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RYN - Q3 2018 Rayonier Inc Earnings Call

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OVERVIEW:

Co. reported 3Q18 sales of $201m and net income attributable to Co. of $23m or $0.18 per share.

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PRESENTATION

Operator

Welcome, and thank you for joining Rayonier's Third Quarter 2018 Teleconference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, you may disconnect now.

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 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'll make 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 results, Chris Corr, Senior Vice President of Real estate, will discuss our Real Estate results.

We're pleased with our third quarter results given the challenging market conditions we faced. For the quarter, we achieved earnings per share of $0.18 and adjusted EBITDA of $83 million, reflecting solid operational performance across all our Timber segments as well as a strong contribution from our Real Estate segment.

Our Real Estate results were driven by $28 million timberland sale in New Zealand comprised of approximately 5,000 productive acres at a price of over $5,600 per acre.

In our Southern Timber segment, wet weather conditions led to lower harvest volumes, but also contributed to greater market tension and stronger pulpwood prices compared to the prior-year quarter.

In our Pacific Northwest Timber segment, we continued to enjoy robust demand and strong pricing in the third quarter, which was partially offset by higher cut and haul costs.

In our New Zealand Timber segment, we saw some pricing softness as expected during the quarter, but are pleased with how quickly these markets have rebounded in response to reduced wood flows from the U.S. following the announcement of tariffs on log exports into China.

With that, let me turn it back over to Mark to review our financial results.

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

Thanks, Dave. Before discussing our quarterly results, I wanted to highlight a change that we've made to our segment reporting. We've reclassified New Zealand timberland sales from the New Zealand Timber segment to the Real Estate segment. This change took effect in the third quarter and we've adjusted prior year period results to reflect this reclassification. We made this change in order to better align our segment reporting with how we internally evaluate business performance, and we believe that it further provides better comparability of our segment financial results from period-to-period.

Moving on, Page 5 of the financial supplement provides a summary of our quarterly results. Sales for the quarter totaled $201 million, while operating income was $46 million and net income attributable to Rayonier was $23 million, or $0.18 per share. Pro forma EPS was also $0.18 per share as we had no pro forma items in the quarter.

Third quarter adjusted EBITDA of $83 million was above the prior-year quarter, primarily due to favorable results in our Real Estate and Pacific Northwest Timber segments, partially offset by lower contributions from our Southern Timber and New Zealand Timber segments.

As Dave noted, our Real Estate results were positively impacted by a timberland sale in New Zealand, which contributed $28 million of adjusted EBITDA and $13 million of net income attributable to Rayonier, or approximately $0.10 per share.

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 prior periods. Our cash available for distribution, or CAD, for the first 9 months was $222 million compared to $144 million in the prior year period, primarily due to higher adjusted EBITDA, lower cash interest paid and 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 $146 million of cash and roughly $975 million of debt. Our net debt of $829 million represented 16% of our enterprise value based on our closing stock price at quarter end. Note that these figures exclude $45 million of cash proceeds from timberland and HBU sales that are currently held by LKE intermediaries and therefore, classified as restricted cash.

I'll now turn the call 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 $8 million and $1 million unfavorable to the prior quarter and the prior year quarter, respectively. Third quarter harvest volume of approximately 1.3 million tons was 160,000 tons and 26,000 tons lower than the prior quarter and the prior year quarter respectively.

Production in the first half of 2018 was unusually high due to strong demand in our markets. So we expected a decrease in harvest volume going to third quarter, which was coupled with wet weather across the South. We were fortunate to avoid significant damage to our timberland properties from the recent hurricanes, Florence and Michael. We sustained relatively minor damage with about 200 acres directly impacted by Hurricane Michael, and we expect to begin salvage operations on those acres in the fourth quarter. While we were fortunate to avoid significant damage to our properties, we do expect some near-term challenges in certain market areas that are approximate to hurricane damage as there will be significant volumes of salvage wood on the market likely for several quarters.

Third quarter pine pulpwood stumpage prices of $16.74 per ton were 4.3% and 2.6% favorable compared to the prior quarter and the prior year quarter, respectively. The increase in pine pulpwood prices was due to wet weather along the East Coast reducing supply and therefore, creating favorable spot markets. The increase over the prior year quarter was also due to the impact of salvage volume from the West Mims fire on the prior year quarter results.

Pine sawtimber stumpage prices of $25.55 per ton were 2.6% and 1.5% unfavorable to the prior quarter and the prior year quarter, respectively. The reduction in price compared to both periods was influenced by a general shift in volume from the East Coast to the Gulf States, combined with the impact of China tariffs on export prices.

During the third quarter, China implemented a tariff of 25% on Southern pine log exports, which has certainly had a negative impact on economics of exporting logs from the South. We're working hard to maintain our Southern export network despite the tariff headwinds and are continuing to monitor the situation closely.

Hardwood prices of $13.34 per ton were 10% favorable to the prior quarter and 17% unfavorable compared to the prior year quarter. Hardwood markets are very localized and product specific, so changes in price tend to be driven by both product and geographic mix.

Now moving to Pacific Northwest Timber segment on Page 10. Adjusted EBITDA of $10 million was $5 million unfavorable to the prior quarter and $2 million favorable to the prior year quarter. Third quarter harvest volume of 310,000 tons was 64,000 tons unfavorable to the prior quarter and 58,000 tons favorable to the prior year quarter. Favorable market conditions afford us an opportunity to accelerate volume in the first half of this year. And as a result, production volume in the third quarter slowed to allow us to meet our sustainable harvest targets. The mills in the prior year quarter were also negatively impacted by fire restrictions that did not reoccur this year.

Delivered sawtimber prices of $102.74 per ton were 1% unfavorable to the prior quarter and 15% favorable to the prior year quarter. The increase in sawtimber prices versus the prior year quarter was driven by strong demand in both export and domestic markets.

Delivered pulpwood prices of $48.93 per ton were 2% unfavorable to the prior quarter and 18% favorable compared to the prior year quarter. The decrease in pulpwood prices compared to prior quarter was driven by geographic mix of sales, whereas the increase in pulpwood prices compared to the prior year quarter was due to price tension from competition from chip exports in the first half of this year.

While the overall pricing dynamics in the Northwest were relatively strong during the third quarter, recent market conditions have deteriorated. Our downstream customers in the Pacific Northwest prepared for the fire season by taking on additional inventories heading into the summer, and have retained these log inventors that the fire season was uneventful compared to the prior year. Coupled with the announcement of tariffs on log exports in China, log prices have declined materially in the fourth quarter.

Page 11 shows results and key operating metrics for our New Zealand Timber segment. We continue to be pleased with the operating performance of our New Zealand Timber segment, which delivered another solid quarter. Adjusted EBITDA in the third quarter of $24 million was $2 million unfavorable compared to prior quarter, primarily due to lower prices in both domestic and export markets, and $4 million unfavorable compared to the prior year quarter due to a combination of lower volumes and lower weighted average prices.

Third quarter harvest volume of 724,000 tons was 2% and 7% lower compared to the prior quarter and the prior year quarter, respectively. The modest volume variances were generally due to the timing of export shipments. Export sawtimber prices of $114.54 per ton decreased 5% compared to the prior quarter and increased 1% compared to the prior year quarter. Demand remains strong in China, but market uncertainty around the U.S.-China trade tensions, coupled with the devaluation of the Chinese yuan caused a dip in log prices. However, we've seen a recent rebound in New Zealand export pricing as a result of lower U.S. log volume going into China.

Domestic sawtimber prices of $80.74 per ton, in U.S. dollar terms were 6% and 3% unfavorable to the prior quarter and prior year quarter, respectively, primarily due to changes in the New Zealand-U. S. exchange rate.

In our Trading segment, third quarter adjusted EBITDA of $0.3 million increased compared to the prior year quarter due to a reduction in export costs, partly offset by lower volumes.

I'll now turn it over to Chris to cover Real Estate.

Christopher T. Corr - *Rayonier Inc. - SVP of Real Estate & Public Affairs*

Thanks, Doug. As previously mentioned, our Real Estate segment results have been reclassified to now include New Zealand timberland sales.

Highlighted on Page 12, sales for our Real Estate segment totaled $36 million on roughly 7,300 acres sold, driven primarily by a nonstrategic timberland sale in the North Island of New Zealand. Excluding Improved Development sales, we generated a weighted average price of $4,749 per acre. Sales in our Improved Development category reflect a steady pace of activity at our Wildlight development project. During the quarter, we closed 20 residential lots for a total of $843,000, or $42,000 per lot, including the first closing on townhome lots. We also closed our roughly 2 acres of commercial property for $500,000, or $225,000 per acre.

The Unimproved Development category, sales totaled $1.2 million comprised of one sale totaling 126 acres in Bryan County Georgia. In the rural category, sales totaled $4.5 million on 1,420 acres at an average price of roughly $3,200 per acre. While we closed fewer transactions in our rural places program than we did in the prior quarter, market interest remain strong and we're encouraged by our current pipeline of opportunities.

In the nonstrategic and timberlands category, sales of $29 million were comprised of 5,785 acres sold at an average price of roughly $5,000 per acre. The results include the sale of 4,996 productive acres in New Zealand for $28 million, or roughly $5,600 per acre.

Following an extraordinarily strong year so far in Real Estate, we expect much lighter activity during the fourth quarter. As we've discussed in the past, our Real Estate results tend to be lumpy from quarter-to-quarter. For our Wildlight project, infrastructure development for the Village Center is largely complete and most lots are either sold or under contract. Our focus is now shifting to refining development plans for the next area of residential development.

I will now turn the call back over to Mark.

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

Thanks, Chris. As we look to the fourth quarter, we expect to achieve our prior full year adjusted EBITDA guidance of $300 million to $315 million before considering the impact of the third quarter New Zealand timberland sale. Based on our current outlook, we're reducing our full year volume guidance in the U.S. South to a range 5.6 million tons to 5.7 million tons as we're pulling back our harvest activity in markets impacted by significant salvage volume following Hurricane Michael. We also expect that Q4 pricing in Southern Timber will be down modestly due to geographic mix. Overall, based primarily on the reduced volume, we expect that adjusted EBITDA will be modestly below our prior guidance.

In our Pacific Northwest segment, we expect to achieve full year harvest volumes of roughly 1.3 million tons and adjusted EBITDA towards the lower end of our prior guidance. While market conditions in the first 9 months have been very favorable, we're currently seeing some headwinds driven primarily by the China tariffs on export logs coupled with high log inventories at domestic mills.

In our New Zealand Timber segment, we remain on track to achieve full year harvest volumes of 2.6 million tons to 2.7 million tons, and we expect to achieve adjusted EBITDA modestly above prior guidance. Prices have rebounded nicely in New Zealand as reduced log inventories in China coupled with reduced wood flows from U.S. have driven increased export demand in New Zealand.

Lastly, on our Real Estate segment, we expect relatively light activity in the fourth quarter following an extraordinarily strong first 9 months of the year.

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

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

Thanks, Mark. Before offering some closing remarks, I'd like to briefly address some organizational changes that were implemented recently within our Real Estate organization.

As our Wildlight and Richmond Hill development projects have continued to gain momentum under Chris Corr's leadership, we've decided that now is the right time to realign our resources to better support these projects over the long term. As such, Chris will assume full-time oversight of our Improved and Unimproved Development business, including these 2 active development projects.

Oversight of HBU and nonstrategic land sales will transition to Rhett Rogers under the portfolio management organization. Both Chris and Rhett will continue to report to me and all real estate activity, including New Zealand land sales will continue to be reported through the Real Estate segment.

In addition, Mike Bell has been promoted to Vice President, Public Affairs and Communications. Mike will oversee all of Rayonier's public affairs and communications efforts and will report to me. We're excited about these changes and feel they will help with both improved alignment and performance going forward.

We have often discussed the quality and diversity of Rayonier's portfolio. Our pure-play focus and nimble approach to capital allocation as key investment attributes that we believe differentiate us from our competitors. We're in the midst of some challenging and uncertain market conditions. Rising interest rates and declining housing affordability have impeded the pace of the housing recovery.

In addition, tariffs on log exports into China have reduced market optionality, and labor availability continues to impact our business in a variety of ways.

Notwithstanding these headwinds, we believe that Rayonier is very well positioned based on the strength of our balance sheet and the construction of our portfolio, which is concentrated in high-quality markets. We've made some very measured and deliberate moves over the past 4 years to position the company for sustainable, long-term success.

We recapitalized our New Zealand joint venture and in so doing, also increased our equity stake ahead of a significant lift in the segment's financial performance. We realigned our Pacific Northwest portfolio to increase our short-term and long-term harvest potential allowing us to capitalize on recent strong market conditions in the region. We made several significant portfolio moves in the South to increase our exposure to the strongest markets. These portfolio moves have all helped to improved our cash flow generation over the past few years, but importantly, they also improve our defensive positioning should markets deteriorate in the future.

In addition, we have also carefully managed our balance sheet by fixing all our long-term debt at advantages rates and extending maturities ahead of a significant rise in interest rates. These moves have been done with an eye towards maintaining a nimble and opportunistic approach to capital allocation decisions all designed with the goal of building long-term value per share.

Our team has done a great job working together, and I continue to be impressed by the tremendous dedication and focus of our employees. Despite challenging market conditions, we had another solid quarter and remain on track for a very strong year. In summary, I'm pleased with how well we're positioned and continue to be optimistic about our long-term prospects for our company.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Collin Mings with Raymond James.

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

Just to start, maybe Doug, just in the prepared remarks you referenced pricing has deteriorated materially in the Pacific Northwest. Can you just maybe quantify that? Just given that, it sound like even as we've moved here into the beginning of the fourth quarter, you've seen further deterioration. So maybe just talk a little bit more about that.

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

Sure. So as we mentioned in the call, we continue to see both strong domestic export pricing in our third quarter, but then late in the fourth quarter, things started to change. The mills are flushed with log inventories and that lack of summer fires, they really have built up towards that. And then we started to see additional supply come on as China imposed export tariffs that range from 5% to 10% based on the species and size. And the threat was -- actually it's 25% to begin with, so we started to see the export business start to pull back even before those tariff really came into place. And so we continue to see that happen and the perfect storm going to happen at the same time that lumber prices took a sharp correction. We had imports up over 25% from year-over-year from other places and offshore and then pessimism over housing starts.

So one thing I think that these lower lumber prices, we believe that's something now that lumber import will start to not be economical anymore and demand even in the seasonal slowdown will start to grow that domestic mill inventory remained in the quarter. We're pleased with our decision to accelerate this harvest the first half of the year, and believe that, that strategy also captured some amount of the pricing upside that occurred this year, and so therefore the average prices were up on a year-over-year basis. So as we've seen it going forward, we think that the right decision was to pull that going forward and sit back and allow some of this volume to work off the inventories and see what's going to happen with export markets as we move forward.

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

Okay. No better way to quantify that in terms of, like, quarter-to-date or quarter-over-quarter to have the deterioration. But I recognize there's a lot of nuances, but just overall, kind of the degree of deterioration?

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

Yes, I don't think we want to get in dollar specific price into the quarter, Collin, obviously, there are a number of third-party services that track log pricing in the Pacific Northwest, and you'll see a little bit of a lag effect there. But like Doug said, Q4 thus far has got a bit of a perfect storm, and so we don't want to be too -- overreact regarding kind of what's happened so far in Q4, because we do think that the longer term trends are certainly positive in the Northwest.

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

Okay. Fair enough. And then Dave just as we think about the New Zealand timberland sale in the quarter, can you just maybe talk a little bit more about how that came out about? And just how does that acreage -- obviously, very healthy pricing there, how does that acreage compare to the rest of your New Zealand position?

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

You bet. Yes, we've always sort of -- some of this to some extent gets back to our broader capital allocation posture as it relates to timberland sales and through keeping an eye towards looking for opportunistic sales, we put in place an effort. Over the last couple of years, we identified 2 properties that were in the Southern portion of the North Island that were very remote relative to our base of operations. They were decent properties, but they were very remote. So a little harder to get to from an access standpoint, less efficient from a mill -- excuse me, from an export standpoint. And so we put in place an effort to capitalize on the rise in the markets in New Zealand and sell those. We sold one of them about a year ago, and then this is the second one that we've completed. And so no we're sort of out of that region. This property in terms of its attributes had an average plantation age of about 16 years. And that's a little older than you would typically have on a perfectly regulated forest. So it was above average from that perspective. It was a lease property. It did not include fee simple ownership. From a productivity standpoint, it was below average relative to the rest of our claim. But importantly, from a valuation standpoint, it was also 100% cable -- or excuse me ground-based logging, which translates to decent value. So overall, we're very happy with the sale and happy to be able to take that capital and look for opportunities to recycle it elsewhere.

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

That's helpful. And then maybe Dave, just sticking with New Zealand, can you just update us on the status of your joint venture partner stake there? I recognize you're limited to some degree given the litigation, but just any update there just given the number of headlines coming out, and where things stand with the Stafford up would be helpful?

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

You bet. So Stafford is -- has largely been successful in their effort to acquire all of Phaunos. We expect that closing to occur any time now. And they're going through the orderly process of transitioning their participation in the joint venture that we control in New Zealand. And as we've said to folks before, we know them well and we've had a long working relationship with them. And so, we see the transition being fairly orderly. And as it relates to the ongoing litigation, that's something that we'll probably not discuss at this juncture.

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

All right. And then just one last one from me, and I'll turn it over. Mark, I mean, you've spend a lot of time discussing timberland markets and it's return to the asset class over time. Just kind of against that backdrop, just maybe talk a little bit about what you're seeing in terms of deal flow? It looks like you guys made a total of about $7 million, $8 million in timberland acquisitions during the quarter. On prior calls kind of been upbeat about the deal environment. Obviously, you've closed on a number of deals over the last year or 2. So just what are you seeing in terms of deal flow? Is there any shift in buyer activity or values or discount rates or anything that you're seeing just given some of the market dynamics here between some concerns near term about housing, the trends in the Pacific Northwest maybe softening a bit, just what are you seeing out there in the timberland markets?

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

I mean, I guess, at a very high level, and I'll invite Doug or Dave to comment as well. I mean, I'd say we continue to see a pretty robust timberland M&A market. We've obviously been less active this year than we have been in the years passed. And I think that that's just a reflection of there haven't been properties to come to market or we haven't sort of won in auction processes for properties that have come to market point that we believe were particularly additive to our portfolio. And so we continue to do a number of bolt-on acquisitions, smaller in size. We're content to hit singles and doubles when we don't see larger opportunities that really fill our needs at the time. But overall, I would say we continue to see a pretty steady pace of activity.

And just to be clear, I'd say the timberland market as a whole doesn't tend to overreact to the noise that we see in the market around kind of monthly housing stats and things of that nature. Keep in mind, this is an asset class. It's underwritten on a 25- to 50-year DCF, assuming -- making assumptions regarding long-term sustainable harvest flows and trend line prices. And so we tend to not see the market correct meaningfully -- the private market correct meaningfully relative to these statistics that we see coming out on a regular basis.

I would say that China situation is certainly creating some noise in the market. Obviously, we had all expected that China was going to present a good opportunity for export out of the South, and it's been a meaningful component of export out of the Northwest. I mean, there is a lot of uncertainty around that right now. But I'd say overall discount rates, maybe there has been a bias towards seeking higher IRRs in transactions given the rise in interest rates. But again, timberland tends to be valued on a real DCF basis. And so while the overall interest rate environment fluctuates, it is certainly up over time, I wouldn't say peoples view of real long term discount rates have changed significantly.

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

Yes. And the only thing I would add to that, Collin, is that the fact that we've had not a lot of closings is not indicative of the activity level. It's been a very busy and active year, but having said that, I think, we -- and this kind of gets back to my some of my prepared remarks, we have a bias towards being in higher quality markets and pursuing higher-quality properties. And we view that both from a defense standpoint and an offense standpoint. And so that has been -- there's been more limited opportunity of those types of properties out there and we're just going to kind continue to be disciplined and kind of stick to our knitting on that particular front.

Operator

Our next question comes from Ketan Mamtora from BMO Capital Markets.

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

Just first question, again, sticking with this tariff issue. Can you comment at all what you're seeing in terms of volumes on your Southern exports? I recall that you all had talked about doubling it from 2017 levels? What have you all seen so far since this got implemented?

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

Sure. This is Doug. Yes, so as you mentioned, we were -- we're in the process of doubling our volumes, and year-to-date we have done approximately 170,000 tons, but in the last quarter really, and threat started coming in really in July, things started to move forward with that. We've definitely slowdown our export volumes out of South. You recall, before we talked, we do about 2% or 3% of our total harvest has been in export market, and of our own properties, we've stepped that back as we mentioned in our comments and probably just trying to keep the doors open. So we've taken a concerted step back in the amount of volume that's now being sent to China.

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

Yes, Ketan to be clear, I mean, it's not particularly advantageous to export volume to China with a 25% export tariff. But that said, we're trying to maintain that network, because we do see China as a longer term opportunity. So again, we don't want to sort of shut down the relationships and the infrastructure that we've created around that business in reaction to the current trade war. Hope and expectations over the long run, that will still be an opportunity for us, but it's definitely not an economical business today.

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

Yes. And that's been shown in the results. This is not just Rayonier, this is all the South in general, but in the second quarter we saw about 630,000 cubic meters export out of the South, and by Q3, that dropped to 400,000 cubic meters to be kind of a relative impact of the trade wars on things and expect that to even decrease a bit more in Q4. What negatively impact these Southern markets, it does have an offsetting positive impact in New Zealand, where as I mentioned before, we're seeing increases in our prices, and we export about fixed amount of volume out of New Zealand. So it's -- from one side it's taken away and it's adding to the other side.

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

And I guess, that's a really positive message in all of this is that we think we've got nice diversification around this issue in a sense that, that China wood demand continues to be very robust. And they've got to get it somewhere, and New Zealand is the biggest log exporter to China. And so as these U.S. trade flows hits on, we've seen a quicker rebound that we anticipated in New Zealand log prices, and so we've had a nice offsetting effect there.

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

Just one more thing to add to that is another thing we've seen is there is fewer exports of logs based in the Northwest, but also other commodities out of the U.S. That means more ships available out there. So they're turning towards New Zealand to look for opportunities to export logs from there. So we would think of stream by shipping, and we're seeing price increases there. But this kind of new influx of shipping capacity we've seen some prices come down on shipping rates also in this quarter, and really going into the next quarter, we believe, it's going to happen. So kind of another offset that just might not expect this to fall through from the less commodities come from U.S. to China.

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

Got it. That's very helpful color. I really appreciate it. And then just turning to U.S. South, on the domestic side, have you seen -- with this sharp drop in lumber prices, have you seen any signs of people pulling back on these sawmill projects that none of really come up quite a bit over the last 12 months? Are you seeing any signs of people either postponing it or pulling back or even saw any signs of kind of caution on bidding for stumpage?

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

Yes, this is Doug again. So we haven't heard of anybody pulling back on their projects. Again, I think a lot of people feel this is a short term thing and not the long term. So I think they're continuing moving forward and delays that we've heard of so far on sawmills have been more around resourcing and getting equipment and people to work on a project. But we haven't heard of anyone who has simply said they're pulling back based on kind of what we believe is going to be a short term correction. On the stumpage side, as probably we've talked about for the last couple of quarters, we didn't see our Southern stumpage prices gone up with the lumber and we also haven't seen them go down with the lumber. So they haven't been correlated with the lumber prices at all. And so, I guess, while it would have been nice to see them run up with the lumber, the other side of the equation have been very stable and we just continue moving forward with what's been going on for the rest of the year.

Operator

Our next question comes from Anthony Pettinari with Citi.

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

This is actually Randy Toth sitting in for Anthony. And I guess, my first question is how are export price realizations out of New Zealand in October? You mentioned they rebounded pretty nicely. What kind of pricing uplift have you seen in 4Q over the 3Q average?

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

Yes. So what I would say is that as we look into our November and December shipments, we're seeing prices comparable our second quarter that we had going into that. So we did see that dip in Q3, but we're starting to see pricing as very comfortable to our Q2. And as I mentioned, we're seeing some cost savings on shippings. So we're looking at a favorable Q4 compared to Q3 and more comparable to Q2.

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

And Randy, this is Dave. I'd add to that. One of the things that we track very carefully is the level of log inventory in the ports in China. And as we've seen that drop in shipments coming from the U.S. associated with this tariff activity, we haven't seen a drop in the takeaway. And so as a result, we've seen the inventory drop pretty dramatically in China. It's now at roughly 3 million cubic meters and the ratio of demand to inventory has come to a level that we haven't seen this low, I mean, probably about 5, 6 years. And so it's really the reason that we've seen this fairly quick turnaround in pricing out of New Zealand. And as Doug mentioned, we've got -- we have a further benefit from lower shipping rates as there's been less activity out of North America. So really gets back to that diversification thing that Mark talked about earlier.

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

Okay. That's helpful. And then just looking at Slide 7, sales generated using the delivered model, were 34% of sales, which I believe is the highest since you guys had breaking that out. Was there anything, in particular, driving that? Or how should we think about that?

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

You're talking with respect to the Southern Timber?

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

Yes. Yes.

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

Yes. No, I think this is necessarily a change in our methodology or things like that. It's matter of removals, and what we saw is we had lower stumpage due to wet weather. So it's really more of a factor of a sales process and what happened with the volumes. So we're able to keep our delivery crews running through the wet weather, and stumpage, some of those crews they had to move off and that's probably more of what you're seeing there. We have had a slight increase as we move through the years. We have moved more to deliver, but it's really very market specific. Each wood basket we think we get the most value, whether we would be selling stumpage are delivered, and so it's a combination of where the harvest are from and also that wet weather impacting stumpage removals.

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

Yes, I suspect, a part of that is driven by geographic mix, whereas, we intend to have more of a delivered model out of the Gulf States and more towards stumpage in the Atlantic region. Is that fair, Doug?

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

Yes, it's a combination, definitely. And one thing we may see going into Q4 is with the Hurricane Michael's impact and the salvage to be done, what we have seen stumpage crews move off of our estate to go do the salvage work. While the delivered crews, we've kept with them, so we have long-term contracts. So we could see that kind of be a considerable impact in Q4, but again, it's more a short-term thing that's happened.

Operator

Our next question comes from Charan Sanghera with RBC Capital Markets.

Charan Sanghera - *RBC Capital Markets, LLC, Research Division - Senior Associate*

A lot a good color this quarter. Just maybe a follow-up question on the export situation out the U.S. So is there any other markets you can divert to given the situation?

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

Yes. We're exploring other markets and we're aware that some other folks are sending to India, and we export to India from New Zealand. There's also folks exporting to the Middle East, Pakistan and other places like that. So we're evaluating those options as we go forward. But at this point in time, we spent a lot of effort to develop our network into China, and don't want to pull back on that right at this minute. So we're exploring those opportunities and looking how we can move some of that wood. But we do think that long term China has the largest opportunities for growth for us. And so we're focused on keeping our relationships with those customers at this time.

Charan Sanghera - *RBC Capital Markets, LLC, Research Division - Senior Associate*

Okay. And then just back to kind of the broader view on the U.S. housing market. Given you guys' involvement in development laid down, what you guys are seeing on the ground? Any talks with their customers there? Is there any kind of shift in near term sentiment?

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

This is Dave. I'll like that. I think, in general, we view this as sort of a continued, steady growth pattern on housing. I think overall, we expect housing starts to come in at roughly that 1.3 million level. I think it's key to remember that we've got some pretty strong markets in various regional areas. I know there has been a lot of media attention off late on through the housing market, "cooling" with the effect of rising interest rates and affordability. But it's also important to sort of look at a bigger picture there. And there has been about an 80-basis-point increase in mortgage rates, and we've seen about a 6% increase in median home prices. But don't forget there's also been a fair bit of noise around the housing stats associated with these 2 hurricanes as well as significant rainfall in Texas.

And the other thing that hasn't been sort of touched on as much is, there has been a pretty meaningful rise in median household income of about 5.6%. And so, you put all that together, and while affordability has ticked down slightly, it's still pretty healthy levels from a long-term perspective. And so I think the thing that we're most encouraged about, we certainly see that in our Wildlight project is strong growth in single-family. We've seen single-family grow by roughly 6% year-over-year. And we're continuing to see repair and remodel growth, which makes up about 40% of the lumber market, that's up by 7.5%. So I'd say, overall, we're generally pleased with how things are going.

And another thing to keep in mind is, there has been a fairly large influx of imported lumber outside of North America into this market to really capitalize on the spike in lumber prices that we saw earlier this year. And we don't see that necessarily occurring downstream. And as we see more of the Southern lumber capacity come online, it's going to push that flow of imports out as a short order effect. And so that's kind of our view in general, and in our mind, it really gets back to the theme I've touched on earlier is, for us, it's all about being in the best and strongest markets. We have a nice presence in the markets that feed both the Florida and Texas housing markets, both of which are very healthy. And once we get past the near-term noise associated with, whether it's hurricanes or rain events, we expect to see a nice response in those markets.

Charan Sanghera - *RBC Capital Markets, LLC, Research Division - Senior Associate*

All right. You touched a bit on affordability. Could you just refresh us on what kind of price points that you guys have for residential or -- so your customers have for residential in Wildlight?

Christopher T. Corr - *Rayonier Inc. - SVP of Real Estate & Public Affairs*

Hey, this is Chris. On average single-family sort of a right around $300,000. But there's a range, of course, down to the lower 2s and up in the 4s.

Operator

Next question comes from John Babcock with Bank of America Merrill Lynch.

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

Just wanted to follow-up. You talked a little bit about some of the uncertainty you're seeing in China and the impact that that's having on New Zealand. Can you just provide a little bit more color on that, generally if there are certain markets that have been impacted, the extent to which that impact has been felt? That sort of color.

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

I mean, what we talked about generally is that, I guess, last quarter, we talked about the noise around the trade tensions kind of causing some pullback in the market in New Zealand, which I think was a bit counterintuitive, because if you see lower trade flows from coming the U.S., the expectation will be that New Zealand would pick up. And that's in fact what's occurred during the course of Q3. So while prices ticked down in New Zealand in Q3, what we've said in the press release and on the call is that we've seen those prices rebound pretty nicely kind of towards the end of Q3 and in kind of what we're seeing so far in Q4.

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

i think, one thing is important also in that. During that time, we saw the Chinese yuan devalue and that impacted the pricing, but as demand has fallen below that level of comfort on the inventory ratio that Dave mentioned, we've seen the prices come back up, the yuan has recovered. So the demand has increased kind of the price that the person is willing to pay in China to get that same.

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

Okay. I guess, where I was getting with that was, whether or not you've actually seen from customers there in China with both kind of the growth that they're exhibiting that's sort all of it in the last quarter. And also just generally the tariffs overall seem to be having an impact. I was just wondering if you're seeing any end-market demand slowdown?

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

No, we haven't really. To-date, we've been very successful. As we mentioned before, we're looking to hit our volume targets for the year and the timing we had around exports in Q3, well, that as we saw some weaker markets at that point in time, and so we look to have some more volume in Q4. So to-date, we're planning on our export targets.

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

And then just -- just last question I had was just on acquisition strategy. I was wondering how that might change if you were to enter a downturn? And then also, what markets right now seem to be a good fit with your footprint? And also considering valuation, where you might target acquisitions?

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

Yes. I think this gets back to what I discussed earlier in terms of having a general bias towards higher quality properties. And I think that we have a point of view and you certainly see this in our investor materials that the lower quality markets have not been priced with as much of a discount as you might otherwise expect. And so I think as we -- as you move forward, if you were to get into a period where you did have our downturn, then it gets to what's your financial capacity and sort of where those opportunities are And I think this is an area where I think we're very well positioned. We have been organically delevering for the past few years. We have a pretty meaningful capacity right now from an incremental debt standpoint and we're going to just continue to be patient and stick with our strategy of going after higher quality property. It doesn't mean that we're not going to look at properties that are of lower quality, but they're going to have to be priced accordingly for us to go after them.

Operator

Our next question will come from Steve Chercover with Davidson.

Steven Pierre Chercover - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

A lot of my questions have really been answered, but I wanted to just drill into a couple of things. When you're referring to increasing your stake in New Zealand, I assume you're referring to the opportunistic incremental purchases you've done over the last several years?

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

Well, I think really what we were referring to, Steve, was when we did the recapitalization transaction, we effectively diluted our partner there down, so we increased our stake from 65% to 77% via that recapitalization transaction.

Steven Pierre Chercover - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Okay. And Stafford's privatization of Phaunos doesn't change your right of first refusal on their stake in Matariki, does it?

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

Well, to be clear, it's not a right of first refusal. It's a right of first offer, and suffice it to say that with the Phaunos acquisition, really largely being, it's not completed yet I believe, but it's essentially done, where Stafford has gotten over their 90% threshold to force the compulsory acquisition of the minority stake there. They'll effectively be our new partner in Matariki.

Steven Pierre Chercover - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Got it. Okay. And then do you have a sense of just how much acreage was impacted by Hurricane Michael and, therefore, will be subject to salvage?

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

I believe, Doug's got some stats on that.

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

Yes, I do. So I'll break these out for you a little bit, and then we can talk about how much capacity we salvaged. So the Florida Forest Service estimates that 2.8 million acres of forestland were moderately to catastrophically impacted by the hurricane with estimated timber losses of $1.3 billion. Approximately 350,000 acres are considered a complete loss and additional 1 million acres were severely damaged, meaning 75% of the timber will require salvage or clean up. And that's an estimated 32 millions tons of pine and 22 million tons of hardwood. So this is, obviously, a Herculean task. And of course, the work is on with...

The Georgia Forestry recently have -- still got a few more unfortunately, the Georgia Forestry Commission shows damage to more than 2 million acres of forest land impacted by the storm with an estimated term value of about $374 million and that's composed of around 11 million tons of pine and 7.7 million tons of hardwood. And there's about 379,000 acres that they also say are severely damaged or a complete loss.

And then Alabama, it was much smaller in that area, but they did also have some damage, and they're talking of roughly 50,000 acres that need to be salvaged. So obviously, it's a huge task in front of our folks. And impacts of the storm are hard to assess at this point. From what we've seen, a lot of it was snapped off due to the high winds and when that happens, from my experience, usually, those trees stand for a long time and then it gets to a certain point and they shake violently and the fibers separate before the tree snaps.

And so right in the eye, a lot of timber is going to be tough to make lumber out of and things like that. But as you get further away, you'll have more blowdown, and those are the ones that I think will be salvageable for lumber. And from what I'm currently hearing what we've seen before, landowners are mainly focused on those higher value logs. So well there may actually been increase of the sawlogs and a decrease of pulpwood production in the local markets for the first few months as folks chase that higher value, and that looks to be what we're seeing. And we've heard about some local sawmills, looking pretty wet decks to take on those logs. So the market impacts are going to be really hard to assess at this point in time. So we understand a little bit further what's going on.

We can see kind of the periphery markets around them have less supply as salvage crews move in that area. And as I mentioned, we could actually see a reduction in pulpwood to start with as folks are trying to capture those logs -- those high value logs. So it's a tricky situation.

The main question is how long would wood be recovered before it deteriorates? And we did a study looking back at the successful salvage efforts from Hurricane Hugo in 1989, which impacted about 4.5 million acres. And they were successful salvaging about 3 tons per acre with all said and done. So obviously, a lot of wood on the ground, but it's very difficult -- a lot of it's not recoverable because of the form it's in. And just as I mentioned, you're working against time, the issue this centers is that the logs should last for 6 months in the field over this winter time, in particular. And that's consistent with what the harvesting crews you've left us. They talked about what they're going to salvage and they'll be away for 6 months. That's not to say that they won't salvage more than 6 months, but we expect the main attempts by kind of these nonlocal crews, targeting those higher value products over that period of time.

So it's really difficult then to just assess when you have 4 million to 5 million acres that's on the ground. But unfortunately, kind of past experience shows that there'll be a flush of wood for a while and then that's going to slowdown, and a lot of it goes into how to deal with the aftermath. And that's been our own case when hurricanes hit us in '80s and '90s, we ended up going after higher value products and then have to do basically use bulldozers and chains and push down standing timber and burn it and get the site prepared and move forward. So it's really hard to assess right now, but that gives you a sense of the scale that the teams have to work for and work with.

So we expect that there'll be impacts on the local markets, and then there'll be impacts on those kind of periphery markets. But thankfully, we only had 200 acres of our salvage. So it's small on us directly, but we are watching. And that's why we've made the decision to pull back some volume in Q4 so we can assess this and see how it's going to impact these, both the local markets. And as I mentioned the interesting thing is, we've had 7 crews to-date and I don't know if another 3 to 5 that are considering leaving over here in the Atlantic coast to go do salvage. So the impact it could have on these markets as there are fewer crews producing for the local mills. So it's a very dynamic situation right now.

Steven Pierre Chercover - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

You mentioned burning it. Maybe that's the one thing that's different than back in the Hurricane Hugo era is the emergence of biomass. So maybe that's the long term destination for a lot of that blowdown. But I was also wondering between the hurricane and there's been recent articles about folks who were sent to plant trees 20, 30 years ago down in the South and the resultant oversupply. Do you think you can play into that and maybe sort of as a source of liquidity for folks who otherwise can't get out and, obviously, it will have to meet all you current thresholds?

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

Yes. I mean, look, we're well capitalized and we're always looking for opportunities, and if we see a dislocation in the market that we think is short term in nature, but we can capitalize on a long term opportunity, we'll certainly focus on that. I mean, the thing to keep in mind regarding these recent hurricanes, this is, like Doug said, a Herculean task to address all the salvage volume. But it will be relatively short term in nature. The longer term impact is there's a lot of timber that -- older timber that's kind of taken out of production. So you could see those markets be supply constrained on a longer term basis.

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

Steve, the other thing I'd add is the reference to the article around the conversation reserve program. Keep in mind that most of that was concentrated in poor markets, and so it's not really as much of an impact in the footprint that we operate in.

Operator

(Operator Instructions) We do have a question coming from Collin Mings with Raymond James.

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

Just one quick follow-up from me. Just going back to Steve's question and Doug's commentary. Just as you think about the movement in these logging crews and the salvage efforts, can you just clarify, do you expect that to impact volumes kind of looking out over the next at least few quarters or also cost? Are you having to pay a little bit more to retain some of the crews that you have as it relates to some of your deliberate log sales activity?

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

No. Primarily volume, and it's really the stumpage crews that are leaving that we see that impact on the volumes. With respect to costs, obviously, salvage cost costs more. And that's something that those crews maybe going over there. But locally, no, we're not seeing the impact of that having to pay to give the crews. It's very hard and very dangerous work to do this type of salvage. You have a lot of trees that are broken off and it's like pick up sticks crisscrossed and so that's the reason that costs go up for that salvage work over there. And -- but locally, we don't see the impact over here.

Operator

And we have no further questions at this time. I will hand the call back for closing.

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

Hi, this is Mark McHugh. Thanks, everybody, for joining the call today. And I look forward to catching up with some of you by phone later.

Operator

With that, we'll conclude today's conference. Thank you for your participation. You may disconnect your lines at this time.
