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RYN - Q3 2019 Rayonier Inc Earnings Call

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OVERVIEW:

Co. reported 3Q19 sales of $156m and net loss attributable to Co. of $0.4m and EPS was roughly breakeven.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome and thank you for joining Rayonier's Third Quarter 2019 Teleconference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time.

And now, I will turn the meeting over to Mr. Mark McHugh, Senior Vice President and CFO. Sir, you may begin.

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

Thank you, and good morning. Welcome to Rayonier's investor teleconference covering third quarter earnings. Our earnings statements and financial supplement were released yesterday afternoon and are available on our website at rayonier.com. I'd like to remind you that in these presentations we include forward-looking statements made pursuant to the safe harbor provisions of federal securities laws. Our earnings release and Form 10-K filed with the SEC list some of the factors that may cause actual results to differ materially from the forward-looking statements we may make.

They're also referenced on Page 2 of our financial supplement. Throughout these presentations, we will also discuss non-GAAP financial measures, which are defined and reconciled to the nearest GAAP measure in our earnings release and supplemental materials.

With that, let's start our teleconference with opening comments from Dave Nunes, President and CEO. Dave?

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

Thanks, Mark. First, I'll make some high-level comments before turning back over to Mark to review our consolidated financial results. Then I'll ask Doug Long, Senior Vice President of Forest Resources, to comment on our U.S. and New Zealand timber results. And following the review of our timber segments, Mark will discuss our Real Estate results as well as our outlook for the remainder of 2019.

We generated adjusted EBITDA of $43 million and breakeven EPS for the third quarter. Our third quarter results were well below last quarter and the prior year quarter, primarily due to the timing of Real Estate transaction activity as anticipated and discussed in our last earnings call. In our Southern Timber segment, volumes declined modestly versus the prior year quarter, while average prices were also lower due to weaker export demand and oversupply of sawtimber in the domestic market. The pulpwood market also experienced some pricing pressure due to excess supply from dry ground conditions during the quarter. Despite these near term headwinds, we remain on track to achieve record adjusted EBITDA in our Southern Timber segment for the full year, 2019, bolstered by a very strong year in non-timber income.

In our Pacific Northwest Timber segment, we continued to contend with soft market conditions resulting from reduced export demand and challenging lumber markets. As noted on prior calls, we've deferred planned harvest volume this year in response to these unfavorable market conditions, which has further impacted results.

In our New Zealand Timber segment, we generated a modest increase in harvest levels versus the prior year quarter, although pricing declined significantly, as China demand weakened and competitive log and lumber supply from Europe, salvage -- European salvaged timber increased significantly. While we've seen a modest improvement in export pricing for midyear lows, pricing still remains well below first half averages.

Lastly, Real Estate activity was relatively light this quarter, while weighted average pricing remains strong due to a significant improved development transaction. Overall, we're on track to achieve full year adjusted EBITDA toward the lower end of our prior guidance.

And with that, let me turn it back over to Mark to review our third quarter financial results.

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

Thanks, Dave. Let's start on Page 5 with our financial highlights. Sales for the quarter totaled $156 million, while operating income was $11 million and net loss attributable to Rayonier was $0.4 million, translating to roughly breakeven EPS for the quarter. Third quarter adjusted EBITDA of $43 million was significantly below the prior year quarter adjusted EBITDA of $83 million, primarily due to a significantly lower contribution from our Real Estate segment as well as weaker results in our Pacific Northwest and New Zealand Timber segments.

On the bottom of Page 5, we provide an overview of our capital resources and liquidity at quarter end as well as the comparison to prior periods. Our cash available for distribution, or CAD, for the first 9 months of the year was $116 million compared to $222 million in the prior-year period, primarily due to lower adjusted EBITDA, higher capital expenditures and higher cash taxes paid, partially offset by lower cash interest paid. A reconciliation of CAD to cash provided by operating activities and other GAAP measures is provided on Page 8 of the financial supplement. We closed the quarter with $57 million of cash and $975 million of debt. Our net debt of $918 million represented 20% of our enterprise value based on our closing stock price at quarter end.

I'll now turn the call back over to Doug to provide a more detailed review of our timber results.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Thanks, Mark. Good morning. Let's start on Page 9 with our Southern Timber segment. Adjusted EBITDA in the third quarter of $23 million was $5 million and $400,000 unfavorable compared to the prior quarter and the prior year quarter, respectively. Third quarter harvest volume of approximately 1.3 million tons was flat compared to prior quarter and 4% lower compared to the prior year quarter. The decline in volumes was driven part to weaker sawtimber demand, particularly in export markets. Quarterly volumes this year have also been impacted by the outside stumpage removals that we experienced in the first quarter of this year. The average pine pulpwood stumpage price of $15.53 per ton was 9% and 7% unfavorable compared to the prior quarter and the prior year quarter, respectively. The reduction in price compared to the prior quarter was due to an increase in supply as a result of dry ground conditions combined with geographic mix, as we harvested less volume from our strongest pulpwood market.

The reduction versus the prior year quarter was driven primarily by geographic mix. The average pine sawtimber price of $23.16 per ton was 10% and 9% unfavorable compared to the prior quarter and the prior year quarter, respectively. The decline in pricing compared to both prior periods was primarily due to weaker export and domestic demand resulting from continued Chinese tariffs on southern yellow pine logs coupled with an increase in tariffs on southern yellow pine lumber, which impacted domestic production.

Our non-timber revenue team continue to deliver strong results. Year-to-date revenue of $27 million is 29% higher in the same period in the prior year, primarily as a result of increased recreational license income and pipeline easements sales.

Now moving to the Pacific Northwest Timber segment on Page 10. Adjusted EBITDA of $3 million was $0.5 million favorable compared to the prior quarter and $7 million unfavorable compared to the prior year quarter. Third quarter harvest volume of 261,000 tons was 4% higher than prior quarter and 16% lower than the prior year quarter. As trade tensions with China have continued, 2019 year-to-date log export volumes have declined to a 10-year low, resulting in continued pressure on pricing. However, we've recently seen a mass uptick in demand, which will provide for increased volumes in Q4. The average delivered sawtimber price of $78.26 per ton was flat compared to the prior quarter and 24% unfavorable compared to the prior year quarter. Following the significant decline in pricing late last year, when the U.S. China trade dispute heated up, pricing has been relatively stable over the last 4 quarters.

The average delivered pulpwood price of $37.87 per ton was 10% and 23% unfavorable compared to the prior quarter and the prior year quarter, respectively. The change in pulpwood prices compared to the prior quarter was primarily driven by excess supply in the market as small-diameter export quality logs were downgraded to domestic pulp logs due to the weakening export demand.

Additional variance relative to the prior year was driven by reduced export demand for chips, which yielded increased fiber supply for domestic mills. In summary, we continue to see various negative impacts related to the U.S. China trade dispute across all product categories in the region.

Page 11 shows results and key operating metrics for our New Zealand Timber segment. Adjusted EBITDA in the third quarter of $18 million was $2 million and $6 million unfavorable compared to the prior quarter and the prior year quarter, respectively. Third quarter harvest volume of 754,000 tons was 10% and 14% higher in the prior quarter and the prior year quarter, respectively. The increase in volume in the third quarter was primarily due to export vessel timing in increased domestic demand as some competitors' harvesting and lower margin force curtailed operations due to the fall on export prices.

The average delivered export sawtimber price of $95.51 per ton was 15% and 17% unfavorable compared to the prior quarter and the prior year quarter, respectively. Many factors have contributed to decline in pricing, including alternative log and lumber supply from Europe, slower consumption of logs and increased deliveries, particularly at the start of the third quarter, which yield elevated port inventories. However, the situation generally improved for the end of third quarter as consumption increased and suppliers from higher cost regions significantly reduced shipments.

Customers have now had the opportunity to trial European spruce salvage logs and our market intelligence suggest that, while there is satisfactory for construction lumber, it did not work well for higher-end uses such as plywood, moldings and furniture for which radiata pine is preferred. As a result, by the end of third quarter, radiata pine inventory at Chinese ports had dropped by almost 30%.

The average domestic sawtimber price of $75.29 per ton in U.S. dollars terms was 9% and 7% unfavorable compared to prior quarter from the prior year quarter, respectively, partially due to the fall in the New Zealand U.S. exchange rate, but also due to the impact of declining export prices. Note that domestic pricing tends to lag behind export pricing as log supplies diverted back in domestic markets when export prices become uncompetitive. Excluding the impact of foreign exchange rates, domestic pricing in New Zealand dollars were 7% and 4% unfavorable compared to the prior quarter and prior year quarter, respectively.

The average domestic pulpwood price of $38.47 per ton was 2% unfavorable compared to the prior quarter and 2% favorable compared to the prior year quarter. In New Zealand dollars, the pulpwood prices were flat compared to the prior quarter but 6% favorable compared to the prior year quarter.

In our Trading segment, we generated breakeven results, which were $200,000 favorable compared to the prior quarter and $300,000 unfavorable to the prior year quarter.

I'll now turn it back over to Mark to cover our Real Estate results and outlook for the remainder of the year.

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

Thanks, Doug. As highlighted on Page 12, our Real Estate segment had a relatively light third quarter. Third quarter sales totaled $9 million on roughly 1,300 acres sold at an average price of $6,500 per acre. $400,000 of deferred revenue was also recognized in the quarter due to the completion of post-closing obligations on prior improved development sales. Adjusted EBITDA for the quarter was $5 million.

Sales in the Improved Development category totaled $4.5 million driven primarily by the $4.2 million sale of a 16-acre grocery retail site in our Wildlight development project. Since project inception, we've realized total commercial sales in Wildlight of roughly $16 million on 76 acres sold at an average price of $215,000 per acre.

Residential momentum in Wildlight also continues to be strong. The development of our next phase of 122 residential lots is well underway with construction scheduled to be substantially completed by the end of Q1 2020.

In the rural category, sales totaled $4 million on roughly 1,100 acres sold at an average price of $3,400 per acre. Rural sales comprised over 20 transactions across our southern footprint. Lastly, sales in the nonstrategic and timberlands category totaled $0.4 million consisting of 200 acres at an average price of $2,100 per acre.

Now moving onto our outlook for the balance of the year. As noted in our earnings release, we expect to achieve full year adjusted EBITDA toward the lower end of our prior guidance of $245 million to $265 million. Market conditions continued to be challenging across our timber segments driven in large part by the decline in the China export market. In our Southern Timber segment, we're reducing our full year volume guidance to a range of 6 million to 6.1 million tons, as we pullback harvest activity in certain markets impacted by the decline in sawtimber demand.

Based primarily on this lower volume estimate, we expect that full year adjusted EBITDA on our Southern Timber segment will be modestly below our prior guidance. In our Pacific Northwest Timber segment, we expect to achieve full year harvest volume in line with our prior guidance of 1.2 million tons and adjusted EBITDA toward the higher end of our prior guidance. While market conditions through the first 9 months have been very difficult, we're starting to see some momentum in demand, which should contribute to stronger results in Q4.

In our New Zealand Timber segment, we remain on track to achieve full year harvest volumes at 2.7 million to 2.8 million tons, while we expect to achieve adjusted EBITDA work towards the lower end of our prior guidance. Pricing in New Zealand has improved modestly from midyear lows but still remains well below average pricing in the first half of the year.

Lastly, in our Real Estate segment, we expect a strong fourth quarter and remain on track to achieve our prior full year adjusted EBITDA guidance for the segment.

I'll now turn the call back to Dave for closing comments.

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

Thanks, Mark. While market conditions across our timber segments have been challenging, we remain focused on our core objectives of generating industry-leading returns and building long-term value per share. To this end, we are, we were pretty active with respect to capital allocation initiatives in the third quarter.

During the third quarter, we closed 7 acquisitions totaling 23,500 acres for an aggregate value of $55.5 million. The 2 largest transactions closed include approximately 4,100 acres in New Zealand acquired for $29.1 million and 10,000 acres located in coastal Florida acquired for $14.8 million. The New Zealand acquisition has an over age-class, is heavily stocked with merchantable timber and is located in strong markets with a good mix of domestic and export log demand. The Florida acquisition has a relatively young age-class profile, but it's situated within one of our strongest markets and is highly complementary to our existing footprint.

Year-to-date acquisitions through the end of the third quarter totaled nearly 38,000 acres for an aggregate value of $82 million.

Our acquisition so far this year reflect our disciplined growth strategy, which is focused on select acquisitions to upgrade our land portfolio, grow our sustainable harvest and are accretive to long-term cash flow generation. We've also enjoyed success through direct negotiations of smaller bolt-on acquisitions and some of our top target markets. We currently have a good pipeline of opportunities and expect Timberland acquisitions activity to remain robust going into next year.

During the third quarter, we also took advantage of the opportunity to repurchase $8.4 million of our stock at an average price of $26.34 per share, which we believe is below our intrinsic value. We continue to be keenly focused on capital allocation, particularly given the volatility that we've seen in the market and the opportunities that this volatility can create. We will continue to actively evaluate all capital allocation alternatives, including acquisitions and buybacks with a focused view toward building long-term value for our shareholders.

In conclusion, I'm very proud of our team for the way that we've executed operationally amidst a challenging market backdrop during the first 9 months of the year. The U.S. China trade dispute continues to generate some challenging market headwinds for our business, but I remain confident in the long-term value potential of our underlying assets and the commitment of our team towards maximizing that value potential.

This concludes our prepared remarks and we'll now turn the call back over to the operator for questions.

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

Yes, before we turn it back to the operator, just one quick correction. I believe we said that our third quarter harvest volumes in New Zealand were 14% higher than the prior quarter. That should have been 4% higher than the prior year quarter. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Anthony Pettinari with Citi.

Randy Devin Toth - *Citigroup Inc, Research Division - Associate*

This is actually Randy Toth sitting in for Anthony. I just wanted to focus on the Southern pine sawtimber prices, which fell 9% in the quarter. I think there was a little surprising to us, given the indexes were basically flat. Can you just talk about what happened more -- what happened there in a little bit more detail, was that something that was Rayonier specific or localized to a specific region? Just any detail would be helpful.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Sure, this is Doug. Quarter-over-quarter, timberland South-wide sawtimber prices typically decreased and have decreased total of the last 15 years from Q2 to Q3, so that's pretty normal trend we see. However, our sawtimber prices were significantly impacted by discount decision with the procurements of our Alabama and Georgia export yards. We had to sell some volume in the yard at essentially pulpwood prices. So during the quarter, at the beginning of the quarter, we decided that things have gotten pretty rough in the export markets,since we -- since we saw the collapse in the Southern Yellow Pine exports from South as other exporters such as ourself looked at trade wins and seized operations. Now that did have an impact that was kind of outsized of what would be normal. But as reported also in timberland south, there was a 5% to 7% correction in the Atlantic Coast Sawtimber markets. And those markets had to realign themselves with the increased amount of sawlogs coming in. So we did have something that was along our Atlantic Coast that wasn't changed. By the end of the quarter, the market appeared to found its new balance though and we don't expect similar drop in Q4. We actually anticipate some modest sawtimber price improvement in similar markets, but, however, that's been the case for the past few years. Our Q4 sales out of Arkansas will again get simply a volume contributor and that will partially offset some of those anticipated gains. So we did have kind of a unique occurrence that happened in the quarter with a lot of export operations shutting down in the Atlantic coast.

Randy Devin Toth - *Citigroup Inc, Research Division - Associate*

Okay. That's helpful. And then, just switching gears to New Zealand. I think you said radiata pine inventories at Chinese ports are 30% lower than average. Have you seen a pickup in demand in October? And how are those prices trending versus the 3Q average?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Yes. That's a great question. So yes, we saw that from high -- almost 5 million tons in Q1, China port inventories have retracted around 3.5 million tons in September. And radiata pine inventories, as you mentioned, (inaudible) dropped almost 30% in September. So we are going to see a positive correction in pricing. The inventory demand ratio, which is something we track closely, has fallen from about 2 months, which is an oversupplied to around 1.6 months, which brings us back into more supplied about situation. And southern regions, it seems that improvement ratio or that significant decrease from marginal suppliers such as South America, and as I mentioned, the tariff constraints in U.S. South, 50% reduction in block trains from Europe on the One Belt's Road initiative from 300 to 150 per month trailing number And that significant increase in plywood manufacturing, which specifically favors radiata demand. So those results have resulted in meaningful price appreciation in the last month.

Operator

The next question comes from Ketan Mamtora with BMO Capital Markets.

Ketan Mamtora - *BMO Capital Markets Equity Research - Analyst*

So just on that last point, Doug, is there any way we can sort of just quantify maybe just even in percentage term how much where it is right now in Q4 versus either Q3 average or where it was at the highest, any sense?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

We're still negotiating, obviously, if things go through but I can tell you that we've seen high single-digit increases.

Ketan Mamtora - *BMO Capital Markets Equity Research - Analyst*

Got it. Okay, that's very helpful. And then, turning to this European pine beetle. It seems like it is working with some applications, not so on some of the applications. But as it stands right now and with all the work that you've done, any perspective on kind of how many years it may take for this to play out? And then what kind of impact you all see both for your log operations in New Zealand and Pacific Northwest? And then sort of implications with potential for more lumber coming into the U.S. and how -- with your Southern Timber position.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Yes. It's a great question. As we mentioned in our teach-in tour. We're still working on trying to understand the exact impacts of European salvaged and what's going on to be quite honest. We done a lot of work on it and we're still focused on what the impacts are. There's a lot of variation. We've been told that for a lot of the product uses that efforts been on the stump for 6 months, it's no longer valid and especially when it's been imported over to China. So there's varying estimates of everything from 2 to 5 years of how much volume can be out there be harvested. So it's really a moving target at this in time, we're trying to understand better. But we've been really pleased to find out that, while customers chase the cheap wood to start with, they're realizing that it's not meeting their needs in a lot of the high-end radiata demand areas, so it's been a positive impact for us and really seeing consumption increase in radiata as we go forward. With respect to lumber, that I don't have as much detail on unfortunately.

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

Ketan, I can speak to one thing that's important to keep in mind. As you think, about lumber just like mills need to find a home for residuals, they also need to find a home for low-grade lumber. And historically, a lot of that low-grade lumber has flown to China. And so we're seeing kind of a second and third order effect where you have that low-grade lumber having a harder time finding a home as it ripples through the market. And I think you also probably are going to have some product substitution issues within European markets that may have a tendency to push more lumber than otherwise would be the case into the U.S. markets. And so those are some of the things that we're keeping an eye on. But this will still be -- this is going to take some time to fully understand and kind of follow some of those second and third order affects.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Yes. I think one thing that's important that I forgot to add, I mentioned earlier in my text is or in comments that we've seen a reduction in those block trains from 300 to 150 month, so half, and a lot of that as we mentioned in our teach-in was subsidized getting that lumber back across the China and other places. So we don't know the exact reasons why that's happened, but it's encouraging to see that there's been a 50% reduction on those trains pulling that lumber across.

Ketan Mamtora - *BMO Capital Markets Equity Research - Analyst*

All right. That's very helpful perspective. Just a couple of other questions. I mean, with this U.S. China current trade dispute, if you were to see a deal happen, how do you kind of see things shaking out? Do you expect things to come back to normal levels pretty soon or is it also a question of rebuilding confidence and trust and it might take some time to get back to where we were?

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

Ketan, I think from our perspective, we're thinking probably more in the latter context. I mean, this has become fairly protracted and in some cases, sort of an emotional dispute. And so I don't see it as a case where if things ended tomorrow, we'd see an immediate pickup. And I think that's -- I think that this whole specter of log and lumber substitution from the European Spruce issue also plays a role in that. And so, yes, it would certainly be helpful, but I think both kind of the cultural aspect of this trade dispute as well as the presence of the European volume is going to make it a slower recovery going forward.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

One thing I'd add to that. I was actually -- just got back from D.C. yesterday and was meeting with folks in the White House with National Economic Council. And talks of the Phase I deal, we're looking at purchase requirements and of up to $50 billion has been mentioned. And forest products have gone from $3 billion to $1 billion in trades, there's about $2 billion of opportunities there. And so 1 thing that could change it would be if there are requirements to put in to reach those $50 billion, it seem that logs would be a good contributor to that and then we'd look at whether it'd be purchase targets. And so we may see a quicker than normal recovery then we would, but that's early days, that's literally having just come back from D.C. meeting with the White House. So we still have a lot of room to work there, but there are some talks about having some actual target purchases that would be above current. And so that could be a positive that we, like I said, haven't factored in and news right off the press.

Ketan Mamtora - *BMO Capital Markets Equity Research - Analyst*

Got it. That's very helpful as well. And then, just one last question from my side. We've seen a lot of distress in the hardwood markets. Is there some -- is that kind of interesting to Rayonier, the hardwood markets at all or would you kind of -- is softwood kind of where your interest is?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

We see the opportunity primarily to leverage our science and technology in softwood markets. So we're primary focused on softwood plantation, that's where we think we have the ability to influence growth. Typically, the softwood plantations 20 years in the South to 40 years in the Northwest, whereas hardwoods often take 40-plus years, up to 80 years I think, so a slow rotation. So we're typically focused more on softwood opportunities.

Operator

Our next question comes from Kurt Yinger with D.A. Davidson.

Unidentified Analyst

First of, obviously, some challenging market conditions this year. If we were to start thinking about 2020, do you think your harvest expectations would be meaningfully different than where you came into the year in 2019, maybe with a little lower on Pacific Northwest because of the China situation or how might we start thinking about 2020 harvest volumes?

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

I don't think we're quite ready to start talking about 2020 yet. But as a general sense, we generally have a view of operating at or around our long-term sustainable yield, and we'll flex that to some degree based on market conditions. But if you kind of look at that as a starting point or baseline, it's generally going to be in that vicinity give or take.

Unidentified Analyst

Okay. And could you maybe help us with the fourth quarter guide for the Pacific Northwest harvest? I mean that kind of implies a lot of volume versus what you've done through the first 3 quarters. Is that primarily the sort of uptick in export demand that you've referenced?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

No. This is Doug, again, sorry. What we're seeing is some increased demand -- we had a weather approach in the fall than normal and so supply starting to be constrained from kind of non-industrial private owners. And so we've seen increased demand from domestic customers. And so one of the reasons we're looking at increased is some stumpage sales out there that we have with that increased demand domestically, we're looking to market some wood additional to our deliver crews.

Unidentified Analyst

Got it. Okay, that's helpful. And then, on kind of the expectations for improved Pacific Northwest log realizations, I mean do you think absent any change in the China trade dispute? Do you think next year that'll be pretty well correlated to the domestic lumber market or how much impact might a stronger year, next year on the lumber side have on pricing in your view?

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

Well certainly, historically, if you go back, the Northwest has enjoyed the volume from heading to China since about 2009 is when the volumes resumed. And so a lot of this, I think in an optionality sense, is going to depend on how this trade dispute sorts itself out. And if, what Doug is describing ends up happening where you have kind of mandated elements of a deal that forced more export, the Northwest is certainly going to be one of those places that will benefit from it. Absent that, I do think it will be more correlated to underlying lumber demand. And the other thing to kind of keep in mind, as you think about 2019, there is a lot of noise in 2019 associated with the permanent curtailment or the curtailment or permanent closure of capacity in Western Canada. And what a lot of people need to recognize is that every time one of those mills was being shut down, you had a good 6-month lag before you really started seeing that in pricing. I think we're just now starting to see some of the impacts on lumber pricing associated with those mill curtailments. And so all else being equal, I think you'd expect to see a more balanced lumber market and that should translate into improved lumber pricing as well as just elasticity from a pricing standpoint on logs.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Yes. I would agree with that. I think we've seen over $2 billion board feet of permanent closures' in British Columbia will be another $700,000 million board feet of temporary curtailments, and so that's about 14% of their production. And I think that's where we're starting to see some potential upside for us in that domestic demand.

Unidentified Analyst

Got it. Okay. That makes a lot of sense. And then, just lastly, going back to the Southern saw log pricing weakness, how much of that might be attributable to both the weather and some discombobulated harvest patterns or kind of transitory items? Because I thought southern log exports were pretty small percentage of sales in recent quarters and I wouldn't have thought that were would kind of have a meaningful impact versus, let's call it, the realizations in the second quarter?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Yes. We did see the dry weather definitely had an impact on sawtimber pricing across the South, which is bears out in the timberland south report. So we did see an impact on that. But we also -- out of our Costal Resource unit, or are Alabama Resource unit, a lot of the volume that we're working on was an export market. So we do have a certain amount of volume that was coming out, that was going into those markets. And so we did -- the pricing that we had to take like say pulpwood prices had a significant impact on sawtimber pricing.

Unidentified Analyst

Okay. So I mean, if the export market stays where it is today, there wouldn't be, I guess, much upside just because of that impact or I'm just trying to figure out whether, call it, the 23 and change is a good way to think about going forward or if it's more a situation of domestically this quarter is being from the supply demand perspective or a little out of whack?

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

Well, we recognize it what Doug described earlier, some of that Q3 price was a function of having to basically sell sawlogs at a discount as we curtailed export operations. So there was a fair bit of noise that influence that. So bear that in mind, that was not a normal run rate quarter.

Operator

Our next question comes from Collin Mings with Raymond James.

Collin Philip Mings - *Raymond James & Associates, Inc., Research Division - Analyst*

First of, going back to some earlier questions. Just given were a year into tariffs now, I mean just what do you think led to the acceleration in the shutdown of some of the export operations? And again, David, it sounds like in particularly, you've curtailed some of your operations too, but it does sound to be a little bit more broad based. What do you think kind of was the trigger point for that? And then just how has this volatility on the export markets may be factored into your acquisition underwriting in the coastal market because I know for a number of years that's been highlighted a favorable attribute of the U.S. South or the particular areas that you're focused in the U.S. South as far as that optionality?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Sure, Collin. I'll start with the first section of that. So I think what's happened is almost all of us exporters, particularly folks like Rayonier who have been exporting for a long time in China want to work through this process with our customers, we had supply chain setup. And so basically, we were in an investment mode and as we thought about it. So obviously the returns weren't great with 25% margin, but we felt like we want to keep those supply chains open and keep things going. So we were in investment mode trying to keep that going, and so our peers and competitors. But I think finally, everyone kind of got that feeling like, okay, this is not ending soon and how long we keep moving with that. And what we really added on to that was we were seeing significant slowdowns on kind of the other side in China of getting cargo unloaded and inspected. And so there was cost that were beyond our control beyond the tariffs that we just couldn't anticipate. And that's what really caused us to say, this is getting too painful. When you -- if you know what tariff and understand that, you can work around it. But when you start to see kind of nontariff trade-related things that are impacting our recoveries realizations, that was at the point where we made those decisions that were tough. And I having talked to several of my peers in other groups, they felt similarly that it was just getting to a point where it was hard to figure out what is going to happen next.

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

And Collin, to your second question regarding underwriting, recognize that we're typically doing very long-term DCF models. And when we think about pricing, we look at some of the market characteristics where we look at underlying demand from known manufacturing customers against the wood basin supply and that really helps inform our pricing. And I think export volatility just does not play that meaningful role when we think about it from an underwriting standpoint as it relates to price forecasting.

Collin Philip Mings - *Raymond James & Associates, Inc., Research Division - Analyst*

Okay. Very helpful color there on both fronts. And then another thing just in the prepared remarks it was highlighted, and it was highlighted in the press release too, just another strong quarter of non-timber income in the U.S. South. Can you just speak to the sustainability of that?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Sure. Yes, being optimist, this has been an outside year for us with respect to particularly pipeline easements, but we see this as a very strong business going forward and that we have more pipeline from the pipeline for a pun but we do see opportunities to have another strong year next year. This will be a peak year though. I can't say we'd be able to replicate these years, but still a very strong year when we compare ourselves on a run rate from prior years.

Collin Philip Mings - *Raymond James & Associates, Inc., Research Division - Analyst*

Okay. And then switching to New Zealand. And I apologize if I missed this, but obviously a lot of focus there on the export side of the equation. But maybe can you just elaborate on what you're seeing on the domestic market in New Zealand?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Sure. Yes. As we mentioned a little bit before, domestic prices typically lag the export market by a month or quarter depending on pricing arrangements. So we do anticipate there'll be some price corrections on the domestic market as a reaction to export price fall over Q3 and then significant increase that we've seen in Q4. So it's early on like I said, we have quarterly and monthly negotiations, so it's a bit of a mixed bag on what's going on. We've -- typically we do see some lag after domestic pricing or after the export pricing.

Collin Philip Mings - *Raymond James & Associates, Inc., Research Division - Analyst*

I appreciate that, Doug, I guess I was getting more to just on the -- just a general demand side of things.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Sorry, demand. On the demand side of things, we're actually still having fairly strong demand domestically. So that hasn't been too much of an issue. I'd say in Q3, we had significantly stronger demand for domestic. As we saw operators that are working in very high cost forests or on the export prices fell, they just couldn't work anymore. So we saw increased domestic demand that point in time. So we're not seeing that typically falling off, but we are, as Dave mentioned on the last call, typically with our harvesting in New Zealand, we contract out almost a 100% of that. And some of those are on 1 to 3-year agreements type of thing, and so it's hard for us to change the lever immediately, but we have those things rolling so we can move that lever back and forth as we respond to markets.

And so we're kind of, as we move into Q4 we look at the opportunities we might have to pull back a little bit in New Zealand as we think about those as some of those kind of crews roll off. And we have the ability also, within our contracts, to scale back those crews, but it's not something we can just turn them off immediately. So New Zealand is a little bit more of a constrained labor market and so our contracts have us working in conjunction with our contractors over there, but we do have the ability as we kind of stage out this contracts to roll off, to bring crews off of different things. We are looking at how we handle our volumes based on markets as we go into Q4.

Collin Philip Mings - *Raymond James & Associates, Inc., Research Division - Analyst*

Okay. That's helpful detail there. And then, one last one for me. Dave, just I appreciate the prepared comments, just on the acquisition activity during the quarter and the pipeline if you look out. Some of your comments though do contrast some of the peers that have just either not been active on the acquisition front or have, again, characterize that it's a pretty quiet market out there. Can you maybe just provide us maybe a little bit more color on what you're seeing or maybe some of the reasons behind you think that are driving your success on the acquisition front?

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

I think, Colin, it's a number of things. I mean, first of all, there's a lot of activity out there, there's a lot of properties out there. I think as we and others have noted, there's a lot of properties that are average or even in some cases below average properties. And we tend to be fairly disciplined about looking for properties that have a good fit. We're always looking to improve our portfolio when we are considering acquisitions. We are not interested in just growth for growth's sake. And so we're very picky about what markets we go into. I think we tend to think of ourselves as very market centric when we look at our acquisition targeting. And so, having said that, I think another aspect of this is that we've had a concerted effort this year to focus on both negotiated transactions as well as smaller transactions that we refer to as bolt-on transactions. And we have had some measure of success. Does it move the needle individually on those acquisitions? Not as much. And I think that's why a lot of larger timber owners tend to shy away from those smaller deals. We tend to look at a more on the margin and we look at them in aggregate. We feel like we've had a good year adding really high quality properties, but in small increments. And so we're happy with what we've done. We think we've developed a nice niche and we're going to take these opportunities as they come and as we were able to develop them.

Operator

The next question comes from Paul Quinn with RBC Capital Markets.

Paul C. Quinn - *RBC Capital Markets, Research Division - Analyst*

Most of the questions I had have been asked. So really I have only got one. Just in the U.S. South, you guys talked about sawtimber pricing down, but what's the reason for the weakness in the pulpwood pricing?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Sure. Great question. So despite the pulpwood, we had dryer than normal summer, which yield excess supply across the operating area. In addition to the dry weather, we were able to work on a backlog of thinning because it was dry and that increased our thinning volumes by 7%. And typically those thinnings net a lower stumpage due to the increased harvesting costs. And then, finally, found the third reason, geographic mix also played significantly in the quarter as pulpwood volumes from our highest region were down 15% and our lowest price region were up 8%. And to give you a sense of difference in price, the pulpwood price is twice as high in the -- twice as high in the highest region versus the lowest region. So there's a significant difference in volume and value there. And that's kind of the main reason as we saw the pulpwood prices changes.

Operator

The next question comes from John Babcock with Bank of America.

John Plimpton Babcock - *BofA Merrill Lynch, Research Division - Associate*

Just wanted to kind of tag on kind of the U.S. South a little bit here. One of your peers mentioned that they were seeing an increase in supply from nonindustrial private landowners. Is this something consistent with what you're seeing and is that kind of part of the reason why sawtimber prices weakened? Obviously, this kind of adds a little bit to some of the other kind of items you mentioned earlier but just want to get some more color there.

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Sure. Yes. As I mentioned, when we have a really dry period of time like the summer, it allows folks who haven't invested in the road networks and even folks who don't even have roads, farmers who may have 100 acres out there, to be able to grow and harvest. And so we have significantly seen an increase in our mobility supply. And you know as the mills, they're smart, when they have the opportunities, they go after them. So it has generated more supply for the mills at this point in time. As we started to see, as I mentioned northwest, the wet weather has started to constrained that supply. And in some parts of the South, we're starting to get more rain and start to see the same thing, but it was a very dry -- dry summer, which allowed us to do our thinnings and allowed this farmers and private owners to be out there and harvest timber that may not be able to last 2 years.

John Plimpton Babcock - *BofA Merrill Lynch, Research Division - Associate*

And just quickly on that also, where are prices currently based on relative to where they were on average in the last quarter?

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

I mean it varies pretty considerably by market. You have a lot of regional differences in the U.S. South that are kind of driving that kind of quarter-to-quarter noise. And so again, I think Q3 for a variety of reasons, the dry weather, the kind of shut down of the export operations, you definitely saw a decline there. Again, unless we had to go market by market, product by product, it's hard to kind of make general commentary on that front.

John Plimpton Babcock - *BofA Merrill Lynch, Research Division - Associate*

That's fair. And then, just the last question. With lumber prices kind of starting to trend upwards over the last week or so, are you seeing any pickup in demand from the sawmills either in the South or Pacific Northwest?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

As we mentioned before, Pacific Northwest, particularly we've seen some increased demand, which has been nice. With respect to the South, we haven't really seen that reflect through, but it's been very short-term as you mentioned, so it hasn't had a chance to work through yet.

Operator

Our next question comes from Mark Weintraub with Seaport Global Securities.

Unidentified Analyst

This is actually Ryan on for Mark. I just have one -- can hear you me?

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

Yes.

Unidentified Analyst

Yes. Great. I just have one quick one on the Southern harvest guidance for the remainder of the year. I saw you guys take that down a bit citing weaker demand. One of your competitors earlier in the week mentioned that there was an influx of supply from the nonindustrial landowners. Just want to know if that was impacting you as well?

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

Yes. As I mentioned earlier, due to that dry weather we are seeing an increased supply from the folks who -- it's been wet over the last couple of years and we haven't been able to bring wood to markets. So now they have this opportunity, they've brought a lot more wood than normal to the market, I would say. And so we have had that impact of increase supply from nonindustrial private forest owners that's impacted us.

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

But you have to also keep in mind that the U.S. South, as Mark mentioned, is quite varied. And we've talked a lot about the bold in inventory of standing timber being very differential across the U.S. South. And so it really does depend on where you're talking about because there's parts of the U.S. South that had really had a tremendous growth in their inventory and you're just going to see both weaker pricing and lower price elasticity than in other areas. So you have to be pretty careful and mindful of where that footprint is when you're thinking about pricing.

Operator

(Operator Instructions) Our next question comes from Chip Dillon with Vertical Research.

Salvator Tiano - *Vertical Research Partners, LLC - VP*

This is Salvator Tiano speaking for Chip. So a couple of questions from me. Firstly, building a little bit on the questions on the South. Do you think these demand -- these extra supply from smaller owners that you saw now was when it done or either significant pent-up capacity, there's standing timber inventory that if we see similar weather conditions in the next 2 years, you could see temporary spike in supply?

David L. Nunes - *Rayonier Inc. - President, CEO & Director*

I mean I think it really gets back to what I just said from the last question. Depending on the region, I think either where you've had a large bolds in inventory and you have favorable weather with smaller nonindustrial privates, you're going to tend to see some of that pent-up supply kind of flowing to the market. And so you just have to be mindful of what region you're referring to. And we pay a lot of attention to that kind of operationally, as we look across the U.S. South.

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

Well really across regions when you see dry weather, you're going to see greater accessibility in the nonindustrial private land owner for us. And so you will tend to see some incremental supply coming to the market with dry weather. Likewise, when you have wet weather, you'll tend to see that that supply pull back and the price response in that regard.

Salvator Tiano - *Vertical Research Partners, LLC - VP*

Okay. Yes. That make sense. Now just a little bit with all the lumber capacity that shift in to the U.S. South, can you just give us a little bit of an update, a little bit where do we stand with the lumber mills that have started? What do you expect to start in the next couple of years? And primarily given the lumber outlook, price now are going higher, slightly at least, but we've seen some curtailments, do you see any capacity that is at least come near your timberlands in the South?

Douglas M. Long - *Rayonier Inc. - SVP of Forest Resources*

Yes. I'll take that. Start with the saw mills, as I talked about going forward. In our local area, we're tracking quite a few as we talked about before, GP Albany is on track to be completed in 2020 from what I understand and that will add a significant amount of volume up to 7,000 or 8,000 tons of additional demand in our wood basket in that area. Another mill on DuPont yard here more locally, also maybe an increasing capacity and so we're seeing potential of additional 150,000 tons demand in that region. And then there's a couple of mills that have opened up, but they're just getting started, and that's where we see a lot of these. So [advil] fiber in Alabama, that's expected to generate significant amount of volume increases as we go forward. Forest products in Lufkin, Texas, another one that sits right there in our wood basket, another 0.5 million tons of impact. And then Interfor and West Fraser announced significant amount of upgrades they're also doing.

So there's millions of board feet of opportunity, but what we're seeing is that, basically, these are coming slow to start up. And then so, and I think Dave mentioned this earlier, when we see these things (inaudible) curtailments, it typically takes 6 months to work sustaining inventory. And on start-ups, we're often seeing intake 1 to 2 years to get going. And so that's a little bit different. They have nameplate capacities, but the rabbit is they're often functioning at 20%, 30% till they get started. So we haven't seen the real impact of all this in-house capacity coming online yet. And really a lot of them are operating at, I would say, 40% to 50% as they work out the kinks and work out getting labor and demand supply and things like that. So it's -- there's a lot of high-level upsides and we think long-term, it's great, but short-term, we haven't seen the exact impact. Although in some of our key markets where these mills have come up, even at 40% we are seeing price tension. That's why I mentioned before, we do expect to see some positive price appreciation in sawtimber going into Q4 in some of our markets, but that additional volume harvesting out of Arkansas will kind of offset some of those upsides.

Salvator Tiano - *Vertical Research Partners, LLC - VP*

Great. And just the last one on the capital allocation. It seems like you're sounding a little more optimistic on M&A, did a lot more this quarter and you're thinking about next year. How should we think a little bit about your capacity to use -- to acquire timberlands without issuing any shares, using cash on hand or potentially issuing new debt, what would be kind of ultimate leverage you'd be willing to take?

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

Yes. We generally guided the market to a comfortable around leverage, debt-to-EBITDA or net debt to EBITDA (technical difficulty) the leverage capacity. I'd say as we sit here today kind of based on our updated guidance for 2019 that would kind of imply somewhere in the sort of $250 million to $300 million of debt capacity within the investment-grade targets that we specified.

Operator

Thank you. And at this time, there are no further questions. I will turn the call back over to speakers for any closing remarks.

Mark D. McHugh - *Rayonier Inc. - Senior VP & CFO*

This is Mark McHugh. I'd like to thank everybody for joining us today. Please feel free to contact me with any follow-up questions. Thank you.

Operator

Thank you. And that does conclude today's conference. Thank you all for participating. You may now disconnect.
