

STRATUS PROPERTIES INC  
Form 10-Q  
May 15, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014  
or

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

For the transition period from to  
Commission File Number: 0-19989

Stratus Properties Inc.

(Exact name of registrant as specified in its charter)

Delaware

72-1211572

(State or other jurisdiction of  
incorporation or organization)

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

212 Lavaca St., Suite 300

Austin, Texas

78701

(Address of principal executive offices)

(Zip Code)

(512) 478-5788

(Registrant's telephone number, including area code)

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

Yes  No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

On April 30, 2014, there were issued and outstanding 8,029,353 shares of the registrant's common stock, par value \$0.01 per share.

---

STRATUS PROPERTIES INC.  
TABLE OF CONTENTS

	Page
<u>Part I. Financial Information</u>	<u>2</u>
<u>Item 1. Financial Statements</u>	<u>2</u>
<u>Consolidated Balance Sheets (Unaudited)</u>	<u>2</u>
<u>Consolidated Statements of Income (Unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income (Unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows (Unaudited)</u>	<u>5</u>
<u>Consolidated Statements of Equity (Unaudited)</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>12</u>
<u>Item 4. Controls and Procedures</u>	<u>22</u>
<u>Part II. Other Information</u>	<u>22</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>22</u>
<u>Item 6. Exhibits</u>	<u>22</u>
<u>Signature</u>	<u>S-1</u>
<u>Exhibit Index</u>	<u>E-1</u>

---

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

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

	March 31, 2014	December 31, 2013	
<b>ASSETS</b>			
Cash and cash equivalents	\$ 19,760	\$ 21,307	
Restricted cash	3,145	5,077	
Real estate held for sale	24,026	18,133	
Real estate under development	76,660	76,891	
Land available for development	21,567	21,404	
Real estate held for investment, net	180,675	182,530	
Investment in unconsolidated affiliates	3,833	4,427	
Other assets	18,213	17,174	
Total assets	\$ 347,879	\$ 346,943	
<b>LIABILITIES AND EQUITY</b>			
Accounts payable	\$ 6,494	\$ 5,143	
Accrued liabilities	5,602	9,360	
Debt	153,241	151,332	
Other liabilities and deferred gain	12,208	11,792	
Total liabilities	177,545	177,627	
Commitments and contingencies			
Equity:			
Stratus stockholders' equity:			
Common stock	91	91	
Capital in excess of par value of common stock	203,822	203,724	
Accumulated deficit	(59,627	) (60,724	)
Accumulated other comprehensive loss	(167	) (22	)
Common stock held in treasury	(20,174	) (19,448	)
Total Stratus stockholders' equity	123,945	123,621	
Noncontrolling interests in subsidiaries	46,389	45,695	
Total equity	170,334	169,316	
Total liabilities and equity	\$ 347,879	\$ 346,943	

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

Table of Contents

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

	Three Months Ended		
	March 31,		
	2014	2013	
Revenues:			
Real estate operations	\$5,431	\$18,862	
Hotel	10,812	10,079	
Entertainment	5,487	3,208	
Commercial leasing	1,569	1,310	
Total revenues	23,299	33,459	
Cost of sales:			
Real estate operations	3,818	15,952	
Hotel	7,632	7,274	
Entertainment	4,021	2,456	
Commercial leasing	701	662	
Depreciation	2,247	2,230	
Total cost of sales	18,419	28,574	
Insurance settlement	(530	) —	
General and administrative expenses	2,062	1,764	
Total costs and expenses	19,951	30,338	
Operating income	3,348	3,121	
Interest expense, net	(849	) (2,299	)
Loss on interest rate cap agreement	(81	) —	
Other income, net	19	1,250	
Income before income taxes and equity in unconsolidated affiliates' income (loss)	2,437	2,072	
Equity in unconsolidated affiliates' income (loss)	681	(38	)
Provision for income taxes	(226	) (203	)
Net income	2,892	1,831	
Net income attributable to noncontrolling interests in subsidiaries	(1,795	) (678	)
Net income attributable to Stratus common stock	\$1,097	\$1,153	
Basic and diluted net income per share attributable to Stratus common stock	\$0.14	\$0.14	
Weighted-average shares of common stock outstanding:			
Basic	8,050	8,105	
Diluted	8,101	8,134	

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

Table of Contents

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

	Three Months Ended March 31,		
	2014	2013	
Net income	\$2,892	\$1,831	
Other comprehensive loss, net of taxes:			
Loss on interest rate swap agreement	(206	) —	
Other comprehensive loss	(206	) —	
Total comprehensive income	2,686	1,831	
Total comprehensive income attributable to noncontrolling interests	(1,734	) (678	)
Total comprehensive income attributable to Stratus common stock	\$952	\$1,153	

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

Table of Contents

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

	Three Months Ended	
	March 31,	
	2014	2013
Cash flow from operating activities:		
Net income	\$2,892	\$1,831
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation	2,247	2,230
Cost of real estate sold	2,584	12,585
Stock-based compensation	98	71
Equity in unconsolidated affiliates' (income) loss	(681	) 38
Deposits	(603	) (225
Development of real estate properties	(7,991	) (3,668
Recovery of land previously sold	—	(485
Municipal utility districts reimbursement	—	208
Decrease (increase) in other assets	881	(2,369
Decrease in accounts payable, accrued liabilities and other	(1,904	) (529
Net cash (used in) provided by operating activities	(2,477	) 9,687
Cash flow from investing activities:		
Capital expenditures	(488	) (70
Return of investment in unconsolidated affiliate	1,275	—
Net cash provided by (used in) investing activities	787	(70
Cash flow from financing activities:		
Borrowings from credit facility	3,500	3,000
Payments on credit facility	(1,171	) (9,447
Borrowings from project loan	—	9
Payments on project and term loans	(420	) (227
Noncontrolling interests distributions	(1,040	) (103
Repurchase of treasury stock	(536	) (371
Net payments for stock-based awards	(190	) (73
Net cash provided by (used in) financing activities	143	(7,212
Net (decrease) increase in cash and cash equivalents	(1,547	) 2,405
Cash and cash equivalents at beginning of year	21,307	12,784
Cash and cash equivalents at end of period	\$19,760	\$15,189

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

Table of Contents

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

	Stratus Stockholders' Equity										
	Common Stock Number of Shares	At Par Value	Capital in Excess of Par Value	Accum- ulated Deficit	Accum- ulated Other Compre- hensive Loss	Common Stock Held in Treasury Number of Shares	At Cost	Total Stratus Stockholders' Equity	Noncontrolling Interests in Subsidiaries	Total Equity	
Balance at December 31, 2013	9,076	\$91	\$203,724	\$(60,724)	\$(22)	1,030	\$(19,448)	\$123,621	\$45,695	\$169,316	
Common stock repurchases	—	—	—	—	—	31	(536)	(536)	—	(536)	
Exercised and issued stock-based awards	31	—	—	—	—	—	—	—	—	—	
Stock-based compensation	—	—	98	—	—	—	—	98	—	98	
Tender of shares for stock-based awards	—	—	—	—	—	11	(190)	(190)	—	(190)	
Noncontrolling interests distributions	—	—	—	—	—	—	—	—	(1,040)	(1,040)	
Total comprehensive income (loss)	—	—	—	1,097	(145)	—	—	952	1,734	2,686	
Balance at March 31, 2014	9,107	\$91	\$203,822	\$(59,627)	\$(167)	1,072	\$(20,174)	\$123,945	\$46,389	\$170,334	
Balance at December 31, 2012	9,037	\$90	\$203,298	\$(63,309)	\$—	940	\$(18,392)	\$121,687	\$87,208	\$208,895	
Common stock repurchases	—	—	—	—	—	37	(371)	(371)	—	(371)	
Exercised and issued stock-based awards	31	1	25	—	—	—	—	26	—	26	
Stock-based compensation	—	—	71	—	—	—	—	71	—	71	
Tender of shares for stock-based awards	—	—	—	—	—	8	(99)	(99)	—	(99)	
Noncontrolling interests distributions	—	—	—	—	—	—	—	—	(4,203)	(4,203)	
	—	—	—	1,153	—	—	—	1,153	678	1,831	



Total comprehensive  
income

Balance at March 31, 2013	9,068	\$91	\$203,394	\$(62,156)	\$—	985	\$(18,862)	\$122,467	\$83,683	\$206,150
------------------------------	-------	------	-----------	------------	-----	-----	------------	-----------	----------	-----------

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

Table of Contents

## STRATUS PROPERTIES INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 1. GENERAL

The accompanying unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2013, included in Stratus Properties Inc.'s (Stratus) Annual Report on Form 10-K (Stratus 2013 Form 10-K) filed with the Securities and Exchange Commission. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments (consisting only of normal recurring items) considered necessary for a fair statement of the results for the first-quarter periods. Operating results for the three-month period ended March 31, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

## 2. EARNINGS PER SHARE

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

	Three Months Ended	
	March 31,	
	2014	2013
Net income	\$2,892	\$1,831
Net income attributable to noncontrolling interests in subsidiaries	(1,795)	(678)
Net income attributable to Stratus common stock	\$1,097	\$1,153
Weighted-average shares of common stock outstanding	8,050	8,105
Add shares issuable upon exercise or vesting of:		
Dilutive stock options	15	6
Restricted stock units	36	23
Weighted-average shares of common stock outstanding for purposes of calculating diluted net income per share	8,101	8,134
Diluted net income per share attributable to Stratus common stock	\$0.14	\$0.14

a. Excludes shares of common stock associated with outstanding stock options with exercise prices less than the average market price of Stratus' common stock that were anti-dilutive based on the treasury stock method totaling approximately 3,000 shares.

Outstanding stock options with exercise prices greater than the average market price for Stratus' common stock during the first-quarter periods are excluded from the computation of diluted net income per share of common stock. Excluded were approximately 28,100 stock options with a weighted-average exercise price of \$27.20 for first-quarter 2014 and 68,100 stock options with a weighted-average exercise price of \$20.41 for first-quarter 2013.

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

Stratus and Canyon-Johnson Urban Fund II, L.P. (Canyon-Johnson) are participants in a joint venture, CJUF II Stratus Block 21, LLC (the Block 21 Joint Venture), for a 36-story mixed-use development in downtown Austin, Texas, anchored by a W Hotel & Residences (the W Austin Hotel & Residences project). Stratus is the manager of, and has an approximate 40 percent interest in, the Block 21 Joint Venture, and Canyon-Johnson has an approximate 60 percent interest in the Block 21 Joint Venture. As of March 31, 2014, cumulative capital contributions totaled \$71.9 million

for Stratus and \$94.0 million for Canyon-Johnson. Distributions in first-quarter 2014 totaled \$0.8 million to Stratus and \$1.0 million to Canyon-Johnson. As of March 31, 2014, inception-to-date distributions totaled \$45.4 million for Stratus and \$51.6 million for Canyon-Johnson. During April 2014, the Block 21 Joint Venture made distributions totaling \$1.9 million to Stratus and \$2.5 million to Canyon-Johnson. The Block 21 Joint Venture is consolidated in Stratus' financial statements based on its assessment that the Block 21 Joint Venture is a variable interest entity (VIE) and that Stratus is the primary beneficiary. Stratus will continue to periodically evaluate which entity is the primary beneficiary of the Block 21 Joint Venture in accordance with applicable accounting guidance. See Note 2 of the Stratus 2013 Form 10-K for further discussion.

Table of Contents

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

	March 31, 2014	December 31, 2013
Assets:		
Cash and cash equivalents	\$ 16,234	\$ 13,192
Restricted cash	3,140	5,069
Real estate held for sale	9,891	10,942
Real estate held for investment, net	155,830	157,541
Other assets	9,060	7,631
Total assets	194,155	194,375
Liabilities:		
Accounts payable	4,044	3,428
Accrued liabilities	4,365	6,856
Debt	99,386	99,754
Other liabilities	5,599	4,761
Total liabilities	113,394	114,799
Net assets	\$ 80,761	\$ 79,576

Profits and losses between partners in a real estate venture should be allocated based on how changes in net assets of the venture would affect cash payments to the investors over the life of the venture and on its liquidation. The amount of the ultimate profits earned by the W Austin Hotel & Residences project will affect the ultimate profit sharing ratios because of provisions in the joint venture agreement, which would require Stratus to return certain previously received distributions to Canyon-Johnson under certain circumstances. Because of the uncertainty of the ultimate profits and, therefore, profit-sharing ratios, the W Austin Hotel & Residences project's cumulative profits or losses are allocated based on a hypothetical liquidation of the Block 21 Joint Venture's net assets as of each balance sheet date. As of March 31, 2014, the cumulative earnings for the W Austin Hotel & Residences project were allocated based on 42 percent for Stratus and 58 percent for Canyon-Johnson.

#### 4. Joint Venture with LCHM Holdings, LLC

On February 28, 2011, Stratus entered into a joint venture (the Parkside Village Joint Venture) with Moffett Holdings, LLC (Moffett Holdings) for the development of Parkside Village, a retail project in the Circle C community. On March 3, 2014, Moffett Holdings redeemed and purchased the membership interest in Moffett Holdings held by LCHM Holdings, LLC (LCHM Holdings). In connection with the redemption, (1) LCHM Holdings received the 625,000 shares of Stratus common stock held by Moffett Holdings and (2) LCHM Holdings entered into an assignment and assumption agreement pursuant to which Moffett Holdings assigned to LCHM Holdings its rights and obligations under the Investor Rights Agreement between Moffett Holdings and Stratus dated as of March 15, 2012. See Note 3 of the Stratus 2013 Form 10-K for further discussion.

#### 5. FAIR VALUE MEASUREMENTS

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

The carrying value for certain Stratus financial instruments (i.e., cash and cash equivalents, restricted cash, accounts payable and accrued liabilities) approximate fair value because of their short-term nature and generally negligible

credit losses. A summary of the carrying amount and fair value of Stratus' other financial instruments follows (in thousands):

8

---

Table of Contents

	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Interest rate cap agreement	\$270	\$270	\$351	\$351
Liabilities:				
Interest rate swap agreement	238	238	32	32
Debt	153,241	153,590	151,332	151,584

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

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

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

## 6. INTEREST AND EQUITY TRANSACTIONS

Interest Expense and Capitalization. Interest expense (before capitalized interest) totaled \$1.7 million for first-quarter 2014 and \$3.1 million for first-quarter 2013. Stratus' capitalized interest costs totaled \$0.8 million for each of the first-quarters of 2014 and 2013. Capitalized interest costs for first-quarter 2014 and 2013 primarily related to development activities at properties in Barton Creek, Circle C and Lakeway, Texas.

Common Stock Repurchases. During first-quarter 2014, Stratus purchased 30,900 shares of its common stock for \$0.5 million (\$17.33 per share). Stratus obtained lender approval for these repurchases. See Note 9 of the Stratus 2013 Form 10-K for further discussion of common stock repurchases permitted under debt agreements.

## 7. INCOME TAXES

Stratus' accounting policy for and other information regarding its income taxes is further described in Notes 1 and 8 of the Stratus 2013 Form 10-K.

Stratus evaluated the recoverability of its deferred tax assets and considered available positive and negative evidence, giving greater weight to losses in recent years, the absence of taxable income in the carry back period and uncertainty regarding projected future financial results. As a result, Stratus concluded that there was not sufficient positive

evidence supporting the realizability of its deferred tax assets beyond an amount totaling \$0.3 million at March 31, 2014, and December 31, 2013.

Stratus' future results of operations may be negatively impacted by an inability to realize a tax benefit for future tax losses or for items that will generate additional deferred tax assets. Stratus' future results of operations may be favorably impacted by reversals of valuation allowances if Stratus is able to demonstrate sufficient positive evidence that its deferred tax assets will be realized.

Table of Contents

The difference between Stratus' consolidated effective income tax rate for the first quarters of 2014 and 2013, and the U.S. federal statutory tax rate of 35 percent was primarily attributable to the realization of deferred tax assets for first-quarter 2014 and additional valuation allowances recorded against deferred tax assets for first-quarter 2013.

8. BUSINESS SEGMENTS

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

The Real Estate Operations segment is comprised of Stratus' real estate assets (developed, under development and undeveloped), which consists of its properties in the Barton Creek community, the Circle C community, Lantana, and Lakeway, Texas, and the condominium units at the W Austin Hotel & Residences project.

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

The Entertainment segment includes ACL Live, a live music and entertainment venue and production studio at the W Austin Hotel & Residences project. In addition to hosting concerts and private events, this venue is the home of Austin City Limits, a television program showcasing popular music legends. The Entertainment segment also includes revenues and costs associated with events hosted at other venues, and the results of the Stageside Productions joint venture with Pedernales Entertainment LLC.

The Commercial Leasing segment includes the office and retail space at the W Austin Hotel & Residences project, a retail building and a bank building in Barton Creek Village, and 5700 Slaughter and Parkside Village in the Circle C community.

Stratus uses operating income or loss to measure the performance of each segment. Stratus allocates parent company general and administrative expenses that do not directly relate to a particular operating segment between the Real Estate Operations and Commercial Leasing segments based on projected annual revenues for each segment. General and administrative expenses related to the W Austin Hotel & Residences project are allocated to the Real Estate Operations, Hotel, Entertainment and Commercial Leasing segments based on projected annual revenues for the W Austin Hotel & Residences project. The following segment information reflects management's determinations that may not be indicative of what actual financial performance of each segment would be if it were an independent entity.



Table of Contents

Segment data presented below was prepared on the same basis as Stratus' consolidated financial statements (in thousands).

	Real Estate Operations <sup>a</sup>	Hotel	Entertainment	Commercial Leasing	Eliminations and Other <sup>b</sup>	Total
Three Months Ended March 31, 2014:						
Revenues:						
Unaffiliated customers	\$5,431	\$10,812	\$5,487	\$1,569	\$—	\$23,299
Intersegment	23	130	7	123	(283)	) —
Cost of sales, excluding depreciation	3,870	7,632	4,069	725	(124)	) 16,172
Depreciation	56	1,473	319	435	(36)	) 2,247
Insurance settlement	(530)	) —	—	—	—	(530)
General and administrative expenses	1,628	72	27	501	(166)	) 2,062
Operating income	\$430	\$1,765	\$1,079	\$31	\$43	\$3,348
Capital expenditures <sup>c</sup>	\$7,991	\$49	\$32	\$407	\$—	\$8,479
Total assets at March 31, 2014	141,617	113,742	49,846	48,834	(6,160)	) 347,879

## Three Months Ended March 31, 2013:

Revenues:						
Unaffiliated customers	\$18,862	\$10,079	\$3,208	\$1,310	\$—	\$33,459
Intersegment	14	82	8	131	(235)	) —
Cost of sales, excluding depreciation	15,980	7,280	2,489	682	(87)	) 26,344
Depreciation	64	1,477	307	419	(37)	) 2,230
General and administrative expenses	1,503	74	23	302	(138)	) 1,764
Operating income	\$1,329	\$1,330	\$397	\$38	\$27	\$3,121
Capital expenditures <sup>c</sup>	\$3,668	\$1	\$9	\$60	\$—	\$3,738
Total assets at March 31, 2013	167,496	118,479	44,795	47,081	(6,686)	) 371,165

a. Includes sales commissions and other revenues together with related expenses.

b. Includes eliminations of intersegment amounts, including the deferred development fee income between Stratus and the Block 21 Joint Venture (see Note 3).

c. Also includes purchases and development of residential real estate held for sale.

## 9. NEW ACCOUNTING STANDARDS

In April 2014, the Financial Accounting Standards Board issued an Accounting Standards Update (ASU), which revises the guidance for reporting discontinued operations. This ASU amends the definition of a discontinued operation and requires additional disclosures about disposal transactions that do not meet the definition of a discontinued operation. For public entities, this ASU is effective for annual periods beginning on or after December 15, 2014, and interim periods within that year. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. Stratus adopted this ASU in first-quarter 2014.

## 10. SUBSEQUENT EVENTS

From April 1, 2014 through April 30, 2014, Stratus purchased 6,000 shares of its common stock for \$0.1 million (\$16.90 per share). Stratus obtained lender approval for these repurchases.

Stratus evaluated events after March 31, 2014, and through the date the financial statements were issued, and determined any events or transactions occurring during this period that would require recognition or disclosure are appropriately addressed in these financial statements.



Table of Contents

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

## OVERVIEW

In management's discussion and analysis "we," "us," "our" and "Stratus" refer to Stratus Properties Inc. and all entities owned or controlled by Stratus Properties Inc. You should read the following discussion in conjunction with discussion and analysis of financial results contained in our Annual Report on Form 10-K for the year ended December 31, 2013 (2013 Form 10-K) filed with the Securities and Exchange Commission. The results of operations reported and summarized below are not necessarily indicative of our future operating results. All subsequent references to "Notes" refer to Notes to Consolidated Financial Statements (Unaudited) located in Part I, Item 1. "Financial Statements," unless otherwise stated.

We are engaged in the acquisition, development, management, operation and/or sale of commercial, hotel, entertainment, and multi- and single-family residential real estate properties located in Texas, primarily in the Austin and central-Texas areas. We generate revenues from sales of developed properties, from our hotel and entertainment operations and from rental income from our commercial properties. See Note 8 for further discussion of our operating segments.

Developed property sales can include condominium units at the W Austin Hotel & Residences project, an individual tract of land that has been developed and permitted for residential use or a developed lot with a home already built on it. We may, on occasion, sell properties under development, undeveloped properties or commercial properties, if opportunities arise that we believe will maximize overall asset values.

Our principal real estate holdings are in southwest Austin, Texas. The number of developed lots/units, under development acreage and undeveloped acreage as of March 31, 2014, that comprise our principal real estate development projects are presented in the following table.

	Developed Lots/Units	Acreage			Undeveloped			Total	Total Acreage
		Under Development Single Family	Commercial	Total	Single family	Multi-family	Commercial		
Austin:									
Barton Creek	31	166	—	166	512	327	418	1,257	1,423
Circle C	57	—	23	23	—	36	228	264	287
Lantana	—	—	—	—	—	—	43	43	43
Lakeway	—	—	—	—	—	—	32	32	32
W Austin Residences	7	—	—	—	—	—	—	—	—
San Antonio:									
Camino Real	—	—	—	—	—	—	2	2	2
Total	95	166	23	189	512	363	723	1,598	1,787

Our principal residential holdings at March 31, 2014, included developed lots at Barton Creek and condominium units at the W Austin Hotel & Residences project. See "Development Activities - Residential" for further discussion. Our principal commercial holdings at March 31, 2014, in addition to the W Austin Hotel & Residences project, consisted of the first phase of Barton Creek Village, and the 5700 Slaughter retail complex and Parkside Village, which are both in the Circle C community. See "Development Activities - Commercial" for further discussion.

The W Austin Hotel & Residences project is located on a two-acre city block in downtown Austin and contains a 251-room luxury hotel, 159 residential condominium units, and office, retail and entertainment space. The hotel is

managed by Starwood Hotels & Resorts Worldwide, Inc. The office space totals 39,328 square feet and the retail space totals 18,362 square feet. The entertainment space, occupied by Austin City Limits Live at the Moody Theater (ACL Live), includes a live music and entertainment venue and production studio.

For first-quarter 2014, our revenues totaled \$23.3 million and our net income attributable to common stock totaled \$1.1 million, compared with revenues of \$33.5 million and net income attributable to common stock of \$1.2 million for first-quarter 2013. The decrease in revenues primarily relates to a decrease in condominium unit sales at the W Austin Residences as inventory has declined. Only seven units remained available for sale at March 31, 2014. The

Table of Contents

results for first-quarter 2014 included a gain of \$0.5 million associated with an insurance settlement. The results for first-quarter 2013 included a gain of \$1.5 million associated with the sale of a 16-acre tract of land at Lantana.

**BUSINESS STRATEGY AND RELATED RISKS**

Our business strategy is to create value for our shareholders by methodically developing high-quality residential and commercial projects using our existing assets and selectively pursuing new development opportunities. We believe that Austin, and other Texas markets, continue to be desirable. Many of our developments are in unique locations where development approvals have historically been subject to regulatory constraints, making it difficult to obtain entitlements. Our Austin assets, which are located in desirable areas with significant regulatory constraints, are highly entitled and, as a result, we believe that through strategic planning and development, we can maximize and fully exploit their value. Additionally, we believe the W Austin Hotel sets a high standard for contemporary luxury in downtown Austin and competes favorably with other hotels and resorts in our geographic market. Our entertainment operations provide quality live music experiences that create awareness for our ACL Live venue and brand, enhancing the overall value of the W Austin Hotel & Residences project. Our current focus is to proceed with the development of our properties, to seek new opportunities to acquire additional properties for potential mixed-use and retail development projects, including with strategic partners where beneficial, and to continue to effectively operate our hotel and entertainment businesses.

In years past, economic conditions, including the constrained capital and credit markets, negatively affected the execution of our business plan, primarily by decreasing the pace of development to match economic and market conditions. We responded to these conditions by successfully restructuring our existing debt, including reducing interest rates and extending maturities, which enabled us to preserve our development opportunities until market conditions improved. Economic conditions have improved and we believe we have the financial flexibility to fully exploit our development opportunities and resources. As of March 31, 2014, we had \$32.7 million of availability under our revolving line of credit with Comerica Bank (the Comerica credit facility) and \$2.5 million in cash and cash equivalents available for use in our real estate operations, excluding \$1.1 million of cash associated with the joint venture with LCHM Holdings, LLC for the development of Parkside Village (the Parkside Village Joint Venture) and \$16.2 million of cash associated with the W Austin Hotel & Residences project. In first-quarter 2014 the joint venture for the W Austin Hotel & Residences project, CJUF II Stratus Block 21, LLC (the Block 21 Joint Venture), paid \$0.8 million in distributions to Stratus and \$1.0 million to Canyon-Johnson Urban Fund II, L.P., Stratus' joint venture partner.

Although we have near-term debt maturities and significant recurring costs, including property taxes, maintenance and marketing, we believe we have sufficient liquidity to address our near term requirements. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risk Factors” in our 2013 Form 10-K for further discussion.

Table of Contents

## DEVELOPMENT ACTIVITIES

Residential. As of March 31, 2014, the number of our residential developed lots/units, lots under development and potential development by area are shown below (excluding lots associated with our unconsolidated joint venture with Trammell Crow Central Texas Development, Inc. relating to Crestview Station (the Crestview Station Joint Venture)):

	Residential Lots/Units			Total
	Developed	Under Development	Potential Development <sup>a</sup>	
W Austin Hotel & Residences project:				
Condominium units <sup>b</sup>	7	—	—	7
Barton Creek:				
Calera:				
Verano Drive	6	—	—	6
Amarra Drive:				
Phase II Lots	25	—	—	25
Phase III Lots	—	64	—	64
Townhomes	—	—	214	214
Section N Multi-family	—	—	1,860	1,860
Other Barton Creek Sections	—	—	155	155
Circle C:				
Meridian	57	—	—	57
Tract 101	—	—	240	240
Tract 102	—	—	56	56
Total Residential Lots/Units	95	64	2,525	2,684

Our development of the properties identified under the heading “Potential Development” is dependent upon the approval of our development plans and permits by governmental agencies, including the City of Austin (the city).

Those governmental agencies may either not approve one or more development plans and permit applications related to such properties or require us to modify our development plans. Accordingly, our development strategy with respect to those properties may change in the future. While we may be proceeding with approved infrastructure projects on some of these properties, they are not considered to be “under development” for disclosure in this table unless other development activities necessary to fully realize the properties’ intended final use are in progress or scheduled to commence in the near term.

b. Owned through a joint venture.