POTLATCH CORP
Form 10-Q
July 26, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2016

or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number 1-32729

POTLATCH CORPORATION

(Exact name of registrant as specified in its charter)

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

601 West First Avenue, Suite 1600
Spokane, Washington 99201

(Address of principal executive offices) (Zip Code)

(509) 835-1500

(Registrant's telephone number, including area code)

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

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 x No o

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	x	Accelerated filer	o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

The number of shares of common stock of the registrant outstanding as of July 25, 2016 was 40,518,533.

POTLATCH CORPORATION AND CONSOLIDATED SUBSIDIARIES

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Part I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Potlatch Corporation and Consolidated Subsidiaries

Consolidated Statements of Income (Loss)

Unaudited (Dollars in thousands, except per share amounts)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	$141,495	$128,747	$269,391	$262,872
Costs and expenses:				
Cost of goods sold	113,377	109,441	223,192	217,213
Selling, general and administrative expenses	13,824	11,995	26,833	24,321
Loss on sale of central Idaho timber and timberlands	48,522	—	48,522	—
	175,723	121,436	298,547	241,534
Operating income (loss)	(34,228)	7,311	(29,156)	21,338
Interest expense, net	(8,206)	(8,016)	(14,231)	(16,085)
Income (loss) before income taxes	(42,434)	(705)	(43,387)	5,253
Income tax benefit	11,196	1,416	12,306	1,114
Net income (loss)	$(31,238)	$711	$(31,081)	$6,367
Net income (loss) per share:				
Basic	$(0.77)	$0.02	$(0.76)	$0.16
Diluted	$(0.77)	$0.02	$(0.76)	$0.16
Dividends per share	$0.375	$0.375	$0.75	$0.75
Weighted-average shares outstanding (in thousands):				
Basic	40,784	40,843	40,837	40,822
Diluted	40,784	40,963	40,837	40,933

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

Potlatch Corporation and Consolidated Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

Unaudited (Dollars in thousands)

	Quarters Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income (loss)	$(31,238)	$711	$(31,081)	$6,367
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 $(815), $(848), $(1,630) and $(1,697)	(1,274)	(1,328)	(2,549)	(2,656)
Amortization of actuarial loss included in net periodic cost, net of tax of $1,826, $1,900, $3,521 and $3,837	2,857	2,974	5,507	6,003
Cash flow hedge, net of tax of $(264), $-, $(369) and $-	(413)	—	(577)	—
Other comprehensive income, net of tax	1,170	1,646	2,381	3,347
Comprehensive income (loss)	$(30,068)	$2,357	$(28,700)	$9,714

See Note 7: Derivative Instruments and Note 9: Pension and Other Postretirement Employee Benefits for additional information. Amortization of prior service credit and amortization of actuarial loss are included in the computation of net periodic cost (benefit).

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

Potlatch Corporation and Consolidated Subsidiaries

Condensed Consolidated Balance Sheets

Unaudited (Dollars in thousands)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash	$25,301	$ 7,886
Short-term investments	40,077	39
Receivables, net	22,531	13,420
Inventories	30,045	35,162
Other assets	17,162	14,246
Total current assets	135,116	70,753
Property, plant and equipment, net	74,558	75,285
Timber and timberlands, net	643,814	816,599
Deferred tax assets, net	51,569	46,600
Other assets	9,088	7,375
Total assets	$914,145	$ 1,016,612
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Revolving line of credit borrowings	$—	$ 30,000
Current portion of long-term debt	5,082	5,007
Accounts payable and accrued liabilities	48,290	39,740
Current portion of pension and other postretirement employee benefits	5,973	5,973
Total current liabilities	59,345	80,720
Long-term debt	581,205	598,874
Pension and other postretirement employee benefits	119,590	119,369
Other long-term obligations	13,462	13,913
Total liabilities	773,602	812,876
Commitments and contingencies		
Stockholders' equity:		
Common stock, $1 par value	40,519	40,681
Additional paid-in capital	352,497	350,541
Accumulated deficit	(140,351)	(72,983)
Accumulated other comprehensive loss	(112,122)	(114,503)
Total stockholders’ equity	140,543	203,736
Total liabilities and stockholders' equity	$914,145	$ 1,016,612

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)

	Six Months Ended June 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$(31,081)	$6,367
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation, depletion and amortization	16,474	15,597
Basis of real estate sold	5,421	1,008
Change in deferred taxes	(6,784)	(1,707)
Employee benefit plans	6,416	3,166
Equity-based compensation expense	2,176	2,259
Loss on sale of central Idaho timber and timberlands	48,522	—
Other, net	(1,280)	(5,496)
Change in working capital and operating-related activities, net	5,797	(4,538)
Net cash from operating activities	45,661	16,656
CASH FLOWS FROM INVESTING ACTIVITIES		
Change in short-term investments	(40,038)	24,537
Property, plant and equipment	(3,488)	(12,248)
Timberlands reforestation and roads	(5,544)	(6,004)
Acquisition of timber and timberlands	(1,161)	—
Net proceeds from sale of central Idaho timber and timberlands	111,460	—
Other, net	109	433
Net cash from investing activities	61,338	6,718
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends to common stockholders	(30,453)	(30,507)
Repayment of revolving line of credit borrowings	(30,000)	—
Proceeds from revolving line of credit borrowings	—	15,000
Repayment of long-term debt	(47,600)	—
Proceeds from issuance of long-term debt	27,500	—
Repurchase of common stock	(5,956)	—
Change in book overdrafts	(2,836)	(2,246)
Employee tax withholdings on vested performance share awards	(102)	(1,445)
Other, net	(137)	(37)
Net cash from financing activities	(89,584)	(19,235)
Increase in cash	17,415	4,139
Cash at beginning of period	7,886	4,644
Cash at end of period	$25,301	$8,783

SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid (received) during the period for:		
Interest, net of amounts capitalized	$13,791	$13,702
Income taxes, net	$(1,740)	$1,512

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

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Notes to Condensed Consolidated Financial Statements

NOTE 1. BASIS OF PRESENTATION

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

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission pertaining to interim financial statements; certain disclosures normally provided in accordance with generally accepted accounting principles in the United States have been omitted. This Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission on February 12, 2016. 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 February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, Leases, which, among other things, requires lessees to recognize most leases on the balance sheet. We have operating leases covering office space, equipment, land and vehicles expiring at various dates through 2028, which would require a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, to be recognized in the statement of financial position. Lease costs would generally continue to be recognized on a straight-line basis. The future minimum payments required under our operating leases totaled $9.6 million at December 31, 2015. The ASU is effective for us on January 1, 2019.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting, which changes several aspects of the accounting for share-based payment award transactions, including accounting for income taxes, diluted shares outstanding, classification of excess tax benefits on the statement of cash flows, forfeitures and minimum statutory tax withholding requirements. This ASU is effective for us on January 1, 2017. The adoption of this guidance is not expected to have a significant effect on our consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which eliminates the probable recognition threshold for credit impairments. The new guidance broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually to include forecasted information, as well as past events and current conditions. There is no specified method for measuring expected credit losses, and an entity is allowed to apply methods that reasonably reflect its expectations of the credit loss estimate. This ASU is effective for us on January 1, 2020. Our credit loss estimates are reflected in our allowance for doubtful accounts on accounts receivables, which had a balance of $0.4 million at December 31, 2015. 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 reconciles the number of shares used in calculating basic and diluted earnings per share:

	Quarters Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands, except per share amounts)	2016	2015	2016	2015
Net income (loss)	$(31,238)	$711	$(31,081)	$6,367
Basic weighted-average shares outstanding	40,784,129	40,842,672	40,836,503	40,822,326
Incremental shares due to:				
Performance shares	—	100,915	—	92,130
Restricted stock units	—	19,901	—	18,396
Diluted weighted-average shares outstanding	40,784,129	40,963,488	40,836,503	40,932,852
Basic net income (loss) per share	$(0.77)	$0.02	$(0.76)	$0.16
Diluted net income (loss) per share	$(0.77)	$0.02	$(0.76)	$0.16

No dilutive potential shares were included in the computation of diluted net income (loss) per share for the three and six months ended 2016 due to the net loss. For the three months ended June 30, 2016 and 2015, there were 107,769 and 1,000 stock-based awards that were excluded from the calculation of diluted earnings per share because they were anti-dilutive. For the six months ended June 30, 2016 and 2015, there were 67,846 and 80,726 anti-dilutive stock-based awards. Anti-dilutive stock-based awards could be dilutive in future periods.

We repurchased 169,625 shares of common stock during the quarter at an average price of $35.08 per share totaling $6.0 million. The shares were retired and the excess repurchase price over par was allocated to accumulated deficit.

NOTE 4. CERTAIN BALANCE SHEET COMPONENTS

INVENTORIES

(Dollars in thousands)	June 30, 2016	December 31, 2015
Inventories:		
Logs	$4,882	$ 9,920
Lumber, plywood and veneer	16,533	16,932
Materials and supplies	8,630	8,310
Total inventories	$30,045	$ 35,162

PROPERTY, PLANT AND EQUIPMENT

(Dollars in thousands)	June 30, 2016	December 31, 2015
Property, plant and equipment	$250,502	$ 248,750

Less: accumulated depreciation	(175,944)	(173,465)
Total property, plant and equipment, net	$74,558	$ 75,285

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NOTE 5. LOSS ON SALE OF CENTRAL IDAHO TIMBER AND TIMBERLANDS

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

The asset group was classified as held and used as of March 31, 2016. Neither a signed letter of intent, nor an approved purchase agreement were in place as of that date. Because negotiations were underway with the buyer at the end of the first quarter, we believed that it was prudent to complete an undiscounted cash flow analysis to determine whether the asset group was impaired. Given the long period of time over which cash flows would be generated in the hold scenario and management's belief that the likelihood that a sale would be completed was 20%, the undiscounted cash flows significantly exceeded the book basis of the asset group. Therefore, at March 31, 2016 management concluded that the asset group was not impaired and recorded the loss on sale in the second quarter of 2016.

NOTE 6. DEBT

In February 2016, we amended our term loan agreement to provide an additional loan in the amount of $27.5 million. This additional tranche refinanced $27.5 million of long-term debt that matured in December 2015 and February 2016. The new debt matures in 2026 and carries a rate equal to 3-month LIBOR plus 2.15% per annum.

In June 2016, we repaid $42.6 million of revenue bonds. The bonds carried a rate of 5.9% and had a maturity date in 2026.

NOTE 7. DERIVATIVE INSTRUMENTS

From time to time, we enter into derivative financial instruments to manage certain cash flow and fair value risks. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset or liability to a particular risk, such as interest rate risk, are considered fair value hedges. We have seven fair value interest rate swaps to convert interest payments on fixed-rate debt to variable-rate 3-month LIBOR plus a spread.

Derivatives designated and qualifying as a hedge of the exposure to variability in the cash flows of a specific asset or liability that is attributable to a particular risk, such as interest rate risk, are considered cash flow hedges. We have one interest rate swap to convert variable-rate debt, comprised of 3-month LIBOR plus a spread, to fixed-rate debt. Our cash flow hedge is expected to be highly effective in achieving offsetting cash flows attributable to the hedged interest rate risk through the term of the hedge. Therefore, changes in the fair value of the interest rate swap are recorded as a component of other comprehensive income and will be recognized in earnings when the hedged interest rate affects earnings. The amounts paid or received on this interest rate hedge will be recognized as adjustments to interest expense. As of June 30, 2016, the amount of net losses expected to be reclassified into earnings in the next 12 months is $0.3 million.

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

		Asset Derivatives			Liability Derivatives	
		June 30,	December 31,		June 30,	December 31,
(Dollars in thousands)	Location	2016	2015	Location	2016	2015

Derivatives designated as hedging instruments:						
Interest rate contracts	Other assets, current	$82	$ 7	Long-term debt	$ 946	$ —
Interest rate contracts	Other assets, non-current	1,610	574			
Total derivatives designated as hedging instruments		$1,692	$ 581		$ 946	$ —

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

(Dollars in thousands)	Location	Quarters Ended June 30, 2016	2015	Six Months Ended June 30, 2016	2015
Derivatives designated in fair value hedging relationships:					
Realized gain on interest rate contracts[1]	Interest expense	$214	$409	$456	$788
Derivatives designated in cash flow hedging relationships:					
Gain (loss) recognized on derivative, net of tax of $(264) and $(369) (effective portion)	Other Comprehensive Income	$(490)	$—	$(654)	$—
Gain (loss) reclassified into income (effective portion)	Interest expense	(77)	—	(77)	—
Net effect on other comprehensive income (loss)		$(413)	$—	$(577)	$—

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

NOTE 8. FINANCIAL INSTRUMENTS

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

(Dollars in thousands)	June 30, 2016 Carrying Amount	Fair Value	December 31, 2015 Carrying Amount	Fair Value
Cash and short-term investments (Level 1)	$65,378	$65,378	$7,925	$7,925
Asset related to interest rate swaps (Level 2)	$1,692	$1,692	$581	$581
Liability related to interest rate swaps (Level 2)	$946	$946	$—	$—
Long-term debt, including fair value adjustments related to hedging instruments (Level 2)	$586,287	$609,232	$603,881	$626,021
Company owned life insurance asset (COLI) (Level 3)	$1,683	$1,683	$687	$687

For cash and short-term investments, the carrying amount approximates fair value due to the short-term nature of these financial instruments.

The fair value of the interest rate swaps were determined by discounting the expected cash flows of each derivative. The analysis reflects the contractual terms of the derivatives, including the period to maturity and uses observable market-based inputs, including interest rate forward curves.

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

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

NOTE 9. 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):

Quarters
Ended
June 30,