STEMCELLS INC
Form 10-Q
November 13, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended: September 30, 2014

Commission File Number: 0-19871

STEMCELLS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**94-3078125**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer identification No)**

7707 Gateway Blvd

Newark, CA 94560

(Address of principal executive offices including zip code)

(510) 456-4000

(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 twelve months (or for such shorter periods that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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 x 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. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

At October 31, 2014, there were 68,729,774 shares of Common Stock, $.01 par value, issued and outstanding.

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STEMCELLS, INC.

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NOTE REGARDING REFERENCES TO US AND OUR COMMON STOCK

Throughout this Form 10-Q, the words we, us, our, and StemCells refer to StemCells, Inc., including our directly ar indirectly wholly-owned subsidiaries. Common stock refers to the common stock, $.01 par value, of StemCells, Inc.

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PART I-FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STEMCELLS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,212,589	$ 30,585,424
Trade receivables	70,495	108,815
Other receivables	173,870	486,222
Prepaid assets	1,037,155	530,037
Deferred financing costs, current	28,409	46,420
Other assets, current	40,000	83,537
Total current assets	33,562,518	31,840,455
Property, plant and equipment, net	5,126,112	5,304,684
Deferred financing costs, non-current	4,162	23,307
Other assets, non-current	399,672	413,717
Goodwill	2,093,602	2,139,294
Other intangible assets, net	1,584,046	1,835,717
Total assets	$ 42,770,112	$ 41,557,174
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,216,980	$ 1,151,903
Accrued expenses and other current liabilities	2,610,659	4,067,916
Deferred revenue, current	27,524	67,245
Capital lease obligation, current	21,827	21,316
Deferred rent, current	73,060	34,366
Loan payable net of discount, current	3,919,286	3,664,370
Bonds payable, current		125,000
Total current liabilities	7,869,336	9,132,116
Capital lease obligations, non-current	13,069	29,422
Loan payable net of discount, non-current	12,049,258	9,244,874
Fair value of warrant liability	4,011,736	5,541,809
Other long-term liabilities	1,273,190	801,388
Deferred rent, non-current	1,757,750	1,790,943

Deferred revenue, non-current	50,291	62,910
Total liabilities	27,024,630	26,603,462
Commitments and contingencies (Note 7)		
Stockholders equity:		
Common stock, $0.01 par value; 225,000,000 shares authorized; issued and outstanding 68,660,276 at September 30, 2014 and 55,138,311 at December 31, 2013	686,603	551,383
Additional paid-in capital	424,902,142	401,680,562
Accumulated deficit	(410,023,000)	(387,530,334)
Accumulated other comprehensive income	179,737	252,101
Total stockholders equity	15,745,482	14,953,712
Total liabilities and stockholders equity	$ 42,770,112	$ 41,557,174

See Notes to Condensed Consolidated Financial Statements.

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STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

	Three months ended September 30, 2014	Three months ended September 30, 2013	Nine months ended September 30, 2014	Nine months ended September 30, 2013
Revenue:				
Revenue from licensing agreements, grants and other	$ 98,293	$ 52,798	$ 145,356	$ 159,773
Revenue from product sales	171,371	271,994	705,992	730,916
Total revenue	269,664	324,792	851,348	890,689
Cost of product sales	58,163	85,743	223,536	230,157
Gross profit	211,501	239,049	627,812	660,532
Operating expenses:				
Research and development	4,657,479	5,184,365	15,654,057	14,553,145
Selling, general and administrative	2,071,198	1,710,749	6,494,595	5,180,027
Wind-down expenses				61,837
Total operating expenses	6,728,677	6,895,114	22,148,652	19,795,009
Loss from operations	(6,517,176)	(6,656,065)	(21,520,840)	(19,134,477)
Other income (expense):				
Change in fair value of warrant liability	4,076,360	(143,511)	95,266	425,570
Interest income	2,223	136	6,097	8,772
Interest expense	(311,349)	(382,119)	(1,035,061)	(785,122)
Other income (expense), net	(7,244)	(10,094)	(38,128)	8,475
Total other expense, net	3,759,990	(535,588)	(971,826)	(342,305)
Net loss	$ (2,757,186)	$ (7,191,653)	$ (22,492,666)	$ (19,476,782)
Basic and diluted net loss per share	$ (0.04)	$ (0.17)	$ (0.38)	$ (0.49)
Weighted average number of common shares outstanding, basic and diluted	66,535,000	41,402,717	59,224,989	39,787,527

See Notes to Condensed Consolidated Financial Statements.

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STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2014	**2013**	**2014**	**2013**
Net loss	$ (2,757,186)	$ (7,191,653)	$ (22,492,666)	$ (19,476,782)
Other comprehensive income (loss)				
Foreign currency translation adjustments	(182,933)	206,120	(72,364)	(23,928)
Unrealized gains (losses) on marketable securities		(425)		1,356
Other comprehensive income (loss)	(182,933)	205,695	(72,364)	(22,572)
Comprehensive loss	$ (2,940,119)	$ (6,985,958)	$ (22,565,030)	$ (19,499,354)

See Notes to Condensed Consolidated Financial Statements.

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STEMCELLS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	Nine months ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net loss	$ (22,492,666)	$ (19,476,782)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	992,612	730,504
Stock-based compensation	1,543,577	2,033,228
Amortization of debt discount and issuance costs	192,117	509,069
Loss (gain) on disposal of fixed assets	8,845	(34,946)
Change in fair value of warrant liability	(95,266)	(425,570)
Changes in operating assets and liabilities:		
Accrued interest and other receivables	277,173	(364,940)
Trade receivables	37,121	57,569
Prepaid and other current assets	(483,178)	782,745
Other assets, non-current	17,207	(52,474)
Accounts payable and accrued expenses	(911,327)	499,935
Accrued wind-down expenses		(1,102,762)
Deferred revenue	(52,291)	(19,146)
Deferred rent	5,500	431,390
Net cash used in operating activities	(20,960,576)	(16,432,180)
Cash flows from investing activities:		
Purchase of marketable securities		(527,967)
Proceeds from the sale and maturity of marketable securities		14,430,000
Purchases of property, plant and equipment	(598,432)	(4,556,406)
Proceeds from sale of property, plant and equipment		38,500
Acquisition of other assets		(100,000)
Net cash provided by (used in) investing activities	(598,432)	9,284,127
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of issuance costs	18,952,721	6,115,442
Proceeds from the exercise of stock options		2,809
Proceeds from the exercise of warrants, net of issuance costs	1,974,931	460,097
Proceeds from loan payable, net of issuance costs	5,775,543	13,558,358
Payments related to net share issuance of stock based awards	(499,333)	(342,366)
Repayment of capital lease obligations	(15,842)	(7,302)
Repayment of loan and bond payable	(2,996,204)	(152,500)
Net cash provided by financing activities	23,191,816	19,634,538

Increase (decrease) in cash and cash equivalents	1,632,808	12,486,485
Effects of foreign exchange rate changes on cash	(5,643)	(2,467)
Cash and cash equivalents, beginning of period	30,585,424	8,471,275
Cash and cash equivalents, end of period	$ 32,212,589	$ 20,955,293
Supplemental disclosure of cash flow information:		
Interest paid	$ 384,545	$ 271,054
Fair value of 329,131 shares issued as consideration under an equity financing agreement[1]		$ 600,006
Equipment acquired under a capital lease[2]		$ 43,600

See Notes to Condensed Consolidated Financial Statements.

1 In June 2013, we entered into an agreement with an institutional investor, under which we have the right to sell up to $30.0 million of common stock to the institutional investor. In consideration for entering into the agreement, we issued 329,131 shares of our common stock to the institutional investor. We will not receive any cash proceeds from the issuance of these 329,131 shares. All shares sold or to be sold under this agreement are offered under our shelf registration statement previously filed with, and declared effective by, the SEC. In October 2013, we terminated the agreement without any cost or penalty.

2 Represents the present value of future minimum capital lease payments for equipment leased.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2014 and 2013

Note 1. Summary of Significant Accounting Policies

Nature of Business.

StemCells, Inc., a Delaware corporation, is a biopharmaceutical company that operates in one segment, the research, development, and commercialization of stem cell therapeutics and related technologies.

The accompanying financial data as of September 30, 2014 and for the three and nine months ended September 30, 2014 and 2013 have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) have been condensed or omitted pursuant to these rules and regulations. The December 31, 2013 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by U.S. GAAP. However, we believe that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

We have incurred significant operating losses since inception. We expect to incur additional operating losses over the foreseeable future. We have very limited liquidity and capital resources and must obtain significant additional capital and other resources in order to provide funding for our product development efforts, the acquisition of technologies, businesses and intellectual property rights, preclinical and clinical testing of our products, pursuit of regulatory approvals, acquisition of capital equipment, laboratory and office facilities, establishment of production capabilities, selling, general and administrative expenses and other working capital requirements. We rely on our cash reserves, proceeds from equity and debt offerings, credit facilities, proceeds from the transfer or sale of intellectual property rights, equipment, facilities or investments, government grants and funding from collaborative arrangements, to fund our operations. If we exhaust our cash reserves and are unable to obtain adequate financing, we may be unable to meet our operating obligations and we may be required to initiate bankruptcy proceedings. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of StemCells, Inc., and our wholly-owned subsidiaries, including StemCells California, Inc., Stem Cell Sciences Holdings Ltd, and Stem Cell Sciences (UK) Ltd. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported in our condensed consolidated financial statements and accompanying notes. Actual results could differ materially from these estimates.

Significant estimates include the following:

the grant date fair value of stock-based awards recognized as compensation expense (see Note 5, Stock-Based Compensation);

the fair value of warrants recorded as a liability (see Note 8, Warrant Liability); and

the fair value of goodwill and other intangible assets (see Note 4, Goodwill and Other Intangible Assets).

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Financial Instruments

Cash and Cash Equivalents

Cash equivalents are money market accounts, money market funds and investments with maturities of 90 days or less from the date of purchase.

Trade and Other Receivables

Our receivables generally consist of interest income on our financial instruments, revenue from licensing agreements and grants, and revenue from product sales.

Warrant Liability

We account for our warrants in accordance with U.S. GAAP which defines how freestanding contracts that are indexed to and potentially settled in a company s own stock should be measured and classified. Authoritative accounting guidance prescribes that only warrants issued by us under contracts that cannot be net-cash settled, and are both indexed to and settled in our common stock, can be classified as equity. As part of both our November 2008 and November 2009 financings, we issued warrants with five year terms to purchase 1,034,483 and 400,000 shares of our common stock at $23.00 and $15.00 per share, respectively. The 1,034,483 warrants issued as part of the November 2008 financing, expired unexercised by their own terms in May 2014. As part of our December 2011 financing, we issued Series A Warrants with a five year term to purchase 8,000,000 shares at $1.40 per share and Series B Warrants with a ninety trading day term to purchase 8,000,000 units at $1.25 per unit. Each unit underlying the Series B Warrants consisted of one share of our common stock and one Series A Warrant. In the first and second quarter of 2012, an aggregate of 2,700,000 Series B Warrants were exercised. For the exercise of these warrants, we issued 2,700,000 shares of our common stock and 2,700,000 Series A Warrants. The remaining 5,300,000 Series B Warrants expired unexercised by their terms on May 2, 2012. As terms of the warrants issued in 2009 and the Series A warrants do not meet the specificize:10pt">

Net working capital adjustment from RTS divestiture

(996)

Change in restricted cash and investments

(6,052) 13,976

Capital expenditures

(77,713) (101,450)

Net cash used in investing activities

(96,275) (86,298)

Cash Flow from Financing Activities:

Proceeds from long-term debt

459,384 842,000

Payments on long-term debt

(509,132) (742,203)

Payments on non-recourse debt

(4,511) (27,153)

Proceeds from non-recourse debt

74,191

Taxes paid related to net share settlements of equity awards

(1,844)

Proceeds from issuance of common stock in connection with ESPP

277 228

Issuance of common stock under prospectus supplement

54,724

Debt issuance costs

(23,508) (19,317)

Income tax benefit related to equity compensation

1,498 1,883

Proceeds from the exercise of stock options

6,384 4,941

Cash dividends paid

(124,084) (107,526)

Net cash used in financing activities

(66,621) (47,147)

Effect of Exchange Rate Changes on Cash and Cash Equivalents

(1,174) (2,969)

Net increase Cash and Cash Equivalents

555 21,406

Cash and Cash Equivalents, beginning of period	52,125	31,755
Cash and Cash Equivalents, end of period	$52,680	$53,161
Supplemental Disclosures:		
Non-cash Investing and Financing activities:		
Capital expenditures in accounts payable and accrued expenses	$11,895	$529

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

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THE GEO GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The GEO Group, Inc., a Florida corporation, and subsidiaries (the Company or GEO) is a fully-integrated real estate investment trust (REIT) specializing in the ownership, leasing and management of correctional, detention and re-entry facilities and the provision of community-based services and youth services in the United States, Australia, South Africa, the United Kingdom and Canada. The Company owns, leases and operates a broad range of correctional and detention facilities including maximum, medium and minimum security prisons, immigration detention centers, minimum security detention centers, as well as community based re-entry facilities. The Company develops new facilities based on contract awards, using its project development expertise and experience to design, construct and finance what it believes are state-of-the-art facilities that maximize security and efficiency. The Company provides innovative compliance technologies, industry-leading monitoring services, and evidence-based supervision and treatment programs for community-based parolees, probationers and pretrial defendants. The Company also provides secure transportation services for offender and detainee populations as contracted domestically and in the United Kingdom through its joint venture GEO Amey PECS Ltd. (GEOAmey). The Company s worldwide operations include the management and/or ownership of approximately 78,500 beds at 98 correctional and detention facilities, including idle facilities, projects under development and recently awarded contracts, and also include the provision of monitoring of more than 70,000 offenders in a community-based environment on behalf of approximately 900 federal, state and local correctional agencies located in all 50 states.

As a part of the Company s conversion to a REIT which became effective January 1, 2013, the Company merged into The GEO Group REIT, Inc. (GEO REIT), a newly formed wholly-owned subsidiary of GEO. The merger became effective June 27, 2014 and was approved by the Company s shareholders on May 2, 2014. The purpose of the merger was to ensure the effective adoption of charter provisions that implement standard REIT share ownership and transfer restrictions. In the merger, shares of GEO s common stock were converted into the same number of GEO REIT shares of common stock. In addition, each share of the Company s common stock held in treasury at June 27, 2014 were retired, and a corresponding adjustment was recorded to common stock and additional paid-in capital. Effective at the time of the merger, GEO REIT was renamed The GEO Group, Inc. Also, in connection with the merger, the Company s authorized common stock was increased from 90 million shares to 125 million shares.

The Company s unaudited consolidated financial statements included in this Quarterly Report on Form 10-Q have been prepared in accordance with accounting principles generally accepted in the United States and the instructions to Form 10-Q and consequently do not include all disclosures required by Form 10-K. The accounting policies followed for quarterly financial reporting are the same as those disclosed in the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 3, 2014 for the year ended December 31, 2013. The accompanying December 31, 2013 consolidated balance sheet has been derived from those audited financial statements. Additional information may be obtained by referring to the Company s Form 10-K for the year ended December 31, 2013. In the opinion of management, all adjustments (consisting only of normal recurring items) necessary for a fair presentation of the financial information for the interim periods reported in this Form 10-Q have been made. Results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results for the entire year ending December 31, 2014, or for any other future interim or annual periods.

2. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company has recorded goodwill as a result of its business combinations. Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the tangible assets and intangible assets acquired net of liabilities assumed, including noncontrolling interests. Changes in goodwill from December 31, 2013 to September 30, 2014 are related to fluctuations in foreign currency exchange rates and additions due to an acquisition completed in the first quarter of 2014 as discussed further below.

The Company has also recorded other finite and indefinite-lived intangible assets as a result of its various business combinations. An acquisition completed in the first quarter of 2014 as discussed further below also led to additions to intangible assets. The Company s intangible assets include facility management contracts, the trade name and technology, as follows (in thousands):

		September 30, 2014			December 31, 2013		
	Weighted Average Useful Life (years)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Facility management contracts	13.4	$ 154,623	$ (53,447)	$ 101,176	$ 151,604	$ (44,646)	$ 106,958
Technology	7.0	24,000	(11,263)	12,737	21,200	(8,758)	12,442
Trade name (Indefinite lived)	Indefinite	45,200		45,200	44,000		44,000
Total acquired intangible assets		$ 223,823	$ (64,710)	$ 159,113	$ 216,804	$ (53,404)	$ 163,400

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Amortization expense was $3.9 million and $11.3 million for the three months and nine months ended September 30, 2014. Amortization expense was $3.6 million and $11.0 million for the three months and nine months ended September 30, 2013. Amortization expense was primarily related to the U.S. Corrections & Detention and GEO Community Services segments amortization of acquired facility management contracts. As of September 30, 2014, the weighted average period before the next contract renewal or extension for the acquired facility management contracts was approximately 2.1 years. Although the facility management contracts acquired have renewal and extension terms in the near term, the Company has historically maintained these relationships beyond the current contractual periods.

Estimated amortization expense related to the Company s finite-lived intangible assets for the remainder of 2014 through 2018 and thereafter is as follows (in thousands):

Fiscal Year	Total Amortization Expense
Remainder of 2014	$ 3,808
2015	15,228
2016	15,228
2017	15,228
2018	12,528
Thereafter	51,893
	$ 113,913

On February 25, 2014, Protocol Criminal Justice, Inc. (Protocol), a recently created subsidiary of the Company s B.I. Incorporated (BI) subsidiary, entered into an Asset Purchase Agreement (the Agreement) with an unrelated entity, APAC Customer Services, Inc., to acquire certain tangible and intangible assets for cash consideration of $13.0 million. The acquisition is expected to provide returns consistent with GEO s targeted returns on invested capital. The final purchase price allocation, which was completed during the second quarter of 2014, resulted in the recognition of intangible assets of $7.1 million related to acquired facility management contracts, acquired technology and trade name, and goodwill of $3.9 million. In addition, the Company acquired accounts receivable, equipment and assumed certain liabilities, none of which were significant. During the measurement period, the Company made $0.1 million in aggregate retrospective adjustments to provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized at that date. These adjustments related primarily to the Company s valuation of intangible assets which resulted in a reduction of intangible assets of $0.3 million and an increase in goodwill of $0.2 million from the amounts previously reported in the Company s unaudited consolidated financial statements as of March 31, 2014.

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3. FINANCIAL INSTRUMENTS

The following tables provide a summary of the Company s significant financial assets and liabilities carried at fair value and measured on a recurring basis as of September 30, 2014 and December 31, 2013 (in thousands):

			Fair Value Measurements at September 30, 2014					
	Carrying Value at September 30, 2014		Quoted Prices in Active Markets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Assets:								
Restricted investment:								
Rabbi Trust	$	11,044		$	11,044			
Fixed income securities		1,994			1,994			
Interest rate cap derivatives		1,161		$	1,161			
Liabilities:								
Interest rate swap derivatives	$	7,048	$	$	7,048	$		

			Fair Value Measurements at December 31, 2013					
	Carrying Value at December 31, 2013		Quoted Prices in Active Markets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Assets:								
Restricted investments:								
Guaranteed Investment Contract	$	5,742		$	5,742			
Rabbi Trust		9,534			9,534			
Fixed income securities		1,993			1,993			
Liabilities:								
Interest rate swap derivative liabilities	$	390	$	$	390	$		

The Company s Level 2 financial instruments included in the tables above as of September 30, 2014 and December 31, 2013 consist of an interest rate swap liability held by the Company s Australian subsidiary, the Company s rabbi trust established for GEO employee and employer contributions to the Company. Non-qualified Deferred Compensation Plan and an investment in Canadian dollar denominated fixed income securities. At December 31, 2013, the Company s Level 2 financial instruments included a guaranteed investment contract which was a restricted investment related to CSC of Tacoma LLC (CSC). During the nine months ended September 30, 2014, the balance in the guaranteed investment contract was liquidated as it was no longer required because it relates to a portion of the CSC bonds which matured in October 2014. Refer to Note 9 - Debt.

The Australian subsidiary s interest rate swap liabilities and interest rate cap assets are valued using a discounted cash flow model based on projected Australian borrowing rates. The Company s restricted investment in the rabbi trust is invested in Company owned life insurance policies which are recorded at their cash surrender values. These investments are valued based on the underlying investments held in the policies separate account. The underlying assets are equity and fixed income pooled funds that are comprised of Level 1 and Level 2 securities. The Canadian dollar denominated securities, not actively traded, are valued using quoted rates for these and similar securities. The restricted investment in the guaranteed investment contract was valued using quoted rates for these and similar securities.

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4. FAIR VALUE OF ASSETS AND LIABILITIES

The Company s consolidated balance sheets reflect certain financial assets and liabilities at carrying value. The carrying value of certain debt instruments, if applicable, is net of unamortized discount. The following tables present the carrying values of those financial instruments and the estimated corresponding fair values at September 30, 2014 and December 31, 2013 (in thousands):

	Carrying Value as of September 30, 2014	Estimated Fair Value Measurements at September 30, 2014			
		Total Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 52,680	$ 52,680	$ 52,680	$	$
Restricted cash	24,764	24,764	6,162	18,602	
Liabilities:					
Borrowings under senior credit facility	$ 336,250	$ 337,731	$	$ 337,731	$
5 $\frac{7}{8}$% Senior Notes	250,000	250,625		250,625	
5.875% Senior Notes	250,000	253,750		253,750	
6.625% Senior Notes	300,000	314,814		314,814	
5.125% Senior Notes	300,000	290,439		290,439	
Non-recourse debt, Australian subsidiary	93,271	93,517		93,517	
Other non-recourse debt, including current portion	60,442	62,721		62,721	

	Carrying Value as of December 31, 2013	Estimated Fair Value Measurements at December 31, 2013			
		Total Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	$ 52,125	$ 52,125	$ 52,125	$	$
Restricted cash	14,592	14,592	1,838	12,754	
Liabilities:					
Borrowings under senior credit facility	$ 638,500	$ 639,246	$	$ 639,246	$
5 $\frac{7}{8}$% Senior Notes	250,000	265,938		265,938	
6.625% Senior Notes	300,000	317,064		317,064	
5.125% Senior Notes	300,000	279,000		279,000	
Non-recourse debt, Australian subsidiary	23,896	24,439		24,439	
Other non-recourse debt, including current portion	60,235	62,319		62,319	

The fair values of the Company s cash and cash equivalents, and restricted cash approximates the carrying values of these assets at September 30, 2014 and December 31, 2013. Restricted cash consists of money market funds, commercial paper and time deposits used for payments on the Company s non-recourse debt and asset replacement funds contractually required to be maintained at the Company s Australian subsidiary. The fair value of the money market funds is based on quoted market prices (Level 1) and the fair value of commercial paper and time deposits is based on market prices for similar instruments (Level 2).

The fair values of the Company s 5⅞% senior unsecured notes due 2022 (5⅞% Senior Notes), 5.875% senior unsecured notes due 2024 (5.875% Senior Notes), 6.625% senior unsecured notes due 2021 (6.625% Senior Notes), and the 5.125% senior unsecured notes due 2023 (5.125% Senior Notes), although not actively traded, are based on published financial data for these instruments. The fair values of the Company s non-recourse debt related to the Washington Economic Development Finance Authority (WEDFA) is based on market prices for similar instruments. The fair value of the non-recourse debt related to the Company s Australian subsidiary is estimated using a discounted cash flow model based on current Australian borrowing rates for similar instruments. The fair value of borrowings under the senior credit facility is based on an estimate of trading value considering the Company s borrowing rate, the undrawn spread and similar instruments.

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5. SHAREHOLDERS EQUITY

The following table presents the changes in shareholders equity that are attributable to the Company s shareholders and to noncontrolling interests (in thousands):

	Common shares Shares	Common shares Amount	Additional Paid-In Capital	Earnings in Excess of Distributions	Accumulated Other Comprehensive Loss	Treasury shares Shares	Treasury shares Amount	Noncontrolling Interests	Total Shareholders Equity
Balance, December 31, 2013	72,082	$ 866	$ 848,018	$ 232,646	$ (4,429)	14,581	$ (53,579)	$ 454	$ 1,023,976
Proceeds from exercise of stock options	338	3	6,381						6,384
Tax benefit related to equity compensation			1,498						1,498
Stock-based compensation expense			885						885
Amortization of restricted stock			5,378						5,378
Restricted stock granted	310	3	(3)						
Restricted stock canceled	(22)								
Dividends paid				(124,084)					(124,084)
Issuance of common stock - prospectus supplement	1,483	15	54,709						54,724
Shares withheld for net settlements of share-based awards	(54)		(428)			43	(1,416)		(1,844)
Re-issuance of treasury shares - ESPP	5		162			(6)	23		185
Issuance of common stock -	3		92						92

ESPP									
Retirement of treasury shares		(146)	(54,826)			(14,618)	54,972		
Net income				105,879				(20)	105,859
Other comprehensive loss					(6,270)			(31)	(6,301)
Balance, September 30, 2014	74,145	$ 741	$ 861,866	$ 214,441	$ (10,699)		$	$ 403	$ 1,066,752

During the nine months ended September 30, 2014, the Company withheld shares through net share settlements to satisfy minimum statutory tax withholding requirements upon vesting of shares of restricted stock held by employees.

REIT Distributions

As a REIT, GEO is required to distribute annually at least 90% of its REIT taxable income (determined without regard to the dividends paid deduction and by excluding net capital gain) and began paying regular quarterly REIT dividends in 2013. The amount, timing and frequency of future dividends, however, will be at the sole discretion of GEO s Board of Directors (the Board) and will be declared based upon various factors, many of which are beyond GEO s control, including, GEO s financial condition and operating cash flows, the amount required to maintain REIT status and reduce any income taxes that GEO otherwise would be required to pay, limitations on distributions in GEO s existing and future debt instruments, limitations on GEO s ability to fund distributions using cash generated through GEO s taxable REIT subsidiaries (TRSs) and other factors that GEO s Board may deem relevant.