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

**FORM 10-Q**

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

**For the quarterly period ended March 31, 2003**

Commission File Number 333-63825

**SCOTIA PACIFIC COMPANY LLC**  
(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of incorporation or organization)

**68-0414690**  
(I.R.S. Employer  
Identification Number)

**P. O. Box 712**  
**125 Main Street, 2nd Floor**  
**Scotia, California**  
(Address of Principal Executive Offices)

**95565**  
(Zip Code)

Registrant's telephone number, including area code: **(707) 764-2330**

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 is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes ☐ No ☒

**Registrant meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this Form with the reduced disclosure format.**

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**SCOTIA PACIFIC COMPANY LLC**

**BALANCE SHEET**  
(In millions of dollars)

	<u>March 31,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
	(Unaudited)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents .....	\$ 3.4	\$ 10.1
Marketable securities .....	21.3	19.3
Receivables from Pacific Lumber .....	6.2	2.6
Prepaid timber harvesting costs .....	7.0	7.3
Other current assets .....	<u>1.0</u>	<u>0.9</u>
Total current assets .....	38.9	40.2
Timber and timberlands, net of accumulated depletion of \$275.0 and \$272.5, respectively .....	236.8	239.4
Property and equipment, net of accumulated depreciation of \$15.4 and \$15.0, respectively .....	24.3	23.7
Deferred financing costs, net .....	14.7	15.1
Restricted cash, marketable securities and other investments .....	41.0	52.9
Other assets .....	<u>5.4</u>	<u>5.6</u>
	<u>\$ 361.1</u>	<u>\$ 376.9</u>
<b>Liabilities and Member Deficit</b>		
Current liabilities:		
Due to Pacific Lumber .....	\$ 1.6	\$ 0.8
Accrued interest .....	10.8	24.9
Other accrued liabilities .....	1.9	2.1
Short-term borrowings .....	14.7	—
Current maturities of long-term debt, excluding \$2.9 and \$2.6, respectively, of repurchased Timber Notes held in the SAR Account .....	<u>18.5</u>	<u>16.8</u>
Total current liabilities .....	47.5	44.6
Long-term debt, less current maturities and excluding \$50.6 and \$52.8, respectively, of repurchased Timber Notes held in the SAR Account .....	723.8	737.7
Other noncurrent liabilities .....	<u>0.2</u>	<u>0.1</u>
Total liabilities .....	<u>771.5</u>	<u>782.4</u>
Contingencies (See Note 3)		
Member deficit .....	(410.4)	(405.5)
	<u>\$ 361.1</u>	<u>\$ 376.9</u>

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

**SCOTIA PACIFIC COMPANY LLC**

**STATEMENT OF INCOME (LOSS)**  
(In millions of dollars)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(Unaudited)</b>	
Log sales to Pacific Lumber .....	\$ 18.4	\$ 15.9
Operating expenses:		
General and administrative .....	5.5	4.5
Depletion, depreciation and amortization .....	3.3	3.4
	<u>8.8</u>	<u>7.9</u>
Operating income .....	9.6	8.0
Other income (expense):		
Interest and other income .....	0.3	1.4
Loss on sale of timberlands .....	(0.4)	—
Interest expense .....	(14.3)	(14.5)
	<u>(14.4)</u>	<u>(13.1)</u>
Net loss .....	<u>\$ (4.8)</u>	<u>\$ (5.1)</u>

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

**SCOTIA PACIFIC COMPANY LLC**

**STATEMENT OF CASH FLOWS**  
(In millions of dollars)

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2003</b>	<b>2002</b>
	<b>(Unaudited)</b>	
<b>Cash flows from operating activities:</b>		
Net loss	\$ (4.8)	\$ (5.1)
Adjustments to reconcile net loss to net cash used for operating activities:		
Depletion, depreciation and amortization	3.3	3.4
Amortization of deferred financing costs	0.3	0.3
Loss on sale of timberlands	0.4	—
Increase (decrease) in cash resulting from changes in:		
Receivables from Pacific Lumber	(3.7)	(2.3)
Prepaid timber harvesting costs	0.3	(0.1)
Due to Pacific Lumber	0.1	(0.3)
Accrued interest	(14.1)	(14.4)
Other accrued liabilities	(0.1)	(0.5)
Other	—	0.3
Net cash used for operating activities	<u>(18.3)</u>	<u>(18.7)</u>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(1.6)	(1.3)
Proceeds from sale of assets	0.7	—
Net cash used for investing activities	<u>(0.9)</u>	<u>(1.3)</u>
<b>Cash flows from financing activities:</b>		
Principal payments on Timber Notes and other timber related debt	(12.1)	(11.6)
Restricted cash withdrawals, net	9.9	31.2
Borrowings (repayments) under line of credit agreement, net	14.7	—
Member distributions	—	(29.4)
Net cash provided by (used for) financing activities	<u>12.5</u>	<u>(9.8)</u>
<b>Net decrease in cash and cash equivalents</b>	<b>(6.7)</b>	<b>(29.8)</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>10.1</b>	<b>37.8</b>
<b>Cash and cash equivalents at end of period</b>	<b><u>\$ 3.4</u></b>	<b><u>\$ 8.0</u></b>
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid	\$ 28.1	\$ 28.5

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

## SCOTIA PACIFIC COMPANY LLC

### CONDENSED NOTES TO FINANCIAL STATEMENTS

#### 1. General

The information contained in the following notes to the financial statements is condensed from that which would appear in the annual financial statements; accordingly, the financial statements included herein should be reviewed in conjunction with the financial statements and related notes thereto contained in the Form 10-K. Any capitalized terms used but not defined in these Condensed Notes to Financial Statements are defined in the "Glossary of Defined Terms" contained in Appendix A. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year end. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the entire year.

The financial statements included herein are unaudited; however, they include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair presentation of the financial position of the Company at March 31, 2003, and the results of operations and cash flows for the three months ended March 31, 2003 and 2002. The Company is a wholly owned subsidiary of Pacific Lumber which is a wholly owned subsidiary of MGI. MGI is an indirect wholly owned subsidiary of MAXXAM.

#### *Liquidity and Cash Resources*

The Company's cash flows from operations are significantly impacted by harvest volumes and log prices. In June 2002, the State Board of Equalization adopted the new Harvest Value Schedule for the second half of 2002. The prices published in that schedule reflected an approximate 16% decline in the SBE Price for small redwood logs and no price change for small Douglas-fir logs from the prior period. The decline in SBE Prices had an adverse impact on the Company's net sales and liquidity during the second half of 2002. Accordingly, with respect to the note payment in January 2003, the Company required funds from its line of credit to pay a portion of the interest due. All of the funds used to pay Scheduled Amortization were provided from the SAR Account.

The Master Purchase Agreement contemplates that all sales of logs by the Company to Pacific Lumber will be at fair market value (based on stumpage prices) for each species and category of timber. The Master Purchase Agreement provides that if the purchase price equals or exceeds the SBE Price and a structuring price set forth in a schedule to the Indenture, the purchase price is deemed to be at fair market value. If the purchase price equals or exceeds the SBE Price, but is less than the structuring price, then the Company is required to engage an independent forestry consultant to confirm that the purchase price reflects fair market value. In January 2003, the Company so engaged a consultant with respect to establishing the purchase prices of logs to be sold to Pacific Lumber in the first half of 2003. The consultant determined that with respect to certain categories of logs, the fair market value was higher than the comparable SBE Price. The prices for redwood logs are expected to be on average approximately 20% higher for the first half of 2003 than those for the second half of 2002. There was relatively no price change for Douglas-fir logs.

With respect to short-term liquidity, the Company believes that existing cash available for principal payments from the SAR Account, and funds available under the Line of Credit, together with cash flows from operations, should provide sufficient funds to meet its working capital, capital expenditures and required debt service obligations through 2003. With respect to long-term liquidity, although the Company expects that cash flows from operations and funds available under the SAR Account and the Line of Credit should be adequate to meet its debt service, working capital and capital expenditure requirements, unless log prices continue to improve, there can be no assurance that this will be the case. In addition, cash flows from operations may continue to be adversely affected if harvest levels decline as a result of regulatory compliance and the litigation discussed in Note 3.

#### *New Accounting Standards*

##### *Accounting for Asset Retirement Obligations*

In June 2001, the FASB issued SFAS No. 143, which addresses accounting and reporting standards for obligations associated with the retirement of tangible long-lived assets and the related asset retirement costs. The Company adopted SFAS No. 143 effective January 1, 2003. In general, SFAS No. 143 requires the recognition of a liability resulting from anticipated asset retirement obligations, offset by an increase in the value of the associated productive asset for such anticipated costs. Over the life of the asset, depreciation expense is to include the ratable expensing of the retirement

cost included with the asset value. The statement applies to all legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and/or the normal operation of a long-lived asset, except for certain lease obligations. Excluded from this statement are obligations arising solely from a plan to dispose of a long-lived asset and obligations that result from the improper operation of an asset (i.e. certain types of environmental obligations). The adoption of SFAS No. 143 did not have a material impact on the Company's financial statements.

#### *Classification of Gains and Losses on Extinguishment of Debt*

In April 2002, the FASB issued SFAS No. 145, which, among other things, rescinds the previous guidance for debt extinguishments. SFAS No. 145 eliminates the requirement that gains and losses from extinguishment of debt be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. However, transactions would not be prohibited from extraordinary item classification if they meet the criteria in APB Opinion No. 30. Applying the provisions of APB Opinion No. 30 will distinguish transactions that are part of an entity's recurring operations from those that are unusual or infrequent or that meet the criteria for classification as an extraordinary item. The Company adopted SFAS No. 145 effective January 1, 2003.

## **2. Restricted Cash, Cash Equivalents, Marketable Securities and Other Investments**

The following amounts are restricted under the terms of the Company's debt agreements (in millions):

	<u>March 31, 2003</u>	<u>December 31, 2002</u>
Current assets:		
Cash and cash equivalents . . . . .	\$ —	\$ 5.2
Marketable securities:		
Amounts held in SAR Account . . . . .	21.3	19.3
	<u>21.3</u>	<u>24.5</u>
Long-term cash, marketable securities and other investments:		
Amounts held in SAR Account . . . . .	87.0	101.6
Other amounts restricted under the Indenture . . . . .	2.6	2.6
Less: Amounts attributable to repurchased Timber Notes held in SAR Account . . . . .	<u>(48.6)</u>	<u>(51.3)</u>
	41.0	52.9
Total restricted cash, cash equivalents, marketable securities and other investments . . . . .	<u>\$ 62.3</u>	<u>\$ 77.4</u>

## **3. Contingencies**

Regulatory and environmental matters play a significant role in the Company's forest products business, which is subject to a variety of California and federal laws and regulations, as well as the HCP and SYP, dealing with timber harvesting practices, threatened and endangered species and habitat for such species, and air and water quality.

The SYP complies with regulations of the California Board of Forestry and Fire Protection requiring timber companies to project timber growth and harvest on their timberlands over a 100-year planning period and to demonstrate that their projected average annual harvest for any decade within a 100-year planning period will not exceed the average annual growth level during the last decade of the 100-year planning period. The SYP is effective for 10 years (subject to review after five years) and may be amended by Pacific Lumber, subject to approval by the CDF. Revised SYPs will be prepared every decade that address the harvest level based upon assessment of changes in the resource base and other factors. The HCP and the Permits allow incidental "take" of certain species located on the Company's timberlands which species have been listed by government entities under the ESA and/or the CESA so long as there is no "jeopardy" to the continued existence of such species. The HCP identifies the measures to be instituted in order to minimize and mitigate the anticipated level of take to the greatest extent practicable. The SYP is also subject to certain of these provisions. The HCP and related Permits have a term of 50 years. Since the consummation of the Headwaters Agreement in March 1999, there has been a significant amount of work required in connection with the implementation of the Environmental Plans, and this work could continue for several more years.

Under the CWA, the EPA is required to establish TMDLs in water courses that have been declared to be "water quality impaired." The EPA and the North Coast Water Board are in the process of establishing TMDLs for many northern California rivers and certain of their tributaries, including nine water courses that flow within the Company's timberlands. The Company expects this process to continue into 2010. In December 1999, the EPA issued a report

dealing with TMDLs on two of the nine water courses. The agency indicated that the requirements under the HCP would significantly address the sediment issues that resulted in TMDL requirements for these two water courses. The North Coast Water Board has begun the process of establishing the TMDL requirements applicable to two other water courses on the Company's timberlands, with a targeted completion of spring 2004 for these two water courses. The final TMDL requirements applicable to the Company's timberlands may require aquatic protection measures that are different from or in addition to those in the HCP or that result from the prescriptions to be developed pursuant to the watershed analysis process provided for in the HCP.

Effective January 1, 2003, a California statute eliminates a waiver previously granted to, among others, timber companies. This waiver had been in effect for a number of years and waived the requirement under California water quality regulations for timber companies to follow certain waste discharge requirements in connection with their timber harvesting and related operations. The new statute provides, however, that regional water boards such as the North Coast Water Board are authorized to renew the waiver. The North Coast Water Board has renewed the waiver for timber companies through December 31, 2003. Should the North Coast Water Board decide not to extend this or another waiver beyond December 31, 2003, it may thereafter notify a company that the North Coast Water Board will require such company to follow certain waste discharge requirements in order to conduct harvesting operations on a THP. The waste discharge requirements may include aquatic protection measures that are different from or in addition to those provided for in the THP approved by the CDF. Accordingly, harvesting activities could be delayed and/or adversely affected as these waste discharge requirements are developed and implemented.

Beginning with the 2002-2003 winter operating period, the Company and Pacific Lumber have been required to submit "Reports of Waste Discharge" to the North Coast Water Board in order to conduct winter harvesting activities in the Freshwater Creek and Elk River watersheds. After consideration of these reports, the North Coast Water Board imposed requirements on the Company and Pacific Lumber to implement additional mitigation and erosion control practices in these watersheds. These additional requirements have somewhat increased operating costs. The North Coast Water Board issued the Elk River Order for the Elk River watershed. In addition, the North Coast Water Board has initiated the process which could result in similar orders for the Freshwater and Bear Creek watersheds, and is contemplating similar actions for the Jordan and Stitz Creeks watersheds. The Elk River Order is aimed at addressing existing sediment production sites through clean up actions. The order, as well as additional orders in the other watersheds (should they be issued), could result in significant costs to the Company beginning in 2003 and extending over a number of years. Pacific Lumber has appealed the Elk River Order to the State Water Board, but the appeal is being held in abeyance while the matter is discussed with the North Coast Water Board and its staff.

Lawsuits are pending and threatened which seek to prevent the Company from implementing the HCP and/or the SYP, implementing certain of the Company's approved THPs, or carrying out certain other operations. The Services Agreement requires Pacific Lumber to prepare and file on behalf of the Company (at Pacific Lumber's cost) all pleadings and motions, and otherwise diligently pursue, appeals of any denial, and defense of any challenge to approval, of any THP or the Environmental Plans or similar plan or permit and related matters.

In March 1999, the *EPIC-SYP/Permits lawsuit* was filed. This action alleges, among other things, various violations of the CESA and the California Environmental Quality Act, and challenges, among other things, the validity and legality of the SYP and the Permits issued by California. The plaintiffs seek, among other things, injunctive relief to set aside California's approval of the SYP and the Permits issued by California. In March 1999, the *USWA lawsuit* was filed challenging the validity and legality of the SYP. In connection with the *EPIC-SYP/Permits lawsuit*, the trial judge has issued a stay of the effectiveness of the Permits for approval of new THPs, but released from the stay, and refused to enjoin, operations under THPs that were previously approved consistent with the Permits. In addition, on November 26, 2002, the Court exempted from the stay all in-process THPs submitted through mid-October 2002. Although the stay prevents the CDF from approving new THPs that rely upon the Permits, the Company is obtaining review and approval of new THPs under a procedure provided for in the forest practice rules that does not depend upon the Permits. Because certain THPs will not qualify for this procedure, there could be a reduction in 2003 harvest levels which could have an adverse impact on the Company. These two cases were consolidated for trial, which concluded on March 28, 2003. The judge has indicated that he expects to rule no earlier than July 2003. The Company believes that appropriate procedures were followed throughout the public review and approval process concerning the Environmental Plans and is working with the relevant government agencies to defend these challenges. The Company does not believe the resolution of these matters should result in a material adverse effect on its financial condition, results of operations or liquidity. However, in addition to the potential short-term adverse impacts described above, these matters could have a long-term negative impact if they are decided adversely to the Company.



In July 2001, the *Bear Creek lawsuit* was filed. The lawsuit alleges that the Company's and Pacific Lumber's harvesting and other activities under certain of its approved and proposed THPs will result in discharges of pollutants in violation of the CWA. The plaintiff asserts that the CWA requires the defendants to obtain a permit from the North Coast Water Board before beginning timber harvesting and road construction activities, and is seeking to enjoin these activities until such permit has been obtained. The plaintiff also seeks civil penalties of up to \$27,500 per day for the defendant's alleged continued violation of the CWA. The Company believes that the requirements under the HCP are adequate to ensure that sediment and pollutants from its harvesting activities will not reach levels harmful to the environment. Furthermore, EPA regulations specifically provide that such activities are not subject to CWA permitting requirements. The Company believes that it has strong legal defenses in this matter; however, there can be no assurance that this lawsuit will not have a material adverse impact on the Company's financial condition, results of operations and/or liquidity.

On November 20, 2002, the *HWC lawsuit*, naming Pacific Lumber as real party in interest, was filed. The suit seeks to enjoin timber operations in the Elk and Freshwater watersheds of the Company's timberlands until and unless the regional and state water boards impose on those operations waste discharge requirements that meet standards demanded by the plaintiff. The Company believes that Pacific Lumber and the regional and state boards have valid defenses to this action. However, an adverse ruling could result in a delay of timber operations that could have a material adverse impact on the Company's financial position, results of operations and/or liquidity.

On February 24, 2003, the recently elected District Attorney of Humboldt County filed the *Humboldt DA action*. The suit was filed under the California unfair competition law and alleges that the Company, Pacific Lumber and Salmon Creek used certain unfair business practices in connection with completion of the Headwaters Agreement, and that this resulted in the ability to harvest significantly more trees under the Environmental Plans than would have otherwise been the case. The suit seeks a variety of remedies including a civil penalty of \$2,500 for each additional tree that has been or will be harvested due to this alleged increase in harvest, as well as restitution and an injunction in respect of the additional timber harvesting allegedly being conducted. On March 27, 2003, the Company filed a motion for sanctions and requested dismissal of the case. A hearing has been scheduled for May 23, 2003. The Company believes that this suit is without merit; however, there can be no assurance that the Company will prevail or that an adverse outcome would not be material to the Company's financial position, results of operations and/or liquidity.

In November 2001, Pacific Lumber filed the *THP No. 520 lawsuit* alleging that the State Water Board had no legal authority to impose mitigation measures that were requested by the staff of the North Coast Water Board during the THP review process and rejected by the CDF. When the staff of the North Coast Water Board attempted to impose these mitigation measures in spite of the CDF's decision, Pacific Lumber appealed to the State Water Board, which imposed certain of the requested mitigation measures and rejected others. Pacific Lumber filed the *THP No. 520 lawsuit* challenging the State Water Board's decision, and on January 24, 2003, the Court granted Pacific Lumber's request for an order invalidating the imposition of these additional measures. Other claims included in this action have been dismissed by Pacific Lumber without prejudice to its future rights. On March 25, 2003, the State Water Board appealed this decision. While the Company believes the Court's decision will be sustained, a reversal could result in increased demands by the regional and state water boards and their staffs to impose controls and limitations on timber harvesting on Pacific Lumber's timberlands beyond those provided for by the Environmental Plans.

The Company, Pacific Lumber and certain of their affiliates are the defendants in the *Cook action* and the *Cave action*. On April 4, 2003, the plaintiffs in these actions filed amended complaints and served the defendants with notice of the actions. The *Cook action* alleges, among other things, that defendants' logging practices have contributed to an increase in flooding along Freshwater Creek (which runs through the Company's timberlands), resulting in personal injury and damages to the plaintiffs' properties. Plaintiffs further allege that in order to have THPs approved in the affected areas, the defendants engaged in certain unfair business practices. The plaintiffs seek, among other things, compensatory and exemplary damages, injunctive relief, and appointment of a receiver to ensure that the watershed is restored. The *Cave action* contains similar allegations and requests similar relief with respect to the Elk River watershed (a portion of which is contained on the Company's timberlands). The Company does not believe the resolution of these actions should result in a material adverse effect on its financial condition, results of operations or liquidity.

While the Company expects environmentally focused objections and lawsuits to continue, it believes that the HCP, the SYP and the Permits should enhance its position in connection with these continuing challenges and, over time, reduce or minimize such challenges.

#### 4. Comprehensive Loss and Member Deficit

Comprehensive loss includes the following (in millions):

	Three Months Ended March 31,	
	2003	2002
Net loss .....	\$ (4.8)	\$ (5.1)
Other comprehensive loss:		
Net change in fair value of available-for-sale investments .....	(0.1)	(1.0)
Total comprehensive loss .....	<u>\$ (4.9)</u>	<u>\$ (6.1)</u>

A reconciliation of the activity in member deficit is as follows (in millions):

	Three Months Ended March 31,	
	2003	2002
Balance at beginning of period .....	\$ (405.5)	\$ (352.3)
Comprehensive loss .....	(4.9)	(6.1)
Member distribution .....	—	(29.4)
Balance at end of period .....	<u>\$ (410.4)</u>	<u>(387.8)</u>

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following should be read in conjunction with the financial statements in Part I, Item 1 of this Report and Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and Item 8. "Financial Statements and Supplementary Data" of the Form 10-K. Any capitalized terms used but not defined in this Item are defined in the "Glossary of Defined Terms" contained in Appendix A. Except as otherwise noted, all references to notes represent the Condensed Notes to Financial Statements included herein.

*This Quarterly Report on Form 10-Q contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. These statements appear in a number of places in this section and in Part II. Item 1. "Legal Proceedings." Such statements can be identified by the use of forward-looking terminology such as "believes," "expects," "may," "estimates," "will," "should," "plans" or "anticipates" or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Readers are cautioned that any such forward-looking statements are not guarantees of future performance and involve significant risks and uncertainties, and that actual results may vary materially from the forward-looking statements as a result of various factors. These factors include the effectiveness of management's strategies and decisions, general economic and business conditions, developments in technology, new or modified statutory or regulatory requirements and changing prices and market conditions. This Form 10-Q and the Form 10-K identify other factors which could cause differences between such forward-looking statements and actual results. No assurance can be given that these are all of the factors that could cause actual results to vary materially from the forward-looking statements.*

### Background

Regulatory and environmental matters play a significant role in the Company's operations. See Item 1. "Business—Regulatory and Environmental Factors" of the Form 10-K and Note 3 for a discussion of these matters. Although the Company experienced improvements in the rate of approvals of THPs in 2001 and 2002, regulatory compliance and related litigation may at times cause delays in obtaining approvals of THPs and delays in harvesting on THPs once they are approved. This could result in a decline in harvest, an increase in the cost of logging operations, and lower net sales, as well as increased costs related to timber harvest litigation. As discussed in Note 3, the North Coast Water Board is requiring Pacific Lumber and the Company to apply certain waste discharge requirements to approved THPs covering winter harvesting operations in the Freshwater, Elk River and Bear Creek watersheds, and the North Coast Water Board could require Pacific Lumber and the Company to follow waste discharge requirements before harvesting operations are conducted on THPs in other watersheds. This requirement could cause delays in harvesting. A stay issued in connection with the *EPIC-SYP/Permits lawsuit* requires Pacific Lumber and the Company to follow an alternative THP approval process for THPs submitted to the CDF after mid-October of 2002, which could result in a reduction of 2003 harvest levels.

Furthermore, there can be no assurance that certain other pending legal, regulatory and environmental matters or future governmental regulations, legislation or judicial or administrative decisions, adverse weather conditions or low log prices will not have a material adverse effect on the Company's financial position, results of operations or liquidity. See Note 3 for further information regarding regulatory and legal proceedings affecting the Company's operations.

### Results of Operations

#### *General*

*Mbfe Concept.* The Mbfe concept was used in structuring the Timber Notes in order to take account of the relative values of the species and categories of timber included in the Company Timber. Under the Mbfe concept, one thousand board feet, net Scribner scale, of old growth redwood timber equates to one Mbfe. One thousand board feet, net Scribner scale, of each other species and category of timber included in the Company Timber was assigned a value in Mbfe equal to a fraction of an Mbfe. This fraction was generally determined by dividing the SBE Price applicable to such species and category for the first half of 1998 by the SBE Price applicable to old growth redwood for the first half of 1998.

*Master Purchase Agreement Provisions.* The Master Purchase Agreement contemplates that all sales of logs by the Company to Pacific Lumber will be at fair market value (based on stumpage prices) for each species and category of timber. The Master Purchase Agreement provides that if the purchase price equals or exceeds the SBE Price and a structuring price set forth in a schedule to the Indenture, the purchase price is deemed to be at fair market value. If the purchase price equals or exceeds the SBE Price, but is less than the structuring price, then the Company is required to

engage an independent forestry consultant to confirm that the purchase price reflects fair market value. Harvest Value Schedules setting forth the SBE Prices are published by the California State Board of Equalization twice a year for the purpose of computing a yield tax imposed on timber harvested between January 1 and June 30 and July 1 and December 31. Harvest Value Schedules are based on twenty-four months of actual log and timber sales that occur within nine specified timber value areas. These sales are arms length transactions adjusted for time by indexing the prices (using log and lumber price trends) to a specific date, which is approximately sixty days prior to the effective date of the Harvest Value Schedules. SBE Prices may not necessarily be representative of actual prices that would be realized from unrelated parties at subsequent dates.

In January 2003, in accordance with the Master Purchase Agreement, the Company engaged an independent forestry consultant with respect to establishing the purchase prices of logs to be sold to Pacific Lumber in the first half of 2003. The consultant determined that with respect to certain categories of logs, the fair market value was higher than the comparable SBE Price. The prices for redwood logs are expected to be on average approximately 20% higher for the first half of 2003 than those for the second half of 2002. There was relatively no price change for Douglas-fir logs.

*Seasonality.* Logging operations on the Company's timberlands are highly seasonal and have historically been significantly higher in the months of April through November than in the months of December through March. Management expects that the Company's revenues and cash flows will continue to be markedly seasonal because of the harvesting, road use, wet weather and other restrictions imposed by the HCP. As a result, a substantial majority of the future harvesting on the Company's timberlands can be expected to be concentrated during the period from June through October of each year. Some of these restrictions may be modified somewhat under the adaptive management provision contained in the HCP, and as a result of the watershed analysis process currently being performed.

#### *Log Sales to Pacific Lumber*

The following table presents price, volume and revenue amounts for the Company for the periods indicated (revenues in millions).

	Three Months Ended March 31, 2003			Three Months Ended March 31, 2002		
	MBFEs	Price \$/MBFE	Revenues	MBFEs	Price \$/MBFE	Revenues
Redwood .....	26,600	\$ 650	\$ 17.3	27,400	\$ 537	\$ 14.7
Douglas Fir .....	3,000	344	1.0	4,300	257	1.1
Other .....	500	236	0.1	400	91	0.1
	<u>30,100</u>	612	<u>\$ 18.4</u>	<u>32,100</u>	494	<u>\$ 15.9</u>

The Company experienced an increase in log sales for the first quarter of 2003 versus the same period of 2002 due to various factors, including a 3% increase in the market price of small redwood logs from that of the first quarter of 2002, an 18% decrease in the use of the helicopter method of logging (which reduces the value of the log to reflect the increased cost of harvesting), as well as an increase in the size of logs delivered. The favorable impact on log sales of the increase in prices was slightly offset by a reduction in the volume of logs delivered.

#### *Operating Income and Net Loss*

Operating income was \$9.6 million and \$8.0 million for the three months ended March 31, 2003 and 2002, respectively. The increase was principally due to the increase in log sales discussed above offset somewhat by an increase in winter road costs as well as increased insurance costs.

Net losses were \$4.8 million and \$5.1 million for the three months ended March 31, 2003 and 2002, respectively. The decrease between periods is due to the increase in operating income discussed above, offset somewhat by a decrease in interest income realized from cash, cash equivalents and other investments (see Note 2).

### **Financial Condition and Investing and Financing Activities**

*This section contains statements which constitute "forward-looking statements" within the meaning of the PSLRA. See above for cautionary information with respect to such forward-looking statements.*

On May 31, 2002, the Line of Credit was extended for an additional year to July 11, 2003. Annually, the Company will request that the Line of Credit be extended for a period of not less than 364 days. If not extended, the Company may draw upon the full amount available. The amount drawn would be repayable in 12 semiannual installments on each note

payment date (after the payment of certain other items, including the Aggregate Minimum Principal Amortization Amount, as defined, then due), commencing approximately two and one-half years following the date of the draw. At March 31, 2003, the Company could have borrowed a maximum of \$58.9 million under the Line of Credit, and there was \$14.7 million outstanding under the Line of Credit.

On the note payment date in January 2003, the Company had \$5.6 million set aside in the note payment account to pay the \$27.9 million of interest due. The Company used \$22.3 million (in addition to \$1.6 million which was borrowed in respect of Timber Notes held by the Company) of the funds available under the Line of Credit to pay the remaining amount of interest due. The Company repaid \$12.1 million of principal on the Timber Notes (an amount equal to Scheduled Amortization) using funds held in the SAR Account.

In April 2003, \$3.4 million of funds from the SAR Account were used to repurchase \$4.0 million principal amount of Timber Notes, as permitted under the Indenture, resulting in a gain of \$0.4 million (net of unamortized deferred financing costs) on extinguishment of debt.

With respect to the note payment date in July 2003, the Company expects to use \$27.4 million (in addition to \$2.0 million which would be borrowed in respect of Timber Notes held by the Company) of the funds available under the Line of Credit to pay the entire amount of interest due. The Company expects to repay \$4.4 million of principal on the Timber Notes (an amount equal to Scheduled Amortization) using funds held in the SAR Account.

With respect to short-term liquidity, the Company believes that existing cash available for principal payments from the SAR Account, and funds available under the Line of Credit, together with cash flows from operations, should provide sufficient funds to meet its working capital, capital expenditures and required debt service obligations through 2003. With respect to long-term liquidity, although the Company expects that cash flows from operations and funds available under the SAR Account and the Line of Credit should be adequate to meet its debt service, working capital and capital expenditure requirements, unless log prices continue to improve, there can be no assurance that this will be the case. In addition, cash flows from operations may continue to be adversely affected if harvest levels decline as a result of the factors discussed in “—Background” above and Note 3.

Pacific Lumber’s cash flows from operations may be adversely affected by diminished availability of logs from the Company, lower lumber prices, adverse weather conditions, or pending legal, regulatory and environmental matters. Pacific Lumber may require funds available under its credit agreement and/or additional prepayments by MGI of an intercompany loan in order to meet its working capital and capital expenditure requirements for the next year.

### **Critical Accounting Policies**

See Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies” of the Form 10-K for a discussion of the Company’s critical accounting policies.

### **New Accounting Pronouncements**

See Note 1 to the Condensed Financial Statements for a discussion of new accounting pronouncements and their potential impact on the Company.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is exposed to changes in interest rates under the Line of Credit, which was established in conjunction with the offering of the Timber Notes. This facility bears interest at either the prime interest rate or LIBOR plus a specified percentage point spread. As of March 31, 2003, there were \$14.7 million in borrowings outstanding under the Line of Credit. Based on the amount of borrowings outstanding under the Line of Credit during the three months ended March 31, 2003, the impact of a 1.0% change in interest rates effective from the beginning of the year would not have been material to the Company’s interest expense for the period.

All of the Company’s other debt is fixed-rate, and therefore, does not expose the Company to the risk of higher interest payments due to changes in market interest rates. The Company does not utilize interest rate swaps or similar

hedging arrangements.

#### **ITEM 4. DISCLOSURE CONTROLS AND PROCEDURES**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Within 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls subsequent to the date the Company completed its evaluation.

### **PART II. OTHER INFORMATION**

#### **ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Note 3 is incorporated herein by reference.

#### **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

**a. Exhibits:**

- \* 99.1 Section 906 Certification of Chief Executive Officer
- \* 99.2 Section 906 Certification of Chief Financial Officer

\* Included with this filing

**b. Reports on Form 8-K:**

On January 21, 2003, the Company filed a current report on Form 8-K (under Item 9), related to the filing of a certificate in respect of the Company's Timber Notes.

On February 20, 2003, the Company filed a current report on Form 8-K (under Item 9), related to the filing of a certificate in respect of the Company's Timber Notes.

On February 25, 2003, the Company filed a current report on Form 8-K (under Item 5), related to the *Humboldt DA action*.

On March 20, 2003, the Company filed a current report on Form 8-K (under Item 9), related to the filing of a certificate in respect of the Company's Timber Notes.

On April 21, 2003, the Company filed a current report on Form 8-K (under Item 9), related to the filing of a certificate in respect of the Company's Timber Notes.

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, who has signed this report on behalf of the Registrant and as the principal financial and accounting officer of the Registrant.

SCOTIA PACIFIC COMPANY LLC

Date: May 15, 2003

By:           /S/      GARY L. CLARK          

Gary L. Clark  
Vice President – Finance and Administration  
(Principal Financial and Accounting Officer)

## CERTIFICATIONS

I, Robert E. Manne, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Scotia Pacific Company LLC;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

By: /S/ ROBERT E. MANNE  
Robert E. Manne  
President and Chief Executive Officer  
(Principal Executive Officer)



I, Gary L. Clark, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Scotia Pacific Company LLC;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 15, 2003

By: /S/ GARY L. CLARK  
Gary L. Clark  
Vice President-Finance and Administration  
(Principal Financial and Accounting Officer)

## Glossary of Defined Terms

*APB Opinion No. 30:* Accounting Principles Board Opinion 30, “Reporting the Results of Operations - Reporting Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions”

*Bear Creek lawsuit:* An action entitled *Environmental Protection Information Association v. Pacific Lumber, Scotia Pacific Company LLC* (No. C01-2821) pending in the U.S. District Court for the Northern District of California

*Cave action:* An action entitled *Steve Cave, et al. v. Gary Clark, et al.* (No. DR0220719) pending in the Superior Court of Humboldt County, California

*CDF:* California Department of Forestry and Fire Protection

*CESA:* California Endangered Species Act

*Company:* Scotia Pacific Company LLC, a limited liability company wholly owned by Pacific Lumber

*Company Timber:* The timber located on the Company’s timberlands which is not subject to harvesting rights by Pacific Lumber

*Cook action:* An action entitled *Alan Cook, et al. v. Gary Clark, et al.* (No. DR020718) pending in the Superior Court of Humboldt County

*CWA:* Federal Clean Water Act

*Elk River Order:* Clean up and abatement order issued to Pacific Lumber by the North Coast Water Board for the Elk River watershed

*Environmental Plans:* The HCP and the SYP

*EPA:* Environmental Protection Agency

*EPIC-SYP/Permits lawsuit:* An action entitled *Environmental Protection Information Association, Sierra Club v. California Department of Forestry and Fire Protection, California Department of Fish and Game, The Pacific Lumber Company, Scotia Pacific Company LLC, Salmon Creek Corporation, et al.* pending in the Superior Court of Humboldt County ( No. CV990452)

*ESA:* The federal Endangered Species Act

*FASB:* Financial Accounting Standards Board

*Form 10-K:* The Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission for the fiscal year ended December 31, 2002

*Harvest Value Schedule:* A schedule setting forth the SBE Prices published bi-annually by the California State Board of Equalization for purposes of computing yield taxes on timber sales

*HCP:* The habitat conservation plan covering multiple species approved on March 1, 1999, in connection with the consummation of the Headwaters Agreement

*Headwaters Agreement:* The September 1996 agreement between Pacific Lumber, the Company, Salmon Creek, the United States and California which provided the framework for the acquisition by the United States and California of the Headwaters Timberlands

*Headwaters Timberlands:* Approximately 5,600 acres of Pacific Lumber timberlands consisting of two forest groves commonly referred to as the Headwaters Forest and the Elk Head Springs Forest which were sold to the United States and California on March 1, 1999

*Humboldt DA action:* A civil suit filed in the Superior Court of Humboldt County by the District Attorney of Humboldt County entitled *The People of the State of California v. Pacific Lumber, Scotia Pacific Holding Company and Salmon Creek Corporation* (No. DR030070)

*HWC lawsuit:* An action entitled *Humboldt Watershed Council, et al v. North Coast Regional Water Quality Control Board, et al.* (No. CPF02-502062), naming Pacific Lumber as real party in interest, pending in the Superior Court of San Francisco County, California

*Indenture:* The indenture governing the Timber Notes

*LIBOR:* London Inter Bank Offering Rate

*Line of Credit:* The agreement between a group of lenders and the Company pursuant to which the Company may borrow in order to pay up to one year's interest on the Timber Notes

*Master Purchase Agreement:* The agreement entered into between Pacific Lumber and the Company that governs all purchases of logs by Pacific Lumber from the Company

*MAXXAM:* MAXXAM Inc.

*Mbfe:* A concept used in structuring the Timber Notes; under this concept one thousand board feet, net Scribner scale, of old growth redwood timber equates to one Mbfe

*MGI:* MAXXAM Group Inc., an indirect wholly owned subsidiary of MAXXAM

*North Coast Water Board:* North Coast Regional Water Quality Control Board

*Pacific Lumber:* The Pacific Lumber Company, a wholly owned subsidiary of MGI

*Permits:* The incidental take permits issued by the United States and California pursuant to the HCP

*PSLRA:* Private Securities Litigation Reform Act of 1995

*Salmon Creek:* Salmon Creek LLC, a wholly owned subsidiary of Pacific Lumber

*SAR Account:* Funds held in a reserve account titled the Scheduled Amortization Reserve Account and used to support principal payments on the Timber Notes

*SBE Price:* The applicable stumpage price for a particular species and size of log, as set forth in the most recent Harvest Value Schedule

*Scheduled Amortization:* The amount of principal which the Company must pay through each Timber Note payment date in order to avoid prepayment or deficiency premiums

*Services Agreement:* Agreement between the Company and Pacific Lumber under which Pacific Lumber provides operational, management and related services to the Company with respect to the Company's timberlands

*SFAS No. 143:* Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations"

*SFAS No. 145:* Statement of Financial Accounting Standards No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections"

*State Water Board:* California State Water Resources Control Board

*SYP*: The sustained yield plan approved on March 1, 1999, in connection with the consummation of the Headwaters Agreement

*THP*: Timber harvesting plan required to be filed with and approved by the CDF prior to the harvesting of timber

*THP No. 520 lawsuit*: An action entitled *The Pacific Lumber Company, et al. v. California State Water Resources Control Board* (No. DR010860) pending in the Superior Court of Humboldt County

*Timber Notes*: The Company's 6.55% Series B Class A-1 Timber Collateralized Notes, 7.11% Series B Class A-2 Timber Collateralized Notes and 7.71% Series B Class A-3 Timber Collateralized Notes due July 20, 2028

*TMDLs*: Total maximum daily load limits

*USWA lawsuit*: An action entitled *United Steelworkers of America, AFL-CIO, CLC, and Donald Kegley v. California Department of Forestry and Fire Protection, The Pacific Lumber Company, Scotia Pacific Company LLC and Salmon Creek Corporation* (No. 99CS00626) pending in the Superior Court of Sacramento County, California