested expense reported. Per-ton costs for 2008 ranged from \$2.05 to \$34.28 per ton for pine sawtimber. Had the Company opted to use a composite depletion rate, cost of pine sawtimber harvested would have been \$.3 million less in 2008, the same in 2007, and \$.3 million more in 2006, (\$.2 million, zero, and \$.2 million, respectively, net of applicable income taxes) than as reported due to the mix of harvest by company during the year. In determining these rates, management must estimate the volume of timber existing on its timberlands. To estimate these fee timber inventories, the Company relies on its experienced forestry personnel and their use of statistical information and data obtained by actual physical measurements and other information gathering techniques. The recognized cost of fee timber harvested is impacted by the accuracy of this volume estimation. (For additional information about the Company's timber and timberlands, refer to Note 5 to the consolidated financial statements.)

- 4) *Property, Plant, and Equipment* — Property, plant, and equipment is stated at cost less accumulated depreciation. Depreciation of buildings, equipment, and other depreciable assets is primarily determined using the straight-line method. Expenditures that substantially improve and/or increase the useful life of facilities or equipment are capitalized. Maintenance and repair costs are expensed as incurred. Gains and losses on disposals or retirements are included in income as they occur.

Property, plant, and equipment assets are evaluated for possible impairment on a specific asset basis or in groups of similar assets, as applicable, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to

be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future net cash flows to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment loss is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell, and depreciation ceases.

Management also evaluates any asset or group of assets for which potential impairment might exist and has determined that there are none requiring an impairment write-down. This process requires management's estimate of future cash flows generated by each asset or group of assets. For any instance where this evaluation process might indicate impairment exists, the appropriate asset's carrying values would be written down to fair value and the amount of the write-down would be charged against the results of continuing operations. (For additional information about the Company's property, plant, and equipment, refer to Note 6 to the consolidated financial statements.)

- 5) *Stock-Based Compensation* — On January 1, 2006, the Company adopted the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement No. 123 (R), "Share-Based Payment," ("SFAS 123 (R)").

The Company adopted SFAS 123 (R) using the modified-prospective transition method. Under this transition method, compensation cost recognized in future interim and annual reporting periods includes: (1) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123, and (2) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123 (R). The results for prior periods have not been restated. The adoption of SFAS No. 123 (R) had an impact on the Company's results of operations. The consolidated statement of income for the years ended December 31, 2008, 2007, and 2006, included \$1,669,000, \$2,676,000, and \$1,207,000, respectively, of stock-based compensation expense reflected in general and administrative expenses.

SFAS No. 123 (R) requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under APB 25 and related interpretations. This requirement increased net financing cash flows, rather than net operating cash flows, for the years ended December 31, 2008, 2007, and 2006, by \$995,000, \$306,000, and \$611,000, respectively. The cumulative effect related to outstanding restricted stock awards as of December 31, 2005, which are not expected to vest based on an estimate of forfeitures, was not material.

Under the fair value recognition provisions of SFAS No. 123 (R), stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense over the requisite service period of the award. For valuation of stock options granted subsequent to the adoption of SFAS No. 123 (R), Deltic elected to use a binomial model to estimate fair value. The fair value of restricted stock awards is determined by reference to the fair market value of the Company's common stock on the date of grant. For restricted stock performance units subsequent to Deltic's adoption of SFAS No. 123 (R), the Monte Carlo simulation is being used to estimate fair value. For all awards subsequent to the adoption of SFAS No. 123 (R), the Company will recognize compensation cost on a straight-line basis over the requisite service period.

Deltic issues restricted stock performance units whose vesting is contingent upon meeting certain financial performance goals based upon the Company's total stockholder return compared to the total return of a Paper and Forest Products Index ("the Index") selected by the Compensation Committee and calculated by Standard and Poor's. Determining the appropriate amount to expense is based on likelihood of achievement of the stated goals and requires judgement,

including forecasting future financial results. This estimate may be revised periodically due to changes in awards as defined under SFAS No. 123 (R). The cumulative impact of any revision is reflected in the period of change.

The Company used historical volatility over the ten-year trading life of its stock to determine volatility assumptions. Risk-free interest rates are based on historical rates and forward-looking factors. The expected dividend yield is based on the Company's average dividend yield from 2004 to 2007. The pre-vesting forfeiture rate is based on historical rates and forward-looking factors. The expected option term is based on the term of the option and historical exercise, and expiration experience.

Assumptions for the 2008, 2007, and 2006 valuation of stock options and restricted stock performance units consisted of the following:

|                                     | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|-------------------------------------|-------------|-------------|-------------|
| Weighted expected volatility        | 29.86%      | 28.72%      | 28.97%      |
| Dividend yield                      | 0.63%       | 0.64%       | 0.76%       |
| Expected term of options (in years) | 6.27        | 6.27        | 6.27        |
| Risk-free interest rate             | 3.67%       | 4.76%       | 4.43%       |

- 6) *Revenue Recognition* — The Company recognizes revenue when the following criteria are met: (1) persuasive evidence of an agreement exists, (2) delivery has occurred or services have been rendered, (3) the price to the buyer is fixed and determinable, and (4) collectibility is reasonably assured. Delivery is not considered to have occurred until the customer takes title and assumes the risks and rewards of ownership. Revenue from the sale of lumber and wood by-products is recorded at the time of shipment due to terms of such sale being designated free on board ("f.o.b.") shipping point. Revenue from the sale of timber-cutting rights to third parties is recorded when legal title passes to the purchaser, which is generally upon delivery of a legally executed timber deed and receipt of payment for the timber. Revenue from intersegment timber sales is recorded when the timber is harvested. Such intersegment sales, which are made at prices which generally approximate market, are eliminated in the consolidated financial statements. Revenue from timberland and real estate sales is recorded under the criteria of the Financial Accounting Standards Board's Statement of Financial Accounting Standards ("SFAS") 66, "Accounting for Sales of Real Estate." Such revenue is recorded at the time the purchaser executes the real estate closing documents and makes payment to the title company handling the closing.
- 7) *Income Taxes* — The Company uses the asset and liability method of accounting for income taxes. Under this method, the provision for income taxes includes amounts currently payable and amounts deferred as tax assets and liabilities, based on differences between financial statement carrying amounts and the tax bases of existing assets and liabilities, and is measured using the enacted tax rates that are assumed will be in effect when the differences reverse. Deferred tax assets are reduced by a valuation allowance which is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The key management decisions related to income taxes are: (1) the determination of current taxability of transactions, (2) the election to capitalize or expense costs incurred, (3) the decision regarding the appropriate depreciation method for income tax purposes (these three factors ultimately affect the Company's cash flows for income taxes paid and determine the differences between the financial statements carrying amounts and tax bases of existing assets and liabilities), and (4) management's estimation of the appropriateness of valuation allowances to reduce any deferred tax assets that exist. Deltic's management periodically evaluates the Company's ability to realize future benefit of deferred tax assets by reviewing the expected turnaround of deferred tax liabilities and the amount of future taxable income and by evaluating

tax planning strategies that could possibly be implemented to realize deferred tax assets.

The Company maintains liabilities for unrecognized tax benefits for various uncertain tax positions taken in our tax return. These liabilities are estimated based on our judgment of our probable outcome of the uncertain tax positions and are adjusted periodically based on changing facts and circumstances. Changes to the liabilities for unrecognized tax benefits could materially affect operating results in the period of change.

#### *Related-Party Transactions*

The Company has committed to provide to Del-Tin Fiber a portion of the plant's fiber and wood supply at market prices. This arrangement benefits Del-Tin Fiber by ensuring a portion of its raw material needs while providing the Company with a purchaser of residual by-products produced by its lumber mills, if needed. The market price that Deltic receives for these transactions is determined by the average price paid during the immediate preceding year by Del-Tin Fiber to other suppliers of the products purchased from the Company. During 2008, 2007, and 2006, Deltic sold Del-Tin Fiber approximately \$4.6 million, \$3.7 million, and \$3.9 million each year, respectively, of these residual by-products.

#### *Impact of Recent Accounting Pronouncements*

(For information regarding the impact of recent accounting pronouncements, refer to the related section in Note 1 to the consolidated financial statements.)

#### *Environmental Matters*

Deltic is committed to protecting the environment and has certain standards with which it must comply based on federal, state, and local laws for the protection of the environment. Costs of compliance through 2008 have not been material, and the Company's management currently has no reason to believe that such costs will become material for the foreseeable future.

#### *Contingencies*

The Company is involved in litigation incidental to its business from time to time. Currently, there are no material legal proceedings outstanding.

#### **Outlook**

Pine sawtimber harvested from Deltic's fee lands in 2009 is projected to be 525,000 to 575,000 tons. Finished lumber production and resulting sales volumes are projected at 220 to 260 million feet for 2009; however, these volumes are dependent upon market conditions. Deltic anticipates that closings for residential lots will be 20 to 30 lots for the year of 2009, barring further declines in economic growth or residential construction activity. The Company will continue to recognize equity in the financial results of Del-Tin Fiber.

The Company's capital expenditures budget for the year of 2009 was prepared in the fall of 2008 and provides for expenditures totaling \$29.3 million. The Woodlands capital budget of \$13 million includes \$8.3 million for timberland acquisitions, which will be dependent on the availability of acreage at prices that meet the Company's criteria for timber stocking, growth potential, site index, and location, and \$3.9 million for reforestation site preparation and planting. During 2009, various sawmill projects are expected to require \$6.7 million. The capital budget for Real Estate operations of \$9 million includes expenditures for real estate lot development totaling \$1 million and for commercial real estate development totaling \$2.3 million, depending upon the demand for residential lots, commercial acreage, and other marketing conditions. In addition, the Real Estate segment is budgeted to spend \$2.3 million for land acquisitions, \$2.8 million for various infrastructure and improvement district assessments, and \$.6 million on other amenity improvements. Capital and other expenditures are under constant review, and these budgeted amounts may be adjusted to reflect changes in the Company's estimated cash flows from operations, borrowings, or repayments under

credit facilities, or general economic conditions.

Certain statements contained in this report that are not historical in nature constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as “expects”, “anticipates”, “intends”, “plans”, “estimates”, or variations of such words and similar expressions are intended to identify such forward-looking statements. These statements reflect the Company’s current expectations and involve certain risks and uncertainties, including those disclosed elsewhere in this report. Therefore, actual results could differ materially from those included in such forward-looking statements.

#### **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Information with respect to quantitative and qualitative disclosures about market risk of the Company is set forth under the caption “Other Matters - Market Risk” in Item 7 of Part II of this report.

## Item 8. Financial Statements and Supplementary Data

### DELTIC TIMBER CORPORATION AND SUBSIDIARIES

#### Consolidated Balance Sheets

December 31, 2008 and 2007

(Thousands of dollars)

|                                                                                   | 2008       | 2007     |
|-----------------------------------------------------------------------------------|------------|----------|
| <b>Assets</b>                                                                     |            |          |
| Current assets                                                                    |            |          |
| Cash and cash equivalents                                                         | \$ 2,413   | 10,673   |
| Trade accounts receivable – net                                                   | 2,991      | 3,941    |
| Other receivables                                                                 | 58         | 161      |
| Inventories                                                                       | 6,511      | 6,156    |
| Prepaid expenses and other current assets                                         | 4,223      | 2,302    |
| Total current assets                                                              | 16,196     | 23,233   |
| Investment in real estate held for development and sale                           | 54,081     | 46,048   |
| Investment in Del-Tin Fiber                                                       | 8,962      | 7,017    |
| Other investments and noncurrent receivables                                      | 5,710      | 2,445    |
| Timber and timberlands – net                                                      | 210,035    | 208,428  |
| Property, plant, and equipment – net                                              | 38,657     | 39,214   |
| Deferred charges and other assets                                                 | 1,092      | 2,359    |
| Total assets                                                                      | \$ 334,733 | 328,744  |
| <b>Liabilities and Stockholders' Equity</b>                                       |            |          |
| Current liabilities                                                               |            |          |
| Current maturities of long-term debt                                              | \$ 1,111   | 3,333    |
| Trade accounts payable                                                            | 1,727      | 2,660    |
| Accrued taxes other than income taxes                                             | 1,758      | 1,650    |
| Income taxes payable                                                              | 16         | 1,371    |
| Deferred revenues and other accrued liabilities                                   | 6,777      | 6,934    |
| Total current liabilities                                                         | 11,389     | 15,948   |
| Long-term debt                                                                    | 75,833     | 66,667   |
| Deferred tax liabilities – net                                                    | 4,758      | 6,800    |
| Guarantee of indebtedness of Del-Tin Fiber                                        | 518        | 1,207    |
| Other noncurrent liabilities                                                      | 29,071     | 20,036   |
| Commitments and contingencies                                                     | -          | -        |
| Stockholders' equity                                                              |            |          |
| Cumulative preferred stock - \$.01 par, authorized 20,000,000 shares, none issued | -          | -        |
| Common stock - \$.01 par, authorized 50,000,000 shares, 12,813,879 shares issued  | 128        | 128      |
| Capital in excess of par value                                                    | 78,660     | 76,637   |
| Retained earnings                                                                 | 155,683    | 155,299  |
| Treasury stock                                                                    | (14,400)   | (12,385) |
| Accumulated other comprehensive income/(loss)                                     | (6,907)    | (1,593)  |
| Total stockholders' equity                                                        | 213,164    | 218,086  |
| Total liabilities and stockholders' equity                                        | \$ 334,733 | 328,744  |

See accompanying notes to consolidated financial statements.

DELTIC TIMBER CORPORATION  
AND SUBSIDIARIES  
Consolidated Statements of Income  
For the Years Ended December 31, 2008, 2007, and 2006  
(Thousands of dollars, except per share amounts)

|                                                                 | <u>2008</u>            | <u>2007</u>          | <u>2006</u>          |
|-----------------------------------------------------------------|------------------------|----------------------|----------------------|
| Net sales                                                       | \$ <u>129,524</u>      | <u>128,255</u>       | <u>153,112</u>       |
| Costs and expenses                                              |                        |                      |                      |
| Cost of sales                                                   | 93,956                 | 81,658               | 106,443              |
| Depreciation, amortization, and cost of<br>fee timber harvested | 14,023                 | 14,332               | 13,774               |
| General and administrative expenses                             | <u>14,040</u>          | <u>15,379</u>        | <u>14,174</u>        |
| Total costs and expenses                                        | <u>122,019</u>         | <u>111,369</u>       | <u>134,391</u>       |
| Gain on involuntary conversion                                  | -                      | 1,887                | -                    |
| Other income – business interruption insurance proceeds         | <u>-</u>               | <u>1,186</u>         | <u>-</u>             |
| Operating income                                                | 7,505                  | 19,959               | 18,721               |
| Equity in earnings of Del-Tin Fiber                             | 2,277                  | 1,679                | 2,872                |
| Interest income                                                 | 299                    | 823                  | 452                  |
| Interest and other debt expense                                 | (5,179)                | (5,138)              | (5,415)              |
| Interest capitalized                                            | 480                    | 769                  | 1,184                |
| Other income/(expense)                                          | <u>(10)</u>            | <u>345</u>           | <u>290</u>           |
| Income before income taxes                                      | 5,372                  | 18,437               | 18,104               |
| Income taxes                                                    | <u>(988)</u>           | <u>(7,326)</u>       | <u>(6,781)</u>       |
| Net income                                                      | \$ <u><u>4,384</u></u> | <u><u>11,111</u></u> | <u><u>11,323</u></u> |
| Earnings per common share                                       |                        |                      |                      |
| Basic                                                           | \$ .35                 | .89                  | .91                  |
| Assuming dilution                                               | \$ .35                 | .89                  | .89                  |
| Dividends declared per common share                             | \$ .30                 | .30                  | .30                  |
| Average common shares outstanding (thousands)                   | 12,447                 | 12,473               | 12,398               |

See accompanying notes to consolidated financial statements.

DELTIC TIMBER CORPORATION  
AND SUBSIDIARIES  
Consolidated Statements of Cash Flows  
For the Years Ended December 31, 2008, 2007, and 2006  
(Thousands of dollars)

|                                                                                       | <u>2008</u>     | <u>2007</u>     | <u>2006</u>     |
|---------------------------------------------------------------------------------------|-----------------|-----------------|-----------------|
| Operating activities                                                                  |                 |                 |                 |
| Net income                                                                            | \$ 4,384        | 11,111          | 11,323          |
| Adjustments to reconcile net income to net cash provided by operating activities      |                 |                 |                 |
| Depreciation, amortization, and cost of fee timber harvested                          | 14,023          | 14,332          | 13,774          |
| Stock-based compensation expense                                                      | 1,669           | 2,676           | 1,207           |
| Deferred income taxes                                                                 | 778             | 1,082           | (4,286)         |
| Real estate costs recovered upon sale                                                 | 1,899           | 5,946           | 11,290          |
| Timberland costs recovered upon sale                                                  | 2,473           | 327             | 77              |
| Equity in earnings of Del-Tin Fiber                                                   | (2,277)         | (1,679)         | (2,872)         |
| Net increase/(decrease) in provisions for pension and other postretirement benefits   | 89              | (183)           | 810             |
| Decrease/(increase) in operating working capital other than cash and cash equivalents | (2,684)         | 1,341           | 4,452           |
| Gain on involuntary conversion                                                        | -               | (1,887)         | -               |
| Other changes in assets and liabilities                                               | <u>1,329</u>    | <u>(4,823)</u>  | <u>3,373</u>    |
| Net cash provided by operating activities                                             | <u>21,683</u>   | <u>28,243</u>   | <u>39,148</u>   |
| Investing activities                                                                  |                 |                 |                 |
| Capital expenditures requiring cash                                                   | (29,267)        | (20,568)        | (27,620)        |
| Net change in purchased stumpage inventory                                            | 1,181           | (2,603)         | 266             |
| Advances to Del-Tin Fiber                                                             | (6,524)         | (4,654)         | (2,832)         |
| Repayments from Del-Tin Fiber                                                         | 6,167           | 3,876           | 3,950           |
| Increase in funds held by trustee                                                     | (3,491)         | (694)           | (111)           |
| Insurance proceeds from involuntary conversion                                        | -               | 1,991           | -               |
| Other – net                                                                           | <u>1,156</u>    | <u>1,629</u>    | <u>2,113</u>    |
| Net cash required by investing activities                                             | <u>(30,778)</u> | <u>(21,023)</u> | <u>(24,234)</u> |
| Financing activities                                                                  |                 |                 |                 |
| Proceeds from borrowings                                                              | 35,000          | 19,000          | 20,000          |
| Repayments of notes payable and long-term debt                                        | (28,056)        | (19,000)        | (24,524)        |
| Treasury stock purchases                                                              | (6,180)         | (4,901)         | -               |
| Common stock dividends paid                                                           | (3,733)         | (3,742)         | (3,721)         |
| Proceeds from stock option exercises                                                  | 3,388           | 997             | 2,450           |
| Excess tax benefits from stock-based compensation                                     | 995             | 306             | 611             |
| Other – net                                                                           | <u>(579)</u>    | <u>(566)</u>    | <u>(8)</u>      |
| Net cash provided/(required) by financing activities                                  | <u>835</u>      | <u>(7,906)</u>  | <u>(5,192)</u>  |
| Net increase/(decrease) in cash and cash equivalents                                  | (8,260)         | (686)           | 9,722           |
| Cash and cash equivalents at beginning of year                                        | <u>10,673</u>   | <u>11,359</u>   | <u>1,637</u>    |
| Cash and cash equivalents at end of year                                              | \$ <u>2,413</u> | <u>10,673</u>   | <u>11,359</u>   |

See accompanying notes to consolidated financial statements.

DELTIC TIMBER CORPORATION  
AND SUBSIDIARIES  
Consolidated Statements of Stockholders' Equity  
For the Years Ended December 31, 2008, 2007, and 2006  
(Thousands of dollars)

|                                                                                                               | <u>2008</u>       | <u>2007</u>     | <u>2006</u>    |
|---------------------------------------------------------------------------------------------------------------|-------------------|-----------------|----------------|
| Cumulative preferred stock – \$.01 par, authorized<br>20,000,000 shares; no shares issued at end of each year | \$ <u>-</u>       | <u>-</u>        | <u>-</u>       |
| Common stock – \$.01 par, authorized 50,000,000<br>shares, 12,813,879 shares issued at end of each year       | <u>128</u>        | <u>128</u>      | <u>128</u>     |
| Capital in excess of par value                                                                                |                   |                 |                |
| Balance at beginning of year                                                                                  | 76,637            | 73,999          | 73,431         |
| Exercise of stock options                                                                                     | 409               | 142             | 434            |
| Tax benefits on stock options                                                                                 | 874               | 413             | 879            |
| Amortization to expense                                                                                       | 1,669             | 2,676           | 1,207          |
| Transition to SFAS No. 123(R)                                                                                 | -                 | -               | (1,581)        |
| Restricted stock awards                                                                                       | (1,214)           | (681)           | (528)          |
| Tax benefits on restricted stock                                                                              | 258               | -               | -              |
| Restricted stock forfeitures                                                                                  | 27                | 88              | 157            |
| Balance at end of year                                                                                        | <u>78,660</u>     | <u>76,637</u>   | <u>73,999</u>  |
| Retained earnings                                                                                             |                   |                 |                |
| Balance at beginning of year                                                                                  | 155,299           | 147,406         | 138,333        |
| Net income                                                                                                    | 4,384             | 11,111          | 11,323         |
| Common stock dividends declared, \$.30 per share                                                              | (3,733)           | (3,742)         | (3,721)        |
| SAB 108 cumulative adjustment                                                                                 | -                 | -               | 1,471          |
| SFAS 158, measurement date transition, net of income taxes                                                    | (267)             | -               | -              |
| FIN 48 adjustment                                                                                             | -                 | 524             | -              |
| Balance at end of year                                                                                        | <u>155,683</u>    | <u>155,299</u>  | <u>147,406</u> |
| Unamortized restricted stock awards                                                                           |                   |                 |                |
| Balance at beginning of year                                                                                  | -                 | -               | (1,879)        |
| Transition to SFAS No. 123(R)                                                                                 | -                 | -               | 1,879          |
| Balance at end of year                                                                                        | <u>-</u>          | <u>-</u>        | <u>-</u>       |
| Treasury stock                                                                                                |                   |                 |                |
| Balance at beginning of year – 425,662, 388,682, and<br>499,372 shares, respectively                          | (12,385)          | (8,932)         | (11,367)       |
| Shares purchased – 129,996, 101,914, and 7,<br>respectively                                                   | (6,180)           | (4,901)         | -              |
| Forfeited restricted stock – 500, 1,775, and 2,934<br>shares, respectively                                    | (28)              | (88)            | (157)          |
| Shares issued for incentive plans – 143,981, 66,709,<br>and 113,631 shares, respectively                      | <u>4,193</u>      | <u>1,536</u>    | <u>2,592</u>   |
| Balance at end of year – 412,177, 425,662, and 388,682,<br>shares, respectively, at cost                      | <u>(14,400)</u>   | <u>(12,385)</u> | <u>(8,932)</u> |
| Accumulated other comprehensive income/(loss)                                                                 |                   |                 |                |
| Balance at beginning of year                                                                                  | (1,593)           | (5,120)         | (402)          |
| Net change in other comprehensive income/(loss),<br>net of income taxes                                       | (5,299)           | 3,527           | -              |
| Minimum pension liability adjustment,<br>net of income taxes                                                  | -                 | -               | 298            |
| Transition to SFAS No. 158, net of income taxes                                                               | -                 | -               | (5,016)        |
| SFAS No. 158, measurement date transition, net of income taxes                                                | (15)              | -               | -              |
| Balance at end of year                                                                                        | <u>(6,907)</u>    | <u>(1,593)</u>  | <u>(5,120)</u> |
| Total stockholders' equity                                                                                    | \$ <u>213,164</u> | <u>218,086</u>  | <u>207,481</u> |

See accompanying notes to consolidated financial statements.

DELTIC TIMBER CORPORATION  
AND SUBSIDIARIES  
Consolidated Statements of Comprehensive Income/(Loss)  
For the Years Ended December 31, 2008, 2007, and 2006  
(Thousands of dollars)

|                                                                                | <u>2008</u>            | <u>2007</u>          | <u>2006</u>          |
|--------------------------------------------------------------------------------|------------------------|----------------------|----------------------|
| Net income                                                                     | \$ <u>4,384</u>        | <u>11,111</u>        | <u>11,323</u>        |
| Other comprehensive income/(loss)                                              |                        |                      |                      |
| Minimum pension liability adjustment                                           | -                      | -                    | 491                  |
| Items related to employee benefit plans:                                       |                        |                      |                      |
| Actuarial gain/(loss) arising during period                                    | (2,368)                | 2,939                | -                    |
| Gain/(loss) on plan assets                                                     | (6,260)                | 873                  | -                    |
| Prior service credit arising during period                                     | -                      | 1,853                | -                    |
| Reclassification adjustment for gains/(losses)<br>included in net income:      |                        |                      |                      |
| Amortization of prior service cost                                             | 51                     | 51                   | -                    |
| Amortization of actuarial gains/(losses)                                       | 57                     | 351                  | -                    |
| Amortization of plan amendment                                                 | (199)                  | (199)                | -                    |
| Income tax expense/(benefit) related to items of<br>other comprehensive income | <u>3,420</u>           | <u>(2,341)</u>       | <u>(193)</u>         |
| Net change in other comprehensive income/(loss)                                | <u>(5,299)</u>         | <u>3,527</u>         | <u>298</u>           |
| Comprehensive income/(loss)                                                    | \$ <u><u>(915)</u></u> | <u><u>14,638</u></u> | <u><u>11,621</u></u> |

See accompanying notes to consolidated financial statements.

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**Note 1 – Significant Accounting Policies**

*Description of Business* — Deltic Timber Corporation (“Deltic” or the “Company”) is a natural resources company engaged primarily in the growing and harvesting of timber and the manufacture and marketing of lumber. Deltic owns approximately 439,000 acres of timberland, primarily in Arkansas and north Louisiana. The Company’s sawmill operations are located at Ola in central Arkansas and at Waldo in south Arkansas. In addition to its timber and lumber operations, the Company is engaged in real estate development in central Arkansas. The Company also holds a 50 percent interest in Del-Tin Fiber, L.L.C., a joint venture to manufacture and market medium density fiberboard (“MDF”).

*Business Environment* — The Company is primarily a wood products producer operating in a commodity-based business environment with a major diversification in real estate development. This environment is affected by a number of factors including general economic conditions, interest rates, credit availability, imports, foreign exchange rates, housing starts, new and existing housing inventory, foreclosures, residential repair and remodeling, commercial construction, industry capacity and production levels, the availability of contractors for logging, hauling, and shipping, the availability of raw materials, costs of fuel, and weather conditions.

*Principles of Consolidation* — The consolidated financial statements of Deltic Timber Corporation include the accounts of Deltic and all majority-owned subsidiaries after elimination of significant intercompany transactions and accounts.

*Use of Estimates* — In the preparation of the Company’s financial statements in conformity with accounting principles generally accepted in the United States of America, management has made a number of estimates and assumptions related to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities. Where available these estimates will approximate market. Actual results may differ from those estimates.

*Cash Equivalents* — Cash equivalents include investments that have a maturity of three months or less from the date of purchase.

*Accounts Receivable* — The Company records trade accounts receivable at net realizable value. This value includes an appropriate allowance for estimated uncollectible accounts to reflect any loss anticipated on the trade accounts receivable balances and charged to the provision for doubtful accounts. The allowance is based upon review of specific receivables outstanding and considers factors such as current overall economic conditions, industry-specific economic conditions, historical customer performance, and anticipated customer performance. At December 31, 2008 and 2007, the balance in the allowance account was \$60,000 and \$52,000, respectively.

*Inventories* — Inventories of logs, lumber, and supplies are stated at the lower of cost or market within Deltic’s operating areas, primarily using the average cost method. Log costs include harvest and transportation cost as appropriate. Lumber costs include materials, labor, and production overhead. (For additional information, see Note 2 – Inventories.)

*Investment in Real Estate Held for Development and Sale* — Real estate held for development and sale is stated at the lower of cost or fair market value less costs to sell, and includes direct costs of land and land development and indirect costs, including amenities. Indirect and amenity costs are allocated to individual lots or acreage sold based on relative sales value. Direct costs are allocated on a specific neighborhood basis, while indirect costs for the Company’s three development areas — Chenal Valley, Chenal Downs, and Red Oak Ridge — are allocated to neighborhoods over the entire respective development area based on relative retail values.

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**Note 1 – Significant Accounting Policies (cont.)**

*Investment in Del-Tin Fiber* — Investment in Del-Tin Fiber L.L.C. (“Del-Tin Fiber”), a 50 percent-owned limited liability company, is accounted for using the equity method and evaluated for possible impairment, as applicable under the requirements of Accounting Principles Board Opinion (“APB”) 18, “The Equity Method of Accounting for Investments in Common Stock.” Cash advances to the joint venture are recorded as increases in the Company's investment carrying value, while cash repayments received from the joint venture result in reductions in investment carrying value. (For additional information, see Note 4 – Investment in Del-Tin Fiber.)

*Timber and Timberlands* — Timber and timberlands, which includes timberland, fee timber, purchased stumpage inventory, and logging facilities, are stated at cost less the cost of fee timber harvested and accumulated depreciation of logging facilities, and includes no estimated future reforestation cost. The cost of timber consists of fee timber acquired and reforestation costs which includes site preparation, seedlings, and labor. The cost of fee timber harvested is based on the volume of timber harvested in relation to the estimated volume of timber recoverable. Logging facilities, which consist primarily of roads constructed and other land improvements, are depreciated using the straight-line method over a ten-year estimated life. The Company estimates its fee timber inventory using statistical information and data obtained from physical measurements and other information gathering techniques. Fee timber carrying costs, commercial thinning, silviculture and timberland management costs are expensed as incurred.

The Company classifies its timberlands and fee timber as either strategic or non-strategic. Strategic timberland including pine forest and pine plantations are prime pine sawtimber growing platforms located within or immediately adjacent to the Company sawmill's operating regions. Deltic manages these acres using modern silviculture methods to achieve optimal volume and quality of its pine sawtimber. The Company harvests sawtimber and pulpwood in accordance with its harvest plans and generally converts sawtimber into lumber in its own sawmills and sells pulpwood in the market. Upon harvest, strategic timberlands are reforested. The Company's timberland acquisition program is focused on the acquisition of timberland in its current operating regions. The Company considers the acquisition and the occasional sale of strategic timberlands as investing activities. The Company has legacy hardwood and other acreage which can not be harvested for conversion in Company sawmills, reforested as pine plantations, or both. These legacy timberlands have been identified as non-strategic and or higher and better use timberlands and are expected to be sold over time. The Woodlands segment manages an annual program to sell a portion of these non-strategic timberlands and or harvest hardwoods for the sale to third parties. The Company considers this program as an operating activity of its Woodlands segment.

In order to acquire and sell assets, primarily timberlands, in a tax efficient manner, the Company enters into like-kind exchange (“LKE”) tax-deferred transactions. The Company generally enters into forward transactions, in which property is sold and the proceeds are reinvested by acquiring similar property; and reverse transactions, in which property is acquired and similar property is subsequently sold. A qualified LKE intermediary is used to facilitate LKE transactions. Proceeds from forward LKE transactions are held by the intermediary and are classified as restricted cash because the funds must be reinvested in similar properties. If the acquisition of suitable LKE properties is not completed within 180 days of the sale of the company-owned property, the proceeds are distributed to us by the intermediary and are reclassified as available cash and applicable income taxes are determined. Amounts deposited with a third party towards the potential future purchase of property are included in other investments and non-current receivables in the consolidated balance sheets and as an investing activity in funds held by trustee in the consolidated statements of cash flows. At December 31, 2008 and 2007, the Company had \$4.3 million and \$.8 million, respectively, of proceeds from land sales deposited with a LKE intermediary.

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**Note 1 – Significant Accounting Policies (cont.)**

*Property, Plant, and Equipment* — Property, plant, and equipment assets are stated at cost less accumulated depreciation. Depreciation of buildings, equipment, and other depreciable assets is primarily determined using the straight-line method. Expenditures that substantially improve and/or increase the useful life of facilities or equipment are capitalized. Maintenance and repair costs are expensed as incurred. Gains and losses on disposals or retirements are recognized in the period they occur.

Property, plant, and equipment assets are evaluated for possible impairment on a specific asset basis or in groups of similar assets, as applicable, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future net cash flows to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment loss is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell, and depreciation ceases.

*Revenue Recognition* — The Company recognizes revenue when the following criteria are met:

(1) persuasive evidence of an agreement exists, (2) delivery has occurred or services have been rendered, (3) the price to the buyer is fixed and determinable, and (4) collectibility is reasonably assured. Delivery is not considered to have occurred until the customer takes title and assumes the risks and rewards of ownership. Revenue from the sale of lumber and wood by-products is recorded at the time of shipment due to terms of such sale being designated free on board ("f.o.b.") shipping point. Revenue from the sale of timber-cutting rights to third parties is recorded when legal title passes to the purchaser, which is generally upon delivery of a legally executed timber deed and receipt of payment for the timber. Revenue from intersegment timber sales is recorded when the timber is harvested; such intersegment sales, which are made at prices which generally approximate market within Deltic's operating area, are eliminated in the consolidated financial statements.

Revenue from the leasing of land for hunting purposes is deferred when received and subsequently recognized over the one-year lease term which begins September 1. At December 31, 2008 and 2007, the Company had deferred hunting lease revenue totaling \$1,236,000 and \$1,165,000, respectively, reflected in the consolidated balance sheets in deferred revenues and other accrued liabilities. Revenue from lease rental payments under mineral leases is deferred when received and recognized ratably over the lease term, related royalty payments are recognized when received. At December 31, 2008 and 2007, the Company had deferred mineral lease revenue of \$4,918,000 and \$5,891,000, respectively of which \$3,009,000 and \$4,116,000 is included in other noncurrent liabilities and \$1,909,000 and \$1,775,000 is included in other current liabilities. Revenue from timberland and real estate is recorded under the criteria of the Financial Accounting Standards Board's Statement of Financial Accounting Standards ("SFAS") No. 66, "Accounting for Sales of Real Estate." Such revenue is recorded when the sale is closed and legal title is transferred and the buyer's initial and continuing investment is adequate, which is generally at the time the purchaser executes the real estate closing documents and makes payment to the title company handling the closing.

*Income Taxes* — The Company uses the asset and liability method of accounting for income taxes. Under this method, the provision for income taxes includes amounts currently payable and amounts deferred as tax assets and liabilities, based on differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities, and is measured using the enacted tax rates that are expected to be in effect when the differences reverse. Deferred tax assets are reduced by a valuation allowance which is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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**Note 1 – Significant Accounting Policies (cont.)**

*Property Taxes* — Property taxes applicable to the Company's assets are estimated and accrued in the period of assessment. At December 31, 2008 and 2007, the Company had accrued property tax expense totaling \$1,596,000 and \$1,470,000, respectively, reflected in the consolidated balance sheet in accrued taxes other than income taxes.

*Stock-Based Compensation* — The Company follows the fair value recognition provisions of Financial Accounting Standards Board ("FASB") Statement No. 123 (R), "Share-Based Payment," ("SFAS 123 (R)"). The Company adopted SFAS 123 (R) using the modified-prospective transition method on January 1, 2006. Awards granted prior to, but not yet vested as of January 1, 2006, are expensed based on the grant-date fair value estimated in accordance with the provisions of SFAS 123, while awards granted subsequent to January 1, 2006, are expensed based on the grant-date fair value estimated in accordance with the provisions of SFAS 123 (R).

*Pensions and Other Postretirement Benefits* — The Company sponsors both a qualified and a nonqualified, noncontributory, defined benefit retirement plan that covers substantially all employees. Benefits are based on years of service and final career-average-pay formulas as defined by the plans. The qualified plan is funded to accumulate sufficient assets to provide for accrued benefits. The nonqualified plan, a supplemental executive plan, is not funded; payments to retirees due under this plan are made on a monthly basis.

The Company also sponsors a defined benefit health care plan and a life insurance benefit plan for substantially all retired employees. The Company measures the costs of its obligations for these plans based on its health care cost trends and actuarial assumptions, including discount rates, mortality, assumed rates of return, compensation increases, and turnover rates. The Company reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The effect of modifications to those assumptions is recorded in accumulated other comprehensive income/(loss) beginning in 2007 and amortized to net periodic cost over future periods using the corridor method. The Company believes that the assumptions utilized in recording its obligations under its plans are reasonable based on its experience and market conditions.

In September 2006, the FASB issued Statement 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which required the Company to record a balance sheet liability equal to the difference between our benefit obligations and plan assets. SFAS No. 158 also required the Company to change the measurement date from September 30 to December 31. SFAS No. 158 was effective for the year ended December 31, 2006, except for the measurement date change, which was effective for the year ended December 31, 2008. The net periodic benefit cost for the period of October 1, 2007, through December 31, 2008, was based on a measurement date of September 30, 2007. The net periodic benefit cost for the period of October 1, 2007, through December 31, 2007, was reflected as an adjustment to retained earnings on December 31, 2008. The impact of this adjustment was a \$15,000 reduction to retained earnings, net of taxes. The net periodic costs are recognized as employees render the services necessary to earn these postretirement benefits. (For additional information, see Note 15 – Employee and Retiree Benefit Plans.)

*Advertising Costs* — Advertising costs, primarily related to marketing efforts for the Company's real estate developments, are expensed as incurred. These costs amounted to \$1,198,000 in 2008, \$1,148,000 in 2007, and \$863,000 in 2006, and are reflected in the consolidated statements of income.

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**Note 1 – Significant Accounting Policies (cont.)**

*Capitalized Interest* — The Company capitalizes interest for qualifying assets during construction under the provisions of SFAS 34, "Capitalization of Interest Cost." Interest is mainly capitalized as an indirect cost for real estate development in the Company's real estate operations. (For additional information, see Note 17 – Supplemental Cash Flow Disclosures.)

*Capital Expenditures* — Capital expenditures include additions to investment in real estate held for development and sale; timber and timberlands; and property, plant, and equipment.

*Net Change in Purchased Stumpage Inventory* — Purchased stumpage inventory consists of timber-cutting rights purchased from third parties specifically for use in the Company's sawmills. Depending on the timing of acquisition and usage of this acquired stumpage inventory, the net change in this inventory can either be a source or use of cash in the Company's consolidated statements of cash flows.

*Earnings per Common Share* — Earnings per share ("EPS") amounts presented are calculated under the provisions of the SFAS 128, "Earnings per Share." Basic earnings per share is computed based on earnings available to common shareholders (net income/(loss) less accrued preferred dividends, if any) and the weighted average number of common shares outstanding. The earnings per share assuming the diluted amounts presented are computed based on earnings available to common shareholders and the weighted average number of common shares outstanding, including shares assumed to be issued under the Company's stock incentive plans unless antidilutive. (For a reconciliation of amounts used in per share computations, see Note 18 – Earnings per Share.)

*Shipping and Handling Costs* — Shipping and handling costs, such as freight to our customers' destinations, are accounted for in accordance with the Emerging Issues Task Force ("EITF") Issue 00-10. As such, shipping and handling costs are included in cost of sales in the Company's consolidated statements of income. These costs, when included in the amount invoiced to customers, are also recognized in net sales.

*Impact of Recent Accounting Pronouncements* —

In September 2008, the Emerging Task Force of FASB reached a consensus on Issue No. 08-6, "Equity Method Investment Accounting Considerations." Issue No. 08-6 is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of Issue No. 08-6 to have a material effect on its consolidated financial statements.

In December 2008, the FASB issued Staff Position, FSP No. FAS 132(R)-1 amends SFAS No. 132(R), "Employers' Disclosures about Pensions and other Postretirement Benefits," to require employers to disclose more information about assets of a defined benefit pension or other post retirement plan. These disclosure requirements are effective for years ending after December 15, 2009.

In September 2008, the FSP issued FAS 133-1 and FIN 45-4, "Disclosures about Credit Derivatives and Certain Guarantees: an Amendment of FASB SFAS No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB SFAS No. 161" is effective for periods ending after November 15, 2008. The FSP requires additional disclosure about exposure to potential loss from credit-risk-related events, including the current status of payment/performance risk. The adoption of FSP 133-1 and FIN 45-4 did not have a material effect on the Company's consolidated financial statements.

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**Note 1 – Significant Accounting Policies (cont.)**

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 provides guidance for using fair value to measure assets and liabilities and requires additional disclosure about the use of fair value measures, the information used to measure fair value, and the effect fair value measurements have on earnings. SFAS 157 does not require any new fair value measurements. SFAS 157 for financial assets and financial liabilities was effective for the Company beginning January 1, 2008. On January 1, 2009, the beginning of the next fiscal year, the standard will also apply to non-financial assets and non-financial liabilities of the Company. The adoption of SFAS 157 for financial assets and financial liabilities did not have a material impact on the Company’s consolidated financial statements. FASB Staff Position SFAS 157-2, “Effective Date of FASB Statement No. 157” (“FSP FAS 157-2”) delays the effective date of SFAS 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Management is evaluating the impact that SFAS 157 will have on its non-financial assets and non-financial liabilities. The Company believes that the impact of these items upon adoption will not be material to its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007) “Business Combinations.” SFAS No. 141 (R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141 (R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141 (R) is effective for business combinations consummated in periods beginning on or after December 15, 2008. Any future acquisitions undertaken by the Company will be impacted by the adoption of this standard.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51.” SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent’s ownership interest, and valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, and will be adopted by Deltic in the first quarter of fiscal 2009.

**Note 2 – Inventories**

Inventories at December 31 consisted of the following:

| (Thousands of dollars) | 2008            | 2007         |
|------------------------|-----------------|--------------|
| Logs                   | \$ 2,264        | 1,800        |
| Lumber                 | 3,938           | 3,994        |
| Materials and supplies | <u>309</u>      | <u>362</u>   |
|                        | <u>\$ 6,511</u> | <u>6,156</u> |

The Company utilizes the lower of cost or market basis for determining inventory-carrying values. Lumber inventory amounts at December 31, 2008 and 2007 are stated at lower of cost or net realizable value.

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**Note 3 – Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets at December 31 consisted of the following:

| (Thousands of dollars)         | 2008            | 2007         |
|--------------------------------|-----------------|--------------|
| Short-term deferred tax assets | \$ 2,031        | 1,545        |
| Refundable income taxes        | 1,543           | -            |
| Prepaid expenses               | 239             | 278          |
| Other current assets           | 410             | 479          |
|                                | <u>\$ 4,223</u> | <u>2,302</u> |

**Note 4 – Investment in Del-Tin Fiber**

Deltic owns 50 percent of the membership of Del-Tin Fiber, which operates a medium density fiberboard (“MDF”) plant near El Dorado, Arkansas.

At December 31, 2008 and 2007, the Company's share of the underlying net assets of Del-Tin Fiber exceeded its investment by \$16,854,000 and \$16,798,000, respectively. The difference relates primarily to the Company's write-off of its carrying amount for its investment in Del-Tin Fiber as of December 31, 2002, which was not recorded by Del-Tin. The equity in earnings of Del-Tin recognized by the Company exceeds its ownership percentage of Del-Tin's earnings because the difference in basis between the Company and Del-Tin is being adjusted to account for Del-Tin's operating results as if it were a consolidated subsidiary.

Cumulative net losses for the facility have amounted to \$84,490,000, of which \$42,245,000 is the Company's share. During 2008, 2007, and 2006 the Company received \$6,167,000, \$3,876,000, and \$3,950,000 in distributions from Del-Tin Fiber, respectively. Contributions to Del-Tin Fiber by the Company as of December 31, 2008, have amounted to \$87,388,000.

On August 26, 2004, the Company executed a guarantee agreement in connection with the refinancing of the debt of Del-Tin Fiber. Under Deltic's guarantee agreement, the Company unconditionally guarantees the payment of 50 percent (\$16,750,000 at December 31, 2008) of Del-Tin Fiber's credit agreement. The Company estimated the proportionate fair value of its guarantee of Del-Tin's credit agreement to be \$3,450,000. The Company is reducing this liability systematically over the life of the credit agreement, as the Company is released from risk under the guarantee. At December 31, 2008, the Company's unamortized balance related to the value of the guarantee was \$517,500. Deltic considers the payment/performance risk associated with this guarantee to be minimal due to the assessment of Del-Tin's balance sheet, past performance, and length of time remaining on the guarantee.

Under the operating agreement, Del-Tin Fiber's employees operate the plant. Deltic has committed to provide a portion of the plant's fiber and wood fuel supply at market prices. During 2008, 2007, and 2006, Deltic sold Del-Tin Fiber approximately \$4,593,000, \$3,772,000, and \$3,939,000, respectively, of these lumber manufacturing by-products. As of December 31, 2008 and 2007, the Company had a receivable from Del-Tin Fiber of \$31,000 and \$193,000, respectively.

In performing the respective impairment evaluations, the Company's management made a number of estimates and assumptions related to future operating results for Del-Tin Fiber, the sale of its ownership interest, the expected selling price for its investment if sold, and the ability to refinance the joint venture's long-term debt. The management of Del-Tin Fiber has performed evaluations of possible impairment of

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**Note 4 – Investment in Del-Tin Fiber (cont.)**

the long-lived assets of the plant in accordance with SFAS 144, as applicable. To date, these analyses have indicated that no impairment exists at the Del-Tin Fiber level.

Del-Tin Fiber's financial position at year-end January 3, 2009 and December 29, 2007, and results of operations for years of 2008 and 2007 consisted of the following:

| (Thousands of dollars)                        | <u>2008</u>      | <u>2007</u>   |
|-----------------------------------------------|------------------|---------------|
| <b>Condensed Balance Sheet Information</b>    |                  |               |
| Current assets                                | \$ 8,290         | 8,891         |
| Property, plant, and equipment – net          | 79,195           | 82,852        |
| Other noncurrent assets                       | <u>130</u>       | <u>94</u>     |
| Total assets                                  | \$ <u>87,615</u> | <u>91,837</u> |
|                                               |                  |               |
| Current liabilities                           | \$ 6,983         | 11,163        |
| Long-term debt                                | 29,000           | 35,000        |
| Members' capital                              | <u>51,632</u>    | <u>45,674</u> |
| Total liabilities and members' capital        | \$ <u>87,615</u> | <u>91,837</u> |
| <b>Condensed Income Statement Information</b> |                  |               |
| Net sales                                     | \$ <u>66,474</u> | <u>64,045</u> |
| Costs and expenses                            |                  |               |
| Cost of sales                                 | 53,997           | 51,181        |
| Depreciation                                  | 5,160            | 5,564         |
| General and administrative expenses           | 2,289            | 2,350         |
| Loss on asset disposition                     | <u>29</u>        | <u>133</u>    |
| Total costs and expenses                      | <u>61,475</u>    | <u>59,228</u> |
|                                               |                  |               |
| Operating income                              | 4,999            | 4,817         |
| Interest income                               | 11               | 35            |
| Interest and other debt expense               | (1,988)          | (3,130)       |
| Other income                                  | <u>-</u>         | <u>87</u>     |
| Net income                                    | \$ <u>3,022</u>  | <u>1,809</u>  |

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**Note 5 – Timber and Timberlands**

Timber and timberlands at December 31 consisted of the following:

| (Thousands of dollars)                                                       | <u>2008</u>       | <u>2007</u>     |
|------------------------------------------------------------------------------|-------------------|-----------------|
| Purchased stumpage inventory                                                 | \$ 2,277          | 3,457           |
| Timberlands                                                                  | 85,524            | 81,514          |
| Fee timber                                                                   | 211,180           | 207,992         |
| Logging facilities                                                           | <u>2,147</u>      | <u>1,979</u>    |
|                                                                              | 301,128           | 294,942         |
| Less accumulated cost of fee timber harvested<br>and facilities depreciation | <u>(91,093)</u>   | <u>(86,514)</u> |
|                                                                              | \$ <u>210,035</u> | <u>208,428</u>  |

Cost of fee timber harvested amounted to \$5,798,000, \$5,932,000, and \$5,920,000 in 2008, 2007, and 2006, respectively. Depreciation of logging facilities was \$48,000, \$39,000, and \$25,000 for the years 2008, 2007, and 2006, respectively.

**Note 6 – Property, Plant, and Equipment**

Property, plant, and equipment at December 31 consisted of the following:

| (Thousands of dollars)        | Range of<br><u>Useful Lives</u> | <u>2008</u>      | <u>2007</u>     |
|-------------------------------|---------------------------------|------------------|-----------------|
| Land                          | N/A                             | \$ 125           | 125             |
| Land improvements             | 10-20 years                     | 5,194            | 4,828           |
| Buildings and structures      | 10-20 years                     | 10,722           | 9,932           |
| Machinery and equipment       | 3-15 years                      | <u>95,226</u>    | <u>90,180</u>   |
|                               |                                 | 111,267          | 105,065         |
| Less accumulated depreciation |                                 | <u>(72,610)</u>  | <u>(65,851)</u> |
|                               |                                 | \$ <u>38,657</u> | <u>39,214</u>   |

Depreciation of property, plant, and equipment charged to operations was \$8,177,000, \$8,361,000, and \$7,830,000 in 2008, 2007, and 2006, respectively. Gains/(losses) on disposals or retirements of assets included in income were \$(64,000), \$1,889,000, and \$(237,000) in 2008, 2007, and 2006, respectively. In 2007, the Company disposed of assets in the amount of \$1,887,000 due to an involuntary conversion. (For additional information, see Note 20 – Business Interruption and Involuntary Conversion.)

**Note 7 – Deferred Revenues and Other Accrued Liabilities**

Deferred revenues and other accrued liabilities at December 31 consisted of the following:

| (Thousands of dollars)        | <u>2008</u>     | <u>2007</u>  |
|-------------------------------|-----------------|--------------|
| Deferred revenues – current   | \$ 3,661        | 3,366        |
| Vacation accrual              | 915             | 885          |
| Deferred compensation         | 1,398           | 1,932        |
| All other current liabilities | <u>803</u>      | <u>751</u>   |
|                               | \$ <u>6,777</u> | <u>6,934</u> |

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**Note 8 – Other Noncurrent Liabilities**

Other noncurrent liabilities at December 31 consisted of the following:

| (Thousands of dollars)                        | 2008             | 2007          |
|-----------------------------------------------|------------------|---------------|
| Accumulated postretirement benefit obligation | \$ 8,691         | 8,163         |
| Deferred compensation                         | 897              | 1,021         |
| Excess thrift plan                            | 567              | 767           |
| Excess retirement plan                        | 3,411            | 3,049         |
| Accrued pension liability                     | 11,129           | 2,842         |
| Deferred revenue – long-term portion          | 3,009            | 4,116         |
| FIN 48 liability                              | 1,315            | -             |
| All other noncurrent payables                 | 52               | 78            |
|                                               | <u>\$ 29,071</u> | <u>20,036</u> |

**Note 9 – Credit Facilities**

The Company has an agreement with SunTrust Bank and other banks which provide an unsecured and committed revolving credit facility totaling \$300,000,000, which includes a \$50,000,000 letter of credit feature and expires on September 9, 2012. At December 31, 2008, \$32,500,000 was outstanding and included in long-term debt. There were no borrowings outstanding at December 31, 2007 and 2006. As of December 31, 2008 and 2007, \$267,500,000 and \$300,000,000, respectively, were available in excess of all borrowings outstanding under or supported by the respective facilities. Borrowings under the current agreement bear interest at a base rate or an adjusted Eurodollar rate plus an applicable margin, depending upon the type of loan the Company executes. The applicable margin component of the interest rate varies with the type of loan and the Company's total debt to capital ratio. No letters of credit supported by the facility were present at December 31, 2008 and 2007. The agreement contains certain restrictive financial covenants, including a leverage ratio of no greater than .65 to 1.0, minimum timber market value greater than 175 percent of outstanding total senior indebtedness, and a fixed charge ratio coverage. Fees associated with the current revolving credit facility include a commitment fee of .10 to .25 percent per annum on the unused portion of the committed amount. In addition, the agreement contains restrictive covenants, including limitations on the incurrence of debt; a minimum consolidated net worth of the sum of \$165,000,000, plus 50 percent of cumulative consolidated net income from April 1, 2005, and a maximum leverage ratio of .6 to 1. The Company incurred aggregate costs of \$1,252,000 related to the securing of the current facility, which were deferred and are being amortized as additional interest expense over the term of the agreement.

The Company may also borrow up to \$1,000,000 under a short-term credit facility with BancorpSouth. The agreement expires December 15, 2009, with annual renewal. The amount available to the Company under this facility is reduced by any borrowings by Deltic. As of December 31, 2008 and 2007, Deltic had no borrowings outstanding under this line of credit, resulting in \$1,000,000 available to the Company. Borrowings bear interest based upon the New York Prime. Deltic also has an agreement with BancorpSouth which provides a \$2,000,000 letter of credit facility. Amounts available to the Company under the facility are reduced by any letters of credit issued on behalf of the Company. Outstanding letters of credit as of December 31, 2008 and 2007 were \$499,000 and \$357,000, respectively, which left \$1,501,000 in 2008 and \$1,643,000 in 2007, available to Deltic.

In addition, Deltic has an agreement with Regions Bank which provides a \$1,000,000 letter of credit facility. The agreement expires in 2010. Amounts available to Deltic under the facility are reduced by any letters of credit issued on behalf of the Company. There were no outstanding letters of credit at December 31, 2008 and 2007, and the entire \$1,000,000 was available.

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**Note 10 – Indebtedness**

The Company's indebtedness at December 31 consisted of the following:

| (Thousands of dollars)                       | 2008             | 2007          |
|----------------------------------------------|------------------|---------------|
| Notes payable, 2.78%*, due 2012 (See Note 9) | \$ 32,500        | -             |
| Senior notes payable, 6.10%, due 2016        | 40,000           | 40,000        |
| Senior notes payable, 6.01%, due 2009-2012   | <u>4,444</u>     | <u>30,000</u> |
|                                              | 76,944           | 70,000        |
| Less: Current maturities of long-term debt   | <u>1,111</u>     | <u>3,333</u>  |
| Long-term debt at December 31                | \$ <u>75,833</u> | <u>66,667</u> |

\*Weighted average interest rate at December 31, 2008.

The Company has private placement debt of \$40,000,000 of Series A Senior Notes ("Notes") with Pacific Coast Farm Credit, a division of American AgCredit due and payable December 18, 2016. The interest rate for the Notes remained the same as under the 1998 agreement (6.66 percent) through December 18, 2008, and after such date the interest rate is reduced to 6.10 percent for the balance of the term of the Notes. No installment payments are required, but the terms allow for prepayments at the option of the Company. The agreement contains certain restrictive financial covenants, including a minimum consolidated net worth of the sum of \$175,567,000, plus 50 percent of net income accrued during each quarter thereafter commencing after December 31, 2006, plus 100 percent of the net proceeds from any public or private offering of common or preferred stock of the company, a maximum funded debt/capitalization ratio of .6 to 1, a fixed charge coverage ratio of not less than 2.5 to 1, and to maintain a timber market value greater than 200 percent of outstanding total senior indebtedness.

On December 20, 2002, Deltic successfully completed the private placement of \$30,000,000 of senior notes with Metropolitan Life and a group of other domestic insurance companies. These unsecured notes have a fixed stated interest rate of 6.01 percent and ultimately mature on December 20, 2012. Semiannual installments of \$3,333,000, or such lesser amount as shall be outstanding, were required beginning on December 20, 2008. The note terms allow for prepayment at the option of the Company in an amount of not less than five percent of the principal amount outstanding at the time of any prepayment. The agreement contains certain restrictive financial covenants, including a minimum consolidated tangible net worth of the sum of \$148,299,000, plus 25 percent of cumulative consolidated adjusted net income from July 1, 2002, and a maximum consolidated debt to consolidated net capitalization ratio of .6 to 1. The Company incurred \$179,000 of costs related to the issuance of these notes, which were deferred and were being amortized as additional interest expense over the term of the underlying debt.

On June 30, 2008, the Company entered into an agreement with Metropolitan Life and a group of other domestic insurance companies to amend the existing note agreement of the \$30,000,000 private placement senior notes. The amendment changed the minimum fixed charge coverage and other ratios applicable to the Company's business to be the same as those contained in the Company's Series A Senior Notes placed with American Ag Credit PCA. The Company incurred \$150,000 of costs of which \$25,000 was deferred, due to the retirement of \$25,000,000 of this debt on November 4, 2008, and will be amortized as additional interest expense over the remaining term of the underlying debt.

On October 29, 2008, the Company delivered a notice of voluntary prepayment ("Notice Letter") to Metropolitan Life Insurance Company, MetLife Investors USA Insurance Company, New England Life Insurance Company, General American Life Insurance Company, MetLife Insurance Company of Connecticut, and Modern Woodmen of America (collectively, the "Note Purchasers") to prepay in full all of its outstanding obligations as of November 4, 2008, relating to the \$30,000,000, 6.01% Senior Notes that were issued pursuant to a Note Purchase Agreement dated December 20, 2002, as amended. As part of the notice, the Company requested that the Note Purchasers waive any prepayment penalty or other

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**Note 10 – Indebtedness (cont.)**

requirement to pay any “make whole” fees. On October 30, 2008, all Note Purchasers, except Modern Woodmen of America, accepted the Company’s proposal, counter-signed the Notice Letter, and waived any prepayment penalties or “make whole” fees. On November 4, 2008, using funds from the Company’s revolving credit facility, \$25,000,000 of the \$30,000,000 notes were paid in full and cancelled. Unamortized deferred debt costs of \$151,000 were expensed at the time of the prepayment.

The scheduled maturities of long-term debt for the next five years are \$1,111,000 in 2009, \$1,111,000 in 2010, \$1,111,000 in 2011, \$33,611,000 in 2012, and none in 2013. (For additional information regarding financial instruments, see Note 9 – Credit Facilities and Note 13 – Fair Value of Financial Instruments.)

**Note 11 – Income Taxes**

The components of income tax expense/(benefit) related to income from operations for the years ended December 31, 2008, 2007, and 2006, consisted of the following:

| (Thousands of dollars) | <u>2008</u>    | <u>2007</u>  | <u>2006</u>    |
|------------------------|----------------|--------------|----------------|
| Federal                |                |              |                |
| Current                | \$ (170)       | 4,985        | 10,988         |
| Deferred               | <u>2,031</u>   | <u>854</u>   | <u>(5,680)</u> |
|                        | 1,861          | 5,839        | 5,308          |
| State                  |                |              |                |
| Current                | 380            | 1,259        | 158            |
| Deferred               | <u>(1,253)</u> | <u>228</u>   | <u>1,315</u>   |
| Total                  | <u>\$ 988</u>  | <u>7,326</u> | <u>6,781</u>   |

The following table provides a reconciliation of the Company’s income tax expense/(benefit) at the statutory U.S. federal rate of 35% to the actual income tax expense/(benefit) for the years ended December 31, 2008, 2007, and 2006, consisted of the following:

| (Thousands of dollars)                                                        | <u>2008</u>   | <u>2007</u>  | <u>2006</u>  |
|-------------------------------------------------------------------------------|---------------|--------------|--------------|
| U.S. Federal income tax using statutory tax rate                              | \$ 1,880      | 6,453        | 6,336        |
| State tax, net of federal tax benefit                                         | 376           | 1,041        | 1,341        |
| Permanent differences                                                         | (77)          | 16           | (44)         |
| Tax effects resulting from:                                                   |               |              |              |
| Recognition of state NOL carry forward available to offset FIN 48 liabilities | (1,290)       | -            | -            |
| Other                                                                         | <u>99</u>     | <u>(184)</u> | <u>(852)</u> |
| Income tax provision as reported                                              | <u>\$ 988</u> | <u>7,326</u> | <u>6,781</u> |

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**Note 11 – Income Taxes (cont.)**

The Company's deferred tax assets and deferred tax liabilities at December 31, 2008 and 2007, consisted of the following:

| (Thousands of dollars)                                  | <u>2008</u>       | <u>2007</u>     |
|---------------------------------------------------------|-------------------|-----------------|
| Deferred tax assets                                     |                   |                 |
| Investment in real estate held for development and sale | \$ 15,424         | 14,845          |
| Postretirement and other employee benefits              | 12,597            | 9,373           |
| Other deferred tax assets                               | <u>4,912</u>      | <u>3,619</u>    |
| Total deferred tax assets                               | <u>32,933</u>     | <u>27,837</u>   |
| Deferred tax liabilities                                |                   |                 |
| Investment in Del-Tin Fiber                             | (5,818)           | (5,800)         |
| Timber and timberlands                                  | (21,073)          | (18,794)        |
| Property, plant, and equipment                          | (5,449)           | (4,391)         |
| Other deferred tax liabilities                          | <u>(3,320)</u>    | <u>(4,107)</u>  |
| Total deferred tax liabilities                          | <u>(35,660)</u>   | <u>(33,092)</u> |
| Net deferred tax liabilities                            | \$ <u>(2,727)</u> | <u>(5,255)</u>  |

In assessing the realizability of deferred tax assets, Deltic's management considers whether it is more likely than not that some portion or all of the Company's total deferred tax assets will not be realized. The ultimate realization of these deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based on the level of historical taxable income and projections for future taxable income over the periods in which the temporary differences are anticipated to reverse, management believes it is more likely than not that the Company will realize the benefits of its deferred tax assets at December 31, 2008, as reductions of future taxable income or by utilizing available tax planning strategies. However, the amount of the net deferred tax assets considered realizable could be adjusted in the future if estimates of taxable income are revised.

Under Interpretation 48, unrecognized tax benefits represent potential future funding obligations to taxing authorities if uncertain tax positions the Company has taken, primarily on previously filed state income tax returns, are not sustained. Liabilities established for unrecognized tax benefits under FIN 48 may not be combined with deferred tax assets or liabilities, however, when the unrecognized tax benefit is directly associated with a tax position taken in a tax year that results (or resulted) in the recognition of a deferred tax asset for an NOL for that year and such NOL has not yet been utilized, net presentation is appropriate. The Company has elected net presentation for state NOL's not yet utilized. Upon the initial adoption of FIN 48, the Company recorded a net cumulative effect adjustment to retained earnings as of January 1, 2007 (which increased retained earnings by \$524,000 as of such date) primarily related to certain previously unrecognized tax benefits that did not meet the criteria for recognition upon adoption of FIN 48.

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**Note 11 – Income Taxes (cont.)**

A reconciliation of the beginning and ending amount of unrecognized tax benefits (excluding both interest and any related federal benefits) is as follows:

|                                                                                                                     |                 |
|---------------------------------------------------------------------------------------------------------------------|-----------------|
| (Thousands of dollars)                                                                                              |                 |
| Balance at January 1, 2007                                                                                          | \$ 230          |
| Increases related to current year tax positions                                                                     | 1,236           |
| Lapse of statute                                                                                                    | <u>(84)</u>     |
| Balance at December 31, 2007                                                                                        | 1,382           |
| Increases related to current year tax positions, net of net operating loss carryforward not utilized of \$3,300,000 | 336             |
| Lapse of statute                                                                                                    | <u>(60)</u>     |
| Balance at December 31, 2008                                                                                        | <u>\$ 1,658</u> |

A discrete event occurred in 2008 related to expiration of the statute of limitations on a state return for the 2004 tax year in which approximately \$24,000,000 of previously unrecognized state NOL carryforwards became available to offset future FIN 48 liabilities. This event resulted in the Company recognizing a deferred tax benefit of \$1,293,000. If the Company were to prevail on all unrecognized tax benefits recorded on the balance sheet, approximately \$1,536,000 for 2008 would benefit the effective tax rate. The Company's policy is to recognize interest expense related to unrecognized tax benefits in interest expense and penalties in other expenses. The Company had approximately \$29,000 and \$42,000 accrued in deferred revenue and other accrued liabilities for interest and penalties at December 31, 2008 and 2007, respectively.

Effective May 22, 2008, the Food, Conservation and Energy Act of 2008, which included provisions reducing the tax rate on qualified timber sales from 35 percent to 15 percent, became effective. The provision is effective for one year, with annual renewals possible. Deltic can expect to pay a lower rate of federal income tax on the lesser of qualifying gains on timber harvests for which they elect capital gain treatment or total taxable income. No significant benefit was recognized in 2008 as the Company anticipates filing a net operating loss carryback claim for the year.

The Company is no longer subject to federal and state income tax examination by tax authorities for years before 2005.

**Note 12 – Stockholders Rights Plan**

The Company has a Stockholders Rights Plan ("Rights Plan"), which provides for each eligible common shareholder to receive a dividend of one preferred stock purchase right ("Right") for each outstanding share of the Company's common stock held. On October 19, 2006, the Company's Board of Directors amended the Rights Plan to, among other items, extend its term to December 31, 2016, and to increase the exercise price of the rights to \$200 per share. The Rights will detach from the common stock and become exercisable: (1) following a specified period of time after the date of the first public announcement that a person or group of affiliated or associated persons ("Acquiring Person"), has become the beneficial owner of 15 percent or more of the Company's common stock or (2) following a specified amount of time of the commencement of a tender or exchange offer by any Acquiring Person, which would, if consummated, result in such persons becoming the beneficial owner of 15 percent or more of the Company's common stock. In either case, the detachment of the Rights from the common stock is subject to extension by a majority of the directors of the Company. The Rights have certain anti-takeover effects and will cause

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**Note 12 – Stockholders Rights Plan (cont.)**

substantial dilution to any Acquiring Person that attempts to acquire the Company without conditioning the offer on a substantial number of Rights being acquired. Other terms of the Rights are set forth in, and the foregoing description is qualified in its entirety by, the Rights Agreement between the Company and Harris N.A. (formerly known as Harris Trust and Savings Bank), as Rights Agent.

**Note 13 – Fair Value of Financial Instruments**

As described in Note 1, the Company adopted SFAS No. 157, Fair Value Measurements (SFAS No. 157), on January 1, 2008, other than for nonrecurring nonfinancial assets and liabilities, which will be effective for the Company on January 1, 2009. SFAS No. 157 establishes a fair value hierarchy based on the quality of inputs used to measure fair value, with level 1 being the highest quality and level 3 being the lowest quality. Level 1 inputs are quoted prices in active markets on identical assets or liabilities. Level 2 inputs are observable inputs other than quoted prices included in Level 1. Level 3 inputs are unobservable inputs which reflect assumptions about pricing by market participants.

The fair value measurements for the Company's financial liabilities accounted for at fair value on a recurring basis at December 31, 2008 are presented in the following table:

| (Thousands of dollars)                   | December 31,<br>2008 | Fair Value Measurements at Reporting Date Using                                    |                                     |                                       |
|------------------------------------------|----------------------|------------------------------------------------------------------------------------|-------------------------------------|---------------------------------------|
|                                          |                      | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Liabilities) Inputs | Significant<br>Observable<br>Inputs | Significant<br>Unobservable<br>Inputs |
|                                          |                      | Level 1                                                                            | Level 2                             | Level 3                               |
| Liabilities                              |                      |                                                                                    |                                     |                                       |
| Nonqualified<br>employee<br>savings plan | \$ (567)             | (567)                                                                              | -                                   | -                                     |

The following table presents the carrying amounts and estimated fair values of financial instruments held by the Company at December 31, 2008 and 2007. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties. The table excludes financial instruments included in current assets and liabilities, except current maturities of long-term debt, all of which have fair values approximating carrying values.

| (Thousands of dollars)                          | 2008               |                         | 2007               |                         |
|-------------------------------------------------|--------------------|-------------------------|--------------------|-------------------------|
|                                                 | Carrying<br>Amount | Estimated<br>Fair Value | Carrying<br>Amount | Estimated<br>Fair Value |
| Financial liabilities                           |                    |                         |                    |                         |
| Long-term debt, including<br>current maturities | \$ (76,944)        | (100,592)               | (70,000)           | (77,216)                |
| Guarantees                                      | \$ (518)           | (518)                   | (1,207)            | (1,207)                 |

*Long-term debt, including current maturities* — The fair value is estimated by discounting the scheduled debt payment streams to present value based on market rates for which the Company's debt could be valued.

*Guarantees* — The carrying amount approximates its fair value.

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**Note 14 – Concentration of Credit Risks**

Financial instruments which potentially subject the Company to credit risk are trade accounts receivable. These receivables normally arise from the sale of wood products and real estate. Concentration of credit with respect to these trade accounts receivable is limited due to the large number of customers comprising the Company's customer base. No single recurring customer accounted for a significant amount of the Company's sales of wood products or real estate in 2008, 2007, or 2006. At December 31, 2008 and 2007, there were no significant accounts receivable from a single customer. The Company performs ongoing credit evaluations of its customers and generally does not require collateral to support accounts receivable.

**Note 15 – Employee and Retiree Benefit Plans**

The Company has both funded and unfunded noncontributory defined benefit retirement plans that cover the majority of its employees. The plans provide defined benefits based on years of service and final average salary. Deltic also has other postretirement benefit plans covering substantially all of its employees. The health care plan is contributory with participants' contributions adjusted as needed. The life insurance plan is noncontributory. The Company measured its plan assets and benefit obligations as of September 30 of each year prior to adoption of the measurement date provisions of SFAS No. 158 during 2008. The following table sets forth the plan's benefit obligations, fair value of plan assets, and funded status at December 31, 2008 and September 30, 2007.

|                                                         | Funded<br>Qualified<br>Retirement<br>Plan |               | Unfunded<br>Nonqualified<br>Retirement<br>Plan |              | Other<br>Postretirement<br>Plans |              |
|---------------------------------------------------------|-------------------------------------------|---------------|------------------------------------------------|--------------|----------------------------------|--------------|
| (Thousands of dollars)                                  | 2008                                      | 2007          | 2008                                           | 2007         | 2008                             | 2007         |
| <b>Change in projected benefit obligation</b>           |                                           |               |                                                |              |                                  |              |
| Benefit obligation at beginning of period               | \$ 22,507                                 | 22,750        | 3,049                                          | 3,187        | 8,163                            | 10,450       |
| Service cost                                            | 1,158                                     | 1,042         | 129                                            | 138          | 277                              | 292          |
| Interest cost                                           | 1,753                                     | 1,288         | 230                                            | 175          | 564                              | 451          |
| Participant contributions                               | -                                         | -             | -                                              | -            | 80                               | -            |
| Plan amendment                                          | -                                         | -             | -                                              | -            | -                                | (1,853)      |
| Actuarial (gain)/loss                                   | 2,282                                     | (1,967)       | 327                                            | (221)        | (241)                            | (751)        |
| Benefits paid                                           | (968)                                     | (606)         | (324)                                          | (230)        | (152)                            | (426)        |
| Benefit obligation at end of period                     | \$ <u>26,732</u>                          | <u>22,507</u> | <u>3,411</u>                                   | <u>3,049</u> | <u>8,691</u>                     | <u>8,163</u> |
| <b>Change in plan assets</b>                            |                                           |               |                                                |              |                                  |              |
| Fair value of plan assets at beginning of period        | \$ 19,665                                 | 16,348        | -                                              | -            | -                                | -            |
| Actual return on plan assets                            | (5,043)                                   | 2,525         | -                                              | -            | -                                | -            |
| Employer contributions                                  | 2,048                                     | 1,474         | 324                                            | 230          | 72                               | 426          |
| Participant contributions                               | -                                         | -             | -                                              | -            | 80                               | -            |
| Benefits paid                                           | (968)                                     | (606)         | (324)                                          | (230)        | (152)                            | (426)        |
| Expenses                                                | (99)                                      | (76)          | -                                              | -            | -                                | -            |
| Fair value of plan assets at end of period <sup>1</sup> | \$ <u>15,603</u>                          | <u>19,665</u> | <u>-</u>                                       | <u>-</u>     | <u>-</u>                         | <u>-</u>     |
| <b>Funded status of plans</b>                           | \$ (11,129)                               | (2,842)       | (3,411)                                        | (3,049)      | (8,691)                          | (8,163)      |

<sup>1</sup>Primarily includes listed stocks and bonds, government securities, and U.S. agency bonds.

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**Note 15 – Employee and Retiree Benefit Plans (cont.)**

| (Thousands of dollars)                                                     | Funded<br>Qualified<br>Retirement<br>Plan |              | Unfunded<br>Nonqualified<br>Retirement<br>Plan |            | Other<br>Postretirement<br>Plans |              |
|----------------------------------------------------------------------------|-------------------------------------------|--------------|------------------------------------------------|------------|----------------------------------|--------------|
|                                                                            | 2008                                      | 2007         | 2008                                           | 2007       | 2008                             | 2007         |
| <b>Assumptions</b>                                                         |                                           |              |                                                |            |                                  |              |
| Weighted average discount rate                                             | 6.01%                                     | 6.33%        | 6.01%                                          | 6.33%      | 6.10%                            | 6.25%        |
| Rate of compensation increase                                              | 5.50%                                     | 5.28%        | 5.50%                                          | 5.28%      | N/A                              | N/A          |
| <b>Amounts recognized in the balance sheet</b>                             |                                           |              |                                                |            |                                  |              |
| Noncurrent liability                                                       | \$ (11,129)                               | (2,842)      | (3,411)                                        | (3,049)    | (8,691)                          | (8,163)      |
| Deferred income taxes – net                                                | \$ 4,260                                  | 979          | 319                                            | 222        | (142)                            | (173)        |
| Accumulated other comprehensive (income)/loss                              | \$ 6,601                                  | 1,517        | 495                                            | 345        | (190)                            | (269)        |
| <b>Amounts recognized in accumulated other comprehensive (income)/loss</b> |                                           |              |                                                |            |                                  |              |
| Funding after measurement date                                             | \$ -                                      | 575          | -                                              | 66         | -                                | -            |
| Net unrecognized loss                                                      | 10,705                                    | 1,688        | 904                                            | 577        | 1,117                            | 1,192        |
| Unrecognized prior service cost/(credit)                                   | 156                                       | 233          | (90)                                           | (76)       | -                                | -            |
| Plan amendment                                                             | -                                         | -            | -                                              | -          | (1,449)                          | (1,654)      |
| Tax effects of changes                                                     | (4,260)                                   | (979)        | (319)                                          | (222)      | 142                              | 193          |
|                                                                            | <u>\$ 6,601</u>                           | <u>1,517</u> | <u>495</u>                                     | <u>345</u> | <u>(190)</u>                     | <u>(269)</u> |

Components of net periodic retirement expense and other postretirement benefits expense consisted of the following:

| (Thousands of dollars)                       | 2008          | 2007         | 2006         |
|----------------------------------------------|---------------|--------------|--------------|
| <b>Funded qualified retirement plan</b>      |               |              |              |
| Service cost                                 | \$ 927        | 1,042        | 962          |
| Interest cost                                | 1,402         | 1,288        | 1,152        |
| Expected return on plan assets               | (1,495)       | (1,246)      | (1,108)      |
| Amortization of prior service cost           | 62            | 62           | 62           |
| Amortization of actuarial loss               | -             | 201          | 241          |
| Net periodic benefit cost                    | <u>\$ 896</u> | <u>1,347</u> | <u>1,309</u> |
| <b>Unfunded nonqualified retirement plan</b> |               |              |              |
| Service cost                                 | \$ 104        | 138          | 70           |
| Interest cost                                | 184           | 175          | 142          |
| Amortization of prior service credit         | (11)          | (11)         | (11)         |
| Amortization of actuarial loss               | 22            | 41           | 7            |
| Net periodic benefit cost                    | <u>\$ 299</u> | <u>343</u>   | <u>208</u>   |

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**Note 15 – Employee and Retiree Benefit Plans (cont.)**

| (Thousands of dollars)                                                                                          | <u>2008</u>     | <u>2007</u>    | <u>2006</u>  |
|-----------------------------------------------------------------------------------------------------------------|-----------------|----------------|--------------|
| <b>Other postretirement benefits</b>                                                                            |                 |                |              |
| Service cost                                                                                                    | \$ 276          | 292            | 550          |
| Interest cost                                                                                                   | 487             | 451            | 525          |
| Amortization of prior service cost                                                                              | -               | -              | 18           |
| Amortization of plan amendment                                                                                  | (199)           | (199)          | -            |
| Amortization of actuarial loss                                                                                  | 35              | 109            | 79           |
| Net periodic benefit cost                                                                                       | <u>\$ 599</u>   | <u>653</u>     | <u>1,172</u> |
| <br><b>Assumptions – pension plans</b>                                                                          |                 |                |              |
| Weighted average discount rate                                                                                  | 6.01 %          | 6.33 %         | 5.75 %       |
| Expected long-term rate of return on plan assets                                                                | 7.50 %          | 7.50 %         | 7.50 %       |
| Rate of compensation increase                                                                                   | 5.50 %          | 5.28 %         | 4.60 %       |
| <br><b>Assumptions – other postretirement</b>                                                                   |                 |                |              |
| Weighted average discount rate                                                                                  | 6.10 %          | 5.50 %         | 5.50 %       |
| <br><b>Other changes in plan assets and benefit obligations recognized in other comprehensive (income)/loss</b> |                 |                |              |
| Funding after measurement date                                                                                  | \$ (641)        | 325            | -            |
| Net unrecognized loss/(gain)                                                                                    | 9,269           | (4,137)        | 560          |
| Unrecognized prior service (credit)                                                                             | (51)            | (51)           | (69)         |
| Actuarial loss/(gain)                                                                                           | (57)            | (351)          | -            |
| Plan amendment                                                                                                  | 199             | (1,654)        | -            |
| Tax effect of changes                                                                                           | <u>(3,420)</u>  | <u>2,341</u>   | <u>(193)</u> |
| Total recognized in other comprehensive (income)/loss                                                           | <u>\$ 5,299</u> | <u>(3,527)</u> | <u>298</u>   |

The estimated net loss and net prior service cost for the defined benefit and supplemental retirement pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$731,000 and \$51,000, respectively. The estimated net loss and plan amendment for the other defined benefit postretirement plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$4,000 and \$199,000, respectively.

The discount rate assumption used by the Company to measure benefit obligations and net periodic expenses is based on the estimated interest rate at which the benefit obligations of its plans can be settled. In determining the discount rate as of the measurement date of its plans for 2006, the Company considered corporate bonds with ratings of AAA or AA, which are deemed high quality, as well as the general level of interest rates since the last measurement date. For 2008 and 2007, the Company used a discount rate durational study of Other Postretirement Employee Benefit (OPEB) liabilities to determine an appropriate discount rate.

To develop the expected long-term rate of return on asset assumption, the Company considered the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium allocated with the other asset classes in which the portfolio is invested, and the expectations for future returns of each asset class. The expected return for each asset class was then weighted, based

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**Note 15 – Employee and Retiree Benefit Plans (cont.)**

on the target asset allocation, to develop the expected long-term rate of return on asset assumption for the portfolio. The returns were adjusted to account for plan expenses. This resulted in the selection of the 7.50 percent assumption.

The accumulated benefit obligation for the Company's retirement plans were \$23,809,000 at December 31, 2008 and \$20,670,000 at December 31, 2007.

The weighted average asset allocation for the Company's qualified retirement plan at December 31, 2008 and 2007 by asset category, consisted of the following:

|                                                 | 2008<br>Target<br>Allocation | <u>2008</u> | 2007<br>Target<br>Allocation | <u>2007</u> |
|-------------------------------------------------|------------------------------|-------------|------------------------------|-------------|
| Equity securities                               | 45-65%                       | 52%         | 45-65%                       | 68%         |
| Debt securities (including<br>cash equivalents) | 35-55%                       | 48%         | 35-55%                       | 32%         |
|                                                 |                              | <u>100%</u> |                              | <u>100%</u> |

Equity securities include domestic and foreign common stock and exchange traded funds. These stocks are invested in ten different categories with no sector holding more than ten percent of the market value and no individual holding accounting for more than one percent of the market value. Mutual funds and proprietary funds are four percent of the total market value. Debt securities include obligations of the U.S. Treasury, U.S. Government Agencies, high rated domestic corporate bonds, or Euro and International fixed income bonds. Of the total market value of plan assets the U.S. Treasuries and U.S. Government Agency bonds total 34 percent, domestic bonds nine percent, and Euro and International fixed income bonds less than one percent. Cash equivalents equal five percent of the market value of plan assets.

The primary investment goals are: (1) preservation of principle, (2) investment in a balanced portfolio, and (3) growth of assets to exceed inflation. To meet these goals, the Company's Investment Committee has adopted the above target asset allocation ranges as outlined in the investment policy for the qualified retirement plan. These ranges allow for flexibility to meet investment goals without exposing the plan's assets to excessive risk.

The amount of projected expense of the qualified retirement plan is expected to be \$2,200,000 for 2009. The current funding status of the qualified retirement plan is expected to require the Company to make a contribution during 2009 of approximately \$1,500,000. Deltic expects to contribute \$235,000 in 2009 to fund benefits to be paid from its nonqualified retirement plan. Estimated benefits to be paid from the retirement plans amount to \$1,004,000 in 2009; \$1,095,000 in 2010; \$1,217,000 in 2011; \$1,285,000 in 2012; \$1,385,000 in 2013; and \$8,444,000 in the period 2014 through 2018.

*Other Postretirement Benefits* — The Company sponsors a plan that provides comprehensive health care benefits (supplementing Medicare benefits for those eligible) and life insurance benefits for retired employees. Costs are accrued for this plan during the service lives of covered employees. Retirees contribute a portion of the self-funded cost of health care benefits and the Company contributes the remainder. The Company pays premiums for life insurance coverage arranged through an insurance company. The health care plan is funded on a pay-as-you-go basis. The Company retains the right to modify or terminate the benefits and/or cost sharing provisions.

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**Note 15 – Employee and Retiree Benefit Plans (cont.)**

Estimated benefit payments to be paid by the Company for other postretirement benefits amount to \$503,000 in 2009; \$557,000 in 2010; \$558,000 in 2011; \$550,000 in 2012; \$553,000 in 2013; and \$2,868,000 in the period 2014 through 2018. The Company expects to contribute approximately \$606,000 to its other postretirement benefit plans in 2009. Effective January 1, 2007, Deltic no longer offers prescription drug coverage under its other postretirement benefits plan to post-65 retirees.

In determining the benefit obligation for health care at December 31, 2008, health care inflation cost was assumed to increase at an annual rate of eight percent in 2009, then decreasing one percent per year to an ultimate cost trend rate of five percent in 2012. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plan. A one percentage-point increase in the assumed health care cost trend would increase the aggregate service and interest cost components of periodic benefit cost for 2009 by \$104,000 and the benefit obligation by \$1,060,000, while a one percentage-point decrease in the assumed rate would decrease the 2009 cost components by \$90,000 and the benefit obligation by \$889,000.

*Thrift Plan* — Employees of the Company may participate in its thrift plan by allotting up to a specific percentage of their base pay. The Company matches contributions at a stated percentage of each employee's allotment. Company contributions to this plan were \$591,000 in 2008, \$589,000 in 2007, and \$653,000 in 2006.

**Note 16 – Incentive Plans**

**Stock Incentive Plan**

On April 25, 2002, the Company's shareholders approved the Deltic Timber Corporation 2002 Stock Incentive Plan ("the 2002 Plan"). The 2002 Plan replaced the 1996 Stock Incentive Plan ("the 1996 Plan"), which was terminated. At December 31, 2008, remaining outstanding options under the 1996 Plan totaled 1,050 shares, all of which were exercisable. Outstanding options under the 1996 Plan will expire from 2009 to 2011 if not exercised and have an average exercise price of \$24.19 based on the fair market value at date of grant.

The 2002 Plan permits annual awards of shares of the Company's common stock to executives, other key employees, and nonemployee directors. Under the plan, the Executive Compensation Committee ("the Committee") is authorized to grant: (1) stock options; (2) restricted stock and restricted stock units; (3) performance units; and (4) other stock-based awards, including stock appreciation rights and rights to dividends and dividend equivalents. The number of shares available for issuance under the 2002 Plan is 1,800,000 shares unless adjustment is determined necessary by the Committee as the result of dividend or other distribution, recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of common stock, or other corporate transaction in order to prevent dilution or enlargement of benefits or potential benefits intended to be made available. At December 31, 2008, 1,229,576 of these 1,800,000 shares were available for award under the 2002 Plan. No participant in the 2002 Plan may receive options and stock appreciation rights in any calendar-year that relates to more than 50,000 shares, and the maximum number of shares which may be awarded as restricted stock and restricted stock units or other stock-based awards is 180,000 shares. The Company has a policy of issuing treasury stock to satisfy all share-based incentive plans.

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**Note 16 – Incentive Plans (cont.)**

Under the fair value recognition provisions of SFAS No. 123 (R), stock-based compensation cost is estimated at the grant date based on the fair value of the award and is recognized as expense over the requisite service period of the award. The fair value of stock options granted subsequent to the adoption of SFAS No. 123 (R), are determined using a binomial model. The fair value of restricted stock awards is determined by reference to the fair market value of the Company's common stock on the date of grant.

Restricted stock performance units issued subsequent to Deltic's adoption of SFAS No. 123 (R), are valued using the Monte Carlo simulation. Compensation cost determined under SFAS No. 123 (R) is recognized on a straight-line basis over the requisite service period. SFAS No. 123 (R) requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow.

Deltic issues restricted stock performance units whose vesting is contingent upon meeting certain financial performance goals based upon the Company's total stockholder return compared to the total return of a Paper and Forest Products Index selected by the Compensation Committee and calculated by Standard and Poor's. Determining the appropriate amount to expense is based on likelihood of achievement of the stated goals and requires judgment, including forecasting future financial results. This estimate may be revised periodically due to changes in awards as defined under SFAS No. 123 (R). The cumulative impact of any revision is reflected in the period of change.

The Company uses historical volatility over a ten-year trading life to determine volatility assumptions. Risk-free interest rates are based on historical rates and forward-looking factors. The expected dividend yield is based on the Company's average dividend yield from 2004 to 2007. The pre-vesting forfeiture rate is based on historical rates and forward-looking factors. The expected option term is based on the term of the option and historical exercise and expiration experience.

Assumptions for the 2008, 2007, and 2006 valuation of stock options and restricted stock performance units consisted of the following:

|                                            | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--------------------------------------------|-------------|-------------|-------------|
| Weighted expected volatility               | 29.86%      | 28.72%      | 28.97%      |
| Dividend yield                             | 0.63%       | 0.64%       | 0.76%       |
| Expected term of options (in years)        | 6.27        | 6.27        | 6.27        |
| Risk-free interest rate – restricted stock | 2.62%       | 4.76%       | 4.43%       |
| Risk-free interest rate - options          | 3.67%       | 4.76%       | 4.43%       |

The adoption of SFAS No. 123 (R) had an impact on the Company's results of operations. The consolidated statements of income for the years ended December 31, 2008, 2007, and 2006 included \$1,669,000, \$2,676,000, and \$1,207,000, respectively, of stock-based compensation expense reflected in general and administrative expenses.

*Stock Options* — For each option granted under the 2002 Plan, the Committee fixes the option price at not less than fair market value on the date of the grant and the option term, not to exceed 10 years from date of grant. The resulting fixed stock-based compensation cost was recognized over the vesting period for these options. Options granted after 1998 have been for ten years and nonqualified. All outstanding options have an option price not less than the market value on the grant date, with a range in option

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**Note 16 – Incentive Plans (cont.)**

prices of \$23.875 to \$57.03 per share. For options granted from 1998 through 2001, one-half could be exercised or surrendered after one year and the remainder after three years. During 2003, the Company granted options for 129,750 shares. For 121,750 shares granted in 2003, one-half could be exercised or surrendered after one year and the remainder after three years. The remaining 8,000 shares awarded to nonemployee directors at an option price of \$24.31 in 2003, were vested immediately when awarded. For all options granted since 2003, one-fourth may be exercised or surrendered after each one-year period over the subsequent four years from issuance. In 2004, 2005, 2006, 2007, and 2008, the Company granted options for 39,687 shares at an option price of \$32.565, 36,160 shares at an option price of \$44.355, 30,956 shares at an option price of \$53.75, 35,344 shares at an option price of \$54.15, and 28,481 shares at an option price of \$51.37, respectively.

*Stock Options* – A summary of stock options as of December 31, 2008, and changes during the year ended are presented below:

|                                     | <u>Shares</u>   | <u>Weighted Average<br/>Exercise Price</u> | <u>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term (Years)</u> | <u>Aggregate<br/>Intrinsic<br/>Value<br/>(\$000)</u> |
|-------------------------------------|-----------------|--------------------------------------------|----------------------------------------------------------------------------|------------------------------------------------------|
| Outstanding at January 1, 2008      | 249,812         | \$ 37.06                                   |                                                                            |                                                      |
| Granted                             | 28,481          | 51.37                                      |                                                                            |                                                      |
| Exercised                           | (102,276)       | 33.13                                      |                                                                            |                                                      |
| Forfeited/expired                   | <u>(10,303)</u> | 27.26                                      |                                                                            |                                                      |
| Outstanding at December 31,<br>2008 | <u>165,714</u>  | \$ <u>42.56</u>                            | <u>5.6</u>                                                                 | \$ <u>529</u>                                        |
| Exercisable at December 31,<br>2008 | <u>103,114</u>  | \$ <u>36.54</u>                            | <u>4.0</u>                                                                 | \$ <u>950</u>                                        |

The weighted-average grant-date fair value of stock options granted during the years ended December 31, 2008, 2007, and 2006 was \$16.46, \$15.78, and \$16.24, respectively. The intrinsic value of options exercised during the years ended December 31, 2008, 2007, and 2006 was \$2,882,000, \$1,095,000, and \$2,291,000, respectively. At December 31, 2008, there was \$781,000 of unrecognized compensation cost related to unvested stock options. The weighted average period remaining to vest is 1.2 years.

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**Note 16 – Incentive Plans (cont.)**

Additional information about stock options outstanding at December 31, 2008, consisted of the following:

| Range of<br>Exercise<br>Prices | Options Outstanding     |                             |                              | Options Exercisable     |                              |
|--------------------------------|-------------------------|-----------------------------|------------------------------|-------------------------|------------------------------|
|                                | Number<br>of<br>Options | Average<br>Life<br>in Years | Average<br>Exercise<br>Price | Number<br>of<br>Options | Average<br>Exercise<br>Price |
| \$23.8750 - \$29.2950          | 50,550                  | 2.4                         | \$27.83                      | 50,550                  | \$27.83                      |
| \$32.5650 - \$35.0000          | 12,757                  | 3.4                         | 32.57                        | 12,757                  | 32.57                        |
| \$44.3550 - \$45.0000          | 23,887                  | 5.1                         | 44.36                        | 21,091                  | 44.36                        |
| \$51.0000 - \$57.0300          | <u>78,520</u>           | 8.2                         | 53.12                        | <u>18,716</u>           | 53.97                        |
|                                | <u>165,714</u>          | 5.6                         | 42.56                        | <u>103,114</u>          | 36.54                        |

*Restricted Stock and Restricted Stock Units* — The Committee may grant restricted stock and restricted stock units to selected employees, with conditions to vesting for each grant established by the Committee. During the vesting period, the grantee may vote and receive dividends on the shares, but shares are subject to transfer restrictions and are all, or partially, forfeited if a grantee terminates, depending on the reason.

A summary of unvested restricted stock as of December 31, 2008, and changes during the year then ended are presented below:

|                               | <u>Shares</u> | <u>Weighted<br/>Average<br/>Grant-Date<br/>Fair Value</u> |
|-------------------------------|---------------|-----------------------------------------------------------|
| Unvested at January 1, 2008   | 66,700        | \$ 44.91                                                  |
| Granted                       | 18,341        | 51.37                                                     |
| Vested                        | (19,611)      | 51.80                                                     |
| Forfeited                     | <u>(231)</u>  | 32.54                                                     |
| Unvested at December 31, 2008 | <u>65,199</u> | \$ 50.43                                                  |

As of December 31, 2008, there was \$1,349,000 of unrecognized compensation cost related to unvested restricted stock. That cost is expected to be recognized over a weighted-average period of 1.7 years.

*Performance Units* — Performance units granted under the 2002 Plan may be denominated in cash, common shares, other securities, other awards allowed under the 2002 Plan, or other property and shall confer on the holder thereof rights valued as determined by the Committee and payable to, or exercisable by, the holder, in whole or in part, upon achievement of such performance goals during such performance periods as the Committee shall establish. Subject to the terms of the 2002 Plan, the performance goals to be achieved during any performance period, the length of any performance period, the amount of any

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**Note 16 – Incentive Plans (cont.)**

performance unit granted, and any payment or transfer to be made pursuant to any performance unit shall be determined by the Committee. During 2008, 2007, and 2006, the Company issued performance units in the form of restricted stock with specified performance requirements. During the vesting period, the grantee may vote and receive dividends on the shares, but shares are subject to transfer restrictions and are all, or partially, forfeited if a grantee terminates, depending on the reason.

A summary of unvested restricted stock performance units as of December 31, 2008, and changes during the year then ended are presented below:

|                               | <u>Shares</u> | <u>Weighted<br/>Average<br/>Grant-Date<br/>Fair Value</u> |
|-------------------------------|---------------|-----------------------------------------------------------|
| Unvested at January 1, 2008   | 46,622        | \$ 46.29                                                  |
| Granted                       | 11,753        | 53.49                                                     |
| Vested                        | (11,611)      | 54.19                                                     |
| Forfeited                     | <u>(269)</u>  | 32.54                                                     |
| Unvested at December 31, 2008 | <u>46,495</u> | \$ 51.50                                                  |

As of December 31, 2008, there was \$888,000 of unrecognized compensation cost related to unvested restricted stock performance units. That cost is expected to be recognized over a weighted-average period of 1.5 years.

During 2007, two executives retired. The Company compensation committee granted them a modification in their employment continuation requirement. The Company recognized incremental stock-based compensation expense of \$1,076,000 for restricted stock awards and \$177,000 for stock options in 2007 related to the modification of these awards.

*Other Stock-based Awards* — The Committee may also grant other awards, including but not limited to, stock appreciation rights and rights to dividends and dividend equivalents that are denominated, or payable in, valued in whole or in part by reference to, or otherwise based on or related to shares of the Company's common stock, including securities convertible in its common stock, as deemed by the Committee to be consistent with the purpose of the 2002 Plan. No such other stock-based awards have been granted.

**Incentive Compensation Plan**

*Cash Awards* — The Company has an incentive compensation plan that provides for annual cash awards to officers and key employees based on actual results for a year compared to objectives established by the Executive Compensation Committee, which administers the Plan, at the beginning of that year. The Company recorded expenses for cash incentive awards of \$328,000, \$825,000, and \$928,000, in 2008, 2007, and 2006, respectively. The Company had accrued provisions for cash incentive awards totaling \$303,000 and \$852,000 at December 31, 2008 and 2007, respectively, reflected in the consolidated balance sheets in deferred revenues and other accrued liabilities.

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**Note 17 – Supplemental Cash Flows Disclosures**

Income taxes paid, net of refunds, were \$220,000, \$4,885,000, and \$8,516,000 in 2008, 2007, and 2006, respectively. Interest paid was \$4,736,000, \$5,028,000, and \$4,931,000 in 2008, 2007, and 2006, respectively. Capitalized interest was \$480,000, \$769,000, and \$1,184,000 during 2008, 2007, and 2006, respectively. Non-cash investing and financing activities excluded from the consolidated statement of cash flows was the non-cash issuance of restricted stock awards in the amount of \$1,214,000 in 2008 and \$681,000 in 2007. Non-cash activity includes land exchanges in 2008 of \$387,000, and \$200,000 in 2006.

(Increases)/decreases in operating working capital other than cash and cash equivalents, for each of the three years ended December 31 consisted of the following:

| (Thousands of dollars)                          | <u>2008</u>       | <u>2007</u>  | <u>2006</u>  |
|-------------------------------------------------|-------------------|--------------|--------------|
| Trade accounts receivable                       | \$ 950            | 206          | 2,057        |
| Other receivables                               | 103               | 611          | (420)        |
| Inventories                                     | (355)             | (1,032)      | 2,551        |
| Prepaid expenses and other current assets       | (1,546)           | (24)         | 1,726        |
| Trade accounts payable                          | (933)             | (1,355)      | (2,406)      |
| Accrued taxes other than income taxes           | 108               | 65           | 577          |
| Deferred revenues and other accrued liabilities | (1,011)           | 2,870        | 367          |
|                                                 | <u>\$ (2,684)</u> | <u>1,341</u> | <u>4,452</u> |

Cash flows provided by other operating activities included an increase/(decrease) in deferred long-term mineral lease bonus revenue of \$(1,107,000) in 2008, \$495,000 in 2007, and \$2,364,000 in 2006.

**Note 18 – Earnings per Share**

The amounts used in computing earnings per share and the effect on income and weighted average number of shares outstanding of dilutive potential common stock consisted of the following:

| (Thousands of dollars, except per share amounts)                                                           | <u>2008</u>     | <u>2007</u>   | <u>2006</u>   |
|------------------------------------------------------------------------------------------------------------|-----------------|---------------|---------------|
| Net income                                                                                                 | \$ <u>4,384</u> | <u>11,111</u> | <u>11,323</u> |
| Weighted average number of common shares used in basic EPS                                                 | 12,447          | 12,473        | 12,398        |
| Effect of dilutive stock awards                                                                            | <u>83</u>       | <u>77</u>     | <u>79</u>     |
| Weighted average number of common shares and dilutive potential common stock used in EPS assuming dilution | <u>12,530</u>   | <u>12,550</u> | <u>12,477</u> |
| Earnings per common share                                                                                  |                 |               |               |
| Basic                                                                                                      | \$ .35          | .89           | .91           |
| Assuming dilution                                                                                          | \$ .35          | .89           | .89           |

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**Note 19 – Staff Accounting Bulletin No. 108**

In September 2005, the SEC issued Staff Accounting Bulletin No. 108 (“SAB 108”), “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.” SAB 108 specifies how the carryover or reversal of prior year unrecorded financial statement misstatements should be considered in quantifying a current year misstatement. SAB 108 requires an approach that considers the amount by which the current year consolidated statement of income is misstated (“rollover approach”) and an approach that considers the cumulative amount by which the current year consolidated balance sheet is misstated (“iron curtain approach”).

Prior to the issuance of SAB 108, either the rollover or iron curtain approach was acceptable for assessing the materiality of financial statement misstatements. Prior to the Company’s application of the guidance in SAB 108, management used the rollover approach for quantifying financial statement misstatements.

Based on the nature of the adjustments and the totality of the circumstance surrounding those adjustments, the Company concluded that the adjustments were immaterial to prior years’ consolidated financial statements under its previous method of assessing materiality, and therefore, elected, as permitted under the transition provisions of SAB 108, to reflect the effect of the adjustments in opening assets and liabilities as of January 1, 2006, with the offsetting adjustment reflected as a cumulative effect adjustment to opening retained earnings as of January 1, 2006.

Effective for the fiscal year ended December 31, 2005, Deltic adopted SAB 108. In accordance with the transition provisions of SAB 108, the Company recorded a \$1,471,000 cumulative effect increase to retained earnings, a \$2,908,000 increase to the Company’s investment in real estate held for development, a \$103,000 increase in deferred charges, a \$591,000 increase in other accrued liabilities, and a \$949,000 increase to deferred income taxes payable as of January 1, 2006, on the consolidated balance sheet.

**Note 20 – Business Interruption and Involuntary Conversion**

On August 9, 2007, the Company experienced a fire in the planer section of its operating facility in Waldo, Arkansas that injured three individuals and caused operations to temporarily cease. The Company was adequately insured under its workers compensation policy for the personal injury of the three individuals. The Waldo facility became fully operational in late October 2007.

The Company maintains business interruption insurance coverage. The Company received cash business interruption proceeds from its insurance carrier of \$3,352,000. The Company recorded \$2,166,000 of direct expenses normally included in cost of sales, and \$1,186,000 was recorded as other operating income from business interruption insurance proceeds in the Company’s consolidated statement of income.

The Company had adequate property damage insurance coverage to enable it to recover the replacement cost of its property and equipment that was destroyed by the fire. During the fourth quarter of 2007, the Company received cash proceeds of \$2,475,000 for property damage, including \$484,000 for contents and repair cost, and \$1,991,000 for replacement cost of a new planer. After a write-off of basis in the amount of \$105,000 for the old planer, the Company recognized a gain from the involuntary conversion of assets in the amount of \$1,887,000. All of the Company’s insurance proceeds were reinvested to fully restore the Waldo operations.

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**Note 21 – Commitments and Contingencies**

*Commitments* — Commitments for capital expenditures at December 31, 2008, were approximately \$740,000 for reforestation and road construction; \$3,329,000 for land acquisitions; \$172,000 for property, plant, and equipment; and \$1,271,000 for investment in real estate held for development and sale and amenities.

*Contingencies* — The Company has various contingencies related to its investment in Del-Tin Fiber and has either recorded such contingencies into its financial statements or disclosed the conditions of the contingency as required by SFAS No. 5, "Accounting for Contingencies", and FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34". (For additional information, see Note 4 – Investment in Del-Tin Fiber.)

On March 28, 2007, the Company and Central Arkansas Water ("CAW"), a consolidated waterworks, entered into a full and complete settlement of a pending condemnation litigation involving 680.06 acres of real property located within the watershed of Lake Maumelle in western Pulaski County, Arkansas. Approximately 640 acres were part of the Company's planned real estate development, The Ridges at Nowlin Creek. The Company will continue to assess the viability of proceeding with the remaining part of its The Ridges of Nowlin Creek planned development. Under the terms of the settlement, CAW has paid the Company \$8,175,000 (approximately \$12,000 per acre) for the land, and granted the Company a 90-year option to repurchase the land for the same amount should CAW determine the land is not needed for watershed protection or if it ceases to use the land for such purpose. During the three months ended March 31, 2007, the Company recorded sales revenues of \$8,175,000 and related costs of \$675,000 for a net operating gain of \$7,500,000 on this transaction.

The Company is also involved in other litigation incidental to its business from time to time. Currently, there are no other material legal proceedings outstanding.

**Note 22 – Business Segments**

The Company's four reporting segments consist of Deltic's three operating business units and its corporate function. Each reporting entity has a separate management team and infrastructure that offers different products and/or services.

Woodlands operations manage the Company's Southern Pine timberlands located primarily in Arkansas and northern Louisiana and derive revenue from the harvest of timber from the timberlands in accordance with its harvest plans, and either sells timber to third parties in the domestic market or to the Company's Mills segment for conversion into lumber. In addition, this segment may, from time to time, identify and sell a portion of its timberland holdings that is either non-strategic to future timberland management activities or has appreciated, due primarily to location, to a level that exceeds its value as a timber-growing asset. This segment also generates revenue from oil and gas royalties and the leasing of hunting, oil and gas, and other rights on its timberlands.

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**Note 22 – Business Segments (cont.)**

The Mills segment consists of Deltic's two sawmills which convert timber, purchased from third parties or the Company's Woodlands segment, into lumber. These mills produce a variety of products, including dimension lumber, boards, and timbers. These products are sold primarily to wholesale distributors, lumber treaters, and truss manufacturers in the South and Midwest and are used in residential construction, roof trusses and laminated beams.

Real Estate operations, which include real estate developments, add value to former timberland by developing it into upscale, planned residential and commercial developments. These developments, which are generally centered around a core amenity, are being developed in stages. Historically, real estate sales have consisted primarily of residential lots sold to builders or individuals, commercial site sales, and sales of undeveloped acreage. In addition, this segment currently leases retail and office space to third parties in a retail center constructed by the Company, and held for sale, in one of its developments. This segment also manages: (1) a real estate brokerage subsidiary which generates commission revenue by reselling existing homes and (2) a country club operation, Chenal Country Club, Inc., around which the Company's Chenal Valley development is centered. This club operation derives its revenues from membership services, food and beverage sales, and membership dues.

Corporate operations consist primarily of senior management, accounting, information systems, human resources, purchasing, treasury, income tax, and legal staff functions that provide support services to the operating business units. The Company currently does not allocate the cost of maintaining these support functions to its operating units.

The accounting policies of the reportable segments are the same as those described in Note 1 – Significant Accounting Policies. The Company evaluates the performance of its segments based on operating income before results of: Del-Tin Fiber, an equity method investee; interest income and expense; other nonoperating income or expense; and income taxes. Intersegment revenues consist primarily of timber sales from the Woodlands segment to the Mills operations.

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**Note 22 – Business Segments (cont.)**

Information about the Company's business segments consisted of the following:

| (Thousands of dollars)                                          | 2008              | 2007            | 2006            |
|-----------------------------------------------------------------|-------------------|-----------------|-----------------|
| Net sales                                                       |                   |                 |                 |
| Woodlands                                                       | \$ 45,979         | 39,567          | 37,667          |
| Mills <sup>4</sup>                                              | 91,442            | 79,341          | 101,879         |
| Real Estate <sup>5</sup>                                        | 11,405            | 30,252          | 35,507          |
| Eliminations <sup>1</sup>                                       | <u>(19,302)</u>   | <u>(20,905)</u> | <u>(21,941)</u> |
|                                                                 | <u>\$ 129,524</u> | <u>128,255</u>  | <u>153,112</u>  |
| Income/(loss) before income taxes                               |                   |                 |                 |
| Operating income                                                |                   |                 |                 |
| Woodlands                                                       | \$ 27,812         | 24,814          | 22,538          |
| Mills <sup>4</sup>                                              | (4,812)           | (2,997)         | (5,340)         |
| Real Estate <sup>5</sup>                                        | (1,881)           | 13,050          | 13,948          |
| Corporate                                                       | (13,131)          | (14,323)        | (13,099)        |
| Eliminations                                                    | <u>(483)</u>      | <u>(585)</u>    | <u>674</u>      |
| Operating income                                                | 7,505             | 19,959          | 18,721          |
| Equity in Del-Tin Fiber                                         | 2,277             | 1,679           | 2,872           |
| Interest income                                                 | 299               | 823             | 452             |
| Interest and other debt expense                                 | (4,699)           | (4,369)         | (4,231)         |
| Other income/(loss)                                             | <u>(10)</u>       | <u>345</u>      | <u>290</u>      |
|                                                                 | <u>\$ 5,372</u>   | <u>18,437</u>   | <u>18,104</u>   |
| Total assets at year-end                                        |                   |                 |                 |
| Woodlands                                                       | \$ 208,988        | 206,280         | 208,086         |
| Mills                                                           | 44,331            | 45,472          | 43,879          |
| Real Estate                                                     | 57,254            | 49,604          | 47,496          |
| Corporate <sup>2,3</sup>                                        | <u>24,160</u>     | <u>27,388</u>   | <u>24,805</u>   |
|                                                                 | <u>\$ 334,733</u> | <u>328,744</u>  | <u>324,266</u>  |
| Depreciation, amortization, and<br>cost of fee timber harvested |                   |                 |                 |
| Woodlands                                                       | \$ 6,185          | 6,212           | 6,362           |
| Mills                                                           | 7,179             | 7,433           | 6,832           |
| Real Estate                                                     | 576               | 582             | 573             |
| Corporate                                                       | <u>83</u>         | <u>105</u>      | <u>7</u>        |
|                                                                 | <u>\$ 14,023</u>  | <u>14,332</u>   | <u>13,774</u>   |
| Capital expenditures                                            |                   |                 |                 |
| Woodlands                                                       | \$ 11,436         | 4,978           | 3,333           |
| Mills                                                           | 6,874             | 5,345           | 8,763           |
| Real Estate                                                     | 11,222            | 10,171          | 15,612          |
| Corporate                                                       | <u>122</u>        | <u>74</u>       | <u>59</u>       |
|                                                                 | <u>\$ 29,654</u>  | <u>20,568</u>   | <u>27,767</u>   |

<sup>1</sup> Primarily intersegment sales of timber from Woodlands to Mills.

<sup>2</sup> Includes investment in Del-Tin Fiber, an equity method investee, of \$8,962,000, \$7,017,000, and \$5,250,000 at December 31, 2008, 2007, and 2006, respectively. (For additional information, see Note 4 – Investment in Del-Tin Fiber.)

<sup>3</sup> Includes balance of timberland sale proceeds held by trustee of \$3,491,000 as of December 31, 2008, \$805,000 as of December 31, 2007, and \$111,000 in 2006.

<sup>4</sup> During 2007, the Company experienced a fire in the planer section of its Waldo Mill that affected the operating results. (For further information, see Note 20 – Business Interruption and Involuntary Conversion)

<sup>5</sup> 2007 results reflect the settlement of the litigation with Central Arkansas Water. (For additional information, see Note 21 – Commitments and contingencies.)

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**Note 23 – Financial Results by Quarter (Unaudited)**

(Thousands of dollars, except per share amounts)

|                               | 2008                     |                           |                          |                           |             |
|-------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|-------------|
|                               | <u>First<br/>Quarter</u> | <u>Second<br/>Quarter</u> | <u>Third<br/>Quarter</u> | <u>Fourth<br/>Quarter</u> | <u>Year</u> |
| Net sales                     | \$ 27,822                | 35,551                    | 34,964                   | 31,187                    | 129,524     |
| Gross profit                  | 3,467                    | 6,667                     | 7,001                    | 4,410                     | 21,545      |
| Operating income/(loss)       | (276)                    | 3,444                     | 2,360                    | 1,977                     | 7,505       |
| Net income/(loss)             | (368)                    | 2,424                     | 2,583                    | (255)                     | 4,384       |
| Earnings per common share     |                          |                           |                          |                           |             |
| Basic                         | \$ (.03)                 | .19                       | .21                      | (.02)                     | .35         |
| Assuming dilution             | \$ (.03)                 | .19                       | .21                      | (.02)                     | .35         |
| Dividends per common share    | \$ .075                  | .075                      | .075                     | .075                      | .300        |
| Market price per common share |                          |                           |                          |                           |             |
| High                          | \$ 56.13                 | 59.46                     | 69.28                    | 63.27                     | 69.28       |
| Low                           | 47.54                    | 50.01                     | 52.97                    | 40.35                     | 40.35       |
| Close, at period-end          | 55.70                    | 53.51                     | 63.64                    | 45.75                     | 45.75       |

|                               | 2007                                 |                           |                                      |                                       |             |
|-------------------------------|--------------------------------------|---------------------------|--------------------------------------|---------------------------------------|-------------|
|                               | <u>First<br/>Quarter<sup>1</sup></u> | <u>Second<br/>Quarter</u> | <u>Third<br/>Quarter<sup>2</sup></u> | <u>Fourth<br/>Quarter<sup>2</sup></u> | <u>Year</u> |
| Net sales                     | \$ 40,377                            | 37,905                    | 25,528                               | 24,445                                | 128,255     |
| Gross profit                  | 15,390                               | 8,875                     | 3,935                                | 4,065                                 | 32,265      |
| Operating income              | 11,683                               | 4,315                     | 766                                  | 3,195                                 | 19,959      |
| Net income/(loss)             | 6,649                                | 2,538                     | 245                                  | 1,679                                 | 11,111      |
| Earnings per common share     |                                      |                           |                                      |                                       |             |
| Basic                         | \$ .53                               | .20                       | .02                                  | .13                                   | .89         |
| Assuming dilution             | \$ .53                               | .20                       | .02                                  | .13                                   | .89         |
| Dividends per common share    | \$ .075                              | .075                      | .075                                 | .075                                  | .300        |
| Market price per common share |                                      |                           |                                      |                                       |             |
| High                          | \$ 56.60                             | 57.87                     | 62.83                                | 59.83                                 | 62.83       |
| Low                           | 46.15                                | 47.03                     | 50.91                                | 45.46                                 | 45.46       |
| Close, at period-end          | 47.96                                | 54.82                     | 56.92                                | 51.49                                 | 51.49       |

<sup>1</sup>First quarter results reflect the settlement of the litigation with Central Arkansas Water. (For additional information, see Note 21 – Commitments and Contingencies.)

<sup>2</sup>Third and fourth quarter results reflect the impact of the planer fire at Waldo. (For additional information, see Note 20 – Business Interruption and Involuntary Conversion.)

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**Note 23 – Financial Results by Quarter (Unaudited) (cont.)**

(Thousands of dollars, except per share amounts)

|                               | 2006                                 |                                       |                                      |                                       |             |
|-------------------------------|--------------------------------------|---------------------------------------|--------------------------------------|---------------------------------------|-------------|
|                               | <u>First<br/>Quarter<sup>1</sup></u> | <u>Second<br/>Quarter<sup>1</sup></u> | <u>Third<br/>Quarter<sup>1</sup></u> | <u>Fourth<br/>Quarter<sup>1</sup></u> | <u>Year</u> |
| Net sales                     | \$ 41,246                            | 41,410                                | 43,698                               | 26,758                                | 153,112     |
| Gross profit                  | 11,080                               | 9,103                                 | 12,318                               | 394                                   | 32,895      |
| Operating income              | 7,261                                | 5,005                                 | 9,030                                | (2,575)                               | 18,721      |
| Net income                    | 3,968                                | 2,984                                 | 6,389                                | (2,018)                               | 11,323      |
| Earnings per common share     |                                      |                                       |                                      |                                       |             |
| Basic                         | \$ .32                               | .24                                   | .52                                  | (.16)                                 | .91         |
| Assuming dilution             | \$ .32                               | .24                                   | .51                                  | (.16)                                 | .89         |
| Dividends per common share    | \$ .075                              | .075                                  | .075                                 | .075                                  | .300        |
| Market price per common share |                                      |                                       |                                      |                                       |             |
| High                          | \$ 60.60                             | 60.99                                 | 56.87                                | 56.28                                 | 60.99       |
| Low                           | 50.01                                | 51.99                                 | 45.20                                | 47.02                                 | 45.20       |
| Close, at period-end          | 60.60                                | 56.37                                 | 47.66                                | 55.78                                 | 55.78       |

<sup>1</sup>Adjusted to reflect the application of Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements." (For additional information, see Note 19 – Staff Accounting Bulletin No. 108.)

## **MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS**

The Shareholders  
Deltic Timber Corporation:

The management of Deltic Timber Corporation has prepared and is responsible for the Company's consolidated financial statements. The statements are prepared in conformity with accounting principles generally accepted in the United States of America, appropriate in the circumstances. In preparing the financial statements, management has, when necessary, made judgments and estimates with consideration given to materiality.

The Company's consolidated financial statements have been audited by KPMG LLP, an independent registered public accounting firm, who have expressed their opinion with respect to the fairness of the consolidated financial statements in conformity with U.S. generally accepted accounting principles. Their audit was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States). The Audit Committee of the Board of Directors ("the Audit Committee") appoints the independent auditors; ratification of the appointment is solicited annually from the shareholders.

The Audit Committee is composed of directors who are not officers or employees of the Company and who have been determined by the Company's Board of Directors to meet applicable independence standards under the Securities Exchange Act of 1934. The Audit Committee meets periodically with KPMG LLP, the Company's internal auditor, and representatives of management to review the Company's internal controls, the quality of its financial reporting, the scope and results of audits, and the independence of the external auditors. The Company's internal auditor and KPMG LLP have unrestricted access to the Audit Committee, without management's presence, to discuss audit findings and other financial matters.

/s/Ray C. Dillon

Ray C. Dillon  
President and Chief Executive Officer  
March 6, 2009

/s/Kenneth D. Mann

Kenneth D. Mann  
Vice President and Chief Financial Officer  
March 6, 2009

## **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Shareholders  
Deltic Timber Corporation:

The management of Deltic Timber Corporation is responsible for establishing and maintaining adequate internal control over financial reporting, and for performing an assessment of the effectiveness of internal control over financial reporting as of December 31, 2008. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. The Company's system of internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and the receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Deltic's management performed an assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2008, based upon criteria in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on its assessment, management determined that the Company's internal control over financial reporting was effective as of December 31, 2008, based on the criteria in *Internal Control – Integrated Framework* issued by COSO.

/s/Ray C. Dillon

Ray C. Dillon  
President and Chief Executive Officer  
March 6, 2009

/s/Kenneth D. Mann

Kenneth D. Mann  
Vice President and Chief Financial Officer  
March 6, 2009

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Deltic Timber Corporation:

We have audited the accompanying consolidated balance sheets of Deltic Timber Corporation and Subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of income, cash flows, stockholders' equity, and comprehensive income for each of the years in the three-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of quantifying financial statement misstatements and on December 31, 2006, the Company changed its accounting for recognition of defined benefit pension and other postretirement plans. As also described in Note 1 to the consolidated financial statements, on January 1, 2007, the Company changed its accounting for uncertain tax positions and on January 1, 2008, the Company changed its measurement date for defined benefit pension and other postretirement plans.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 6, 2009 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/KPMG LLP

KPMG LLP  
Shreveport, Louisiana  
March 6, 2009

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Deltic Timber Corporation:

We have audited Deltic Timber Corporation's (the Company) internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Deltic Timber Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Deltic Timber Corporation and Subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, cash flows, stockholders' equity, and comprehensive income for each of the years in the three-year period ended December 31, 2008, and our report dated March 6, 2009 expressed an unqualified opinion on those consolidated financial statements.

/s/KPMG LLP

KPMG LLP  
Shreveport, Louisiana  
March 6, 2009

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

**Item 9A. Controls and Procedures**

***Evaluation of Disclosure Controls and Procedures***

Deltic Timber Corporation (“Deltic” or “the Company”) has established disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the officers who certify the Company's financial reports and to other members of senior management and the Board of Directors.

Based on their evaluation as of December 31, 2008, the Chief Executive Officer and Chief Financial Officer of the Company have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms and this information was accumulated and communicated to the Company's Management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures.

***Management's Report on Internal Control Over Financial Reporting***

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, Deltic conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on evaluation under the framework in *Internal Control – Integrated Framework*, management concluded that internal control over financial reporting was effective as of December 31, 2008. The effectiveness of the Company's internal control over financial reporting as of December 31, 2008, has been audited by KPMG, LLP, an independent registered public accounting firm, as stated in their report which appears in the Company's 2008 Annual Report to Shareholders which is included in this Form 10-K.

***Changes in Internal Control Over Financial Reporting***

Deltic's management, with the Chief Executive Officer and Chief Financial Officer, have evaluated any changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth quarter in the case of an annual report), and have concluded that there was no change to Deltic's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, Deltic's internal control over financial reporting.

**Item 9B. Other Information**

None.

## **PART III**

### **Item 10. Directors, Executive Officers, and Corporate Governance**

The sections entitled “Nominees For Election as Directors”, “Directors Whose Term of Office Continue”, and “Committees of the Board of Directors” appearing in the Registrant’s proxy statement for the annual meeting of shareholders to be held on April 23, 2009, sets forth certain information with respect to the directors of the registrant, including directors who serve on the Company’s Audit Committee and who have been designated an Audit Committee financial expert, and is incorporated herein by reference. Certain information with respect to persons who are or may be deemed to be executive officers of the Registrant is set forth under the caption “Executive Officers of the Registrant” in Part I of this report.

The sections entitled “Procedures for Stockholder Nominations and Proposals” and “Corporate Governance” appearing in the Registrant’s proxy statement for the annual meeting of stockholders to be held April 23, 2009 sets forth certain information respectively in regards to applicable procedures for stockholders to submit director nominations and proposals and the Company’s Code of Business Conduct and Ethics and is incorporated herein by reference.

### **Item 11. Executive Compensation**

Information required by this Item will be contained in the Registrant’s proxy statement for the annual meeting of stockholders to be held on April 23, 2009, to be filed not later than 120 days following the end of the Registrant’s fiscal year ended December 31, 2008, which will set forth certain information with respect to executive compensation of the Registrant and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information required by this Item will be contained in the Registrant's proxy statement for the annual meeting of stockholders to be held on April 23, 2009, to be filed not later than 120 days following the end of the Registrant's fiscal year ended December 31, 2008, which will set forth certain information with respect to security ownership of certain beneficial owners and management of the Registrant and is incorporated herein by reference.

The following table sets forth information as of December 31, 2008, with respect to Deltic common stock issuable under the Company's compensation plans.

| Plan Category                                              | Number of securities to be issued upon exercise of outstanding options, warrants, or rights<br>(a.) | Weighted average exercise price of all outstanding options, warrants, or rights,<br>(b.) | Number of securities remaining available for future issuance under equity compensation plans [excluding securities included in (a.)]<br>(c.) |
|------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 165,714                                                                                             | \$ 42.56                                                                                 | 1,229,576                                                                                                                                    |
| Equity compensation plans not approved by security holders | -                                                                                                   | -                                                                                        | -                                                                                                                                            |
|                                                            | <u>165,714</u>                                                                                      | <u>\$ 45.56</u>                                                                          | <u>1,229,576</u>                                                                                                                             |

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information required by this Item will be contained in the Registrant's proxy statement for the annual meeting of stockholders to be held on April 23, 2009, to be filed not later than 120 days following the end of the Registrant's fiscal year ended December 31, 2008, which will set forth certain information with respect to certain relationships and related transactions of the Registrant and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

Information required by this Item will be contained in the Registrant's proxy statement for the annual meeting to be held on April 23, 2009, to be filed not later than 120 days following the end of the Registrant's fiscal year ended December 31, 2008, which will set forth certain information with respect to principal accountant fees and services and is incorporated herein by reference.

## **PART IV**

### **Item 15. Exhibits and Financial Statement Schedules**

#### **a. Financial Statements, Schedules and Exhibits.**

##### **1. Consolidated Financial Statements.**

Consolidated Balance Sheets - December 31, 2008 and 2007.

Consolidated Statements of Income for the Years Ended December 31, 2008, 2007, and 2006.

Consolidated Statements of Cash Flows for the Years Ended December 31, 2008, 2007, and 2006.

Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2008, 2007, and 2006.

Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2008, 2007, and 2006.

Notes to Consolidated Financial Statements, including Consolidated Quarterly Income Information (unaudited).

Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements.

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting.

##### **2. Financial Statement Schedules.**

Financial Statements of Del-Tin Fiber L.L.C., an affiliate accounted for by the equity method, which constituted a significant subsidiary for the year ended January 3, 2009.

Other Financial statement schedules are omitted because either they are not applicable or the required information is included in the consolidated financial statements or notes thereto.

##### **3. Exhibits.**

###### **3 Articles of Incorporation and Bylaws.**

3.1 Amended and Restated Certificate of Incorporation of Deltic Timber Corporation as of December 17, 1996 (incorporated by reference to Exhibit 3.1 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1996).

3.2 Amended and Restated Bylaws of Deltic Timber Corporation (incorporated by reference to Exhibit 3.2 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1996).

###### **4 Instruments Defining the Rights of Security Holders.**

- 4.1 Rights Agreement dated as of December 11, 1996, between Deltic Timber Corporation and Harris Trust and Savings Bank, as Rights Agent (incorporated by reference to Exhibit 4 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1996, and subsequently amended with Amendment No. 1 dated October 15, 1998, and Amendment No. 2 dated October 19, 2006).
- 10 Material contracts.
  - 10.1 Deltic Timber Corporation 2002 Stock Incentive Plan (incorporated by reference to the Exhibit 10.1 to Registrant's Current Report on Form 8-K dated October 18, 2006).
  - 10.2 Distribution Agreement (incorporated by reference to Exhibit 10.2 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1996).
  - 10.3 Tax Sharing Agreement (incorporated by reference to Exhibit 10.3 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1996).
  - 10.4 Credit facility dated December 19, 1996 (incorporated by reference to Exhibit 10.4 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997).
  - 10.5 Certificate of Designation of the Cumulative Redeemable Preferred Stock, 7.54% Series (\$.01 Par Value), of Deltic Timber Corporation (incorporated by reference to Exhibit 10.5 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1997).
  - 10.6 Fiber Supply Agreement dated February 21, 1995, with Del-Tin Fiber L.L.C. (incorporated by reference to Exhibit 10.2 to Registrant's Registration of Securities Report on Form 10).
  - 10.7 Note Purchase Agreement dated December 18, 1998 (incorporated by reference to Exhibit 10.7 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
  - 10.8 Selective Sections of Del-Tin Fiber L.L.C.'s Project Credit Agreement dated November 23, 1998 (incorporated by reference to Exhibit 10.8 to Registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
  - 10.9 Revolving Credit Agreement dated June 20, 2001 (incorporated by reference to Exhibit 10.9 to Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001.)
  - 10.10 Note Purchase Agreement dated December 20, 2002, (incorporated by reference to Exhibit 10.10 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2002).
  - 10.11 First Amended and Restated Revolving Credit Agreement dated September 30, 2003 (incorporated by reference to Exhibit 10.11 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).
  - 10.12 Guarantee Agreement between Deltic Timber Corporation and SunTrust Bank related to the Del-Tin Fiber Credit Agreement dated August 26, 2004 (incorporated by reference to Exhibit 10.12 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2004).

- 10.13 Annual Incentive Compensation Plan (incorporated by reference to Exhibit 10.13 to Registrant's Current Report on Form 8-K dated October 18, 2006).
- 10.14 Non Qualified Stock Option Form (incorporated by reference to Exhibit 10.14 to Registrant's Current Report on Form 8-K dated October 18, 2006).
- 10.15 Restricted Stock Award Agreement and Stock Power (incorporated by reference to Exhibit 10.15 to Registrant's Current Report on Form 8-K dated October 18, 2006).
- 10.16 Performance Based Restricted Stock Award Agreement and Stock Power (incorporated by reference to Exhibit 10.16 to Registrant's Current Report on Form 8-K dated October 18, 2006).
- 10.17 Change-in-Control and Involuntary Severance Agreement with CEO (incorporated by reference to Exhibit 10.17 to Registrant's Current Report on Form 8-K dated October 18, 2006).
- 10.18 Change-in-Control Agreement with CEO Direct Reports (incorporated by reference to Exhibit 10.18 to Registrant's Current Report on Form 8-K dated October 18, 2006).
- 10.19 Revolving Credit Agreement dated September 9, 2005 (incorporated by reference to Exhibit 10.19 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
- 10.20 Deltic Timber Corporation Supplemental Executive Retirement Plan (incorporated by reference to Exhibit 10.20 to the Registrant's Current Report on Form 8-K dated October 18, 2006).
- 10.21 Amended and Restated Note Purchase Agreement dated March 30, 2007 (incorporated by reference to Exhibit 10.7 to Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2007).
- 10.22 First Amendment to the Revolving Credit Agreement dated August 7, 2007 (incorporated by reference to Exhibit 10.21 to Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2007).
- 10.23 Termination of a Material Definitive Agreement (incorporated by reference to Exhibit 10.23 to Registrant's Current Report on Form 8-K dated October 30, 2008).
- 21 Subsidiaries of the Registrant, included elsewhere herein.
- 23 Consents of Independent Registered Public Accounting Firm.
- 23.1 Consent of Independent Registered Public Accounting Firm related to reports on financial statements and internal control over financial reporting of Deltic Timber Corporation, included elsewhere herein.
- 23.2 Consent of Independent Registered Public Accounting Firm related to report on financial statements of Del-Tin Fiber L.L.C., included elsewhere herein.
- 23.3 Consent of Independent Registered Public Accounting Firm related to report on financial statements of Del-Tin Fiber L.L.C., included elsewhere herein.

- 31.1 Chief Executive Officer Certification Required by Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Chief Financial Officer Certification Required by Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification Required by Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibits other than those listed above have been omitted since they either are not required or are not applicable.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DELTIC TIMBER CORPORATION

By: /s/Ray C. Dillon  
Ray C. Dillon, President

Date: March 06, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below on March 6, 2009 by the following persons on behalf of the registrant and in the capacities indicated.

/s/Robert C. Nolan  
Robert C. Nolan, Chairman and Director

/s/Ray C. Dillon  
Ray C. Dillon, President and Chief  
Executive Officer and Director  
(Principal Executive Officer)

/s/Randolph C. Coley  
Randolph C. Coley, Director

/s/David L. Lemmon  
David L. Lemmon, Director

/s/Christoph Keller, III  
Christoph Keller, III, Director

/s/R. Hunter Pierson, Jr.  
R. Hunter Pierson, Jr., Director

/s/R. Madison Murphy  
R. Madison Murphy, Director

/s/Robert B. Tudor  
Robert B. Tudor, Director

/s/J. Thurston Roach  
J. Thurston Roach, Director

/s/Kenneth D. Mann  
Kenneth D. Mann, Vice President,  
Treasurer and Chief Financial Officer  
(Principal Financial Officer)

/s/Byrom L. Walker  
Byrom L. Walker, Controller  
(Principal Accounting Officer)

Deltic Timber Corporation  
Subsidiaries of the Registrant  
As of December 31, 2008

| <u>Subsidiaries</u>                   | <u>State of<br/>Incorporation</u> |
|---------------------------------------|-----------------------------------|
| Deltic Timber Purchasers, Inc.        | Arkansas                          |
| Deltic Southwest Timber Company       | Arkansas                          |
| Deltic Real Estate Investment Company | Delaware                          |
| Chenal Properties, Inc.               | Arkansas                          |
| Chenal Country Club, Inc.             | Arkansas                          |

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors  
Deltic Timber Corporation:

We consent to the incorporation by reference in the registration statements (No. 333-34317, No. 333-76294, and No. 333-90026) on Form S-8 of Deltic Timber Corporation of our reports dated March 6, 2009, with respect to the consolidated balance sheets of Deltic Timber Corporation and Subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, cash flows, stockholders' equity, and comprehensive income for each of the years in the three-year period ended December 31, 2008, and the effectiveness of internal control over financial reporting as of December 31, 2008, which reports appear in the December 31, 2008 annual report on Form 10-K of Deltic Timber Corporation.

Our report refers to changes in the methods of quantifying financial statement misstatements and accounting for recognition of defined benefit pension and other postretirement plans in 2006, to changes in accounting for uncertain tax positions in 2007, and to changes in the measurement date for defined benefit pension and other postretirement plans in 2008.

/s/KPMG LLP

KPMG LLP  
Shreveport, Louisiana  
March 6, 2009

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors  
Deltic Timber Corporation  
El Dorado, Arkansas

We consent to the inclusion of our report dated January 27, 2009, with respect to the financial statements of Del-Tin Fiber, L.L.C. as of and for the fiscal years ending January 3, 2009 and December 29, 2007.

/s/Frost PLLC

Little Rock, Arkansas  
March 6, 2009

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors  
Deltic Timber Corporation

We consent to the use of our report dated February 12, 2007, with respect to the statements of operations, cash flows, and members' capital of Del-Tin Fiber L.L.C. for the year ended December 30, 2006, included herein.

/s/KPMG LLP

KPMG LLP  
Shreveport, Louisiana  
March 6, 2009

CHIEF EXECUTIVE OFFICER CERTIFICATION  
REQUIRED BY SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Ray C. Dillon, certify that:

1. I have reviewed this annual report on Form 10-K of Deltic Timber Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's Chief Financial Officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the Company and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting;
5. The Company's Chief Financial Officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors:
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/Ray C. Dillon

Ray C. Dillon  
Chief Executive Officer  
March 6, 2009

CHIEF FINANCIAL OFFICER CERTIFICATION  
REQUIRED BY SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Kenneth D. Mann, certify that:

1. I have reviewed this annual report on Form 10-K of Deltic Timber Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations, and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's Chief Executive Officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the Company and we have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting;
5. The Company's Chief Executive Officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors:
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/Kenneth D. Mann

Kenneth D. Mann  
Chief Financial Officer  
March 6, 2009

**CERTIFICATION REQUIRED BY SECTION 906  
OF THE SARBANES-OXLEY ACT OF 2002**

The certification set forth below is being submitted in connection with this annual report on Form 10-K of Deltic Timber Corporation ("the report") for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 ("the Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Ray C. Dillon, the Chief Executive Officer, and Kenneth D. Mann, the Chief Financial Officer, each certifies that, to the best of his knowledge:

- (1) the report fully complies with the requirements of section 13(a) or 15(d) of the Exchange Act; and
- (2) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of Deltic Timber Corporation.

/s/Ray C. Dillon

Ray C. Dillon  
Chief Executive Officer  
March 6, 2009

/s/Kenneth D. Mann

Kenneth D. Mann  
Chief Financial Officer  
March 6, 2009



# CORPORATE INFORMATION

## Corporate Offices

210 East Elm, P. O. Box 7200  
El Dorado, Arkansas 71731-7200  
(870) 881-9400  
[www.deltic.com](http://www.deltic.com)

## Stock Exchange Listing

Trading symbol: DEL  
New York Stock Exchange

## Transfer Agent and Registrar

Computershare Investor Services, L.L.C.  
2 North LaSalle Street, P. O. Box 1689  
Chicago, Illinois 60602

## Annual Meeting

The annual meeting of the Company's shareholders will be held at 10 a.m. on April 23, 2009, at the South Arkansas Arts Center, 110 East 5th Street, El Dorado, Arkansas. A formal notice of the meeting, together with a proxy statement and proxy form, are enclosed with this report.

## Form 10-K

A copy of the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission, is contained herein and may also be obtained from Deltic's website at [www.deltic.com](http://www.deltic.com).

## Inquiries

Inquiries regarding shareholder account matters should be addressed to:

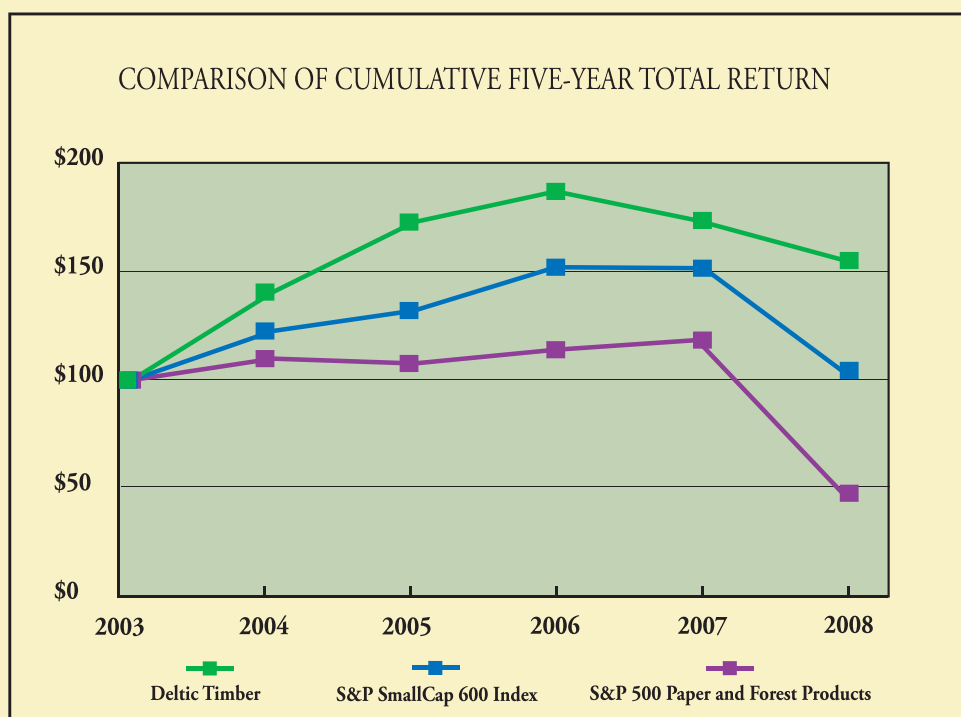
Phillip A. Pesek, Secretary  
Deltic Timber Corporation  
P. O. Box 7200  
El Dorado, Arkansas 71731-7200

Members of the financial community should direct their inquiries to:

Kenneth D. Mann, Chief Financial Officer  
Deltic Timber Corporation  
P. O. Box 7200  
El Dorado, Arkansas 71731-7200  
(870) 881-6432

The Company has filed the required certifications under Section 302 of the Sarbanes-Oxley Act of 2002 regarding the quality of its public disclosures as Exhibits 31.1 and 31.2 to its Annual Report on Form 10-K for the year ended December 31, 2008. In 2008, after Deltic Timber Corporation's annual meeting of stockholders, the Company filed with the New York Stock Exchange the CEO certification regarding its compliance with the NYSE corporate governance listing standards as required by NYSE Rule 303A.12(a).

## Stock Performance



The graphed stock performance represents the cumulative total return for the Company's common stock compared to issuers with similar capitalization, and to peer industry issuers for the period December 31, 2003, through December 31, 2008. The calculated returns assume an investment of \$100 on December 31, 2003, and that all dividends were reinvested.



**Deltic Timber Corporation**

210 East Elm, P. O. Box 7200  
El Dorado, Arkansas 71731-7200  
[www.deltic.com](http://www.deltic.com)



SUSTAINABLE  
FORESTRY  
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Certified Fiber  
Sourcing

[www.sfiprogram.org](http://www.sfiprogram.org)