

STRATUS PROPERTIES INC
Form 10-Q
August 10, 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 June 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: 000-19989

Stratus Properties Inc.

(Exact name of registrant as specified in its charter)

Delaware

72-1211572

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification No.)

212 Lavaca St., Suite 300

Austin, Texas

78701

(Address of principal executive offices)

(Zip Code)

(512) 478-5788

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer 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 Accelerated filer Non-accelerated filer 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

On July 31, 2015, there were issued and outstanding 8,061,106 shares of the registrant's common stock, par value \$0.01 per share.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

STRATUS PROPERTIES INC.
CONSOLIDATED BALANCE SHEETS (Unaudited)
(In Thousands)

	June 30, 2015	December 31, 2014	
ASSETS			
Cash and cash equivalents	\$25,474	\$29,645	
Restricted cash	6,485	7,615	
Real estate held for sale	50,927	12,245	
Real estate under development	127,808	123,921	
Land available for development	24,151	21,368	
Real estate held for investment, net	153,099	178,065	
Investment in unconsolidated affiliates	615	795	
Deferred tax assets	9,934	11,759	
Other assets	18,211	17,274	
Total assets	\$416,704	\$402,687	
LIABILITIES AND EQUITY			
Liabilities:			
Accounts payable	\$11,590	\$8,076	
Accrued liabilities	7,894	9,670	
Debt	210,758	196,477	
Other liabilities and deferred gain	8,729	13,378	
Total liabilities	238,971	227,601	
Commitments and contingencies			
Equity:			
Stratus stockholders' equity:			
Common stock	91	91	
Capital in excess of par value of common stock	204,546	204,269	
Accumulated deficit	(45,698)	(47,321))
Accumulated other comprehensive loss	(265)	(279))
Common stock held in treasury	(20,470)	(20,317))
Total stockholders' equity	138,204	136,443	
Noncontrolling interests in subsidiaries	39,529	38,643	
Total equity	177,733	175,086	
Total liabilities and equity	\$416,704	\$402,687	

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)
(In Thousands, Except Per Share Amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Revenues:				
Hotel	\$ 11,054	\$ 10,560	\$ 22,673	\$ 21,372
Entertainment	4,995	3,513	9,304	9,000
Real estate operations	2,234	6,824	4,710	12,255
Commercial leasing	1,703	1,624	3,524	3,193
Total revenues	19,986	22,521	40,211	45,820
Cost of sales:				
Hotel	8,295	7,641	16,377	15,273
Entertainment	3,688	2,515	7,091	6,536
Real estate operations	2,011	4,682	4,121	8,500
Commercial leasing	959	703	1,700	1,404
Depreciation	2,346	2,225	4,650	4,472
Total cost of sales	17,299	17,766	33,939	36,185
General and administrative expenses	2,145	1,959	4,121	4,021
Insurance settlement	—	(46	) —	(576
Total costs and expenses	19,444	19,679	38,060	39,630
Operating income	542	2,842	2,151	6,190
Interest expense, net	(1,031	) (974	) (1,881	) (1,823
Loss on interest rate cap agreement	(13	) (170	) (68	) (251
Other income, net	285	3	289	22
(Loss) income before income taxes and equity in unconsolidated affiliates' (loss) income	(217	) 1,701	491	4,138
Equity in unconsolidated affiliates' (loss) income	(239	) (243	) (118	) 438
Benefit from (provision for) income taxes	216	(194	) (47	) (420
(Loss) income from continuing operations	(240	) 1,264	326	4,156
Income from discontinued operations, net of taxes	—	—	3,218	—
Net (loss) income	(240	) 1,264	3,544	4,156
Net income attributable to noncontrolling interests in subsidiaries	(879	) (1,045	) (1,921	) (2,840
Net (loss) income attributable to common stock	\$(1,119	) \$219	\$1,623	\$1,316
Basic and diluted net (loss) income per share attributable to common stockholders:				
Continuing operations	\$(0.14	) \$0.03	\$(0.20	) \$0.16
Discontinued operations	\$—	\$—	\$0.40	\$—
Basic and diluted net (loss) income per share attributable to common stockholders	\$(0.14	) \$0.03	\$0.20	\$0.16
Weighted-average shares of common stock outstanding:				
Basic	8,061	8,030	8,051	8,040
Diluted	8,061	8,068	8,081	8,085

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME (Unaudited)
 (In Thousands)

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2015	2014	2015	2014	
Net (loss) income	\$ (240	) \$ 1,264	\$ 3,544	\$ 4,156
Other comprehensive loss, net of taxes:					
Gain (loss) on interest rate swap agreement	182	(229) 19	(435)
Other comprehensive loss	182	(229) 19	(435)
Total comprehensive (loss) income	(58	) 1,035	3,563	3,721
Total comprehensive income attributable to noncontrolling interests	(952) (975) (1,926) (2,709)
Total comprehensive (loss) income attributable to common stock	\$ (1,010	) \$ 60	\$ 1,637	\$ 1,012

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In Thousands)

	Six Months Ended		
	June 30,		
	2015	2014	
Cash flow from operating activities:			
Net income	\$3,544	\$4,156	
Adjustments to reconcile net income to net cash used in operating activities:			
Depreciation	4,650	4,472	
Cost of real estate sold	2,098	6,081	
Deferred gain on sale of 7500 Rialto	(5,000)) —	
Stock-based compensation	269	220	
Equity in unconsolidated affiliates' income	118	(438))
Deposits	82	(101))
Deferred income taxes	1,829	—	
Purchases and development of real estate properties	(15,703)	) (24,817))
Municipal utility district reimbursement	5,307	—	
Decrease in other assets	193	1,093	
Increase (decrease) in accounts payable, accrued liabilities and other	2,022	(1,233))
Net cash used in operating activities	(591)	) (10,567))
Cash flow from investing activities:			
Capital expenditures	(16,740)	) (953))
Return of investment in unconsolidated affiliates	62	1,345	
Net cash (used in) provided by investing activities	(16,678)	) 392)
Cash flow from financing activities:			
Borrowings from credit facility	23,500	23,500	
Payments on credit facility	(15,366)	) (6,828))
Borrowings from project loans	15,810	6,000	
Payments on project and term loans	(9,662)	) (5,067))
Net payments for stock-based awards, including excess tax benefit	(144)	) (190))
Noncontrolling interests distributions	(1,040)	) (3,581))
Repurchase of treasury stock	—	(637))
Financing costs	—	(69))
Net cash provided by financing activities	13,098	13,128	
Net (decrease) increase in cash and cash equivalents	(4,171)	) 2,953)
Cash and cash equivalents at beginning of year	29,645	21,307	
Cash and cash equivalents at end of period	\$25,474	\$24,260	

The accompanying Notes to Consolidated Financial Statements (Unaudited), which include information regarding noncash transactions, are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.
CONSOLIDATED STATEMENTS OF EQUITY (Unaudited)
(In Thousands)

	Stratus Stockholders' Equity									
	Common Stock Number of Shares	At Par Value	Capital in Excess of Par Value	Accum- ulated Deficit	Accum- ulated Other Compre- hensive Loss	Common Stock Held in Treasury Number of Shares	At Cost	Total Stratus Stockholders' Equity	Noncontrolling Interests in Subsidiaries	Total Equity
Balance at December 31, 2014	9,116	\$91	\$204,269	\$(47,321)	\$(279)	1,081	\$(20,317)	\$136,443	\$38,643	\$175,086
Exercised and issued stock-based awards	37	—	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	269	—	—	—	—	269	—	269
Tax benefit for stock-based awards	—	—	8	—	—	—	—	8	—	8
Tender of shares for stock-based awards	—	—	—	—	—	12	(153)	(153)	—	(153)
Noncontrolling interests distributions	—	—	—	—	—	—	—	—	(1,040)	(1,040)
Total comprehensive income	—	—	—	1,623	14	—	—	1,637	1,926	3,563
Balance at June 30, 2015	9,153	\$91	\$204,546	\$(45,698)	\$(265)	1,093	\$(20,470)	\$138,204	\$39,529	\$177,733
Balance at December 31, 2013	9,076	\$91	\$203,724	\$(60,724)	\$(22)	1,030	\$(19,448)	\$123,621	\$45,695	\$169,316
Common stock repurchases	—	—	—	—	—	37	(637)	(637)	—	(637)
Exercised and issued stock-based awards	31	—	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	220	—	—	—	—	220	—	220
Tender of shares for stock-based awards	—	—	—	—	—	11	(190)	(190)	—	(190)

Noncontrolling interests distributions	—	—	—	—	—	—	—	—	(3,581)	(3,581)
Total comprehensive income (loss)	—	—	—	1,316	(304)	—	—	1,012	2,709	3,721
Balance at June 30, 2014	9,107	\$91	\$203,944	\$(59,408)	\$(326)	1,078	\$(20,275)	\$124,026	\$44,823	\$168,849

The accompanying Notes to Consolidated Financial Statements (Unaudited) are an integral part of these consolidated financial statements.

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STRATUS PROPERTIES INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. GENERAL

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2014, included in Stratus Properties Inc.'s (Stratus) Annual Report on Form 10-K (Stratus 2014 Form 10-K) filed with the Securities and Exchange Commission. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary for a fair statement of the results for the interim periods reported. Operating results for the three-month and six-month periods ended June 30, 2015, are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

2. EARNINGS PER SHARE

Stratus' basic net (loss) income per share of common stock was calculated by dividing the net (loss) income attributable to common stock by the weighted-average shares of common stock outstanding during the second-quarter and six-month periods. A reconciliation of net (loss) income and weighted-average shares of common stock outstanding for purposes of calculating diluted net (loss) income per share (in thousands, except per share amounts) follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net (loss) income	\$(240)	\$1,264	\$3,544	\$4,156
Net income attributable to noncontrolling interests in subsidiaries	(879)	(1,045)	(1,921)	(2,840)
Net (loss) income attributable to Stratus common stock	\$(1,119)	\$219	\$1,623	\$1,316
Weighted-average shares of common stock outstanding	8,061	8,030	8,051	8,040
Add shares issuable upon exercise or vesting of:				
Dilutive stock options	—	15	6	15
Restricted stock units	—	^a 23	24	^a 30
Weighted-average shares of common stock outstanding for purposes of calculating diluted net (loss) income per share	8,061	8,068	8,081	8,085
Diluted net (loss) income per share attributable to common stock	\$(0.14)	\$0.03	\$0.20	\$0.16

a. Excludes shares of common stock totaling approximately 26 thousand for second-quarter 2015 and 31 thousand for the first six months of 2015 associated with anti-dilutive RSUs.

Outstanding stock options with exercise prices greater than the average market price for Stratus' common stock during the period are excluded from the computation of diluted net income per share of common stock. Excluded stock options totaled approximately 25 thousand for second-quarter 2015, 26 thousand for the first six months of 2015, and 28 thousand for both second-quarter and the first six months of 2014.

3. JOINT VENTURE WITH CANYON-JOHNSON URBAN FUND II, L.P.

Stratus and Canyon-Johnson Urban Fund II, L.P. (Canyon-Johnson) are participants in the CJUF II Stratus Block 21, LLC joint venture (the Block 21 Joint Venture) for a 36-story mixed-use development in downtown Austin, Texas, anchored by W Hotel & Residences (the W Austin Hotel & Residences project). Stratus is the manager of, and has an

approximate 40 percent interest in, the Block 21 Joint Venture, and Canyon-Johnson has an approximate 60 percent interest. As of June 30, 2015, cumulative capital contributions totaled \$71.9 million for Stratus and \$94.0 million for Canyon-Johnson. Distributions totaled \$0.8 million to Stratus and \$1.0 million to Canyon-Johnson for both second-quarter and the first six months of 2015. As of June 30, 2015, the inception-to-date distributions totaled \$53.4 million to Stratus and \$62.6 million to Canyon-Johnson.

Upon formation of the Block 21 Joint Venture and at reconsideration events defined by accounting guidance, Stratus performed evaluations and concluded that the Block 21 Joint Venture was a variable interest entity and that Stratus is the primary beneficiary. Stratus will continue to evaluate which entity is the primary beneficiary of the Block 21 Joint Venture in accordance with applicable accounting guidance. See Note 2 in the Stratus 2014 Form 10-K for further discussion.

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Stratus' consolidated balance sheets include the following assets and liabilities of the Block 21 Joint Venture (in thousands):

	June 30, 2015	December 31, 2014
Assets:		
Cash and cash equivalents	\$21,222	\$17,319
Restricted cash	6,135	7,090
Real estate held for investment, net	147,721	151,078
Other assets	6,407	6,042
Total assets	181,485	181,529
Liabilities:		
Accounts payable	2,915	2,859
Accrued liabilities	5,376	6,901
Debt	97,492	98,267
Other liabilities	6,267	5,346
Total liabilities	112,050	113,373
Net assets	\$69,435	\$68,156

Profits and losses among partners in a real estate venture are allocated based on how changes in net assets of the venture would affect cash payments to the partners over the life of the venture and on its liquidation. The amount of the ultimate profits earned by the Block 21 Joint Venture will affect the ultimate profit sharing ratios because of provisions in the joint venture agreement, which would require Stratus to return certain previously received distributions to Canyon-Johnson under certain circumstances. Because of the uncertainty of the ultimate profits and, therefore, profit-sharing ratios, the Block 21 Joint Venture's cumulative profits or losses are allocated based on a hypothetical liquidation of the Block 21 Joint Venture's net assets as of each balance sheet date. As of June 30, 2015, the cumulative earnings of the Block 21 Joint Venture were allocated based on 42 percent for Stratus and 58 percent for Canyon-Johnson.

On July 6, 2015, Stratus notified Canyon-Johnson of its election to purchase Canyon-Johnson's interest in the Block 21 Joint Venture for \$60.9 million. Canyon-Johnson triggered the process on May 12, 2015, requiring Stratus to elect to either sell its interest in the joint venture to Canyon-Johnson for \$44.5 million or purchase Canyon-Johnson's interest in the joint venture for \$60.9 million. In accordance with the terms of the joint venture's operating agreement, closing, which is subject to customary conditions, will occur no later than November 10, 2015. The purchase will be made in connection with the refinancing of the W Austin Hotel & Residences project, which is currently being negotiated. Upon completion of the purchase transaction, Stratus will own 100 percent of and will continue to consolidate the Block 21 Joint Venture. The change in ownership will be reflected in stockholder's equity on the Consolidated Balance Sheet.

4. FAIR VALUE MEASUREMENTS

Fair value accounting guidance includes a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

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The carrying value for certain Stratus financial instruments (i.e., cash and cash equivalents, restricted cash, accounts payable and accrued liabilities) approximates fair value because of their short-term nature and generally negligible credit losses. A summary of the carrying amount and fair value of Stratus' other financial instruments follows (in thousands):

	June 30, 2015		December 31, 2014	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Interest rate cap agreement	\$10	\$10	\$79	\$79
Liabilities:				
Interest rate swap agreement	581	581	596	596
Debt	210,758	210,899	196,477	196,856

Interest Rate Cap Agreement. On September 30, 2013, the Block 21 Joint Venture paid \$0.5 million to enter into an interest rate cap agreement, which caps the one-month London Interbank Offered Rate (LIBOR), the variable rate in the Bank of America loan agreement relating to the W Austin Hotel & Residences project (the BoA loan), at 1 percent for the first year the BoA loan is outstanding, 1.5 percent for the second year and 2 percent for the third year. Stratus uses an interest rate pricing model that relies on market observable inputs such as LIBOR to measure the fair value of the interest rate cap agreement. Stratus also evaluated the counterparty credit risk associated with the interest rate cap agreement, which is considered a Level 3 input, but did not consider such risk to be significant. Therefore, the interest rate cap agreement is classified within Level 2 of the fair value hierarchy.

Interest Rate Swap Agreement. On December 13, 2013, Stratus' joint venture with LCHM Holdings, LLC, formerly Moffett Holdings, LLC, for the development of Parkside Village (the Parkside Village Joint Venture), entered into an interest rate swap agreement with Comerica Bank that effectively converts the variable rate portion of Parkside Village's loan from Comerica Bank (the Parkside Village loan) from one-month LIBOR to a fixed rate of 2.3 percent. With the interest rate swap agreement in place, the Parkside Village Joint Venture's interest cost on the Parkside Village loan will be 4.8 percent through the December 31, 2020, maturity date. Stratus also evaluated the counterparty credit risk associated with the interest rate swap agreement, which is considered a Level 3 input, but did not consider such risk to be significant. Therefore, the interest rate swap agreement is classified within Level 2 of the fair value hierarchy.

On July 2, 2015, Stratus completed the sale of the Parkside Village property. In connection with the sale, Stratus fully repaid the amount outstanding under the Parkside Village loan. See Note 10 for further discussion.

Debt. Stratus' debt is recorded at cost and is not actively traded. Fair value is estimated based on discounted future expected cash flows at estimated current market interest rates. Accordingly, Stratus' debt is classified within Level 2 of the fair value hierarchy. The fair value of debt does not represent the amounts that will ultimately be paid upon the maturities of the loans.

5. DEBT

Tecoma Construction Loan. On January 8, 2015, a Stratus subsidiary entered into a \$34.1 million construction loan agreement with Comerica Bank to fund the development and construction of the first phase of a multi-family development in Section N of Barton Creek, which is referred to as the Tecoma Barton Creek multi-family project (the Tecoma construction loan). The interest rate on the Tecoma construction loan is a LIBOR-based rate (as defined in the loan agreement) plus 2.5 percent. The Tecoma construction loan matures on January 8, 2018, and Stratus has the option to extend the maturity date for two additional twelve-month periods, subject to certain debt service coverage conditions. The Tecoma construction loan is fully guaranteed by Stratus until certain operational milestones (as

defined in the loan agreement) are met.

Interest Expense and Capitalization. Interest expense (before capitalized interest) totaled \$2.3 million for second-quarter 2015, \$1.9 million for second-quarter 2014, \$4.6 million for the first six months of 2015, and \$3.6 million for the first six months of 2014. Stratus' capitalized interest costs totaled \$1.3 million for second-quarter 2015, \$1.0 million for second-quarter 2014, \$2.7 million for the first six months of 2015, and \$1.8 million for the first six months of 2014. Capitalized interest costs for the 2015 and 2014 periods primarily related to development activities at Lakeway and certain properties in Barton Creek.

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6. INCOME TAXES

Stratus' accounting policy for and other information regarding its income taxes is further described in Notes 1 and 8 in the Stratus 2014 Form 10-K.

Stratus had deferred tax assets (net of deferred tax liabilities) totaling \$9.9 million at June 30, 2015, and \$11.8 million at December 31, 2014. Stratus' future results of operations may be negatively impacted by an inability to realize a tax benefit for future tax losses or for items that will generate additional deferred tax assets.

The difference between Stratus' consolidated effective income tax rate for second-quarter and the first six months of 2015, and the U.S. Federal statutory income tax rate of 35 percent, was primarily attributable to state income taxes offset by the tax effect of income attributable to noncontrolling interests. During the first six months of 2014, Stratus was subject to state income taxes while maintaining a valuation allowance against its deferred tax assets related to federal income taxes. During fourth-quarter 2014, Stratus released the valuation allowance and recorded a tax benefit.

7. BUSINESS SEGMENTS

Stratus currently has four operating segments: Real Estate Operations, Hotel, Entertainment and Commercial Leasing.

The Real Estate Operations segment is comprised of Stratus' real estate assets (developed, under development and available for development), which consist of its properties in Austin, Texas (the Barton Creek community, the Circle C community, Lantana and the condominium units at the W Austin Hotel & Residences project); in Lakeway, Texas (The Oaks at Lakeway) located in the greater Austin area; and in Magnolia, Texas located in the greater Houston area.

The Hotel segment includes the W Austin Hotel located at the W Austin Hotel & Residences project.

The Entertainment segment includes ACL Live, a live music and entertainment venue and production studio at the W Austin Hotel & Residences project. In addition to hosting concerts and private events, this venue is the