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RYN.N - Q2 2020 Rayonier Inc Earnings Call

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OVERVIEW:

Co. reported 2Q20 sales of $196m and net income attributable to RYN of $2m or $0.01 per share. Expects 2020 net income attributable to RYN to be $38-43m and EPS to be $0.27-0.31.

CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome, and thank you for joining Rayonier's Second Quarter 2020 Teleconference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect at this time. 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 second quarter earnings. Our earnings statements and financial supplement were released yesterday afternoon and are available on our website at rayonier.com.

In these presentations, we include forward-looking statements made pursuant to the safe harbor provisions of federal securities laws. Our earnings release and SEC filings list some of the factors that may cause actual results to differ materially from the forward-looking statements that we may make. They are 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, and good morning, everyone.

First, I'd like to point out that we are conducting this call from multiple locations, so, bear with us as we move from speaker to speaker in addressing your questions. I will begin the call by making some high-level comments before turning it back over to Mark to review our consolidated financial results. Then we'll ask Doug Long, Senior Vice President, 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 2020.

Before discussing our results for the quarter, I'd like to briefly update everyone on our ongoing response to the COVID-19 pandemic.

We continue to contend with the challenges associated with the COVID-19 pandemic. Here at Rayonier. We have responded by prioritizing the health and safety of our employees and contractors, as well as their families, while working to ensure business continuity. In mid-March, we implemented a work from home model for all U.S. office employees and instituted enhanced safety guidelines for field employees in an effort to do our part as a company to mitigate the spread of COVID-19. These measures have largely been effective in stemming the spread of this virus within our employee and contractor workforce, and have allowed us to continue to supply our customers with logs and other products. Given the current state of the pandemic, we anticipate remaining in this mode in many of our locations through at least the end of the year and will likely not fully reopen our offices until a vaccine has been implemented or the number of new cases has dramatically subsided.

In New Zealand, the government instituted a more stringent lockdown measure across a broader range of businesses, including forestry, beginning in late March and lasting through late April, which serve to effectively end community spread of infections there. As a result, the New Zealand economy has fully reopened, and our offices there are now operational.

I'm very proud of how our employees have stepped up to keep our business running amid this pandemic, while observing the necessary social distancing and safety protocols to mitigate the further spread of COVID-19. While this has been extremely disruptive to all aspects of life, I believe we are managing through it very well.

With the closing of the Pope Resources transaction on May 8, this quarter marks the first quarter that we are reporting the combined results of the 2 companies. Our team did a great job of both closing this transaction on an accelerated time frame and in developing a thoughtful integration plan that effectively blended the best practices and considerable talent within each organization. All this work had to be completed under social distancing protocols associated with COVID-19, which is a tribute to the dedication and professionalism of both organizations. It also reinforced the strong cultural fit between our respective companies, and we're all very excited about the future prospects of the combined organization.

With that, I'd now like to switch gears and briefly discuss our quarterly results. For the second quarter, we reported adjusted EBITDA of $79 million and pro forma net income of $15 million or $0.11 cents per share. Overall, I'm pleased with how our team navigated very challenging market conditions amid the COVID-19 pandemic to deliver strong operational results across all segments. This is a tribute to both the diversity of our market exposure across our various segments as well as the dedication of our outstanding employees.

Our Southern Timber segment reported adjusted EBITDA of $26 million for the quarter, slightly below the prior year's strong quarter, which was driven by substantial pipeline easement revenue. Second quarter results were aided by both volumes that were up 20% relative to the prior year quarter and stronger sawlog markets towards the end of the quarter, driven by strong lumber pricing and resurgent export markets. Our Southern Timber segment continues to enjoy very high margins and relatively low cash flow volatility.

In our Pacific Northwest Timber segment, we achieved adjusted EBITDA of $4 million, up substantially from the prior year quarter on the strength of significantly higher volumes from Rayonier legacy lands as well as the addition of 55,000 tons of volume from the Pope Resources assets. We further enjoyed much stronger log prices towards the end of the quarter, driven by stronger lumber pricing, a resumption of normalized log export activity and the improved species mix from the Pope Resources acquisition.

In our New Zealand timber segment, we reported adjusted EBITDA of $10 million, which is roughly half the level from our prior year quarter. The primary driver was a 23% reduction in volume-based on the loss of over a month's worth of production associated with the strict New Zealand government lockdown measures put in place to contend with the impacts of COVID-19. Log pricing for both export and domestic markets was also off due to both the buildup of log inventories in China and a weaker New Zealand dollar.

Lastly, our Real Estate segment, as anticipated last quarter, reported very strong second quarter Adjusted EBITDA of $45 million, driven by the sale of 20,000 acres, comprising of a mix of rural development and non-strategic parcels. We continue to be encouraged by the stability of demand across all sales categories within our Real Estate segment.

With that, let me turn it back over to Mark to review our financial results as well as some changes that we've made to our financial disclosures this quarter.

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

Thanks, Dave.

Before discussing our results for the quarter, I'd like to briefly comment on our recent acquisition of Pope Resources as well as some changes that we implemented this quarter to our business segments and non-GAAP measures.

As Dave noted, we completed our acquisition of Pope Resources during the second quarter. The aggregate consideration paid by Rayonier to acquire all of the outstanding limited partnership units and general partnership interest of Pope consisted of $170 million dollars of cash, 7.2 million common shares of Rayonier and 4.5 million operating partnership or OP units of Rayonier LP. We also assumed or repaid approximately $110 million dollars of legacy Pope debt.

The Pope Resources transaction added to our portfolio, approximately 124,000 acres of timberland in Washington, co investments in three private equity timber funds, a fund management business that oversees these private equity timber funds and an attractive pipeline of HBU opportunities in the West Puget Sound area.

As a result of the Pope Resources acquisition, we have revised our reportable business segments, adding one additional segment, which we refer to as the "Timber Funds" segment. This segment reflects the operations of the private equity timber funds and fund management business acquired as part of the Pope transaction. As communicated in our earnings release, despite not having a majority interest in the three private equity timber funds, as the managing member of the funds, we are required to consolidate 100% of the fund's operating results, assets and liabilities. As such, all three timber funds are fully consolidated into our financial statements, and the income or loss attributed to third-party investors is reflected as an adjustment in our income statement under the caption "net income or loss attributable to non-controlling interests in consolidated affiliates."

Since we are required to consolidate the timber funds in our financial statements, we implemented changes to certain non-GAAP measures in order to better reflect the proportionate financial contribution from this business to Rayonier. Specifically, we have revised our definitions of pro forma revenues, pro forma operating income and Adjusted EBITDA to incorporate the "look-through" contribution from each of the three timber funds based on Rayonier's respective ownership interest, as well as the full amount of management fees received by Rayonier for managing the timber funds. We believe that these changes will provide our investors and analysts with more useful information to assess the economic value of and contribution from the Timber Funds business to Rayonier.

I'd also like to highlight that this is our first quarter reporting under the UPREIT structure, which we put in place to facilitate the Pope Resources acquisition. As noted earlier, we issued 4.5 million OP units of Rayonier LP as consideration in the acquisition. These OP units are generally considered to be economic equivalents to Rayonier common shares, and the number of such units outstanding will be reflected on the cover of our Form 10-Q and within our financial reports going forward. Also, because these units are registered securities, we will be reporting the financial results of Rayonier, L.P. within our quarterly SEC filings going forward. Please note that the only significant difference between the financial reports of Rayonier Inc. and those of Rayonier, L.P. relates to the adjustment in Rayonier Inc.'s income statement under the caption "net income attributable to non-controlling interest in the operating partnership."

Lastly, we also communicated in our earnings release that effective April 1st, we changed the composition of our real estate sales categories to better align with the way we evaluate real estate sales internally. The rural category now includes all real estate sales (excluding development sales) representing a demonstrable premium above timberland value. The timberland and Non-Strategic category now includes all real estate sales representing little as no premium to timberland value. This category consists primarily of sales of property that management views as non-strategic to our long-term portfolio as well as sales of property for capital allocation purposes that did not fit the definition of a Large Disposition. In summary, we revised these categories to place a greater emphasis on premium rather than end use, which more closely aligns with how we manage the business internally. All prior period amounts have been reclassified to reflect the new composition of these sales categories. Note that the improved Development, Unimproved Development and Large Disposition categories were unchanged, and this reclassification had no impact on consolidated segment results.

I'll now switch gears and provide an overview of our second quarter results, starting on Page 5 with our financial highlights. Sales for the quarter totaled $196 million dollars, while operating income was $12 million dollars, and net income attributable to Rayonier was $2 million or $0.01 cent per share. On a pro forma basis, net income was $15 million dollars or $0.11 cents per share. The pro forma adjustment for the second quarter consisted of approximately $13 million of costs related to the merger with Pope Resources.

Second quarter adjusted EBITDA of $79 million was well above the prior year quarter adjusted EBITDA of $61 million, primarily due to much stronger results in our Real Estate segment partially offset by significantly lower results in our New Zealand Timber segment due to the COVID-19 shutdown.

On the bottom of Page 5, we provide an overview of our capital resources and liquidity at quarter end as well as a comparison to year end. Our Cash Available for Distribution, or CAD, for the first half of the year was $80 million dollars compared to $95 million dollars in the prior year period, primarily due to lower adjusted EBITDA, higher cash interest paid and higher cash taxes paid, partially offset by lower capital expenditures. 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 $88 million of cash and $1.3 billion dollars of debt, both of which exclude cash and debt attributable to the Timber Funds segment, which is non-recourse to Rayonier. Our quarter end debt balance reflects the credit facilities that we closed in April, which were used to fund the Pope Resources acquisition. Our net debt of $1.2 billion dollars represented 26% 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*

Thank you, Mark.

Good morning.

Let's start on Page 9 with our Southern Timber segment. Adjusted EBITDA in the second quarter of $26 million dollars was $7 million dollars and $1 million dollars unfavorable compared to the prior quarter and the prior year quarter, respectively. Second quarter harvest volume of approximately 1.5 million tons was 17% lower compared to the prior quarter but 20% higher compared to the prior year quarter. Both 2020 and 2019 experienced a reduction in volume in the second quarter, following comparatively strong volumes in the first quarter of each year. For the first half of the year, volume of 3.4 million tons was 5% higher than the same period in the prior year as we pulled forward some pulpwood production to meet strong demand during the early stages of the COVID-19 pandemic.

The average pine pulpwood stoppage price of $15.94/ton was flat compared to the prior quarter and 7% unfavorable compared to the prior year quarter. Pulpwood demand remained strong into the second quarter, which resulted in stable pricing compared to the prior quarter. The decline in price relative to the prior year quarter was driven by increased availability of log supply due to drier ground conditions.

The average pine sawtimber summaged price of $25.48/ton was 5% and 1% unfavorable compared to the prior quarter and the prior year quarter, respectively. At the onset of COVID-19 and into the second quarter, we experienced uncertainty in lumber markets as well as an increase in pulpwood volumes. This resulted in increased mix of chip-n-saw logs at lower pricing which is partially offset by higher pricing for larger diameter sawlogs due to resurgence of exports to China.

Second quarter non-timber income of $5 million dollars was $4 million below the prior year quarter due to a reduction in pipeline easement revenue. It's important to note that this comparison is being made against a record high year for our non-timber income business in 2019.

Now moving to our Pacific Northwest Timber segment on Page 10. Adjusted EBITDA of $4 million was $6 million dollars unfavorable compared to the prior quarter, but $2 million dollars favorable compared to the prior year quarter. This was largely volume-driven, as second quarter harvest volume of 385,000 tons was 19% below the prior quarter, but 54% higher compared to the prior year quarter. Of the 385,000 tons of harvest volume in the second quarter, 55,000 tons represented volume from the newly acquired Pope Resources timberlands. A decrease in volume compared to the prior quarter was driven by the addition of stumpage sale volumes in the first quarter to capture strong pricing. The increase in volume compared to the prior year quarter was primarily due to the comparatively light harvest activity in the prior year quarter coupled with 55,000 tons of incremental volume from the acquired Pope Resources timberland.

The average delivered sawtimber price of $75.39/ton was flat compared to the prior quarter and 4% unfavorable compared to the prior year quarter. Market uncertainty lingered through much of the second quarter as a result of COVID-19 as well as weaker export market demand due to the excess supply of European spruce, which put pressure on sawtimber prices. It's worth noting that we did see demand pick up considerably toward the end of the quarter in both the domestic and export markets.

The average delivered pulpwood price of $36.92/ton was 3% and 13% unfavorable compared to the prior quarter and the prior year quarter, respectively. The increased supply of pulpwood chips on the open market combined with market-related downtime at domestic pulp mills continued to keep pulpwood prices low.

Page 11 shows results in key operating metrics for our New Zealand Timber segment. Adjusted EBITDA in the second quarter of $10 million dollars approximates the prior quarter and was $10 million dollars unfavorable compared to the prior year quarter. Second quarter harvest volume of 529,000 tons was 10% higher than the prior quarter, but 23% lower than the prior year quarter. After over a month of no production during the government-mandated lockdown, we were permitted to resume production on April 28th. At the same time, China was emerging from its COVID-19 lockdowns and demand surged as mills restocked log decks. During the last two months of the second quarter, our team did an incredible job of safely resuming production to 110% of plan in order to meet pent-up export and domestic demand, thereby delivering exceptional results under these circumstances.

The average delivered export sawtimber price of $98.75/ton was 4% favorable compared to the prior quarter due to the pickup in export demand, but 12% unfavorable compared to the prior year quarter, as the COVID-19 pandemic weighed heavily on pricing in both China and New Zealand.

The average domestic sawtimber price of $66.95/ton in U.S. dollar terms, was 4% and 19% unfavorable compared to the prior quarter and the prior year quarter, respectively. Compared to the prior quarter, the variance was largely due to changes in the NZ$/US$ exchange rate, whereas compared to the prior year quarter, lower pricing, generally followed export market trends due to COVID-19. Excluding the impact of foreign exchange rates, domestic pricing in NZ. dollars was 1% favorable compared to the prior quarter and 12% unfavorable compared to the prior year quarter.

The average domestic pulpwood price of $32.10/ton was 5% and 18% unfavorable compared to the prior quarter and the prior year quarter, respectively, which was driven by the same factors as domestic sawtimber.

I'll now briefly discuss the results from our newly created Timber Funds segment. Highlighted on Page 12, the Timber Funds segment generated consolidated EBITDA of $2 million dollars in the second quarter on harvest volume of 90,000 tons. Adjusted EBITDA, which reflects the look-through contribution from the funds was $700,000 dollars.

Lastly, in our Trading segment, we generated adjusted EBITDA of $100,000 in the second quarter which is $100,000 and $300,000 favorable compared to prior quarter in the prior year quarter, respectively.

I'll now turn it back over to Mark to cover our real estate results. Mark?

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

Thanks, Doug.

As highlighted on Page 13, our Real Estate segment delivered strong results in the second quarter. Sales totaled $50 million on roughly 20,000 acres sold at an average price of over $2,500 dollars per acre. Adjusted EBITDA for the quarter was $45 million dollars.

Sales in the Improved Development category totaled $6 million dollars, highlighted by the sale of a 119-acre industrial site in our Richmond Hill Development Project, south of Savannah, GA for $5 million dollars or $45,000 per acre. Due to post-closing infrastructure obligations, we only recognized $3.5 million as revenue from this sale and our second quarter results. We also closed on the first 17 residential lots in the "Forest Park" phase of our Wildlight development project, north of Jacksonville, FL, for $1 million or $63,000 dollars per lot.

Sales in the Unimproved Development category totaled $8 million dollars, which consisted of a 570-acre sale in St. Johns County, FL, at a price of approximately $15,000 dollars per acre.

In the rural category, sales totaled $27 million dollars on roughly 7,700 acres sold at an average price of $3,500 dollars per acre, including a 4,500 acre sale for $17 million or $3,700 per acre and a 2,800 acre sale for $9 million dollars or $32.50 per acre. Both of these sales were in St. John's County, Florida.

Lastly, sales in the timberlands and Non-strategic category totaled $10 million dollars, consisting of roughly 12,000 acres at an average price of $800 per acre. Sales in this category consisted primarily of several low-value geographically-isolated parcels in Georgia.

Now moving on to our outlook. As communicated on our first quarter earnings call, we are updating our full year guidance to reflect a partial-year contribution from the newly acquired Pope Resources assets, as well as our improved outlook with respect to market conditions for the balance of the year.

Page 15 of our Financial Supplement provides our updated financial guidance by segment for 2020 and Schedule G of our earnings release provides a reconciliation of our Adjusted EBITDA guidance to Net Income Attributable to Rayonier and EPS.

We now anticipate full year net income attributable to Rayonier of $38 million to $43 million dollars, EPS of $0.27 to $0.31 cents, pro forma EPS of $0.17 to $0.21 cents, and Adjusted EBITDA of $240 million to $260 million dollars. Adjusted EBITDA reflects an anticipated partial-year contribution of $17 million to $20 million from the acquired Pope Resources assets.

With respect to our individual segments, we now expect that our Southern Timber segment will achieve full-year harvest volumes of 6.0 million to 6.2 million tons with higher Adjusted EBITDA of $104 million to $109 million dollars. The improved outlook is driven by increases in export volume and stronger sawtimber demand. We expect that weighted average pricing in the U.S. South will remain relatively flat as improved sawtimber demand roughly offsets lower pulpwood pricing due to anticipated mill downtime and increased supply of wood chip residuals and geographic mix.

In our Pacific Northwest Timber segment, we now expect full-year harvest volumes of 1.6 million to 1.7 million tons and higher Adjusted EBITDA of $30 million to $32 million dollars, which reflects the estimated partial-year contribution from the acquired Pope Resources timberlands. We further expect some strengthening of Pacific Northwest Sawtimber pricing due to improving end markets and a higher value species mix. We anticipate that pulpwood pricing will be relatively flat and dependent on the duration of domestic mill curtailments.

In our New Zealand Timber segment, we now anticipate higher harvest volumes of 2.3 million to 2.5 million tons and higher full year Adjusted EBITDA of $50 million to $56 million dollars. The increase in both volume and Adjusted EBITDA is attributable to the shorter-than-anticipated shutdown of economic activity in New Zealand as well as strong demand following the shutdown. We anticipate relatively flat pricing through the second half of the year with seasonal demand offset by continued competition from alternative supply sources.

In our Real Estate segment, we expect to achieve full-year Adjusted EBITDA of $77 million to $83 million due to continued strong demand for rural properties as well as an improved demand outlook for development properties.

Lastly, we expect that our new Timber Funds segment will contribute full- year Adjusted EBITDA of $3 million to $4 million dollars.

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

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

Thanks, Mark.

As we've all seen, the COVID-19 pandemic presents an unprecedented challenge for the global economy, and while we're partially recovered from the depths of the economic slowdown, we are still a long way from a full recovery. While we are very encouraged by the resiliency that our business has exhibited over the past several months, we also expect some continued volatility in end markets as the pandemic evolves. Nevertheless, I continue to believe that Rayonier is very well positioned to weather this storm. I'm heartened to see the dedication and adaptability that our people have demonstrated throughout the COVID-19 pandemic, and I'm further extremely confident in the strength of our balance sheet, liquidity position and financial flexibility. As a pure-play timberland REIT, we enjoy strong margins and substantially less volatility than downstream manufacturing businesses, and we have a geographically diverse portfolio that further mitigates our exposure to any single region or product category.

I want to reiterate how proud I am of how our employees have responded and continue to manage through this crisis with poise and determination. I feel very fortunate to be surrounded by such exceptional talent and dedication to all levels of our organization. Despite the significant challenges ahead, we remain keenly focused on executing against our strategic priorities and achieving our mission of generating industry-leading returns and building long-term value per share. We will continue to leverage the diversity and optionality of our portfolio and harness the power of our culture and dedication of our employees to achieve these results.

This now concludes our prepared remarks, and I'll turn it back over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is coming from Anthony Pettinari of Citi.

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

This is actually (inaudible). Can you talk about the drivers of the full year harvest expectations, especially in the U.S. South? I think in the release, there was mention of increased export volume in the primary driver. Can you touch on your expectations for U.S. South for the year? And maybe remind us how that compares to annual numbers we saw before the tariffs?

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

Sure. This is Doug. The increase in the South was a combination of both export and we've seen increased demand for domestic lumber. And that interest management on drive the so log demand for us. So a lot of that increase is on the domestic side for lumber, within on the margins would be the increase on the export side. With respect to exports, and that's just due to the leverage of where our land base is. In Q1, exports were fairly calm. The U.S. China trade war was still in people's minds and the COVID impacts in China. But as it got through Phase I, we saw tariffs being put -- restrictions being released on the tariffs on a monthly basis. So there was waivers being allowed. And so we were able to ramp up our export volumes. And I'm not going to go into our specific volumes that we have, but shipments from the U.S. South increased over 100% between Q1 and Q2, and we're seeing similar increases via South as we go forward. So demand for southern Yellow pine in China has definitely grown and is strong. And one of the good things about sending out pine is it's used in treating and other products that typically don't compete with the European spruce or the Radiata pine in New Zealand. So we've continued to see strong demand and look forward to more of that as we go forward in the second half of the year.

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

And then just maybe switching gears. With the Pope Deal now closed, you've had those timberlands for a couple of months now. Can you talk what type of land sales you could see and how you're planning on deleveraging maybe the time line there? Any detail there would be helpful.

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

Yes, sure. Recognize that we had the large disposition in the first quarter. Of this year in Mississippi for $116 million. And really, as we kind of started out the year with the announcement of Pope, we had anticipated that, that was going to comprise the bulk of our deleveraging kind of needed to stay within the the credit metrics of where we want it to be. Obviously, that was before the pandemic, which put some pressure on EBITDA and thus leverage. So I think with where we sit today, I mean, if you look at just the midpoint of our EBITDA guidance, relative to quarter end debt, I think that puts us at about 4.8x net debt to EBITDA for the year. But obviously, that reflects only a partial year contribution from the Pope assets. If you normalize Pope, at more of a full year run rate, we're probably closer to 4.5x. And so I'd say clearly towards the higher end of where we'd like to be. But that said, I think that we would expect to delever largely through our organic cash flow growth as we return to a more normalized operating environment. Of course, we always have the flexibility to execute additional asset sales. If we think that, that's necessary and appropriate at any point in time. But again, I think that we'd like to see cash flow grow from here as we return to more normalized operations.

Operator

The next question is coming from Mark Wilde, BMO Capital Markets.

Jesse Barone - *BMO Capital Markets Equity Research - Research Analyst*

It's Jesse Barone on for Mark. Just starting kind of what are you guys seeing in China? What are inventory levels like how demand kind of progresses as you went through Q2 and into Q3?

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

Sure. I'll take that, Justin. This is Dave. Yes, keep in mind that when when we came out of the Lunar New Year, and we were in the midst of the COVID pandemic. The inventories in China jumped to a record high level of 7 million cubic meters in Q1. And so as we've seen the Chinese economy reopen, that's come down considerably. It's dipped to as low as just under 4 million cubic meters. Our estimate right now is that it sits at about 4.4 million cubic meters. One of the things that we track is a ratio of supply to demand as measured in months, and we're currently sitting at about 1.9 months and we feel that, that's a pretty -- we like to see it in that range. We feel that's a pretty stable part of the market or environment. Having said that, keep in mind, there has been a tremendous amount of rain in China as well as flooding. And that's disrupted both construction projects and more recently, ports. And so that's overlaying an otherwise fairly positive environment. Mills, to our understanding, are still operating at about a 60% capacity. So we feel the combination of the mills kind of ramping back up, them getting through the rainy period that they're dealing with right now and the fact that inventories are relatively imbalanced, we generally see a stronger second half of the year.

Jesse Barone - *BMO Capital Markets Equity Research - Research Analyst*

Great. That's super helpful. Just one other from me. Kind of any updated thinking around the Timber Funds business? I know you guys have said before that you weren't really looking to grow the business. But now that you actually own it kind of any updated thinking around there?

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

No. I mean, we still continue to keep all our options on the table with respect to that. Mark walked you through how we're handling the pro forma contribution of the business. And I'd say more to come on that in the future.

Operator

The next question is coming from Kurt Yinger, D.A. Davidson.

Kurt Willem Yinger - *D.A. Davidson & Co., Research Division - Research Associate*

I just wanted to start off. I mean, could you talk a little bit about the impact of having Pope in the mix and what that will kind of look like for your average realizations in the Pacific Northwest?

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

Yes. I'll take that a little bit, and then Doug can touch on that afterwards. Keep in mind that for pope, it does a number of things. First of all, they have a heavier mix of Douglas-fir in their merchantable timber inventory. And so generally speaking, you've got more optionality around Douglas-fir from a market standpoint. You've got a you've got deeper exposure, say, to the Japan market as well as the domestic market. And then 2, keep in mind that the Pope lands have a more gentle topography. And so the instance of more expensive cable logging is much, much lower on pope and so that brings down your logging costs considerably. And then in general, the pop plans are slightly closer to customers. And so the hauling costs are different. So the OBP rates for pope are considerably lower than they are on the Rayonier portfolio. And then in addition, we do serve some similar customers. And so it gives us some added volume with respect to serving those customers and exposure. So we're really excited about what it does from a markets perspective. And then also with respect to the real estate side of the business, it's very similarly structured and run to how we treat our real estate business in the Jacksonville and Savannah area. And so we're looking forward to sort of combining that and just adding an additional strong market that the Puget Sound region represents.

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

This is Doug. Dave cleared it -- Pope obviously did a great job with it. I'd just say one thing I would add is over quarter-over-quarter, we -- from last year this year, we saw a pretty big increase in our chip and saw volume just regarding our stands we're harvesting in which you would expect to bring down our average pricing for sawtimber, but given the increased mix and things that Dave just talked about Pope, we had flat on pricing overall, so just shows that it adds that contribution.

Kurt Willem Yinger - *D.A. Davidson & Co., Research Division - Research Associate*

Okay. Perfect. And as we start looking ahead to 2021 with the full year of Pope, I mean any noteworthy differences between the impact that's kind of assumed in the second half guide versus what we might think about on an annualized basis?

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

Yes. Recall that when we announced the transaction, we estimated a 5-year average annual EBITDA contribution of $38 million. Obviously, with just the timing of the year, that we closed the transaction as well as doing so in the midst of the COVID-19 pandemic. We're not going to get a pro-rated contribution of that magnitude. But the all things considered, I think the assets are operating very well. I think our longer-term expectations haven't really changed meaningfully. And again, I think we're pretty positive on the outlook for that business and those assets in particular, recognize as well that going into the year, we didn't obviously control the operation of those assets up until the date of acquisition. And so they had harvested, I'd say, a higher proportion of their annual plan than the proportion of the year that we're actually through. And so again, just another reason that the pro-rated contribution this year is not going to be reflective of what we would expect the run rate contribution to be.

Kurt Willem Yinger - *D.A. Davidson & Co., Research Division - Research Associate*

Okay. And then my last one, could you just remind us how to think about the real estate segment at a high level, kind of year in, year out, and I realize it's lumpy and maybe some of the stuff you have going on down in Florida makes it tougher to think about that in the near term, but any sort of long-term thoughts there?

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

Yes, I'll start with that, and Mark chime in afterwards. I mean, I think at one level, and Mark kind of touched on this a little bit in the way we've restructured the sales categories. Our focus is really on generating premium. And historically, the sector has had a period where a number of players have sold timberland at timberland value to simply generate cash to fund a dividend that's otherwise can't be funded with normal operations. And we decidedly stepped away from that practice, deemphasize that and really put much more emphasis on premium. And so we still have sales in our nonstrategic category that are either lower quality assets or assets that we will sell for capital allocation purposes. But in terms of how we think about the real estate segment, how we operate it, it's just really all about premium. And you can see that if you look deeper into some of the data in our IR deck. And then within the real estate segment, we kind of have 3 broad areas. The first is our rural sales. And we're particularly encouraged by how we see that playing out. We see that potentially as one of the benefits of the COVID environment where people are looking to get out of more urban areas. And we have strong demand in Florida, Texas and Louisiana, in particular, in that rural category. And we have a number of product types that we're very encouraged by how that has been developing. And we really see that as a stable baseline of our real estate business. And then kind of moving up the food chain, we have unimproved development, and this is where we have made some investments in infrastructure -- or excuse me, investments in entitlements to allow for downstream development. And we typically sell the project once those entitlements have been have been reached. And it's essentially selling the land at an unimproved level, but with those added entitlements. And so a relatively modest amount of CapEx involved. And then we have 3 -- we have -- then we move to sort of the highest level within our Real Estate segment, and that's the improved development. And we really have 3 project areas there. And these are areas where we have a lot of surrounding land, and we feel there's value in investing -- in getting those catalyzed to improve the broader absorption. And we talk about these a lot. These are the Wildlight Florida project. This is 20 miles north of Jacksonville that we've started about 4 years ago. And keep in mind that to date, only about 260 net acres have been absorbed within that project. And we have 25,000 acres within a 5-mile radius of that project. And so we see that as a project that's going to have a lot of room to grow over the years and decades ahead. And then moving North, we have our Richmond Hill project that's just 20 miles South of Savannah. Fairly similar to Wildlight in terms of strong schools, a growing area. We've made some good initial sales there, and we've made a lot of progress in getting public infrastructure projects completed this year. We have a new I-95 interchange that's under construction. We have a new elementary school that's under construction and a high school that's under construction on our project, a 2-mile parkway, water and sewer utilities. And those are really all designed to help open up more of that project. And again, like Wildlight, within a 5-mile radius of this project, we have roughly 20,000 acres. And then our third improved development project is associated with the Pope assets. And these assets are all in the West Puget Sound area. Roughly 30 miles northwest of Seattle. And in particular, these projects have benefited from a new Kingston passenger only ferry service into downtown Seattle. And so once we saw that ferry service open up, we've seen improved demand coming over into Kitsap County where that's located. And so we've got 2 projects there that fit within our improved development category one, one is called Arborwood right near Kingston, roughly 2 miles from Kingston. And then the other is the historic Mill Town of Port Gamble. And we're very excited about both these projects. There are in earlier stages of development, certainly relative to our Florida and Georgia projects, but very similar characteristics. So we're excited about those. And that gives you just sort of a little bit of a sense of how we approach those. But again, I think that if I leave you with one thing, it's a focus on premiums.

Operator

The next question is coming from Paul Quinn, RBC Capital Markets.

Paul C. Quinn - *RBC Capital Markets, Research Division - Director of Paper and Forest Products & Paper and Forest Products Analyst*

Yes. Appreciate the revised guidance. And knowing that we're at record lumber prices. Just wondering how that is tracking through to your log sales? And what's embedded in in the revised EBITDA guide, considering that the mix changes quarter-over-quarter?

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

Sure. This is Doug. I'll start with that. Increase in log prices typically lag the lumber price rallies. And what we saw is some areas are really started to gain confidence in the current lumber rally in June and so while Sun Yield pine pricing was up 17% at the end of Q2, it's really up 34% since then. So as we all know, it had a big jump and Doug-fir lumber rally was a bit slower, but has done the same thing since then. And so we're pretty optimistic about that. And with that, once the -- once we saw those procured mills get confidence, we saw them come back into full production across the board in the South and Northwest. And they really got that confidence repair remodeling and then housing construction restrictions were relieved as part of COVID. And so in typical Northwest, where that supply and demand ratio is more tensions. And as Dave mentioned, we saw export markets pick back up, we saw lumber prices increases translate back to the stump more rapidly. But with the southern mills now mainly back at full production, we're seeing that price intention in some southern wood baskets also, particularly those near active export markets. And that's making it back to stumpage now, too. So I won't go into specifics of price premiums because we're currently in negotiations across the Northwest and the South, and I don't want to tip our hands or expectations. But as you mentioned, our guidance has been updated to reflect the signals that we're seeing in those markets.

Paul C. Quinn - *RBC Capital Markets, Research Division - Director of Paper and Forest Products & Paper and Forest Products Analyst*

Okay. That's helpful. And you guys just closed on Pope, which is going to take a little while to digest and then simulate. And balance sheet seems to be a little heavy. Is it fair to say that you'll be a little quieter on the M&A front going forward here?

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

Yes. I think certainly, we're towards the upper end of our targeted debt capacity. And so absent the ability to sort of grow with equity I think we are going to certainly be a little pickier as we think about acquisitions going forward. Generally, right now, it's a quieter period. I think with COVID travel restrictions, you're not seeing as many offerings out on the market because it's difficult for people to do some of that confirmatory due diligence. We're still looking at all the things that are out there. But I'd say that's a fair assumption that we're being just a little pickier right now until we get the balance sheet to a little more comfortable level.

Paul C. Quinn - *RBC Capital Markets, Research Division - Director of Paper and Forest Products & Paper and Forest Products Analyst*

So that's not to suggest you weren't picky in the past, but I'll leave it there that's best of luck.

Operator

Our next question is from Mark Weintraub with Seaport.

Mark Adam Weintraub - *Seaport Global Securities LLC, Research Division - MD & Senior Research Analyst*

Just one -- just following up actually on the last question and just getting a clarification. Maybe I misheard, but I thought you had indicated in prepared comments that you're assuming relatively flattish U.S. saw timber prices through the back half of the year. And then it sounds as though in the answer to the last question that you're beginning to see evidence of maybe log pricing in the U.S. South having a more positive bend. Maybe I misheard? Or is that -- would that show up more likely next year? Maybe start there.

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

Yes. No, I'll clarify that. So we're actually seeing expectations of increased price for sawlogs. But what we think is that on average, our composite average price in the South is going to be relatively flat. So that's what we're referring to on the kind of flat for the year. And the reason for that is if you look back over previous years, typically, as we go into the second half of the year, we have increased harvest out of our kind of stall states, and particularly our Arkansas area where prices are much lower and so we see pulpwood prices in particular, go down significantly. We also typically saw at prior time of the year, have about a 5% increase in spending volumes tapered to pulpwood. So the comment is basically that we're going to see increased sawtimber prices what we're seeing but that's going to be helping to offset the volume geographic mix that we're going to have as we shift more volume to lower-priced regions in the Gulf states as well as the increased percentage of thin volume of pulpwood. So we're looking at the average composite price being relatively flat. So that's kind of the differentiation there.

Mark Adam Weintraub - *Seaport Global Securities LLC, Research Division - MD & Senior Research Analyst*

Got it. Okay. And then just tying this and then I know, Dave, in your -- in the press release, you talked about this, the lag between the strength in wood products, and you'd expect that to translate to improved log prices over time. And I assume that is part of, Mark, when you make the comment about in terms of getting to debt targets, you expect cash flow growth to more normalized type levels. And I assume that is an important part of the equation. A, just get confirmation on that. And to the extent that you're comfortable giving any sense of magnitude, that would be helpful. And then, b, are there any other significant drivers in getting to the more normalized level of cash flow when you think about your leverage targets over time that we should be cognizant of?

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

Yes, sure, Mark. I'm happy to take that. I think there are a few components of that. I mean, certainly, growth in pricing is an element of what we see as getting to a normalized level of cash flow. We recognized as well, I mean there was lost volume that occurred this year, particularly in Q2 around the COVID-19 pandemic. And so yes, certainly in the Pacific Northwest Timber segment and New Zealand, Pacific Northwest because of the midyear Pope acquisition in New Zealand because of the shutdown in which we weren't really moving any log volume. We're going to end the year, even the updated guidance that we provided, which is up from the last guidance, is going to be below our long-term sustainable yield. And so I think that we have the opportunity for cash flow growth, both from a pricing improvement, as well as just returning to more of a normalized level of harvest activity because, certainly, this year is not going to be there across the portfolio.

Operator

Our next question now from John Babcock with Bank of America.

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

So just quickly here and kind of following on the question, I guess, that Paul was asking. As you look at future of timberland acquisitions and now with the close of the polk transaction, how does this change your emphasis on M&A in the Northwest and also in kind of the U.S. South and generally the mix that you're looking at there?

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

Yes. I would say that we don't have a prescribed view around portfolio mix. I think at all times, we're looking for properties that have a complementary fit from an age class perspective with our existing asset base. And so that holds true really in all geographies, and we're always looking for properties that have a nice fit. And then lastly, it's that ability to find things that we feel like we can buy at competitive rates. We have a higher proportion of transactions that we do on a negotiated basis as opposed through auctions. And so we're always looking at things that may not necessarily be out there in the market. But -- and I think lastly, we have a regular program of smaller bolt-on transactions that are often brought forward by local geographies that they see a property they're familiar with that has a nice fit with our existing asset base. And we've had a steady stream of those over the past number of years.

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

Okay. And then next question, I mean the UPREIT structure is not one that we typically see, at least among many publicly traded stocks. And so I want to get your sense. I mean, do you intend to keep this sort of entity structure going forward? What's the longer-term plan with that?

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

Yes. John, so when we laid this out, it was really designed to be used across multiple transactions going forward. And so we set it up that way. We set it up to be investor friendly. It's designed to allow for investors of a particular company. And if you take Pope Resources, for example, we have roughly 4.5 million OP units. And these were unitholders of Pope who chose to take a portion of their consideration with those OP units, and recognize that going forward, they have thus deferred the capital gains from that transaction. And then when they choose to exchange those OP units for Rayonier shares in the future, they, at that point, recognize the capital gain treatment. And so it gives those investors a tremendous amount of flexibility going forward to defer or to manage at an individual investor level when they take the capital gains tax liability associated with that transaction. And we think that, that's very attractive to other timber owning organizations, where you might have different points of view from different investors. And so our -- it's our hope that we can, over time, grow this this part of the business by being able to offer to those owners the ability to to take these OP units. And recognize that for many timber owners, they've owned these lands for long periods of time. And some of them just don't want to sell. They'd like to retain that optionality. So holding those OP units allows you to, in effect, recognize a value for those at current value for those in exchange for Rayonier OP units, but at the same time, retain all the optionality that you would have had you kept those assets in the first place. And then I think lastly, keep in mind that most owners of timberland don't have a deeply diversified portfolio. And so one of the things that the OP units offers is essentially the ability to more broadly diversify. And I think that certainly is the case within the Pope Resources unitholders. Thinking about Rayonier, we've got a very diversified mix of assets and markets between the U.S. South, the Pacific Northwest and New Zealand. And now those Pope Resources, unitholders that selected the OP units as part of that transaction, they now have a commensurate ownership across all of those diversified wood baskets. So we're pretty excited about it. There were some costs to get this kind of up and running. And -- but now that it's up and running, we're excited about trying to grow it with other assets. And it gives us as Rayonier, the opportunity to do that in a manner that doesn't increase our debt load per se. It's another form of growing through the use of our equity. So we look at it as an additional tool in our tool chest, and we're excited to have it in play now.

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

Okay. And then just last quick question here. Might you be able to provide the earnings contribution from Pope in the Pacific Northwest in the last quarter?

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

Yes. It was roughly $2 million.

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

Of EBITDA?

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

It was roughly $2 million of EBITDA. That's correct. It was a bit lower than that, probably like $1.5 million -- $1.5 million to $2 million. And John, just real quick on that point. Recognize that, like we said, when we announced the transaction, those assets have a higher contribution margin because of -- like Dave talked about earlier, because of the lower operating cost, lower OBT costs as well as a higher mix of Doug-fir. Going to get a higher contribution per ton from those Pope Resources assets than we had in the legacy portfolio. So again, we expect it's going to be a pretty meaningful contributor going forward.

Operator

As I have no further requests, I'd like to turn it back to management for closing remarks. Thank you.

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

Yes, sure. This is Mark McHugh. Thank you all for joining us today. And feel free to follow-up with me with any questions.

Operator

Conference has now concluded. Thank you for your participation. Please go ahead and disconnect. Thank you very much.