Pope Resources

2006 ANNUAL REPORT

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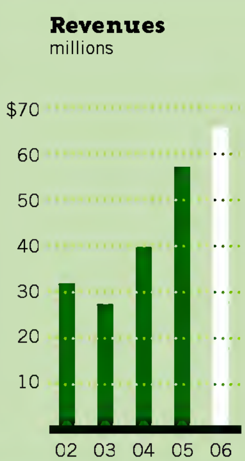
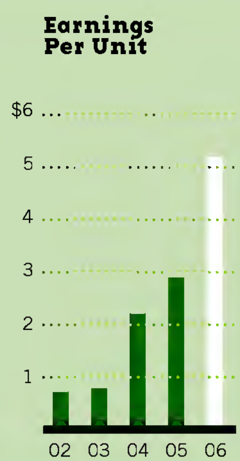
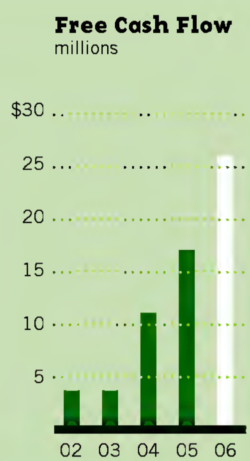
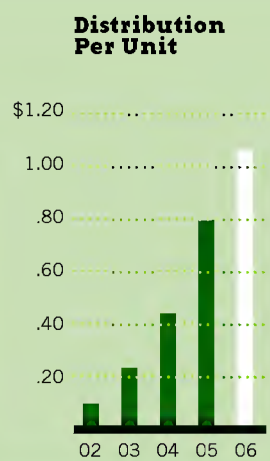
Financial Highlights

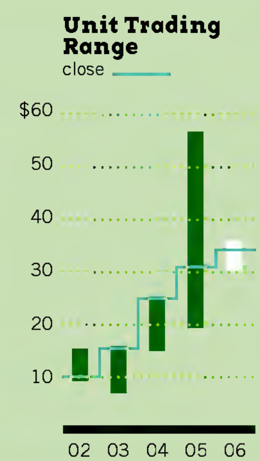
(Thousands, except per unit data)	**2006**	2005	2004
Revenues			
Fee Timber	**$35,260**	$44,424	$33,571
Timberland Management & Consulting	**3,670**	7,764	1,601
Real Estate	**27,320**	4,818	4,476
Total revenues	**$66,250**	$57,006	$39,648
Income/(loss) from operations			
Fee Timber	**$14,592**	$16,320	$15,126
Timberland Management & Consulting	**1,266**	3,540	(598)
Real Estate	**13,864**	1,270	1,586
Administrative	**(3,817)**	(3,651)	(2,986)
Total income from operations	**$25,905**	$17,479	$13,128
Net income	**$24,910**	$13,684	$10,176
Net income per fully diluted unit	**$5.23**	$2.88	$2.22
Earnings before interest, depreciation, depletion, and amortization (EBITDDA)	**$33,178**	$28,410	$18,880
EBITDDA per fully diluted unit	**$6.97**	$5.98	$4.11
Free cash flow	**$25,784**	$15,978	$10,906
Free cash flow per fully diluted unit	**$5.41**	$3.36	$2.37
Unit price at year-end	**$34.32**	$31.02	$25.00
Distribution per unit	**$1.06**	$0.80	$0.44
Units outstanding	**4,647**	4,627	4,539
Total assets	**$180,282**	$106,358	$94,868
Long-term debt, including current portion	**32,208**	33,883	35,766
Minority interest – IPMB	**77**	325	30
Minority interest – ORM Timber Fund I, LP	**46,685**	0	0
Partners' capital	**87,605**	66,405	54,533
Partners' capital per unit	**$18.85**	$14.35	$12.01
Fee timber owned (thousand acres)	**114**	115	115
Fee timber harvest (MMBF)	**54.5**	74.2	60.3











David L. Nunes
PRESIDENT AND CHIEF EXECUTIVE OFFICER

Dear Unitholders,

By all accounts, 2006 was a record year for Pope Resources, with net income of $25 million, or $5.23 per fully diluted unit, on revenue of $66 million. While we are certainly pleased with our results for 2006, we recognize that our performance this past year was in large part a function of successfully executing the strategies we established over the past five years and having the confidence to stick with those strategies over an extended period of time.

The successful execution of these long-term strategies translated to the generation of a record $26 million of free cash flow and an accompanying improvement in our balance sheet, which saw cash and short-term investments grow to $32 million by year end. As testament to the long-term benefit of sticking with our strategies, we have also seen our book value, as measured on a per-unit basis, grow by 210% over the past five years, from $8.98 per unit at the end of 2001 to $18.85 per unit at the end of 2006.

These record results were driven primarily by our Real Estate segment, where, with the closing of three large transactions in our Gig Harbor and Bremerton projects, we "harvested" the product of many years of adding value to our lands. For some time, we have described our Real Estate segment as having "lumpy harvests" and 2006 was the textbook example of this phenomenon, when we realized $14 million of operating income on revenues of $27 million (representing 54% and 41%, respectively, of our consolidated totals).

While this past year was noteworthy for the culmination of projects that helped bolster our financial results, it also marked the launch of new initiatives that, while not yet reflected in our financial results, will serve us well in the future. I will discuss these initiatives in greater detail in the balance of this letter, where we will review both 2006 performance and our future growth strategies.

2006 Year in Review

Financial and operating highlights for this past year, by segment, are described below. For a more detailed description of 2006 results, please review Management's Discussion and Analysis of Financial Condition and Results of Operations from our SEC Form 10-K, which is included in this annual report.

Fee Timber. Notwithstanding the earlier comments about the Real Estate segment's impact on our 2006 overall results, the fact remains that our Fee Timber segment is still our primary "engine" for generating cash flow and creating unitholder value. The typical determinants of annual performance for this segment are log prices and harvest volume.

Heading into 2006, we assumed that there would be some softening of housing markets that would result in a progressive decline in log prices throughout the year. Our response was to significantly front-load our planned 2006 harvest volume, which translated to 71% of our annual harvest falling in the first two quarters. As anticipated, housing markets did indeed slow down in the second half of the year and lumber and log prices fell significantly by year end. However, by front-loading our harvest volume, we realized a 6% increase in prices for 2006, with average realized log prices of $611 per thousand board feet (MBF).

Following the completion of incremental harvests from two 2004 timberland acquisitions, our annual log harvest volume for 2006 declined 27% to 55 million board feet (MMBF). This represents a settling back to a level more in line with our long-term sustainable harvest of just under 50 MMBF. Notwithstanding the 27% drop in harvest volume, Fee Timber operating income declined by only 11% to

$14.6 million, driven by the aforementioned 6% increase in log price realizations and 2005 segment results that were burdened by higher-than-usual depletion costs.

Timberland Management & Consulting. During 2006, we completed the disposition of all of the Washington state timberland holdings of Cascade Timberlands LLC, the largest client in our third-party Timberland Management & Consulting segment. While we earned property disposition fees from these transactions, they were more than offset by the impact of fewer acres under management, and thus operating earnings declined from $3.5 million in 2005 to $1.3 million in 2006.

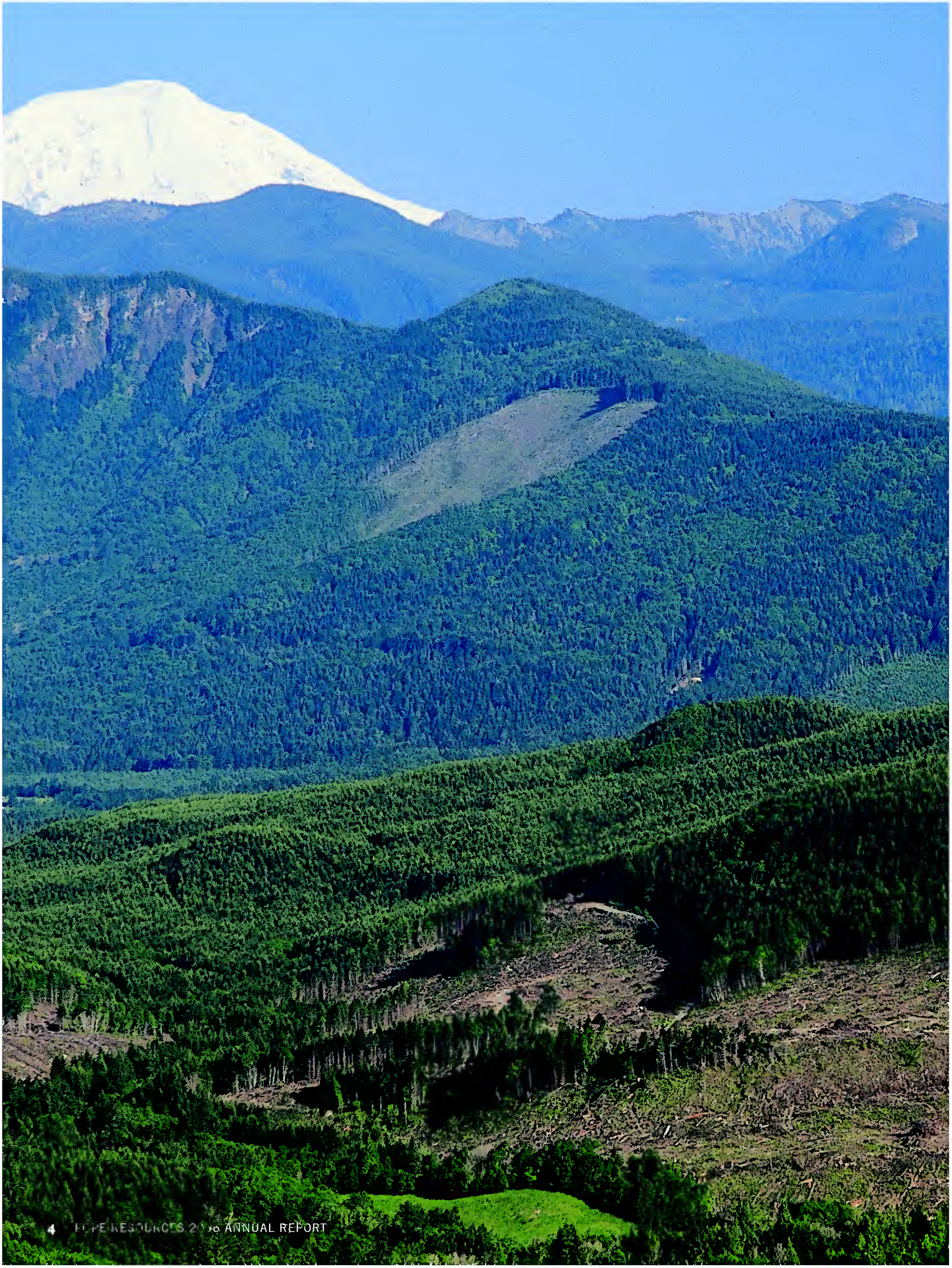
In August of 2005, we closed on our first private equity timber fund, ORM Timber Fund I, LP. This $62 million fund, of which Pope Resources is a 20% investor alongside other third-party investors, will focus on owning and managing timberland investments in the Pacific Northwest. In late 2006, we completed the acquisition of two Pacific Northwest tree farms totaling 24,000 acres for $58 million, representing 95% of the fund's committed capital and allowing us to deploy nearly $12 million of our co-investment capital. As we begin managing these properties for the fund, Pope Resources will benefit through increased economies of scale, fee income from managing the properties, and our 20% co-investment share of cash flows generated from harvesting activities.

Real Estate. Three years ago, the City of Gig Harbor approved a Comprehensive Plan amendment that provided for the upzoning of 35 acres of our 327-acre mixed use project from business-park to commercial zoning. Our real estate team worked diligently to achieve this result and continued their efforts over the past three years working with both the City and potential customers interested in acquiring this land. Through the end of 2006, following completion of $12.7 million of road, water and sewer infrastructure spending, we closed on our first three sales from this project. We sold nearly 18 acres of commercial land to Costco for $7.6 million, 6 acres of commercial land surrounding the Costco site for $7.2 million, and 11 acres of business park land to the YMCA for $1.9 million. Revenue from the 6-acre commercial land sale was not recognized in 2006 due to the buyer's right of rescission if certain site improvements are not completed on a timely basis. These three sales were important both from the perspective of "unlocking" the value we've been working hard to create and in paying for the infrastructure spending on this project. We are now in the enviable position of having a major development project being cash flow break-even in its early stages, thus assuring that future Gig Harbor sales contribute proportionately more to project returns and cash flows.

Our other significant sale in 2006 occurred at our Bremerton property, a 264-acre mixed use project within the Bremerton city limits. As with Gig Harbor, we had significant infrastructure spending to complete before concluding any sales from this project. Following completion of $2.4 million of road and other infrastructure spending, we closed on a $12 million sale for the entire 200-acre residential component of this project. As of year-end, we had an additional $0.4 million of project infrastructure expenditures to complete, and as a result we have deferred $1.3 million of revenue until that work is finished.

Healthy markets for rural residential home sites translated into the sale of an additional 527 acres of higher-and-better-use lands in 2006 totaling $2.6 million. We also completed a commercial sale of 8 acres adjacent to our headquarters building in Poulsbo for $2.2 million and a conservation sale of 401 acres of sensitive lands near the entrance to Mount Rainier National Park for $1.4 million. These sales represented a record year for our Real Estate segment, which generated over of $11 million of free cash flow for the year.

General & Administrative. While we are focused on keeping our general and administrative costs fairly static even as we grow the company, we nevertheless experienced a modest 5% increase in 2006 to $3.8 million. Much of the increase was attributable to higher professional fees associated with complying with the Sarbanes-Oxley Act. However, given the strong revenue year we had in 2006, our general and administrative costs, as a percent of total revenue, declined to 5.8%.



Matching Short-term Execution with Long-term Strategy

In addition to describing our financial performance and highlighting the events of the prior year, I like to devote a significant portion of the president's letter each year to detailing our long-term strategies for adding value to the lands under our stewardship. As evidenced in our 2006 performance, we believe value is created and at times "unlocked" from these lands at the intersection of short-term execution with these long-term strategies. In this year's letter, we will examine three of our core long-term strategies.

Strategy #1: Grow our timberland asset base to enhance sustainable harvest and long-term cash flows

Pope Resources has three primary vehicles for funding new timberland investments: free cash flow from harvesting activities off our existing timberland base, the reinvestment of real estate sales proceeds, and incremental borrowings. Historically, our generation of organic cash flow has been fairly modest and has dictated only sporadic involvement in the timberland acquisition market.

In 2001, we utilized real estate sale proceeds along with incremental borrowings secured by our Hood Canal tree farm to acquire the 44,000-acre Columbia tree farm. This tree farm had a significant component of 25 to 44 year old age classes, complementing the age-class profile of our Hood Canal tree farm, which had a high proportion of both younger age classes and mature merchantable stands. In 2007, we expect the Columbia tree farm to contribute 26% of the harvest volume and 23% of the revenue from timber properties owned directly by the Partnership. The proportion of harvest and revenue attributable to the Columbia tree farm is expected to continue to grow over the next ten years as the age-class profile of Columbia matures.

In 2004, we identified two small timberland acquisitions adjacent to each of our two main tree farms that contained a high proportion of merchantable timber that would allow us, in a relatively short period of time, to recoup our capital outlay. At the time, we viewed these opportunities as serving both a short-term cash management strategy as well as a long-term timberland acquisition strategy. We spent $21 million to acquire 4,700 acres of timberland with 48 MMBF of merchantable timber volume. Through the end of 2006, we have generated over $20 million of pre-tax cash flow from these two properties, leaving us with 4,555 incremental acres of productive timberland holding an additional 6 MMBF of 35 years and older merchantable timber at a net cost of $1 million. We expect to realize an additional $2 million over the next two years from the sale of 300 acres of selected higher-and-better-use parcels from these acquisitions. While adding to our long-term timberland base, these two acquisitions also allowed us to quickly recover our investment outlay and be in a position to put our cash to work elsewhere.

Our 20% co-investment in ORM Timber Fund I LP represents our most recent and primary initiative to grow our timberland base, albeit derivatively. In 2006, we invested nearly $12 million as our co-investment share of the fund's acquisition of 24,000 acres of property. In addition to enjoying the added economies of scale and the service fee income associated with managing these properties, this fund will help to increase our sustainable harvest level and long-term cash flows coming from our Fee Timber asset base. When factoring in our 20% co-investment in the fund and "looking through" to the effective impact on our total harvest volume, the fund will help to increase our long-term sustainable harvest level by 1.6 MMBF to over 51 MMBF. This represents a substantial increase over the 37 MMBF of sustainable harvest we had prior to the acquisition of the Columbia tree farm in 2001. As we grow our timber fund business, we expect this "look through" impact to our effective sustainable harvest level, and the resultant improvement in cash flow, to continue to improve.

This fund is the first of what we hope to be a series of such funds that will provide us, by investing our own capital alongside outside investors, the significant benefit of being in the market all the time rather than once every five to 10 years. This ongoing exposure to the timberland market will keep our acquisition processes and skills sharp, and ensures that we stay abreast of market developments. As we build these fund portfolios, we expect to obtain greater geographic diversification within the Pacific Northwest all the while adding operational scale. We plan to keep our fund sizes relatively small compared to our competitors and will focus on more of a "middle markets" timberland acquisition strategy to avoid competing in larger transactions where we believe the competition for timberland is fiercest and the pressure to pay a premium is strongest.

Strategy #2: Leverage our timberland management capabilities

We created the Olympic Resource Management ("ORM") brand in 1997 to capitalize on our timberland management capabilities by offering a full suite of services to other timberland owners. Since that time, we have managed more than 1.5 million acres across western North America and have established a reputation as the premier third-party timberland manager in the western U.S. This business has provided additional economies of scale otherwise unavailable to us, generated meaningful service fee income, sharpened our management processes, allowed us to attract outstanding talent that neither our own assets nor those of our clients could justify alone, and instilled an external focus in place of what had been a fairly insular culture during the early years of the partnership.

In 2006, we completed sales of timberlands in Washington on behalf of Cascade Timberlands LLC and signed a new 3-year contract to continue managing 292,000 acres in Oregon for Cascade. We are also managing the 24,000 acres of timberland acquired by our new timber fund in late 2006. We believe these management opportunities provide a platform for continuing to build the capabilities for which ORM is widely recognized.

Strategy #3: Generate growth capital by "harvesting" value from our Real Estate portfolio

Our Real Estate efforts focus on early stage entitlement activities that make downstream development possible. Securing favorable zoning and obtaining final plat approvals to allow for the highest and best use of the properties are examples of ways in which we seek to enhance property values. Where appropriate, our efforts also include road building and the extension of utilities to increase the value of building lots. This work occurs across our 2,700-acre Real Estate portfolio, which contains a wide range of property types, from urban parcels where values are measured in square-foot increments to parcels where the higher-and-better-use opportunity consists of a 40-acre or larger rural residential lot. We believe that population pressures over time as well as related transportation infrastructure improvements will gradually shift much of our timberland holdings contained in the 70,000-acre Hood Canal tree farm to other higher valued uses. This understanding reinforces our self-image as a "land company" where management of many of our properties, be they currently in the Fee Timber or the Real Estate portfolio, is informed by a long-range view of property potential that demands close synchronization between timber and real estate operations.

The Gig Harbor, Bremerton, and Kingston properties represent that portion of the portfolio with the highest values per square foot or per acre, as the case may be. The multi-year effort to create value in the first two of these properties was realized in a significant way in 2006 as I have noted above. Such "harvests" of real estate value will fund timberland acquisition growth, as was the case in 2006 when our timber fund co-investment capital was sourced from the free cash flow coming from our Real Estate segment. While these projects are finite in size, we do expect to realize additional "harvests" of value over the balance of this decade and beyond.

Strategies for enhancing unitholder value

As we pursue our long-term strategies, we also continue to evaluate how best to deploy our assets to fuel growth and enhance unitholder value. In particular, we review our investment alternatives with respect to available cash and short-term investments, which totaled $32 million as of year-end 2006.

A significant portion of our cash position is earmarked for timber fund co-investment capital. We are launching our second fund with an anticipated co-investment requirement of $20 million. We believe good timberland investments are still obtainable notwithstanding the increased competition to place capital in the asset class. We do recognize that prices have been bid up and return expectations appear to have lowered. Nonetheless, we intend to maintain our disciplined acquisition approach, not only for the benefit of our third-party investors but also in serving our own interests as co-investors in the fund. Success in this regard is not a sure bet, but in our view is still very much worth the risk and endeavor.

We have increased our quarterly distribution each year from $0.05 per quarter beginning in the third quarter of 2002 to $0.28 per quarter beginning in the third quarter of 2006. We aim to continue to grow our distribution rate over time while setting it at a level that we can maintain both in down markets and without incurring any incremental debt. We also intend to retain a portion of our capital to continue to grow the company.

Somewhat akin to increasing the distribution is the alternative possibility of returning capital to our unitholders by undertaking an open market buyback program with excess cash. While conceptually attractive at appropriate prices, our relatively small public float and limited trading volume, coupled with federal securities regulations that impose specific limits on such programs, effectively limit the practicality of such a repurchase program. We are similarly hampered in using our excess cash to pay down our $30 million of long-term debt. Our timber mortgage, which has a term that lasts until 2011, has an interest rate make-whole provision that translates into a prepayment penalty that effectively prevents us from paying down the principal balance ahead of schedule.

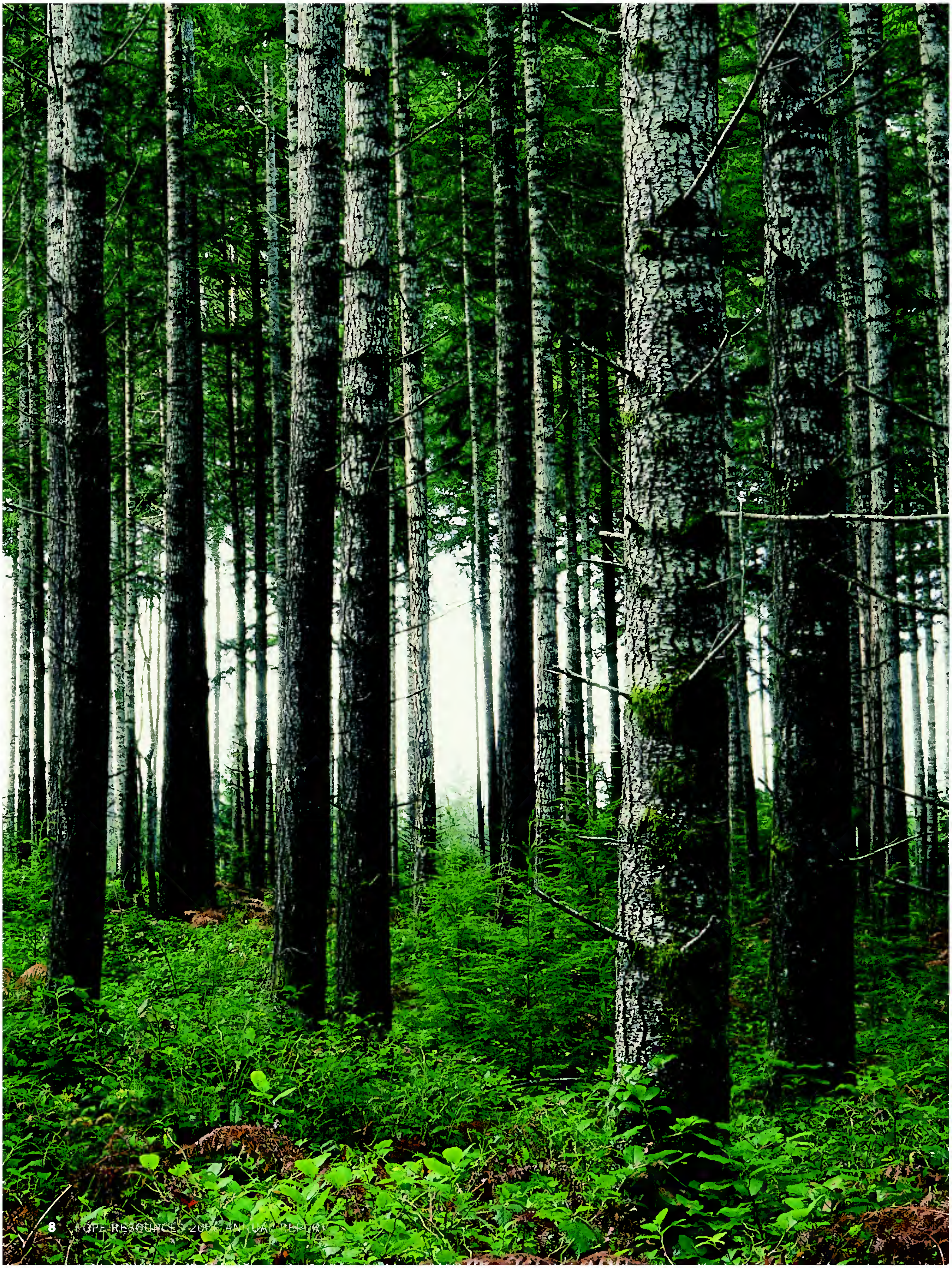
Looking Forward

We believe we are in that sweet spot where short-term execution intersecting with long-term strategies will continue to produce significant value for our unitholders. This past year was extremely rewarding, not only from the perspective of having achieved record financial results, but also in the context of seeing the value of sticking to our long-term strategies. The confidence we had to stick with our long-term strategies was rewarded with the first closings from our Gig Harbor project and the success in investing most of the capital from our first timber fund. These successes have instilled a sharpened sense of purpose within our team and a confidence that we can accomplish anything we put our minds to.

I do not believe we will see another year with results as strong as 2006 for awhile, if ever. I also recognize that 2007 may offer some downward bumps in the road in terms of realizations on land and timber as we work through a tough patch in the housing industry. Long-term, however, I am very confident that this company's strategies for its assets together with its core competencies will continue to bear fruit for the benefit of our unitholders. I am pleased to report that, to this end, our management team is putting its money where its mouth is. Our management team now owns 2.4% of the company, consisting of 1.4% owned outright and 1.0% owned through restricted units. We are pleased with the strong alignment of interest this creates between ourselves and other unitholders.

I am grateful for our outstanding team of employees dedicated to realizing an exciting vision for Pope Resources. To our unitholders, thanks for your support of our vision, strategies, and team.

David L. Nunes
President and Chief Executive Officer
March 15, 2007



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Management's Discussion and Analysis of Financial Condition and Results of Operations

This report contains a number of projections and statements about our expected financial condition, operating results, and business plans and objectives. These statements reflect management's estimates based upon our current goals, in light of management's knowledge of existing circumstances and expectations about future developments. Statements about expectations and future performance are "forward looking statements" which describe our goals, objectives and anticipated performance. These statements are inherently uncertain, and some or all of these statements may not come to pass. Accordingly, you should not interpret these statements as promises that we will perform at a given level or that we will take any or all of the actions we currently expect to take. Our future actions, as well as our actual performance, will vary from our current expectations, and under various circumstances these variations may be material and adverse. Some of the factors that may cause our actual operating results and financial condition to fall short of our expectations are set forth in that part of our 2006 10-K report entitled "Risk Factors". Other issues that may have an adverse and material impact on our business, operating results and financial condition include environmental and land use regulations that limit our ability to harvest timber and develop property and economic conditions that affect consumer demand for our products and the prices we receive for them, and other risks and uncertainties which are discussed in our other filings with the Securities and Exchange Commission. The forward-looking statements in this report reflect our estimates as of the date of the report, and we cannot undertake to update these statements as our business operations and environment change.

This discussion should be read in conjunction with the Partnership's audited consolidated financial statements included with this report.

EXECUTIVE OVERVIEW

Pope Resources, A Delaware Limited Partnership ("we" or the "Partnership"), was organized in late 1985 as a result of a spin-off by Pope & Talbot, Inc. ("P&T"). We are engaged in three primary businesses. The first, and by far most significant segment in terms of owned assets and operations, is the Fee Timber segment. Operations in this segment consist of growing timber to be harvested as logs for sale to domestic and to a lesser extent export manufacturers. The second most significant business in terms of total assets owned is the development and sale of real estate. Real Estate activities primarily take the form of securing permits, entitlements, and, in some cases, installing infrastructure for raw land development and then realizing that land's value by the selling of larger parcels to buyers who will take the land further up the value chain, either to home buyers or to operators and lessors or commercial property. Since these land projects span multiple years, the Real Estate segment may incur losses for multiple years while a project is developed until that project is sold resulting in operating income. Our third business is providing timberland-related services to third parties and raising investment capital from third parties for private equity timber funds like ORM Timber Fund I, LP (the Fund).

As of December 31, 2006, we owned nearly 114,000 acres of timberland in western Washington State plus nearly 2,700 acres of real estate held for sale or development. Our third-party Timberland Management & Consulting services have historically been conducted in Washington, Oregon, and California.

Macroeconomic factors that have a significant bearing on our business include housing starts in the U.S. (and to a lesser degree in Japan); interest rates; and currency exchange rates – particularly those between the U.S. and Canada, Japan, and Europe. The first two of these factors reflect or influence the health of the U.S. housing market. Currency exchange rates influence the competitiveness of our primary product compared to logs that might be imported from Canada, Europe, or the Southern Hemisphere. Our export logs are sold to domestic intermediaries who then export the logs. A favorable US$/yen exchange rate can help these intermediaries compete in the Japanese market with logs that originate from Canada, Europe, or the Southern Hemisphere, thus increasing the price that we are able to realize from the sale of this export-quality log volume.

As an owner and manager of timberland, we focus keenly on three "product" markets: lumber, logs, and timberland. Each of these markets has unique and distinct market factors so that they do not move up or down in lockstep with each other. Generally, the lumber market is the most volatile as it responds quickly (even daily) to changes in housing-driven demand and to changes in lumber inventories. Log markets will in turn be affected by what is happening in the lumber spot markets, but pricing shifts typically adjust monthly rather than daily. Log price volatility is also moderated because logs are used to produce products besides just lumber (especially pulp). The market for timberland tends to be less volatile with pricing that lags both lumber and log markets. This is a function of the longer time horizons utilized by timberland investors where the short-swing fluctuations of log or lumber prices become stabilized in acquisition modeling. We watch the lumber market because activity there can presage log price changes. We are in the log market constantly as we negotiate delivery prices to our customers. The timberland market is important as we are constantly evaluating our own portfolio and its underlying value as well as the opportunities to adjust that portfolio through either the acquisition or disposition of such land.

Management's major opportunity and challenge is to grow our revenue base profitably. Our current strategy for adding timberland acreage is centered on our timber fund business model. For example, the Fund acquired 24,000 acres of timberland in late 2006 of which we own 20% and earn both an asset management and on-the-ground timberland management fee from managing these timberlands. Our real estate challenges center around how and when to "harvest" a parcel of land and capture the optimum value increment by selling the property.

Our consolidated revenue in 2006, 2005, and 2004, on a percentage basis by segment, are as follows:

Segment	2006	2005	2004
Fee Timber	53%	78%	85%
Timberland Management & Consulting	5%	14%	4%
Real Estate	42%	8%	11%

Further segment financial information is presented in Note 10 to the Partnership's Consolidated Financial Statements included with this report.

Outlook

Management plans to decrease harvest volume from fee owned timberland from 54.5 MMBF in 2006 to 49.5 MMBF in 2007 in line with long-term sustainable harvest plans. At the end of 2006, when our 2006 harvest was largely complete, log prices softened from the prices realized earlier in the year. This softening was caused by a number of factors including a slow-down in domestic housing starts and an increase in lumber imported from Canada. The increase in Canadian imports followed resolution of the softwood lumber agreement. Management expects some recovery from this decline in log prices later in 2007, but we expect average 2007 log price realized to decline from 2006 levels. ORM Timber Fund I, LP (the Fund) is expected to begin harvesting in 2007. Revenue generated from this harvest will be consolidated into the Partnership's financial statements but is not expected to contribute to operating income as the timberlands owned by this fund will have a separate depletion pool and depletion charges are expected to offset the majority of the net stumpage realized upon harvest. The 80% interest in the Fund owned by third-parties is reported beneath operating income and is labeled Minority Interest-ORM Timber Fund I, LP.

We are also anticipating a decrease in operating income generated by the Real Estate segment. In previous editions of this analysis, we have noted that our results from the Real Estate segment can vary significantly from year to year. Real Estate results in 2006 reflect the sales of a high-value commercial property and a business park property from our development at Gig Harbor and a large residential plat sale from our Bremerton project. Transactions planned for 2007 are expected to result in a substantial decline in both revenue and operating income from the levels achieved in 2006. Revenue generated by the Timberland Management & Consulting segment is expected to decrease as a result of the absence of a disposition fee earned in 2006 and lower timberland management fees, offset in part by higher fees from our Fund.

RESULTS OF OPERATIONS

The following table reconciles net income for the years ended December 31, 2006 to 2005 and 2005 to 2004. In addition to the table's numeric analysis, the explanatory text that follows describes many of these changes by business segment.

Year to Year Comparisons

(Amounts in $000's except per unit data)	2006 vs. 2005 Total	2005 vs. 2004 Total
Net income:		
Year ended December 31, 2006	$24,910	
Year ended December 31, 2005	13,684	$13,684
Year ended December 31, 2004		10,176
Variance	$11,226	$3,508
Detail of earnings variance:		
Fee Timber		
Log price realizations (A)	$1,813	$3,490
Log volumes (B)	(11,295)	7,368
Production costs	4,583	(3,653)
Depletion	2,993	(5,506)
Other Fee Timber	173	(505)
Timberland Management & Consulting		
Management fee changes	(2,707)	3,715
Disposition fees	(45)	1,396
Other Timberland Mgmnt & Consulting	478	(973)
Real Estate		
Development property sales	14,436	10
Environmental remediation	46	268
Other Real Estate	(1,889)	(594)
General & administrative costs	(166)	(665)
Interest expense	1,100	173
Other (taxes, minority int., interest inc.)	1,706	(1,016)
Total change in earnings	$11,226	$3,508

(A) Price variance allocated based on changes in price using the current period volume.

(B) Volume variance allocated based on change in sales volume and the average log sales price for the prior period less variance in log production costs.

FEE TIMBER

Revenue and Operating Income

Fee Timber revenue is earned primarily from the harvest and sale of logs from the Partnership's 114,000 acres of fee timberland located in western Washington and, to a lesser extent from the lease of cellular communication towers, the sale of gravel and other forest products that result from timberland operations. Revenue from the sale of timberland tracts will also appear periodically in results for this segment. Our Fee Timber revenue is driven primarily by the volume of timber harvested, which we ordinarily express in terms of millions of board feet, or "MMBF", and by the average prices realized on log sales, which we express in dollars per thousand board feet, or "MBF". In late 2006, the Fund acquired 24,000 acres of timberland. Harvest activities from these properties are expect to begin in 2007 and will be consolidated into this discussion of operations.

Revenue and operating income for the Fee Timber segment for each year in the three-year period ended December 31, 2006, are as follows (all amounts in millions).

Year Ended	Timber revenue	Mineral, cell tower, and other revenue	Total segment revenue	Operating income	Harvest volume
December 31, 2006	**$33.3**	**$2.0**	**$35.3**	**$14.6**	**54.5**
December 31, 2005	42.7	1.7	44.4	16.3	74.2
December 31, 2004	31.9	1.7	33.6	15.1	60.3

Fiscal Year 2006 compared to 2005. Harvest volume declined 27% from 2005 to 2006. This decrease was due to an elevated harvest in 2005 owing primarily to our harvest of two tracts acquired in late 2004. Average log prices in 2006 were up $35 per MBF, representing a 6% increase over 2005's log prices. The $0.3 million increase in other revenue is due primarily to an increase in gravel royalties resulting from increased residential and commercial construction in our local markets. The decrease in harvest volume, offset somewhat by stronger prices and increased gravel royalties, resulted in the $9.1 million, or 20%, decrease in Fee Timber revenue for 2006 versus 2005.

Operating income in 2006 attributed to the Fee Timber segment decreased $1.7 million, or 10% from 2005. Harvest volume from one of the 2004 acquisitions has a separate depletion pool because the property has characteristics that are different from the pooled property. Specifically, the timber on this property at the time of acquisition was almost completely merchantable. As a result of accounting for harvests from this particular acreage using the separate depletion pool and its correspondingly high per MBF depletion charge, the incremental harvest from this acquisition generated significant cash flow but had much less impact on operating income. The cash generated through 2005 and into 2006 related to the timber harvested from this particular fourth quarter 2004 acquisition has served to recoup effectively its entire purchase price.

Fiscal Year 2005 compared to 2004. Harvest volume was up 23% during 2005 from 2004. This increase was due to a higher planned harvest in 2005. This increase in harvest was also due to the two timberland acquisitions from 2004. In addition, average log prices were up $47 per MBF, representing a 9% increase over 2004's log prices. Taken together, these higher volumes and stronger prices resulted in the $10.8 million, or 32%, increase in revenue for 2005 versus 2004. Operating income in 2005 for the Fee Timber segment increased $1.2 million, or 8% from 2004. Notably, the increase in harvest volume did not result in a proportionate increase in operating income due primarily to a $58 per MBF, or $5.5 million, increase in depletion expense when comparing 2004 and 2005. This increase in depletion relates to the establishment of a separate depletion cost pool to account for one of the 2004 acquisitions, as described above.

Log Volume

Log volume sold for each year in the three-year period ended December 31, 2006, is as follows:

Volume (in MMBF)	2006	% Total	2005	% Total	2004	% Total
Sawlogs						
Douglas-fir	38.9	71%	43.7	59%	35.7	59%
Whitewood	3.8	7%	11.0	15%	10.6	18%
Cedar	1.1	2%	4.5	6%	1.4	2%
Hardwoods	3.6	7%	5.1	7%	2.9	5%
Pulp						
All Species	7.1	13%	9.9	13%	9.7	16%
Total	54.5	100%	74.2	100%	60.3	100%

Log volume decreased 27% in 2006 from the elevated harvest in 2005 related to the 2004 timberland acquisitions. The aforementioned 2004 acquisitions were largely harvested in 2005 and contained a relatively high volume of cedar and red alder sawlogs. Pulp log volume as a percentage of total volume remained at 13% in 2006 when compared to 2005.

Log volume increased 23% in 2005 due to the 2004 timberland acquisitions. One of these properties contained a relatively high volume of cedar and red alder sawlogs. Pulp log volume as a percentage of total volume decreased to 13% from 16% as a result of the harvest of fewer low-quality timber stands in 2005 compared to 2004.

Log Prices

We have categorized our sawlog volume by species, which is a significant driver of price realized as indicated by the table below. The average log price realized by species for each year in the three-year period ended December 31, 2006, is as follows:

Price $/MBF	2006	% Change	2005	% Change	2004
Sawlogs					
Douglas-fir	$669	4%	$644	4%	$619
Whitewood	445	-6%	472	12%	423
Cedar	1,093	16%	942	-6%	999
Hardwoods	681	13%	605	3%	587
Pulp					
All Species	268	26%	213	-5%	224

Douglas-fir: Douglas-fir is noted for its structural characteristics that make it generally preferable to other softwoods and hardwoods for the production of construction grade lumber and plywood. The price realized on Douglas-fir logs increased 4% in 2006 from 2005. The increase in price realized in 2006 is attributed to a combination of strong housing starts in the U.S. and additional lumber mills opening in the Puget Sound area of Washington. The price realized on Douglas-fir logs increased 4% in 2005 from 2004 due to the same trends noted as present in 2006.

Whitewood: "Whitewood" is a term used to describe several softwood species, but for us primarily refers to western hemlock. Though generally considered to be of a lower quality than Douglas-fir, these logs are also used for manufacturing construction grade lumber and plywood. The average price realized on whitewood decreased 6% in 2006 from 2005, and increased 12% in 2005 from 2004. In addition to a decline in whitewood market prices during 2006 a larger impact can be attributed to harvesting lower quality logs in 2006 versus 2005. Whitewood harvest volume in 2005 included a large component of high quality whitewood sawlogs from one of the 2004 timberland acquisitions which increased our average price realization in the prior year.

Cedar: Cedar prices have increased in 2006 from 2005 and decreased in 2005 from 2004. The strong price realized for 2006 reflects a general decline in cedar volume available in the Puget Sound area with resultant upward pressure on price due to continuing demand for such logs. Cedar prices declined from 2004 to 2005, with this downward shift attributable to a decrease in mills located in the Puget Sound area of Washington that manufacture cedar products.

Hardwood: “Hardwood” can refer to many different species, but on our tree farms primarily consists of red alder. The price realized from the sale of red alder sawlogs has increased steadily over the last two years with limited supply and increased demand as a result of new mills focused on hardwood lumber production in the Pacific Northwest. The local mills that process alder sawlogs are using the resource to manufacture lumber for use in furniture construction.

Pulp: Pulp is a lower quality log of any species that is manufactured into wood chips. These chips are used primarily to manufacture unbleached linerboard used in paper bags and cardboard boxes. The price realized from the sale of pulp logs is primarily driven by local pulp log inventories. The increases in pulp log prices result from a decline in sawmill production and a corresponding reduction in the inventory of residual chips from lumber manufacturing. Relatively strong prices combined with a weakening lumber market has resulted in an increase in sawmill downtime which has in turn reduced the supply of wood chips available in the Puget Sound market.

Customers

	2006		2005		2004	
Destination	**Volume***	**Price**	Volume*	Price	Volume*	Price
Domestic mills	44.3	$659	59.0	$632	40.8	$574
Export brokers	3.1	700	5.3	629	9.8	638
Pulp	7.1	268	9.9	213	9.7	224
Total	54.5	$611	74.2	$576	60.3	$529

** Volume in MMBF*

Lumber mills purchased 81% of our harvest volume sold in 2006, and average price realizations were 4% higher than the price realized in 2005. The increase in price realized is due to the strong housing market experienced in 2006. Export brokers represent those log buyers that purchase our logs and then resell them primarily to the export market. A factor in the increase in average price is the lower mix in 2006 compared to 2005 of western hemlock volume which carries a lower market value than Douglas-fir logs. Volume sold to pulp log customers represented 13% of total volume sold for both 2006 and 2005.

Lumber mills purchased 80% of our harvest volume sold in 2005 and price realizations were 10% higher than the price realized in 2004. The increase in price realized is due to the strong housing market experienced in 2005. Export brokers usually buy high-quality Douglas-fir logs, but in 2005 they also bought some western hemlock logs for export to Korea. As a result of this sort mix in 2005 with a heavier component than usual for us of western hemlock, the average price realized from sales to these brokers declined slightly in 2005 from 2004 levels despite a relatively strong export market for logs in 2005.

Harvest Volumes and Seasonality

The Partnership's nearly 114,000 acres of timberland consist of both the 70,000-acre Hood Canal tree farm and the 44,000-acre Columbia tree farm. The Hood Canal tree farm is located in the Hood Canal region of Washington State. Most of this tree farm acreage is at a relatively low elevation where harvest activities are possible year-round. As a result of this competitive advantage, we are often able to harvest and sell a greater portion of our annual harvest in the first half of the year when the log supply in the marketplace tends to be lower.

The percentage of annual harvest volume by quarter for each year in the three-year period ended December 31, 2006 is as follows:

Year ended	Q1	Q2	Q3	Q4
December 31, 2006	**40%**	**31%**	**22%**	**7%**
December 31, 2005	31%	30%	28%	11%
December 31, 2004	34%	29%	22%	15%

Cost of Sales

Cost of sales for the Fee Timber segment consists of harvest costs and depletion expense. We are using two separate depletion rates in 2006, one for volume harvested from those timberlands we acquired in the fourth quarter of 2004 (the "Quilcene Timberlands"), and one for volume harvested from all other owned timberlands. Harvest costs represent the direct cost incurred to convert trees into logs and deliver those logs to their point of sale and associated state excise taxes owed on the harvest of logs. Depletion expense represents the cost of acquiring or growing the timber harvested. This cost is calculated using a depletion rate that is derived as follows:

$$\text{Depletion rate} = \frac{\text{Accumulated cost of timber and capitalized road expenditures}}{\text{Estimated volume of 40-year-old merchantable timber available for harvest}}$$

The depletion rate is then applied to volume harvested to calculate depletion expense.

Fee Timber cost of sales, expressed on a per MBF basis for each year in the three-year period ended December 31, 2006, is as follows:

Year Ended	Depletion cost per MBF	Harvest, haul, and other costs per MBF	Total cost of sales per MBF
December 31,2006	**$110**	**$187**	**$297**
December 31,2005	142	179	321
December 31,2004	84	159	243

As described above, a depletion rate is calculated based upon the historical cost of the timber and related capitalized road expenditures. That calculated rate is then applied to all volume harvested. We harvested a total of approximately 55 MMBF in 2006, with 7 MMBF attributable to the separate depletion pool created for the Quilcene Timberlands. The depletion expense resulting from Quilcene Timberlands log harvests approximated the net stumpage value (delivered log price less harvesting and transportation cost) realized on the sale of this particular timber. As such, the incremental harvest from this acquired property resulted in a negligible net income impact even as it generated significant operating cash flow and EBITDDA.

Depletion expense is generated from the harvest and sale of timber and some minor amount of depletion results from Real Estate sales when land is sold with standing timber. Depletion expense resulting from timber harvest for each year in the three-year period ended December 31, 2006 was made up of the following:

	Year ended December 31, 2006		
	Pooled	Separate	Total
Volume harvested (MBF)	**47,682**	**6,851**	**54,533**
Rate/MBF	**$68.97**	**$396.63**	**$110.13**
Depletion expense ($ 000's)	**$3,288**	**$2,717**	**$6,006**

	Year ended December 31, 2005		
	Pooled	Separate	Total
Volume harvested (MBF)	57,194	17,051	74,245
Rate/MBF	$73.29	$374.46	$142.46
Depletion expense ($ 000's)	$4,192	$6,385	$10,577

	Year ended December 31, 2004		
	Pooled	Separate	Total
Volume harvested (MBF)	57,987	2,329	60,316
Rate/MBF	$72.30	$377.35	$84.07
Depletion expense ($ 000's)	$4,192	$879	$5,071

Harvest costs vary based upon the physical site characteristics of acreage harvested. Harvest units that are difficult to access, or that are located on steep hillsides requiring cable harvest systems, are more expensive to harvest. Haul costs vary based upon the distance between the harvest site and the customer's location. Per MBF harvest and haul costs have increased in 2006 relative to 2005 due to having harvested timber from harvest units located on hillsides rather than harvest units located on relatively flat ground. The increase in harvest and haul cost in 2005 relative to 2004 is due primarily to increased fuel costs.

Fee Timber cost of sales for each year in the three-year period ended December 31, 2006 is as follows (all dollar amounts in millions):

Year ended	Depletion	Harvest, haul, and other	Total cost of sales
December 31, 2006	**$6.0**	**$10.2**	**$16.2**
December 31, 2005	10.6	13.2	23.8
December 31, 2004	5.1	9.6	14.7

Fee Timber cost of sales decreased $7.6 million in 2006 from 2005 and increased $9.1 million in 2005 from 2004. The decrease in 2006 from 2005 is due to a reduction in harvest from both our pooled and separate depletion pool harvest units. The increase in 2005 and 2004 is due to the combination of increased harvest volume and an increase in depletion rate due to a separate depletion pool used for timber harvested from 2004 acquisitions. The impact of this additional depletion was particularly pronounced in 2005 due to the aforementioned harvest volume in that period from the 2004 timberland acquisitions.

Operating Expenses

Fee Timber operating expenses for each of the three years ended December 31, 2006, 2005, and 2004 were $4.4 million, $4.3 million, and $3.8 million, respectively. Operating costs remained constant in 2006 relative to 2005. Operating costs increased in 2005 relative to 2004 due primarily to an increase in road maintenance expenditures. The increase in road costs in 2005 result primarily from the increase in harvest volume, but also reflect increased costs resulting from the Road Maintenance and Abandonment Plan rules in Washington State. Washington State has enacted new water quality rules, which have resulted in changes to the rules surrounding road maintenance and construction. As a result, culverts that do not comply with the new rules need to be replaced, which has caused an increase in road maintenance costs over the last three years and is expected to continue into 2007.

TIMBERLAND MANAGEMENT & CONSULTING

Revenue and Operating Income

The Timberland Management & Consulting segment generates revenue by providing timberland management and forestry consulting services to timberland owners and managers. An additional aspect of that segment's activities is the development of timberland property portfolios on behalf of third-party clients and the Timber Fund.

The Timberland Management & Consulting segment is currently managing over 290,000 acres of timberland for Cascade Timberlands LLC and an additional 24,000 acres for the Fund. The Cascade project included management, consulting, and disposition services during 2005 and 2006. Revenue and operating income for the Timberland Management & Consulting segment for each year in the three-year period ended December 31, 2006, are as follows (all dollar amounts in millions):

Year ended	Revenue	Operating income (loss)
December 31, 2006	**$3.7**	**$1.3**
December 31, 2005	7.8	3.5
December 31, 2004	1.6	-0.6

Fiscal Year 2006 compared to 2005. Revenue and operating income for 2006 was $4.1 million and $2.2 million lower, respectively, than for 2005. These decreases are due to a decline in acres under management partially offset by timberland disposition fees earned by providing such services to our primary timberland management client, Cascade Timberlands LLC. Cascade's sale of portions of its holdings resulted in a disposition fee earned in the first quarter of 2006 followed by a reduction in timberland management fees. We have entered into an agreement to continue managing Cascade's timberland from 2007 through 2009.

On August 1, 2005 we announced that management had obtained capital commitments of $61.8 million, of which Pope Resources and ORMLLC have committed $12.4 million, to the Fund's capital. In the fourth quarter of 2006 ORMLLC successfully placed $58.5 million of the Fund's committed capital. Pope Resources and ORMLLC represent 20%, or $11.7 million, of the investment capital in the Fund. ORMLLC is the general partner of the Fund and earns management fees for managing the Fund's timberlands and operations. As noted above, we also treat the Fund as a consolidated subsidiary and report these results under the Fee Timber segment. Operating results attributed to the 80% third party interest in the fund are reported under Minority Interest-ORM Timber Fund I, LP below operating income.

Fiscal Year 2005 compared to 2004. Revenue and operating income for 2005 were $6.2 million and $4.1 million higher, respectively, than 2004. The increase in revenue and operating income is primarily due to timberland management, timberland disposition, and consulting services provided to Cascade for its timberland located in Washington and Oregon. ORMLLC began providing timberland management and other timberland consulting services to this client in January 2005. Revenue generated in

2004 consisted of fees earned while providing advisory services to the parties that eventually became the owners of Cascade and fees generated through providing miscellaneous consulting and management services to a variety of timberland owners.

Operating Expenses

Fiscal Year 2006 compared to 2005. Timberland Management & Consulting operating expenses decreased $1.8 million in 2006 from 2005. The decrease in operating expenses resulted from the closing of two offices that were used for managing timberlands formerly owned by Cascade, and a decrease in activities surrounding capital raising for the Fund. Following the sale of two of Cascade's tree farms we closed our forestry field offices in Port Angeles, Washington in late 2005 and in Sedro-Woolley, Washington in early 2006. The Timberland Management & Consulting segment was not engaged in raising capital in 2006 but was working to locate suitable timber properties for the Fund. This shift in activities resulted in a decline in operating expense.

Fiscal Year 2005 compared to 2004. Timberland Management & Consulting operating expenses for 2005 were $2.0 million higher than in 2004. The increase in operating expenses is primarily attributable to the opening of two new forestry field office locations in Sedro-Woolley, Washington and Bend, Oregon and the additional staffing necessary to provide services under the timberland management agreement with Cascade. Organization and start-up expenses for the Fund totaled $559,000 during 2005. These expenses are included in Timberland Management & Consulting operating expenses.

REAL ESTATE

Revenue and Operating Income

The Partnership's Real Estate segment consists primarily of revenue from the sale of land together with residential and commercial property rents. The Partnership's real estate holdings are located primarily in Pierce, Kitsap, and Jefferson Counties in Washington State.

Results from Real Estate operations are expected to vary significantly from year to year as we make multi-year investments in entitlements and infrastructure prior to selling entitled or developed land. Revenue and operating income for the Real Estate segment for each year in the three-year period ended December 31, 2006, are as follows (all dollar amounts in millions):

Year ended	Revenue	Environmental remediation expense	Operating income
December 31, 2006	**$27.3**	**$0.3**	**$13.9**
December 31, 2005	4.8	0.2	1.3
December 31, 2004	4.5	0.5	1.6

Revenue in the Real Estate segment is generated through the sale of land and the rental of homes and commercial properties at the Port Gamble townsite. Land sales include the sale of raw land which generally consist of larger acreage sales rather than single lot sales and are normally completed with very little capital investment prior to sale. Rural Lifestyles lot sales generally require some capital improvements such as zoning, road building, or utility access improvements prior to completing the sale. Commercial and residential plat land sales represent land sold after development rights have been obtained and are generally sold with certain infrastructure improvements.

Real Estate segment revenue for each of the years ended December 31, 2006, 2005 and 2004 consists of the following:

Description	Revenue	Gross Margin	Acres Sold	Revenue/ Acre	Gross Margin/ Acre
Commercial/Business Park	$11,637,000	$6,184,000	37	$314,514	$167,135
Residential Plat	10,673,000	7,715,000	200	53,365	38,575
Rural Residential	2,596,000	1,872,000	527	4,926	3,552
Other Land Sale	1,400,000	1,003,000	401	3,491	2,501
Rentals	1,002,000	1,002,000	N/A	N/A	N/A
Other	12,000	12,000	N/A	N/A	N/A
2006 Total	$27,320,000	$17,788,000	1,165	$22,580	$14,398
Rural Residential	$2,967,000	$2,276,000	524	$5,662	$4,344
Other Land Sale	890,000	848,000	390	2,282	2,174
Rentals	914,000	N/A	N/A	N/A	N/A
Other	47,000	34,000	N/A	N/A	N/A
2005 Total	$4,818,000	$3,158,000	914	$3,418	$3,418
Residential Plat	$1,500,000	$1,203,000	210	$7,143	$5,729
Rural Residential	234,000	103,000	72	3,250	1,431
Other Land Sale	1,871,000	1,777,000	426	4,392	4,171
Rentals	846,000	N/A	N/A	N/A	N/A
Other	25,000	23,000	N/A	N/A	N/A
2004 Total	$4,476,000	$3,106,000	708	$5,092	$4,355

Fiscal Year 2006 compared to 2005. In 2006, revenue and operating income for the Real Estate segment increased by $22.5 million and $12.6 million, respectively, over 2005 amounts. These revenue and income numbers are unprecedented for this segment and are highly unlikely to be replicated anytime soon. We have often described Real Estate segment results as “lumpy” given the long lead-time required to perfect entitlements for development projects and the challenges inherent in negotiating and closing complex sale agreements. Results in 2006 epitomize the upside of this reality as we have sold properties from two projects following multiple years or investment.

At our development project in Gig Harbor, Washington we sold a total of nearly 29 acres of those portions of the property zoned as either commercial or business-park resulting in $9.5 million of revenue and $5.9 million of gross margin. The remaining commercial/business park property sale recognized as revenue in 2006 was for 8 acres of property contiguous to our headquarters building in Poulsbo, Washington. In 2007, we expect to realize an additional $7.2 million of revenue on a 6-acre sale of commercially zoned Gig Harbor property. This transaction was closed in late 2006 but was not recognized as revenue or income in 2006 due to a rescission clause included in the sale agreement that is exercisable by the buyer if we do not complete certain infrastructure improvements. These transactions represent the culmination of a number of years of investment and work with community and political leaders to build support for the project.

The 200-acre, $10.7 million residential plat sale identified in the preceding table was from our Bremerton West Hills project. There is an additional $1.3 million of revenue from this sale that was deferred as of December 31, 2006 and is expected to be recognized in 2007 as certain infrastructure improvements are completed. Approximately 60 acres of the project are zoned light industrial and are being marketed for sale as individual lots with a light-industrial park setting.

The 401-acre, $1.4 million “Other Land Sale” in the preceding table represents environmentally sensitive property sold to the Nisqually Land Trust. This transaction is an excellent example of private industry working with environmental interests to promote a win-win outcome for various public and private interests. The Nisqually Land Trust's acquisition protects a forested parcel near the entrance to Mount Rainier National Park while allowing us to redeploy the capital to other timberland or real estate opportunities.

The Partnership's Rural Residential lot program typically produces lots from 5 to 80 acres in size, based on underlying zoning densities. This type of program entails an entitlement effort typically consisting of simple lot segregations and boundary line adjustments. Development activities include minor road building, surveying, and the extension of utilities. Rural Residential revenue in 2006 consists of 13 separate transactions totaling 527 acres. Price per acre realized from these sales is affected by whether the property is sold with legal access. In 2006 Rural Residential acreage sales included 78 acres sold without first obtaining legal access. These sales grossed an average of $3,943 per acre, while the remaining 444 acres that were sold with legal access grossed an average of $5,097 per acre. We anticipate selling approximately 150 to 300 acres annually in the Rural Lifestyles lot program. We exceeded this target range in 2006 and 2005 due to a strong market interest in rural lots. This strong interest cooled as 2006 progressed and we currently expect that Rural Residential land sales in 2007 will fall towards the low end of the range in 2007.

Fiscal Year 2005 compared to 2004. Revenue increased $342,000, or 8%, to $4.8 million in 2005 from $4.5 million in 2004 while operating income for this segment decreased to $1.3 million in 2005 from $1.6 million in 2004. The increase in revenue is primarily due to an increase in Rural Residential acreage sold in 2005 relative to 2004. Land sale revenue in 2005 consists of 17 separate transactions totaling 914 acres with $3.0 million representing 524 acres coming from 14 Rural Residential lot sales. One of the primary drivers in the price per acre realized from these sales in 2005 was whether the property was sold with legal access. For example, in 2005 Rural Residential acreage sales included 263 acres sold without first obtaining legal access. These sales grossed an average of $1,683 per acre, while the remaining 261 acres that were sold with legal access grossed an average of $9,672 per acre. The decline in operating income for 2005 from 2004 is due to the mix of properties sold in 2005 versus 2004. Raw land revenue in 2004 included a $1.9 million sale to Kitsap County of 426 acres that the County plans to develop into a park. This property required very little entitlement or other improvements prior to the sale, which generated a relatively high gross margin from the sale.

Other land sale revenue realized in 2005 represented a sale of relatively less attractive development property to the Washington State Department of Fish and Wildlife for $890,000 or $2,282 per acre.

Cost of Sales

Real Estate cost of sales for each of the three years ended December 31, 2006, 2005, and 2004 were $9.5 million, $749,000, and $497,000, respectively. Cost of sales during the periods presented result from the aforementioned land sales. The increase in cost of sales in 2006 relative to 2005 was due primarily to the increase in development activities performed on properties sold, particularly on the Gig Harbor and Bremerton properties. Cost of sales in 2005 increased relative to 2004 due to the increase in acres sold.

Operating Expenses

Real Estate operating expenses for each of the three years ended December 31, 2006, 2005, and 2004 were $3.9 million, $2.8 million, and $2.4 million, respectively. Environmental remediation expenses for 2006, 2005, and 2004 were $260,000, $198,000, and $466,000, respectively. Operating expenses less environmental remediation charges, the latter discussed in more detail below, increased $1.1 million in 2006 compared to 2005 and $633,000 in 2005 compared to 2004. Higher operating expenses in the Real Estate segment are due to an increase in personnel and project related expenditures incurred in connection with a number of projects, particularly at Gig Harbor, Bremerton, Kingston, and Port Gamble.

Environmental Remediation

The Partnership has accrued liabilities for environmental cleanup of $242,000 and $158,000 as of December 31, 2006 and 2005, respectively, for estimated environmental remediation charges in and around the townsite of Port Gamble. Port Gamble is a historic town that was owned by Pope & Talbot, Inc. (P&T) for decades until 1985 when the townsite and other assets were spun off to the Partnership. P&T continued to operate the townsite through 1995 and lease the millsite at Port Gamble until January 2002 when a settlement agreement was signed between the Partnership and P&T. This settlement agreement set forth how the two companies would apportion the costs and responsibility for environmental remediation in Port Gamble. The "millsite" is referred to as such because a lumber mill operated on that portion of the property for over one hundred years until 1995, before it was dismantled by the end of 1996.

Progress was made during 2006 on the environmental remediation project as evidenced by the receipt of a "No Further Action" letter from the Washington State Department of Ecology for a number of historic landfills near the townsite. As this cleanup project progressed, some of the uncertainties surrounding the estimated cost to complete the project have been clarified. Management recognized this uncertainty in prior reporting periods by booking a liability to the low end of an estimated range of costs to complete the cleanup, in accordance with GAAP. During this period, more complete information became available that always seemed to extend the cost exposure and, thus, require booking to a new low end of the estimated cleanup cost range. As of the 4th quarter of 2006 management believes that project cost uncertainties are sufficiently clarified that we are accruing an estimated liability at year-end 2006 that represents management's best estimate of the cost to complete the project, as opposed to setting the accrual at the low end of a revised liability range. Our currently estimated range of costs to complete the project is $155,000 to $340,000 and we are accruing at December 31, 2006 to a point near the middle of this range.

The environmental liability at December 31, 2006 includes $236,000 that the Partnership expects to expend in the next 12 months and $6,000 thereafter. Current activities at the site include monitoring to determine if prior cleanup activities were effective. Activity in the environmental remediation liability is detailed as follows:

Year ended December 31	Balances at the Beginning of the Year	Additions to Accrual	Expenditures for Remediation	Balances at the End of the Year
2004	$292,000	$466,000	$284,000	$474,000
2005	474,000	198,000	514,000	158,000
2006	**158,000**	**260,000**	**176,000**	**242,000**

As of December 31, 2006 the majority of the cleanup work apportioned to the Partnership under the aforementioned settlement agreement was complete. Most of the ongoing expenditures now represent the cost of groundwater monitoring at those specific sites where contaminants were excavated and removed.

GENERAL AND ADMINISTRATIVE (G&A)

Fiscal Year 2006 compared to 2005. G&A costs increased $166,000, or 5%, to $3.8 million from $3.7 million in 2005. The increase in general and administrative expenses experienced in 2006 is due to an increase in costs associated with new internal control reporting and related audit requirements under the Sarbanes Oxley Act. G&A costs represented 6% of revenue in 2006 and 2005.

Fiscal Year 2005 compared to 2004. G&A costs increased $665,000, or 22%, to $3.7 million from $3.0 million in 2004. The increase in general and administrative expenses experienced in 2005 is due to an increase in compensation cost following strong financial performance in 2004 and 2005, as well as costs associated with new audit requirements under the Sarbanes Oxley Act. G&A costs represented 6% of revenue in 2005 as compared to 8% of revenue in 2004.

INTEREST INCOME AND EXPENSE

Interest income for 2006 increased to $1.2 million in 2006 from $402,000 in 2005 and $100,000 in 2004. The increase in interest income is due to higher cash and short-term investment balances. Our combined cash and short-term investments balance in 2006 grew from $18.4 million at December 31, 2005 to $32.2 million at December 31, 2006. In January 2004 our then-available cash balance was used to complete a timberland acquisition such that relatively little interest income accrued over the balance of 2004. We have invested cash in excess of immediate operating cash requirements in auction rate securities. The maturities on these securities are long-term while the interest rate earned resets every 28 days.

Interest expense net of interest capitalized to development projects was $1.8 million for 2006, $2.9 million in 2005, and $3.1 million in 2004. The Partnership's debt consists primarily of mortgage debt with a fixed interest rate and amortization schedule. The outstanding debt has not been reduced with available cash and short-term investment balances because the terms of the timberland mortgages include a “make whole” premium paid to the lender for unscheduled principal payments. The decrease in interest expense from 2005 to 2006 is primarily the result of capitalizing $912,000 of interest to our development projects at Gig Harbor and Bremerton. In addition, interest expense related to our timberland mortgages is reduced as we continue to make annual $1.5 million principal payments at the end of each year's first quarter. In 2007 the principal payment due on our timberland mortgages decreases to $1.3 million.

INCOME TAXES

Pope Resources is a limited partnership and is, therefore, not subject to income tax at the entity level. Instead, taxable income/loss flows through and is reported to unitholders each year on a Form K-1 for inclusion in each unitholder's tax return. Pope Resources does, however, have corporate subsidiaries that are subject to income tax and this is why a line item for such tax appears on the statements of operations for the Partnership even though the Partnership itself pays no income tax. The corporate tax-paying entities are utilized for our third-party service fee businesses.

Fiscal Year 2006 compared to 2005. We have recorded a provision for income taxes of $439,000 in 2006 and $1.0 million in 2005. The decrease in tax expense is due to the decline in income generated by our Timberland Management & Consulting segment that tracks with the decline in acres under management as previously described.

Fiscal Year 2005 compared to 2004. We have recorded a provision for income taxes of $1.0 million in 2005, as compared to no tax expense for the corresponding period of 2004. The increase in tax expense is due to improved results in our Timberland Management & Consulting segment largely attributable to an increase in acres under management and disposition fees.

MINORITY INTEREST-ORM TIMBER FUND I, LP

Minority Interest-ORM Timber Fund I, LP represents the 80% portion of the Fund's 2006 net loss attributed to third-party owners of the Fund. In the fourth quarter of 2006 the Fund acquired 24,000 acres of timberland. Harvest activity from this property is expected to commence at the end of the first quarter of 2007.

MINORITY INTEREST-IPMB

Minority Interest-IPMB represents that share of income earned from the Investor Portfolio Management Business (IPMB) allocated to Pope MGP, Inc., the Managing General Partner of the Partnership. The 1997 amendment to the Limited Partnership Agreement authorizing the Partnership to pursue the IPMB further specifies that income from the IPMB will be split using a sliding scale allocation method beginning at 80% to the Partnership's wholly-owned subsidiary, ORM, Inc., and 20% to Pope MGP, Inc. The sliding scale allocation method evenly divides IPMB income between ORM, Inc. and Pope MGP, Inc. once such income reaches $7,000,000 in a given fiscal year. The share of IPMB allocated to Pope MGP is further split between Pope MGP and a management incentive plan. In 2006, this management incentive portion represented 50% of Pope MGP's share of the IPMB, or $77,000, and is included in Timberland Management & Consulting operating expenses.

Current activities of the IPMB include timberland consulting, management and disposition services, and expenses associated with the launch of a private equity timber fund, all contained in the Timberland Management & Consulting segment.

Fiscal Year 2006 compared to 2005. The charge or expense that is the allocation of income to a minority interest decreased to $77,000 in 2006 from $321,000 in 2005. The decrease in minority interest allocation is due to the decline in Timberland Management & Consulting results because of the decrease in acres under management for Cascade.

Fiscal Year 2005 compared to 2004. The charge or expense that is the allocation of income to a minority interest increased from zero in 2004 to $321,000 in 2005. The increase in minority interest allocation is due to improved Timberland Management & Consulting results related to our work on behalf of Cascade.

SUPPLEMENTAL SEGMENT INFORMATION

The following table provides quarterly comparative operating information for our segments:

Segment Information	Three months ended December 31,		Twelve months ended December 31,	
(all amounts in $000's)	**2006**	2005	**2006**	2005
Revenues:				
Fee Timber	**$2,973**	$5,194	**$35,260**	$44,424
Timberland Management & Consulting (TM&C)	**524**	2,641	**3,670**	7,764
Real Estate	**13,036**	1,072	**27,320**	4,818
Total	**16,533**	8,907	**66,250**	57,006
EBITDDA:				
Fee Timber	**1,247**	2,544	**21,004**	27,034
TM&C	**(46)**	1,508	**1,262**	3,637
Real Estate	**8,274**	(10)	**14,511**	1,448
General & administrative	**(1,012)**	(1,115)	**(3,599)**	(3,709)
Total	**8,463**	2,927	**33,178**	28,410
Depreciation, depletion and amortization:				
Fee Timber	**318**	950	**6,266**	10,714
TM&C	**19**	23	**73**	97
Real Estate	**325**	43	**647**	178
General & administrative	**38**	65	**218**	263
Total	**700**	1,081	**7,204**	11,252
Operating income/(loss):				
Fee Timber	**783**	1,594	**14,592**	16,320
TM&C	**(100)**	1,485	**1,266**	3,540
Real Estate	**7,949**	(53)	**13,864**	1,270
General & administrative	**(1,050)**	(1,134)	**(3,817)**	(3,651)
Total	**$7,582**	$1,892	**$25,905**	$17,479

Reconciliation Between Cash from Operations and EBITDDA

(all amounts in $000's)	Three months ended December 31, 2006	Three months ended December 31, 2005	Twelve months ended December 31, 2006	Twelve months ended December 31, 2005
Cash from operations	$15,148	$6,656	$43,571	$28,909
Added back:				
Change in working capital	3,889	-	5,324	-
Interest	-	539	625	2,477
Deferred revenue	-	-	-	614
Minority interest	143	-	31	-
Deferred taxes	-	435	-	-
Income tax provision	-	-	439	997
Less:				
Change in working capital	-	(4,456)	-	(4,075)
Interest	(16)	-	-	-
Deferred revenue	(7,502)	(81)	(8,533)	-
Cost of land sold	(2,981)	(90)	(7,818)	(434)
Deferred taxes	(27)	-	(16)	-
Equity based compensation	(177)	(76)	(444)	(76)
Income tax provision	(14)			
Other	-	-	(1)	(2)
EBITDDA	$8,463	$2,927	$33,178	$28,410

Selected Statistics

(all amounts in $000's)	Three months ended December 31, 2006	Three months ended December 31, 2005	Twelve months ended December 31, 2006	Twelve months ended December 31, 2005
Log sale volumes (thousand board feet):				
Sawlogs				
Douglas-fir	2,046	4,923	38,954	43,720
Whitewood	172	1,170	3,800	11,007
Cedar	301	229	1,075	4,447
Hardwood	421	699	3,591	5,143
Pulp				
All species	763	1,319	7,113	9,928
Total	3,703	8,340	54,533	74,245
Average price realizations (per thousand board feet):				
Sawlogs				
Douglas-fir	$621	$653	$669	$644
Whitewood	419	446	445	472
Cedar	1,183	908	1,093	942
Hardwood	815	544	681	605
Pulp				
All species	328	225	268	213
Overall	619	554	611	576

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

We ordinarily finance our business activities using funds from operations and, where appropriate in management's assessment, bank lines of credit. We generate operating cash flow through the sale of timber products; by providing timberland management, disposition, and consulting services; by developing timberland investment portfolios for third-parties; and by selling land for development. Significant recurring uses of cash include the following: replanting and fertilizing trees; maintaining an adequate road system on our tree farms; investing in our development properties; funding annual debt payments on timber mortgages and local improvement district debt; funding quarterly cash distributions; and funding general and administrative expenses.

Funds generated internally from operations and externally through financing are expected to provide the required resources for the Partnership's future capital expenditures. The Partnership's debt-to-total-capitalization ratio as measured by the book value of equity was 27% at December 31, 2006 versus 34% at December 31, 2005. The Partnership's debt consists primarily of a timberland mortgage with a fixed amortization schedule and loan terms that include a prepayment penalty. We currently operate without an operating line of credit due to the cash we hold in excess of our current operating needs. We will continue to monitor and forecast our expected cash requirements and re-establish a line of credit if need for the additional liquidity should arise.

On August 1, 2005 we announced the closing of the Fund with committed equity of $61.8 million, of which Pope Resources has committed to invest $12.4 million. The Fund made two significant timberland acquisitions in 2006 by investing $58.5 million, for which Pope Resources contributed $11.7 million. The first transaction was for 15,000 acres and the second was for 9,000 acres. Now that the Fund is essentially invested we are working on raising capital for the second fund. Management anticipates that this second fund will be sized at approximately $100 million and that we will co-invest at the same 20% level ($20 million in this case), as was done in the first fund.

The Partnership made two significant timberland acquisitions in 2004 by investing a total of $21.2 million. The first transaction was for 3,300 acres of timberland acquired in January 2004. This property is being managed as part of the Columbia tree farm inasmuch as these acquired acres are intermingled with that larger holding. The second acquisition totaled 1,346 acres and closed during fourth quarter 2004 and was an opportunity to acquire timberland tracts adjacent to the Partnership's existing Hood Canal tree farm. We have termed these the Quilcene Timberlands and these properties were forested with ready-to-harvest, merchantable timber. These acquisitions were funded primarily by cash reserves supplemented by draws on a bank line of credit. The January acquisition had an impact on 2004 and 2005 harvest levels (and cash flows). The Quilcene Timberlands acquisition had a small impact on 2004 harvest levels and a major impact on 2005 and 2006 harvest levels and cash flows. Harvest-related cash flows resulting from these acquisitions have served to offset essentially all of each of the respective purchase prices.

The annual harvest target for 2007 is expected to be approximately 49 MMBF as compared to 55 MMBF in 2006, which is down following the completion of harvest activities from the 2004 timberland acquisitions. For 2007 and beyond, absent new acquisitions or major dispositions, we expect an annual harvest level of approximately 49 MMBF. The planned decrease in harvest volume in 2007 relative to 2006 will result in a decline in Fee Timber revenue and cash flow.

During the year ended December 31, 2006, overall cash and cash equivalents increased $3.8 million and we invested an additional $10.0 million in short-term investments. This compares to the year ended December 31, 2005 when we experienced a decrease in cash and cash equivalents of $2.6 million and invested $15.0 million in short-term investments.

Operating cash activities. The table below provides the components of operating cash flows for each of the three years ended December 31, 2006, 2005, and 2004. Cash received from customers and paid to suppliers and employees results from the harvest and sale of forest products from our tree farms; timberland management, disposition, and consulting services provided to timberland owners; and finally, the sale of our development properties.

Operating cash activities *(in thousands):*	Years Ended December 31, 2006	2005	2004
Cash received from customers	$69,548	$56,730	$40,513
Cash paid to suppliers and employees	(25,030)	(25,232)	(19,693)
Interest received	1,095	377	105
Interest paid	(1,795)	(2,892)	(3,058)
Income taxes paid	(247)	(74)	(13)
Cash provided by operating activities	$43,571	$28,909	$17,854

Cash generated by operating activities increased to $43.6 million in 2006 from $28.9 million in 2005. The increase in cash generated by operating activities resulted primarily from two major land sales that created nearly $20.0 million of cash flow. By segment, earnings before interest, taxes, depreciation, depletion, and amortization (EBITDDA) decreased $6.0 million for the Fee Timber segment and increased $13.1 million for the Real Estate segment in 2006 relative to 2005.

In 2005, cash generated by operating activities increased to $28.9 million in 2005 from $17.9 million in 2004. The increase in cash generated by operating activities primarily resulted from the Fee Timber segment increase in timber volume harvested from 60 MMBF in 2004 to 74 MMBF in 2005 combined with a $47 per MBF, or 9%, increase in realized prices on log volume sold in 2005 compared to 2004. Additionally, the Timberland Management & Consulting segment's $4.2 million increase in EBITDDA also contributed to the increase in operating cash flows in 2005.

Cash used in investing activities. The table below represents the components of cash used in investing activities for the three years 2006, 2005, and 2004. Recurring investing activities consist primarily of tree planting, road building and investment in our development properties to build infrastructure and acquire the entitlements necessary to make further development of the properties possible. In 2004 we invested $21.2 million to purchase timberlands with $20.8 million of that total directed at two separate transactions that added nearly 4,700 acres to our timberland holdings.

Investing activities *(in thousands):*	Years Ended December 31, 2006	2005	2004
Buildings and equipment	$622	$784	$701
Development properties	10,458	4,960	1,484
Timber and roads	1,098	1,012	1,075
Timberland acquisitions	57,805	-	21.240
Purchase of short-term investments	10,000	15,000	-
Proceeds from the sale of fixed assets	-	(6)	-
Cash used in investing activities	$79,983	$21,750	$24,500

Cash used in investing activities increased to $79.9 million in 2006 from $21.8 million in 2005. Investing activities in 2006 consisted primarily of the Fund's $57.8 million acquisition of two timber properties. Cash used to purchase the timberland by the Fund was sourced primarily from the $46.8 million of capital contributions from the third-party investors in the Fund. Additional investing activities consisted of $10.0 million of auction rate securities and $12.2 million of capital expenditures. Cash used to purchase short-term investments represents the acquisition of these auction rate securities that are being used as a vehicle for investing cash balances in excess of cash required for immediate operating needs. We incurred capital expenditures for development costs in 2006 for the following Real Estate properties: $8.7 million at the Gig Harbor site; $1.4 million at the Bremerton site; and $398,000 on the Partnership's other development properties. Other capital expenditures included $1.1 million of reforestation and road building costs on our owned timberlands; and $622,000 of buildings and equipment expenditures that consist of $462,000 of capital expenditures at the Port Gamble townsite and $160,000 of other miscellaneous expenditures.

Cash used in investing activities decreased to $21.8 million in 2005 from $24.5 million in 2004. Investing activities in 2005 consisted primarily of the purchase of $15.0 million of auction rate securities and $6.8 million of capital expenditures. Cash used to purchase short-term investments represents the acquisition of auction rate securities which we use as a vehicle for investing cash balances in excess of cash required for immediate operating needs. We incurred capital expenditures in 2005 for the following items: $3.7 million of development costs at the Gig Harbor site; $1.3 million of development costs on the Partnership's other development properties; $1.0 million of reforestation and road building costs on the owned timberlands; $440,000 of capital expenditures at the Port Gamble townsite and $344,000 of other miscellaneous expenditures. The small decline in timber and road investing activities in 2005 versus 2004 is due to delaying fertilization until 2006.

Cash used in financing activities. The table below represents the components of cash used in financing activities for the three years 2006, 2005, and 2004. Our financing activities primarily reflect payments made on timber mortgages and other debt, unitholder distributions, capital contributions by third-party investors in the timber funds, and payments to the Managing General Partner, Pope MGP, for its minority interest allocation of IPMB income. These payments and outflows are partially offset by cash received from the exercise of unit options issued to employees and directors.

	Years Ended December 31,		
Financing activities *(in thousands):*	**2006**	2005	2004
Mortgage/LID payments	**$(1,675)**	$(1,883)	$(1,979)
Net (paydown) draw on line of credit	**-**	(758)	758
ORM Timber Fund I, LP, Capital Contributions	**46,831**	-	-
Cash distribution to unitholders	**(4,961)**	(3,701)	(1,989)
Cash received from unit option exercises	**254**	1,813	310
Minority interest distribution	**(204)**	(26)	(58)
Cash provided (used) by financing activities	**$40,245**	($4,555)	($2,958)

Cash generated from financing activities increased to $40.2 million for 2006 from $4.6 million used in 2005. Cash generated by financing activities in 2006 consisted of $46.8 million of capital contributions to the Fund by the third-party investors, and $254,000 received from the exercise of unit options, which is partially offset by unit holder distributions totaling $5.0 million, $1.7 million of payments on long-term debt, and $204,000 in minority interest distributions. In the third quarter of 2006 we increased our quarterly distribution from $0.25 to $0.28 per unit.

Cash used in financing activities increased to $4.6 million for 2005 from $3.0 million for the corresponding period in 2004. Cash used for financing activities in 2005 consisted of $1.9 million of payments on long-term debt, $758,000 of pay downs of the line of credit, four unitholder distributions totaling $3.7 million and $26,000 in minority interest distributions. These cash outflows were partially offset by $1.8 million received from the exercise of unit options. The increase in cash used for financing activities in 2005 compared to 2004 is due primarily to an increase in our quarterly distributions. In the third quarter of 2005 we increased our quarterly distribution rate from $0.15 to $0.25 per unit as a result of the increase in cash generated from operations in 2005.

EXPECTED FUTURE CHANGES TO CASH FLOWS

Operating activities. As discussed above, we plan to decrease the Partnership's annual harvest volume from 55 MMBF in 2006 to 49.5 MMBF in 2007. This decrease is due to completion in 2006 of the incremental harvest from the two timberland acquisitions in 2004 that were stocked primarily with merchantable timber. The decreased harvest level will translate to lower cash flow from Fee Timber operations in 2007. Real Estate transactions in 2007 are expected to generate a small fraction of the cash that the 2006 transactions generated.

Investing activities. We have secured a committed equity balance of $61.8 million for the Fund, of which Pope Resources has committed to invest $12.4 million. The Fund has placed $57.8 million in two timberland acquisitions and management is now working on securing capital commitments for a second fund. The level of co-investment in the second fund is expected to be the same 20% as was the case in the first fund, but the size of the second fund will be larger, likely approximating $100 million. In addition to these co-investment obligations, capital infrastructure expenditures on our projects at Gig Harbor and Bremerton are expected to total $3.4 million and $1.3 million, respectively, in 2007. The majority of Gig Harbor capital expenditures in 2007 are expected to reflect work on the retail pad construction, utility connections or infrastructure, and road access on the property. Capital expenditures on the Bremerton property in 2007 will primarily relate to completion of a storm water retention facility together with a road and sewer extension.

Financing activities. The capital required for Gig Harbor and Bremerton is expected to be funded through our current cash and short-term investment balances as well as operations. We anticipate that cash generated from property sales will quickly result in positive cash flow that will offset this short-term capital requirement. Management is currently projecting that cash on hand, short-term investments, and cash generated from operating activities will be sufficient to bridge the front-loading of the capital needs for development properties and co-investments in future timber funds. This point of view reflects management's rationale for not renewing our bank line of credit, which has been utilized by the Partnership at various times in its history.

Our debt-to-total-capitalization ratio as of December 31, 2006, as measured by the book and market value of our equity, was 27% and 17%, respectively. Should a financing need arise, management is comfortable that there is room to take on some debt with the ratios at these levels, since our loan covenant which limits debt-to-total-capitalization to 50% is measured against the lower of these two calculations. The Hood Canal tree farm secures the Partnership's current timberland mortgages while the Columbia tree farm is not currently used as collateral for any debt obligations. To date the Partnership's strong financial position has enabled fairly easy access to credit at reasonable terms when needed.

SEASONALITY

Fee Timber. The Partnership owns nearly 114,000 acres of timberland in Washington State. Our timber acreage is concentrated in two non-contiguous tree farms: the 70,000-acre Hood Canal tree farm located in Kitsap, Jefferson, and Mason Counties on the eastern side of Washington's Olympic Peninsula, and the 44,000-acre Columbia tree farm located in Cowlitz, Clark, Lewis, and Skamania counties on the western side of Washington's Cascade mountain range.

The Hood Canal tree farm is concentrated at low elevations, which permits us to harvest trees year-round. Generally, we concentrate our harvests from this tree farm in the winter and spring when supply, and thus competition, is typically lower and, accordingly, when we can expect to receive higher prices. With the acquisition of the Columbia tree farm in 2001, management expected a decrease in the seasonality of Fee Timber operations as the Columbia tree farm is at higher elevations where harvest activities are generally possible only in the late spring and summer months. In practice, over the last two years our harvest has tended to be more front-loaded, as log prices have been relatively strong in the first half of the year and winter weather has been relatively benign, enabling management to front-load the harvest plan. In future periods, management expects quarterly harvest volume to be affected by both local market conditions for logs and weather conditions.

Timberland Management & Consulting. Timberland Management & Consulting operations are not significantly seasonal.

Real Estate. While Real Estate results are not expected to be seasonal, the nature of the activities in this segment will likely result in periodic large transactions that will have significant positive impacts on both revenue and operating income of the Partnership in periods in which these transactions close, and relatively limited revenue and income in other periods, with the 2006 year a classic case-in-point. While the "lumpiness" of these results is not primarily a function of seasonal weather patterns, we do expect to see some seasonal fluctuations in this segment because of the general effects of weather on Pacific Northwest development activities.

CONTRACTUAL OBLIGATIONS, COMMERCIAL COMMITMENTS AND CONTINGENCIES

Our commitments at December 31, 2006 consist of operating leases, and purchase obligations entered into in the normal course of business.

		Payments Due By Period/ Commitment Expiration Period			
Obligation or Commitment *(in '000s)*	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Total debt	$32,208	$1,342	$2,684	$27,888	$294
Operating leases	151	90	59	2	-
Interest on debt	12,483	2,784	4,795	4,346	558
Unconditional purchase obligations	690	690	-	-	-
Other long term obligations	351	81	135	50	85
Total contractual obligations	$45,883	$4,987	$7,673	$32,286	$937

We have debt totaling $32.2 million with the contractual maturities described in Note 3 of the Partnership's Consolidated Financial Statements included with this report. The Partnership has committed to invest the additional $735,000 of its 20% capital commitment to the Fund if an additional timberland acquisition is closed by the Fund.

Unconditional purchase obligations represent contracted infrastructure construction at the Gig Harbor property. Other long-term obligations include $135,000 of contributions to the YMCA of Pierce County's fund for building a new facility at Gig Harbor. This commitment was made as part of the sale of business park property at the Gig Harbor project to the YMCA. The remaining balance in other long-term obligations is a $210,000 liability for a supplemental employment retirement plan and $6,000 for the environmental remediation liability at the Port Gamble townsite.

The Partnership may from time to time be a defendant in lawsuits arising in the ordinary course of business. Management believes that loss to the Partnership, if any, will not have a material adverse effect to the Partnership's consolidated financial condition or results of operations.

OFF-BALANCE SHEET ARRANGEMENTS

The Partnership is not a party to off-balance sheet arrangements and does not hold any variable interests in unconsolidated entities.

CAPITAL EXPENDITURES AND COMMITMENTS

Projected capital expenditures in 2007 are $8.6 million, excluding any potential co-investment by the Partnership in the second timber fund. Projected capital expenditures are currently expected to include $3.4 million for the Gig Harbor site and $1.3 million for the Bremerton site. These expenditures could be increased or decreased as a consequence of future economic conditions. Projected capital expenditures at the Gig Harbor and Bremerton site are subject to permitting timetables and progress towards closing on specific land sale transactions.

GOVERNMENT REGULATION

Compliance with laws, regulations, and demands usually involves capital expenditures as well as operating costs. We cannot easily quantify future amounts of capital expenditures required to comply with laws, regulations, and demands, or the effects on operating costs, because in some instances compliance standards have not been developed or have not become final or definitive. Accordingly, at this time we have not included herein a quantification of future capital requirements to comply with any new regulations being developed by United States regulatory agencies.

Additionally, many federal and state environmental regulations, as well as local zoning and land use ordinances, place limits upon various aspects of our operations. These limits include restrictions on our harvest methods and volumes, remediation requirements that may increase our post-harvest reclamation costs, ESA limitations on our ability to harvest in certain areas, zoning and development restrictions that impact our real estate segment, and a wide range of other existing and pending statutes and regulations. Various initiatives are presented from time to time that seek further restrictions on timber and real estate development businesses, and although management currently is not aware of any material noncompliance with applicable law, we cannot assure readers that we ultimately will be successful in complying with all such regulations or that additional regulations will not ultimately have a material adverse impact upon our business.

ACCOUNTING MATTERS

Critical Accounting Policies and Estimates

Management believes its most critical accounting policies and estimates relate to management's calculation of timber depletion and liabilities for matters such as environmental remediation, and potential asset impairments. In relation to liabilities, potential impairments and other estimated charges, it is management's policy to conduct ongoing reviews of significant accounting policies and assumptions used in the preparation of the financial results of the Partnership. The assumptions used are tested against available and relevant information and reviewed with subject-matter experts for consistency and reliability. During the preparation of financial results, tests are conducted to ascertain that the net book carrying values of assets are not in excess of estimated future cash flows. These tests use current market information, if available, or other generally accepted valuation methods, such as future cash flows. When the use of estimates is necessary, an exact answer is unlikely, and therefore, the range of likely outcomes is used in the preparation of the financial statements. Tests are also applied in order to be reasonably assured that liabilities are properly reflected on the records of the Partnership and that the notes to the financial statements are prepared in a fashion that informs readers of possible outcomes and risks associated with the conduct of business.

Purchased timberland cost allocation. When the Partnership acquires timberlands, a purchase price allocation is performed that allocates cost between the categories of merchantable timber, premerchantable timber, and land based upon the relative fair values pertaining to each of the categories. When timberland is acquired the land is separately evaluated for current value. To the extent the land has value under current market conditions as something other than timberland; we assign a value greater than that typically associated with timberland.

Depletion. Depletion represents the cost of timber harvested and the amortized cost of the permanent road system and is charged to operations by applying a depletion rate to volume harvested during the period. The depletion rate is calculated on January 1st of each year by dividing the Partnership's cost of merchantable timber and the cost of the permanent road system by the volume of merchantable timber. For purposes of the depletion calculation, merchantable timber is defined as timber that is equal to or greater than 40 years of age. To calculate the depletion rate the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. Prior to the fourth quarter of 2004, all of the Partnership's timberlands were aggregated into one depletion cost pool. The Partnership acquired approximately 1,400 acres of timberland in the last quarter of 2004 that was accounted for in two separate depletion pools. These acquisitions were almost entirely merchantable timber, which made the inventory characteristics of these acquisitions sufficiently different from our existing timber pool to indicate separate depletion pools were warranted under our accounting policy. Harvest activities for one of these separate depletion pools was completed in 2004, the other was harvested in 2004, 2005, and 2006. The depletion cost on this harvest is expected to approximate the net stumpage realized on the sale, which will result in relatively little net income impact from the harvest but will generate operating cash flow. With a decrease from this separate depletion pool in 2007 we expect the overall weighted average depletion rate in 2007 will be approximately $67/MBF which represents a decline from $110/MBF in 2006 as the Partnership does not plan to harvest timber in 2007 from the separate depletion pool.

Timber inventory volumes take into account the applicable state and Federal regulatory limits on timber harvests as applied to the Partnership's properties, including the Forests and Fish law that supplements Washington State's forest practice regulations to provide for expanded riparian management zones, wildlife leave trees, and other harvest restrictions. Timber inventory volume is accounted for by the Partnership's standing timber inventory system, which utilizes annual statistical sampling of the timber (cruising) together with adjustments made for estimated annual growth and the depletion of areas harvested.

The standing inventory system is subject to two processes each year to monitor accuracy. The first is the annual cruise process and the second is a comparison of (a) volume actually extracted by harvest to (b) inventory in the standing inventory system at the time of the harvest. A "cruise", which utilizes statistical sampling techniques, represents a physical measurement of timber on a specific set of acres. The cruise process is completed when the physical measurement totals are compared to the volume captured in the standing inventory system. Only productive acres with timber that is at least 20 years old are selected as subject to a cruise. The Partnership cruised 20% of its productive acres with 20-year-old-or-greater timber in 2006 and 16% in 2005 and 20% in 2004 and plans to cruise 20% of productive acres in 2007. Specific acres are first selected for cruising with a bias towards those acres that have gone the longest without a cruise and, second, with a bias towards those acres that have been growing the longest. As the cruise is being performed, only those trees with a breast height diameter (approximately 4.5 feet from the ground) of at least 6 inches are measured for inclusion in the inventory.

A 5% change in estimated timber inventory volume would have changed 2006 depletion expense by $173,000.

Environmental remediation. The environmental remediation liability represents estimated payments to be made to monitor (and remedy if necessary) certain areas in and around the townsite and millsite of Port Gamble, Washington. Port Gamble is a historic town that was owned and operated by P&T, a related party, until 1985 when the townsite and other assets were spun off to the Partnership. P&T continued to operate the townsite until 1996 and leased the millsite at Port Gamble through January 2002, at which point P&T signed an agreement with the Partnership dividing the responsibility for environmental remediation of Port Gamble between the two parties.

The environmental remediation liability on the Partnership's books is based upon an estimate of the Partnership's portion of the cleanup costs under this agreement with P&T. While the majority of the Partnership's portion of the cleanup efforts is complete, there remains the possibility that the remaining remediation or monitoring activities may exceed estimates, resulting in an additional environmental remediation charge. Management will continue to monitor the remaining liability against estimates to complete to determine if an adjustment to the environmental remediation liability is necessary to accurately represent management's estimate of remaining cost to complete the project.

Property development costs. The Partnership is developing several master planned communities with the Gig Harbor and Bremerton projects being the most notable currently. Costs of development, including interest, are capitalized for these projects and allocated to individual lots based upon their relative preconstruction value. This allocation of basis supports, in turn, the computation of those amounts reported as a current vs. long-term asset ("Land Held for Sale" and "Land Held for Development", respectively). As lot sales occur, the allocation of these costs becomes part of cost of sales attributed to individual lot sales. Costs associated with land including acquisition, project design, architectural costs, road construction, and utility installation are accounted for as investment activities (as opposed to an operating activity) on our statement of cash flows. These investments are often made for a number of years prior to the realization of revenue from the disposition of these properties. Cash generated from the sale of these properties is classified as an operating activity on our cash flow statement as the sale of these properties is the main operating activity of our Real Estate segment.

Percentage of completion revenue recognition. The partnership accounts for revenue recognized from development sales consistent with Statement of Financial Accounting Standards No. 66 Accounting for Sales of Real Estate. When a real estate transaction is closed with significant outstanding obligations to complete infrastructure or other construction, revenue is recognized on a percentage of completion method by calculating a ratio of costs incurred to total costs expected. Revenue is deferred by the ratio of remaining costs to complete. As a result of this accounting the Partnership has deferred $1.3 million of revenue related to the Bremerton West Hills closing. An additional $7.2 million of revenue related to the Gig Harbor retail pad closing has been deferred due to a rescission clause in the purchase and sale agreement that can be exercised by the buyer if we do not complete certain infrastructure improvements.

Consolidated Balance Sheets

As of December 31 (in thousands)	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	$7,194	$3,361
Short-term investments	25,000	15,000
Accounts receivable	1,074	1,049
Land held for sale	2,813	4,371
Current portion of contracts receivable	4,547	14
Prepaid expenses and other	499	336
Total current assets	41,127	24,131
Properties and equipment, at cost:		
Land held for development	13,294	9,661
Land	23,554	15,542
Roads and timber, net of accumulated depletion of $43,461 and $37,030	96,883	53,019
Buildings and equipment, net of accumulated depreciation of $6,748 and $6,488	3,405	3,340
Total properties and equipment, at cost	137,136	81,562
Other assets:		
Contracts receivable, net of current portion	1,161	483
Other	858	182
Total other assets	2,019	665
Total assets	$180,282	$106,358
LIABILITIES AND PARTNERS' CAPITAL		
Accounts payable	$1,114	$1,147
Accrued liabilities	3,083	3,865
Environmental remediation	236	152
Current portion of long-term debt	1,342	1,602
Minority interest - IPMB	77	325
Deposit	85	59
Deferred revenue	8,838	304
Total current liabilities	14,775	7,454
Long-term debt	30,866	32,281
Minority interest - ORM Timber Fund I, LP	46,685	-
Other long-term liabilities	351	218
Commitments and contingencies		
Partners' capital (units outstanding: 4,647 and 4,627)	87,605	66,405
Total liabilities and partners' capital	$180,282	$106,358

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations

Years ended December 31 (in thousands except per unit data)	2006	2005	2004
Revenue:			
Fee Timber	$35,260	$44,424	$33,571
Timberland Management & Consulting	3,670	7,764	1,601
Real Estate	27,320	4,818	4,476
Total revenues	66,250	57,006	39,648
Costs and expenses:			
Cost of sales:			
Fee Timber	(16,221)	(23,847)	(14,687)
Real Estate	(9,532)	(748)	(497)
Total cost of sales	(25,753)	(24,595)	(15,184)
Operating expenses:			
Fee Timber	(4,447)	(4,257)	(3,758)
Timberland Management & Consulting (TM&C)	(2,404)	(4,224)	(2,199)
Real Estate	(3,664)	(2,602)	(1,927)
Real Estate environmental remediation	(260)	(198)	(466)
General & Administrative (G&A)	(3,817)	(3,651)	(2,986)
Total operating expenses	(14,592)	(14,932)	(11,336)
Operating income (loss):			
Fee Timber	14,592	16,320	15,126
Timberland Management & Consulting	1,266	3,540	(598)
Real Estate	13,864	1,270	1,586
Unallocated G&A	(3,817)	(3,651)	(2,986)
Total operating income	25,905	17,479	13,128
Other income (expense):			
Interest expense	(2,691)	(2,879)	(3,052)
Interest Capitalized to Development Projects	912	-	-
Interest income	1,154	402	100
Total other expense	(625)	(2,477)	(2,952)
Income before income taxes and minority interest	25,280	15,002	10,176
Income tax expense	(439)	(997)	-
Income before minority interest	24,841	14,005	10,176
Minority interest-ORM Timber Fund I, LP	146	-	-
Minority interest - IPMB	(77)	(321)	-
Net income	$24,910	$13,684	$10,176
Earnings per unit:			
Basic	$5.37	$2.97	$2.25
Diluted	$5.23	$2.88	$2.22
Distributions per unit	$1.06	$0.80	$0.44

See accompanying notes to consolidated financial statements.

Consolidated Statements of Partners' Capital and Comprehensive Income

Years Ended December 31 (in thousands)	General Partners	Limited Partners	Total
December 31, 2003	882	45,154	46,036
Net income and comprehensive income	135	10,041	10,176
Distributions	(26)	(1,963)	(1,989)
Proceeds from option exercises	-	310	310
December 31, 2004	991	53,542	54,533
Net income and comprehensive income	178	13,506	13,684
Distributions	(48)	(3,653)	(3,701)
Equity based compensation	-	76	76
Proceeds from option exercises	-	1,813	1,813
December 31, 2005	$1,121	$65,284	$66,405
SAB 108 Adjustment	7	546	553
Adjusted January 1, 2006	**$1,128**	**$65,830**	**$66,958**
Net income and comprehensive income	**322**	**24,588**	**24,910**
Distributions	**(64)**	**(4,897)**	**(4,961)**
Equity based compensation	**-**	**444**	**444**
Proceeds from option exercises	**-**	**254**	**254**
December 31, 2006	**$1,386**	**$86,219**	**$87,605**

Weighted average units outstanding:	12/31/2006	12/31/2005	12/31/2004
Basic	**4,642**	4,605	4,522
Diluted	**4,762**	4,753	4,594

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended December 31 (in thousands)	2006	2005	2004
Cash flows from operating activities:			
Cash received from customers	$69,548	$56,730	$40,513
Cash paid to suppliers and employees	(25,030)	(25,232)	(19,693)
Interest received	1,095	377	105
Interest paid	(1,795)	(2,892)	(3,058)
Income taxes paid	(247)	(74)	(13)
Net cash provided by operating activities	43,571	28,909	17,854
Cash flows from investing activities:			
Capital expenditures	(12,177)	(6,756)	(3,260)
Proceeds from sale of fixed assets		6	-
Purchase of short-term investments	(10,000)	(15,000)	-
Timberland acquisition	(57,806)	-	(21,240)
Net cash used in investing activities	(79,983)	(21,750)	(24,500)
Cash flows from financing activities:			
Cash distributions to unitholders	(4,961)	(3,701)	(1,989)
Net draw (repayment) on line of credit	-	(758)	758
ORM Timber Fund I, LP capital contributions	46,831	-	-
Repayment of long-term debt	(1,675)	(1,883)	(1,979)
Proceeds from option exercises	254	1,813	310
Minority interest distribution	(204)	(26)	(58)
Net cash provided by (used in) financing activities	40,245	(4,555)	(2,958)
Net increase (decrease) in cash and cash equivalents	3,833	2,604	(9,604)
Cash and cash equivalents:			
Beginning of year	3,361	757	10,361
End of year	$7,194	$3,361	$757

Reconciliation of net income to net cash provided by operating activities:			
Net income	$24,910	$13,684	$10,176
Cost of land sold	7,709	434	209
Minority interest-IPMB	77	321	-
Minority interest-ORM Timber Fund I, LP	(146)	-	-
Depreciation and amortization	712	640	660
Depletion	6,305	10,612	5,092
Deferred tax expense (benefit)	(16)	890	-
Equity based compensation	444	76	-
Increase (decrease) in cash from changes in operating accounts:			
Accounts receivable	(25)	71	(255)
Contracts receivable	(5,211)	267	304
Other current assets	(220)	(141)	336
Accounts payable and accrued liabilities	890	2,923	228
Environmental remediation	84	(316)	182
Deposits	27	81	38
Deferred revenue	8,534	(614)	815
Other long-term liabilities	133	(18)	80
Other long term assets	(636)	-	-
Other, net	-	(1)	(11)
Net cash provided by operating activities	$43,571	$28,909	$17,854

See accompanying notes to consolidated financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of operations:

Pope Resources, A Delaware Limited Partnership (the "Partnership") is a publicly traded limited partnership engaged primarily in managing timber resources on its own properties as well as those owned by others. Pope Resources' active subsidiaries include ORM, Inc., which is responsible for managing Pope Resources' timber properties; Olympic Resource Management LLC, which provides timberland management and consulting activities and is responsible for developing the timber fund business; Olympic Property Group I, LLC, which manages the Port Gamble town and millsites and land that is classified as development property; and OPG Properties LLC, which owns land that is held as development property. These consolidated financial statements also include ORM Timber Fund I, LP (the Fund). Olympic Resource Management LLC is the general partner and owns 1% of the Fund and Pope Resources owns 19% of the Fund. The Fund's purpose is to invest in timberlands. See Note 2 for additional information.

The managing general partner is Pope MGP, Inc. The Partnership operates in three business segments: Fee Timber, Timberland Management & Consulting, and Real Estate. Fee Timber represents the growing and harvesting of trees from owned properties. Timberland Management & Consulting represents management, acquisition, disposition, and consulting services provided to third-party owners of timberlands and provides management service to the Fund. Real Estate consists of obtaining entitlements for properties that have been identified as having value as developed residential or commercial property and operating the Partnership's existing commercial and residential properties in Kitsap and Pierce Counties, Washington.

Principles of consolidation:

The consolidated financial statements include the accounts of the Partnership and its subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Minority Interest:

Minority Interest – IPMB represents Pope MGP, Inc.'s interest in the Investor Portfolio Management Business (IPMB) (see Note 9) and has been classified as a current liability since the minority interest's share in income is generally distributed on an annual basis. Minority Interest – ORM Timber Fund I, LP represents the 80% interest in the Fund owned by third-party investors. The Fund is consolidated into Pope Resource's financial statements due to Olympic Resource Management's role as General Partner of the Fund.

Use of estimates in financial statements:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

Cost of sales:

For statement of operations presentation, cost of sales consists of the Partnership's cost basis in timber, real estate, and other inventory sold, and direct costs incurred to make those assets saleable. Those direct costs include the expenditures associated with the harvesting and transporting of timber and closing costs incurred in land and lot sale transactions.

Concentration of credit risk:

Financial instruments that potentially subject the Partnership to concentrations of credit risk consist principally of accounts and contracts receivable. The Partnership limits its credit exposure by considering the creditworthiness of potential customers. The Partnership does not maintain an allowance for doubtful accounts, as losses from accounts receivable have historically been minimal.

Contracts receivable:

The Partnership sells land parcels under contracts requiring a minimum cash down payment of 20% and having financing terms of up to 15 years at interest rates between zero and 10% per annum. The Partnership reduces credit risk on contracts through down payment requirements and utilizing the underlying land as collateral.

At December 31, 2006, minimum principal payments on contracts receivable for the next five years and thereafter are due as follows (in thousands):

2007	$4,547
2008	617
2009	16
2010	285
2011	10
Thereafter	233

Income taxes:

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Operating loss and tax credit carryforwards are also factored into the calculation of deferred tax assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. 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.

Property, equipment, and roads:

Depreciation is provided using the straight-line method over the estimated useful lives of the assets, which range from 5 to 39 years. The Partnership capitalizes the cost of building permanent roads on the tree farms and expenses temporary roads and road maintenance. Capitalized roads are depleted as timber is harvested. The road depletion rate is calculated by dividing the cost of capitalized roads at the beginning of the year by merchantable timber inventory. The resulting rate is applied to timber harvested during the year to determine road depletion expense.

When facts and circumstances indicate the carrying value of properties may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the property to the projected future undiscounted cash flows. Upon indication that the carrying value of such assets may not be recoverable, the Partnership would recognize an impairment loss, determined on the basis of fair market value, and charge this amount against current operations.

Buildings and equipment consist of the following as of December 31, 2006 and 2005 (in thousands):

Description	12/31/2006	12/31/2005
Buildings	$6,825	$6,303
Equipment	2,750	2,948
Furniture and fixtures	578	577
Total	10,153	9,828
Accumulated depreciation	(6,748)	(6,488)
Net buildings and equipment	$3,405	$3,340

Timber:

The depletion rate is calculated by dividing estimated 40-year old merchantable timber inventory into the cost basis of merchantable inventory as of the beginning of the year. To calculate the depletion rate the Partnership uses a combined pool when the characteristics of the acquired timber are not significantly different from the Partnership's existing timberlands. The Partnership acquired approximately 1,400 acres of timberland in the last quarter of 2004 that was accounted for as a separate depletion pool. This acquisition was almost entirely merchantable timber, which made the inventory characteristics of the acquisition sufficiently different from our existing timber pool to indicate a separate depletion pool was warranted under our accounting policy. The cost of replanting acres harvested is initially capitalized as a part of pre-merchantable timber. Then, after 40 years such costs are reclassified from pre-merchantable to merchantable timber and are then incorporated into the cost basis for purposes of calculating the depletion rate. A depletion rate is calculated for each depletion pool and that rate is applied to timber volume harvested from that depletion pool.

Land held for development or sale:

Land held for development represents the Partnership's cost basis in land that has been identified as having greater value as development than timber property. Our Real Estate segment works with these properties to establish entitlements with city and county officials that allow for further development. Project costs clearly associated with development or construction of these properties are capitalized. Indirect costs that do not clearly relate to projects under development or construction are expensed as incurred. Those properties that are either under contract or where the Partnership is planning to sell within the next 12 months are classified as a current asset under Land Held for Sale.

Deferred revenue:

Deferred revenue represents the unearned portion of revenue collected. The balance at December 31, 2006 includes $8,577,000 for two real estate transactions. The partnership deferred one transaction in the amount of $7,231,000 due to the buyer's rescission clause surrounding the partnership's obligation to complete certain infrastructure improvements which are expected to be completed in 2007 and an additional transaction where $1.3 million of total revenue of $12.0 million was deferred as infrastructure improvement obligations under the sale agreement were not complete as of December 31, 2006. The remainder of the balance represents the unearned portion of the amounts received on annual cell tower leases. The balance at December 31, 2005 includes $106,000 collected on one real estate transaction where a portion of the revenue was deferred.

Revenue recognition:

Revenue on timber sales is recorded when title and risk of loss passes to the buyer. Revenue on real estate sales is recorded on the date the sale closes, upon receipt of adequate down payment, and receipt of the buyer's obligation to make continuing payments towards purchase of the property. The Partnership does not currently sell real estate with less than a 20% down payment. Management fees and consulting service revenue is recognized as the related services are provided. Accounts receivable includes earned but unbilled services of $3,000, and $9,000 at December 31, 2006 and 2005, respectively.

Land sales:

The Partnership considers the sale of land to be part of its normal operations and therefore recognizes revenue from the sale and cost of sales for the Partnership's basis in the property sold. Cash generated from these sales are included in cash flow from operations on the Partnership's statements of cash flows. Investments to acquire timberlands, from which the sale of land with a higher or better use is made, and the costs incurred to develop those properties are reported in investing activities. These cash outflows are often made years prior to realization through sale of the property and, in many cases, the acquisition of the timberlands occurred prior to the requirement to include cash flow statements.

Equity-based compensation:

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment (SFAS No. 123R) using the modified prospective approach and accordingly have not restated prior period results. SFAS 123R established the accounting for equity instruments exchanged for employee services. Under SFAS 123R, share-based compensation cost is measured at the grant date based on the calculated fair value of the award. We have also changed our accounting for equity-based compensation awarded to retirement eligible directors and employees to expense the award over the lesser of the vesting period or the period between the grant date and eligibility for retirement. The impact of the adoption of SFAS 123R on our earnings was $183,000 or $0.04 per diluted unit for the year ended December 31, 2006.

Prior to the adoption of SFAS No. 123R, we accounted for equity-based compensation granted to employees in accordance with Accounting Principles Board (APB) No. 25, Accounting for Stock Issued to Employees, and related interpretations. The following table presents the impact of our adoption of SFAS 123R on selected line items from our condensed consolidated statement of earnings for the three years ended December 31, 2006:

	For the Year Ended December 31, 2006	
	Following FAS 123R	If Reported Following APB 25
Condensed statement of earnings:		
Operating profit	$25,905	$26,088
Income before income taxes and minority interest	$25,280	$25,463
Net income	$24,910	$25,093
Earnings per unit:		
Basic	$5.37	$5.41
Diluted	$5.23	$5.27

	For the Year Ended December 31, 2005	
	Following FAS 123R	If Reported Following APB 25
Condensed statement of earnings:		
Operating profit	$17,336	$17,479
Income before income taxes and minority interest	$14,859	$15,002
Net income	$13,541	$13,684
Earnings per unit:		
Basic	$2.94	$2.97
Diluted	$2.85	$2.88

	For the Year Ended December 31, 2004	
	Following FAS 123R	If Reported Following APB 25
Condensed statement of earnings:		
Operating profit	$12,906	$13,128
Income before income taxes and minority interest	$9,954	$10,176
Net income	$9,954	$10,176
Earnings per unit:		
Basic	$2.20	$2.25
Diluted	$2.17	$2.22

In 2005, we adopted the 2005 Unit Incentive Plan. Following adoption of this new plan the Board of Directors began issuing restricted units instead of unit options as its primary method of granting equity-based compensation. Units issued as a result of option exercises and restricted unit grants are funded through the issuance of new units. As of December 31, 2006, total compensation expense related to non-vested awards not yet recognized was $777,000 with a weighted average 35 months remaining to vest.

In addition to accounting and disclosure presented in accordance with APB No. 25, we also provided the disclosures required under SFAS No. 123, *Accounting for Stock Based Compensation* (SFAS No. 123) as amended by SFAS No. 148, *Accounting for Stock Based Compensation – Transition and Disclosures*. As a result, no expense was reflected in our net income for the period ended December 31, 2005 and 2004 for unit options, as all options granted had an exercise price equal to the market value of the underlying units on the grant date.

The table below reflects our proforma net income per unit for the period shown had compensation for unit options been determined based on the fair value at the grant date, consistent with the methodology prescribed under SFAS No. 123:

(In thousands except per unit data)	Year Ended December 31, 2005	2004
Net income as reported:	$13,684	$10,176
Add back employee units based compensation expense recognized	76	-
Subtract proforma compensation expense under SFAS No. 123	(218)	(222)
Proforma net income under SFAS No. 123	$13,542	$9,954
Earnings per unit as reported:		
Basic	$2.97	$2.25
Diluted	$2.88	$2.22
Proforma:		
Basic	$2.94	$2.20
Diluted	$2.85	$2.17

No unit options were granted in 2006. For unit options granted in 2005 and 2004, grant date fair values were determined based upon the following:

	Year Ended December 31, 2005	2004
Expected life	5 years	5 years
Risk free interest rate	4.00%–4.56%	3.97%–4.75%
Dividend yield	1.2%–2.3%	1.2%–1.8%
Volatility	25.0%–31.7%	20.7%–25.4%
Weighted average value	$8.59	$4.46

Comprehensive income:

Comprehensive income consists of net income. The Consolidated Statements of Partners' Capital and Comprehensive Income contain the disclosure and calculation of comprehensive income.

Income per partnership unit:

Basic income per partnership unit is computed using the weighted average number of units outstanding during each year. Diluted income per unit is calculated using the weighted average units outstanding during the year, plus the dilutive impact of unit options outstanding. Unit options are excluded from the computation if their effect is anti-dilutive.

Year Ended December 31	2006	2005	2004
Weighted average units outstanding (in thousands):			
Basic	4,642	4,605	4,522
Dilutive effect of unit options	120	148	72
Diluted	4,762	4,753	4,594

As of each year-end date in the table above, a certain number of unit options outstanding were not included in the calculation of earnings per partnership unit as they were anti-dilutive. These unit option totals were 1,100, 1,100, and 148,086, in 2006, 2005, and 2004, respectively.

Statements of cash flows:

The Partnership considers all highly liquid debt instruments with maturity of three months or less when purchased to be cash equivalents.

New accounting standards:

In July 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.* This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. While our analysis of the impact this Interpretation is not yet complete, we do not anticipate it will have a material impact on our retained earnings at the time of adoption.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ("FAS 157"). This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of FAS 157 is not expected to have a material impact on our financial position, results of operations or cash flows.

Recently adopted accounting standards:

Effective January 1, 2006, the beginning of the Partnership's fiscal year ended December 31, 2006, the Partnership adopted Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment".

The Partnership increased Partners' Capital by $553,000 on January 1, 2006 as a result of adopting Securities and Exchange Commission Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements" (SAB 108). The transition provisions of SAB 108 permit the Partnership to adjust for the cumulative effect on Partners' Capital of immaterial errors relating to prior years. This increase in Partners' Capital consists of $421,000 of interest expense that was not capitalized to the Gig Harbor project in 2005 and 2004, plus $158,000 of minority interest that had been over-accrued prior to 2003 net of a $26,000 understatement of depreciation expense in 2001.

2. ORM TIMBER FUND I, LP (the Fund)

On August 1, 2005 the Partnership announced that management had obtained capital commitments of $61.8 million, of which Pope Resources and Olympic Resource Management LLC committed $12.4 million, for the launch of a private equity timber fund, the Fund. In the fourth quarter of 2006 Olympic Resource Management LLC invested $58.5 million of the Fund's committed capital with the acquisition of two separate tree farms representing 24,000 acres. Pope Resources and Olympic Resource Management LLC represent 20% of the investment capital in the Fund or $11.7 million of the capital invested. Olympic Resource Management LLC is the general partner in the Fund and earns management fees for managing the Fund's timberlands and operations. The 2006 ORM Timber Fund I, LP statement of operations contains minimal activity as harvest activities are not expected to commence until the end of the first quarter of 2007. The Fund had a loss of $183,000 at December 31, 2006 that consisted primarily of management fee expenses of $130,000 paid to Olympic Resource Management LLC, which is eliminated in the consolidation by the Partnership.

The Partnership's consolidated financial statements include the Fund's assets and liabilities at December 31, 2006 which are as follows:

Current assets	$778
Timber, land, and roads	57,803
Total Assets	$58,581
Current liabilities	$224
Members' capital	58,357
Total liabilities and members' capital	$58,581

3. LONG-TERM DEBT

Long-term debt at December 31 consists of *(in thousands)*:	2006	2005
Mortgage note payable to an insurance company, with interest at 9.65%, collateralized by timberlands, with monthly interest payments and annual principal payments maturing April 2011	$10,099	$10,638
Mortgage note payable to an insurance company, with interest at 7.63%, collateralized by timberlands, with monthly interest payments and annual principal payments maturing April 2011	21,555	22,555
Local improvement district assessments, with interest ranging from 5.03% to 6.5%, due through 2013	554	690
	32,208	33,883
Less current portion	(1,342)	(1,602)
Total long-term debt	$30,866	$ 32,281

The Partnership's debt agreements contain covenants which require the Partnership to maintain a required debt service coverage ratio and a debt to market capitalization ratio. As of December 31, 2006, the Partnership was in compliance with its debt covenants.

At December 31, 2006, principal payments on long-term debt for the next five years and thereafter are due as follows (in thousands):

2007	$ 1,342
2008	1,342
2009	1,342
2010	1,342
2011	26,546
Thereafter	294

4. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Partnership's financial instruments include cash and cash equivalents, short term investments, accounts receivable, contracts receivable, accounts payable, and accrued liabilities, for which the carrying amount of each approximates fair value based on current market interest rates or their short-term nature. The fair value of fixed rate debt having a carrying value of $32.2 million and $33.9 million has been estimated based on current interest rates for similar financial instruments to be approximately $33.7 million and $36.1 million as of December 31, 2006 and 2005, respectively.

5. INCOME TAXES

The Partnership is not subject to income taxes. Instead, partners are taxed on their share of the Partnership's taxable income, whether or not cash distributions are paid. However, the Partnership is subject to income taxes through operations in several of its taxable subsidiaries. The following tables provide information on the impact of income taxes in those taxable subsidiaries. Consolidated Partnership earnings are reconciled to earnings before income taxes in taxable subsidiaries for the years ended December 31 as follows:

	Years Ended December 31,		
(in 000's):	**2006**	2005	2004
Consolidated Partnership income before income taxes (less minority interest)	**$25,349**	$14,681	$10,176
Less: Income earned in entities that pass-through pre-tax earnings to the partners	**24,134**	12,006	10,335
Income (loss) subject to income taxes	**1,215**	2,675	(159)

The provision for income taxes relating to taxable subsidiaries of the Partnership consists of the following income tax expense for the years ended December 31:

	Years Ended December 31,		
(in 000's):	**2006**	2005	2004
Current	**$(455)**	$(107)	$ -
Deferred	**16**	(890)	-
Total	**$(439)**	$(997)	$ -

A reconciliation between the federal statutory tax rate and the Partnership's effective tax rate is as follows for the years ended December 31:

	2006	2005	2004
Statutory tax on income	34%	34%	34%
Income (loss) earned in entities that pass-through pre-tax earnings to the partners	(32%)	(27%)	(34%)
Effective income tax rate	2%	7%	-%

The net deferred income tax assets include the following components as of December 31:

(000's)	2006	2005
Current (included in prepaid expenses and other)	$50	$108
Non current (included in other assets)	82	8
Total	$132	$116

The deferred tax assets are comprised of the following:

(000's)	2006	2005
Employee-related accruals	50	32
Depreciation	17	8
Other	65	76
Total	$132	$116

6. UNIT INCENTIVE PLAN

The Partnership's 2005 Unit Incentive Plan (New Plan) authorized the granting of nonqualified equity compensation to employees, officers, and directors of the Partnership. A total of 1,105,815 units have been reserved for issuance under the New Plan of which there are 1,073,115 units authorized but unissued as of December 31, 2006. The Partnership has issued 19,000 restricted units under the New Plan in 2006. These units vest over four years with 50% vesting after three years and the remaining 50% vesting after the fourth year from date of grant provided the grantee is still an employee as of the vesting date. The grantee may not transfer restricted units until the holder fulfills the vesting requirements, which last for four years.

Restricted units:

Pope Resources changed the primary form of equity compensation from unit options to restricted units upon adoption of the 2005 Unit Incentive Plan. The Human Resources Committee makes awards of restricted units to directors and senior managers of the Partnership and its subsidiaries. The restricted unit grants ordinarily vest over four years and are compensatory in nature. Restricted unit awards entitle the recipient to full distribution rights during the vesting period but are restricted from disposition and may be forfeited until the units vest. The fair value, as calculated using the intrinsic value method, is charged to income over the vesting period.

Restricted unit activity for the three years ended December 31, 2006 was as follows:

	Units	Weighted Average Grant date Fair Value ($)
Outstanding at December 31, 2004	-	-
Grants	20,000	33.44
Outstanding at December 31, 2005	20,000	33.44
Grants	19,000	34.75
Forfeited	(1,500)	33.44
Outstanding at December 31, 2006	**37,500**	**34.10**

Unit options:

Unit options have not been granted since December 2005. Units options granted prior to January 1, 2006 were non-qualified options granted at an exercise price not less than 100% of the fair value on the grant date. Unit options granted to employees vested over four or five years. Board members had the option of receiving their annual retainer in the form of unit options and those options vested immediately as they were granted monthly for services rendered during the month. Options granted have a life of ten years.

	Options	Price ($)
Vested at December 31, 2003	199,965	18.71
Unvested at December 31, 2003	154,775	13.69
Outstanding at December 31, 2003	354,740	16.52
Exercised	(20,500)	(15.12)
Granted	29,451	17.90
Vested	53,976	6.79
Vested at December 31, 2004	233,441	15.65
Unvested at December 31, 2004	130,250	18.61
Outstanding at December 31, 2004	363,691	16.71
Exercised	(87,779)	20.66
Granted	2,100	32.51
Vested	56,820	27.28
Vested at December 31, 2005	200,482	16.57
Unvested at December 31, 2005	77,530	13.02
Outstanding at December 31, 2005	278,012	15.58
Forfeitures	(4,800)	12.00
Exercised	(19,750)	12.86
Vested	33,012	13.12
Vested at December 31, 2006	**213,744**	**16.38**
Unvested at December 31, 2006	**39,718**	**13.06**
Outstanding at December 31, 2006	**253,462**	**15.86**

The aggregate spread between the option exercise price and unit market price (intrinsic value) of all options outstanding at December 31, 2006 was $4.2 million. The aggregate intrinsic value of all exercisable options at December 31, 2006 was $3.9 million. The total intrinsic value of options exercised during 2006 was $405,000. The weighted average remaining contractual term for all outstanding options at December 31, 2006 was 5.1 years. The weighted average remaining contractual term for all exercisable options at December 31, 2006 was 5.0 years.

The total fair value of unit options vested determined using the Black-Scholes option pricing model as of December 31, 2006 was $911,000. There were 1,085,815 and 1,073,115 units available for issuance under the 2005 Unit Incentive Plan as of December 31, 2005 and December 31, 2006, respectively.

7. EMPLOYEE BENEFITS

As of December 31, 2006, all employees of the Partnership and its subsidiaries are eligible to receive benefits under a defined contribution plan. During 2006, 2005 and 2004 the Partnership matched 50% of the employees' contributions up to 8% of compensation. The Partnership's contributions to the plan amounted to $130,000, $116,000, $90,000, for the years ended December 31, 2006, 2005, and 2004, respectively.

8. COMMITMENTS AND CONTINGENCIES

Environmental remediation:

The Partnership has an accrual for estimated environmental remediation costs of $242,000 and $158,000 as of December 31, 2006 and 2005, respectively. The accrual represents estimated payments to be made to remedy and monitor certain areas in and around the townsite and millsite of Port Gamble. Port Gamble is a historic town that was owned and operated by Pope & Talbot, Inc. (P&T), a related party, until 1985 when the townsite, millsite and other assets were spun off to the Partnership. P&T continued to operate the millsite until 1996 and leased the millsite and townsite at Port Gamble through January 2002, at which point P&T signed an agreement with the Partnership dividing the responsibility for environmental remediation of Port Gamble between the two parties.

Based on information provided by consultants and P&T, the Partnership estimates that the cost range for cleaning up the Port Gamble townsite, millsite and surrounding area to applicable State standards is between $155,000 and $340,000. This cost range includes an assumption that monitoring results currently being conducted result in an indication that cleanup activities completed to date were adequate. In the event that current monitoring activities indicate that additional site cleanup is required, the estimate of environmental remediation costs will increase above the current accrual. The environmental remediation liability at December 31, 2006 is based upon an estimate of the Partnership's portion of the cleanup and monitoring costs that remain to be completed under this agreement.

Performance bonds:

In the ordinary course of business, and as part of the entitlement and development process, the Partnership is required to provide performance bonds to ensure completion of certain public facilities. The Partnership had performance bonds of $6,266,000 and $1,930,000 outstanding at December 31, 2006 and 2005, respectively.

Operating leases:

The Partnership has non-cancelable operating leases for automobiles, office space, and computer equipment. The lease terms are from 12 to 48 months. Rent expense under the operating leases totaled $115,000, $111,000, and $95,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

At December 31, 2006 future minimum rental payments required by year under non-cancelable operating leases are as follows (in thousands):

Year	Amount
2007	$90
2008	51
2009	8
2010	2

Supplemental Employee Retirement Plan:

The Partnership has a supplemental employee retirement plan for a retired key employee. The plan provides for a retirement income of 70% of his base salary at retirement after taking into account both 401(k) and Social Security benefits with a fixed payment set at $25,013 annually. The Partnership accrued $7,000 in 2005 and an additional $23,000 in 2006 for this benefit based on an approximation of the cost of purchasing a life annuity paying the aforementioned benefit amount. The balance of the projected liability as of December 31, 2006 and 2005 was $210,000 and $212,000, respectively.

Contingencies:

The Partnership may from time to time be a defendant in various lawsuits arising in the ordinary course of business. Management believes Partnership losses related to such lawsuits, if any, will not have a material adverse effect to the Partnership's consolidated financial condition or results of operations or cash flows.

9. RELATED PARTY TRANSACTIONS AND MINORITY INTEREST

Pope MGP, Inc. is the managing general partner of the Partnership and receives an annual management fee of $150,000.

The minority interest-IPMB represents Pope MGP, Inc.'s profit-sharing interest in the IPMB. The 1997 amendment to the Limited Partnership Agreement authorizing management to pursue the IPMB specifies that annual net income from the IPMB will be split using a sliding scale allocation method, commencing with 80% to ORM, Inc., a subsidiary of Pope Resources, and 20% to Pope MGP, Inc. The sliding scale allocation method will allocate income evenly between ORM, Inc. and Pope MGP, Inc. once net income from the IPMB reaches $7.0 million in a fiscal year. The share of IPMB allocated to Pope MGP is further split between Pope MGP and a management incentive plan referred to as the Long-term Incentive Plan. This portion of Pope MGP's share of the IPMB is $77,000 in 2006 and is included in Timberland Management & Consulting operating expenses. The aforementioned amendment authorizing pursuit of the IPMB limits cumulative net expenditures to $5.0 million. As of December 31, 2006, cumulative revenue from the IPMB exceeds cumulative IPMB expenditures.

10. SEGMENT AND MAJOR CUSTOMER INFORMATION

The Partnership's operations are classified into three segments: Fee Timber, Timberland Management & Consulting, and Real Estate. The Fee Timber segment consists of the harvest and sale of timber from the Partnership's nearly 114,000 acres of fee timberland in Washington State.

The Timberland Management & Consulting segment began providing management, disposition, and technical forestry services to a client owning 522,000 acres of timberland on January 1, 2005. That same client sold 230,000 acres of timberland. We now manage approximately 292,000 acres of timberland for this client and an additional 24,000 acres for the Fund.

The Real Estate segment's operations consist of management of development properties, and the rental of residential and commercial properties in Port Gamble and Kingston, Washington. Real Estate is working with nearly 2,700 acres of early stage development properties as of December 31, 2006. All of the Partnership's real estate activities are in Washington State.

For the year ended December 31, 2006, the Partnership had three major customers that represented 16%, 12% and 12% of consolidated revenue, respectively. For the year ended December 31, 2005, the Partnership had three major customers that represented 13%, 10% and 10% of consolidated revenue, respectively.

Identifiable assets are those used exclusively in the operations of each industry segment or those allocated when used jointly. The Partnership does not allocate cash, accounts receivable, certain prepaid expenses, or the cost basis of the Partnership's administrative office for purposes of evaluating segment performance. Intersegment transactions are valued at prices that approximate the price that would be charged to a major third-party customer. Details of the Partnership's operations by business segment for the years ended December 31 were as follows (in thousands):

	2006	2005	2004
Revenues:			
Fee Timber	35,905	44,427	33,629
Timberland Management & Consulting	3,860	7,786	2,018
Real Estate	27,356	4,854	4,512
Total Revenue (Internal)	67,121	57,067	40,159
Elimination of Intersegment Revenue	(871)	(61)	(511)
Total Revenue (External)	66,250	57,006	39,648
Intersegment Revenue or Transfers			
Fee Timber	(645)	(3)	(58)
Timberland Management & Consulting	(190)	(22)	(417)
Real Estate	(36)	(36)	(36)
Total	(871)	(61)	(511)
Operating Income:			
Fee Timber	15,047	16,290	14,784
Timberland Management & Consulting	1,419	3,538	(284)
Real Estate	13,255	1,302	1,614
G&A	(3,816)	(3,651)	(2,986)
Total Operating Income	25,905	17,479	13,128
Intersegment Charges or Transfers			
Fee Timber	(455)	30	342
Timberland Management & Consulting	(153)	2	(314)
Real Estate	609	(32)	(28)
G&A	(1)	-	-
Total	0	0	0
Depreciation, Amortization and Depletion			
Fee Timber	6,079	10,714	5,193
Timberland Management & Consulting	73	97	88
Real Estate	647	178	133
G&A	218	263	338
Total	7,017	11,252	5,752

	2006	2005	2004
Assets			
Fee Timber	125,464	74,596	82,159
Timberland Management & Consulting	690	174	169
Real Estate	14,528	10,144	6,084
G&A	39,600	21,444	6,456
Total	180,282	106,358	94,868
Capital and Land Expenditures			
Fee Timber	58,944	1,159	22,358
Timberland Management & Consulting	2	133	73
Real Estate	10,919	5,400	2,006
G&A	118	64	63
Total	69,983	6,756	24,500
Sales of forest products			
Domestic	31,486	38,972	27,727
Export, indirect	1,808	3,784	5,844
Sales of homes, lots, and undeveloped acreage	26,318	3,898	3,630
Fees for service	6,638	10,352	2,447
Total Revenues	66,250	57,006	39,648

11. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

(in thousands except per unit amounts)	Revenue	Income from Operations	Net Income	Earnings per Partnership unit basic	Earnings per Partnership unit diluted
2006					
First quarter	$16,083	$6,180	$5,298	$1.14	$1.11
Second quarter	15,610	3,740	3,540	.77	.75
Third quarter	18,024	8,403	8,279	1.78	1.74
Fourth quarter	16,533	7,582	7,793	1.68	1.63
2005					
First quarter	$16,656	$5,671	$4,606	$1.01	$.97
Second quarter	16,131	5,095	4,069	.89	.86
Third quarter	15,312	4,821	4,137	.90	.87
Fourth quarter	8,907	1,892	872	.17	.18

Report of Independent Registered Public Accounting Firm

The Board of Directors and Unitholders
Pope Resources, A Delaware Limited Partnership:

We have audited the accompanying consolidated balance sheets of Pope Resources, A Delaware Limited Partnership, and subsidiaries (collectively, the Partnership) as of December 31, 2006 and 2005, and the related consolidated statements of operations, partners' capital and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Partnership'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 the 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 Pope Resources, A Delaware Limited Partnership, and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

Effective January 1, 2006, the Partnership adopted Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" and Securities and Exchange Commission Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Partnership's internal control over financial reporting as of December 31, 2006, 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 8, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

KPMG LLP
Seattle, Washington
February 28, 2007

Report of Independent Registered Public Accounting Firm

The Board of Directors and Unitholders
Pope Resources, A Delaware Limited Partnership:

We have audited management's assessment, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A of Pope Resources' 2006 Annual Report on Form 10-K, that Pope Resources, A Delaware Limited Partnership maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Partnership'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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Partnership'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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and 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, management's assessment that Pope Resources, A Delaware Limited Partnership maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Pope Resources, A Delaware Limited Partnership maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Pope Resources, A Delaware Limited Partnership and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of operations, partners' capital and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2006, and our report dated February 28, 2007 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

KPMG LLP
Seattle, Washington
February 28, 2007

11-Year Financial Summary

Results of operations

(Dollar amounts are in thousands except per unit data)	2006	2005	2004	2003
Revenues				
Fee Timber	$35,260	$44,424	$33,571	$22,916
Timberland Management & Consulting	3,670	7,764	1,601	2,386
Real Estate	27,320	4,818	4,476	1,734
Total revenues	66,250	57,006	39,648	27,036
Costs and expenses				
Cost of sales	25,753	24,595	15,184	10,540
Operating expenses	10,515	11,083	7,884	7,031
General and administrative expenses	3,817	3,651	2,986	2,842
Impairment, exit, and environmental remediation costs	260	198	466	-
Total operating costs and expenses	40,345	39,527	26,520	20,413
Income from operations	25,905	17,479	13,128	6,623
Depreciation, depletion, and amortization	7,204	11,252	5,752	3,546
Net interest expense	625	2,477	2,952	2,806
Income tax expense/(benefit)	439	997	-	242
Minority interest - IPMB	77	321	-	47
Minority interest - ORM Timber Fund I, LP	(146)	-	-	-
Net income/(loss)	24,910	13,684	10,176	3,528
PER UNIT RESULTS				
Net income/(loss)	$5.23	$2.88	$2.22	$0.78
Distributions	1.06	0.80	0.44	0.24
Partners' capital	18.85	14.35	12.01	10.19
Weighted average units outstanding (000)	4,762	4,753	4,594	4,522
CASH FLOW				
Net cash provided by operating activities	$43,571	$28,909	$17,854	$8,641
Investing activities (excluding short term investments)	69,983	6,750	24,500	2,000
Distributions to unitholders	4,961	3,701	1,989	1,084
Payment/(issuance) of long-term debt	1,675	1,883	1,979	1,662
EBITDDA #	33,178	28,410	18,880	10,122
Free cash flow #	25,784*	16,731	10,898*	3,595
FINANCIAL POSITION				
Working capital	$26,352	$16,677	$(3,105)	$8,962
Land and timber, net of depletion	133,731	78,222	87,517	69,003
Total assets	180,282	106,358	94,868	86,308
Long-term debt, including current portion	32,208	33,883	35,766	37,745
Partners' capital	87,605	66,405	54,533	46,036
FINANCIAL RATIOS #				
Total Debt to Total Capitalization	27%	34%	40%	45%
Debt to EBITDDA	1.0	1.2	1.9	3.7
EBITDDA to Interest Expense	12.3	9.9	6.2	3.3
Return on Assets	17%	14%	11%	4%
Return on Equity	32%	23%	20%	8%
Enterprise value / EBITDDA	4.8	5.4	6.5	8.7
UNIT TRADING PRICES #				
High	$36.00	$56.85	$25.25	$15.99
Low	30.00	19.35	15.00	7.00
Year-end close	34.32	31.02	25.00	15.43
Market capitalization (year end - $millions)	159	144	113	70
Enterprise value (year end - $millions)	159	159	148	97
Fee timber harvest (MMBF)	54.5	74.2	60.3	45.0
Employees at December 31 (full time equivalent) #	60	65	49	48

Definitions
EBITDDA = Net income before interest expense, interest income, taxes, depreciation, depletion, and amortization
Free cash flow = net income plus depreciation, depletion, and cost of land sold less principal payments and capital expenditures excluding timberland acquisitions
Total Debt to Total Capitalization = Long-term debt plus current portion of long-term debt divided by total debt plus partners' capital
Debt to EBITDDA = Long-term debt, including current portion, divided by EBITDDA
EBITDDA to Interest Expense = EBITDDA divided by interest expense, including capitalized interest

2002	2001	2000	1999	1998	1997	1996
$23,298	$24,999	$21,444	$23,467	$20,985	$19,694	$21,772
7,295	9,703	11,011	11,705	8,906	-	-
1,599	13,143	18,202	15,681	13,061	10,415	11,241
32,192	47,845	50,657	50,853	42,952	30,109	33,013
11,354	20,431	16,970	15,799	12,120	10,937	12,160
10,074	17,998	20,209	20,092	13,355	9,773	7,275
3,774	5,110	7,254	8,282	7,105	4,545	3,760
1,403	1,250	12,101	-	-	-	-
26,605	44,789	56,534	44,173	32,580	25,255	23,195
5,587	3,056	(5,877)	6,680	10,363	4,854	9,818
3,864	7,698	2,899	2,683	2,053	1,647	1,458
2,894	2,961	700	1,039	788	1,008	1,106
(788)	356	(326)	259	310	-	-
147	171	-	316	256	-	-
-	-	-	-	-	-	-
3,334	(432)	(6,251)	5,066	8,792	3,509	8,334
$0.74	$(0.10)	$(1.38)	$1.11	$1.94	$0.78	$1.84
0.10	-	0.40	0.40	0.40	0.49	0.82
9.65	8.98	9.12	10.91	10.16	8.61	8.32
4,520	4,526	4,528	4,548	4,534	4,526	4,519
$9,005	$11,237	$9,973	$8,347	$9,152	$5,820	$12,330
1,676	46,392	2,539	3,764	5,582	3,515	2,581
452	-	1,811	1,810	2,260	1,763	3,706
1,110	(26,540)	424	497	2,594	333	3,289
9,304	10,583	(2,978)	9,047	11,943	6,164	10,898
4,119	2,588*	(6,603)	5,983	3,805	2,069	5,469
$3,792	$(979)	$26,642	$15,720	$12,685	$13,816	$14,635
70,495	71,549	25,411	28,002	27,973	26,095	26,077
86,788	84,187	60,857	66,880	62,706	56,319	54,599
39,239	39,667	13,127	13,688	14,200	14,674	15,003
43,598	40,673	41,280	49,302	45,896	38,911	37,616
47%	49%	24%	22%	24%	27%	29%
4.2	3.7	(4.4)	1.5	1.2	2.4	1.4
2.8	3.1	(2.3)	7.0	8.5	4.3	7.9
4%	-1%	-10%	8%	15%	6%	15%
8%	-1%	-14%	11%	21%	9%	24%
9.9	10.4	(42.8)	16.5	12.8	20.1	9.8
$15.50	$24.50	$25.75	$35.00	$32.50	$31.00	$23.40
9.30	14.00	18.88	27.88	24.06	17.40	15.80
10.11	14.75	24.50	29.25	32.50	30.00	20.00
46	67	111	132	147	136	90
78	105	114	141	158	147	102
45.1	36.3	37.3	42.0	38.9	33.2	31.6
79	123	241	257	157	88	56

Return on Assets = Net income divided by the average of beginning and ending total assets
Return on Equity = Net income divided by the average of beginning and ending partners' capital
Enterprise value / EBITDDA = Average of beginning and ending enterprise value divided by EBITDDA
Weighted Average Units Outstanding = Weighted average units outstanding for the year plus the effect of dilutive unit options outstanding
Enterprise value = market capitalization less cash plus total debt outstanding

Footnotes

** Timberland acquisitions and timber fund co-investments are excluded from the calculation of free cash flow.*
 # Unaudited

Headquarters

Pope Resources
19245 10th Avenue NE
Poulsbo, Washington 98370
Phone: (360) 697-6626
Fax: (360) 697-1156
Website: www.poperesources.com
Email: investors@orminc.com

Directors

John E. Conlin
President & Chief Operating Officer
NWQ Investment Management Company, LLC
Los Angeles, California

Douglas E. Norberg
Vice Chairman
Wright Runstad & Company
Seattle, Washington

David L. Nunes
President and Chief Executive Officer
Pope Resources
Poulsbo, Washington

Peter T. Pope
Chairman and CEO, Retired
Pope & Talbot, Inc.
Portland, Oregon

J. Thurston Roach
Private Investor
Seattle, Washington

Officers

David L. Nunes
President and Chief Executive Officer

Thomas M. Ringo
Vice President & Chief Financial Officer

Stock Exchange Listing
Pope Resources' units trade on the NASDAQ Global Market® under the symbol POPEZ.

Investor Contact
Any questions or information requests can be referred to:

Thomas M. Ringo
Vice President and Chief Financial Officer
Phone: 360-697-6626
E-mail: investors@orminc.com

Unit Transfer Agent and Registrar
Mellon Investor Services, LLC
85 Challenger Road
Ridgefield Park, NJ 07660
800-356-2017
www.melloninvestor.com

Annual Meeting
No annual meeting is required for the partnership.

Form 10-K
This report and Pope Resources' Report on Form 10-K are available on the Partnership's website (www.poperesources.com) by clicking on "Investor Relations" and then scrolling to either "Financial Information" or "SEC Filings" on the left-side navigation bar. Additionally, copies of this report and the Form 10-K are available without charge upon request to:

Pope Resources
Investor Relations Department
19245 10th Avenue NE
Poulsbo, WA 98370

Independent Accountants
KPMG LLP
801 Second Avenue, Suite 900
Seattle, WA 98104