

POTLATCH CORP
Form 10-Q
October 28, 2015

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

Form 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2015

or
 Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number 1-32729

POTLATCH CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization) 601 West First Avenue, Suite 1600 Spokane, Washington (Address of principal executive offices) (509) 835-1500 (Registrant's telephone number, including area code)	82-0156045 (I.R.S. Employer Identification No.) 99201 (Zip Code)
---	--

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

(Do not check if a smaller reporting company)

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

The number of shares of common stock of the registrant outstanding as of October 26, 2015 was 40,677,586.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES
Table of Contents

	Page Number
PART I. - FINANCIAL INFORMATION	
ITEM 1. <u>Financial Statements</u>	
<u>Consolidated Statements of Income for the quarters and nine months ended September 30, 2015 and 2014</u>	<u>2</u>
<u>Consolidated Statements of Comprehensive Income for the quarters and nine months ended September 30, 2015 and 2014</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets at September 30, 2015 and December 31, 2014</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014</u>	<u>5</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>6</u>
ITEM 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>15</u>
ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>25</u>
ITEM 4. <u>Controls and Procedures</u>	<u>25</u>
PART II. - OTHER INFORMATION	
ITEM 1. <u>Legal Proceedings</u>	<u>26</u>
ITEM 1A. <u>Risk Factors</u>	<u>26</u>
ITEM 6. <u>Exhibits</u>	<u>26</u>
<u>SIGNATURES</u>	<u>27</u>
<u>EXHIBIT INDEX</u>	<u>28</u>

Part I

ITEM 1. FINANCIAL STATEMENTS

Potlatch Corporation and Consolidated Subsidiaries

Consolidated Statements of Income

Unaudited (Dollars in thousands, except per share amounts)

	Quarter Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Revenues	\$174,475	\$177,215	\$437,347	\$460,713
Costs and expenses:				
Cost of goods sold	136,072	121,574	353,285	322,016
Selling, general and administrative expenses	10,689	10,772	35,010	32,794
	146,761	132,346	388,295	354,810
Operating income	27,714	44,869	49,052	105,903
Interest expense, net	(8,335)	(5,506)	(24,420)	(16,475)
Income before income taxes	19,379	39,363	24,632	89,428
Income tax benefit (provision)	2,419	(6,209)	3,533	(19,654)
Net income	\$21,798	\$33,154	\$28,165	\$69,774
Net income per share:				
Basic	\$0.53	\$0.81	\$0.69	\$1.71
Diluted	\$0.53	\$0.81	\$0.69	\$1.71
Distributions per share	\$0.375	\$0.35	\$1.125	\$1.05
Weighted-average shares outstanding (in thousands):				
Basic	40,846	40,745	40,831	40,733
Diluted	40,985	40,889	40,967	40,861

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

Potlatch Corporation and Consolidated Subsidiaries
 Consolidated Statements of Comprehensive Income
 Unaudited (Dollars in thousands)

	Quarter Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$21,798	\$33,154	\$28,165	\$69,774
Other comprehensive income, net of tax:				
Pension and other postretirement employee benefits:				
Amortization of prior service credit included in net periodic cost, net of tax of \$(850), \$(867), \$(2,547) and \$(2,601)	(1,327	) (1,357	) (3,983	) (4,069
Amortization of actuarial loss included in net periodic cost, net of tax of \$2,009, \$1,621, \$5,846 and \$4,866	3,139	2,538	9,142	7,612
Other comprehensive income, net of tax	1,812	1,181	5,159	3,543
Comprehensive income	\$23,610	\$34,335	\$33,324	\$73,317

Amortization of prior service credit and amortization of actuarial loss are included in the computation of net periodic cost (benefit). See [Note 6: Pension and Other Postretirement Employee Benefits](#) for additional information.

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

Potlatch Corporation and Consolidated Subsidiaries
Condensed Consolidated Balance Sheets
Unaudited (Dollars in thousands, except per share amounts)

	September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash	\$1,306	\$4,644
Short-term investments	40	26,368
Receivables, net	29,645	9,928
Inventories	40,379	31,490
Deferred tax assets, net	6,168	6,168
Other assets	16,754	15,065
Total current assets	94,292	93,663
Property, plant and equipment, net	74,716	65,749
Timber and timberlands, net	822,353	828,420
Deferred tax assets, net	36,715	37,228
Other assets	11,499	10,361
Total assets	\$1,039,575	\$1,035,421
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$66,233	\$49,324
Current portion of long-term debt	27,500	22,870
Total current liabilities	93,733	72,194
Long-term debt	602,675	606,473
Liability for pension and other postretirement employee benefits	114,542	115,936
Other long-term obligations	13,586	15,752
Total liabilities	824,536	810,355
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$1 par value	40,678	40,605
Additional paid-in capital	348,847	346,441
Accumulated deficit	(61,253)	(43,588)
Accumulated other comprehensive loss	(113,233)	(118,392)
Total stockholders' equity	215,039	225,066
Total liabilities and stockholders' equity	\$1,039,575	\$1,035,421

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

Potlatch Corporation and Consolidated Subsidiaries
Condensed Consolidated Statements of Cash Flows
Unaudited (Dollars in thousands)

	Nine Months Ended September 30,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$28,165	\$69,774
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation, depletion and amortization	28,154	19,326
Basis of real estate sold	3,389	7,289
Change in deferred taxes	(2,786	) 1,127
Employee benefit plans	4,774	616
Equity-based compensation expense	3,589	3,058
Other, net	(675	) (1,805
Funding of qualified pension plan	—	(3,550
Working capital and operating-related activities, net	(9,462	) 11,829
Net cash from operating activities	55,148	107,664
CASH FLOWS FROM INVESTING ACTIVITIES		
Change in short-term investments	26,328	(12,793
Transfer to company owned life insurance (COLI)	—	(25,476
Property, plant and equipment	(16,240	) (9,174
Timberlands reforestation and roads	(11,155	) (7,840
Acquisition of timber and timberlands	(9,320	) (3,143
Other, net	644	1,126
Net cash from investing activities	(9,743	) (57,300
CASH FLOWS FROM FINANCING ACTIVITIES		
Distributions to common stockholders	(45,761	) (42,621
Employee tax withholdings on equity-based compensation	(1,445	) (1,092
Change in book overdrafts	(1,440	) (2,919
Other, net	(97	) (1,019
Net cash from financing activities	(48,743	) (47,651
Change in cash	(3,338	) 2,713
Cash at beginning of period	4,644	5,586
Cash at end of period	\$1,306	\$8,299
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest, net of amounts capitalized	\$18,067	\$11,164
Income taxes, net	\$1,528	\$12,192

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

INDEX FOR NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

	Page Number	
Note 1.	<u>Basis of Presentation</u>	<u>6</u>
Note 2.	<u>Recent Accounting Pronouncements</u>	<u>6</u>
Note 3.	<u>Earnings Per Share</u>	<u>7</u>
Note 4.	<u>Inventories</u>	<u>7</u>
Note 5.	<u>Equity-Based Compensation</u>	<u>8</u>
Note 6.	<u>Pension and Other Postretirement Employee Benefits</u>	<u>10</u>
Note 7.	<u>Financial Instruments</u>	<u>12</u>
Note 8.	<u>Income Taxes</u>	<u>13</u>
Note 9.	<u>Commitments and Contingencies</u>	<u>13</u>
Note 10.	<u>Segment Information</u>	<u>14</u>

NOTE 1. BASIS OF PRESENTATION

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

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission pertaining to interim financial statements; certain disclosures normally provided in accordance with generally accepted accounting principles in the United States have been omitted. This Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission on February 13, 2015. We believe that all adjustments necessary for a fair statement of the results of such interim periods have been included and all such adjustments are of a normal recurring nature.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In April 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-03, Interest - Imputation of Interest, Simplifying the Presentation of Debt Issuance Costs. The amendments in ASU No. 2015-03 require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. ASU No. 2015-03 is effective for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. Early adoption is permitted. The adoption of this guidance is not expected to have a significant effect on our consolidated financial statements or financial covenants.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330) - Simplifying the Measurement of Inventory. The amendments in ASU No. 2015-11 apply to inventory measures using first-in, first-out (FIFO) or average cost and will require entities to measure inventory at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the normal course of business, minus the cost of completion, disposal and transportation. Replacement cost and net realizable value less a normal profit margin will no longer be considered. ASU No. 2015-11 is effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. The adoption of this guidance is not expected to have a significant effect on our consolidated financial statements.

NOTE 3. EARNINGS PER SHARE

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

(Dollars in thousands, except per share amounts)	Quarter Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$21,798	\$33,154	\$28,165	\$69,774
Basic weighted-average shares outstanding	40,846,315	40,744,667	40,831,296	40,732,704
Incremental shares due to:				
Performance shares	118,149	114,579	115,534	98,877
Restricted stock units	20,624	27,816	20,039	27,416
Stock options	—	2,218	—	1,981
Diluted weighted-average shares outstanding	40,985,088	40,889,280	40,966,869	40,860,978
Basic net income per share	\$0.53	\$0.81	\$0.69	\$1.71
Diluted net income per share	\$0.53	\$0.81	\$0.69	\$1.71

For the three months ending September 30, 2015, there were 36 incremental stock-based awards that were excluded from the calculation of diluted earnings per share because they were anti-dilutive. For the nine months ended September 30, 2015, and the three and nine months ending September 30, 2014, there were no incremental anti-dilutive stock-based awards. Anti-dilutive stock-based awards could be dilutive in future periods.

NOTE 4. INVENTORIES

The following table details the composition of our inventories:

(Dollars in thousands)	September 30, 2015	December 31, 2014
Inventories:		
Wood Products finished goods inventory	\$17,192	\$17,286
Logs	15,232	7,930
Materials and supplies	7,955	6,274
	\$40,379	\$31,490

NOTE 5. EQUITY-BASED COMPENSATION

As of September 30, 2015, we had two stock incentive plans under which performance shares, restricted stock units (RSUs), and deferred compensation stock equivalent units were outstanding. These plans have received shareholder approval. We were originally authorized to issue up to 1.6 million shares and 1.0 million shares under our 2005 Stock Incentive Plan and 2014 Stock Incentive Plan, respectively. At September 30, 2015, approximately 1.1 million shares were authorized for future use under the two plans. We issue new shares of common stock to settle performance shares, restricted stock units and deferred compensation stock equivalent units.

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

(Dollars in thousands)	Quarter Ended		Nine Months Ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Employee equity-based compensation expense:				
Performance shares	\$ 1,090	\$ 882	\$ 2,912	\$ 2,577
Restricted stock units	240	144	677	481
Total employee equity-based compensation expense	\$ 1,330	\$ 1,026	\$ 3,589	\$ 3,058
Deferred compensation stock equivalent units expense (income)	\$(1)	\$ 62	\$ 165	\$ 217
Total tax benefit recognized for share-based expense	\$ 89	\$ 111	\$ 241	\$ 125

PERFORMANCE SHARES

The following table presents the key inputs used in the Monte Carlo simulation method to calculate the fair value of the performance share awards in 2015 and 2014, and the resulting fair values:

	Nine Months Ended		
	September 30,		
	2015	2014	
Shares granted	78,974	87,441	
Stock price as of valuation date	\$40.00	\$39.76	
Risk-free rate	1.07	% 0.72	%
Fair value of a performance share	\$36.71	\$45.57	

The following table summarizes outstanding performance share awards as of September 30, 2015, and changes during the nine months ended September 30, 2015:

(Dollars in thousands, except grant date fair value)	Shares	Weighted-Avg. Grant Date Fair Value	Aggregate Intrinsic Value
Unvested shares outstanding at January 1	160,233	\$53.86	
Granted	78,974	\$36.71	
Forfeited	(1,079	) \$41.29	
Unvested shares outstanding at September 30	238,128	\$48.23	\$6,690

As of September 30, 2015, there was \$4.1 million of unrecognized compensation cost related to unvested performance share awards, which is expected to be recognized over a weighted-average period of 1.8 years.

RESTRICTED STOCK UNITS

The following table summarizes outstanding RSU awards as of September 30, 2015, and changes during the nine months ended September 30, 2015:

(Dollars in thousands, except grant date fair value)	Shares	Weighted-Avg. Grant Date Fair Value	Aggregate Intrinsic Value
Unvested shares outstanding at January 1	32,455	\$42.24	
Granted	27,820	\$39.99	
Vested	(4,700	) \$43.22	
Forfeited	(359	) \$40.27	
Unvested shares outstanding at September 30	55,216	\$41.03	\$1,590

The fair value of each RSU equaled our common share price on the date of grant. The total fair value of RSU awards vested during the nine months ended September 30, 2015 was \$0.2 million. As of September 30, 2015, there was \$1.2 million of total unrecognized compensation cost related to unvested RSU awards, which is expected to be recognized over a weighted-average period of 1.4 years.

NOTE 6. PENSION AND OTHER POSTRETIREMENT EMPLOYEE BENEFITS

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

(Dollars in thousands)	Quarter Ended September 30,			
	Pension		OPEB	
	2015	2014	2015	2014
Service cost	\$1,559	\$1,270	\$5	\$7
Interest cost	4,241	4,796	364	435
Expected return on plan assets	(5,220	) (6,128) —	—
Amortization of prior service cost (credit)	151	187	(2,328	) (2,411
Amortization of actuarial loss	4,636	3,613	512	546
Net periodic cost (benefit)	\$5,367	\$3,738	\$(1,447	) \$(1,423

(Dollars in thousands)	Nine Months Ended September 30,			
	Pension		OPEB	
	2015	2014	2015	2014
Service cost	\$4,620	\$3,810	\$16	\$19
Interest cost	12,759	14,388	1,092	1,306
Expected return on plan assets	(15,603	) (18,384) —	—
Amortization of prior service cost (credit)	454	561	(6,984	) (7,231
Amortization of actuarial loss	13,452	10,839	1,536	1,639
Net periodic cost (benefit)	\$15,682	\$11,214	\$(4,340	) \$(4,267
During the nine				