RAYONIER ADVANCED MATERIALS INC.
Form 10-Q
November 04, 2014

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 September 27, 2014

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 001-36285
RAYONIER ADVANCED MATERIALS INC.
Incorporated in the State of Delaware
I.R.S. Employer Identification No. 46-4559529
1301 RIVERPLACE BOULEVARD, SUITE 2300
JACKSONVILLE, FL 32207
(Principal Executive Office)
Telephone Number: (904) 357-4600

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 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	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 registrant had 42,653,189 shares of common stock, $.01 par value per share, outstanding as of October 22, 2014,

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

RAYONIER ADVANCED MATERIALS INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 27, 2014	September 30, 2013	September 27, 2014	September 30, 2013
NET SALES	$253,695	$225,523	$709,725	$764,876
COST OF SALES	198,006	158,147	546,942	515,842
GROSS MARGIN	55,689	67,376	162,783	249,034
Selling and general expenses	9,493	8,144	26,730	26,894
Other operating expense (income), net	4,518	(144)	44,800	3,761
OPERATING INCOME	41,678	59,376	91,253	218,379
Interest expense	(9,469)	—	(12,694)	—
Interest and miscellaneous (expense) income, net	(57)	292	(62)	292
INCOME BEFORE INCOME TAXES	32,152	59,668	78,497	218,671
Income tax expense	(12,744)	(19,702)	(23,580)	(49,704)
NET INCOME	$19,408	$39,966	$54,917	$168,967
EARNINGS PER SHARE OF COMMON STOCK (Note 10)				
Basic earnings per share	$0.46	$0.95	$1.30	$4.01
Diluted earnings per share	$0.46	$0.95	$1.30	$4.01
DIVIDENDS DECLARED PER SHARE	$0.07	$—	$0.07	$—
COMPREHENSIVE INCOME:				
NET INCOME	$19,408	$39,966	$54,917	$168,967
OTHER COMPREHENSIVE INCOME				
Net gain (loss) from pension and postretirement plans, net of income tax (expense) benefit of ($2,779), ($734), $501 and ($2,299)	4,834	1,280	(871)	3,999
Total other comprehensive income (loss)	4,834	1,280	(871)	3,999
COMPREHENSIVE INCOME	$24,242	$41,246	$54,046	$172,966

See Notes to Condensed Consolidated Financial Statements.

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RAYONIER ADVANCED MATERIALS INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands)

	September 27, 2014	December 31, 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$28,163	$—
Accounts receivable, less allowance for doubtful accounts of $151 and $140	93,266	71,097
Inventory	122,141	128,706
Deferred tax assets	11,206	22,532
Prepaid and other current assets	43,856	23,720
Total current assets	298,632	246,055
TOTAL PROPERTY, PLANT AND EQUIPMENT, GROSS	2,000,820	1,955,953
LESS — ACCUMULATED DEPRECIATION	(1,156,378)	(1,109,665)
TOTAL PROPERTY, PLANT AND EQUIPMENT, NET	844,442	846,288
OTHER ASSETS (Note 16)	103,276	27,923
TOTAL ASSETS	$1,246,350	$1,120,266
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY		
CURRENT LIABILITIES		
Accounts payable	$49,804	$54,198
Current maturities of long-term debt	8,400	—
Accrued taxes	5,099	1,867
Accrued payroll and benefits	22,161	10,814
Accrued interest	10,855	—
Accrued customer incentives	14,921	7,728
Other current liabilities	12,543	5,239
Current liabilities for disposed operations (Note 14)	7,515	—
Total current liabilities	131,298	79,846
LONG-TERM DEBT	938,471	—
NON-CURRENT LIABILITIES FOR DISPOSED OPERATIONS (Note 14)	84,193	—
PENSION AND OTHER POSTRETIREMENT BENEFITS (Note 9)	98,285	21,793
DEFERRED INCOME TAXES	—	49,224
OTHER NON-CURRENT LIABILITIES	7,547	1,102
COMMITMENTS AND CONTINGENCIES (Notes 8 and 12)		
STOCKHOLDERS' (DEFICIT) EQUITY		
Preferred stock, 10,000,000 shares authorized at $0.01 par value, 0 issued and outstanding as of September 27, 2014 and December 31, 2013	—	—
Common stock, 140,000,000 shares authorized at $0.01 par value, 42,653,189 and 0 issued and outstanding, as of September 27, 2014 and December 31, 2013, respectively	427	—
Additional paid-in capital	57,358	—
Retained earnings	4,760	1,415,894
Transfers to Rayonier, net	—	(407,894)
Accumulated other comprehensive loss	(75,989)	(39,699)
TOTAL STOCKHOLDERS' (DEFICIT) EQUITY	(13,444)	968,301
TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	$1,246,350	$1,120,266

See Notes to Condensed Consolidated Financial Statements.

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RAYONIER ADVANCED MATERIALS INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Nine Months Ended	
	September 27, 2014	September 30, 2013
OPERATING ACTIVITIES		
Net income	$54,917	$168,967
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	62,115	51,142
Stock-based incentive compensation expense	5,614	4,845
Amortization of capitalized debt costs	550	—
Deferred income taxes	760	(12,027)
Increase in liabilities for disposed operations	20,019	—
Amortization of losses and prior service costs from pension and postretirement plans	5,662	6,298
Loss from sale/disposal of property, plant and equipment	988	1,260
Other	—	(583)
Changes in operating assets and liabilities:		
Receivables	(21,405)	(18,780)
Inventories	6,565	(1,918)
Accounts payable	(10,556)	10,263
Accrued liabilities	24,979	1,966
All other operating activities	(20,356)	(22,623)
Expenditures for disposed operations	(2,151)	—
CASH PROVIDED BY OPERATING ACTIVITIES	127,701	188,810
INVESTING ACTIVITIES		
Capital expenditures	(60,214)	(81,540)
Purchase of timber deeds	(12,692)	—
Purchase of land	(1,528)	—
Jesup plant cellulose specialties expansion	—	(137,392)
Other	(1,450)	(1,335)
CASH USED FOR INVESTING ACTIVITIES	(75,884)	(220,267)
FINANCING ACTIVITIES		
Issuance of debt	1,025,000	—
Repayment of debt	(77,100)	—
Proceeds from the issuance of common stock	549	—
Debt issuance costs	(15,432)	—
Common stock repurchased	(92)	—
Net payments (to) from Rayonier	(956,579)	31,457
CASH (USED FOR) PROVIDED BY FINANCING ACTIVITIES	(23,654)	31,457
CASH AND CASH EQUIVALENTS		
Change in cash and cash equivalents	28,163	—
Balance, beginning of year	—	—
Balance, end of period	$28,163	$—
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period:		
Interest	$1,881	$—

Income taxes	$18,350	$—
Non-cash investing and financing activities:		
Capital assets purchased on account	$7,935	$27,394

See Notes to Condensed Consolidated Financial Statements.

RAYONIER ADVANCED MATERIALS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

1. SEPARATION AND BASIS OF PRESENTATION

The Separation

On May 27, 2014, the board of directors of Rayonier Inc. (“Rayonier”) approved the separation of its performance fibers segment from Rayonier to form an independent, publicly traded corporation named Rayonier Advanced Materials Inc. (“Rayonier Advanced Materials” or “the Company”). Subsequently, the Company entered into a separation and distribution agreement with Rayonier (the “Separation Agreement”), whereby Rayonier agreed to distribute 100% of the outstanding common stock of the Company to Rayonier shareholders in a tax-free distribution (the “Distribution”). As a condition to the Distribution, Rayonier received a private letter ruling from the Internal Revenue Service to the effect that, based on certain facts, assumptions, representations and undertakings set forth in the ruling, for U.S. federal income tax purposes, the Distribution of the Company’s stock was not taxable to Rayonier or U.S. holders of Rayonier common shares, except in respect to cash received in lieu of fractional share interests. A registration statement on Form 10 (the “Form 10”), as amended through the time of its effectiveness, was filed by the Company with the U.S. Securities and Exchange Commission (the “SEC”) and was declared effective on June 13, 2014.

The Distribution was made on June 27, 2014 to Rayonier shareholders of record as of the close of business on June 18, 2014. Holders of Rayonier common shares received one share of the Company’s common stock for every three Rayonier common shares held on the record date. This resulted in the distribution of 42,176,565 shares of the Company’s common stock to Rayonier shareholders after the market closed on June 27, 2014. In addition, the Company made special cash distributions to Rayonier in an aggregate amount of $906.2 million and, as between Rayonier and the Company, assumed certain liabilities associated with pension, other post-retirement employee benefits and environmental remediation. After consideration of the cash retained by the Company at the date of Distribution, as well as cash flow impacts for the six months ending June 27, 2014, the net distribution to Rayonier was $956.6 million.

Following the Distribution, Rayonier retained no equity ownership interest in the Company, and each company now has independent public ownership, boards of directors and management.

Separation Costs

For the nine months ended September 27, 2014, the Company recorded separation costs of $19.4 million within other operating expenses, consisting mostly of professional service fees within the finance, legal and information system functions.

Basis of Presentation

The unaudited condensed consolidated financial statements and notes thereto of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the rules and regulations of the SEC. In the opinion of management, these financial statements and notes reflect all adjustments (all of which are normal recurring adjustments) necessary for a fair presentation of the results of operations, financial position and cash flows for the periods presented. These statements and notes should be read in conjunction with the financial statements and supplementary data included in the Company’s Audited Combined Financial Statements for the year ended December 31, 2013, which is included in our Form 10, as well as in conjunction with the interim financial information in our report on Form 10-Q for the quarterly period ended June 28, 2014. The results of operations for the three and nine months ended September 27, 2014, are not necessarily indicative of the results to be expected for the full year.

Prior to the Distribution, the Company’s results of operations, financial position and cash flows consisted of the performance fibers segment of Rayonier and an allocable portion of its corporate costs (together, the “performance fibers business”). These financial statements have been presented as if the performance fibers business had been combined for all periods presented. All intercompany transactions are eliminated. Historically, financial statements have not been prepared for the performance fibers business. The accompanying financial statements for the Company have been derived from the historical accounting records of Rayonier.

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RAYONIER ADVANCED MATERIALS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

The statements of income for periods prior to the Distribution include allocations of certain costs from Rayonier related to the operations of the Company. These corporate administrative costs were charged to the Company based on employee headcount and payroll costs. The combined statements of income also include expense allocations for certain corporate functions historically performed by Rayonier and not allocated to its operating segments. These allocations were based on revenues and specific identification of time and/or activities associated with the Company. Management believes the methodologies employed for the allocation of costs were reasonable in relation to the historical reporting of Rayonier, but may not necessarily be indicative of costs had the Company operated on a stand-alone basis during the periods prior to the Distribution, nor what the costs may be in the future.

Fiscal Year

Prior to the Distribution, the Company’s quarter and fiscal year end was the last day of the calendar quarter and calendar year, respectively. In connection with the Distribution, the Company changed its interim reporting periods to the last Saturday of the fiscal quarter. The Company’s fiscal year end will remain the last day of the calendar year. As the effect on prior interim period results were not material, prior periods have not been revised.

New or Recently Adopted Accounting Pronouncements

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The standard requires a disposal of a component of an entity to be reported in discontinued operations if it represents a strategic shift with a major effect on an entity’s operations and financial results. It also removes requirements related to the evaluation of the component’s effect on ongoing operations and the entity’s continuing involvement with the component. Additional disclosures about discontinued operations are also required under this standard. ASU No. 2014-08 is required to be applied prospectively for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning December 15, 2014. Early adoption is permitted for disposals (or classifications as held for sale) that have not been previously reported. The Company does not expect the adoption of this standard will have a material impact on the consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, a comprehensive new revenue recognition standard. This standard will supersede virtually all current revenue recognition guidance. The core principle is that a company will recognize revenue when it transfers goods or services to customers in an amount that reflects consideration to which the company expects to be entitled to in exchange for those goods or services. This standard will be effective for the Company’s first quarter 2017 Form 10-Q filing with full or modified retrospective adoption permitted. The Company is currently evaluating the impact of this standard on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This standard requires a performance target that affects vesting and that could be achieved after the requisite service period to be treated as a performance condition. The current accounting standard for stock-based compensation as it applies to awards with performance conditions should be applied. This guidance is effective for fiscal years, including interim reporting periods, beginning after December 15, 2015, and is applicable to the Company's fiscal year beginning January 1, 2016. The Company is currently evaluating this guidance, but does not expect the adoption of this standard will have a material impact to its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern, to provide guidance on management’s responsibility in evaluating whether there is substantial doubt about a company’s ability to continue as a going concern and to provide related footnote disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016 with early adoption permitted. The Company does not expect the adoption of this standard will have a material impact on the consolidated financial statements.

Subsequent Events

The Company signed a one-year contract extension with Nantong Cellulose Fibers Co., Ltd., a significant customer. A report on Form 8-K was filed on October 20, 2014 with the SEC, in respect to this event.

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RAYONIER ADVANCED MATERIALS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

2. RELATED PARTY TRANSACTIONS

As discussed in Note 1 — Separation and Basis of Presentation, for periods prior to the Distribution, the Consolidated Statements of Income and Comprehensive Income include expense allocations for certain corporate functions historically performed by Rayonier and not allocated to its operating segments, including general corporate expenses related to executive oversight, accounting, treasury, tax, legal, human resources and information technology. Net charges from Rayonier for these services, reflected in selling and general expenses in the Condensed Consolidated Statements of Income and Comprehensive Income were $0 and $3.5 million for the three months ended September 27, 2014, and September 30, 2013, respectively, and $8.0 million and $12.5 million for the nine months ended September 27, 2014 and September 30, 2013, respectively.

For periods prior to the Distribution, the Consolidated Statements of Income and Comprehensive Income also include allocations of certain costs from Rayonier related to the operations of the Company including: medical costs for active salaried and retired employees, worker’s compensation, general liability and property insurance, salaried payroll costs, equity based compensation and a pro-rata share of direct corporate administration expense for accounting, human resource services and information system maintenance. Net charges from Rayonier for these costs, reflected in the Condensed Consolidated Statements of Income and Comprehensive Income were $0 and $12.7 million for the three months ended September 27, 2014 and September 30, 2013, respectively, and $27.3 million and $38.3 million for the nine months ended September 27, 2014 and September 30, 2013, respectively.

3. INCOME TAXES

In connection with the Separation, the Company entered into a tax matters agreement with Rayonier. The agreement governs the parties’ respective rights, responsibilities and obligations with respect to taxes for any period (or portion thereof) ending on or before the Distribution. Generally, Rayonier Advanced Materials is liable for all pre-distribution U.S. federal income taxes, state taxes and non-income taxes attributable to Rayonier’s former performance fibers business.

The Company’s effective tax rate for the third quarter of 2014 was 39.6 percent compared with 33.0 percent for the corresponding period of 2013. The effective tax rate differs from the federal statutory rate of 35 percent primarily due to the manufacturing tax credit, state taxes and nondeductible expenses.

The Company’s effective tax rate for the first nine months of 2014 was 30.0 percent compared with 23.0 percent for the corresponding period of 2013. The effective tax rate differs from the federal statutory rate of 35 percent primarily due to the reversal of a tax reserve related to the taxability of the cellulosic biofuel producer credit (“CBPC”) for 2014 and the alternative fuel mixture credit (“AFMC”) for the CBPC exchange for 2013.

The provision for income taxes for periods prior to the Distribution has been computed as if the Company were a stand-alone company.

4. INVENTORY

As of September 27, 2014 and December 31, 2013, the Company’s inventory included the following:

	September 27, 2014	December 31, 2013
Finished goods	$97,777	$105,398
Work in progress	3,569	3,555
Raw materials	17,900	17,420
Manufacturing and maintenance supplies	2,895	2,333
Total inventory	$122,141	$128,706

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RAYONIER ADVANCED MATERIALS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

5.STOCKHOLDERS' (DEFICIT) EQUITY
An analysis of stockholders' (deficit) equity for the nine months ended September 27, 2014 and the year ended December 31, 2013 is shown below (share amounts not in thousands):

	Common Stock			Retained	Transfers	Accumulated	Total
	Shares	Par Value	Additional Paid in Capital	Earnings (Accumulated Deficit)	(to) from Rayonier, net	Other Comprehensive Loss	Stockholders' (Deficit) Equity
Balance, December 31, 2012	—	$—	$—	$ 1,196,127	$ (406,753)	$ (64,670)	$ 724,704
Net income	—	—	—	219,767	—	—	219,767
Net gain from pension and postretirement plans	—	—	—	—	—	24,971	24,971
Net transfers to Rayonier	—	—	—	—	(1,141)	—	(1,141)
Balance, December 31, 2013	—	$—	$—	$ 1,415,894	$ (407,894)	$ (39,699)	$ 968,301
Net income	—	—	—	54,917	—	—	54,917
Net loss from pension and postretirement plans	—	—	—	—	—	(871)	(871)
Net transfers to Rayonier	—	—	—	—	(1,001,509)	(35,419)	(1,036,928)
Reclassification to additional paid-in capital at distribution date	—	—	53,696	(1,463,099)	1,409,403	—	—
Issuance of common stock at the separation	42,176,565	422	(422)	—	—	—	—
Issuance of common stock under incentive stock plans	477,234	5	544	—	—	—	549
Stock-based compensation	—	—	2,052				2,052
Repurchase of common stock	(610)	—	(92)	—	—	—	(92)
Adjustments to tax assets and liabilities associated with the Distribution	—	—	1,580	—	—	—	1,580
Dividends ($0.07 per share)	—	—	—	(2,952)	—	—	(2,952)
Balance, September 27, 2014	42,653,189	$ 427	$ 57,358	$ 4,760	$—	$ (75,989)	$ (13,444)

Net Parent Company Investment

The following is a reconciliation of the amounts presented as “Net transfers to Rayonier” in the above table and the amounts presented as “Net payments (to) from Rayonier” on the Condensed Consolidated Statements of Cash Flows.

	Nine Months Ended	
	September 27, 2014	September 30, 2013
Allocation of costs from Rayonier (a)	$(35,279)	$(50,815)
Cash receipts received by Rayonier on Company's behalf	472,780	787,857
Cash disbursements made by Rayonier on Company's behalf	(484,318)	(700,740)
Net distribution to Rayonier on separation	(906,200)	—
Net liabilities from transfer of assets and liabilities with Rayonier (b)	(83,911)	—
Net transfers (to) from Rayonier	(1,036,928)	36,302
Non-cash adjustments:		
Stock-based compensation	(3,562)	(4,845)
Net liabilities from transfer of assets and liabilities with Rayonier (b)	83,911	—
Net payments (to) from Rayonier per the Condensed Consolidated Statements of Cash Flows, prior to separation	$(956,579)	$31,457

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RAYONIER ADVANCED MATERIALS INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)
(Dollar amounts in thousands unless otherwise stated)

(a) Included in the costs allocated to the Company from Rayonier are expense allocations for certain corporate functions historically performed by Rayonier and not allocated to its operating segments. See Note 2— Related Party Transactions to the Consolidated Financial Statements.
(b) In accordance with the Separation Agreement, certain assets and liabilities were transferred to the Company that were not included in the historical financial statements for periods prior to the Distribution. These non-cash capital contributions included:

- $73.9 million of disposed operations liabilities (See Note 14 - Liabilities for Disposed Operations for additional information)
- $73.8 million of employee benefit plan liabilities (See Note 9 - Employee Benefit Plans for additional information)
- $67.4 million of deferred tax assets (primarily associated with the liabilities above)
- $3.6 million of other liabilities, net

6. ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated Other Comprehensive Loss was comprised of the following:

	For the Period Ended	
	September 27, 2014	September 30, 2013
Unrecognized components of employee benefit plans, net of tax		
Balance, beginning of period	$(39,699)	$(64,670)
Amounts reclassified from accumulated other comprehensive loss (a)	3,596	3,999
Other comprehensive loss before reclassifications	(4,467)	—
Net other comprehensive (loss) income	(871)	3,999
Net transfer from Rayonier (b)	(35,419)	—
Balance, end of period	$(75,989)	$(60,671)

(a) These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 9 — Employee Benefit Plans