RAYONIER INC
Form 10-Q
October 28, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______________to______________

COMMISSION FILE NUMBER 1-6780

RAYONIER INC.

Incorporated in the State of North Carolina

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

1301 Riverplace Boulevard, Jacksonville, Florida 32207

(Principal Executive Office)

Telephone Number: (904) 357-9100

Former Address

50 North Laura Street, Jacksonville, Florida 32202

Indicate by check mark whether the registrant (l) has filed all reports required to be filed by Section l3 or l5(d) of the Securities Exchange Act of l934 during the preceding l2 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ¨ NO x

As of October 22, 2010, there were outstanding 80,564,846 Common Shares of the Registrant.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

RAYONIER INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
SALES	$ 377,515	$ 300,648	$ 999,925	$ 858,731
Costs and Expenses				
Cost of sales	269,203	231,836	744,996	672,855
Selling and general expenses	17,125	15,972	49,264	44,962
Other operating income, net (Note 2)	(792)	(59,251)	(6,620)	(150,425)
	285,536	188,557	787,640	567,392
Equity in income (loss) of New Zealand joint venture	103	(943)	634	(2,782)
OPERATING INCOME BEFORE GAIN ON SALE OF A PORTION OF THE INTEREST IN THE NEW ZEALAND JOINT VENTURE	92,082	111,148	212,919	288,557
Gain on sale of a portion of the interest in the New Zealand joint venture (Note 6)			12,367	
OPERATING INCOME	92,082	111,148	225,286	288,557
Interest expense	(12,943)	(12,789)	(37,680)	(37,630)
Interest and miscellaneous income, net	345	310	943	594
INCOME BEFORE INCOME TAXES	79,484	98,669	188,549	251,521
Income tax expense	(16,580)	(17,529)	(30,134)	(36,707)
NET INCOME	62,904	81,140	158,415	214,814
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign currency translation adjustments	3,198	2,620	(64)	13,568
Joint venture cash flow hedges	(104)	968	922	(1,659)

Amortization of pension and postretirement benefit costs, net of income tax expense (benefit) of $661 and $347, and ($1,705) and $1,013	1,210	1,170	5,849	2,286
COMPREHENSIVE INCOME	$ 67,208	$ 85,898	$ 165,122	$ 229,009
EARNINGS PER COMMON SHARE				
Basic earnings per share	$ 0.78	$ 1.03	$ 1.98	$ 2.72
Diluted earnings per share	$ 0.77	$ 1.01	$ 1.95	$ 2.69

See Notes to Condensed Consolidated Financial Statements.

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RAYONIER INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands)

	September 30, 2010	December 31, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 405,665	$ 74,964
Accounts receivable, less allowance for doubtful accounts of $349 and $1,150	114,545	103,740
Inventory		
Finished goods	61,817	70,548
Work in process	6,368	8,884
Raw materials	15,750	6,829
Manufacturing and maintenance supplies	2,280	2,243
Total inventory	86,215	88,504
Income tax and alternative fuel mixture credit receivable	1,582	192,579
Prepaid and other current assets	53,690	49,909
Total Current Assets	661,697	509,696
TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION	1,130,661	1,188,559
PROPERTY, PLANT AND EQUIPMENT		
Land	24,818	24,789
Buildings	127,064	126,443
Machinery and equipment	1,329,152	1,275,955
Total property, plant and equipment, gross	1,481,034	1,427,187
Less accumulated depreciation	(1,109,744)	(1,082,248)
Total property, plant and equipment, net	371,290	344,939
INVESTMENT IN JOINT VENTURE	65,312	50,999
OTHER ASSETS	163,175	158,738
TOTAL ASSETS	$ 2,392,135	$ 2,252,931
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 50,689	$ 58,584
Bank loans and current maturities		4,650
Accrued interest	11,633	6,512

Accrued customer incentives	13,751	25,644
Current liabilities for dispositions and discontinued operations (Note 11)	11,696	10,648
Other current liabilities	87,285	69,073
TOTAL CURRENT LIABILITIES	175,054	175,111
LONG-TERM DEBT	766,102	694,999
NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS (Note 11)	80,474	87,943
PENSION AND OTHER POSTRETIREMENT BENEFITS (Note 13)	111,957	111,662
OTHER NON-CURRENT LIABILITIES	35,909	37,010
COMMITMENTS AND CONTINGENCIES (Notes 10 and 12)		
SHAREHOLDERS EQUITY		
Common Shares, 240,000,000 and 120,000,000 shares authorized, 80,549,849 and 79,541,974 shares issued and outstanding	594,147	561,962
Retained earnings	701,527	663,986
Accumulated other comprehensive loss	(73,035)	(79,742)
TOTAL SHAREHOLDERS EQUITY	1,222,639	1,146,206
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 2,392,135	$ 2,252,931

See Notes to Condensed Consolidated Financial Statements.

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RAYONIER INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
OPERATING ACTIVITIES		
Net income	$ 158,415	$ 214,814
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	115,687	126,834
Non-cash cost of real estate sold	6,531	6,295
Stock-based incentive compensation expense	11,610	11,952
Gain on sale of a portion of the interest in the New Zealand joint venture	(11,545)	
Amortization of convertible debt discount	6,103	4,575
Deferred income tax expense (benefit)	14,871	(5,721)
Excess tax benefits on stock-based compensation	(5,071)	(2,287)
Other	4,571	9,250
Changes in operating assets and liabilities:		
Receivables	(10,756)	(20,493)
Inventories	(3,481)	(4,122)
Accounts payable	(8,993)	(16,407)
Income tax and alternative fuel mixture credit receivable	190,997	(132,616)
Other current assets	(6,032)	(13,018)
Accrued liabilities	16,476	32,922
Other assets	629	15
Other non-current liabilities	(321)	8,293
Expenditures for dispositions and discontinued operations	(6,484)	(5,968)
CASH PROVIDED BY OPERATING ACTIVITIES	473,207	214,318
INVESTING ACTIVITIES		
Capital expenditures	(95,614)	(65,078)
Change in restricted cash	(13,209)	1,243
Other	6,211	(7,685)
CASH USED FOR INVESTING ACTIVITIES	(102,612)	(71,520)
FINANCING ACTIVITIES		
Issuance of debt	157,000	257,500
Repayment of debt	(96,650)	(185,620)
Dividends paid	(120,156)	(118,540)
Proceeds from the issuance of common shares	21,532	9,228
Excess tax benefits on stock-based compensation	5,071	2,287
Purchase of exchangeable note hedge		(23,460)
Proceeds from issuance of warrant		12,506

Debt issuance costs	(537)	(4,129)
Repurchase of common shares	(6,028)	(1,388)
CASH USED FOR FINANCING ACTIVITIES	(39,768)	(51,616)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(126)	278
CASH AND CASH EQUIVALENTS		
Increase in cash and cash equivalents	330,701	91,460
Balance, beginning of year	74,964	61,685
Balance, end of period	$ 405,665	$ 153,145
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period:		
Interest	$ 24,499	$ 21,749
Income taxes	$ 4,538	$ 9,547
Non-cash investing activity:		
Capital assets purchased on account	$ 9,800	$ 3,315

See Notes to Condensed Consolidated Financial Statements.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Dollars in thousands unless otherwise stated)

1. BASIS OF PRESENTATION AND NEW ACCOUNTING PRONOUNCEMENTS

Basis of Presentation

The unaudited condensed consolidated financial statements and notes thereto of Rayonier Inc. and its subsidiaries (Rayonier or the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information in the financial statements of the Company s Annual Report on Form 10-K has been condensed. In the opinion of management, these financial statements and notes reflect all adjustments (including normal recurring adjustments) necessary for a fair presentation of the results of operations, financial position and cash flows for the periods presented. These statements and notes should be read in conjunction with the financial statements and supplementary data included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the SEC.

Subsequent Events

The Company evaluated events and transactions that occurred after the balance sheet date but before financial statements were issued, and two subsequent events warranted disclosure. See Note 2 *Alternative Fuel Mixture Credit (AFMC) and Cellulosic Biofuel Producer Credit (CBPC)* and Note 13 *Employee Benefit Plans* for additional information.

New or Recently Adopted Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued new guidance related to consolidation which replaced the quantitative-based risks and rewards calculation for determining which enterprise has a controlling interest in a variable interest entity with an approach primarily qualitative in nature. This Standard requires additional disclosures about an enterprise s involvement in variable interest entities and was effective January 1, 2010 for Rayonier. The Company s application of this guidance had no effect on the accompanying condensed consolidated financial statements. See Note 9 *Fair Value Measurements* for additional information about the Company s variable interest entity.

Also in June 2009, the FASB issued new guidance related to the accounting for transfers of financial assets. The new standard eliminates the concept of a qualifying special-purpose entity (QSPE) and associated guidance and creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale. Entities formerly classified as QSPEs are now evaluated for consolidation under the provisions related to the consolidation of controlling and non-controlling interests in an entity. Under the new guidance, the Company s investment in a special purpose entity does not require consolidation. See Note 9 *Fair Value Measurements* for additional information about this entity.

2. ALTERNATIVE FUEL MIXTURE CREDIT (AFMC) AND CELLULOSIC BIOFUEL PRODUCER CREDIT (CBPC)

The U.S. Internal Revenue Code allowed a tax credit for taxpayers that produced and used an alternative fuel in the operation of their business. Rayonier produces and uses an alternative fuel (black liquor) at its Jesup, Georgia and Fernandina Beach, Florida Performance Fibers mills, which qualified for the $0.50 per gallon credit of alternative fuel used in operations through December 31, 2009. Accordingly, the Condensed Consolidated Statements of Income and Comprehensive Income for the three and nine months ended September 30, 2009, include income of $55.8 million and $141.8 million, net of associated expenses, recorded in Other operating income, net for black liquor produced and used.

Subsequent Event

In October 2010, the Internal Revenue Service released clarification that both the AFMC and CBPC can be claimed in the same taxable year for different volumes of black liquor. Rayonier has applied for the cellulosic biofuel producer registration. If IRS approval is received, Rayonier will be able to claim the CBPC credit, which is $1.01 per gallon, for black liquor used in the operation of its business in 2009 which was not claimed for the AFMC. Rayonier will recognize the benefits for CBPC when approval is received.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

3. EARNINGS PER COMMON SHARE

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

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net income	$ 62,904	$ 81,140	$ 158,415	$ 214,814
Shares used for determining basic earnings per common share	80,262,781	79,145,323	80,038,032	78,956,526
Dilutive effect of:				
Stock options	386,407	413,740	383,529	356,068
Performance and restricted shares	821,561	548,052	763,284	433,440
Shares used for determining diluted earnings per common share	81,470,749	80,107,115	81,184,845	79,746,034
Basic earnings per common share:	$ 0.78	$ 1.03	$ 1.98	$ 2.72
Diluted earnings per common share:	$ 0.77	$ 1.01	$ 1.95	$ 2.69

4. INCOME TAXES

Rayonier is a real estate investment trust (REIT). In general, only Rayonier TRS Holdings Inc. (TRS), the Company s wholly-owned taxable subsidiary whose businesses include the Company s non-REIT qualified activities, is subject to corporate income taxes. However, Rayonier Inc. is subject to U.S. federal corporate income tax on built-in gains (the excess of fair market value over tax basis for property held upon REIT election at January 1, 2004) on taxable sales of such property during calendar years 2004 through 2010 and 2012 through 2013. Accordingly, the provision for corporate income taxes relates principally to current and deferred taxes on certain property sales and on TRS income.

The Company s effective tax rate is below the 35 percent U.S. statutory tax rate primarily due to tax benefits associated with being a REIT. Effective tax rates before discrete items were 19.2 percent and 25.2 percent for the three months ended September 30, 2010 and 2009, respectively. Year-to-date effective tax rates before discrete items were 18.3 percent and 22.1 percent in 2010 and 2009, respectively. The lower rates in 2010 were due to proportionately higher earnings from the REIT.

Including discrete items, the effective tax rates for the quarter and year-to-date were 20.9 percent and 16.0 percent compared to 17.8 percent and 14.6 percent in 2009, respectively.

5. RESTRICTED DEPOSITS

In order to qualify for like-kind exchange (LKE) treatment, the proceeds from real estate sales must be deposited with a third party intermediary. These proceeds are accounted for as restricted cash until a suitable replacement property is acquired. In the event that LKE purchases are not completed, the proceeds are returned to the Company after 180 days and reclassified as available cash. As of September 30, 2010 and December 31, 2009, the Company had $13.3 million and $0.1 million, respectively, of proceeds from real estate sales classified as restricted cash in Other Assets, which were deposited with an LKE intermediary.

6. JOINT VENTURE INVESTMENT

The Company owns an interest in Matariki Forestry Group (Matariki), a joint venture (JV) that owns or leases approximately 0.3 million acres of New Zealand timberlands. In addition to this investment, Rayonier New Zealand Limited (RNZ), a wholly-owned subsidiary of Rayonier, serves as the manager of the JV forests and operates a log trading business.

Rayonier s investment in the JV is accounted for using the equity method of accounting. Income from the JV is reported in the Timber segment as operating income since the Company manages the forests and its JV interest is an extension of the Company s operations. A portion of Rayonier s investment is recorded at historical cost which generates a difference between the book value of the Company s investment and its proportionate share of the JV s net assets. The difference represents the Company s unrecognized gain from RNZ s sale of timberlands to the JV in 2005. The deferred gain is recognized on a straight-line basis over the estimated number of years the JV expects to harvest the timberlands.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

In the third quarter of 2008, Rayonier s Board of Directors approved a plan to offer to sell the Company s 40 percent interest in the JV as well as the operations of RNZ. As a result, the operating results of the JV and RNZ were segregated from continuing operations in the Condensed Consolidated Statements of Income and Comprehensive Income and reported as discontinued operations.

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

In February 2010, the JV sold a 35 percent interest in the JV to a new investor for NZ$167 million. Matariki issued new shares to the investor and used the proceeds entirely to pay down a portion of its outstanding NZ$367 million debt. Upon closing, Rayonier s ownership interest in Matariki declined from 40 percent to 26 percent. As a result of this transaction, results for 2010 include a gain of $11.5 million, net of $0.9 million in tax, or $0.14 per diluted share.

7. SHAREHOLDERS EQUITY

An analysis of shareholders equity for the nine months ended September 30, 2010 and the year ended December 31, 2009 is shown below (share amounts not in thousands):

	Common Shares			Accumulated Other Comprehensive	
	Shares	Amount	Retained Earnings	Income (Loss)	Shareholders Equity
Balance, December 31, 2008	78,814,431	$ 527,302	$ 509,931	$ (98,296)	$ 938,937
Net income			312,541		312,541
Dividends ($2.00 per share)			(158,486)		(158,486)
Issuance of shares under incentive stock plans	776,905	11,115			11,115
Equity portion of convertible debt		8,850			8,850
Warrants and hedge, net		(2,391)			(2,391)
Stock-based compensation		15,754			15,754
Excess tax benefit on stock-based compensation		2,720			2,720
Repurchase of common shares	(49,362)	(1,388)			(1,388)
Net gain from pension and postretirement plans				4,879	4,879
Foreign currency translation adjustment				15,980	15,980
Joint venture cash flow hedges				(2,305)	(2,305)
Balance, December 31, 2009	79,541,974	$ 561,962	$ 663,986	$ (79,742)	$ 1,146,206
Net income			158,415		158,415
Dividends ($1.50 per share)			(120,874)		(120,874)

Issuance of shares under incentive stock plans	1,143,983	21,532			21,532
Stock-based compensation		11,610			11,610
Excess tax benefit on stock-based compensation		5,071			5,071
Repurchase of common shares	(136,108)	(6,028)			(6,028)
Amortization of pension and postretirement benefit costs				5,849	5,849
Foreign currency translation adjustment				(64)	(64)
Joint venture cash flow hedges				922	922
Balance, September 30, 2010	80,549,849	$ 594,147	$ 701,527	$ (73,035)	$ 1,222,639

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

8. SEGMENT INFORMATION

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

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

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

	September 30, 2010	December 31, 2009
ASSETS		
Timber	$ 1,275,276	$ 1,259,675
Real Estate	77,654	71,118
Performance Fibers	554,186	517,941
Wood Products	20,180	21,972
Other Operations	26,656	19,432
Corporate and other	438,183	362,793
TOTAL	$ 2,392,135	$ 2,252,931

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
SALES				
Timber	$ 47,343	$ 46,465	$ 143,368	$ 124,957
Real Estate	45,162	21,966	90,891	89,936
Performance Fibers	246,314	216,837	648,032	597,580

Wood Products	14,652	13,259	52,157	37,532
Other Operations	25,449	8,512	72,803	23,171
Intersegment Eliminations	(1,405)	(6,391)	(7,326)	(14,445)
TOTAL	$ 377,515	$ 300,648	$ 999,925	$ 858,731

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
OPERATING INCOME (LOSS)				
Timber	$ 9,151	$ 1,038	$ 26,023	$ (867)
Real Estate	30,788	12,795	52,325	51,363
Performance Fibers	62,311	49,524	152,158	125,060
Wood Products	(1,368)	(1,999)	2,943	(8,142)
Other Operations	(798)	(1,286)	538	(2,618)
Corporate and other	(8,002)	51,076(a)	(8,701)(b)	123,761(a)
TOTAL	$ 92,082	$ 111,148	$ 225,286	$ 288,557

(a) Three and nine months ended September 30, 2009 include $55.8 million and $141.8 million relating to the AFMC. For additional information, see Note 2 *Alternative Fuel Mixture Credit (AFMC) and Cellulosic Biofuel Producer Credit (CBPC).*

(b) Includes a gain of $12.4 million from the sale of a portion of the Company s interest in its New Zealand joint venture. See Note 6 *Joint Venture Investment* for additional information.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
DEPRECIATION, DEPLETION AND AMORTIZATION				
Timber	$ 14,813	$ 19,083	$ 48,819	$ 58,515
Real Estate	9,284	4,811	21,286	22,256
Performance Fibers	13,922	15,025	41,929	42,021
Wood Products	936	1,060	3,080	3,491
Other Operations		1	2	2
Corporate and other	210	179	571	549
TOTAL	$ 39,165	$ 40,159	$ 115,687	$ 126,834

9. FAIR VALUE MEASUREMENTS

The following table presents the carrying amount and estimated fair values of financial instruments held by the Company at September 30, 2010 and December 31, 2009, using market information and what the Company believes to be appropriate valuation methodologies under generally accepted accounting principles:

Asset (liability)	September 30, 2010 Carrying Amount	Fair Value	December 31, 2009 Carrying Amount	Fair Value
Cash and cash equivalents	$ 405,665	$ 405,665	$ 74,964	$ 74,964
Short-term debt			(4,650)	(4,650)
Long-term debt	(766,102)	(882,920)	(694,999)	(790,763)

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

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

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

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

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

Asset	Carrying Value at September 30, 2010	Level 2	Carrying Value at December 31, 2009	Level 2
Investment in special-purpose entity	$ 2,879	$ 2,879	$ 2,733	$ 2,733

The fair value of the investment in the special-purpose entity is determined by summing the discounted value of future principal and interest payments that Rayonier will receive from the special-purpose entity. The interest rate of a similar instrument is used to determine the discounted value of the payments.

Variable Interest Entity

Rayonier holds a variable interest in a bankruptcy-remote, limited liability subsidiary (special-purpose entity) which was created in 2004 when Rayonier monetized a $25.0 million installment note and letter of credit received in connection with a timberland sale. The Company contributed the note and a letter of credit to the special-purpose entity and using the installment note and letter of credit as collateral, the special-purpose entity issued $22.6 million of 15-year Senior Secured Notes and remitted cash of $22.6 million to the Company. There are no restrictions that relate to the transferred financial assets. Rayonier maintains a $2.6 million interest in the entity and receives immaterial cash payments equal to the excess of interest received on the installment note over the interest paid on the Senior Secured Notes. The Company s interest is recorded at fair value and is included in Other Assets in the Condensed Consolidated Balance Sheets. In addition, the Company calculated and recorded a de minimus guarantee liability to reflect its obligation of up to $2.6 million under a make-whole agreement pursuant to which it guaranteed certain obligations of the entity. This guarantee obligation is also collateralized by the letter of credit. The Company s interest in the entity, together with the make-whole agreement, represents the maximum exposure to loss as a result of the Company s involvement with the special-purpose entity. Upon maturity of the Senior Secured Notes in 2019 and termination of the special purpose entity, Rayonier will receive the remaining $2.6 million of cash. The Company determined, based upon an analysis under the variable interest entity guidance, that it does not have the power to direct activities that most significantly impact the entity s economic success. Therefore, Rayonier is not the primary beneficiary and is not required to consolidate the entity.

10. GUARANTEES

The Company provides financial guarantees as required by creditors, insurance programs, and state and foreign governmental agencies. As of September 30, 2010, the following financial guarantees were outstanding:

	Maximum Potential Payment	Carrying Amount of Liability
Standby letters of credit (a)	$ 43,807	$ 38,110
Guarantees (b)	2,555	43
Surety bonds (c)	11,718	1,786
Total	$ 58,080	$ 39,939

(a) Approximately $39 million of the standby letters of credit serve as credit support for industrial revenue bonds. The remaining letters of credit support obligations under various insurance related agreements, primarily workers compensation and pollution liability policy requirements. These letters of credit expire at various dates during 2010 and 2011 and will be renewed as required.

(b) In conjunction with a timberland sale and note monetization in the first quarter of 2004, the Company issued a make-whole agreement pursuant to which it guaranteed $2.6 million of obligations of a special-purpose entity that was established to complete the monetization. At September 30, 2010, the Company has recorded a de minimus liability to reflect the fair market value of its obligation to perform under the make-whole agreement.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

(c) Rayonier issued surety bonds primarily to secure timber in the State of Washington and to provide collateral for the Company s workers compensation self-insurance program in Washington and Georgia. These surety bonds expire at various dates during 2010, 2011 and 2014, and are expected to be renewed as required.

11. LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS

An analysis of activity in the liabilities for dispositions and discontinued operations for the nine months ended September 30, 2010 and the year ended December 31, 2009, is as follows:

	September 30, 2010	December 31, 2009
Balance, January 1	$ 98,591	$ 104,575
Expenditures charged to liabilities	(6,484)	(8,095)
Increase to liabilities	63	2,111
Balance, end of period	92,170	98,591
Less: Current portion	(11,696)	(10,648)
Non-current portion	$ 80,474	$ 87,943

Subject to the factors described in the next paragraph of this footnote and in Note 16 *Liabilities for Dispositions and Discontinued Operations* in the 2009 Annual Report on Form 10-K, the Company believes established liabilities are sufficient for costs expected to be incurred over the next 20 years with respect to its dispositions and discontinued operations. Remedial actions for these sites vary, but can include, among other remedies, on-site (and in certain cases off-site) removal or treatment of contaminated soils and sediments, recovery and treatment/remediation of groundwater, and other remediation and/or control of contamination sources.

In addition, the Company is exposed to the risk of reasonably possible additional losses in excess of the established liabilities. As of September 30, 2010, it is estimated that this amount could range up to $36 million and arises from uncertainty over the availability or effectiveness of certain remediation technologies, additional or different contamination that may be discovered, development of new or improved environmental remediation technologies, changes in applicable law and the exercise of discretion in interpretation of applicable law and regulations by governmental agencies.

For additional information on the Company s environmental liabilities refer to Note 16 *Liabilities for Dispositions and Discontinued Operations* in the 2009 Annual Report on Form 10-K.

12. CONTINGENCIES

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

There have been no material changes in the status of the other specific matters referenced in Note 16 *Liabilities for Dispositions and Discontinued Operations* in the 2009 Annual Report on Form 10-K.

13. EMPLOYEE BENEFIT PLANS

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

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(Unaudited)

(Dollars in thousands unless otherwise stated)

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

	Pension Three Months Ended September 30,		Postretirement Three Months Ended September 30,	
	2010	2009	2010	2009
Components of Net Periodic Benefit Cost				
Service cost	$ 1,549	$ 1,182	$ 148	$ 181
Interest cost	4,435	4,864	258	257
Expected return on plan assets	(5,412)	(5,489)		
Amortization of prior service cost	414	664	21	22
Amortization of plan amendment			(637)	(2,391)
Amortization of losses	1,614	1,949	459	1,273
Net periodic benefit cost	$ 2,600	$ 3,170	$ 249	$ (658)

	Pension Nine Months Ended September 30,		Postretirement Nine Months Ended September 30,	
	2010	2009	2010	2009
Components of Net Periodic Benefit Cost				
Service cost	$ 4,647	$ 4,867	$ 440	$ 361
Interest cost	13,305	13,562	772	858
Expected return on plan assets	(16,238)	(16,071)		
Amortization of prior service cost	1,243	1,372	65	66
Amortization of plan amendment			(5,421)	(7,175)
Amortization of losses	4,842	4,647	3,415	4,389
Net periodic benefit cost	$ 7,799	$ 8,377	$ (729)	$ (1,501)

The Company made no discretionary contributions to the pension plans during the nine months ended September 30, 2010.

Subsequent Event

In October 2010, Rayonier made a $50 million discretionary pension contribution in order to improve funded status. The Company does not expect to make any additional discretionary contributions in 2010.

14. DEBT

In March 2010, TRS borrowed $75 million under a five-year term loan agreement with a group of banks at LIBOR plus 275 basis points. There were no other significant changes to the Company s outstanding debt as reported in Note 13 *Debt* of the Company s 2009 Annual Report on Form 10-K.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

15. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

	September 30, 2010	December 31, 2009
Foreign currency translation adjustments	$ 26,705	$ 26,769
Joint venture cash flow hedges	(1,383)	(2,305)
Unrecognized components of employee benefit plans, net of tax	(98,357)	(104,206)
Total	$ (73,035)	$ (79,742)

16. CONSOLIDATING FINANCIAL STATEMENTS

In October 2007, TRS issued $300 million of 3.75% Senior Exchangeable Notes due 2012, and in August 2009 TRS issued $172.5 million of 4.50% Senior Exchangeable Notes due 2015. The notes for both transactions are guaranteed by Rayonier and are non-callable. In connection with these exchangeable notes, the Company provides the following condensed consolidating financial information in accordance with SEC Regulation S-X Rule 3-10, *Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered*. Each entity in the consolidating financial information follows the same accounting policies as described in the consolidated financial statements, except for the use of the equity method of accounting to reflect ownership interests in wholly-owned subsidiaries which are eliminated upon consolidation and the allocation of certain expenses of Rayonier incurred for the benefit of its subsidiaries.

On July 29, 2010, Rayonier Inc. reorganized its operating structure by creating a new wholly owned operating entity Rayonier Operating Company LLC (ROC), and entering into a contribution agreement under which Rayonier Inc. contributed all assets and liabilities to ROC. As part of this agreement, ROC guarantees the TRS notes mentioned above. Rayonier Inc. s guarantee of the TRS notes was unchanged by the transaction. Accordingly, the Company has revised its presentation of previously reported consolidating financial statements to reflect ROC as a subsidiary guarantor.

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(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

CONDENSED CONSOLIDATING STATEMENTS OF INCOME
For the Three Months Ended September 30, 2010

	Rayonier Inc. (Parent Guarantor)	ROC (Subsidiary Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$	$ 349,311	$ 69,040	$ (40,836)	$ 377,515
Costs and Expenses							
Cost of sales				280,715	33,900	(45,412)	269,203
Selling and general expenses		2,735		13,613	777		17,125
Other operating expense (income), net		54		679	(1,525)		(792)
		2,789		295,007	33,152	(45,412)	285,536
Equity in (loss) income of New Zealand joint venture		(44)		147			103
OPERATING (LOSS) INCOME		(2,833)		54,451	35,888	4,576	92,082
Interest expense		(80)	(7,352)	(5,483)	(28)		(12,943)
Interest and miscellaneous income (expense), net		1,335	(1,299)	(4,866)	5,175		345
Equity in income from subsidiaries	62,904	66,724	26,606			(156,234)	
INCOME BEFORE INCOME TAXES	62,904	65,146	17,955	44,102	41,035	(151,658)	79,484
Income tax (expense) benefit		(2,242)	3,158	(17,496)			(16,580)
NET INCOME	$ 62,904	$ 62,904	$ 21,113	$ 26,606	$ 41,035	$ (151,658)	$ 62,904

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

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

	Rayonier Inc. (Parent Guarantor)	ROC (Subsidiary Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$	$ 266,859	$ 47,691	$ (13,902)	$ 300,648
Costs and Expenses							
Cost of sales				215,399	31,218	(14,781)	231,836
Selling and general expenses		2,926		12,222	829	(5)	15,972
Other operating expense (income), net		43		(57,004)	(2,290)		(59,251)
		2,969		170,617	29,757	(14,786)	188,557
Equity in (loss) income of New Zealand joint venture		(1,248)		305			(943)
OPERATING (LOSS) INCOME		(4,217)		96,547	17,934	884	111,148
Interest income (expense)		209	(5,919)	(5,920)	(1,159)		(12,789)
Interest and miscellaneous income (expense), net		1,255	(1,124)	(1,087)	1,296	(30)	310
Equity in income from subsidiaries	81,140	85,757	71,305			(238,202)	
INCOME BEFORE INCOME TAXES	81,140	83,004	64,262	89,540	18,071	(237,348)	98,669
Income tax (expense) benefit		(1,864)	2,570	(18,235)			(17,529)
NET INCOME	$ 81,140	$ 81,140	$ 66,832	$ 71,305	$ 18,071	$ (237,348)	$ 81,140

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

CONDENSED CONSOLIDATING STATEMENTS OF INCOME
For the Nine Months Ended September 30, 2010

	Rayonier Inc. (Parent Guarantor)	ROC (Subsidiary Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$	$ 928,643	$ 203,909	$ (132,627)	$ 999,925
Costs and Expenses							
Cost of sales				754,937	99,782	(109,723)	744,996
Selling and general expenses		7,591		39,343	2,330		49,264
Other operating expense (income), net		73		(955)	(5,738)		(6,620)
		7,664		793,325	96,374	(109,723)	787,640
Equity in (loss) income of New Zealand joint venture		(18)		652			634
OPERATING (LOSS) INCOME BEFORE GAIN ON SALE OF A PORTION OF THE INTEREST IN THE NEW ZEALAND JOINT VENTURE		(7,682)		135,970	107,535	(22,904)	212,919
Gain on sale of a portion of the interest in the New Zealand joint venture		4,670		7,697			12,367
OPERATING (LOSS) INCOME		(3,012)		143,667	107,535	(22,904)	225,286
Interest income (expense)		70	(22,075)	(15,568)	(107)		(37,680)
Interest and miscellaneous income (expense), net		11,595	(3,897)	(21,214)	14,459		943
Equity in income from subsidiaries	158,415	153,546	71,055			(383,016)	
INCOME BEFORE INCOME TAXES	158,415	162,199	45,083	106,885	121,887	(405,920)	188,549
Income tax (expense) benefit		(3,784)	9,480	(35,830)			(30,134)
NET INCOME	$ 158,415	$ 158,415	$ 54,563	$ 71,055	$ 121,887	$ (405,920)	$ 158,415

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

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

	Rayonier Inc. (Parent Guarantor)	ROC (Subsidiary Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$	$ 724,718	$ 165,713	$ (31,700)	$ 858,731
Costs and Expenses							
Cost of sales				599,381	108,397	(34,923)	672,855
Selling and general expenses		7,824		34,635	2,503		44,962
Other operating expense (income), net		131		(143,781)	(6,775)		(150,425)
		7,955		490,235	104,125	(34,923)	567,392
Equity in (loss) income of New Zealand joint venture		(2,808)		26			(2,782)
OPERATING (LOSS) INCOME		(10,763)		234,509	61,588	3,223	288,557
Interest expense		(27)	(15,133)	(18,998)	(3,472)		(37,630)
Interest and miscellaneous income (expense), net		2,831	(2,671)	(3,357)	3,884	(93)	594
Equity in income from subsidiaries	214,814	227,265	173,441			(615,520)	
INCOME BEFORE INCOME TAXES	214,814	219,306	155,637	212,154	62,000	(612,390)	251,521
Income tax (expense) benefit		(4,492)	6,498	(38,713)			(36,707)
NET INCOME	$ 214,814	$ 214,814	$ 162,135	$ 173,441	$ 62,000	$ (612,390)	$ 214,814

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

CONDENSED CONSOLIDATING BALANCE SHEETS
As of September 30, 2010

	Rayonier Inc. (Parent Guarantor)	ROC (Subsidiary Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
ASSETS							
CURRENT ASSETS							
Cash and cash equivalents	$	$ 39,334	$	$ 304,289	$ 62,042	$	$ 405,665
Accounts receivable, less allowance for doubtful accounts		1,028		111,675	1,842		114,545
Inventory				99,114		(12,899)	86,215
Intercompany interest receivable					4,296	(4,296)	
Income tax and alternative fuel mixture credit receivable		1		1,581			1,582
Prepaid and other current assets		1,759	804	48,969	2,158		53,690
Total current assets		42,122	804	565,628	70,338	(17,195)	661,697
TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION				38,004	1,091,555	1,102	1,130,661
NET PROPERTY, PLANT AND EQUIPMENT		1,529		367,855	1,148	758	371,290
INVESTMENT IN JOINT VENTURE		77,435		(12,123)			65,312
INVESTMENT IN SUBSIDIARIES	1,222,639	1,253,561	907,669			(3,383,869)	
INTERCOMPANY/NOTES RECEIVABLE							
OTHER ASSETS		22,691	9,309	664,725	18,545	(552,095)	163,175
TOTAL ASSETS	$ 1,222,639	$ 1,397,338	$ 917,782	$ 1,624,089	$ 1,181,586	$ (3,951,299)	$ 2,392,135
LIABILITIES AND SHAREHOLDERS EQUITY							

CURRENT LIABILITIES							
Accounts payable	$	$ 1,948	$	$ 46,073	$ 2,668	$	$ 50,689
Accrued interest		244	6,158	5,231			11,633
Accrued customer incentives				13,751			13,751
Current liabilities for dispositions and discontinued operations				11,696			11,696
Other current liabilities		20,318		43,886	23,081		87,285
Total current liabilities		22,510	6,158	120,637	25,749		175,054
LONG-TERM DEBT			447,435	318,667			766,102
NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS				80,474			80,474
PENSION AND OTHER POSTRETIREMENT BENEFITS		87,415		24,542			111,957
OTHER NON-CURRENT LIABILITIES		11,798		23,506	605		35,909
INTERCOMPANY PAYABLE		52,976		148,594	19,039	(220,609)	
TOTAL LIABILITIES		174,699	453,593	716,420	45,393	(220,609)	1,169,496
TOTAL SHAREHOLDERS EQUITY	1,222,639	1,222,639	464,189	907,669	1,136,193	(3,730,690)	1,222,639
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 1,222,639	$ 1,397,338	$ 917,782	$ 1,624,089	$ 1,181,586	$ (3,951,299)	$ 2,392,135

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

CONDENSED CONSOLIDATING BALANCE SHEETS
As of December 31, 2009

	Rayonier Inc. (Parent Guarantor)	ROC (Subsidiary Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
ASSETS							
CURRENT ASSETS							
Cash and cash equivalents	$	$ 2,895	$	$ 69,722	$ 2,347	$	$ 74,964
Accounts receivable, less allowance for doubtful accounts				101,710	2,030		103,740
Inventory				114,187		(25,683)	88,504
Intercompany interest receivable					1,081	(1,081)	
Income tax and alternative fuel mixture credit receivable				192,579			192,579
Prepaid and other current assets		1,430	758	44,722	2,999		49,909
Total current assets		4,325	758	522,920	8,457	(26,764)	509,696
TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION		1,807		87,747	1,099,005		1,188,559
NET PROPERTY, PLANT AND EQUIPMENT		1,493		341,790	1,147	509	344,939
INVESTMENT IN JOINT VENTURE		75,248		(24,249)			50,999
INVESTMENT IN SUBSIDIARIES	1,146,206	1,173,256	869,169			(3,188,631)	
OTHER ASSETS		23,135	11,668	496,195	4,313	(376,573)	158,738
TOTAL ASSETS	$ 1,146,206	$ 1,279,264	$ 881,595	$ 1,424,403	$ 1,112,922	$ (3,591,459)	$ 2,252,931
LIABILITIES AND SHAREHOLDERS EQUITY							

CURRENT LIABILITIES							
Accounts payable	$	$ 3,057	$	$ 54,871	$ 656	$	$ 58,584
Bank loans and current maturities				4,650			4,650
Accrued interest		519	5,286	707			6,512
Accrued customer incentives				25,644			25,644
Current liabilities for dispositions and discontinued operations				10,648			10,648
Other current liabilities		18,885		37,726	12,462		69,073
Total current liabilities		22,461	5,286	134,246	13,118		175,111
LONG-TERM DEBT		5,000	441,332	243,667	5,000		694,999
NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS				87,943			87,943
PENSION AND OTHER POSTRETIREMENT BENEFITS		86,522		25,140			111,662
OTHER NON-CURRENT LIABILITIES		13,352		23,035	23,553	(22,930)	37,010
INTERCOMPANY PAYABLE		5,723		41,203	8,706	(55,632)	
TOTAL LIABILITIES		133,058	446,618	555,234	50,377	(78,562)	1,106,725
TOTAL SHAREHOLDERS EQUITY	1,146,206	1,146,206	434,977	869,169	1,062,545	(3,512,897)	1,146,206
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 1,146,206	$ 1,279,264	$ 881,595	$ 1,424,403	$ 1,112,922	$ (3,591,459)	$ 2,252,931

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2010

	Rayonier Inc. (Parent Guarantor)	ROC (Subsidiary Guarantor)	Rayonier TRS Holdings, Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
CASH PROVIDED BY OPERATING ACTIVITIES	$ 104,652	$ 146,909	$ 25,000	$ 296,986	$ 196,190	$ (296,530)	$ 473,207
INVESTING ACTIVITIES							
Capital expenditures		(818)		(73,617)	(21,179)		(95,614)
Purchase of timberlands					(48,487)	48,487	
Purchase of real estate				(41,253)		41,253	
Change in restricted cash					(13,209)		(13,209)
Other				6,590	(379)		6,211
CASH USED FOR INVESTING ACTIVITIES		(818)		(108,280)	(83,254)	89,740	(102,612)
FINANCING ACTIVITIES							
Issuance of debt				75,000	82,000		157,000
Repayment of debt		(5,000)		(4,650)	(87,000)		(96,650)
Dividends paid	(120,156)						(120,156)
Proceeds from the issuance of common shares	21,532						21,532
Excess tax benefits on stock-based compensation				5,071			5,071
Debt issuance costs				(537)			(537)
Repurchase of common shares	(6,028)						(6,028)
Distributions to parent		(104,652)	(25,000)	(28,897)	(48,241)	206,790	
CASH (USED FOR) PROVIDED BY FINANCING ACTIVITIES	(104,652)	(109,652)	(25,000)	45,987	(53,241)	206,790	(39,768)
EFFECT OF EXCHANGE RATE CHANGES ON CASH				(126)			(126)
CASH AND CASH EQUIVALENTS							

Change in cash and cash equivalents			36,439			234,567		59,695		330,701
Balance, beginning of year			2,895			69,722		2,347		74,964
Balance, end of period	$	$	39,334	$	$	304,289	$	62,042	$	$ 405,665

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2009

	Rayonier Inc. (Parent Guarantor)	ROC (Parent Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
CASH PROVIDED BY OPERATING ACTIVITIES	$ 98,194	$ 122,216	$ 25,000	$ 58,394	$ 169,973	$ (259,459)	$ 214,318
INVESTING ACTIVITIES							
Capital expenditures		(4)		(45,513)	(22,155)	2,594	(65,078)
Change in restricted cash					1,243		1,243
Investment in Subsidiaries			(144,911)			144,911	
Other				(7,240)	(445)		(7,685)
CASH USED FOR INVESTING ACTIVITIES		(4)	(144,911)	(52,753)	(21,357)	147,505	(71,520)
FINANCING ACTIVITIES							
Issuance of debt			172,500	5,000	80,000		257,500
Repayment of debt		(20,000)		(85,620)	(80,000)		(185,620)
Dividends paid	(118,540)						(118,540)
Proceeds from the issuance of common shares	9,228						9,228
Excess tax benefits on stock-based compensation				2,287			2,287
Repurchase of common shares	(1,388)						(1,388)
Purchase of exchangeable note hedge			(23,460)				(23,460)
Proceeds from issuance of warrant	12,506						12,506
Debt issuance costs			(4,129)				(4,129)
Distributions to / from Parent		(98,194)	(25,000)	117,240	(106,000)	111,954	
CASH (USED FOR) PROVIDED BY FINANCING ACTIVITIES	(98,194)	(118,194)	119,911	38,907	(106,000)	111,954	(51,616)
EFFECT OF EXCHANGE RATE CHANGES ON CASH				278			278
CASH AND CASH EQUIVALENTS							

Change in cash and cash equivalents		4,018		44,826	42,616		91,460
Balance, beginning of year		9,741		47,082	4,862		61,685
Balance, end of period	$	$ 13,759	$	$ 91,908	$ 47,478	$	$ 153,145

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

When we refer to we, us, our, the Company, or Rayonier, we mean Rayonier Inc. and its consolidated subsidiaries. References herein to N Financial Statements refer to the Notes to the Condensed Consolidated Financial Statements of Rayonier Inc. included in Item 1 of this Report.

The Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide a reader of our financial statements with a narrative from the perspective of management on our financial condition, results of operations, liquidity, and certain other factors which may affect future results. Our MD&A should be read in conjunction with the 2009 Annual Report on Form 10-K.

Forward - Looking Statements

Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, provide a safe harbor for forward-looking statements to encourage companies to provide prospective information about their companies. Certain statements in this document regarding anticipated financial outcomes including earnings guidance, if any, business and market conditions, outlook and other similar statements relating to Rayonier s future financial and operational performance, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and other federal securities laws. These forward-looking statements are identified by the use of words such as may, will, should, expect, estimate, believe, anticipate and other similar language.

Forward looking statements are subject to future events, risks and uncertainties (many of which are beyond our control or are currently unknown to us) as well as potentially inaccurate estimates, assumptions and judgments by us that could cause actual results to differ materially from results contemplated by our forward-looking statements. Some of these events, risks and uncertainties are set forth in Item 1A *Risk Factors* in our 2009 Annual Report on Form 10-K. Forward-looking statements are not guarantees of future performance and undue reliance should not be placed on these statements.

Critical Accounting Policies and Use of Estimates

The preparation of our consolidated financial statements requires us to make estimates, assumptions and judgments that affect our assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. We base these estimates and assumptions on historical data and trends, current fact patterns, expectations and other sources of information we believe are reasonable. Actual results may differ from these estimates under different conditions. For a full description of our critical accounting policies, see Item 7 *Management s Discussion and Analysis of Financial Condition and Results of Operations* in the 2009 Annual Report on Form 10-K.

Segments

We are a leading international forest products company primarily engaged in timberland management, the sale and entitlement of real estate, and the production and sale of high value specialty cellulose fibers and fluff pulp. We operate in four reportable business segments: Timber, Real Estate, Performance Fibers, and Wood Products. The Timber sales include all activities which relate to the harvesting of timber. Real Estate sales include all property sales, including those designated for higher and better use (HBU). The assets of the Real Estate segment include HBU property held by the Company s real estate subsidiary, TerraPointe LLC. The Performance Fibers segment includes two major product lines, cellulose specialties and absorbent materials. The Wood Products segment is comprised of lumber operations. Our remaining operations include harvesting and selling timber acquired from third parties (log trading). These operations are combined and reported in Other Operations. Sales between operating segments are made based on fair market value, and intercompany sales, purchases and profits or losses are eliminated in consolidation.

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

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Results of Operations, Three and Nine Months Ended September 30, 2010 Compared to Three and Nine Months Ended September 30, 2009.

Financial Information (in millions)	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Sales				
Timber	$ 47.3	$ 46.5	$ 143.4	$ 125.0
Real Estate				
Development	0.4		2.0	1.4
Rural	18.6	14.1	26.2	23.7
Non-Strategic Timberlands	26.2	7.8	62.7	64.8
Total Real Estate	45.2	21.9	90.9	89.9
Performance Fibers				
Cellulose specialties	186.7	173.1	506.6	464.5
Absorbent materials	59.6	43.7	141.4	133.1
Total Performance Fibers	246.3	216.8	648.0	597.6
Wood Products	14.7	13.3	52.1	37.5
Other operations	25.4	8.5	72.8	23.2
Intersegment Eliminations	(1.4)	(6.4)	(7.3)	(14.5)
Total Sales	$ 377.5	$ 300.6	$ 999.9	$ 858.7
Operating Income (Loss)				
Timber	$ 9.2	$ 1.0	$ 26.0	$ (0.9)
Real Estate	30.8	12.8	52.3	51.4
Performance Fibers	62.3	49.5	152.2	125.1
Wood Products	(1.4)	(2.0)	2.9	(8.1)
Other operations	(0.8)	(1.3)	0.5	(2.6)
Corporate and other expenses / eliminations (1)	(8.0)	51.1	(8.6)	123.7
Total Operating Income	92.1	111.1	225.3	288.6
Interest Expense	(12.9)	(12.8)	(37.7)	(37.6)
Interest / Other income	0.3	0.3	0.9	0.5
Income tax expense	(16.6)	(17.5)	(30.1)	(36.7)

Net Income	$ 62.9	$ 81.1	$ 158.4	$ 214.8
Diluted Earnings Per Share	$ 0.77	$ 1.01	$ 1.95	$ 2.69

(1) The nine months ended September 30, 2010 includes a first quarter gain of $12.4 million from the sale of a portion of the Company s interest in its New Zealand joint venture. See Note 6 *Joint Venture Investment* for additional information. The three and nine months ended September 30, 2009 include $55.8 million and $141.8 million, respectively, related to the alternative fuel mixture credit (AFMC). See Note 2 *Alternative Fuel Mixture Credit (AFMC) and Cellulosic Biofuel Producer Credit (CBPC)* for additional information.

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TIMBER

Sales (in millions)		Changes Attributable to:			
	2009	Price	Volume/Mix	Other	2010
Three months ended September 30,					
Eastern	$ 29.5	$ 3.5	$ (8.2)	$	$ 24.8
Western	14.8	6.3	(0.9)		20.2
New Zealand	2.2				