RAYONIER INC
Form 10-Q
July 24, 2008
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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 June 30, 2008

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

50 North Laura Street, Jacksonville, FL 32202

(Principal Executive Office)

Telephone Number: (904) 357-9100

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 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 July 21, 2008, there were outstanding 78,625,172 Common Shares of the Registrant.

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RAYONIER INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended, June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
SALES	$ 304,867	$ 300,351	$ 589,060	$ 600,081
Costs and Expenses				
Cost of sales	237,036	231,125	448,047	462,867
Selling and general expenses	16,862	16,122	31,806	31,967
Other operating income, net	(3,420)	(1,548)	(4,706)	(4,542)
	250,478	245,699	475,147	490,292
Equity in (loss) income of New Zealand joint venture	(804)	1,071	168	1,094
OPERATING INCOME	53,585	55,723	114,081	110,883
Interest expense	(11,726)	(13,615)	(22,924)	(27,233)
Interest and miscellaneous income, net	620	1,171	2,120	2,184
INCOME BEFORE INCOME TAXES	42,479	43,279	93,277	85,834
Provision for income taxes	(5,063)	(9,968)	(15,310)	(17,444)
NET INCOME	37,416	33,311	77,967	68,390
OTHER COMPREHENSIVE (LOSS) INCOME				
Foreign currency translation adjustment	(1,587)	3,128	2,509	2,270
Amortization of pension and postretirement costs, net of tax provision of $627 and $511, and $1,189 and $1,071	1,440	1,227	2,785	2,552
COMPREHENSIVE INCOME	$ 37,269	$ 37,666	$ 83,261	$ 73,212
EARNINGS PER COMMON SHARE				
Basic earnings per share	$ 0.48	$ 0.43	$ 1.00	$ 0.88
Diluted earnings per share	$ 0.47	$ 0.42	$ 0.98	$ 0.87

See Notes to Condensed Consolidated Financials Statements.

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RAYONIER INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands)

	June 30, 2008	December 31, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 21,008	$ 181,081
Accounts receivable, less allowance for doubtful accounts of $586 and $677	99,023	81,068
Inventory		
Finished goods	76,459	63,083
Work in process	6,494	9,188
Raw materials	7,253	10,122
Manufacturing and maintenance supplies	2,327	1,898
Total inventory	92,533	84,291
Other current assets	61,912	49,780
Total current assets	274,476	396,220
TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION	1,285,750	1,117,219
PROPERTY, PLANT AND EQUIPMENT		
Land	24,983	25,282
Buildings	124,165	124,030
Machinery and equipment	1,228,106	1,190,852
Total property, plant and equipment	1,377,254	1,340,164
Less-accumulated depreciation	(1,017,183)	(994,409)
	360,071	345,755
INVESTMENT IN JOINT VENTURE	64,769	62,766
OTHER ASSETS	166,804	157,081
	$ 2,151,870	$ 2,079,041
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 78,814	$ 66,224
Bank loans and current maturities	585	55,585
Accrued taxes	15,223	7,179
Accrued payroll and benefits	18,192	30,065
Accrued interest	3,992	3,481
Accrued customer incentives	8,279	12,350
Other current liabilities	41,406	33,460
Current liabilities for dispositions and discontinued operations **(Note 11)**	10,474	10,069
Total current liabilities	176,965	218,413

LONG-TERM DEBT	794,259	694,259
NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS (Note 11)	98,399	103,616
PENSION AND OTHER POSTRETIREMENT BENEFITS (Note 13)	68,218	67,217
OTHER NON-CURRENT LIABILITIES	18,412	14,439
COMMITMENTS AND CONTINGENCIES (Notes 10 and 12)		
SHAREHOLDERS EQUITY		
Common shares, 120,000,000 shares authorized 78,623,522 and 78,216,696 shares issued and outstanding	497,167	487,407
Retained earnings	518,794	519,328
Accumulated other comprehensive loss	(20,344)	(25,638)
	995,617	981,097
	$ 2,151,870	$ 2,079,041

See Notes to Condensed Consolidated Financials Statements.

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RAYONIER INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
OPERATING ACTIVITIES		
Net income	$ 77,967	$ 68,390
Non-cash items included in net income:		
Depreciation, depletion and amortization	71,899	77,997
Non-cash cost of forest fire losses		9,601
Non-cash cost of real estate sold	4,606	3,578
Non-cash stock-based incentive compensation expense	7,075	7,597
Deferred income tax provision	6,943	988
Excess tax benefits on stock-based compensation	(2,088)	(4,675)
Other	2,926	2,759
(Increase) decrease in accounts receivable	(17,955)	418
Decrease in inventory	8,126	6,011
Increase (decrease) in accounts payable	10,009	(7,103)
Increase in other current assets	(14,303)	(7,694)
Increase (decrease) in accrued liabilities	1,421	(23,115)
Increase in other non-current liabilities	545	3,911
Decrease (increase) in other assets	1,096	(1,392)
Expenditures for dispositions and discontinued operations	(3,394)	(5,671)
CASH PROVIDED BY OPERATING ACTIVITIES	154,873	131,600
INVESTING ACTIVITIES		
Capital expenditures	(59,881)	(51,162)
Purchase of timberlands and wood chipping facilities	(229,424)	(11,668)
Decrease (increase) in restricted cash	6,591	(43,213)
Other	(1,510)	102
CASH USED FOR INVESTING ACTIVITIES	(284,224)	(105,941)
FINANCING ACTIVITIES		
Issuance of debt	120,000	100,000
Repayment of debt	(75,000)	(93,000)
Dividends paid	(78,343)	(72,749)
Repurchase of common shares	(3,738)	
Issuance of common shares	4,335	11,256
Excess tax benefits on stock-based compensation	2,088	4,675
CASH USED FOR FINANCING ACTIVITIES	(30,658)	(49,818)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(64)	290
CASH AND CASH EQUIVALENTS		
Decrease in cash and cash equivalents	(160,073)	(23,869)

Balance, beginning of year	181,081	40,171
Balance, end of period	$ 21,008	$ 16,302
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION AND NONCASH INVESTING ACTIVITIES:		
Cash paid during the period:		
Interest	$ 21,022	$ 42,797
Income taxes	$ 3,840	$ 15,653
Non-cash investing activity:		
Capital assets purchased on account	$ 12,665	$ 8,702

See Notes to Condensed Consolidated Financials 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

The unaudited condensed consolidated financial statements of Rayonier Inc. and its subsidiaries (Rayonier or the Company), 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. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of certain estimates by management in determining the amount of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. There are risks inherent in estimating; therefore, actual results could differ from those estimates. For a full description of the Company s significant accounting policies, please refer to the Notes to Consolidated Financial Statements in the 2007 Annual Report on Form 10-K.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157). This Standard defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. It applies to other accounting pronouncements where the FASB requires or permits fair value measurements but does not require any new fair value measurements. In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2, *Effective Date of FASB Statement No. 157*, which delayed the effective date of SFAS 157 for certain non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company adopted SFAS 157 for financial assets and liabilities on January 1, 2008. Adoption of SFAS 157 did not have any impact on the Company s results of operations or financial position and did not result in any additional disclosures. The Company is in the process of evaluating the effect, if any, the adoption of FSP No. 157-2 will have on its results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities- Including an amendment of FASB Statement No. 115* (SFAS 159 *).* This statement permits entities to choose to measure selected financial assets and liabilities at fair value. The Company did not elect to adopt the provisions of SFAS 159 for existing instruments eligible on January 1, 2008.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)). This statement modifies certain aspects of how the acquiring entity recognizes and measures the identifiable assets, the liabilities assumed and the goodwill acquired in a business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company has not determined the impact, if any, the statement will have on its financial condition, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51* (SFAS 160). SFAS 160 is effective for fiscal years beginning after December 15, 2008. This statement addresses changes to noncontrolling interests (more commonly known as minority interests) which is the portion of equity in a subsidiary not attributable to the parent entity. Presently, the Company does not have any non-controlling interests. Therefore, the Company currently believes that the impact of SFAS 160, if any, will primarily depend on the materiality of non-controlling interests arising in future transactions, including those entered into during 2008, to which the financial statement presentation and disclosure provisions of SFAS 160 will apply.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). This Statement requires enhanced disclosures about an entity s derivative and hedging activities, including (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The Company is in the process of evaluating the effect, if any, the adoption of SFAS 161 will have on its financial statements.

In May 2008, the FASB issued FASB Staff Position No. ARB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP ARB 14-1). FSP ARB 14-1 requires that entities with convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) separately account for the liability and equity components in a manner that reflects the entity s nonconvertible debt borrowing rate when interest expense is recognized in subsequent periods. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008. The Company s convertible debt is within the scope of FSP ARB 14-1. The Company is in the process of determining the impact the statement will have on its financial condition, results of operations and cash flows.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

2. EARNINGS PER COMMON SHARE

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

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net income	$ 37,416	$ 33,311	$ 77,967	$ 68,390
Shares used for determining basic earnings per common share	78,377,396	77,446,494	78,315,808	77,298,865
Dilutive effect of:				
Stock options	716,053	963,245	716,557	988,325
Performance and restricted shares	304,038	356,953	278,336	296,056
Shares used for determining diluted earnings per common share	79,397,487	78,766,692	79,310,701	78,583,246
Earnings per share:				
Basic	$ 0.48	$ 0.43	$ 1.00	$ 0.88
Diluted	$ 0.47	$ 0.42	$ 0.98	$ 0.87

3. INCOME TAXES

Rayonier is a real estate investment trust (REIT). In general, only the Company s taxable REIT subsidiaries, whose businesses include the Company s non-REIT qualified activities, are subject to U.S. federal and state corporate income taxes. However, the Company is subject to U.S. corporate income tax on built-in gains (the excess of fair market value over tax basis for property held by the Company upon REIT election at January 1, 2004) on taxable sales of such built-in gain property during the first 10 years following the election to be taxed as a REIT. Accordingly, the only provision for U.S. corporate income taxes relates to current and deferred taxes on certain property sales and on income from taxable REIT subsidiary operations. In addition, the Company is subject to foreign tax on non-U.S. operations.

Prohibited Transactions

As a REIT, the Company can be subject to a 100 percent tax on the gain resulting from prohibited transactions. The Company believes it has not engaged in any prohibited transactions since it elected REIT status.

Like-Kind Exchanges

Under current tax law, the built-in gain tax from the sale of REIT property can be eliminated if sale proceeds from relinquished properties are reinvested in similar property consistent with the like-kind exchange (LKE) requirements of the Internal Revenue Code of 1986, as amended, so long as the replacement property is owned at least until expiration of the built-in gain period (10-year period which began on January 1, 2004).

However, this does not restrict the Company s ability to harvest timber on a pay-as-cut basis from such replacement property during the built-in gain period.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

Undistributed Foreign Earnings

The Company has undistributed foreign earnings from its non-U.S. operations, which it intends to permanently reinvest overseas. The Company also intends to reinvest all future foreign earnings overseas. Therefore, no U.S. corporate income taxes have been provided on undistributed foreign earnings.

Provision for Income Taxes

The following table reconciles the Company s income tax provision at the U.S. statutory tax rate to the reported provision and effective tax rate for the three and six months ended June 30 (dollars in millions):

	Three months ended June 30,			
	2008	**%**	**2007**	**%**
Income tax provision at U.S. statutory rate	$ (14.8)	(35.0)	$ (15.1)	(35.0)
State and local income taxes, net of federal benefit	(0.2)	(0.5)	(0.4)	(0.8)
REIT income not subject to federal tax	10.2	24.0	6.1	14.0
Permanent differences/other	(0.2)	(0.2)	0.4	0.9
Income tax provision before discrete items	$ (5.0)	(11.7)	$ (9.0)	(20.9)
Discrete items	(0.1)	(0.2)	(1.0)	(2.1)
Income tax provision as reported	$ (5.1)	(11.9)	$ (10.0)	(23.0)

	Six months ended June 30,			
	2008	**%**	**2007**	**%**
Income tax provision at U.S. statutory rate	$ (32.6)	(35.0)	$ (30.0)	(35.0)
State and local income taxes, net of federal benefit	(0.8)	(0.9)	(0.7)	(0.8)
REIT income not subject to federal tax	17.9	19.1	13.7	16.0
Permanent differences/other	0.1	0.3	0.9	1.0
Income tax provision before discrete items	$ (15.4)	(16.5)	$ (16.1)	(18.8)
Discrete items	0.1	0.1	(1.3)	(1.5)
Income tax provision as reported	$ (15.3)	(16.4)	$ (17.4)	(20.3)

The Company s effective tax rate was 11.9 percent and 23.0 percent for the three months ended June 30, 2008 and 2007, and 16.4 percent and 20.3 percent for the six months ended June 30, 2008 and 2007, respectively. The rates decreased primarily due to proportionately lower expected earnings from the Company s taxable REIT subsidiary.

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, including LKE transactions. Partially offsetting these benefits is the loss of tax deductibility on interest expense of $1.3 million and $2.7 million for the three and six months ended June 30, 2008, respectively, and corporate overhead expenses associated with REIT activities of $2.9 million and $5.4 million for the same periods. The Company recognized $5.7 million in LKE tax benefits during the six months ended June 30, 2008 compared to $2.4 million in the six months ended June 30, 2007.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

Tax Audits

The following table provides detail of the tax years that remain subject to examination by the Internal Revenue Service (IRS) and other significant taxing jurisdictions:

Taxing Jurisdiction	Open Tax Periods
U.S. Internal Revenue Service	2005 2008
State of Florida	2003 2008
State of Georgia	2003 2008
State of Alabama	2003 2008
New Zealand Inland Revenue	2004 2008

The Company is currently at the Appeals administrative level related to one matter from the IRS examination of tax year 2003 and has other matters under review by various taxing authorities, including the examination of tax years 2005 and 2006 by the IRS. The Company believes its reported tax positions are technically sound and its uncertain tax position liabilities at June 30, 2008 adequately reflect the probable resolution of these items.

FIN 48 Disclosures

There were no significant changes to the Company s uncertain tax positions for the six months ended June 30, 2008. For a detail of the Company s uncertain tax positions, please refer to Note 9 *Income Taxes* in the 2007 Annual Report on Form 10-K.

4. RESTRICTED DEPOSITS

For certain real estate sales to qualify for LKE treatment, the sales proceeds must be deposited with a third party intermediary and accounted for as restricted cash until qualifying replacement property is acquired. In the event that LKE purchases are not completed, the proceeds are returned to the Company and reclassified as cash after 180 days. As of June 30, 2008 and December 31, 2007, the Company had $3.4 million and $10.0 million, respectively, of proceeds from real estate sales classified as restricted cash in Other assets, which were on deposit with an LKE intermediary.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

5. SHAREHOLDERS EQUITY

An analysis of shareholders equity for the six months ended June 30, 2008 and the year ended December 31, 2007 is shown below (share amounts not in thousands):

	Common Shares			Accumulated Other	
	Shares	Amount	Retained Earnings	Comprehensive Loss	Shareholders Equity
Balance, December 31, 2006	76,879,826	$ 450,636	$ 495,988	$ (28,646)	$ 917,978
Net income			174,269		174,269
Dividends ($1.94 per share)			(150,929)		(150,929)
Issuance of shares under incentive stock plans	1,412,781	18,891			18,891
Stock-based compensation expense		13,478			13,478
Warrants and hedge, net		(355)			(355)
Excess tax benefit on stock-based compensation		7,907			7,907
Repurchase of common shares	(75,911)	(3,150)			(3,150)
Net loss from pension and postretirement plans				(3,997)	(3,997)
Foreign currency translation adjustment				7,005	7,005
Balance, December 31, 2007	78,216,696	$ 487,407	$ 519,328	$ (25,638)	$ 981,097
Net income			77,967		77,967
Dividends ($1.00 per share)			(78,501)		(78,501)
Issuance of shares under incentive stock plans	491,322	4,335			4,335
Stock-based compensation expense		7,075			7,075
Excess tax benefit on stock-based compensation		2,088			2,088
Repurchase of common shares	(84,496)	(3,738)			(3,738)
Amortization of pension and postretirement costs				2,785	2,785
Foreign currency translation adjustment				2,509	2,509
Balance, June 30, 2008	78,623,522	$ 497,167	$ 518,794	$ (20,344)	$ 995,617

6. TIMBERLANDS ACQUISITION

In April 2008, the Company acquired approximately 56,300 acres of timberlands in the state of Washington for $213 million, funding the acquisition with $128 million of cash on hand and borrowings from the Company s existing credit facility. This acquisition increased the Company s existing holdings of merchantable Douglas fir and western hemlock timber and was accounted for as an asset purchase.

7. JOINT VENTURE INVESTMENT

The Company holds a 40 percent interest in a joint venture (JV) that owns approximately 340,000 acres of New Zealand timberlands. Rayonier s investment in the JV is accounted for using the equity method of accounting. In addition to the Company having an equity investment, Rayonier

New Zealand Limited (RNZ), a wholly-owned subsidiary of Rayonier Inc., serves as the manager of the JV forests, for which it receives a fee. 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 its operations. While the JV is subject to New Zealand income taxes, the Company generally is not required to pay U.S. federal and state income taxes on its equity investment income as it is a REIT subsidiary.

A portion of the Company s equity method 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 upon formation in 2005. The deferred gain is recognized on a straight-line basis over the estimated number of years the JV expects to harvest from the timberlands.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

The Company s investment in the JV was $64.8 million and $62.8 million at June 30, 2008 and December 31, 2007, respectively. The increase in the investment is mainly due to the change in the exchange rate between the New Zealand Dollar and the U.S. Dollar. For the three and six months ended June 30, 2008, the Company recognized an equity loss of $0.8 million and equity earnings of $0.2 million, respectively. For the three and six months ended June 30, 2007, the Company s equity earnings were $1.1 million.

8. SEGMENT INFORMATION

Rayonier operates in four reportable business segments as defined by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131): Timber, Real Estate, Performance Fibers, and Wood Products. Timber sales include all activities that relate to the harvesting of timber. Real Estate sales currently include the sale of all properties, 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, and parcels previously reported in the Timber segment. Allocations of depletion expense and non-cash costs of real estate sold are recorded when the Company sells an asset from the Timber segment. The Performance Fibers segment includes two major product lines, cellulose specialties and absorbent materials. The Wood Products segment is comprised of the Company s lumber operations. The Company s remaining operations include harvesting and selling timber acquired from third parties (log trading) and trading wood products. As permitted by SFAS 131, these operations are combined and reported in an Other category. Sales between operating segments are made based on fair market value, and intercompany profit or loss is 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 (provision)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:

	June 30, 2008	December 31, 2007
ASSETS		
Timber	$ 1,381,963	$ 1,204,253
Real Estate	92,975	65,101
Performance Fibers	501,395	466,909
Wood Products	30,383	29,307
Other Operations	33,063	29,671
Corporate and other	112,091	283,800
TOTAL	$ 2,151,870	$ 2,079,041

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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 June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
SALES				
Timber	$ 55,258	$ 56,701	$ 102,457	$ 121,706
Real Estate	23,425	29,154	52,776	50,151
Performance Fibers	187,121	167,840	362,047	334,222
Wood Products	24,489	23,774	43,401	43,467
Other Operations	14,574	22,892	28,379	50,499
Corporate and other		(10)		36
TOTAL	$ 304,867	$ 300,351	$ 589,060	$ 600,081

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
OPERATING INCOME (LOSS)				
Timber (a)	$ 9,485	$ 11,036	$ 21,505	$ 37,305
Real Estate	14,616	23,939	36,384	39,154
Performance Fibers	36,747	30,970	73,803	58,080
Wood Products	(338)	(681)	(2,882)	(4,009)
Other Operations	1,092	(974)	519	(2,255)
Corporate and other	(8,017)	(8,567)	(15,248)	(17,392)
TOTAL	$ 53,585	$ 55,723	$ 114,081	$ 110,883

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
DEPRECIATION, DEPLETION AND AMORTIZATION				
Timber (a)	$ 21,406	$ 26,164	$ 39,473	$ 47,937
Real Estate	2,633	990	5,328	3,155
Performance Fibers	12,837	17,811	24,001	33,131
Wood Products	1,363	1,604	2,807	3,196
Other Operations	8	10	17	30
Corporate and other	149	74	273	149
TOTAL	$ 38,396	$ 46,653	$ 71,899	$ 87,598

(a) Three and six months ended June 30, 2007 includes the $10.1 million forest fire loss.

9. FINANCIAL INSTRUMENTS

Commodity Swap Agreements

The Company enters into commodity forward contracts to fix some of its fuel oil and natural gas costs at its Performance Fibers mills. The Company s commodity forward contracts do not qualify for hedge accounting under SFAS 133 and instead are required to be marked-to-market.

During the three and six months ended June 30, 2008, the Company realized a gain of $0.9 million and $1.1 million, respectively, on fuel oil forward contracts. During the three and six months ended June 30, 2007, the Company realized a de minimus gain and a loss of $0.3 million, respectively, on fuel oil forward contracts. The mark-to-market adjustments are recorded in Other operating income, net. The mark-to-market valuation on outstanding fuel oil forward contracts at June 30, 2008 resulted in an asset of $0.9 million. At December 31, 2007, there were no outstanding fuel oil or natural gas forward contracts.

RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

10. GUARANTEES

The Company provides financial guarantees as required by creditors, insurance programs and state and foreign governmental agencies. As of June 30, 2008, the following financial guarantees were outstanding:

	Maximum Potential Payment	Carrying Amount of Liability
Standby letters of credit (1)	$ 71,778	$ 62,471
Guarantees (2)	5,119	63
Surety bonds (3)	9,789	1,441
Total	$ 86,686	$ 63,975

(1) Approximately $62 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 2008 and will be renewed as required.

(2) In conjunction with RNZ s sale of timberlands to the New Zealand JV in October 2005, the Company guaranteed five years of Crown Forest license obligations. The JV is the primary obligor and has posted a bank performance bond with the New Zealand government. If the JV fails to pay the obligation, the New Zealand government will demand payment from the bank that posted the bond. If the bank defaults on the bond, the Company would then have to perform. As of June 30, 2008, two annual payments, of $1.3 million each, remain. This guarantee expires in 2010.

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 $2.5 million of obligations of a qualified special purpose entity that was established to complete the monetization. At June 30, 2008 and December 31, 2007, the Company has recorded a de minimus liability to reflect the fair market value of its obligation to perform under the make-whole agreement.

(3) 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 that state. These surety bonds expire at various dates during 2009 and are renewed as required.

11. LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS

The Company s dispositions and discontinued operations include its Port Angeles, WA mill, which was closed in 1997; Southern Wood Piedmont Company (SWP), which ceased operations in 1989 except for investigation and remediation activities; the Eastern Research Division (ERD), which ceased operations in 1981; and other miscellaneous assets held for disposition. SWP is subject to the Resource Conservation and Recovery Act (RCRA), or has been designated a potentially responsible party, or has had other claims made against it, under the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and/or other federal or state statutes relating to the investigation and remediation of environmentally-impacted sites, with respect to 10 former SWP wood treating sites which are no longer operating.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

An analysis of activity in the liabilities for dispositions and discontinued operations for the six months ended June 30, 2008 and the year ended December 31, 2007, is as follows:

	June 30, 2008		December 31, 2007
Balance, January 1,	$ 113,685		$ 122,516
Expenditures charged to liabilities	(3,394)		(8,575)
Additions/(reductions) to liabilities	(1,418)	*	(256)
Balance, end of period	108,873		113,685
Less: Current portion	(10,474)		(10,069)
Non-current portion	$ 98,399		$ 103,616

* Includes $2.1 million reserve reduction for Combe Fill South lawsuit. See Note 12 - *Contingencies.*

Rayonier has identified specific liabilities for three SWP sites (Augusta, GA, Spartanburg, SC, and East Point, GA) as material and requiring separate disclosure, which was presented in the Company s 2007 Annual Report on Form 10-K. There have not been any significant changes in these sites liability reserves for the six months ended June 30, 2008. Rayonier accounts for environmental liabilities on an undiscounted basis. For an analysis of the activity for the three years ended December 31, 2007 and a brief description of these individually material sites, see the Company s 2007 Annual Report on Form 10-K, Note 15 to Consolidated Financial Statements.

The Company estimates that expenditures for environmental remediation, monitoring and other costs for all dispositions and discontinued operations will be approximately $8 million in 2008 and $10 million in 2009. Such costs will be charged against its liabilities for dispositions and discontinued operations, which include environmental investigation, remediation and monitoring costs. 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 may include, among other remedies, removal or treatment of contaminated soils, recovery and treatment/remediation of groundwater, and source remediation and/or control.

In addition, the Company is exposed to the risk of reasonably possible additional losses in excess of the established liabilities. As of June 30, 2008, this amount could range up to $30 million and arises from uncertainty over the effectiveness of treatments, additional contamination that may be discovered, changes in applicable law and the exercise of discretion in interpretation of applicable law and regulations by governmental agencies, and in environmental remediation technology.

The reliability and precision of cost estimates for these sites and the amount of actual future environmental costs can be impacted by various factors, including but not limited to: significant changes in discharge or treatment volumes, requirements to perform additional or different remediation, changes in environmental remediation technology, the extent of groundwater contamination migration, additional findings of contaminated soil or sediment off-site, remedy selection, and the outcome of negotiations with federal and state agencies. Additionally, the potential for Brownfield (environmentally impacted site considered for re-development) treatment of a site, or other similar projects, could accelerate expenditures as well as impact the amount and/or type of remediation required, as could new laws, regulations and the exercise of discretion in interpretation of applicable law and regulations by governmental agencies. Based on information currently available, the Company does not believe that any future changes in estimates, if necessary, would materially affect its consolidated financial position or results of operations.

12. CONTINGENCIES

From time to time, Rayonier may become liable with respect to pending and threatened litigation and environmental and other matters. The following updates or repeats commentary included in the 2007 Annual Report on Form 10-K.

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.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

Legal Proceedings

Combe Fill South In 1998, the U.S. Environmental Protection Agency (EPA) and the New Jersey Department of Environmental Protection (DEP) filed separate lawsuits against Rayonier Inc., and approximately 30 other defendants, in the U.S. District Court, District of New Jersey, seeking recovery of current and future response costs and natural resource damages under applicable federal and state law relating to a contaminated landfill in Chester Township, New Jersey, referred to as Combe Fill South (Combe). It is alleged that the Company s former ERD in Whippany, New Jersey sent small quantities of dumpster waste, via a contract hauler, to Combe in the 1960s and early 1970s. The Company is working with other defendants in a joint defense group, which subsequently filed third-party actions against over 200 parties seeking contribution. A court-ordered mediation process has been ongoing. In second quarter 2008, a tentative settlement of this matter was reached, subject to finalization of documentation and court approval, resulting in the Company s liability of approximately $0.3 million, a reduction of the prior reserve by $2.1 million. The Company believes that its liabilities at June 30, 2008 adequately reflect the probable costs to be incurred upon the ultimate resolution of these matters.

Jesup Mill Consent Decree In November 2007, the Company and the Environmental Protection Division of the Georgia Department of Natural Resources (EPD) reached agreement, subject to public comment, on a consent decree that would resolve certain issues relating to the color of the Jesup mill s permitted effluent discharged to the Altamaha River. Under the consent decree, Rayonier has agreed to implement a color reduction plan which will include installation of additional brown stock washing capacity (to better remove residual pulping liquors from cooked wood pulp) and oxygen delignification technology (which reduces the lignin content in the pulp prior to bleaching), spill recovery systems and modifications to certain operating practices. These projects will be completed over a seven year period pursuant to a time frame set forth in the consent decree, and the costs are expected to approximate $75.0 million. The consent decree also provides for decreasing color limits in the mill s effluent over the seven year period as projects are completed. No citations, fines or penalties are imposed by the consent decree, except that stipulated penalties may be assessed by EPD in the event that the projects are not completed by the agreed schedule. The public comment period has passed and the consent decree is now final.

East Point, Georgia Notice of Violation (NOV) On March 28, 2008, SWP received an NOV and Proposed Consent Order (the Order) from EPD relating to its East Point, Georgia site. The Order asserts that SWP violated conditions in its RCRA Part B permit, specifically related to SWP s alleged failure to report the presence of oil (referred to as DNAPL, or dense non-aqueous phase liquid) in a monitoring well. Under the terms of the Order, EPD proposed a fine of $0.8 million and is demanding that SWP perform a facility-wide remedial investigation; also, based on such investigation, EPD has required that SWP prepare a new corrective action plan for the facility. Finally, EPD is requesting an immediate increase in SWP s financial assurance for the site to $17.6 million from the current level of approximately $4.0 million. (Note that financial assurance is provided for SWP via a Rayonier Inc. guaranty.) The Company is conducting a factual and legal analysis of EPD s claims and intends to vigorously defend this matter. The Company believes its liabilities at June 30, 2008 adequately reflect the probable costs to be incurred upon the ultimate resolution of these matters.

Environmental Matters

The Company is subject to stringent environmental laws and regulations concerning air emissions, water discharges, waste handling and disposal, and forestry operations. Such environmental laws and regulations include the Federal Clean Air Act, the Clean Water Act, RCRA, CERCLA, the Endangered Species Act, and similar state laws and regulations. Management closely monitors its environmental responsibilities, and believes that the Company is in substantial compliance with current environmental requirements. Notwithstanding Rayonier s current compliance status, many of its operations are subject to stringent and constantly evolving environmental requirements, which are often the result of legislation, regulator discretion, regulation and negotiation. As such, contingencies in this area include, without limitation:

The Company s manufacturing facilities operate in accordance with various permits, which often impose conditions that require significant expenditures to ensure compliance. Upon renewal and renegotiation of these permits, the issuing agencies often seek to impose new or additional conditions, which could adversely affect the Company s operations and financial performance.

As environmental laws and regulations change, and regulatory administrative and judicial interpretations of new and existing laws and regulations are made, the Company s operations may be adversely affected.

In Rayonier s forestry operations, federal, state and local laws and regulations intended to protect threatened and endangered animal and plant species and their habitat, as well as wetlands and waterways, limit, and in some cases may prevent, timber harvesting, road construction and other activities on private lands. For example, Washington, where the Company holds approximately 426,000 acres of timberlands, has among the most stringent forestry laws and regulations in the country.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

Environmental requirements relating to real estate development, and especially in respect of wetland delineation and mitigation, stormwater management, drainage, waste disposal, and potable water supply and protection, may significantly impact the size, scope, timing, and financial returns of the Company s projects. Moreover, multiple permits are often required for a project, and may involve a lengthy application process.

The Company s discontinued operations with historical environmental contamination are subject to a number of federal, state, and local laws. As these requirements change over time, they may mandate more stringent levels of soil and groundwater investigation, remediation, and monitoring. While management believes that the Company s current estimates are adequate, future changes to these legal requirements could adversely affect the cost and timing of its activities on these sites.

Over time, the complexity and stringency of environmental laws and regulations have increased significantly, and the cost of compliance with these laws and regulations has also increased. In general, management believes these trends will continue.

It is the opinion of management that substantial expenditures will be required over the next 10 years in the area of environmental compliance. See Note 11 *Liabilities for Dispositions and Discontinued Operations* for additional information regarding the Company s environmental liabilities.

13. EMPLOYEE BENEFIT PLANS

The Company has four qualified non-contributory defined benefit pension plans, which collectively cover substantially all employees hired prior to January 2006, and an unfunded plan that provides benefits in excess of amounts allowable under current tax law in the qualified plans. 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 periodic benefit cost for the Company s pension and postretirement plans (medical and life insurance) for the three and six months ended June 30, 2008 and 2007 are shown in the following table:

	Pension Three Months Ended June 30,		Postretirement Three Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Components of Net Periodic Benefit Cost				
Service cost	$ 1,718	$ 1,898	$ 177	$ 167
Interest cost	4,142	3,832	680	699
Expected return on plan assets	(5,459)	(4,500)		
Amortization of prior service cost	357	334	195	194
Amortization of losses	1,211	933	304	277
Net periodic benefit cost	$ 1,969	$ 2,497	$ 1,356	$ 1,337

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

(Dollars in thousands unless otherwise stated)

	Pension Six Months Ended June 30, 2008	Pension Six Months Ended June 30, 2007	Postretirement Six Months Ended June 30, 2008	Postretirement Six Months Ended June 30, 2007
Components of Net Periodic Benefit Cost				
Service cost	$ 3,304	$ 3,504	$ 341	$ 322
Interest cost	7,966	7,077	1,308	1,261
Expected return on plan assets	(10,276)	(8,610)		
Amortization of prior service cost	686	697	374	373
Amortization of losses	2,329	1,944	585	609
Net periodic benefit cost	$ 4,009	$ 4,612	$ 2,608	$ 2,565

The Company does not have any required pension plan contributions for 2008 and has not made any discretionary pension contributions during the six months ended June 30, 2008.

14. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Accumulated Other Comprehensive Income (Loss) was comprised of the following as of June 30, 2008 and December 31, 2007:

	June 30, 2008	December 31, 2007
Foreign currency translation adjustments	$ 36,806	$ 34,297
Unrecognized components of employee benefit plans, net of tax	(57,150)	(59,935)
Total	$ (20,344)	$ (25,638)

During the six months ended June 30, 2008, the increase in net foreign currency translation adjustments was due to the change in the New Zealand to U.S. dollar exchange rate. Amortization of unrecognized components of employee pension and postretirement plan expense of $1.4 million and $2.8 million was recognized during the three and six months ended June 30, 2008, respectively.

15. CONSOLIDATING FINANCIAL STATEMENTS

In October 2007, Rayonier TRS Holdings Inc. (TRS), a wholly-owned subsidiary of Rayonier Inc., issued $300 million of 3.75% Senior Exchangeable Notes due 2012. The notes are guaranteed by Rayonier Inc. and are non-callable. In connection with this offering, the Company is providing 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 Inc., incurred for the benefit of its subsidiaries.

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollars amounts in thousands unless otherwise stated)

	Condensed Consolidating Statements of Income For the Three Months Ended June 30, 2008					
	Rayonier Inc. (Parent Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$ 263,434	$ 203,135	$ (161,702)	$ 304,867
Costs and Expenses						
Cost of sales			221,000	63,644	(47,608)	237,036
Selling and general expenses	2,820		13,225	817		16,862
Other operating expense (income), net	142		(2,481)	(1,081)		(3,420)
	2,962		231,744	63,380	(47,608)	250,478
Equity in (loss) income of New Zealand joint venture	(1,027)		223			(804)
OPERATING (LOSS) INCOME	(3,989)		31,913	139,755	(114,094)	53,585
Interest income (expense)	92	(3,166)	(7,299)	(1,357)	4	(11,726)
Interest and miscellaneous income (expense), net	891	(774)	(661)	1,229	(65)	620
Equity in income from subsidiaries	40,926	17,916			(58,842)	
INCOME BEFORE INCOME TAXES	37,920	13,976	23,953	139,627	(172,997)	42,479
Income tax (provision) benefit	(504)	1,478	(6,037)			(5,063)
NET INCOME	$ 37,416	$ 15,454	$ 17,916	$ 139,627	$ (172,997)	$ 37,416

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollar amounts in thousands unless otherwise stated)

	Condensed Consolidating Statements of Income For the Three Months Ended June 30, 2007					
	Rayonier Inc. (Parent Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$ 236,521	$ 73,803	$ (9,973)	$ 300,351
Costs and Expenses						
Cost of sales	(119)		201,699	39,537	(9,992)	231,125
Selling and general expenses	3,348		11,907	867		16,122
Other operating income, net	(94)		(146)	(1,308)		(1,548)
	3,135		213,460	39,096	(9,992)	245,699
Equity in income of New Zealand joint venture	330		741			1,071
OPERATING (LOSS) INCOME	(2,805)		23,802	34,707	19	55,723
Interest expense	(72)		(8,674)	(4,903)	34	(13,615)
Interest and miscellaneous income (expense), net	147		(1,057)	2,115	(34)	1,171
Equity in income from subsidiaries	37,681	8,310			(45,991)	
INCOME BEFORE INCOME TAXES	34,951	8,310	14,071	31,919	(45,972)	43,279
Income tax provision	(1,640)		(5,761)		(2,567)	(9,968)
NET INCOME	$ 33,311	$ 8,310	$ 8,310	$ 31,919	$ (48,539)	$ 33,311

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollar amounts in thousands unless otherwise stated)

	Condensed Consolidating Statements of Income For the Six Months Ended June 30, 2008					
	Rayonier Inc. (Parent Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$ 492,280	$ 295,827	$ (199,047)	$ 589,060
Costs and Expenses						
Cost of sales			409,715	97,399	(59,067)	448,047
Selling and general expenses	5,346		24,889	1,571		31,806
Other operating income, net	(60)		(1,786)	(2,860)		(4,706)
	5,286		432,818	96,110	(59,067)	475,147
Equity in (loss) income of New Zealand joint venture	(3)		171			168
OPERATING (LOSS) INCOME	(5,289)		59,633	199,717	(139,980)	114,081
Interest income (expense)	628	(6,305)	(13,915)	(3,336)	4	(22,924)
Interest and miscellaneous income (expense), net	1,778	(1,547)	(628)	2,583	(66)	2,120
Equity in income from subsidiaries	81,883	27,868			(109,751)	
INCOME BEFORE INCOME TAXES	79,000	20,016	45,090	198,964	(249,793)	93,277
Income tax (provision) benefit	(1,033)	2,945	(17,222)			(15,310)
NET INCOME	$ 77,967	$ 22,961	$ 27,868	$ 198,964	$ (249,793)	$ 77,967

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollar amounts in thousands unless otherwise stated)

	Condensed Consolidating Statements of Income For the Six Months Ended June 30, 2007					
	Rayonier Inc. (Parent Guarantor)	Rayonier TRS Holdings Inc. (Issuer)	Subsidiaries of Rayonier TRS Holdings Inc. (Non-guarantors)	All Other Subsidiaries (Non-guarantors)	Consolidating Adjustments	Total Consolidated
SALES	$	$	$ 475,227	$ 141,369	$ (16,515)	$ 600,081
Costs and Expenses						
Cost of sales	(139)		406,726	73,206	(16,926)	462,867
Selling and general expenses	7,083		23,218	1,666		31,967
Other operating (income) expense, net	(111)		(1,754)	(2,677)		(4,542)
	6,833		428,190	72,195	(16,926)	490,292
Equity in (loss) income of New Zealand joint venture	(18)		1,112			1,094
OPERATING (LOSS) INCOME	(6,851)		48,149	69,174	411	110,883
Interest expense	(170)		(17,297)	(9,800)	34	(27,233)
Interest and miscellaneous income (expense), net	670		(1,956)	3,504	(34)	2,184
Equity in income from subsidiaries	77,465	17,705			(95,170)	
INCOME BEFORE INCOME TAXES	71,114	17,705	28,896	62,878	(94,759)	85,834
Income tax provision	(2,724)		(11,191)		(3,529)	(17,444)
NET INCOME	$ 68,390	$ 17,705	$ 17,705	$ 62,878	$ (98,288)	$ 68,390

RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollar amounts in thousands unless otherwise stated)

Condensed Consolidating Balance Sheets
As of June 30, 2008

	Rayonier Inc. (Parent 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	$ 7,658	$	$ 5,714	$ 7,636	$	$ 21,008
Accounts receivable, less allowance for doubtful accounts	47		94,477	4,499		99,023
Inventory			137,207		(44,674)	92,533
Intercompany interest receivable				1,042	(1,042)	
Other current assets	11,162		47,271	3,479		61,912
Total current assets	18,867		284,669	16,656	(45,716)	274,476
TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION	1,807		98,644	1,185,299		1,285,750
NET PROPERTY, PLANT AND EQUIPMENT	2,483		356,121	1,467		360,071
INVESTMENT IN JOINT VENTURE	91,226		(26,457)			64,769
INVESTMENT IN SUBSIDIARIES	962,654	486,884			(1,449,538)	
INTERCOMPANY/NOTES RECEIVABLE	26,344		32,550	6,813	(65,707)	
OTHER ASSETS	24,525	17,028	508,197	7,515	(390,461)	166,804
TOTAL ASSETS	$ 1,127,906	$ 503,912	$ 1,253,724	$ 1,217,750	$ (1,951,422)	$ 2,151,870
LIABILITIES AND SHAREHOLDERS EQUITY						
CURRENT LIABILITIES						
Accounts payable	$ 3,905	$	$ 74,090	$ 819	$	$ 78,814
Bank loans and current maturities			585			585
Accrued taxes	67	(5,659)	15,529	5,286		15,223
Accrued payroll and benefits	8,101		8,991	1,100		18,192
Accrued interest	21	2,375	1,575	21		3,992
Accrued customer incentives			8,279			8,279
Other current liabilities	11,766		13,996	15,644		41,406
Current liabilities for dispositions and discontinued operations			10,474			10,474
Total current liabilities	23,860	(3,284)	133,519	22,870		176,965
LONG-TERM DEBT		300,000	441,680	52,579		794,259
NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS			98,399			98,399
PENSION AND OTHER POSTRETIREMENT BENEFITS	68,636		(418)			68,218

OTHER NON-CURRENT LIABILITIES	14,498		3,214	17,102	(16,402)	18,412
INTERCOMPANY PAYABLE	25,295	5,594	90,446	7,327	(128,662)	
TOTAL LIABILITIES	132,289	302,310	766,840	99,878	(145,064)	1,156,253
TOTAL SHAREHOLDERS EQUITY	995,617	201,602	486,884	1,117,872	(1,806,358)	995,617
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 1,127,906	$ 503,912	$ 1,253,724	$ 1,217,750	$ (1,951,422)	$ 2,151,870

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RAYONIER INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Dollar amounts in thousands unless otherwise stated)

	Condensed Consolidating Balance Sheets As of December 31, 2007					
	Rayonier Inc. (Parent 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	$ 4,211	$	$ 173,029	$ 3,841	$	$ 181,081
Accounts receivable, less allowance for doubtful accounts	217		79,142	1,709		81,068
Inventory			88,979		(4,688)	84,291
Intercompany interest receivable				1,137	(1,137)	
Other current assets	12,823		32,226	4,731		49,780
Total current assets	17,251		373,376	11,418	(5,825)	396,220
TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION	1,819		36,015	1,079,385		1,117,219
NET PROPERTY, PLANT AND EQUIPMENT	2,147		342,173	1,435		345,755
INVESTMENT IN JOINT VENTURE	89,933		(27,167)			62,766
INVESTMENT IN SUBSIDIARIES	918,269	494,063			(1,412,332)	
INTERCOMPANY/NOTES RECEIVABLE	53,397		12,851	14,819	(81,067)	
OTHER ASSETS	28,692	18,772	386,762	13,260	(290,405)	157,081
TOTAL ASSETS	$ 1,111,508	$ 512,835	$ 1,124,010	$ 1,120,317	$ (1,789,629)	$ 2,079,041
LIABILITIES AND SHAREHOLDERS EQUITY						
CURRENT LIABILITIES						
Accounts payable	$ 3,123	$	$ 60,673	$ 2,428	$	$ 66,224
Bank loans and current maturities			585	55,000		55,585
Accrued taxes	109	(1,687)	6,483	2,274		7,179
Accrued payroll and benefits	18,339		11,726			30,065
Accrued interest		2,370	1,100	11		3,481
Accrued customer incentives			12,350			12,350
Other current liabilities	11,719		12,598	9,143		33,460
Current liabilities for dispositions and discontinued operations			10,069			10,069
Total current liabilities	33,290	683	115,584	68,856		218,413
LONG-TERM DEBT		300,000	341,680	52,579		694,259
NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS			103,616			103,616
PENSION AND OTHER POSTRETIREMENT BENEFITS	67,606		(389)			67,217

OTHER NON-CURRENT LIABILITIES	10,333	3,521	16,987	(16,402)	14,439
INTERCOMPANY PAYABLE	19,182	65,935	55,486	(140,603)	
TOTAL LIABILITIES	130,411				