MITCHAM INDUSTRIES INC
Form 8-K
June 06, 2011

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

# FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported): June 6, 2011

# Mitcham Industries, Inc.

(Exact name of registrant as specified in its charter)

| Texas | 000-25142 | 76-0210849 |
|---|---|---|
| (State or other jurisdiction of incorporation) | (Commission File Number) | (I.R.S. Employer Identification No.) |
| 8141 SH 75 South, P.O. Box 1175, Huntsville, Texas | | 77342 |
| (Address of principal executive offices) | | (Zip Code) |

Registrant s telephone number, including area code: 936-291-2277

Not Applicable

Former name or former address, if changed since last report

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

**Top of the Form**

**Item 2.02 Results of Operations and Financial Condition.**

On June 6, 2011 Mitcham Industries, Inc. issued a press release announcing earnings for the quarter ended April 30, 2011. The date and time for a conference call discussing the earnings are also included in the press release. The text of the press release is attached to this report as Exhibit 99.1.

The information in this report is being furnished, not filed, for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and pursuant to Item 2.02 of form 8-K will not be incorporated by reference into any filing under the Securties Act of 1933, as amended, unless specifically identified therein as being incorporated therein by reference.

**Item 9.01 Financial Statements and Exhibits.**

(c) Exhibits. The following exhibits are filed as a part of this report:

Exhibit No. Description

99.1 Mitcham Industries, Inc. press release dated June 6, 2011

**Top of the Form**

**SIGNATURES**

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 hereunto duly authorized.

| | |
|---|---|
| | Mitcham Industries, Inc. |
| *June 6, 2011* | By: */s/ Robert P. Capps* |
| | *Name: Robert P. Capps*<br>*Title: Chief Financial Officer* |

**Top of the Form**

Exhibit Index

| Exhibit No. | Description |
|---|---|
| 99.1 | Mitcham Industries, Inc. press release dated June 6, 2011 |

ng.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

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| | |
|---|---|
| $ | 0.44 |
| Diluted | |
| $ | 0.43 |
| $ | 0.43 |

| | |
|---|---|
| Weighted average number of shares | |
| Basic | 98,497,788 |
| | 98,497,788 |
| Diluted | 103,063,565 |

103,063,565

Cash dividends paid per common share

$

0.40

$

0.40

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**Extra Space Storage Inc.**

**Notes to Unaudited Pro Forma Condensed Consolidated Statement of Operations**

**for the Six Months Ended June 30, 2012**

**(in thousands, except share data)**

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(1) Reflects the results of operations of the Company as filed in its Form 10-Q for the six months ended June 30, 2012.

(2) Represents the pro forma revenues and operating expenses of PRISA III for the period from January 1, 2012 to June 30, 2012, which were not reflected in the historical condensed consolidated statement of operations of the Company.

(3) Adjustment to eliminate the management fee revenue earned by the Company for managing the properties owned by PRISA III. Prior to the acquisition, the Company managed the properties owned by PRISA III in exchange for a management fee of approximately 6% of cash collected by the properties. Subsequent to the acquisition by the Company, all properties are self-managed.

(4) Adjustments include depreciation and amortization expense for the period from January 1, 2012 to June 30, 2012, which was not reflected in the historical condensed consolidated statement of operations of the Company. Adjustments to depreciation and amortization expense are summarized as follows:

| | | **Building** | | **Customer Intangibles** | | **Lease Intangible** | | **Total** |
|---|---|---|---|---|---|---|---|---|
| Assets acquired | $ | 256,792 | $ | 5,636 | $ | 440 | $ | 262,868 |
| Amortization/depreciation period (in years) | | 39.0 | | 1.5 | | 7.3 | | |
| Annual amortization/depreciation | | 6,584 | | 3,757 | | 61 | | 10,402 |
| Amortization/depreciation for period ended June 30, 2012 | $ | 3,292 | $ | 1,879 | $ | 30 | $ | 5,201 |

(5) Debt of $145,000 was assumed in the acquisition of PREI s interest in PRISA III. The debt assumed has a fixed rate of 4.97%. Adjustments to interest expense represent interest for the period from January 1, 2012 to June 30, 2012, which was not reflected in the historical consolidated condensed statement of operations of the Company. The amount of interest is calculated as if the acquisition occurred on January 1, 2012.

(6) Interest income was reduced by $221 for the use of net cash in the acquisition as if it had occurred on January 1, 2012.

(7) Adjustment to eliminate the equity in earnings related to PRISA III for the six months ended June 30, 2012.

(8) Income allocated to Preferred Operating Partnership noncontrolling units and Operating Partnership and other noncontrolling units was adjusted to reflect the increase in net income resulting from the acquisition and other pro forma adjustments as follows:

| | **Preferred Operating Partnership** | **Operating Partnership** | **Total** |
|---|---|---|---|
| Increase in net income as a result of acquisitions and other pro forma adjustments: | $ 809 | $ 809 | $ 809 |
| Weighted average percentage OP units held by noncontrolling interests | 0.97% | 2.88% | 3.85% |
| Increase in net income allocated to Operating Partnership and other noncontrolling interests | $ 8 | $ 23 | $ 31 |

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**Extra Space Storage Inc.**

**Unaudited Pro Forma Condensed Consolidated Statement of Operations**

**for the Year Ended December 31, 2011**

**(in thousands, except share data)**

| | Historical Extra Space Storage Inc. (1) | PRISA III Acquisition (2) | Pro Forma Adjustments | Pro Forma Total |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Property rental | $ 268,725 | $ 32,357 | $ | $ 301,082 |
| Management and franchise fees | 29,924 | | (1,796)**(3)** | 28,128 |
| Tenant reinsurance | 31,181 | | | 31,181 |
| Total revenues | 329,830 | 32,357 | (1,796) | 360,391 |
| | | | | |
| **Expenses:** | | | | |
| Property operations | 95,481 | 12,885 | (1,796)**(3)** | 106,570 |
| Tenant reinsurance | 6,143 | | | 6,143 |
| Unrecovered development and acquisition costs | 2,896 | | | 2,896 |
| Severance costs | 2,137 | | | 2,137 |
| General and administrative | 49,683 | | | 49,683 |
| Depreciation and amortization | 58,014 | | 10,402**(4)** | 68,416 |
| Total expenses | 214,354 | 12,885 | 8,606 | 235,845 |
| | | | | |
| Income from operations | 115,476 | 19,472 | (10,402) | 124,546 |
| | | | | |
| Interest expense | (67,301) | | (7,207)**(5)** | (74,508) |
| Non-cash interest expense related to amortization of discount on exchangeable senior notes | (1,761) | | | (1,761) |
| Interest income | 1,027 | | (442)**(6)** | 585 |
| Interest income on note receivable from Preferred Operating Partnership unit holder | 4,850 | | | 4,850 |
| Income before equity in earnings of real estate ventures and income tax expense | 52,291 | 19,472 | (18,051) | 53,712 |
| | | | | |
| Equity in earnings of real estate ventures | 7,287 | | (330)**(7)** | 6,957 |
| Income tax expense | (1,155) | | | (1,155) |
| **Net income** | 58,423 | 19,472 | (18,381) | 59,514 |
| Net income allocated to Preferred Operating Partnership noncontrolling interests | (6,289) | | (11)**(8)** | (6,300) |
| Net income allocated to Operating Partnership and other noncontrolling interests | (1,685) | | (35)**(8)** | (1,720) |
| **Net income attributable to common stockholders** | $ 50,449 | $ 19,472 | $ (18,427) | $ 51,494 |
| | | | | |
| Net income per common share | | | | |
| Basic | $ 0.55 | | | $ 0.56 |
| Diluted | $ 0.54 | | | $ 0.55 |
| | | | | |
| Weighted average number of shares | | | | |
| Basic | 92,097,008 | | | 92,097,008 |

| | | | | |
|---|---|---|---|---|
| Diluted | | 96,683,508 | | 96,683,508 |
| **Cash dividends paid per common share** | $ | 0.56 | $ | 0.56 |

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**Extra Space Storage Inc.**

**Notes to Unaudited Pro Forma Condensed Consolidated Statement of Operations**

**for the Year Ended December 31, 2011**

**(in thousands, except share data)**

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(1) Reflects the results of operations of the Company as filed in its Form 10-K for the year ended December 31, 2011.

(2) Represents the pro forma revenues and operating expenses of PRISA III for the year ended December 31, 2011, which were not reflected in the historical condensed consolidated statement of operations of the Company.

(3) Adjustment to eliminate the management fee revenue earned by the Company for managing the properties owned by PRISA III. Prior to the acquisition, the Company managed the properties owned by PRISA III in exchange for a management fee of approximately 6% of cash collected by the properties. Subsequent to the acquisition by the Company, all properties are self-managed.

(4) Adjustments include depreciation and amortization expense for the period from January 1, 2011 to December 31, 2011, which was not reflected in the historical condensed consolidated statement of operations of the Company. Adjustments to depreciation and amortization expense are summarized as follows:

| | Building | Customer Intangibles | Lease Intangible | Total |
|---|---|---|---|---|
| Assets acquired | $ 256,792 | $ 5,636 | $ 440 | $ 262,868 |
| Amortization/depreciation period (in years) | 39.0 | 1.5 | 7.3 | |
| Annual amortization/depreciation | $ 6,584 | $ 3,757 | $ 61 | $ 10,402 |

(5) Debt of $145,000 was assumed in the acquisition of PREI s interest in PRISA III. The debt assumed has a fixed rate of 4.97%. Adjustments to interest expense represent interest for the period from January 1, 2011 to December 31, 2011, which was not reflected in the historical consolidated condensed statement of operations of the Company. The amount of interest is calculated as if the acquisition occurred on January 1, 2011.

(6) Interest income was reduced by $442 for the use of net cash in the acquisition as if the acquisition had occurred on January 1, 2011.

(7) Adjustment to eliminate the equity in earnings related to PRISA III for the year ended December 31, 2011.

(8) Income allocated to Preferred Operating Partnership noncontrolling units and Operating Partnership and other noncontrolling units was adjusted to reflect the increase in net income resulting from the acquisitions and other pro forma adjustments as follows:

| | Preferred Operating Partnership | Operating Partnership | Total |
|---|---|---|---|
| Increase in net income as a result of acquisitions and other pro forma adjustments: | $ 1,091 | $ 1,091 | $ 1,091 |
| Weighted average percentage OP units held by noncontrolling interests | 1.03% | 3.23% | 4.26% |
| Increase in net income allocated to Operating Partnership and other noncontrolling interests | $ 11 | $ 35 | $ 46 |

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**ESS PRISA III LLC**

**Financial Statements and Report of Independent Auditors**

**For the Years ended December 31, 2011, 2010 and 2009**

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**Report of Independent Auditors**

To the Members of

ESS PRISA III LLC

We have audited the accompanying balance sheets of ESS PRISA III LLC as of December 31, 2011, 2010, and 2009, and the related statements of operations, members equity, and cash flows for the years then ended. These financial statements are the responsibility of the management of ESS PRISA III LLC. Our responsibility is to express an opinion on this financial statement based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of ESS PRISA III LLC s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ESS PRISA III LLC s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, assessing the basis of accounting used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ESS PRISA III LLC at December 31, 2011, 2010, and 2009, and the results of its operations and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Salt Lake City, Utah

April 2, 2012

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ESS PRISA III LLC

BALANCE SHEETS

(dollars in thousands)

| | December 31, 2011 | December 31, 2010 | December 31, 2009 |
|---|---|---|---|
| **Assets** | | | |
| Investment in real estate: | | | |
| Land | $ 66,728 | $ 66,581 | $ 66,173 |
| Buildings and equipment | 175,763 | 174,647 | 174,166 |
| | 242,491 | 241,228 | 240,339 |
| Less: accumulated depreciation and amortization | (32,034) | (26,735) | (21,458) |
| Investment in real estate, net | 210,457 | 214,493 | 218,881 |
| Cash and cash equivalents | 2,854 | 1,236 | 907 |
| Restricted cash | 1,286 | 1,141 | 1,291 |
| Accounts receivable, net of allowance for doubtful accounts of $6, $7 and $7, respectively | 422 | 431 | 471 |
| Deferred financing costs, net | 175 | 498 | 821 |
| Prepaid expenses and other assets | 682 | 561 | 647 |
| Total assets | $ 215,876 | $ 218,360 | $ 223,018 |
| **Liabilities and members equity** | | | |
| Liabilities: | | | |
| Note payable | $ 145,000 | $ 145,000 | $ 145,000 |
| Payable to related party | 260 | 109 | 353 |
| Accounts payable and accrued expenses | 909 | 677 | 685 |
| Property taxes payable | 568 | 541 | 550 |
| Rents received in advance | 1,616 | 1,555 | 1,512 |
| Total liabilities | 148,353 | 147,882 | 148,100 |
| Commitments and contingencies (note 4) | | | |
| Members equity | 67,523 | 70,478 | 74,918 |
| Total liabilities and members equity | $ 215,876 | $ 218,360 | $ 223,018 |

See accompanying notes.

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ESS PRISA III LLC

STATEMENTS OF OPERATIONS

(dollars in thousands)

| | For the Year Ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| Operating revenues: | | | |
| Rental income | $ 30,965 | $ 29,644 | $ 29,222 |
| Other income | 1,392 | 1,432 | 1,470 |
| Total operating revenues | 32,357 | 31,076 | 30,692 |
| Operating expenses: | | | |
| Property operations | 5,026 | 5,166 | 5,367 |
| Payroll expense | 2,842 | 2,726 | 2,646 |
| Property taxes | 3,221 | 3,371 | 3,464 |
| Management fees | 1,796 | 1,722 | 1,686 |
| Depreciation and amortization | 5,314 | 5,277 | 5,213 |
| Total operating expenses | 18,199 | 18,262 | 18,376 |
| Income from operations | 14,158 | 12,814 | 12,316 |
| Interest expense | (7,630) | (7,630) | (7,630) |
| Gain on sale of real estate assets | 167 | | |
| Net income | $ 6,695 | $ 5,184 | $ 4,686 |

See accompanying notes.

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ESS PRISA III LLC

STATEMENTS OF MEMBERS EQUITY

(dollars in thousands)

| | ESS LLC | Prudential | Total |
|---|---|---|---|
| Balance at January 1, 2009 | $ 4,122 | $ 77,166 | $ 81,288 |
| Member distributions | (559) | (10,497) | (11,056) |
| Net income | 237 | 4,449 | 4,686 |
| Balance at December 31, 2009 | 3,800 | 71,118 | 74,918 |
| Member distributions | (487) | (9,137) | (9,624) |
| Net income | 263 | 4,921 | 5,184 |
| Balance at December 31, 2010 | 3,576 | 66,902 | 70,478 |
| Member distributions | (488) | (9,162) | (9,650) |
| Net income | 338 | 6,357 | 6,695 |
| Balance at December 31, 2011 | $ 3,426 | $ 64,097 | $ 67,523 |

See accompanying notes.

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ESS PRISA III LLC

STATEMENTS OF CASH FLOWS

(dollars in thousands)

| | For the Year Ended December 31, 2011 | 2010 | 2009 |
|---|---|---|---|
| **Operating activities** | | | |
| Net income | $ 6,695 | $ 5,184 | $ 4,686 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 5,314 | 5,277 | 5,213 |
| Amortization of deferred financing costs | 323 | 323 | 323 |
| Gain on sale of real estate assets | (167) | | |
| Changes in assets and liabilities: | | | |
| Accounts receivable, net | 9 | 40 | 79 |
| Prepaid expenses and other assets | (121) | 86 | (8) |
| Payable to related party | 151 | (244) | 209 |
| Accounts payable and accrued expenses | 232 | (8) | 16 |
| Property taxes payable | 27 | (9) | 35 |
| Rents received in advance | 61 | 43 | (136) |
| Net cash provided by operating activities | 12,524 | 10,692 | 10,417 |
| | | | |
| **Investing activities** | | | |
| Change in restricted cash | (145) | 150 | 1,033 |
| Investment in real estate assets | (1,384) | (889) | (894) |
| Proceeds from sale of real estate assets | 273 | | |
| Net cash provided by (used in) investing activities | (1,256) | (739) | 139 |
| | | | |
| **Financing activities** | | | |
| Payment of transition liabilities | | | (588) |
| Member distributions | (9,650) | (9,624) | (11,056) |
| Net cash used in financing activities | (9,650) | (9,624) | (11,644) |
| Net increase (decrease) in cash | 1,618 | 329 | (1,088) |
| | | | |
| Cash and cash equivalents at beginning of the year | 1,236 | 907 | 1,995 |
| Cash and cash equivalents at end of the year | $ 2,854 | $ 1,236 | $ 907 |
| | | | |
| **Supplemental disclosure of cash flow information** | | | |
| Cash paid for interest | $ 7,307 | $ 7,307 | $ 7,307 |

See accompanying notes.

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ESS PRISA III LLC

Notes to Financial Statements

(dollars in thousands)

**1. Description of Business and Summary of Significant Accounting Policies**

**Business**

ESS PRISA III LLC, (the Company), a Delaware limited liability company, is engaged in the business of owning, leasing, managing and operating self-storage facilities located throughout the United States of America. On July 14, 2005, the Company was formed by Prudential Insurance Company of America, an affiliate of Prudential Financial, Inc (Prudential) and Extra Space Storage LLC (ESS LLC) and, unless terminated or extended by mutual agreement of the members, will continue until December 31, 2055. The Company owned 36 self-storage facilities at December 31, 2011, 2010 and 2009.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Investment in Real Estate**

Real estate assets are stated at cost less accumulated depreciation and amortization. Costs associated with the development, construction, renovation and improvement of real estate assets are capitalized. Interest, property taxes and other costs associated with development incurred during the construction period are capitalized as building costs. Expenditures for maintenance and repairs are charged to expense as incurred. Major replacements and betterments that improve or extend the life of the asset are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are generally between 3 and 39 years. The cost of real estate sold, or otherwise disposed of, and the related accumulated depreciation or amortization, are removed from the accounts and any gain or loss is reflected in earnings.

Intangible lease rights represent the value assigned to one property that is subject to a land and building lease. These rights, which totaled $1,176, at December 31, 2011, 2010 and 2009, are classified as buildings in the accompanying balance sheets and are being amortized over the term of the lease through October 31, 2039. As of December 31, 2011, 2010 and 2009, accumulated amortization totaled $511, $488 and $464, respectively.

**Intangible Assets     Tenant Relationships**

In connection with the Company s acquisition of real estate assets, the purchase price is allocated to the tangible and intangible assets and liabilities acquired based on their estimated fair values. The values of the tangible assets, consisting of land and buildings, are determined as if vacant, that is, at replacement cost. Intangible assets, which represent the value of tenant relationships, are recorded at their fair values.

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ESS PRISA III LLC

Notes to Financial Statements (continued)

(dollars in thousands)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

Because the Company s leases are month-to-month, no value is assigned to acquired in-place leases other than the tenant relationships, which are recorded at their fair values based on the avoided cost to replace the current leases. The Company measures the value of tenant relationships based on the rent lost due to the amount of time required to replace existing customers which is based on the Company s historical experience with turnover in its facilities. The Company amortizes the tenant relationships on a straight-line basis over the estimated life that a tenant utilizes the facility (18 months). At December 31, 2011, 2010 and 2009, intangible assets related to tenant relationships of $4,823 were fully amortized.

**Asset Impairment**

The Company evaluates real estate assets, which are held for use, for impairment whenever events or circumstances indicate an impairment may exist. An impairment loss is recorded if the net carrying value of the asset exceeds the undiscounted future net operating cash flows attributable to the asset. The impairment loss recognized equals the excess of net carrying value over the related fair value of the asset. No impairment charges have been recognized for the years ended December 31, 2011, 2010 or 2009.

When real estate assets are identified as held for sale, the Company discontinues depreciating the assets and estimates the fair value, net of selling costs. If the estimated fair value, net of selling costs, is less than the net carrying value of the asset, a valuation allowance is established. The operations of assets classified as held for sale or sold during the period are presented as discontinued operations. Management has determined no property was held for sale at December 31, 2011, 2010 or 2009.

**Cash and Cash Equivalents**

Cash equivalents are short-term, highly liquid instruments with original maturities of 30 days or less. The Company s cash is deposited with financial institutions located primarily in California and North Carolina, and at times may exceed federally insured limits.

**Restricted Cash**

Restricted cash comprises funds held by the Company s lender for property taxes and funds which have been restricted for capital improvements. These balances are deposited with a financial institution located in California, and at times may exceed federally insured limits.

**Deferred Financing Costs**

Deferred financing costs are amortized on a straight-line basis, which approximates the effective interest method, over the term of the respective loan agreement.

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ESS PRISA III LLC

Notes to Financial Statements (continued)

(dollars in thousands)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Fair Value of Financial Instruments**

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, payable to related party, accounts payable and accrued expenses at December 31, 2011, 2010 and 2009 approximate fair value due to the short-term nature of these instruments. The fair value of the note payable at December 31, 2011, 2010 and 2009, which was based on the present value of estimated future cash flows using interest rates available to the Company for similar debt, was approximately $147,600, $149,400 and $150,000, respectively.

**Members Equity**

Members profits, losses and distributions are allocated in accordance with the terms of the operating agreement of the Company. Membership equity interests are held 95% by Prudential and 5% by ESS LLC. Preferred returns are paid on member equity interests under the following schedule:

| | Preferred Return |
|---|---|
| July 14, 2005 December 31, 2007 | 10.00% |
| January 1, 2008 December 31, 2009 | 11.00 |
| January 1, 2010 December 31, 2011 | 12.00 |
| January 1, 2012 and thereafter | 13.00 |

As of December 31, 2011, 2010 and 2009 the cumulative unpaid preferred return on members equity for Prudential was $6,015, $3,360 and $946, respectively. For the same periods, the cumulative unpaid preferred return on members equity for ESS LLC was $321, $179 and $50, respectively. Excess profit participation interests over the preferred return are held 80% by Prudential and 20% by ESS LLC.

**Revenue and Expense Recognition**

Rental revenues are recognized as earned based upon amounts that are currently due from tenants. Leases are generally on month-to-month terms. Prepaid rents are recognized on a straight-line basis over the term of the leases. Promotional discounts are recognized as a reduction to rental income over the promotional period. Late charges, administrative fees, merchandise sales and truck rentals are recognized in other income when earned. Interest income is recognized as earned.

Property expenses, including utilities, repairs and maintenance and other costs to manage the facilities are recognized as incurred. The Company accrues for property tax expense based upon estimates and historical trends.

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ESS PRISA III LLC

Notes to Financial Statements (continued)

(dollars in thousands)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

**Real Estate Sales**

The Company evaluates real estate sales for both sale recognition and profit recognition. In general, sales of real estate and related profits/losses are recognized when all consideration has changed hands, and when risks and rewards of ownership have been transferred. Certain types of continuing involvement preclude sale treatment and related profit recognition; other forms of continuing involvement allow for sale recognition but require deferral of profit recognition.

**Advertising Costs**

The Company incurs advertising costs primarily attributable to directory, direct mail, internet and other advertising. Recurring phonebook advertising costs are deferred and amortized over the expected benefit period, determined to be 12 months. At December 31, 2011, prepaid advertising costs of $83 were included in prepaid expenses and other assets. All other advertising costs are expensed as incurred. The Company recognized advertising expense of $535, $638 and $646, respectively, for the years ended December 31, 2011, 2010 and 2009.

**Income Taxes**

The Company has elected partnership status for income tax purposes and, accordingly, is generally not directly subject to tax. The tax effects of the Company s operations are passed directly to the members. Therefore, no provision for income taxes has been recorded in the financial statements.

**2. Note Payable**

The note payable is a mortgage loan bearing interest at a fixed rate of 4.97%. The loan is collateralized by real estate assets and the assignment of rents. Interest payments are made monthly with all principal and remaining interest due August 11, 2012. Management expects to refinance the loan before the due date because of strong property performance and a current favorable lending environment for properties with low loan-to-value ratios.

**3. Related Party Transactions**

The Company has entered into various transactions with related parties as summarized below:

a. The Company s management agreement with Extra Space Management Incorporated (ESMI), a subsidiary of ESS LLC, provides for management fees of 5.6% of gross rental revenues actually received for the management of all operations at the Company s self-storage facilities. During the years ended December 31, 2011, 2010 and 2009, management fee expense of $1,796, $1,722 and $1,686, respectively, was recognized for services provided by ESMI. At December 31, 2011, 2010 and 2009, $156, $110 and $143, respectively, related to management fees was included in payable to related party.

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ESS PRISA III LLC

Notes to Financial Statements (continued)

(dollars in thousands)

**3. Related Party Transactions (continued)**

b. The Company uses ESMI to service payroll and other administrative activities. The Company reimburses ESMI only for the costs incurred, and no service fee is paid to ESMI. At December 31, 2011, 2010 and 2009, payables to ESMI of $103, $0 and $209, respectively, related to these activities, was included in payable to related party.

c. Prior to 2011, Prudential bound coverage for the Company s property insurance as part of a larger insurance binder including properties not owned by the Company. The Company reimbursed Prudential for the direct costs related to the property insurance coverage. Those costs totaled $267 and $239, respectively, for the years ended December 31, 2010 and 2009. At December 31, 2010 and 2009, there were no payables due to Prudential for property insurance.

**4. Commitments and Contingencies**

The Company owns one self-storage facility that is subject to a land and building lease. During 2009, the lease was renegotiated. The new lease term, including all extensions, ends in 2039. At December 31, 2011, future minimum rental payments under this noncancelable operating lease were as follows:

| **Year Ending December 31,** | | |
|---|---|---|
| 2012 | $ | 181 |
| 2013 | | 181 |
| 2014 | | 181 |
| 2015 | | 181 |
| 2016 | | 181 |
| Thereafter | | 4,143 |

Under the terms of the lease, the Company is responsible for property taxes and operating expenses. Rent expense for the years ended December 31, 2011, 2010 and 2009 totaled $161, $175 and $225, respectively.

**5. Recently Issued Accounting Standards**

In December 2007, the Financial Accounting Standards Board (FASB) issued revised Statement No. 141, *Business Combinations* (ASC 805) (FAS 141(R)). This guidance establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the assets acquired and liabilities assumed. Generally, assets acquired and liabilities assumed in a transaction are recorded at the acquisition-date fair value with limited exceptions. The guidance also changed the accounting treatment and disclosure for certain specific items in a business combination. The Company adopted this guidance for all acquisitions subsequent to January 1, 2009.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (ASC 855). This guidance is intended to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. This guidance requires disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting

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ESS PRISA III LLC

Notes to Financial Statements (continued)

(dollars in thousands)

**5. Recently Issued Accounting Standards (continued)**

this date, that is, whether this date represents the date the financial statements were issued or were available to be issued. The Company adopted this guidance effective for the year ended December 31, 2009.

On June 30, 2009, the FASB issued Statement No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles  a replacement of FASB Statement No. 162* (ASC 105-10-05). The standard establishes the FASB Codification (the Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. The Codification is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted the Codification effective December 31, 2009 and has included the references to the Codification, as appropriate, in these financial statements.

**6. Subsequent Events**

The Company has evaluated subsequent events through April 2, 2012, the date the financial statements are available to be issued. There were no subsequent events that require disclosure.

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**ESS PRISA III LLC**

**Unaudited Financial Statements for the Six Months Ended June 30, 2012**

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ESS PRISA III LLC

BALANCE SHEET

(dollars in thousands)

| | | June 30, 2012 (unaudited) |
|---|---|---|
| **Assets** | | |
| | | |
| Investment in real estate: | | |
| Land | $ | 66,849 |
| Buildings and equipment | | 176,032 |
| | | 242,881 |
| Less: accumulated depreciation and amortization | | (34,701) |
| Investment in real estate, net | | 208,180 |
| | | |
| Cash and cash equivalents | | 3,405 |
| Restricted cash | | 1,675 |
| Accounts receivable, net of allowance for doubtful accounts of $4 | | 408 |
| Receivable from related party | | 171 |
| Deferred financing costs, net | | 13 |
| Prepaid expenses and other assets | | 83 |
| | | |
| Total assets | $ | 213,935 |
| | | |
| **Liabilities and members equity** | | |
| | | |
| Liabilities: | | |
| Note payable | $ | 145,000 |
| Accounts payable and accrued expenses | | 587 |
| Property taxes payable | | 458 |
| Rents received in advance | | 1,625 |
| | | |
| Total liabilities | | 147,670 |
| | | |
| Commitments and contingencies | | |
| | | |
| Members equity | | 66,265 |
| | | |
| Total liabilities and members equity | $ | 213,935 |

See accompanying notes.

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ESS PRISA III LLC

STATEMENTS OF OPERATIONS

(dollars in thousands)

| | For the Six Months Ended June 30, 2012 (unaudited) | 2011 (unaudited) |
|---|---|---|
| Operating revenues: | | |
| Rental income | $ 15,710 | $ 15,040 |
| Other income | 691 | 675 |
| Total operating revenues | 16,401 | 15,715 |
| Operating expenses: | | |
| Property operations | 2,227 | 2,377 |
| Payroll expense | 1,455 | 1,401 |
| Property taxes | 1,778 | 1,416 |
| Management fees | 920 | 880 |
| Depreciation and amortization | 2,667 | 2,658 |
| Total operating expenses | 9,047 | 8,732 |
| Income from operations | 7,354 | 6,983 |
| Interest expense | (3,825) | (3,805) |
| Net income | $ 3,529 | $ 3,178 |

See accompanying notes.

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ESS PRISA III LLC

STATEMENT OF CASH FLOWS

(dollars in thousands)

| | | For the Six Months Ended June 30, 2012 (unaudited) |
|---|---|---|
| **Operating activities** | | |
| Net income | $ | 3,529 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | | 2,667 |
| Amortization of deferred financing costs | | 162 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | | 14 |
| Prepaid expenses and other assets | | 599 |
| Payable to related party | | (431) |
| Accounts payable and accrued expenses | | (322) |
| Property taxes payable | | (110) |
| Rents received in advance | | 9 |
| Net cash provided by operating activities | | 6,117 |
| | | |
| **Investing activities** | | |
| Change in restricted cash | | (389) |
| Investment in real estate assets | | (390) |
| Net cash used in investing activities | | (779) |
| | | |
| **Financing activities** | | |
| Member distributions | | (4,787) |
| Net cash used in financing activities | | (4,787) |
| Net increase in cash | | 551 |
| | | |
| Cash and cash equivalents at beginning of the year | | 2,854 |
| Cash and cash equivalents at end of the year | $ | 3,405 |
| | | |
| **Supplemental disclosure of cash flow information** | | |
| Cash paid for interest | $ | 3,663 |

See accompanying notes.

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ESS PRISA III LLC

Notes to Unaudited Interim Financial Statements

(dollars in thousands)

**1. Description of Business and Summary of Significant Accounting Policies**

**Business**

ESS PRISA III LLC, (the Company), a Delaware limited liability company, is engaged in the business of owning, leasing, managing and operating self-storage facilities located throughout the United States of America. On July 14, 2005, the Company was formed by Prudential Insurance Company of America, an affiliate of Prudential Financial, Inc (Prudential) and Extra Space Storage LLC (ESS LLC) and, unless terminated or extended by mutual agreement of the members, will continue until December 31, 2055. The Company owned 36 self-storage facilities at June 30, 2012.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Investment in Real Estate**

Real estate assets are stated at cost less accumulated depreciation and amortization. Costs associated with the development, construction, renovation and improvement of real estate assets are capitalized. Interest, property taxes and other costs associated with development incurred during the construction period are capitalized as building costs. Expenditures for maintenance and repairs are charged to expense as incurred. Major replacements and betterments that improve or extend the life of the asset are capitalized. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which are generally between 3 and 39 years. The cost of real estate sold, or otherwise disposed of, and the related accumulated depreciation or amortization, are removed from the accounts and any gain or loss is reflected in earnings.

Intangible lease rights represent the value assigned to one property that is subject to a land and building lease.

**Intangible Assets Tenant Relationships**

In connection with the Company s acquisition of real estate assets, the purchase price is allocated to the tangible and intangible assets and liabilities acquired based on their estimated fair values. The values of the tangible assets, consisting of land and buildings, are determined as if vacant, that is, at replacement cost. Intangible assets, which represent the value of tenant relationships, are recorded at their fair values.

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ESS PRISA III LLC

Notes to Unaudited Financial Statements (continued)

(dollars in thousands)

**1. Description of Business and Summary of Significant Accounting Policies (continued)**

Because the Company s leases are month-to-month, no value is assigned to acquired in-place leases other than the tenant relationships, which are recorded at their fair values based on the avoided cost to replace the current leases. The Company measures the value of tenant relationships based on the rent lost due to the amount of time required to replace existing customers which is based on the Company s historical experience with turnover in its facilities. The Company amortizes the tenant relationships on a straight-line basis over the estimated life that a tenant utilizes the facility (18 months).

**Asset Impairment**

The Company evaluates real estate assets, which are held for use, for impairment whenever events or circumstances indicate an impairment may exist. An impairment loss is recorded if the net carrying value of the asset exceeds the undiscounted future net operating cash flows attributable to the asset. The impairment loss recognized equals the excess of net carrying value over the related fair value of the asset.

When real estate assets are identified as held for sale, the Company discontinues depreciating the assets and estimates the fair value, net of selling costs. If the estimated fair value, net of selling costs, is less than the net carrying value of the asset, a valuation allowance is established. The operations of assets classified as held for sale or sold during the period are presented as discontinued operations.

**Fair Value of Financial Instruments**

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, payable to related party, accounts payable and accrued expenses at June 30, 2012 approximate fair value due to the short-term nature of these instruments. The fair value of the note payable at June 30, 2012, which was based on the present value of estimated future cash flows using interest rates available to the Company for similar debt, was approximately $145,000.

**Revenue and Expense Recognition**

Rental revenues are recognized as earned based upon amounts that are currently due from tenants. Leases are generally on month-to-month terms. Prepaid rents are recognized on a straight-line basis over the term of the leases. Promotional discounts are recognized as a reduction to rental income over the promotional period. Late charges, administrative fees, merchandise sales and truck rentals are recognized in other income when earned. Interest income is recognized as earned.

Property expenses, including utilities, repairs and maintenance and other costs to manage the facilities are recognized as incurred. The Company accrues for property tax expense based upon estimates and historical trends.

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**SIGNATURES**

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 hereunto duly authorized.

| | | | |
|---|---|---|---|
| | EXTRA SPACE STORAGE INC. | | |
| Date: September 18, 2012 | By | /s/ P. Scott Stubbs | |
| | | Name: | P. Scott Stubbs |
| | | Title: | Executive Vice President and Chief Financial Officer |

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**EXHIBITS**

| Exhibit Number | Description of Exhibit |
|---|---|
| 10.1 | Membership Interest Purchase Agreement, dated as of April 13, 2012, between Extra Space Properties Sixty Three LLC and PRISA III Co-Investment LLC (incorporated by reference to the Company s Form 8-K filed on April 16, 2012). |
| 23.1 | Consent of Ernst & Young LLP, Independent Auditors. |