

RAYONIER INC  
Form 10-Q  
July 26, 2013  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

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 No. 13-2607329

1301 RIVERPLACE BOULEVARD

JACKSONVILLE, FL 32207

(Principal Executive Office)

Telephone Number: (904) 357-9100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 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  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  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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of July 18, 2013, there were outstanding 126,119,760 Common Shares of the registrant.



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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

RAYONIER INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
AND COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
SALES	\$409,077	\$348,096	\$802,796	\$684,667
Costs and Expenses				
Cost of sales	297,698	243,571	563,716	479,279
Selling and general expenses	16,929	15,892	33,028	35,157
Other operating expense (income), net	291	(5,295 )	(3,212 )	(6,433 )
	314,918	254,168	593,532	508,003
Equity in income of New Zealand joint venture	304	170	562	184
OPERATING INCOME BEFORE GAIN ON CONSOLIDATION OF NEW ZEALAND JOINT VENTURE	94,463	94,098	209,826	176,848
Gain related to consolidation of New Zealand joint venture (Note 6)	16,098	—	16,098	—
OPERATING INCOME	110,561	94,098	225,924	176,848
Interest expense	(10,019 )	(16,056 )	(17,736 )	(27,880 )
Interest and miscellaneous income, net	2,598	84	2,656	60
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	103,140	78,126	210,844	149,028
Income tax expense	(15,249 )	(12,035 )	(19,695 )	(30,338 )
INCOME FROM CONTINUING OPERATIONS DISCONTINUED OPERATIONS, NET (Note 2)	87,891	66,091	191,149	118,690
Income from discontinued operations, net of income tax expense of \$0, \$1,505, \$22,273 and \$1,927	—	2,988	44,477	3,825
NET INCOME	87,891	69,079	235,626	122,515
Net income attributable to noncontrolling interest	727	—	727	—
NET INCOME ATTRIBUTABLE TO RAYONIER INC.	87,164	69,079	234,899	122,515
OTHER COMPREHENSIVE (LOSS) INCOME				
Foreign currency translation adjustment	(28,201 )	(8,081 )	(27,226 )	(2,255 )
New Zealand joint venture cash flow hedges	222	(1,998 )	775	(793 )
Amortization of pension and postretirement plans, net of income tax expense of \$1,620, \$1,482, \$3,824 and \$2,850	3,717	3,401	8,687	6,541
Total other comprehensive (loss) income	(24,262 )	(6,678 )	(17,764 )	3,493
COMPREHENSIVE INCOME	63,629	62,401	217,862	126,008
Comprehensive loss attributable to noncontrolling interest	(9,505 )	—	(9,505 )	—
COMPREHENSIVE INCOME ATTRIBUTABLE TO RAYONIER INC.	\$73,134	\$62,401	\$227,367	\$126,008
EARNINGS PER COMMON SHARE (Note 3)				
BASIC EARNINGS PER SHARE ATTRIBUTABLE TO RAYONIER INC.				

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Continuing Operations	\$0.69	\$0.54	\$1.52	\$0.97
Discontinued Operations	—	0.02	0.36	0.03
Net Income	\$0.69	\$0.56	\$1.88	\$1.00
DILUTED EARNINGS PER SHARE ATTRIBUTABLE TO RAYONIER INC.				
Continuing Operations	\$0.67	\$0.52	\$1.46	\$0.93
Discontinued Operations	—	0.02	0.34	0.03
Net Income	\$0.67	\$0.54	\$1.80	\$0.96

See Notes to Consolidated Financial Statements.

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RAYONIER INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Unaudited)  
(Dollars in thousands)

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$343,581	\$280,596
Accounts receivable, less allowance for doubtful accounts of \$685 and \$417	116,538	100,359
Inventory		
Finished goods	79,121	103,568
Work in progress	3,047	4,446
Raw materials	14,620	17,602
Manufacturing and maintenance supplies	2,303	2,350
Total inventory	99,091	127,966
Deferred tax assets	55,563	15,845
Prepaid and other current assets	67,444	41,508
Total current assets	682,217	566,274
TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION	2,080,611	1,573,309
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Land	22,996	27,383
Buildings	166,578	147,445
Machinery and equipment	1,644,945	1,444,012
Construction in progress	123,621	268,459
Total property, plant and equipment, gross	1,958,140	1,887,299
Less — accumulated depreciation	(1,105,708)	(1,180,261)
Total property, plant and equipment, net	852,432	707,038
INVESTMENT IN JOINT VENTURE (Note 6)	—	72,419
OTHER ASSETS	212,791	203,911
<b>TOTAL ASSETS</b>	<b>\$3,828,051</b>	<b>\$3,122,951</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$133,255	\$70,381
Current maturities of long-term debt	75,463	150,000
Accrued taxes	20,158	13,824
Accrued payroll and benefits	20,489	28,068
Accrued interest	9,835	7,956
Accrued customer incentives	10,743	10,849
Other current liabilities	51,842	18,640
Current liabilities for dispositions and discontinued operations (Note 13)	8,686	8,105
Total current liabilities	330,471	307,823
LONG-TERM DEBT	1,591,834	1,120,052
NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS (Note 13)	69,442	73,590
PENSION AND OTHER POSTRETIREMENT BENEFITS (Note 15)	158,594	159,582
OTHER NON-CURRENT LIABILITIES	27,590	23,900
COMMITMENTS AND CONTINGENCIES (Notes 11, 12 and 14)		

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SHAREHOLDERS' EQUITY

Common Shares, 480,000,000 shares authorized, 126,119,760 and 123,332,444 shares issued and outstanding	679,803		670,749
Retained earnings	1,000,647		876,634
Accumulated other comprehensive loss	(116,911	)	(109,379
TOTAL RAYONIER INC. SHAREHOLDERS' EQUITY	1,563,539		1,438,004
Noncontrolling interest	86,581		—
TOTAL SHAREHOLDERS' EQUITY	1,650,120		1,438,004
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$3,828,051		\$3,122,951

See Notes to Consolidated Financial Statements.

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RAYONIER INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(Dollars in thousands)

	Six Months Ended June 30,	
	2013	2012
<b>OPERATING ACTIVITIES</b>		
Net income	\$235,626	\$122,515
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation, depletion and amortization	79,659	64,592
Non-cash cost of real estate sold	2,593	2,401
Stock-based incentive compensation expense	6,226	9,460
Amortization of debt discount/premium	837	3,863
Deferred income taxes	38,107	(15,044)
Tax benefit of AFMC for CBPC exchange	(18,761)	)
Amortization of losses from pension and postretirement plans	11,617	9,391
Gain on sale of discontinued operations, net	(42,670)	)
Gain related to consolidation of New Zealand joint venture	(16,098)	)
Other	(8,936)	) (586)
Changes in operating assets and liabilities:		
Receivables	(11,782)	) (13,773)
Inventories	27,325	7,096
Accounts payable	19,535	(9,518)
Income tax receivable/payable	(5,626)	) 31,758
All other operating activities	(7,654)	) 1,524
Payment to exchange AFMC for CBPC	(70,311)	)
Expenditures for dispositions and discontinued operations	(4,015)	) (4,803)
<b>CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>235,672</b>	<b>208,876</b>
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(94,126)	) (76,246)
Purchase of additional interest in New Zealand joint venture	(139,879)	) —
Purchase of timberlands	(10,447)	) (8,687)
Jesup mill cellulose specialties expansion (gross purchases of \$114,449 and \$72,662, net of purchases on account of \$14,264 and \$8,664)	(100,185)	) (63,998)
Proceeds from disposition of Wood Products business, net of income tax payments of \$11,137	72,953	—
Change in restricted cash	7,603	(14,427)
Other	20,076	(704)
<b>CASH USED FOR INVESTING ACTIVITIES</b>	<b>(244,005)</b>	<b>) (164,062)</b>
<b>FINANCING ACTIVITIES</b>		
Issuance of debt	455,000	355,000
Repayment of debt	(273,087)	) (188,110)
Dividends paid	(113,222)	) (98,201)
Proceeds from the issuance of common shares	6,643	3,980
Excess tax benefits on stock-based compensation	7,399	4,234
Debt issuance costs	—	(3,653)
Repurchase of common shares	(11,241)	) (7,783)
<b>CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>71,492</b>	<b>65,467</b>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	<b>(174)</b>	<b>) 219</b>



CASH AND CASH EQUIVALENTS

Change in cash and cash equivalents	62,985	110,500
Balance, beginning of year	280,596	78,603
Balance, end of period	\$343,581	\$189,103

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period:

Interest	\$16,754	\$10,936
Income taxes	\$84,508	\$10,989

Non-cash investing activity:

Capital assets purchased on account	\$59,729	\$30,175
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Non-cash financing activity:

Shareholder debt assumed in acquisition of New Zealand joint venture	\$125,532	\$—
Conversion of shareholder debt to equity noncontrolling interest	\$(95,961)	) \$—

See Notes to Consolidated Financial Statements.

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RAYONIER INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)  
(Dollar amounts in thousands unless otherwise stated)

1. BASIS OF PRESENTATION

Basis of Presentation

The unaudited 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”). In the opinion of management, these financial statements and notes reflect all adjustments (all of which are 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, 2012, as filed with the SEC.

Reclassifications

Certain 2012 amounts have been reclassified to agree with the current year presentation. See Note 2 — Sale of Wood Products Business for information regarding reclassifications for discontinued operations.

New Accounting Standards

In December 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The standard requires enhanced disclosures about assets and liabilities that are subject to a master netting agreement or when the right of offset exists. In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. This pronouncement limits the scope of ASU No. 2011-1. The standards’ disclosure requirements are retrospective and were effective beginning in first quarter 2013. See Note 9 — Derivative Financial Instruments and Hedging Activities for the disclosures required under this guidance.

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This standard requires reporting, in one place, information about reclassifications out of AOCI by component. An entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount is reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified to net income in their entirety, an entity is required to cross-reference to other currently required disclosures that provide additional detail about those amounts. The information required by this standard must be presented in one place, either parenthetically on the face of the financial statements by income statement line item or in a note. See Note 17 — Accumulated Other Comprehensive Loss for the disclosures required under this guidance.

In March 2013, the FASB issued ASU No. 2013-05, Parent’s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. This standard requires a parent entity to release a related foreign entity’s cumulative translation adjustment into net income only if its sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The cumulative translation adjustment should be released into net income if the transaction results in the loss of a controlling financial interest in a foreign entity or results in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date. ASU No. 2013-05 will be effective for first quarter 2014. The Company does not expect that the adoption of this standard will have a material impact on the consolidated financial statements.

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 were identified that warranted disclosure. On July 19, 2013, the Board of Directors approved an increase in the quarterly dividend per share from \$0.44 per share to \$0.49 per share

effective for the third quarter 2013 distribution. Additionally, the New Zealand JV negotiated an amendment to its debt facility, as discussed in Note 16 — Debt.

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

**2. SALE OF WOOD PRODUCTS BUSINESS**

On March 1, 2013, Rayonier completed the sale of its Wood Products business (consisting of three lumber mills in Baxley, Swainsboro and Eatonton, Georgia) to International Forest Products Limited (“Interfor”) for \$80 million plus a working capital adjustment. The sale is consistent with the Company’s strategic plan to fully position its manufacturing operations in the specialty chemicals sector. Rayonier will not have significant continuing involvement in the operations of the Wood Products business. Accordingly, the operating results of the Wood Products business, formerly reported as a separate operating segment, are classified as discontinued operations in the Company’s Consolidated Statements of Income and Comprehensive Income for all periods presented. Certain administrative and general costs historically allocated to the Wood Products segment, which will remain with the Company after the sale, are reported in continuing operations.

Rayonier recognized an after-tax gain of \$42.7 million on the sale. The gain is included in “Income from discontinued operations, net” on the Consolidated Statements of Income and Comprehensive Income for the six months ended June 30, 2013.

The following table summarizes the operating results of the Company’s discontinued operations and the related gain for the three and six months ended June 30, 2013 and 2012, as presented in “Income from discontinued operations, net” in the Consolidated Statements of Income and Comprehensive Income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Sales	\$—	\$23,830	\$16,968	\$43,039
Cost of sales and other	—	(19,337 )	(14,258 )	(37,287 )
Gain on sale of discontinued operations	—	—	64,040	—
Income from discontinued operations before income taxes	—	4,493	66,750	5,752
Income tax expense	—	(1,505 )	(22,273 )	(1,927 )
Income from discontinued operations, net	\$—	\$2,988	\$44,477	\$3,825

The sale did not meet the “held for sale” criteria prior to the period it was completed. The major classes of Wood Products assets and liabilities included in the sale were as follows:

	March 1, 2013
Accounts receivable, net	\$4,127
Inventory	4,270
Prepaid and other current assets	2,053
Property, plant and equipment, net	9,990
Total assets	\$20,440
Total liabilities	\$596

Cash flows from discontinued operations are immaterial both individually and in the aggregate. As such, they are included with cash flows from continuing operations in the Consolidated Statements of Cash Flows.

Pursuant to the purchase and sale agreement, Rayonier will provide Interfor with saw timber procurement services for the three lumber mills through December 31, 2013. Rayonier also contracted with Interfor to purchase wood chips produced at the lumber mills for use at Rayonier’s Jesup mill and market other wood chips produced by the mills to third parties on Interfor’s behalf. The Company will purchase 100 percent of the Baxley mill chips for five years and

25 percent of the Swainsboro mill chips through 2013. The purchase price of these chips will be based on the average price paid by the Company to unrelated third parties.

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

Prior to the Wood Products sale, saw timber procurement services for and wood chip purchases from the lumber mills were intercompany transactions eliminated in consolidation as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Wood chip purchases	\$—	\$3,003	\$1,650	\$6,237
Saw timber procurement services	—	287	223	574
Total intercompany	\$—	\$3,290	\$1,873	\$6,811

## 3. EARNINGS PER COMMON SHARE

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Income from continuing operations	\$87,891	\$66,091	\$191,149	\$118,690
Income from continuing operations attributable to noncontrolling interest	727	—	727	—
Income from continuing operations attributable to Rayonier Inc.	\$87,164	\$66,091	\$190,422	\$118,690
Income from discontinued operations attributable to Rayonier Inc.	\$—	\$2,988	\$44,477	\$3,825
Net income attributable to Rayonier Inc.	\$87,164	\$69,079	\$234,899	\$122,515
Shares used for determining basic earnings per common share	126,027,297	122,455,464	125,257,876	122,403,388
Dilutive effect of:				
Stock options	504,321	669,298	519,014	692,622
Performance and restricted shares	386,228	726,368	384,910	727,968
Assumed conversion of Senior Exchangeable Notes (a)	2,217,058	2,669,808	2,173,658	2,830,382
Assumed conversion of warrants (a) (b)	1,632,345	890,189	2,250,361	1,077,217
Shares used for determining diluted earnings per common share	130,767,249	127,411,127	130,585,819	127,731,577
Basic earnings per common share attributable to Rayonier Inc.:				
Continuing operations	\$0.69	\$0.54	\$1.52	\$0.97
Discontinued operations	—	0.02	0.36	0.03
Net income	\$0.69	\$0.56	\$1.88	\$1.00
Diluted earnings per common share attributable to Rayonier Inc.:				
Continuing operations	\$0.67	\$0.52	\$1.46	\$0.93
Discontinued operations	—	0.02	0.34	0.03
Net income	\$0.67	\$0.54	\$1.80	\$0.96



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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Anti-dilutive shares excluded from the computations of diluted earnings per share:				
Stock options, performance and restricted shares	199,245	318,666	207,097	326,777
Assumed conversion of exchangeable note hedges	2,217,058	2,669,808	2,173,658	2,830,382
(a)				
Total	2,416,303	2,988,474	2,380,755	3,157,159

(a) The Senior Exchangeable Notes due 2012 (the “2012 Notes”) matured in October 2012; however, no additional shares were issued due to offsetting exchangeable note hedges. Similarly, Rayonier will not issue additional shares upon maturity of the Senior Exchangeable Notes due 2015 (the “2015 Notes”) due to offsetting hedges. Accounting Standards Codification 260, Earnings Per Share requires the assumed conversion of the Notes to be included in dilutive shares if the average stock price for the period exceeds the strike prices, while the assumed conversion of the hedges is excluded since they are anti-dilutive. As such, the dilutive effect of the assumed conversion of the 2012 Notes was only included for the three and six months ended June 30, 2012, while the effect of the 2015 Notes was included for all periods presented.

The warrants sold in conjunction with the 2012 Notes began maturing on January 15, 2013 and matured ratably through March 27, 2013. As a result, 2,037,303 shares were issued through the end of the first quarter and 97,918 shares were issued in the first week of April. The dilutive impact of these warrants was calculated based on the length of time they were outstanding before settlement. Rayonier will distribute additional shares upon maturity of the warrants for the 2015 Notes if the stock price exceeds \$39.35 per share. For information on the potential dilutive impact of the Senior Exchangeable Notes, warrants and exchangeable note hedges, see Note 11 — Debt in the 2012 Annual Report on Form 10-K and Note 16 — Debt of this Form 10-Q.

(b) The higher shares used for the assumed conversion of the warrants were primarily due to an increase in the average stock price from \$43.74 for the three months ended June 30, 2012 to \$57.15 for the three months ended June 30, 2013 and from \$44.40 for the six months ended June 30, 2012 to \$56.34 for the six months ended June 30, 2013. The impact of the higher stock price was partially offset by a decrease in dilutive shares due to the maturity of the warrants on the Notes due 2012.

**4. INCOME TAXES**

Rayonier is a real estate investment trust (“REIT”). In general, only its taxable REIT subsidiaries, whose businesses include the Company’s non-REIT qualified activities, and foreign operations are subject to corporate income taxes. However, the Company was 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. In 2011, the law provided a built-in-gains tax holiday. In 2013, the law provided a built-in gains tax holiday for 2012 (retroactive) and 2013. Accordingly, the provision for corporate income taxes relates principally to current and deferred taxes on taxable REIT subsidiaries’ income and foreign operations.

Alternative Fuel Mixture Credit (“AFMC”) and Cellulosic Biofuel Producer Credit (“CBPC”)

The U.S. Internal Revenue Code allowed two credits for taxpayers that produced and used an alternative fuel in the operation of their business through December 31, 2009. The AFMC is a \$.50 per gallon refundable tax credit (which is not taxable), while the CBPC is a \$1.01 per gallon credit that is nonrefundable, taxable and has limitations based on an entity’s tax liability. Rayonier produces and uses an alternative fuel (“black liquor”) at its Jesup, Georgia and Fernandina Beach, Florida performance fibers mills, which qualified for both credits. The Company claimed the AFMC on its 2009 tax return.



In the first quarter of 2013 and the second quarter of 2012, management approved the exchange of approximately 120 million and 60 million gallons respectively, of black liquor previously claimed for the AFMC for the CBPC. As a result, the Company recorded a \$19 million tax benefit in first quarter 2013. The second quarter 2012 impact of the exchange was a \$9.1 million tax benefit partially offset by a \$3.4 million interest expense accrual. The IRS later released guidance stating interest payments are not required for AFMC funds exchanged for the CBPC, based upon the manner of the Company's original claim. As such, Rayonier subsequently reversed the interest expense in third quarter 2012. For additional information on the AFMC and CBPC, see Note 8 — Income Taxes in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

#### Provision for Income Taxes from Continuing Operations

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. The Company's effective tax rate in 2013 was lower than 2012 primarily due to recording the additional AFMC exchange, the federal research and experimentation tax credit and a \$4.9 million benefit associated with the completion of an

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

internal transfer of properties.

The table below reconciles the U.S. statutory rate to the Company's effective tax rate for each period presented (in millions of dollars):

	Three Months Ended June 30,					
	2013		2012			
Income tax expense at federal statutory rate	\$36	35.0	%	\$27	35.0	%
REIT income not subject to tax	(15	) (14.3	)	(6	) (8.7	)
Income tax expense before discrete items	21	20.7	%	21	26.3	%
Exchange of AFMC for CBPC	—	—		(9	) (10.9	)
Other	(6	) (5.9	)	—	—	
Income tax expense as reported	\$15	14.8	%	\$12	15.4	%

	Six Months Ended June 30,					
	2013		2012			
Income tax expense at federal statutory rate	\$74	35.0	%	\$52	35.0	%
REIT income not subject to tax	(26	) (12.4	)	(12	) (8.1	)
Other	(2	) (0.7	)	(1	) (0.5	)
Income tax expense before discrete items	46	21.9	%	39	26.4	%
Exchange of AFMC for CBPC	(19	) (8.9	)	(9	) (6.0	)
Gain related to consolidation of New Zealand joint venture	(5	) (2.7	)	—	—	
Other	(2	) (1.0	)	—	—	
Income tax expense as reported	\$20	9.3	%	\$30	20.4	%

**Provision for Income Taxes from Discontinued Operations**

In the first quarter, Rayonier completed the sale of its Wood Products business for \$80 million plus a working capital adjustment. For the six months ended June 30, 2013 and 2012, income tax expense related to discontinued operations was \$22.3 million (\$21.4 million from the gain on sale) and \$1.9 million, respectively. For the three months ended June 30, 2012, income tax related to discontinued operations was \$1.5 million. See Note 2 — Sale of Wood Products Business for additional information.

**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 LKE purchases are not completed, the proceeds are returned to the Company after 180 days and reclassified as available cash. As of June 30, 2013 and December 31, 2012, the Company had \$3.0 million and \$10.6 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**

On April 4, 2013 (the "acquisition date"), the Company acquired an additional 39 percent ownership interest in Matariki Forestry Group, a joint venture ("JV") that owns or leases approximately 0.3 million acres of New Zealand timberlands. As a result of the acquisition, Rayonier is a 65 percent owner of the JV and 100 percent of the results of its operations subsequent to April 4, 2013 have been included in the Company's consolidated financial statements, along with 100 percent of the JV's assets and liabilities at June 30, 2013. The portions of the consolidated financial position and results of operations attributable to the JV's 35 percent noncontrolling interest are also shown separately. Rayonier New

Zealand Limited (“RNZ”), a wholly-owned subsidiary of Rayonier Inc., continues to serve as the manager of the JV forests and operates a log trading business.

The purchase price of the additional interest in the JV was \$139.9 million, which included \$3.3 million of contingent consideration and was financed through our term credit agreement. As the purchase price was in New Zealand dollars, the Company

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

purchased foreign currency forward contracts to mitigate foreign currency risk on the purchase price. As a result, the Company recorded a benefit of \$1.7 million and received that amount upon maturity of the contracts on April 2, 2013. The contingent consideration arrangement required the Company to pay an additional consideration to the JV's selling (former) shareholders equal to a multiple of the increase in log prices for a six month period beginning in November 2012. We estimated the fair value of the contingent consideration arrangement at the acquisition date to be \$3.3 million. Fair value was determined using an average of the cost and freight (CFR) selling price of China A-grade 3.8 meter logs. As of June 30, 2013, the contingent consideration had been determined and paid in the amount of \$3.3 million.

Prior to the acquisition date, the Company accounted for its 26 percent interest in the JV as an equity method investment. The additional 39 percent interest acquired resulted in the Company obtaining a controlling financial interest in the JV and accordingly, the purchase was accounted for as a step-acquisition. Upon consolidation, the Company recognized a \$10.1 million deferred gain, which resulted from the original sale of its New Zealand operations to the joint venture in 2005 and a \$6 million benefit due to the required fair market value remeasurement of the Company's equity interest in the JV held before the purchase of the additional interest. Both gains are included in the line item "Gain related to consolidation of New Zealand joint venture" in the Consolidated Statements of Income and Comprehensive Income. The acquisition-date fair value of the previous equity interest was \$93.3 million. We have applied estimates and judgments in order to determine the fair value of assets acquired and liabilities assumed at the acquisition date. In determining fair value we utilized valuation methodologies including discounted cash flow analysis. The assumptions made in performing these valuations include assumptions as to discount rates, foreign exchange rates, and commodity prices. Any significant change in key assumptions may cause the acquisition accounting to be revised.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date:

	April 4, 2013
Accounts receivable, net	\$9,777
Inventory	2,465
Other current assets	6,767
Timber and timberlands, net	545,287
Other assets	25,436
Total identifiable assets acquired	589,732
Accounts payable	11,679
Current maturities of long-term debt	3,843
Accrued interest	2,038
Other current liabilities	3,624
Long-term debt (third party)	196,319
Long-term debt (shareholders) (a)	125,532
Other non-current liabilities	13,565
Total liabilities assumed	356,600
Net identifiable assets	233,132
Less: Fair value of equity method investment	(93,253 )
Purchase price	\$139,879

(a) Long-term debt included \$125.5 million of shareholder loans payable to the noncontrolling interest by the JV. Subsequent to the acquisition date, \$96.0 million of the noncontrolling interest's shareholder loans were converted to preferred equity.



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## RAYONIER INC. AND SUBSIDIARIES

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(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

The Company's operating results for the three and six months ended June 30, 2013 reflect 26 percent of the JV's income prior to the acquisition date, as reported in "Equity in income of New Zealand joint venture" in the Consolidated Statements of Income and Comprehensive Income. The amounts of revenue and earnings of the JV included in the Company's Consolidated Statements of Income and Comprehensive Income from the acquisition date to the period ended June 30, 2013 are as follows:

	Revenue and earnings from April 4, 2013 to June 30, 2013
Sales	\$47,426
Net Income	2,076

The following represents the pro forma consolidated sales and net income as if the JV had been included in the consolidated results of the Company for the three and six months ended June 30, 2013 and 2012:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Sales	\$409,077	\$399,228	\$837,322	\$778,810
Net Income	\$87,891	\$67,376	\$233,867	\$118,730

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

## 7. SHAREHOLDERS' EQUITY

An analysis of shareholders' equity for the six months ended June 30, 2013 and the year ended December 31, 2012 is shown below (share amounts not in thousands):

	Rayonier Inc. Shareholders Common Shares		Retained Earnings	Accumulated Other Comprehensive Income/(Loss)	Non-controlling Interest	Total Shareholders' Equity
	Shares	Amount				
Balance, December 31, 2011	122,035,177	\$630,286	\$806,235	\$(113,448 )	\$ —	\$1,323,073
Net income	—	—	278,685	—	—	278,685
Dividends (\$1.68 per share)	—	—	(208,286 )	—	—	(208,286 )
Issuance of shares under incentive stock plans	1,467,024	25,495	—	—	—	25,495
Stock-based compensation	—	15,116	—	—	—	15,116
Excess tax benefit on stock-based compensation	—	7,635	—	—	—	7,635
Repurchase of common shares (169,757 )	(169,757 )	(7,783 )	—	—	—	(7,783 )
Net loss from pension and postretirement plans	—	—	—	(496 )	—	(496 )
Foreign currency translation adjustment	—	—	—	4,352	—	4,352
Joint venture cash flow hedges	—	—	—	213	—	213
Balance, December 31, 2012	123,332,444	\$670,749	\$876,634	\$(109,379 )	\$ —	\$1,438,004
Acquisition of noncontrolling interest	—	—	—	—	96,086	96,086
Net income	—	—	234,899	—	727	235,626
Dividends (\$0.88 per share)	—	—	(110,886 )	—	—	(110,886 )
Issuance of shares under incentive stock plans	861,838	6,643	—	—	—	6,643
Stock-based compensation	—	6,253	—	—	—	6,253
Excess tax benefit on stock-based compensation	—	7,399	—	—	—	7,399
Repurchase of common shares (209,743 )	(209,743 )	(11,241 )	—	—	—	(11,241 )
Settlement of warrants (Note 16)	2,135,221	—	—	—	—	—
Amortization of pension and postretirement plans	—	—	—	8,687	—	8,687
Foreign currency translation adjustment	—	—	—	(17,650 )	(9,576 )	(27,226 )
Joint venture cash flow hedges	—	—	—	1,431	(656 )	775
Balance, June 30, 2013	126,119,760	\$679,803	\$1,000,647	\$(116,911 )	\$ 86,581	\$1,650,120

## 8. SEGMENT AND GEOGRAPHICAL INFORMATION

Rayonier operates in three reportable business segments: Forest Resources, Real Estate and Performance Fibers. Prior to the first quarter of 2013, the Company operated in four reportable business segments, which included Wood Products. In March 2013, the Company sold its Wood Products business and its operations are shown as discontinued operations for all periods presented. See Note 2 — Sale of Wood Products Business for additional information. On April 4, 2013, Rayonier acquired an additional 39 percent interest in the JV, bringing its total ownership to 65 percent. As a result, the JV's results of operations have been consolidated and included within the Forest Resources segment since April 4, when the Company acquired control of the entity. Accordingly, the JV's assets and liabilities are fully consolidated at June 30, 2013. See Note 6 — Joint Venture Investment for further information regarding the Company's joint venture.

Forest Resources sales include all activities related 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 Company's remaining operations include harvesting and selling timber acquired



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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

from third parties (log trading). These operations are reported in "Other Operations." Sales between operating segments are made based on estimated 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 Consolidated Statements of Income and Comprehensive Income is equal to segment income (loss). Certain income (loss) items in the 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 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:

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
Forest Resources	\$2,275,145	\$1,690,030
Real Estate	85,018	112,647
Performance Fibers	1,067,673	902,309
Wood Products (a)	—	18,454
Other Operations	31,045	23,296
Corporate and other	369,170	376,215
Total	\$3,828,051	\$3,122,951

(a) The Company sold its Wood Products segment during the first quarter of 2013. See Note 2 — Sale of Wood Products Business for additional information.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>SALES</b>				
Forest Resources	\$109,060	\$52,663	\$166,162	\$104,858
Real Estate	13,376	11,680	37,673	24,326
Performance Fibers	253,025	254,509	537,213	505,364
Other Operations	33,872	29,268	62,099	50,409
Intersegment Eliminations (b)	(256	) (24	) (351	) (290
Total	\$409,077	\$348,096	\$802,796	\$684,667

(b) Intersegment eliminations primarily reflect sales from our Forest Resources segment to our Performance Fibers segment.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>OPERATING INCOME(LOSS)</b>				
Forest Resources	\$20,890	\$8,249	\$34,145	\$16,254
Real Estate	6,105	5,999	22,947	12,477
Performance Fibers	79,081	83,727	170,751	164,357
Other Operations	1,779	1,148	1,944	218
Corporate and other (c)	2,706	(5,025	) (3,863	) (16,458
Total	\$110,561	\$94,098	\$225,924	\$176,848

(c) The three and six months ended June 30, 2013 includes a \$16.1 million gain related to the consolidation of the New Zealand JV. See Note 6 — Joint Venture Investment.



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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
DEPRECIATION, DEPLETION AND AMORTIZATION				
Forest Resources	\$27,291	\$17,066	\$43,735	\$33,900
Real Estate	2,469	1,600	6,646	3,445
Performance Fibers	13,649	15,139	28,802	26,500
Corporate and other	258	374	476	747
Total	\$43,667	\$34,179	\$79,659	\$64,592

## 9. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The Company is exposed to market risk related to potential fluctuations in foreign currency exchange rates, interest rates and fuel prices. The Company's New Zealand JV uses derivative financial instruments to mitigate the financial impact of exposure to these risks.

Accounting for derivative financial instruments is governed by ASC Topic 815, "Derivatives and Hedging," ("ASC 815"). In accordance with ASC 815, the Company records its derivatives instruments at fair value as either assets or liabilities in the Consolidated Balance Sheets. Changes in the instruments' fair value are accounted for based on their intended use. Gains and losses on derivatives that are designated and qualify for cash flow hedge accounting are recorded as a component of accumulated other comprehensive income ("AOCI") and reclassified into earnings when the hedged transaction materializes. The ineffective portion of any hedge as well as changes in the fair value of derivatives not designated as hedging instruments and those which are no longer effective as hedging instruments, are recognized immediately in earnings.

## Foreign Currency Exchange and Option Contracts

The functional currency of the Company's New Zealand-based operations and JV is the New Zealand dollar. These operations are exposed to foreign currency risk on export sales and ocean freight payments which are predominately denominated in US dollars. The Company typically hedges at least 70 percent of its estimated foreign currency exposure with respect to the following three months forecasted sales and purchases and 50 percent of the forward twelve months.

The fair value of foreign currency exchange contracts is determined by a mark to market valuation which estimates fair value by discounting the difference between the contracted forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate. The fair value of foreign currency option contracts is based on a mark to market calculation using the Black Scholes option pricing model.

## Interest Rate Swaps

The Company uses interest rate swaps to manage the JV's exposure to interest rate movements on its variable rate debt attributable to changes in the New Zealand Bank bill rate. By converting a portion of these borrowings from floating rates to fixed rates the Company has reduced the impact of interest rate changes on its expected future cash outflows. As of June 30, 2013, the Company's interest rate contracts had maturity dates through January 2020.

## Fuel Hedge Contracts

The Company uses fuel swap contracts to manage its JV's exposure to changes in New Zealand's domestic diesel prices. The fuel swaps are quoted by domestic banks in New Zealand dollar price terms. As of June 30, 2013 all of the contracts had maturities of less than one year. The fair value of the fuel swap contracts is determined by a mark to market valuation which estimates fair value by discounting the difference between the contracted forward price and the current forward price for the residual maturity of the contract.



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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

The following table demonstrates the impact of the Company's derivatives on the Consolidated Statements of Income and Comprehensive Income for the second quarter and six months ended June 30, 2013:

	Income Statement Location	June 30, 2013	
		Three Months Ended	Six Months Ended
Derivatives designated as cash flow hedges:			
Foreign currency exchange contracts	Other comprehensive income/(loss) (a)	\$(1,509 )	\$(1,509 )
Foreign currency option contracts	Other comprehensive income/(loss) (a)	(363 )	(363 )
Derivatives not designated as hedging instruments:			
Foreign currency exchange contracts	Other operating (expense) income	(456 )	1,426
Foreign currency option contracts	Other operating (expense) income	(1,491 )	(1,491 )
Interest rate swaps	Interest and other miscellaneous income	2,650	2,650
Fuel hedges	Cost of sales - benefit	148	148

(a) See Note 17 — Accumulated Other Comprehensive Loss.

During the next 12 months, the amount of the June 30, 2013 AOCI balance, net of tax, expected to be reclassified into earnings as a result of the maturation of the Company's derivative instruments is a loss of approximately \$1.9 million. The following table contains the notional amounts of the derivative financial instruments recorded in the Consolidated Balance Sheet at June 30, 2013:

	June 30, 2013 Notional Amount (a)
Derivatives designated as cash flow hedges:	
Foreign currency exchange contracts	19,000
Foreign currency option contracts	26,000
Derivatives not designated as hedging instruments:	
Foreign currency exchange contracts	7,020
Foreign currency option contracts	30,000
Interest rate swaps	172,497
Fuel contracts	40

(a) All notional amounts are stated in dollars except fuel contracts which are denominated in thousands of barrels.

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

The following table contains the fair values of the derivative financial instruments recorded in the Consolidated Balance Sheet at June 30, 2013:

	June 30, 2013	
	Location on Balance Sheet	Fair Value Assets (Liabilities) (a)
Derivatives designated as cash flow hedges:		
Foreign currency exchange contracts	Other current liabilities	(891 )
Foreign currency option contracts	Other current liabilities	(363 )
Derivatives not designated as hedging instruments:		
Foreign currency exchange contracts	Other current liabilities	(174 )
Foreign currency option contracts	Other current liabilities	(352 )
Interest rate swaps	Other current liabilities	(2,843 )
	Other non-current liabilities	(6,443 )
Fuel contracts	Other assets	69
Total derivative contracts:		
Other assets		69
Total derivative assets		\$69
Other current liabilities		(4,623 )
Other non-current liabilities		(6,443 )
Total derivative liabilities		\$(11,066 )

(a) See Note 10 — Fair Value Measurements for further information on the fair value of our derivatives including their classification within the fair value hierarchy.

## Offsetting Derivatives

Derivative financial instruments are presented at their gross fair values in the Consolidated Balance Sheets. The Company's derivative financial instruments are not subject to master netting arrangements which would allow the right of offset.

## 10. FAIR VALUE MEASUREMENTS

## Fair Value of Financial Instruments

The Accounting Standards Codification established a three-level hierarchy that prioritizes the inputs used to measure fair value as follows:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than quoted prices included in Level 1.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

The following table presents the carrying amount, estimated fair values and categorization under the fair value hierarchy of financial instruments held by the Company at June 30, 2013 and December 31, 2012, using market information and what management believes to be appropriate valuation methodologies under generally accepted accounting principles:

Asset (liability)	June 30, 2013			December 31, 2012		
	Carrying Amount	Fair Value		Carrying Amount	Fair Value	
		Level 1	Level 2		Level 1	Level 2
Cash and cash equivalents	\$343,581	\$343,581	\$—	\$280,596	\$280,596	\$—
Restricted cash (a)	2,956	2,956	—	10,559	10,559	—
Current maturities of long-term debt	(75,463 )	—	(75,463 )	(150,000 )	—	(150,000 )
Long-term debt	(1,591,834 )	—	(1,718,249 )	(1,120,052 )	—	(1,250,341 )
Interest rate swaps (b)	(9,286 )	—	(9,286 )	—	—	—
Foreign currency exchange contracts (b)	(1,065 )	—	(1,065 )	—	—	—
Foreign currency option contracts (b)	(716 )	—	(716 )	—	—	—
Fuel contracts (b)	69	—	69	—	—	—

(a) Restricted cash is recorded in “Other Assets” and represents the proceeds from LKE sales deposited with a third-party intermediary.

(b) See Note 9 — Derivative Financial Instruments and Hedging Activities for information regarding the Balance Sheet classification of the Company’s derivative financial instruments.

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

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

Debt — The fair value of fixed rate debt is based upon quoted market prices for debt with similar terms and maturities. The variable rate debt adjusts with changes in the market rate, therefore the carrying value approximates fair value.

Interest rate swap agreements — The fair value of interest rate contracts is determined by discounting the expected future cash flows, for each instrument, at prevailing interest rates.

Foreign currency exchange contracts — The fair value of foreign currency exchange contracts is determined by a mark-to-market valuation which estimates fair value by discounting the difference between the contracted forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate.

Foreign currency option contracts — The fair value of foreign currency options contracts is based on a mark-to-market calculation using the Black-Scholes option pricing model.

Fuel contracts — The fair value of diesel fuel contracts is determined by a mark-to-market valuation which estimates fair value by discounting the difference between the contracted forward price and the current forward price for the residual maturity of the contract.

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

## 11. GUARANTEES

The Company provides financial guarantees as required by creditors, insurance programs, and various governmental agencies. As of June 30, 2013, the following financial guarantees were outstanding:

Financial Commitments	Maximum Potential Payment	Carrying Amount of Liability
Standby letters of credit (a)	\$18,205	\$15,000
Guarantees (b)	2,254	43
Surety bonds (c)	7,231	1,360
Total financial commitments	\$27,690	\$16,403

(a) Approximately \$15 million of the standby letters of credit serve as credit support for industrial revenue bonds. The remaining letters of credit support various insurance related agreements, primarily workers' compensation and pollution liability policy requirements. These letters of credit will expire at various dates during 2013 and 2014 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 \$2.3 million of obligations of a special-purpose entity that was established to complete the monetization. At June 30, 2013, the Company has a de minimus liability to reflect the fair market value of its obligation to perform under the make-whole agreement.

(c) Rayonier issues surety bonds primarily to secure timber harvesting obligations in the State of Washington and to provide collateral for the Company's workers' compensation self-insurance program in that state. These surety bonds expire at various dates between 2013 and 2014 and are expected to be renewed as required.

## 12. COMMITMENTS

As disclosed in the Company's Annual Report on Form 10-K, Rayonier leases certain buildings, machinery and equipment under various operating leases. The Company's commitments have not materially changed since December 31, 2012 except as related to the acquisition of a controlling interest in the New Zealand joint venture. The following table shows the increase in the Company's commitments, as of June 30, 2013, as a result of the JV acquisition:

	Forestry Rights (a)	Forest Leases (b)
Remaining 2013	\$884	\$541
2014	1,528	1,075
2015	1,528	1,075
2016	1,528	1,075
2017	1,528	1,075
Thereafter	39,757	53,889
	\$46,753	\$58,730

(a) Forestry rights grant access to the leased land for the purpose of harvesting. The majority of the JV's forestry rights terminate with the harvest of the land's existing crop and require the land to be left in the cut condition upon termination.

(b) Forest leases have an average term between 30 and 99 years. Annual rent is indexed to the Consumer Price Index or current market values. A number of these leases require the land to be returned in a fully stocked condition (replanted).

The JV has a number of Crown Forest Licenses ("CFL") with the New Zealand government. The leases extend indefinitely and may only be terminated upon a 35 year termination notice from the government. If no termination



notice is given, the leases renew automatically each year for a one year term. As of June 30, 2013, the JV has three CFL's under termination notice, with one terminating in 2034 and the remaining two expiring in 2062. The annual license fee is determined based on current market value, with three yearly rent reviews. The total annual license fee on the CFL's is \$2.7 million per year.

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## RAYONIER INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)

## 13. LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS

An analysis of the liabilities for dispositions and discontinued operations follows:

	June 30, 2013	December 31, 2012
Balance, beginning of period	\$81,695	\$90,824
Expenditures charged to liabilities	(4,015	) (9,926 )
Increase to liabilities	448	797
Balance, end of period	78,128	81,695
Less: Current portion	(8,686	) (8,105 )
Non-current portion	\$69,442	\$73,590

The Company is exposed to the risk of reasonably possible additional losses in excess of the established liabilities. As of June 30, 2013, this amount could range up to \$29 million, attributable to several of the applicable sites, and arises from uncertainty over the availability, feasibility and effectiveness of certain remediation technologies, additional or different contamination that may be discovered, development of new or more effective environmental remediation technologies, potential changes in applicable law and regulations, and the exercise of discretion in interpretation of applicable law and regulations by governmental agencies.

The Company believes established liabilities are sufficient for probable 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 include on-site (and in certain cases off-site) removal or treatment of contaminated soils and sediments, recovery and treatment/remediation of groundwater, and source remediation and/or control.

## 14. CONTINGENCIES

Rayonier is engaged in various legal actions, including certain environmental proceedings, and 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 adverse effect on the Company's financial position, results of operations, or cash flow.

## 15. EMPLOYEE BENEFIT PLANS

The Company has four qualified non-contributory defined benefit pension plans covering a significant majority of its employees and an unfunded plan that provides benefits in excess of amounts allowable under current tax law in the qualified plans. Currently, all qualified plans 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.

The net pension and postretirement benefit costs that have been recognized during the stated periods are shown in the following tables:

	Pension		Postretirement	
	Three Months Ended		Three Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Components of Net Periodic Benefit Cost				
Service cost	\$2,011	\$2,102	\$249	\$227

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Interest cost	3,953	4,321	240	242
Expected return on plan assets	(5,966	) (6,369	) —	—
Amortization of prior service cost	322	327	6	6
Amortization of losses	4,791	4,394	218	156
Net periodic benefit cost	\$5,111	\$4,775	\$713	\$631

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollar amounts in thousands unless otherwise stated)