RAYONIER INC
Form 10-Q
October 28, 2009
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# UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2009

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 1-6780

# RAYONIER INC.

**Incorporated in the State of North Carolina**

**I.R.S. Employer Identification Number 13-2607329**

**50 North Laura Street, Jacksonville, FL 32202**

**(Principal Executive Office)**

**Telephone Number: (904) 357-9100**

Indicate by check mark whether the registrant (l) 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 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 (Section 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

As of October 22, 2009, there were outstanding 79,464,488 Common Shares of the Registrant.

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**RAYONIER INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

**AND COMPREHENSIVE INCOME**

**(Unaudited)**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **SALES** | $ 300,648 | $ 317,465 | $ 858,731 | $ 906,525 |
| Costs and Expenses | | | | |
| Cost of sales | 231,836 | 252,714 | 672,855 | 700,761 |
| Selling and general expenses | 15,972 | 16,192 | 44,962 | 47,998 |
| Other operating income, net (Note 2) | (59,251) | (1,488) | (150,425) | (6,193) |
| | 188,557 | 267,418 | 567,392 | 742,566 |
| Equity in loss of New Zealand joint venture | (943) | (1,046) | (2,782) | (878) |
| **OPERATING INCOME** | 111,148 | 49,001 | 288,557 | 163,081 |
| Interest expense | (12,789) | (11,829) | (37,630) | (37,438) |
| Interest and miscellaneous income, net | 310 | 341 | 594 | 2,462 |
| **INCOME BEFORE INCOME TAXES** | 98,669 | 37,513 | 251,521 | 128,105 |
| Income tax expense | (17,529) | (8,611) | (36,707) | (22,941) |
| **NET INCOME** | 81,140 | 28,902 | 214,814 | 105,164 |
| **OTHER COMPREHENSIVE INCOME (LOSS)** | | | | |
| Foreign currency translation adjustments | 2,620 | (9,843) | 13,568 | (7,333) |
| Joint venture cash flow hedges | 968 | - | (1,659) | - |
| Retiree benefit plan amendment, net of income tax expense of $7,668 and $7,668 | - | 16,388 | - | 16,388 |
| Amortization of pension and postretirement plans, net of income tax expense of $347 and $406, and $1,013 and $1,595 | 1,170 | 995 | 2,286 | 3,779 |
| **COMPREHENSIVE INCOME** | $ 85,898 | $ 36,442 | $ 229,009 | $ 117,998 |
| **EARNINGS PER COMMON SHARE** | | | | |
| Basic earnings per share | $ 1.03 | $ 0.37 | $ 2.72 | $ 1.34 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Diluted earnings per share | $ | 1.01 | $ | 0.36 | $ | 2.69 | $ | 1.32 |

See Notes to Condensed Consolidated Financial Statements.

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**RAYONIER INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Unaudited)**

**(Dollars in thousands)**

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 153,145 | $ 61,685 |
| Accounts receivable, less allowance for doubtful accounts of $899 and $1,130 | 97,072 | 75,657 |
| Inventory | | |
| Finished goods | 77,091 | 78,577 |
| Work in process | 10,796 | 7,412 |
| Raw materials | 9,524 | 8,400 |
| Manufacturing and maintenance supplies | 2,564 | 2,477 |
| Total inventory | 99,975 | 96,866 |
| Income tax and alternative fuel mixture credit receivable | 134,502 | 1,886 |
| Prepaid and other current assets | 58,944 | 42,929 |
| Total Current Assets | 543,638 | 279,023 |
| **TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION** | 1,191,689 | 1,254,978 |
| **PROPERTY, PLANT AND EQUIPMENT** | | |
| Land | 24,877 | 24,445 |
| Buildings | 124,451 | 124,174 |
| Machinery and equipment | 1,265,028 | 1,244,946 |
| Total property, plant and equipment | 1,414,356 | 1,393,565 |
| Less - accumulated depreciation | (1,068,071) | (1,042,756) |
| | 346,285 | 350,809 |
| **INVESTMENT IN JOINT VENTURE** | 48,849 | 42,950 |
| **OTHER ASSETS** | 161,723 | 154,104 |
| **TOTAL ASSETS** | $ 2,292,184 | $ 2,081,864 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable | $ 49,110 | $ 70,714 |
| Bank loans and current maturities | 660 | 620 |
| Accrued interest | 14,302 | 4,202 |
| Current liabilities for dispositions and discontinued operations (Note 12) | 9,354 | 8,214 |

| | | |
|---|---|---|
| Other current liabilities | 92,939 | 75,871 |
| **TOTAL CURRENT LIABILITIES** | 166,365 | 159,621 |
| **LONG-TERM DEBT** | 809,070 | 746,591 |
| **NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS (Note 12)** | 90,227 | 96,361 |
| **PENSION AND OTHER POSTRETIREMENT BENEFITS (Note 14)** | 113,792 | 121,440 |
| **OTHER NON-CURRENT LIABILITIES** | 34,983 | 18,914 |
| **COMMITMENTS AND CONTINGENCIES (Notes 11 and 13)** | | |
| **SHAREHOLDERS EQUITY** | | |
| Common Shares, 120,000,000 shares authorized, 79,453,170 and 78,814,431 shares issued and outstanding | 555,840 | 527,302 |
| Retained earnings | 606,008 | 509,931 |
| Accumulated other comprehensive loss | (84,101) | (98,296) |
| **TOTAL SHAREHOLDERS EQUITY** | 1,077,747 | 938,937 |
| **TOTAL LIABILITIES AND SHAREHOLDERS EQUITY** | $ 2,292,184 | $ 2,081,864 |

See Notes to Condensed Consolidated Financial Statements.

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**RAYONIER INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**(Dollars in thousands)**

| | Nine Months Ended September 30, 2009 | 2008 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income | $ 214,814 | $ 105,164 |
| Non-cash items included in income: | | |
| Depreciation, depletion and amortization | 126,834 | 112,037 |
| Non-cash cost of real estate sold | 6,295 | 7,638 |
| Non-cash stock-based incentive compensation expense | 11,952 | 10,187 |
| Amortization of convertible debt discount | 4,575 | 4,027 |
| Deferred income tax (benefit) expense | (5,721) | 10,793 |
| Excess tax benefits on stock-based compensation | (2,287) | (3,406) |
| Other | 9,250 | 4,113 |
| Changes in operating assets and liabilities: | | |
| Receivables | (20,493) | (17,786) |
| Inventories | (4,122) | (2,095) |
| Accounts payable | (16,407) | 7,254 |
| Income tax and alternative fuel mixture credit receivable | (132,616) | 10,342 |
| Other current assets | (13,018) | (10,757) |
| Accrued liabilities | 32,922 | 26,216 |
| Other assets | 15 | (2,386) |
| Other non-current liabilities | 8,293 | (8,021) |
| Expenditures for dispositions and discontinued operations | (5,968) | (5,142) |
| CASH PROVIDED BY OPERATING ACTIVITIES | 214,318 | 248,178 |
| **INVESTING ACTIVITIES** | | |
| Capital expenditures | (65,078) | (74,852) |
| Purchase of timberlands | - | (229,525) |
| Change in restricted cash | 1,243 | 4,604 |
| Other | (7,685) | (8,400) |
| CASH USED FOR INVESTING ACTIVITIES | (71,520) | (308,173) |
| **FINANCING ACTIVITIES** | | |
| Issuance of debt | 257,500 | 155,000 |
| Repayment of debt | (185,620) | (110,585) |
| Dividends paid | (118,540) | (117,639) |
| Repurchase of common shares | (1,388) | (3,738) |
| Proceeds from the issuance of common shares | 9,228 | 8,254 |
| Excess tax benefits on stock-based compensation | 2,287 | 3,406 |
| Purchase of exchangeable note hedge (Note 15) | (23,460) | - |
| Proceeds from issuance of warrant (Note 15) | 12,506 | - |
| Debt issuance costs | (4,129) | - |
| CASH USED FOR FINANCING ACTIVITIES | (51,616) | (65,302) |

| | | | | |
|---|---|---|---|---|
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH** | | 278 | | (792) |
| **CASH AND CASH EQUIVALENTS** | | | | |
| Increase (decrease) in cash and cash equivalents | | 91,460 | | (126,089) |
| Balance, beginning of year | | 61,685 | | 181,081 |
| Balance, end of period | $ | 153,145 | $ | 54,992 |
| **SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION** | | | | |
| Cash paid during the period: | | | | |
| Interest | $ | 21,749 | $ | 22,213 |
| Income taxes | $ | 9,547 | $ | 765 |
| Non-cash investing activity: | | | | |
| Capital assets purchased on account | $ | 3,315 | $ | 5,118 |

See Notes to Condensed Consolidated Financial Statements.

**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

## 1. BASIS OF PRESENTATION AND NEW ACCOUNTING PRONOUNCEMENTS

***Basis of Presentation***

The unaudited condensed consolidated financial statements and notes thereto of Rayonier Inc. and its subsidiaries ( Rayonier or the Company ) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission. In the opinion of management, these financial statements and notes reflect all adjustments (including normal recurring adjustments) necessary for a fair presentation of the results of operations, financial position and cash flows for the periods presented. These statements and notes should be read in conjunction with the financial statements and supplementary data included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, as filed with the Securities and Exchange Commission.

***New or Recently Adopted Accounting Pronouncements***

In May 2008, the Financial Accounting Standards Board ( FASB ) issued new guidance related to accounting for convertible debt instruments which may be settled in cash upon conversion. This guidance requires entities with convertible debt instruments that may be settled in cash upon conversion, including partial cash settlement, to separately account for the liability and equity components in a manner that reflects the entity s nonconvertible debt borrowing rate when interest expense is recognized in subsequent periods. The Company adopted this guidance on January 1, 2009 and retrospectively applied the fair value of the equity component net of accumulated amortization in 2007 and 2008. The adoption resulted in the recognition of a $23.7 million debt discount, an $8.7 million deferred tax liability and a $15.0 million increase to shareholders equity, net of income taxes as of December 31, 2008. The Company recorded additional interest expense, net of tax benefits, related to the amortization of the debt discount of $2.9 million, or $.04 per diluted share, and $2.6 million, or $0.03 per diluted share, in the nine months ended September 30, 2009 and 2008. See Note 15 *Convertible Debt* for additional information on the Company s convertible debt.

In December 2008, the FASB issued new guidance related to employers disclosures about postretirement benefit plan assets. The guidance amended previous guidance to require disclosure of investment policies, strategies, categories of plan assets and information about the fair value measurements of plan assets of a defined pension or other postretirement plan. The disclosures are effective for fiscal years ending after December 15, 2009. The Company will properly disclose all information required by this new guidance related to postretirement benefit plan assets in its 2009 Form 10-K.

In May 2009, the FASB issued new guidance related to the disclosure of subsequent events. This standard is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, this standard sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. This guidance is effective for fiscal years and interim periods ended after June 15, 2009. As such, the Company evaluated events and transactions that occurred during the period from September 30, 2009, the date of the balance sheet, through October 28, 2009, the date of issuance of the unaudited interim condensed consolidated financial statements, and did not identify any events or transactions that should be recognized or disclosed.

In June 2009, the FASB issued new guidance related to the accounting for transfers of financial assets. The new standard eliminates the concept of a qualifying special-purpose entity ( QSPE ) and associated guidance and creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale. Existing QSPEs will be evaluated for consolidation under the provisions related to the consolidation of controlling and non-controlling interests in an entity. The Standard is effective for fiscal years beginning after November 15, 2009. The Company has not yet determined the impact of this pronouncement on its consolidated financial statements.

In June 2009, the FASB issued new guidance related to enhanced disclosures by public entities and enterprises by replacing the quantitative-based risks and rewards calculation for determining which enterprise has a controlling interest in a variable interest entity with an approach primarily qualitative in nature. This Standard requires additional disclosures about an enterprise s involvement in variable interest entities and is effective for fiscal years beginning after November 15, 2009. The Company has not yet determined the impact of this pronouncement on its consolidated financial statements.

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

## 2. ALTERNATIVE FUEL MIXTURE CREDIT

The U.S. Internal Revenue Code provides a tax credit for taxpayers that produce and use an alternative fuel in the operation of their business. Rayonier produces and uses an alternative fuel ( black liquor ) at its Jesup, Georgia and Fernandina Beach, Florida Performance Fibers mills. The credit is $0.50 per gallon for each gallon of alternative fuel used in operations. On April 8, 2009, Rayonier received notification from the Internal Revenue Service that its application for registration as an alternative fuel mixer had been approved. Accordingly, the Condensed Consolidated Statements of Income and Comprehensive Income for the three and nine months ended September 30, 2009, include a credit of $55.8 million and $141.8 million, net of associated expenses, recorded in Other operating income, net for black liquor produced and used. The Company will continue to recognize credits as they are earned through the expiration of the tax credit, currently scheduled for December 31, 2009.

## 3. INVESTMENT IN JOINT VENTURE

The Company holds a 40 percent interest in a joint venture ( JV ) that owns or leases approximately 327,000 acres of New Zealand timberlands. In addition to the investment, Rayonier New Zealand Limited ( RNZL ), a wholly-owned subsidiary of Rayonier Inc., serves as the manager of the JV forests and operates a log trading business. In the third quarter of 2008, Rayonier s Board of Directors approved a plan to offer to sell the Company s 40 percent interest in the JV as well as the operations of RNZL. As a result, the operating results of the JV and RNZL were segregated from continuing operations in the Condensed Consolidated Statements of Income and Comprehensive Income and reported as discontinued operations.

In the second quarter of 2009, as a result of distressed capital markets and the weak global economic conditions, Rayonier and its joint venture partners decided to discontinue the sale process of their New Zealand holdings and continue with on-going operations. Accordingly, the operating results are included in continuing operations in the Condensed Consolidated Statements of Income and Comprehensive Income for all periods presented.

## 4. EARNINGS PER COMMON SHARE

The following table provides details of the calculation of basic and diluted earnings per common share:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Net income [1] | $ 81,140 | $ 28,902 | $ 214,814 | $ 105,164 |
| Shares used for determining basic earnings per common share | 79,145,323 | 78,580,895 | 78,956,526 | 78,404,815 |
| Dilutive effect of: | | | | |
| Stock options | 413,740 | 645,664 | 356,068 | 691,910 |
| Performance and restricted shares | 548,052 | 344,804 | 433,440 | 292,560 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Shares used for determining diluted earnings per common share | | 80,107,115 | | 79,571,363 | | 79,746,034 | | 79,389,285 |
| Basic earnings per common share: [1] | $ | 1.03 | $ | 0.37 | $ | 2.72 | $ | 1.34 |
| Diluted earnings per common share: [1] | $ | 1.01 | $ | 0.36 | $ | 2.69 | $ | 1.32 |

[1] 2008 has been restated as a result of adopting new guidance related to accounting for convertible debt instruments that may be settled in cash upon conversion. See Note 1 *Basis of Presentation and New Accounting Pronouncements*.

**5. INCOME TAXES**

Rayonier is a real estate investment trust ( REIT ). In general, only the Company s taxable REIT subsidiaries, whose businesses include the Company s non-REIT qualified activities, are subject to U.S. federal and state corporate income tax. However, the Company is subject to U.S. federal corporate income tax on built-in gains (the excess of fair market value over tax

**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

basis for property held by the Company upon REIT election at January 1, 2004) on taxable sales of such built-in gain property during the first 10 years following the election to be taxed as a REIT. Accordingly, the provision for corporate income taxes relates principally to current and deferred taxes on income from taxable REIT subsidiary operations and on certain property sales. In addition, the Company is subject to foreign tax on non-U.S. operations.

***Provision for Income Taxes***

The Company s effective tax rate is below the 35 percent U.S. statutory tax rate primarily due to tax benefits associated with being a REIT and like-kind exchange ( LKE ) transactions. Third quarter tax rates before discrete items were 25.2 percent and 14.3 percent in 2009 and 2008, respectively. Year-to-date effective tax rates before discrete items were 22.1 percent and 15.5 percent in 2009 and 2008 respectively. The increased rates in 2009 were due to proportionately higher earnings from the Company s taxable REIT subsidiary. REIT income not subject to tax decreased the tax rates (from the statutory rate) by 13.0 percent and 19.7 percent for the nine months ending September 30, 2009 and 2008, respectively.

Including discrete items, the effective tax rates for the quarter and year-to-date were 17.8 percent and 14.6 percent compared to 23.0 percent and 17.9 percent in 2008, respectively. In the third quarter of 2008, the Company recorded discrete tax items primarily related to the Company s decision to offer its New Zealand operations for sale.

***Uncertain Tax Positions***

In accordance with the provisions related to accounting for uncertainty in income taxes, the Company recognizes the impact of a tax position if the position is more likely than not to prevail upon examination by the IRS. At September 30, 2009 and December 31, 2008, the Company s liability was $18.1 million and $3.9 million, respectively. The increase reflects changes as a result of the uncertain positions taken or expected to be taken during the current year and IRS examination of tax years 2005 and 2006.

**6. RESTRICTED DEPOSITS**

For certain real estate sales to qualify for LKE treatment, the sales proceeds must be deposited with a third party intermediary and accounted for as restricted cash until qualifying replacement property is acquired. In the event that LKE purchases are not completed, the proceeds are returned to the Company and reclassified as cash after 180 days. As of September 30, 2009 and December 31, 2008, the Company had $0.2 million and $1.5 million, respectively, of proceeds from real estate sales classified as restricted cash in Other Assets, which were on deposit with an LKE intermediary.

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

**7. SHAREHOLDERS EQUITY**

An analysis of shareholders equity for the nine months ended September 30, 2009 and the year ended December 31, 2008 is shown below (share amounts not in thousands):

| | Common Shares | | Retained | Accumulated Other Comprehensive | Shareholders |
|---|---|---|---|---|---|
| | Shares | Amount [1] | Earnings [1] | Income (Loss) | Equity |
| **Balance, December 31, 2007** | 78,216,696 | $ 506,650 | $ 518,618 | $ (25,638) | $ 999,630 |
| Net income | - | - | 148,583 | - | 148,583 |
| Dividends ($2.00 per share) | - | - | (157,270) | - | (157,270) |
| Issuance of shares under incentive stock plans | 690,031 | 8,265 | - | - | 8,265 |
| Stock-based compensation | - | 13,344 | - | - | 13,344 |
| Excess tax benefit on stock-based compensation | - | 3,248 | - | - | 3,248 |
| Repurchase of common shares | (92,296) | (3,979) | - | - | (3,979) |
| Net loss from pension and postretirement plans | - | - | - | (65,527) | (65,527) |
| Retiree medical benefit plan amendment | - | - | - | 16,377 | 16,377 |
| Foreign currency translation adjustment | - | - | - | (23,508) | (23,508) |
| Other | - | (226) | - | - | (226) |
| **Balance, December 31, 2008** | 78,814,431 | $ 527,302 | $ 509,931 | $ (98,296) | $ 938,937 |
| Net income | - | - | 214,814 | - | 214,814 |
| Dividends ($1.50 per share) | - | - | (118,737) | - | (118,737) |
| Issuance of shares under incentive stock plans | 688,101 | 9,228 | - | - | 9,228 |
| Stock-based compensation | - | 11,952 | - | - | 11,952 |
| Excess tax benefit on stock-based compensation | - | 2,287 | - | - | 2,287 |
| Repurchase of common shares | (49,362) | (1,388) | - | - | (1,388) |
| Warrants and hedge, net (Note 15) | - | (2,391) | - | - | (2,391) |
| Equity portion of convertible debt (Note 15) | - | 8,850 | - | - | 8,850 |
| Amortization of pension and postretirement plans | - | - | - | 2,286 | 2,286 |
| Foreign currency translation adjustment | - | - | - | 13,568 | 13,568 |
| Joint venture cash flow hedges | - | - | - | (1,659) | (1,659) |
| **Balance, September 30, 2009** | 79,453,170 | $ 555,840 | $ 606,008 | $ (84,101) | $ 1,077,747 |

[1] 2008 has been restated as a result of adopting new guidance related to accounting for convertible debt instruments that may be settled in cash upon conversion. See Note 1 *Basis of Presentation and New Accounting Pronouncements*.

**8. SEGMENT INFORMATION**

Rayonier operates in four reportable business segments: Timber, Real Estate, Performance Fibers, and Wood Products. Timber sales include all activities that relate to the harvesting of timber. Real Estate sales include all property sales, including those designated for higher and better use ( HBU ). The assets of the Real Estate segment include HBU property held by the Company s real estate subsidiary, TerraPointe LLC, and parcels under contract previously in the Timber segment. Allocations of depletion expense and non-cash costs of real estate sold are recorded when the Real Estate segment sells an asset from the Timber segment. The Performance Fibers segment includes two major product lines, cellulose specialties and absorbent materials. The Wood Products segment is comprised of the Company s lumber operations. The Company s remaining operations include harvesting and selling timber acquired from third parties (log trading). These operations are combined and reported in Other Operations. Sales between operating segments are made based on fair market value, and intercompany sales, purchases and profits (losses) are eliminated in consolidation. The Company evaluates financial performance based on the operating income of the segments.

Operating income (loss) as presented in the Condensed Consolidated Statements of Income and Comprehensive Income is equal to segment income (loss). Certain income (loss) items in the Condensed Consolidated Statements of Income and Comprehensive Income are not allocated to segments. These items, which include gains (losses) from certain asset dispositions, interest income (expense), miscellaneous income (expense) and income tax (expense) benefit, are not considered by Company management to be part of segment operations.

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

Total assets, sales, operating income (loss) and depreciation, depletion and amortization by segment including Corporate were as follows:

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| **ASSETS** | | |
| Timber | $ 1,307,575 | $ 1,323,111 |
| Real Estate | 71,762 | 73,021 |
| Performance Fibers | 527,016 | 495,659 |
| Wood Products | 23,193 | 26,573 |
| Other Operations | 22,782 | 26,565 |
| Corporate and other [1] | 339,856 | 136,935 |
| **TOTAL** | $ 2,292,184 | $ 2,081,864 |

[1] Includes $133 million in net receivables due to the alternative fuel mixture credit recorded in 2009. See Note 2 *Alternative Fuel Mixture Credit* for additional information.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **SALES** | | | | |
| Timber | $ 46,465 | $ 42,902 | $ 124,957 | $ 145,359 |
| Real Estate | 21,966 | 26,014 | 89,936 | 78,790 |
| Performance Fibers | 216,837 | 210,096 | 597,580 | 572,143 |
| Wood Products | 13,259 | 24,098 | 37,532 | 67,499 |
| Other Operations | 8,512 | 14,355 | 23,171 | 42,734 |
| Intersegment Eliminations | (6,391) | - | (14,445) | - |
| **TOTAL** | $ 300,648 | $ 317,465 | $ 858,731 | $ 906,525 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **OPERATING INCOME (LOSS)** | | | | |
| Timber | $ 1,038 | $ (1,414) | $ (867) | $ 20,089 |
| Real Estate | 12,795 | 14,017 | 51,363 | 50,401 |
| Performance Fibers | 49,524 | 43,029 | 125,060 | 116,832 |

| | | | | |
|---|---|---|---|---|
| Wood Products | (1,999) | 327 | (8,142) | (2,555) |
| Other Operations | (1,286) | 463 | (2,618) | 982 |
| Corporate and other [1] | 51,076 | (7,421) | 123,761 | (22,668) |
| **TOTAL** | $ 111,148 | $ 49,001 | $ 288,557 | $ 163,081 |

[1] Three and nine months ended September 30, 2009 include $55.8 million and $141.8 million relating to the alternative fuel mixture credit. See Note 2 *Alternative Fuel Mixture Credit* for additional information.

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **DEPRECIATION, DEPLETION AND AMORTIZATION** | | | | |
| Timber | $ 19,083 | $ 19,636 | $ 58,515 | $ 59,110 |
| Real Estate | 4,811 | 5,155 | 22,256 | 10,483 |
| Performance Fibers | 15,025 | 14,028 | 42,021 | 38,029 |
| Wood Products | 1,060 | 1,161 | 3,491 | 3,967 |
| Other Operations | 1 | 7 | 2 | 24 |
| Corporate and other | 179 | 151 | 549 | 424 |
| **TOTAL** | $ 40,159 | $ 40,138 | $ 126,834 | $ 112,037 |

**9. FINANCIAL INSTRUMENTS**

***Commodity Swap Agreements***

The Company enters into commodity forward contracts to fix some of its fuel oil and natural gas costs at its Performance Fibers mills. The forward contracts partially mitigate the risk of a change in Performance Fibers margins resulting from an increase or decrease in fuel oil and natural gas prices. At September 30, 2009, the Company had hedges through the end of 2009 on 15,700 barrels of fuel oil. The Company s commodity forward contracts do not qualify for hedge accounting and instead are required to be marked-to-market. The mark-to-market adjustments are recorded in Other operating income, net.

The following table presents the location of all assets and liabilities associated with the Company s hedging instruments within the Condensed Consolidated Balance Sheets:

| **Derivatives not designated as hedging instruments** | **Balance Sheet Location** | Fair Value at: September 30, 2009 | Fair Value at: December 31, 2008 |
|---|---|---|---|
| Fuel oil contracts | Other current liabilities | $ (122) | $ (3,825) |

The following table presents the impact of derivative instruments and their location within the Condensed Consolidated Statements of Income and Comprehensive Income:

| **Derivatives not designated as hedging instruments** | **Location of (Loss)/Gain Recognized in Income** | Three Months Ended September 30, 2009 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|---|---|---|
| Fuel oil contracts | Other operating income, net | $ (5) | $ (346) | $ 1,216 | $ 750 |

**10. FAIR VALUE MEASUREMENTS**

Assets and liabilities measured at fair value on a recurring basis are summarized below:

| Asset (liability) | Carrying Value at September 30, 2009 | Level 2 |
|---|---|---|
| Investment in qualified special-purpose entity | $ 2,757 | $ 2,757 |
| Commodity swap agreements | (122) | (122) |

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

The following table presents the carrying amount and estimated fair values of financial instruments held by the Company at September 30, 2009 and December 31, 2008, using market information and what the Company believes to be appropriate valuation methodologies.

| | September 30, 2009 | | December 31, 2008 | |
|---|---|---|---|---|
| Asset (liability) | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash and cash equivalents | $ 153,145 | $ 153,145 | $ 61,685 | $ 61,685 |
| Short-term debt | (660) | (660) | (620) | (620) |
| Long-term debt | (809,070) | (912,929) | (746,591) | (700,369) |

Rayonier uses the following methods and assumptions in estimating the fair value of its financial instruments:

*Cash and cash equivalents* The carrying amount is equal to fair market value.

*Debt* The Company s short-term bank loans and floating rate debt approximate fair value. The fair value of fixed rate long-term debt is based upon quoted market prices for debt with similar terms and maturities.

**11. GUARANTEES**

The Company provides financial guarantees as required by creditors, insurance programs, and federal, state and non-U.S. governmental agencies. As of September 30, 2009, the following financial guarantees were outstanding:

| | Maximum Potential Payment | Carrying Amount of Liability |
|---|---|---|
| Standby letters of credit (1) | $ 47,745 | $ 39,278 |
| Guarantees (2) | 3,767 | 53 |
| Surety bonds (3) | 11,128 | 1,956 |
| Total | $ 62,640 | $ 41,287 |

(1) Approximately $39 million of the standby letters of credit serve as credit support for industrial revenue bonds. The remaining letters of credit supports obligations under various insurance related agreements, primarily workers compensation and pollution liability policy requirements. These letters of credit expire at various dates during 2009 and 2010, and will be renewed as required.

(2) In conjunction with RNZL s sale of timberlands to the New Zealand JV in October 2005, the Company guaranteed five years of Crown Forest license obligations. The JV is the primary obligor and has posted a bank performance bond with the New Zealand government. If the JV fails to pay the obligation, the New Zealand government will demand payment from the bank that posted the

bond. If the bank defaults on the bond, the Company would then have to perform. As of September 30, 2009, a payment of $1.2 million remains. This guarantee expires in 2010.

In conjunction with a timberland sale and note monetization in the first quarter of 2004, the Company issued a make-whole agreement pursuant to which it guaranteed $2.5 million of obligations of a qualified special-purpose entity that was established to complete the monetization. At September 30, 2009 and December 31, 2008, the Company has recorded a de minimus liability to reflect the fair market value of its obligation to perform under the make-whole agreement.

(3) Rayonier issued surety bonds primarily to secure timber in the State of Washington and to provide collateral for the Company s workers compensation self-insurance program in Washington and Georgia. These surety bonds expire at various dates during 2009 and 2010, and are renewed as required.

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

**12. LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS**

An analysis of activity in the liabilities for dispositions and discontinued operations for the nine months ended September 30, 2009 and the year ended December 31, 2008, is as follows:

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Balance, January 1 | $ 104,575 | $ 113,685 |
| Expenditures charged to liabilities | (5,968) | (7,660) |
| Increase (reduction) to liabilities | 974 | (1,450) |
| Balance, end of period | 99,581 | 104,575 |
| Less: Current portion | (9,354) | (8,214) |
| Non-current portion | $ 90,227 | $ 96,361 |

The Company believes established liabilities are sufficient for costs expected to be incurred over the next 20 years with respect to its dispositions and discontinued operations. The Company is exposed to the risk of reasonably possible additional losses in excess of the established liabilities. As of September 30, 2009, this amount could range up to $32 million and arises from uncertainty over the availability or effectiveness of certain remediation technologies, additional or different contamination that may be discovered, development of new or improved environmental remediation technologies, changes in applicable law and the exercise of discretion in interpretation of applicable law and regulations by governmental agencies.

For additional information on the Company s environmental liabilities refer to Note 15 *Liabilities for Dispositions and Discontinued Operations* in the 2008 Annual Report on Form 10-K.

**13. CONTINGENCIES**

From time to time, Rayonier becomes subject to pending and threatened litigation in commercial, tort, regulatory and environmental matters, among others. For additional information refer to Note 16 *Contingencies* in the 2008 Annual Report on Form 10-K.

The Company has been named as a defendant in various other lawsuits and claims arising in the normal course of business. While the Company has procured reasonable and customary insurance covering risks normally occurring in connection with its businesses, it has in certain cases retained some risk through the operation of self-insurance, primarily in the areas of workers compensation, property insurance, and general liability. These other lawsuits and claims, either individually or in the aggregate, are not expected to have a material effect on the Company s financial position, results of operations, or cash flow. Note the following:

*East Point, Georgia Notice of Violation ( NOV )* In the Company s 2008 Annual Report on Form 10-K and Quarterly Report on Form 10-Q for the second quarter of 2009, there was a discussion of an NOV and proposed consent order received on March 28, 2008 by Southern Wood Piedmont Company ( SWP ) from the Environmental Protection Division ( EPD ) of the Georgia Department of Natural Resources, relating to SWP s East Point, Georgia site. On October 23, 2009, EPD and SWP reached agreement to resolve this entire matter via a negotiated consent order, whereby SWP agreed, among other things, to pay a penalty of $100,000 and perform additional soil and groundwater investigatory and analysis activities on an agreed-upon timetable, and prepare an amended corrective action plan for the site, with stipulated penalties if these activities are not performed within the specified timeframes. The Company believes that, based on current information, its liabilities at September 30, 2009 adequately reflect the probable costs to be incurred based upon the ultimate resolution of this matter.

There have been no material changes in the status of the other specific matters referenced in Note 16 *Contingencies* in the 2008 Annual Report on Form 10-K.

**14. EMPLOYEE BENEFIT PLANS**

The Company has four qualified non-contributory defined benefit pension plans covering a majority of its employees and an unfunded pension plan which provides benefits in excess of amounts allowable under current tax law in the qualified plans. Employee benefit plan liabilities are calculated using actuarial estimates and management assumptions. These estimates are based on historical information, along with certain assumptions about future events. Changes in assumptions, as well as changes in actual experience, could cause the estimates to change.

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

The net periodic benefit costs for the Company s pension and postretirement plans (medical and life insurance) are shown in the following table:

| | Pension Three Months Ended September 30, | | Postretirement Three Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Components of Net Periodic Benefit Cost | | | | |
| Service cost | $ 1,182 | $ 1,718 | $ 181 | $ 138 |
| Interest cost | 4,864 | 4,142 | 257 | 287 |
| Expected return on plan assets | (5,489) | (5,215) | - | - |
| Amortization of prior service cost | 664 | 358 | 22 | 490 |
| Amortization of plan amendment | - | - | (2,391) | (797) |
| Amortization of losses | 1,949 | 1,211 | 1,273 | 139 |
| Net periodic benefit cost | $ 3,170 | $ 2,214 | $ (658) | $ 257 |

| | Pension Nine Months Ended September 30, | | Postretirement Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| Components of Net Periodic Benefit Cost | | | | |
| Service cost | $ 4,867 | $ 5,022 | $ 361 | $ 479 |
| Interest cost | 13,562 | 12,109 | 858 | 1,595 |
| Expected return on plan assets | (16,071) | (15,490) | - | - |
| Amortization of prior service cost | 1,372 | 1,042 | 66 | 864 |
| Amortization of plan amendment | - | - | (7,175) | (797) |
| Amortization of losses | 4,647 | 3,540 | 4,389 | 725 |
| Net periodic benefit cost | $ 8,377 | $ 6,223 | $ (1,501) | $ 2,866 |

The Company contributed approximately $9 million to the pension plans during the nine months ended September 30, 2009. The Company expects pension contributions to be approximately $10 million for full year 2009.

**15. CONVERTIBLE DEBT**

*4.50% Convertible notes issued August 2009*

In August 2009, Rayonier TRS Holdings Inc. ( TRS ), a wholly-owned subsidiary of Rayonier, issued $172.5 million of 4.50 percent Senior Exchangeable Notes due 2015. The notes are guaranteed by Rayonier and are non-callable. The $172.5 million in principal will be settled in cash and any excess exchange value will be settled at the option of the Company in either cash or stock of Rayonier. Noteholders may convert their notes to common stock of Rayonier Inc., subject to certain conversion provisions including the market price of the stock and the trading price of the convertible notes. The initial exchange rate is 19.91 shares per $1,000 principal based on an exchange price equal to 122.5 percent of the stock s closing price of $41.01 on August 6, 2009, or $50.24 per share.

In separate transactions, TRS and Rayonier purchased exchangeable note hedges and sold warrants, respectively, based on 3,433,699 underlying shares of Rayonier. These transactions had the effect of increasing the conversion premium from 22.5 percent to 46 percent or to $60.00 per share. The exchangeable note hedge and warrant transactions are intended to limit exposure of potential dilution to Rayonier shareholders from noteholders who could exchange the notes for Rayonier common shares. On exercise of the hedges, TRS will receive shares of Rayonier common stock equal to the difference between the then market price and the strike price of $50.24. The holders of the warrants will receive net shares from Rayonier if the share price is above $60.00 at maturity of the warrants.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

The purchased hedges and sold warrants are not part of the terms of the notes and will not affect the noteholders rights. Likewise, the noteholders will not have any rights with respect to the hedges or the warrants. The purchased hedges and the sold warrants meet the definition of derivatives. However, because these instruments have been determined to be indexed to the Company s own stock and have been recorded in shareholders equity in the Condensed Consolidated Balance Sheet, the instruments are not subject to the mark-to-market adjustments

*3.75% Convertible notes issued October 2007*

In October 2007, TRS issued $300 million of 3.75 percent Senior Exchangeable Notes due 2012. The notes are guaranteed by Rayonier and are non-callable. The $300 million in principal will be settled in cash and any excess exchange value will be settled at the option of the Company in either cash or stock of Rayonier. Noteholders may convert their notes subject to certain conversion provisions including the market price of the Company s common stock and the trading price of the convertible notes. The initial exchange rate is 18.24 shares per $1,000 principal based on an exchange price equal to 122 percent of the stock s closing price of $44.93 on October 10, 2007, or $54.81 per share.

In separate transactions, TRS and Rayonier purchased an exchangeable note hedge and sold warrants, respectively, based on 5,472,991 underlying shares of Rayonier. These transactions had the effect of increasing the conversion premium from 22 percent to 40 percent or to $62.90 per share. On exercise of the hedge, TRS will receive shares of Rayonier common stock equal to the difference between the then market price and the strike price of $54.81. The holders of the warrants will receive net shares from Rayonier if the share price is above $62.90 at maturity of the warrants.

The purchased hedge and sold warrants are not part of the terms of the notes and will not affect the noteholders rights. Likewise, the noteholders will not have any rights with respect to the hedge or the warrants. The purchased hedge and the sold warrants meet the definition of derivatives. However, because these instruments have been determined to be indexed to the Company s own stock and have been recorded in shareholders equity in the Condensed Consolidated Balance Sheet, the instruments are not subject to the mark-to-market adjustments.

The amounts related to convertible debt in the Condensed Consolidated Balance Sheets are as follows:

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Liabilities: | | |
| Principal amount of debt | | |
| 3.75% Senior Exchangeable Notes | $ 300,000 | $ 300,000 |
| 4.50% Senior Exchangeable Notes | 172,500 | - |
| Unamortized discount | | |
| 3.75% Senior Exchangeable Notes | (19,423) | (23,748) |
| 4.50% Senior Exchangeable Notes | (13,687) | - |
| Net carrying amount of debt | $ 439,390 | $ 276,252 |
| Equity: | | |
| Common Stock | $ 28,093 | $ 19,243 |

The unamortized discounts for the 3.75 percent and 4.50 percent Senior Exchangeable Notes will be amortized through October 2012 and August 2015, respectively.

**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**(Dollars in thousands unless otherwise stated)**

The amount of interest related to the convertible debt recognized in the Condensed Consolidated Statements of Income and Comprehensive Income is as follows:

| | Three Months Ended September 30, 2009 | Three Months Ended September 30, 2008 | Nine Months Ended September 30, 2009 | Nine Months Ended September 30, 2008 |
|---|---|---|---|---|
| Contractual interest coupon | | | | |
| 3.75% Senior Exchangeable Notes | $ 2,813 | $ 2,813 | $ 8,438 | $ 8,412 |
| 4.50% Senior Exchangeable Notes | 970 | - | 970 | - |
| Amortization of debt discount | | | | |
| 3.75% Senior Exchangeable Notes | 1,442 | 1,342 | 4,325 | 4,027 |
| 4.50% Senior Exchangeable Notes | 250 | - | 250 | - |
| Total interest expense recognized | $ 5,475 | $ 4,155 | $ 13,983 | $ 12,439 |

The effective interest rate on the liability component of both issues for the three and nine months ended September 30, 2009 and 2008 was 6.21 percent.

## 16. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated Other Comprehensive Income (Loss) was comprised of the following:

| | September 30, 2009 | December 31, 2008 |
|---|---|---|
| Foreign currency translation adjustments | $ 24,357 | $ 10,789 |
| Joint venture cash flow hedges | (1,659) | - |
| Unrecognized components of employee benefit plans, net of tax | (106,799) | (109,085) |
| Total | $ (84,101) | $ (98,296) |

During the nine months ended September 30, 2009, the increase in net foreign currency translation adjustments was due to the strengthening of the New Zealand dollar against the U.S. dollar.

## 17. CONSOLIDATING FINANCIAL STATEMENTS

In October 2007, TRS issued $300 million of 3.75 percent Senior Exchangeable Notes due 2012, and in August 2009 TRS issued $172.5 million of 4.5 percent Senior Exchangeable Notes due 2015. The notes for both transactions are guaranteed by Rayonier and are non-callable. In connection with these exchangeable notes, the Company provides the following condensed consolidating financial information in accordance with SEC Regulation S-X Rule 3-10, *Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered.* Each entity in the consolidating financial information follows the same accounting policies as described in the consolidated financial statements, except for the use of the equity method of accounting to reflect ownership interests in wholly-owned subsidiaries which are eliminated upon consolidation and the allocation of certain expenses of Rayonier incurred for the benefit of its subsidiaries.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless otherwise stated) (Continued)

CONDENSED CONSOLIDATING STATEMENTS OF INCOME
For the Three Months Ended September 30, 2009

| | Rayonier Inc. (Parent Guarantor) | Rayonier TRS Holdings Inc. (Issuer) | Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors) | All Other Subsidiaries (Non-guarantors) | Consolidating Adjustments | Total Consolidated |
|---|---|---|---|---|---|---|
| **SALES** | $ - | $ - | $ 266,859 | $ 47,691 | $ (13,902) | $ 300,648 |
| Costs and Expenses | | | | | | |
| Cost of sales | - | - | 215,399 | 31,218 | (14,781) | 231,836 |
| Selling and general expenses | 2,926 | - | 12,222 | 829 | (5) | 15,972 |
| Other operating expense (income), net | 43 | - | (57,004) | (2,290) | - | (59,251) |
| | 2,969 | - | 170,617 | 29,757 | (14,786) | 188,557 |
| Equity in (loss) income of New Zealand joint venture | (1,248) | - | 305 | - | - | (943) |
| **OPERATING (LOSS) INCOME** | (4,217) | - | 96,547 | 17,934 | 884 | 111,148 |
| Interest income (expense) | 209 | (5,919) | (5,920) | (1,159) | - | (12,789) |
| Interest and miscellaneous income (expense), net | 1,255 | (1,124) | (1,087) | 1,296 | (30) | 310 |
| Equity in income from subsidiaries | 85,757 | 71,305 | - | - | (157,062) | - |
| **INCOME BEFORE INCOME TAXES** | 83,004 | 64,262 | 89,540 | 18,071 | (156,208) | 98,669 |
| Income tax (expense) benefit | (1,864) | 2,570 | (18,235) | - | - | (17,529) |
| **NET INCOME** | $ 81,140 | $ 66,832 | $ 71,305 | $ 18,071 | $ (156,208) | $ 81,140 |

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollar amounts in thousands unless otherwise stated) (Continued)**

**CONDENSED CONSOLIDATING STATEMENTS OF INCOME**
**For the Three Months Ended September 30, 2008**

| | Rayonier Inc. (Parent Guarantor) | Rayonier TRS Holdings Inc. (Issuer) | Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors) | All Other Subsidiaries (Non-guarantors) | Consolidating Adjustments | Total Consolidated |
|---|---|---|---|---|---|---|
| **SALES** | $ - | $ - | $ 294,079 | $ 31,907 | $ (8,521) | $ 317,465 |
| Costs and Expenses | | | | | | |
| Cost of sales | - | - | 245,697 | 28,418 | (21,401) | 252,714 |
| Selling and general expenses | 2,606 | - | 12,769 | 817 | - | 16,192 |
| Other operating expense (income), net | 61 | - | (109) | (1,440) | - | (1,488) |
| | 2,667 | - | 258,357 | 27,795 | (21,401) | 267,418 |
| Equity in (loss) income of New Zealand joint venture | (626) | - | (420) | - | - | (1,046) |
| **OPERATING (LOSS) INCOME** | (3,293) | - | 35,302 | 4,112 | 12,880 | 49,001 |
| Interest income (expense) | 1,076 | (4,507) | (7,238) | (1,161) | 1 | (11,829) |
| Interest and miscellaneous income (expense), net | 901 | (773) | (979) | 1,224 | (32) | 341 |
| Equity in income from subsidiaries | 26,987 | 13,315 | - | - | (40,302) | - |
| **INCOME BEFORE INCOME TAXES** | 25,671 | 8,035 | 27,085 | 4,175 | (27,453) | 37,513 |
| Income tax benefit (expense) | 3,231 | 1,928 | (13,770) | - | - | (8,611) |
| **NET INCOME** | $ 28,902 | $ 9,963 | $ 13,315 | $ 4,175 | $ (27,453) | $ 28,902 |

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**RAYONIER INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Dollar amounts in thousands unless otherwise stated) (Continued)**

**CONDENSED CONSOLIDATING STATEMENTS OF INCOME**
**For the Nine Months Ended September 30, 2009**

| | Rayonier Inc. (Parent Guarantor) | Rayonier TRS Holdings Inc. (Issuer) | Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors) | All Other Subsidiaries (Non-guarantors) | Consolidating Adjustments | Total Consolidated |
|---|---|---|---|---|---|---|
| **SALES** | $ - | $ - | $ 724,718 | $ 165,713 | $ (31,700) | $ 858,731 |
| Costs and Expenses | | | | | | |
| Cost of sales | - | - | 599,381 | 108,397 | (34,923) | 672,855 |
| Selling and general expenses | 7,824 | - | 34,635 | 2,503 | | 44,962 |
| Other operating expense (income), net | 131 | - | (143,781) | (6,775) | - | (150,425) |
| | 7,955 | - | 490,235 | 104,125 | (34,923) | 567,392 |
| Equity in (loss) income of New Zealand joint venture | (2,808) | - | 26 | - | - | (2,782) |
| **OPERATING (LOSS) INCOME** | (10,763) | - | 234,509 | 61,588 | 3,223 | 288,557 |
| Interest expense | (27) | (15,133) | (18,998) | (3,472) | - | (37,630) |
| Interest and miscellaneous income (expense), net | 2,831 | (2,671) | (3,357) | 3,884 | (93) | 594 |
| Equity in income from subsidiaries | 227,265 | 173,441 | - | - | (400,706) | - |
| **INCOME BEFORE INCOME TAXES** | 219,306 | 155,637 | 212,154 | 62,000 | (397,576) | 251,521 |
| Income tax (expense) benefit | (4,492) | 6,498 | (38,713) | - | - | (36,707) |
| **NET INCOME** | $ 214,814 | $ 162,135 | $ 173,441 | $ 62,000 | $ (397,576) | $ 214,814 |

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless otherwise stated) (Continued)

**CONDENSED CONSOLIDATING STATEMENTS OF INCOME**
**For the Nine Months Ended September 30, 2008**

| | Rayonier Inc. (Parent Guarantor) | Rayonier TRS Holdings Inc. (Issuer) | Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors) | All Other Subsidiaries (Non-guarantors) | Consolidating Adjustments | Total Consolidated |
|---|---|---|---|---|---|---|
| **SALES** | $ - | $ - | $ 786,359 | $ 327,734 | $ (207,568) | $ 906,525 |
| Costs and Expenses | | | | | | |
| Cost of sales | - | - | 655,412 | 125,817 | (80,468) | 700,761 |
| Selling and general expenses | 7,952 | - | 37,658 | 2,388 | - | 47,998 |
| Other operating expense (income), net | 1 | - | (1,894) | (4,300) | - | (6,193) |
| | 7,953 | - | 691,176 | 123,905 | (80,468) | 742,566 |
| Equity in (loss) income of New Zealand joint venture | (629) | - | (249) | - | - | (878) |
| **OPERATING (LOSS) INCOME** | (8,582) | - | 94,934 | 203,829 | (127,100) | 163,081 |
| Interest income (expense) | 1,704 | (13,497) | (21,153) | (4,497) | 5 | (37,438) |
| Interest and miscellaneous income (expense), net | 2,679 | (2,320) | (1,606) | 3,807 | (98) | 2,462 |
| Equity in income from subsidiaries | 107,165 | 41,183 | - | - | (148,348) | - |
| **INCOME BEFORE INCOME TAXES** | 102,966 | 25,366 | 72,175 | 203,139 | (275,541) | 128,105 |
| Income tax benefit (expense) | 2,198 | 5,853 | (30,992) | - | - | (22,941) |
| **NET INCOME** | $ 105,164 | $ 31,219 | $ 41,813 | $ 203,139 | $ (275,541) | $ 105,164 |