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RYN - Q2 2016 Rayonier Inc Earnings Call

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OVERVIEW:

Co. reported 2Q16 sales of $262m and net income of $110m or $0.89 per share.

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Welcome and thank you for joining Rayonier's second-quarter 2016 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 McHugh - *Rayonier Inc. - SVP & 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.

I would like to remind you that in these presentations we include forward-looking statements made pursuant to the Safe Harbor provisions of the 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 measures in our earnings release and supplemental materials.

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

Dave Nunes - *Rayonier Inc. - President & CEO*

I will make some overall comments before turning it back over to Mark to review our financial results. Then I will ask Doug Long, our Senior Vice President US Operations to comment on US timber results. I will discuss New Zealand timber results, and following the review of our timber segments, Chris Corr, Senior Vice President of Real Estate will discuss our real estate results.

For the second quarter, we reported pro forma net income of $9 million or $0.07 per share. In our Southern timber segment, following a very strong first quarter, timber volumes declined in line with our expectations, and average prices were modestly lower due primarily to geographic mix. In our Northwest timber segment, continued headwinds and export markets coupled with a reduction in local sawmill capacity resulted in lower volumes, although we saw a material improvement in price relative to Q1.

In our New Zealand timber segment, we reported a record quarter as the region continues to benefit from strong demand from China for Radiata pine logs, strong local markets, and reduced costs. As expected, our pro forma Real Estate segment results were relatively light this quarter due to the timing of anticipated closings, but we are expecting a strong second half of the year based on our current pipeline of transactions.

Overall, we're pleased with our results. While we continue to experience a slower than anticipated recovery in US sawlog prices, the high quality and diversity of our portfolio allowed us to achieve a solid quarter that puts us well on pace to achieve our prior full-year adjusted EBITDA guidance.

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

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Thanks, Dave. Let's start on page 5 with our financial highlights. Sales for the quarter totaled $262 million while operating income was $122 million, and net income was $110 million or $0.89 per share. Pro forma net income was $9 million or $0.07 per share. Pro forma items this quarter included $600,000 of costs related to shareholder litigation, and a $101 million gain from a large disposition.

Second-quarter adjusted EBITDA of $45 million was below last quarter primarily due to lower volumes in our Southern and Pacific Northwest timber segments. This decline in volumes was expected as we experienced extraordinary high volumes in Q1 due to accelerated stumpage removals in the US South, as discussed last quarter.

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 six months was $57 million compared to $54 million in the prior-year period, primarily due to higher adjusted EBITDA. A reconciliation of CAD to cash provided by operating activities and other GAAP measures is provided on page 9 of the financial supplement.

We closed the quarter with $130 million of cash and roughly $1.05 billion of debt. Our quarter-end debt balance reflects the incremental term loan that we closed in the second quarter, which was used to fund the Menasha acquisition. At quarter end our net debt of $923 million represented 22% of our enterprise value based on our closing stock price on June 30.

During the quarter, we entered into a $100 million interest rate swap to fix the rate on the remaining portion of our $300 million incremental term loan. With this swap in place, we have now fixed the rate on all of our term loan debt and roughly 98% of our total debt.

Overall, taking account of estimated patronage payments and interest rate swaps, our debt balances have a weighted average interest rate of 3.3% and a weighted average maturity of about 7.5 years. We're very pleased with our current capital structure and believe it positions us well for the future.

I'll now turn the call back -- over to Doug to review US timber results.

Douglas Long - *Rayonier Inc. - SVP, US Operations*

Thanks, Mark. Good morning. Let's start on page 10 with the Southern Timber segment. Adjusted EBITDA in the second quarter of $22 million was $11 million unfavorable to first quarter, and $3 million unfavorable to the same period in the prior year, due primarily to decreased volume. As communicated on our last call, we fully expected a decrease in volume following the extraordinarily high level production in the first quarter. In addition, we experienced significant rainfall in the Southwest which caused several interruptions in harvest activity in that region.

Pine pulpwood prices of $18.31 per ton in the second quarter were 3% below the first quarter and 4% below the same period in the prior year. This modest reduction in pricing was largely due to geographic mix, as well as the inclusion of some salvage volumes and additional thinning sales in the quarter.

Pine period prices of $27 per ton in the second quarter were essentially flat to the first quarter and 1% below the same period in the prior year. Overall, sawtimber pricing has been relatively flat during the year, with period differences larger attributable to geographic mix.

Now moving to the Pacific Northwest timber segment on page 11, adjusted EBITDA in the second quarter of $4.8 million was $1.2 million unfavorable compared to the first quarter, due primarily to a 19% reduction in volume in response to soft market conditions. Favorable sawtimber prices in the second quarter compared to the first quarter helped to partially offset the reduced volume. The average sawtimber price of $74.54 per ton was 10% higher than the first quarter due to a higher mix of Douglas fir, plus the introduction of higher-priced sawtimber from our new Oregon acquisition, where harvesting began in June. Initial product prices for our new Oregon markets have been in line with our expectations.

Compared with the prior year quarter, adjusted EBITDA of $4.8 million was $200,000 favorable primarily due to a 7% increase in volumes. Partially offsetting the increase in volume were lower pulp and sawtimber prices, which were 1% and 3% respectively versus the prior quarter.

Now Dave will review New Zealand timber results. Dave?

Dave Nunes - *Rayonier Inc. - President & CEO*

Thanks Doug. Page 12 shows the results and key operating metrics for our New Zealand timber segment. Overall, we're very pleased with the performance of our New Zealand timber segment, which experienced its strongest quarter to-date since we began consolidating the JV into our financial results in 2013.

Compared to the prior year quarter, adjusted EBITDA increased to $16 million from $6 million on the strength of higher domestic and export product prices, as well as volumes that were 7% higher relative to the prior-year quarter. Export prices increased 13% compared to the prior-year quarter due to increased demand for Radiata pine logs from China, while domestic prices increased 7% in US Dollar terms compared to the prior-year quarter as a result of strong local demand for construction material.

While we anticipate some minor seasonal price declines in China in the third quarter, we believe export log prices will remain relatively stable over the balance of the year, as current softwood log inventories in China are just under 3 million cubic meters or roughly 1.6 months of demand. New Zealand also continues to benefit from favorable freight costs due to low oil prices and ample shipping capacity.

In our trading segment, sales volumes were 37% higher compared to the prior-year period while, average prices increased 11%. The increase in both volume and price was primarily due to stronger demand from China.

I will now turn it over to Chris to cover real estate.

Christopher Corr - *Rayonier Inc. - SVP, Real Estate and Public Affairs*

Thanks Dave. Moving on to page 13, sales from the real estate segment in the second quarter totaled $137 million on roughly 58,000 acres sold. Excluding the large disposition of 55,000 acres in Washington, sales in our core real estate business were relatively light, totaling $8 million on 2900 acres sold. As discussed last quarter these lower results for the second quarter were expected based on the timing of anticipated closings for the year.

In the rural category, sales totaled $7 million on approximately 2700 acres, at an average price of $2711 per acre. This includes a single sale in Texas of almost 900 acres at $3100 per acre. In the non-strategic and Timberland category, sales totaled $500,000 and 252 acres at an average price of $2161 per acre.

Looking ahead, we expect the remainder of the year to be dominated by a few larger HBU opportunities that are currently in our pipeline. We are still solidly on track to achieve our full-year guidance and expect a comparatively strong third quarter.

Overall, we remain highly focused on unlocking the value of our HBU development and rural properties. Specifically, early infrastructure investments in our Wildlight project north of Jacksonville are proceeding on plan, and we are encouraged by the market interest that we are seeing there.

The Wildlight Elementary School broke ground this spring and our new Rayonier office building is also well underway. We look forward to reporting on the progress of this project in the quarters ahead.

I'll now turn the call back over to Mark.

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Thanks, Chris. As we look into the second half of the year, we anticipate continued strength in New Zealand export and domestic markets, and improved real estate results due to a strong pipeline of closings. Based on our year-to-date results and our outlook for the second half of the year, we expect that we will comfortably achieve our prior full year of adjusted EBITDA guidance of $195 million to $215 million.

As a reminder, due to depletion pulling with respect to the Menasha acquisition that closed in the second quarter, we expect that the per-ton depletion rate in the Pacific Northwest segment will roughly double in the second half of the year, which will drive approximately $10 million of incremental depletion expense relative to our original guidance. With respect to real estate activity, despite a comparatively light first half of the year, we still expect to achieve our full-year adjusted EBITDA guidance for this segment, with Q3 anticipated to be the strongest quarter of the year based on our current pipeline of closings.

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

Dave Nunes - *Rayonier Inc. - President & CEO*

Thanks, Mark. Concurrent with our first-quarter earnings release we announced a series of strategic and financial transactions that repositioned our Pacific Northwest portfolio, and established a strong capital structure to support future growth. We are very pleased to have closed these transactions during the second quarter, and proud of the tireless efforts of our team to integrate the newly acquired Menasha properties into our Pacific Northwest operations.

In addition to the many portfolio moves we've made over the past two years, we've undertaken initiatives to streamline our operations and improve decision-making. We're pleased with the progress we've made to-date in improving on the ground operational execution across our business units, and believe we are starting to see some of this progress in our strong year-to-date performance. We are solidly on track to achieve our full-year adjusted EBITDA guidance for 2016, and we are optimistic about our outlook for 2017 and beyond.

As we've stated in the past, capital allocation will continue to be a chief priority for our board and senior leadership team. We are confident that the moves we've made to-date will contribute to long-term value creation for our shareholders, and we look forward to continuing to evaluate all opportunities to enhance shareholder value through prudent, disciplined and flexible capital allocation.

Lastly, I'd also like to remind you we will be hosting an Investor Day in Amelia Island, Florida, on Wednesday and Thursday, November 9 and 10. We look forward to showcasing portions of our Southeast Timberland portfolio, introducing you to more of our team of timber and real estate professionals, and introducing the work we are doing at Wildlight to unlock value in our land portfolio. We will be contacting you soon with more information on this event.

I would like to now close the formal part of the presentation and will turn the call back to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Chip Dillon, Vertical Research Partners.

Chip Dillon - *Vertical Research Partners - Analyst*

Good morning, guys.

Dave Nunes - *Rayonier Inc. - President & CEO*

Good morning.

Chip Dillon - *Vertical Research Partners - Analyst*

First question is on the Pacific Northwest segment volumes, if you could just review for us the impact -- you mentioned the $10 million depletion impact in half the year from the acquisition of Menasha. What kind of volume impact should we expect there?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Last quarter we had indicated that relative to our prior guidance of 1.2 million tons for the year that we anticipated the Menasha, the combination of the Menasha acquisition, the Washington disposition would revise our volume guidance to 1.3 million tons per year. We haven't changed that guidance.

Chip Dillon - *Vertical Research Partners - Analyst*

Okay. And as we think about -- let's make sure I get this right, so, year-to-date, I'm just looking at your slide here. You are at about 600,000, so the way you think about it is, it would have about a 700,000 ton impact. So, it's basically 200,000 ton a year increase?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Yes. Really that was the guidance for, just for 2016. We could go back -- I could walk you back through some of the guidance we gave longer-term. Again it was different relative to our outlook for the next five years versus long-term sustainable yield.

Chip Dillon - *Vertical Research Partners - Analyst*

That's okay. I'm sure we can go back and see that. That's fine. And then if you could talk a little bit about what's going on with China? That sounds great that you are seeing a boost there.

Is that something that is -- that is surprising to you versus say six months ago, five months ago? And do you think it's sort of a sugar high, maybe government spending-induced demand? Or do you think there is something more sustainable there?

Dave Nunes - *Rayonier Inc. - President & CEO*

I would say it's a mix. If you break down -- if you break down the market there is a couple of things going on.

First of all, and there's both some demand elements and some supply elements. On the supply side, there historically has been a fairly decent volume of softwood harvest in the northeastern part of China adjacent to the Russian border. And that's an area that's been widely reported as having suffered over harvesting, and they really ratcheted the harvesting back on that rather dramatically. And that, historically, has fed into domestic processing of both saw and timber and plywood.

So, while the construction market is down, and that's what I think a lot of press coverage gets done, certainly, as it relates to US exports -- as the domestic new construction has come down, so too has the supply and it somewhat offset that. The other important thing to recognize is the fit out market is a big part of the market for Radiata pine. That really ties to the inventory of completed apartments. There still is a large inventory of those.

That feeds for us the plywood sector, where over 30% of Radiata goes into plywood. I think that's the piece that's probably, as expected, has continued to be strong.

As we saw a limited build in inventory around the Chinese New Year, we expected that that would translate into a stronger pricing. So, there's certainly -- we continue to expect strong performance.

I think the other factor to keep in mind is that you've got, freight rates have played a big role. Freight rates have come up a little bit recently but they are still down considerably from the past. That's been driven both by oil pricing, as well as availability of ships. And so you put all that together and it worked out to be a very strong quarter for us in New Zealand.

Chip Dillon - *Vertical Research Partners - Analyst*

Got you. And then just a follow-up, quick one for Mark. You've obviously done a lot of work to get the debt totally fixed, I guess, you're 98% fixed. Some people would say, rates may go negative, what are you doing? I would take the opposite view. I think it's admirable.

You mentioned the 7-year -- 7.5-year average maturity. Any potential in the next 12 months to 24 months to extend that maturity? Especially if finance rates stay where they are?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Yes, we're pretty comfortable with our maturity profile. Really, we have three primary tranches of debt now. We have the two Farm Credit term loans, one of which expires in 2026. The other one is 2024.

And then we have the notes outstanding that mature in 2022. We've really got a nicely stacked maturity profile with really, our major maturities in 2022, 2024 and 2026. Probably not much of an opportunity to extend it much beyond that but we feel good about where we stand.

Chip Dillon - *Vertical Research Partners - Analyst*

Okay. Last quick question. I know you guys have a little bit of land, I think in Arkansas. Not a lot but, obviously, you do benefit from the pellet plants going in there. Is it a major factor one way or the other whether or not the announced pulp mill actually gets built?

Douglas Long - *Rayonier Inc. - SVP, US Operations*

This is Doug. You are right. We have a few timber needs in the Arkansas area but not much of our states in -- Really, where that pulp mill is going to be located at, it wouldn't have much impact on us. It would be a good thing if something were to happen, but we are not counting on that. Those timber deeds expire in the next two years, so by the time a pulp mill was built we probably wouldn't realize much impact.

Chip Dillon - *Vertical Research Partners - Analyst*

Okay, thank you.

Operator

Mark Wilde, BMO.

Mark Wilde - *BMO Capital Markets - Analyst*

Good morning.

Dave Nunes - *Rayonier Inc. - President & CEO*

Good morning, Mark.

Mark Wilde - *BMO Capital Markets - Analyst*

Dave, I wondered just if you could share some thoughts with us on this US Canadian lumber trade case and the impact to Rayonier. Have you done any kind of work in terms of sensitivities on increased demand in the southern US or increased lumber prices?

Dave Nunes - *Rayonier Inc. - President & CEO*

Yes, I mean, we're monitoring it. I think like a lot of people, there's -- we've noted the higher volumes of wood coming in from Canada this year into the US market, and you certainly see that when you look at operating rates of mills.

I think that, given that we're not a lumber producer, we have a little bit more of an indirect bearing on this issue. I think that we certainly expect to see some impact with duties once the one-year time frame has come up.

And we still kind of look more in a longer-term sense that as you see housing, as you see housing pick back up you are going to have to rely more on Southern capacity too meet that. And so we've really been positioning ourselves more for some of those midterm type price improvements where we expect to see more of that elasticity.

I don't know Doug, if you want to add anything more from your perspective?

Douglas Long - *Rayonier Inc. - SVP, US Operations*

I would agree with you. We have seen quite a bit of wood as everyone knows, flowing down from Canada. That's kind of had -- our domestic sawmill customers in particular approach the market very cautiously. It's kept the headwinds on sawlog pricing. Kind of as Dave said, as we look at things, we could see potentially some more wood flowing in over the next quarter but over the long run, I think Dave hit the nail on the head, we are looking further out at the recovery and let things happen.

We continuously evaluate our markets and seek to optimize the shareholder value by adjusting harvest either up or down to match market conditions. We're watching it very closely and it's just something that we have to keep a constant eye to and evaluate as we go forward.

Mark Wilde - *BMO Capital Markets - Analyst*

Okay. And then, Dave you've been there about two years now. I wonder as you've gotten more familiar with the Rayonier portfolio, whether you've seen more opportunities or whether there's been any kind of change in your view about where opportunities exist within the portfolio, whether it's for higher and better use, or rural land sales or whatever?

Dave Nunes - *Rayonier Inc. - President & CEO*

Yes, and you're right, I just passed my two year mark, and it's still a learning process, I think, to some degree getting a full understanding of markets and portfolios. But I continue to be pleased with the overall quality and diversification of the portfolio. And I think this quarter is a great example of that.

New Zealand really came through for us, and it's a great example of being in strong softwood growing markets, and having diversity of markets. And so, that proved out.

I think as we look at our Timberland portfolio, were focused a lot on looking at near-term and midterm growth and drains dynamics to see where we've got markets that we'd like to add assets to, as well as areas where we may want to shrink our footprint. I think that our team has done a very good job, and disciplined job of really understanding where we have good markets to enter.

I think the Menasha acquisition is a great example of that. That was a deal that introduced us to some very strong domestic markets in Oregon, and it diversified our species mix to a heavier mix of Douglas fir. And from a portfolio standpoint, you couldn't ask for much more. So, we are pleased with that.

As it relates to your part of the question on HBU, I think, again, we have a pretty good model there. Under the leadership of Doug and Chris, our teams are working very well together in identifying properties that make sense to sell.

I think one of the things we have done maybe differently from the past is, we've focused more on some of the qualitative attributes of properties that we're looking to sell, and, specifically, looking for properties that are below average quality from a timber standpoint, but that might offer some HBU opportunity and getting those out of the portfolio to improve the quality of the Timberland portfolio through subtraction. We've done that on a lot of small sales, and we are happy with some of that change.

But I think we have a good model, and were starting off, I think, with a really strong portfolio. And now the emphasis is really to continue to make it better.

Mark Wilde - *BMO Capital Markets - Analyst*

Okay, I will turn it over. Thanks, Dave.

Operator

Collin Mings, Raymond James. Your line is now open.

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

Good morning, guys. You touched on your sawlog pricing in the US South being negatively impacted by the mix in the quarter. Can you maybe expand on this? Maybe given some of the data out there indicating that there was a year-over-year downticket pricing in Q2, walk us through some of the different variances you're seeing across your different wood baskets in the south?

Douglas Long - *Rayonier Inc. - SVP, US Operations*

This is Doug, I'll go ahead and take a swing at that for you. As we've talked about relatively across the South, we've seen things fairly on even trends. But what we did have for ourselves in this past quarter, due to a lot of the wet weather that happens quickly in the Texas markets and things like that, our production of sawtimber in that area when significantly down. Particularly in our larger [ply-log sized] of things. That's kind of what the geography mix had as issue for us there.

Overall, on pricing, as we said, we really haven't seen any major changes for the sawlog or chip and saw price today. They have been kind of hanging out here. As I mentioned before, due to that SLA agreement and what's going on, folks have been very cautious about how they're going to approach things. So we've seen things pretty much just moderated and standing at the current pricing.

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

Okay. And then from the different wood baskets perspective, no part of your footprint in the US ops that you're seeing relatively better trends in right now?

Douglas Long - *Rayonier Inc. - SVP, US Operations*

Oh in sawtimber? No, not particularly. It's been fairly constant across the board. Really what's driven our things is just that wet weather created a difference in mix harvest for us. And so we had extensively less sawtimber coming out of that Texas, Louisiana market.

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

Okay. And then, I think going back to Mark's question, just as far as everyone started the year pretty upbeat that there would be more deal flow in the Timberland space. Maybe update us on what you are seeing as far as opportunities Dave, can you maybe recycle some more capital? And then going back to the portfolio refinement question, is there anything maybe on the scale of what you did with FIA that you're actually looking to maybe sell or dispose of to free up some more capital right now?

Dave Nunes - *Rayonier Inc. - President & CEO*

We generally aren't going to get too specific on active M&A discussions, whether it's on the sell side or the buy side. I'd say that generally, this year has played out consistent with what we thought it would. It has been a very strong year from a deal flow standpoint in all of the geographies that we work in, and our team has been extremely busy looking at a number of different properties to add to the portfolio.

I think that this is where -- this is where the discipline in kind of understanding what you want comes into play. And we've been pretty careful to make sure that the things that were adding, we're adding for the right reasons.

We've been looking at things like, in that Western acquisition, areas to even out our age class distribution, cash flow, the cash flow attributes of properties are also very important. And as I said, we put a lot of effort into understanding growth drain dynamics as we look at opportunities. I think one of the things about the heavy deal flows is, it's allowed us to be a lot more selective than you might be in other years and pickier about the types of things that we really go after.

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

Okay. And then one last one and I will turn it over. Just going back to, Dave, your comments as well as Chip's questions. The difference in trends you are seeing as far as the export markets as it relates to the Pacific Northwest versus the strength that you're seeing in New Zealand, is that driven, just to clarify, more driven by type of demand that you are seeing out of China for a particular species? Or is it a function of some of the currency and shipping rate dynamics you talked about?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think it's both. And recognize, again, China, in a real broad brush sense the China market has two primary markets. There's the new construction market, and the fit out market. And the Pacific Northwest tends to compete more heavily in the new construction market. And so, that's -- and that's generally been a negative because that market has declined some. Then I think the other factor that you have is the currency has made imported lumber a lot more competitive out both Canada as well as Russia.

So, that's one of the reasons that you see a divergent behavior in terms of export markets between the Northwest and New Zealand; whereas New Zealand, as I said earlier, has a much heavier reliance on plywood and that fit out market. And it competes also in some slightly different geographic markets within China. Again, it really gets back to that diversity comment that we made earlier. China is a very good place and it's got very, very different markets, and so the Northwest and New Zealand really compete differently.

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

Great. Appreciate the extra color, Dave. I'll turn it over.

Operator

Thank you. Paul Quinn, RBC Capital Markets. Your line is now open.

Paul Quinn - *RBC Capital Markets - Analyst*

Thanks very much, and good morning gentlemen.

Dave Nunes - *Rayonier Inc. - President & CEO*

Morning, Paul.

Paul Quinn - *RBC Capital Markets - Analyst*

Thought I'd ask a couple of easy questions. On the real estate guidance, I guess the guidance on sales remains at $70 million to $80 million for the year, and I guess you're just over $21 million year to date which suggests the back half is somewhere around $55 million? How would you split that between Q3 and Q4? Is that 60% Q3, 40% Q4?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Yes, I mean the guidance we are giving is, relative, kind of looking at the quarter-over-quarter trend. We are expecting Q3 will be the heaviest of the year.

Paul Quinn - *RBC Capital Markets - Analyst*

Okay and --

Mark McHugh - *Rayonier Inc. - SVP & CFO*

We try not to give too much precision around this, Paul, just because this is heavily driven by timing of closings, and whether deals tips on one side of $930,000 or not can drive that. Though we try not to get overly specific, but we do expect Q3, if you kind of just stack up the quarters and you've got sort of two in the bag, that Q3 will be the heaviest of the year.

Paul Quinn - *RBC Capital Markets - Analyst*

Okay. And then on this issue of soft Pacific Northwest but strong New Zealand on the log side, does that -- and the idea that Pacific Northwest goes more into new construction and New Zealand, the Radiata goes more into the fit out markets, does that suggest that Chinese new construction is slowing and that's going to hurt your fit out demand down the road? Or is that, Q3 is going to be reasonable and then Q4 you might see a slowdown?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think our understanding is there is still a pretty large inventory of apartments, that ties into that fit out market. It's obviously differential city by city. But we don't expect -- we expect that, that's going to keep that fit out market busy for some time.

And then the other thing on the new construction is, keep in mind that while the activity is down, so too us that domestic supply, which has been a competition for imports. And so, while you've seen that new construction activity come down, that reduction in supply has had an offsetting effect.

Paul Quinn - *RBC Capital Markets - Analyst*

Okay. And just a follow-up on that. Just the reduction in Chinese supply, has that been offset by the increased Russian imports?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think Russia has certainly participated in it. Russia's issues are really around infrastructure.

Right now it's an interplay between a currency that's in their favor, and poor infrastructure which is not. And so, Russia, we continue to believe that Russia does not have a strong ability to overwhelm that market, but they are certainly a meaningful contributor both on the log and lumber side.

Paul Quinn - *RBC Capital Markets - Analyst*

All right. That's all I had. Best of luck going forward.

Dave Nunes - *Rayonier Inc. - President & CEO*

Thanks.

Operator

Mark Weintraub, Buckingham Research.

Mark Weintraub - *Buckingham Research Group - Analyst*

I think through the first four months of this year, lumber production in the US was actually flat, all of the increase was in Canada? Did you either have data as to what's happened in the more recent months and/or just a view from what you are seeing from the field, as to whether or not that continues to be the case?

Douglas Long - *Rayonier Inc. - SVP, US Operations*

Mark, this is Doug again. I don't have data for that but the field intelligence we've had is it's been a similar trend, basically. As I mentioned before, the domestic mills have been very cautious, there has been more and more wood coming across from Canada. We've seen production definitely at reduced capacities from what those mills were able to produce at.

Dave Nunes - *Rayonier Inc. - President & CEO*

And you see that, Mark, in some of the published operating rates of mills in Canada versus either the US South or the Pacific Northwest.

Mark Weintraub - *Buckingham Research Group - Analyst*

Interesting the lumber prices still have, even though production hasn't moved that much it would seem, in the US, prices have been going up. And, typically, their tends to be a relationship to sawtimber maybe after a lag with lumber.

Any color, any thoughts as to whether that will resume? Or whether, because of maybe more standing inventory on the ground, it's going to play out a bit differently than we have normally seen?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think we got a few things going on there. You are right in the sense that lumber prices are stronger than some of that kind of underlying factors. I think you have a couple of things going on.

One, we've seen stronger repair and remodel activity. And two, we've seen a modest increase in the proportion of single-family starts. And so, those have been positive.

As it relates to the broader question around sawtimber, I think it really gets to geographic specifics, and one of the things that we try to look at in our most recent investor deck is the differential growth in the inventory across the South. We looked at Timber Mart-South data, and, essentially created a build in inventory by the Timber Mart-South regions. You can see, just like pricing behavior, that build in inventory has been very differential, and I think that leads to differential pricing behavior and it certainly has had, I think an impact both in sawtimber pricing and, as well as how we see the growth/drain dynamics playing out over the next few years.

Mark Weintraub - *Buckingham Research Group - Analyst*

Just to confirm, because that really is exactly what I was trying to get my arms around. I do think in answer to a prior question you suggested there wasn't, at least currently, much differential you were seeing in the US South from one local market to the next. Was that accurate?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think some of that statement was our own portfolio. And I think that we have -- we're fortunate in that we're located in, I think, some generally stronger areas. But if you look across the broader US South portfolio, you look at the data that we had provided, you do have some regions that had quite a bit more inventory build. I think you're going to see different pricing in those geographies.

So, again, our comments were really more in terms of our own pricing around the markets that we are in. But we're not in all of the markets.

Mark Weintraub - *Buckingham Research Group - Analyst*

Okay, thank you.

Operator

Thank you. Our next question is from George Staphos, Bank of America Merrill Lynch. Your line is now open sir.

George Staphos - *BofA Merrill Lynch - Analyst*

Good morning. Appreciate all of the details and taking my questions. Maybe last question for me on the Pacific Northwest versus New Zealand questions that were discussed earlier.

Is there a species in the Northwest that would compete against Radiata pine? Would hemlock do well in the fit out markets? Trying to get a sense -- recognizing that currency is a factor here as well, if there is anything we could supply into that market longer term?

Dave Nunes - *Rayonier Inc. - President & CEO*

I think their certainly is overlap and all these markets. I don't mean it to be sort of very black and white but, hemlock and Douglas fir tend to have slightly better structural characteristics than Radiata, and so they naturally flow more into the solid-sawn products, whereas Radiata is an ideal species for plywood. And that's probably the main -- that's probably the main difference.

George Staphos - *BofA Merrill Lynch - Analyst*

Okay.

Dave Nunes - *Rayonier Inc. - President & CEO*

I think in solid-sawn woods you're going to see some overlap of the various species, but I think that plywood difference is probably the thing to keep in mind the most.

George Staphos - *BofA Merrill Lynch - Analyst*

You need kind of a lighter wood I guess, is that right David?

Dave Nunes - *Rayonier Inc. - President & CEO*

It's not that it's lighter, it's better suited to that market. Or put another way, it's less well-suited to the heavier structural demands of solid-sawn wood, of larger cut solid-sawn wood.

George Staphos - *BofA Merrill Lynch - Analyst*

Okay. Thanks for that. The next question I had, you talked about Southern prices being down from a mix standpoint, and you gave us a lot of detail around that and we appreciate it. To the extent that availability improves, do you think that, that's going to put further downward pressure on pricing? Will there be some sort of offset to that additional supply on price as we look out to third quarter and fourth quarter in the South on saw logs?

Dave Nunes - *Rayonier Inc. - President & CEO*

To some extent, you have too really get back to the fact that you're dealing with a lot of micro markets. And so, it's going to be market by market based. This really gets back to what I was talking about earlier with Mark Weintraub's question on looking across the South at where we see build in inventory.

George Staphos - *BofA Merrill Lynch - Analyst*

Okay. So, at this juncture, it's indeterminate and it is going to be market by market. It doesn't sound like you'd be expecting much the way of inflation over the rest of the year though in the South and sawtimber. Would that be fair?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

That's right George, we're guiding to relatively flat prices through the balance of the year, and part of that again is driven by the SLA lumber agreement and the uncertainty around that, the behavior mills going into that.

Dave Nunes - *Rayonier Inc. - President & CEO*

You also see that, George in some of the recent data on permits, generally, trailing some of the earlier projections around housing starts for the year. I think that this is shaping up to be yet another year where housing starts are kind of moving along at a fairly modest improvement relative to the past.

George Staphos - *BofA Merrill Lynch - Analyst*

Understood. A couple of last ones and I'll turn it over, and I'll ask them in sequence here for time efficiency.

One, your land values in real estate were actually quite good relative to what have we plugged into our model. You mentioned I think you sold 9000 acres in Texas and I think the price was around $3000 an acre, if you can comment a bit on what the attributes of that land were? If you had previously, I missed it. That's number one.

Number two, if I look at the Southern results that you've posted, just curious why there was a bigger negative effect on EBITDA from volume mix than that which you showed on the revenue line? If I'm reading it correctly, for the South.

And then, lastly, at 3 million cubic meters, is that a level of inventory in China that gets you sufficient pricing tension? A quarter or two down the road where should we begin to worry if there is a threshold of inventory in the log decks in China that you would guide us to? Thank you, guys and, good luck in the quarter.

Christopher Corr - *Rayonier Inc. - SVP, Real Estate and Public Affairs*

George, to answer the first question, related to the Texas deal, it was actually 900 acres, not 9000 in both places.

George Staphos - *BofA Merrill Lynch - Analyst*

Sorry. I misspoke.

Christopher Corr - *Rayonier Inc. - SVP, Real Estate and Public Affairs*

$3100 an acre. Good pricing. It's in Texas, north of Houston. So, the attributes in terms of value is that this is good ranch land, rural recreation land.

The buyer was unsolicited and their intent is to use it for their own recreational purposes so, it's just about that, in Texas where sometimes wealth is counted in acres we get strong buyers like this. That's the story on that one.

Mark McHugh - *Rayonier Inc. - SVP & CFO*

George, this is Mark. I wasn't clear on the second question, it was in relation to the volume impact on EBITDA?

George Staphos - *BofA Merrill Lynch - Analyst*

Yes. If I understood it correctly, it looked like you had $1 million effect on EBIT in the South from volume. On EBITDA it was more like $2.2 million. Just curious why that was the case. Not trying to be pedantic there, just of more of a nit type of question.

The last one was on log decks in China.

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Yes, probably just had to do -- I'd need to follow up on that to get into the detail, but it probably just has to do with differential on depletion rates in different geographies.

Dave Nunes - *Rayonier Inc. - President & CEO*

Yes if we are comparing Q1 to Q2 or Q --

George Staphos - *BofA Merrill Lynch - Analyst*

I think it's your year on year chart in Q2.

Dave Nunes - *Rayonier Inc. - President & CEO*

Okay.

George Staphos - *BofA Merrill Lynch - Analyst*

We can follow-up. I don't want to take away from the call.

The last thing on the log decks?

Dave Nunes - *Rayonier Inc. - President & CEO*

Yes, recognize that the inventory figures in China really are a compilation of many, many different ports. I think the key is not just the total, but the key is really what that translates to in terms of months of supply. And we generally feel that anything under two months of demand, excuse me, is going to translate to stable pricing.

And if you get below, we feel like if you get below 1.3 months of demand then you are going to see really strong pricing. We're sitting right now at about 1.6, sort of right in the middle of that range. And so, we generally feel that, historically, that has tended to support fairly stable pricing.

And so that's what really gives us the confidence to make comments that we see the second half of the year being relatively stable. So, the total volume is important but it's also really important to understand some of those demand characteristics and what that ratio looks like.

George Staphos - *BofA Merrill Lynch - Analyst*

Thank you for all of the color, and also the great supplemental pack. I will turn it over. Good luck in the quarter.

Dave Nunes - *Rayonier Inc. - President & CEO*

Thanks.

Operator

We have another question from Daniel Rohr, Morningstar Inc. Your line is now open.

Daniel Rohr - *Morningstar - Analyst*

Good morning. You mentioned the diversity of end markets in China, with the Pacific Northwest being tied to new construction and New Zealand tied more to the fit out market. Very, very helpful stuff. Just wanted to dig into that a little bit more.

When I look at the data through June, residential floor space starts in China are up 14% year to date, which is pretty much the same rate we were running at in the first quarter. So, my question is, how much lag we traditionally see between real estate starts and associated with demand?

Dave Nunes - *Rayonier Inc. - President & CEO*

That's a hard one, Dan. I don't have a sense of where that translates.

Daniel Rohr - *Morningstar - Analyst*

Okay.

Dave Nunes - *Rayonier Inc. - President & CEO*

Keep in mind, it's not just -- with the solid-sawn wood, it's not just residential starts as much as it is just broader infrastructure development.

Daniel Rohr - *Morningstar - Analyst*

Okay.

Dave Nunes - *Rayonier Inc. - President & CEO*

Keeping in mind that a lot of that sawn wood is used for concrete forms.

Daniel Rohr - *Morningstar - Analyst*

I guess my theory was that possibly some of the type of demand we are seeing for Pacific Northwest logs might be attributable to what we are seeing in Chinese industrial production and associated pallet demand. I don't know if pallets are a major end-use for what you guys are shipping out of the Pacific Northwest?

Dave Nunes - *Rayonier Inc. - President & CEO*

No, that's too low value a product. You'll see maybe more of that in other sort of off species. I think the Northwest has probably had, a fair bit of this has probably been tied to currency as well.

Daniel Rohr - *Morningstar - Analyst*

Okay, okay. All right, thank you very much.

Dave Nunes - *Rayonier Inc. - President & CEO*

Thank you.

Operator

(Operator Instructions)

We have a follow-up question from Chip Dillon, Vertical Research Partners. Your line is now open, sir.

Chip Dillon - *Vertical Research Partners - Analyst*

I just had a general question about, you gave a great slide on your M&A, acquisitions strategy. Or Timberland acquisition strategy. When you look at today's interest rate environment, if you were to debt-finance Timberland, sort of at some of the asking prices you are seeing in areas that might be of interest to you, would you say the spread looks good to you? Or it's not very favorable? How do you sort of compare the cap rates and the returns you are seeing with the financing costs?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

We continue to think that in the M&A market the going rate from a DCF, a discount rate standpoint, is in probably the 5% to 5.5% range, 5% to 5.5% real, which would be net of inflation. The deals I would say that we're more focused on tend to be deals that are delivering the majority of that, or the vast majority of that in cash flow. And so, we are frequently are looking at deals that have relatively strong cash yields relative to that discount rate.

Certainly, with where we are able to finance and the debt markets today, there's a pretty healthy spread. Call it 200 to 300 basis points to our debt financing rates.

Dave Nunes - *Rayonier Inc. - President & CEO*

But certainly, to your question, in an all debt-financed transaction, it's going to impact that maturity profile of properties that you go after.

Chip Dillon - *Vertical Research Partners - Analyst*

Got you. Meaning that, the way you would finance it would be some of the function of how you see the timber harvest slowing?

Dave Nunes - *Rayonier Inc. - President & CEO*

Right.

Chip Dillon - *Vertical Research Partners - Analyst*

I see.

Dave Nunes - *Rayonier Inc. - President & CEO*

It's got to be able to cover that debt load.

Chip Dillon - *Vertical Research Partners - Analyst*

Yes. Understood.

Mark McHugh - *Rayonier Inc. - SVP & CFO*

We really look at that in a portfolio sense and not on a deal-by-deal basis.

Chip Dillon - *Vertical Research Partners - Analyst*

I see. Thank you.

Operator

Thank you. We have another follow-up question from Mark Wilde, BMO.

Mark Wilde - *BMO Capital Markets - Analyst*

I think you might have answered a big part of my question when you answered Chip's. I was just curious with these low interest rates, very low interest rates, whether you're seeing any downward pressure on discount rates?

Christopher Corr - *Rayonier Inc. - SVP, Real Estate and Public Affairs*

I'd say that they've held relatively firm in the last, probably in the last 18 months. Again, what we've seen is differential discount rates for different quality transactions.

I think on average across the US South we think the going rate is in that 5% to 5.5% real, but we've seen people pay up for very high quality properties. Likewise, we've seen some no-sales and then some transactions that, certainly, traded above that relative to the risk of the particular portfolio, or the inventory mix and the maturity of the age class.

Mark Wilde - *BMO Capital Markets - Analyst*

Okay. Mark, I know over time there have been points where a lot of the activity with the TIMOs have come from offshore money, and with rates so low over in Europe right now, are you getting a sense that the TIMOs are seeing more offshore money coming in?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

I think that's probably true, Mark, in both the private equity, as well as some of the public equity, I think you are seeing more of it as well in the context of investors into the timber REITs space. But I think we are continuing to see fairly healthy demand for timber from offshore capital for all of the reasons that you would expect. Reflect quality, the interest, the low interest rates in Europe as an example.

You're seeing yield, people coming here for safe yield. And so, I don't think we've see any dissipation of that type of capital flow.

Mark Wilde - *BMO Capital Markets - Analyst*

Okay. And then last question kind of along the same lines. Dave, a while back you mentioned to me that you thought discount rates were still wider down in New Zealand. Have you seen any tightening there?

Dave Nunes - *Rayonier Inc. - President & CEO*

New Zealand has less deal flow, certainly, than the US so you don't have as many data points. I think that there have been some recent transactions in New Zealand where we've seen -- we've seen lower discount rates than what you typically see in a lot of appraisals.

I think one of the things to keep in mind with New Zealand though is that, a lot of the land in New Zealand is tied up in long-term leases or in forestry rights. Those leases, I think, tend to contribute to a higher blended discount rate in New Zealand, relative, say, to the US.

Mark Wilde - *BMO Capital Markets - Analyst*

Okay, that's helpful.

Mark McHugh - *Rayonier Inc. - SVP & CFO*

That's an important point.

Operator

Thank you. We have one last question from Collin Mings at Raymond James.

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

Thanks, just two quick follow-ups. First, Mark, recognizing your commitment to maintaining an investment-grade rating, maybe talk about your appetite for additional share repurchases. Obviously the stock has moved nicely this year, just how are you thinking about no shares repurchased during the quarter?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

I think last quarter you had asked the question, Collin, what our available capacity was for capital allocation and we had indicated that we felt it was in the range of $50 million in order to stay comfortably within the metrics that have been prescribed by the rating agencies to maintain the investment-grade rating. That hasn't really changed. We didn't do any share repurchase in the last quarter or announce any acquisitions. So, I would say that sort of volume of capacity is likely around the same.

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

Okay. And just as far as -- still on my math you guys are still trading below NAV, but the stock is up again nicely year to date. Should we continue to think about you holding that dry powder a little bit more for acquisitions at this point?

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Again, I think what we've always said about capital allocation is, it's going to be flexible and opportunistic. We're going to take advantage of what we see as the best available opportunities to maximize long-term shareholder value.

We don't put hard limits on where we buy back stock. We don't put hard limits on what we want to acquire in any given period. We really try to look at our available capacity, the market dynamics that we are seeing both in the stock as well as in the M&A market, and just be very flexible and opportunistic.

Dave Nunes - *Rayonier Inc. - President & CEO*

And I think, to reiterate some of the discussion provides quarter, the Menahsa acquisition is a great example of that. It was a very high quality property, and because of its scale and other attributes it required a fair bit of creativity and flexibility and we brought in a partner to break it up. We also sold the land in Washington to help fund it. That's an example where the opportunity itself influenced our manner in going after it.

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

Okay, and actually my second question was actually going back to Menasha. As far as all of the expert conversation this morning focused on China this morning, but as you incorporate the Menasha Timberland, should we expect to see some increase in your export activities to Japan, is there an opportunity just given the Douglas fir mix of that property?

Dave Nunes - *Rayonier Inc. - President & CEO*

Yes, I think there's definitely some opportunities there. Coos Bay is not as big of a port as some of the Washington ports as it relates to volume going into Japan, but you are right on the species, in a species sense there's more opportunity. I think the other thing to keep in mind though is, that domestic market is a very strong market, and it's a very tensioned market.

So, you've got a decent amount of competition between the export markets and the domestic markets in that geography. And we look at it as just having really nice optionality. And so, that is one of the things that we will be looking at over time, just the ability to penetrate that Japan market a little bit more out of Coos Bay. But it's not to the same degree as, say, the long view the market.

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

Great. Thanks, Dave.

Operator

Thank you. We show no further questions at this time.

Mark McHugh - *Rayonier Inc. - SVP & CFO*

Thank you for joining the call. This is Mark McHugh. If you have any follow-up questions, please contact me.
