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

# FORM 10-Q

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

**For the quarterly period ended September 30, 2003**

Commission File Number 333-63825

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

| | |
|---|---|
| **Delaware**<br>(State or other jurisdiction of incorporation or organization) | **68-0414690**<br>(I.R.S. Employer Identification Number) |
| **P. O. Box 712**<br>**125 Main Street, 2nd Floor**<br>**Scotia, California**<br>(Address of Principal Executive Offices) | **95565**<br>(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)

| | September 30, 2003 (Unaudited) | December 31, 2002 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 3.4 | $ 10.1 |
| Marketable securities | 22.2 | 19.3 |
| Receivables from Pacific Lumber | 8.5 | 2.6 |
| Prepaid timber harvesting costs | 6.1 | 7.3 |
| Other current assets | 1.5 | 0.9 |
| Total current assets | 41.7 | 40.2 |
| Timber and timberlands, net of accumulated depletion of $280.0 and $272.5, respectively | 232.5 | 239.4 |
| Property and equipment, net of accumulated depreciation of $16.5 and $15.0, respectively | 25.0 | 23.7 |
| Deferred financing costs, net | 13.9 | 15.1 |
| Restricted cash, marketable securities and other investments | 36.6 | 52.9 |
| Other assets | 5.0 | 5.6 |
| | $ 354.7 | $ 376.9 |
| **Liabilities and Member Deficit** | | |
| Current liabilities: | | |
| Due to Pacific Lumber | $ 1.3 | $ 0.8 |
| Accrued interest | 10.7 | 24.9 |
| Other accrued liabilities | 2.9 | 2.1 |
| Short-term borrowings | 20.3 | – |
| Current maturities of long-term debt, excluding $4.0 and $2.6, respectively, of repurchased Timber Notes held in the SAR Account | 18.3 | 16.8 |
| Total current liabilities | 53.5 | 44.6 |
| Long-term debt, less current maturities and excluding $52.6 and $52.8, respectively, of repurchased Timber Notes held in the SAR Account | 715.6 | 737.7 |
| Other noncurrent liabilities | 0.3 | 0.1 |
| Total liabilities | 769.4 | 782.4 |
| Contingencies (See Note 3) | | |
| Member deficit | (414.7) | (405.5) |
| | $ 354.7 | $ 376.9 |

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

## SCOTIA PACIFIC COMPANY LLC

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

| | Three Months Ended September 30, 2003 | Three Months Ended September 30, 2002 | Nine Months Ended September 30, 2003 | Nine Months Ended September 30, 2002 |
|---|---|---|---|---|
| | (Unaudited) | | | |
| Log sales to Pacific Lumber | $ 22.4 | $ 19.7 | $ 55.9 | $ 49.7 |
| Operating expenses: | | | | |
| General and administrative | 6.1 | 6.1 | 16.5 | 14.5 |
| Depletion, depreciation and amortization | 3.7 | 4.0 | 9.8 | 10.2 |
| | 9.8 | 10.1 | 26.3 | 24.7 |
| Operating income | 12.6 | 9.6 | 29.6 | 25.0 |
| Other income (expense): | | | | |
| Interest and other income | 1.0 | 1.1 | 2.8 | 4.0 |
| Gain on repurchase of debt | – | – | 0.4 | – |
| Gain on sales of assets | – | – | 0.8 | – |
| Interest expense | (14.1) | (14.5) | (42.6) | (43.5) |
| | (13.1) | (13.4) | (38.6) | (39.5) |
| Net loss | $ (0.5) | $ (3.8) | $ (9.0) | $ (14.5) |

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

## SCOTIA PACIFIC COMPANY LLC

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

| | Nine Months Ended September 30, 2003 | Nine Months Ended September 30, 2002 |
|---|---|---|
| | (Unaudited) | |
| **Cash flows from operating activities:** | | |
| Net loss | $ (9.0) | $ (14.5) |
| Adjustments to reconcile net loss to net cash used for operating activities: | | |
| Gain on repurchase of debt | (0.4) | – |
| Gain on sales of assets | (0.8) | – |
| Depletion, depreciation and amortization | 9.8 | 10.2 |
| Amortization of deferred financing costs | 1.0 | 1.0 |
| Increase (decrease) in cash resulting from changes in: | | |
| Receivables from Pacific Lumber | (5.9) | (3.2) |
| Prepaid timber harvest costs | 1.2 | – |
| Due to Pacific Lumber | 0.5 | – |
| Accrued interest | (14.2) | (14.4) |
| Other accrued liabilities | 0.8 | (0.7) |
| Other | (0.6) | (0.6) |
| Net cash used for operating activities | (17.6) | (22.2) |
| **Cash flows from investing activities:** | | |
| Proceeds from sales of assets | 3.2 | – |
| Capital expenditures | (5.9) | (4.9) |
| Net cash used for investing activities | (2.7) | (4.9) |
| **Cash flows from financing activities:** | | |
| Principal payments on Timber Notes and other timber-related debt | (16.5) | (14.9) |
| Member distributions | – | (29.4) |
| Borrowings (repayments) under the Line of Credit, net | 20.3 | 5.5 |
| Net changes in debt related restricted cash, marketable securities and other investments | 9.8 | 30.1 |
| Net cash provided by (used for) financing activities | 13.6 | (8.7) |
| **Net decrease in cash and cash equivalents** | (6.7) | (35.8) |
| **Cash and cash equivalents at beginning of period** | 10.1 | 37.8 |
| **Cash and cash equivalents at end of period** | $ 3.4 | $ 2.0 |
| **Supplemental disclosure of cash flow information:** | | |
| Interest paid | $ 55.9 | $ 56.9 |

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 September 30, 2003, the results of operations for the three and nine months ended September 30, 2003 and 2002, and the cash flows for the nine months ended September 30, 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. 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, in accordance with the Master Purchase Agreement, the Company so 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 were 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.

In June 2003, the State Board of Equalization adopted the new Harvest Value Schedule for the second half of 2003. The prices published in that schedule reflected a 22% increase in the SBE Price for small redwood logs and an 11% increase for small Douglas-fir logs from the prices published for the first half of 2003, and a 7% increase from the price in effect for small redwood logs (i.e., the prices established using the independent forestry consultant) during the first half of 2003.

With respect to the note payment date in January 2004, the Company expects to use funds available under the Line of Credit to pay a substantial portion of the $27.3 million of interest due (in addition to $2.0 million due in respect of Timber Notes held by the Company). The Company expects to repay $13.1 million of principal on the Timber Notes (an amount equal to Scheduled Amortization) using funds held in the SAR Account.

As discussed further in Note 3, regulatory compliance and litigation have caused and may continue to cause delays in harvesting which 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.

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 debt service obligations through 2004; however, there can be no assurance that this will be the case. 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 will be adversely affected if harvest levels decline or costs increase as a result of various regulatory, environmental and litigation matters discussed in Note 3.

***New Accounting Standards***

*Accounting for Asset Retirement Obligations*

In January 2003, the Company adopted 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. 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 position or results of operations.

*Classification of Gains and Losses from Extinguishment of Debt*

In January 2003, the Company adopted 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 adoption of SFAS No. 145 resulted in the inclusion of gains on repurchases of debt for the three and nine months ended September 30, 2003, in other income rather than as an extraordinary item in the financial statements.

## 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):

| | September 30, 2003 | December 31, 2002 |
|---|---|---|
| Current assets: | | |
| Restricted cash and cash equivalents | $ – | $ 5.2 |
| Marketable securities, restricted: | | |
| Amounts held in SAR Account | 22.2 | 19.3 |
| | 22.2 | 24.5 |
| Long-term restricted cash, marketable securities and other investments: | | |
| Amounts held in SAR Account | 85.5 | 101.6 |
| Other amounts restricted under the Indenture | 2.6 | 2.6 |
| Less: Amounts attributable to repurchased Timber Notes held in SAR Account | (51.5) | (51.3) |
| | 36.6 | 52.9 |
| Total restricted cash, cash equivalents, marketable securities and other investments | $ 58.8 | $ 77.4 |

## 3. Contingencies

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

From March 1999 until October 2002, the Company prepared THPs in accordance with the SYP. The SYP was intended to comply 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 forest practice rules allow companies which do not have a sustained yield plan to follow an alternative procedure. As discussed below, on October 31, 2003, the Court hearing the *EPIC-SYP/Permits* and *USWA lawsuits* entered a judgment invalidating the SYP and the California Permits. As a result of this case, the Company has since October 2002 been obtaining review and approval of prepared

THPs under this alternative procedure and expects to follow this procedure for the foreseeable future.

The HCP and related Federal Permits allow incidental “take” of certain species located on the Company’s timberlands which species have been listed by the federal government under the ESA 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 HCP and Federal 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 fall 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 eliminated 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 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 and costs could increase.

In October 2003, California enacted Senate Bill 810, which provides regional water quality control boards with additional authority related to the approval of THPs. Under this law, which will become effective on January 1, 2004, a THP “may not be approved if the appropriate regional water quality control board finds, based on substantial evidence, that the timber operations proposed in the plan will result in a discharge into a watercourse that has been classified as impaired due to sediment...that causes or contributes, to a violation of the regional water quality control plan.” The Company is uncertain of the operational and financial effects which will ultimately result from Senate Bill 810; however, because substantially all rivers and waterbodies on the Company’s timberlands are classified as impaired, implementation of this law could result in delays in obtaining approval of THPs, increased costs and additional protection measures beyond those contained in the HCP.

The North Coast Water Board has issued orders for the Elk River and Freshwater watersheds requiring the Company and Pacific Lumber to submit “Reports of Waste Discharge” to the North Coast Water Board in order to conduct winter harvesting activities in these 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 for the 2002-2003 winter operating period. These additional requirements have somewhat increased operating costs. Reports of Waste Discharge for the 2003-2004 winter operating period have been submitted and the North Coast Water Board imposed requirements similar to those imposed for the 2002 - 2003 winter operating period. In addition, the North Coast Water Board has issued the Elk River Order for the Elk River watershed which is aimed at addressing existing sediment production sites through clean up actions. The North Coast Water Board has also initiated the process which could result in similar orders for the Freshwater and Bear Creek watersheds, and are contemplating similar actions for the Jordon and Stitz Creek watersheds. The Elk River Order, as well as additional orders in the other watersheds (should they be issued), could result in significant costs to the Company beginning in 2004 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 by the Company and Pacific Lumber with the North Coast Water Board and its staff.

Lawsuits are pending which seek to prevent the Company from implementing 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 alleged, among other things, various violations of the CESA and the California Environmental Quality Act, and challenged, among other things, the validity and legality of the SYP and the California Permits. The plaintiffs sought, among other things, to set aside California's approval of the SYP and the California Permits and injunctive relief to prevent implementation of THPs approved in reliance upon these documents. In March 1999, the *USWA lawsuit* was filed challenging the validity and legality of the SYP. The *EPIC-SYP/Permits* and *USWA lawsuits* were consolidated for trial, which concluded on March 28, 2003. On October 31, 2003, the Court entered a judgment invalidating the SYP and the California Permits due to several deficiencies in agency procedures and the failure of the Company and Pacific Lumber to submit a complete and comprehensible SYP. The Court's decision, however, allows for harvesting on THPs which rely on the SYP and were approved prior to July 23, 2003. The short-term effect of the ruling will be to preclude approval, under the SYP, of a small number of THPs which were under review but had not been approved, and which will result in a minor reduction in 2003 harvesting that had been expected from these specific THPs. As a result of this case, the Company has since October 2002 been obtaining review and approval of new THPs under a procedure provided for in the forest practice rules that does not depend upon the SYP and the California Permits and expects to follow this procedure for the forseeable future. In addition, the Company is in the process of considering the options available to it in light of this development, including appealing the Court's decision and resubmission of an SYP.

In July 2001, the *Bear Creek lawsuit* was filed. The lawsuit alleges that the Company's and Pacific Lumber's harvesting and other forestry activities under certain of its approved 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. On October 14, 2003, in connection with certain motions that had been filed, the Court upheld the validity of an EPA regulation which exempts harvesting and other forestry activities from certain discharge requirements. Both state and federal agencies, along with Pacific Lumber and other timber companies, have relied upon this regulation for more than 25 years. However, the Court interpreted the regulation in such a way as to narrow the forestry operations which are exempted, thereby limiting the regulation's applicability. This ruling has widespread implications for the timber industry in the United States. The case is not yet final as the trial has not yet been held, and there are many unresolved issues involving interpretation of the Court's decision and its application to actual operations. Should the decision ultimately become final and held to apply to Pacific Lumber's timber operations, it may have some or all of the following effects: impose additional permitting requirements, delay approvals of THPs, increase harvesting costs and add water protection measures beyond those contained in the HCP. Nonetheless, due to the historical reliance by timber companies on the regulation, it is not likely that civil penalties will be awarded for operations that occurred prior to the Court's decision. While the impact of a conclusion to this case that upholds the October 14, 2003 ruling may be adverse, the Company does not believe that such an outcome would have a material adverse impact on the Company's financial condition, results of operations and/or liquidity. Nevertheless, due to the numerous ways in which the Court's interpretation of the regulation could be applied to actual operations, there can be no assurance that this will be the case.

On November 20, 2002, the *HWC lawsuit* was filed seeking to enjoin timber operations in the Elk and Freshwater watersheds of the Company's timberlands until and unless the regional and state water boards imposed on those operations waste discharge requirements that met standards demanded by the plaintiff. In August 2003, this case was dismissed by the Court at the request of the plaintiff.

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. A hearing on the Company's motions for sanctions and requested dismissal of the case was held on July 28, 2003, and the Company is awaiting the Court's decision. 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 the Company's timberlands beyond those provided for by the Environmental Plans or could provide additional regulatory powers to the regional and state water boards and their staffs beyond those provided in Senate Bill 810.

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 damage 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.

## 4. Comprehensive Loss and Member Deficit

Comprehensive loss includes the following (in millions):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| Net loss | $ (0.5) | $ (3.8) | $ (9.0) | $ (14.5) |
| Other comprehensive income (loss): | | | | |
| Net change in fair value of available-for-sale investments | (0.1) | 0.4 | (0.2) | (0.1) |
| Total comprehensive loss | $ (0.6) | $ (3.4) | $ (9.2) | $ (14.6) |

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

| | Nine Months Ended September 30, 2003 |
|---|---|
| Balance at beginning of period | $ (405.5) |
| Comprehensive loss | (9.2) |
| Balance at end of period | $ (414.7) |

## 5. Subsequent Event

In November 2003, Pacific Lumber and the Company sold approximately 681 acres of timberlands within an area known as the Grizzly Creek grove. The Company received $8.2 million in cash, and expects to recognize a gain of approximately $7.5 million in the fourth quarter of 2003 related to this sale.

## 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, developments in litigation, 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. Regulatory compliance and litigation have caused and may continue to 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 and Elk River 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. These requirements could cause increased costs and delays in harvesting.

Also discussed in Note 3 is the enactment of Senate Bill 810, which provides regional water quality control boards with additional authority related to the approval of THPs. Implementation of this law could result in delays in obtaining approvals of THPs, increased costs and additional water protection measures beyond those contained in the HCP.

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 legislative matters and legal proceedings relating to 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 were 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.

In June 2003, the State Board of Equalization adopted the new Harvest Value Schedule for the second half of 2003. The prices published in that schedule reflected a 22% increase in the SBE Price for small redwood logs and an 11% increase for small Douglas-fir logs from the prices published for the first half of 2003, and a 7% increase from the price in effect for small redwood logs (i.e., the prices established using the independent forestry consultant) during the first half of 2003.

*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 legislation, regulation or 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.

*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 September 30, 2003 | | | Three Months Ended September 30, 2002 | | |
|---|---|---|---|---|---|---|
| | **MBFEs** | **Price $/MBFE** | **Revenues** | **MBFEs** | **Price $/MBFE** | **Revenues** |
| Redwood | 26,200 | $ 691 | $ 18.1 | 27,000 | $ 550 | $ 14.8 |
| Douglas Fir | 8,200 | 502 | 4.1 | 11,000 | 417 | 4.6 |
| Other | 800 | 216 | 0.2 | 1,000 | 281 | 0.3 |
| | 35,200 | 636 | $ 22.4 | 39,000 | 505 | $ 19.7 |

| | Nine Months Ended September 30, 2003 | | | Nine Months Ended September 30, 2002 | | |
|---|---|---|---|---|---|---|
| | **MBFEs** | **Price $/MBFE** | **Revenues** | **MBFEs** | **Price $/MBFE** | **Revenues** |
| Redwood | 73,200 | $ 672 | $ 49.2 | 74,200 | $ 573 | $ 42.5 |
| Douglas Fir | 13,900 | 453 | 6.3 | 17,600 | 389 | 6.8 |
| Other | 1,600 | 250 | 0.4 | 1,500 | 235 | 0.4 |
| | 88,700 | 630 | $ 55.9 | 93,300 | 533 | $ 49.7 |

For the three months ended September 30, 2003, the Company experienced an increase in log revenues due predominately to the increase in the price for redwood logs as well as an increase in the volume of larger logs delivered; however, this increase was offset somewhat by an increase in the use of the helicopter method of logging (which reduces the price received for the log to reflect the increased cost of harvesting). The Company experienced an increase in log sales for the first nine months of 2003 versus the same period of 2002 due predominantly to a 19% increase in average realized price.

*Operating Income and Net Loss*

Operating income was $12.6 million and $9.6 million for the three months ended September 30, 2003 and 2002, respectively. Operating income was $29.6 million and $25.0 million for the nine months ended September 30, 2003 and 2002, respectively. Changes for the three and nine month periods were principally due to the increase in log sales discussed above offset by increases in expenses relating to winter road maintenance, insurance, employee benefits, and security costs.

Net losses were $0.5 million and $3.8 million for the three months ended September 30, 2003 and 2002, respectively. Net losses for the nine months ended September 30, 2003 and 2002, were $9.0 million and $14.5 million, respectively. The decreases in losses between periods are due to the increase in operating income discussed above, gains resulting from the sale of timberlands and repurchases of debt, and to a lesser extent, a decrease in interest expense between periods. The favorable impact from these items was offset somewhat by a decrease in interest income realized from cash, cash equivalents and other investments.

**Financial Condition and Investing and Financing Activities**

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

Due to its highly leveraged condition, the Company is more sensitive than less leveraged companies to factors affecting its operations, including low log prices, governmental regulation and litigation affecting its timber harvesting practices (see "—Results of Operations—Background" above and Note 3), and general economic conditions. The Company's cash flows from operations are significantly impacted by harvest volumes and log prices. The Master Purchase Agreement between the Company and Pacific Lumber 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. See "—Results of Operations—Master Purchase Agreement" above for further information on this agreement.

On June 20, 2003, the Line of Credit was extended to July 7, 2006. At or near the completion of such extension, the Company will request that the Line of Credit be extended for a further 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 September 30, 2003, the Company could have borrowed a maximum of $58.5 million under the Line of Credit, and there was $20.3 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 of interest due 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.

On the note payment date in July 2003, the Company used $27.4 million (in addition to $2.0 million due 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 repaid $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 the note payment date in January 2004, the Company expects to use the funds available under the Line of Credit to pay a substantial portion of the $27.3 million of interest due (in addition to $2.0 million due in respect of Timber Notes held by the Company). The Company expects to repay $13.1 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.

On August 12, 2003, Standard & Poor's Ratings Services announced that it was lowering its ratings on all classes of the Timber Notes. Ratings on the Class A-1 Timber Notes were lowered from A to BBB+; ratings on the Class A-2 Timber Notes were lowered from A to BBB; and ratings on the Class A-3 Timber Notes were lowered from BBB to BB. Standard & Poor's also indicated that the ratings remain on CreditWatch with negative implications and that the lowered ratings reflect the negative impact that depressed timber prices, lower harvest levels, and higher operating costs have had on the Company's cash flow available for debt service.

As discussed in Note 5, the Company received $8.2 million in November 2003 for the sale of timberlands in the Grizzly Creek grove. The proceeds will be used to pay down a portion of the Line of Credit.

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 debt service obligations through 2004; however, there can be no assurance that this will be the case. 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 will be adversely affected if harvest levels decline or costs increase as a result of the various regulatory, environmental and litigation matters 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 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 September 30, 2003, there were $20.3 million in borrowings outstanding under the Line of Credit. Based on the amount of borrowings outstanding under the Line of Credit during the nine months ended September 30, 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.

None of the Company's other debt is exposed 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.

As of the end of the period covered by 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:**

* 31.1 Section 302 Certification of Chief Executive Officer

* 31.2 Section 302 Certification of Chief Financial Officer

* 32.1 Section 906 Certification of Chief Executive Officer

* 32.2 Section 906 Certification of Chief Financial Officer

* Included with this filing

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

Since the filing of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003, the Company has filed or furnished on the dates indicated the following current reports on Form 8-K:

August 20, 2003 - report under Item 9 related to the filing of a certificate in respect of the Company's Timber Notes.

September 22, 2003 - report under Item 9 related to the filing of a certificate in respect of the Company's Timber Notes.

September 26, 2003 - report under Item 5 related to a supplemental statement of decision with respect to the *EPIC-SYP/Permits* and *USWA lawsuits*.

October 20, 2003 - report 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: November 14, 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

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

*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, California

*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, California ( No. CV990452)

*ESA:* The federal Endangered Species Act

*Federal Permits:* The incidental take permits issued by the federal government pursuant to the HCP

*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 SBE Prices which is 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 in March 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 in March 1999

*Humboldt DA action:* A civil suit filed in the Superior Court of Humboldt County, California 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 County Watershed Council, et al. v. North Coast Regional Water Quality Control Board, et al.* (No. CV03-0438), naming Pacific Lumber as real party in interest, which had been pending in the Superior Court of Humboldt 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 developed for use in structuring the Timber Notes; under this concept one thousand board feet, net Scribner scale, of residual 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 in March 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, California

*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