RAYONIER INC
Form 10-Q
November 04, 2016
Table of Contents

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
OR
o 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
225 WATER STREET, SUITE 1400
JACKSONVILLE, FL 32202
(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 x NO o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES x NO o
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 x Accelerated filer o
Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x

As of October 31, 2016, there were outstanding 122,877,503 Common Shares of the registrant.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

RAYONIER INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(Dollars in thousands, except per share amounts)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| SALES | $171,421 | $151,657 | $567,814 | $407,764 |
| Costs and Expenses | | | | |
| Cost of sales | 116,624 | 116,044 | 362,790 | 326,966 |
| Selling and general expenses | 10,607 | 10,689 | 31,638 | 34,315 |
| Other operating income, net (Note 15) | (5,499) | (2,855) | (20,867) | (15,567) |
| | 121,732 | 123,878 | 373,561 | 345,714 |
| OPERATING INCOME | 49,689 | 27,779 | 194,253 | 62,050 |
| Interest expense | (8,544) | (7,581) | (23,603) | (24,608) |
| Interest income and miscellaneous income (expense), net | 258 | (1,558) | (1,115) | (4,250) |
| INCOME BEFORE INCOME TAXES | 41,403 | 18,640 | 169,535 | 33,192 |
| Income tax (expense) benefit | (779) | 541 | (2,274) | 1,309 |
| NET INCOME | 40,624 | 19,181 | 167,261 | 34,501 |
| Less: Net income (loss) attributable to noncontrolling interest | 1,269 | (488) | 3,613 | (1,379) |
| NET INCOME ATTRIBUTABLE TO RAYONIER INC. | 39,355 | 19,669 | 163,648 | 35,880 |
| OTHER COMPREHENSIVE INCOME (LOSS) | | | | |
| Foreign currency translation adjustment, net of income tax expense of $0, $429, $0 and $1,581 | 12,022 | (13,370) | 28,046 | (53,087) |
| Cash flow hedges, net of income tax benefit (expense) of $229, $185, $1,293 and $1,687 | 4,195 | (14,120) | (22,055) | (17,983) |
| Actuarial change and amortization of pension and postretirement plans, net of income tax expense of $0, $66, $0 and $404 | 632 | 890 | 1,881 | 2,414 |
| Total other comprehensive income (loss) | 16,849 | (26,600) | 7,872 | (68,656) |
| COMPREHENSIVE INCOME (LOSS) | 57,473 | (7,419) | 175,133 | (34,155) |
| Less: Comprehensive income (loss) attributable to noncontrolling interest | 3,649 | (5,363) | 11,808 | (18,884) |
| COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO RAYONIER INC. | $53,824 | ($2,056) | $163,325 | ($15,271) |
| EARNINGS PER COMMON SHARE (Note 11) | | | | |
| Basic earnings per share attributable to Rayonier Inc. | $0.32 | $0.16 | $1.34 | $0.28 |
| Diluted earnings per share attributable to Rayonier Inc. | $0.32 | $0.16 | $1.33 | $0.28 |
| | | | | |
| Dividends declared per share | $0.25 | $0.25 | $0.75 | $0.75 |

See Notes to Consolidated Financial Statements.

Table of Contents

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

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | $110,039 | $51,777 |
| Accounts receivable, less allowance for doubtful accounts of $35 and $42 | 24,731 | 20,222 |
| Inventory (Note 16) | 16,064 | 15,351 |
| Prepaid expenses | 12,564 | 12,654 |
| Assets held for sale (Note 18) | 47,361 | — |
| Other current assets | 3,369 | 5,681 |
| Total current assets | 214,128 | 105,685 |
| TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION | 2,325,489 | 2,066,780 |
| HIGHER AND BETTER USE TIMBERLANDS AND REAL ESTATE DEVELOPMENT | 70,324 | 65,450 |
| INVESTMENTS (NOTE 6) | | |
| PROPERTY, PLANT AND EQUIPMENT | | |
| Land | 1,832 | 1,833 |
| Buildings | 9,673 | 9,014 |
| Machinery and equipment | 3,469 | 3,686 |
| Construction in progress | 4,993 | 1,282 |
| Total property, plant and equipment, gross | 19,967 | 15,815 |
| Less — accumulated depreciation | (8,891) | (9,073) |
| Total property, plant and equipment, net | 11,076 | 6,742 |
| OTHER ASSETS | 50,381 | 71,281 |
| TOTAL ASSETS | $2,671,398 | $2,315,938 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable | $23,735 | $21,479 |
| Current maturities of long-term debt | 31,752 | — |
| Accrued taxes | 6,892 | 3,685 |
| Accrued payroll and benefits | 6,224 | 7,037 |
| Accrued interest | 8,313 | 6,153 |
| Other current liabilities | 23,227 | 21,103 |
| Total current liabilities | 100,143 | 59,457 |
| LONG-TERM DEBT, NET OF DEFERRED FINANCING COSTS | 1,033,288 | 830,554 |
| PENSION AND OTHER POSTRETIREMENT BENEFITS (Note 14) | 34,702 | 34,137 |
| OTHER NON-CURRENT LIABILITIES | 54,684 | 30,050 |
| COMMITMENTS AND CONTINGENCIES (Notes 7 and 9) | | |
| SHAREHOLDERS' EQUITY | | |
| Common Shares, 480,000,000 shares authorized, 122,876,035 and 122,770,217 shares issued and outstanding | 707,977 | 708,827 |
| Retained earnings | 683,596 | 612,760 |
| Accumulated other comprehensive loss | (30,388) | (33,503) |
| TOTAL RAYONIER INC. SHAREHOLDERS' EQUITY | 1,361,185 | 1,288,084 |
| Noncontrolling interest | 87,396 | 73,656 |

| | | |
|---|---|---|
| TOTAL SHAREHOLDERS' EQUITY | 1,448,581 | 1,361,740 |
| TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY | $2,671,398 | $2,315,938 |

See Notes to Consolidated Financial Statements.

Table of Contents

RAYONIER INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)
(Dollars in thousands, except share data)

| | Common Shares | | | | | |
|---|---|---|---|---|---|---|
| | Shares | Amount | Retained Earnings | Accumulated Other Comprehensive Income/(Loss) | Non-controlling Interest | Shareholders' Equity |
| Balance, December 31, 2014 | 126,773,097 | $702,598 | $790,697 | ($4,825) | $86,681 | $1,575,151 |
| Net income (loss) | — | — | 46,165 | — | (2,224) | 43,941 |
| Dividends ($1.00 per share) | — | — | (124,943) | — | — | (124,943) |
| Issuance of shares under incentive stock plans | 205,219 | 2,117 | — | — | — | 2,117 |
| Stock-based compensation | — | 4,484 | — | — | — | 4,484 |
| Tax deficiency on stock-based compensation | — | (250) | — | — | — | (250) |
| Repurchase of common shares | (4,208,099) | (122) | (100,000) | — | — | (100,122) |
| Net gain from pension and postretirement plans | — | — | — | 2,933 | — | 2,933 |
| Adjustments to Rayonier Advanced Materials | — | — | 841 | — | — | 841 |
| Foreign currency translation adjustment | — | — | — | (21,567) | (10,884) | (32,451) |
| Cash flow hedges | — | — | — | (10,044) | 83 | (9,961) |
| Balance, December 31, 2015 | 122,770,217 | $708,827 | $612,760 | ($33,503) | $73,656 | $1,361,740 |
| Net income | — | — | 163,648 | — | 3,613 | 167,261 |
| Dividends ($0.75 per share) | — | — | (92,122) | — | — | (92,122) |
| Issuance of shares under incentive stock plans | 149,666 | 889 | — | — | — | 889 |
| Stock-based compensation | — | 3,894 | — | — | — | 3,894 |
| Repurchase of common shares | (43,848) | (139) | (690) | — | — | (829) |
| Actuarial change and amortization of pension and postretirement plan liabilities | — | — | — | 1,881 | — | 1,881 |
| Foreign currency translation adjustment | — | — | — | 20,527 | 7,519 | 28,046 |
| Cash flow hedges | — | | — | (22,731) | 676 | (22,055) |
| Recapitalization of New Zealand Joint Venture | — | (5,398) | — | 3,438 | 1,960 | — |
| Recapitalization costs | — | (96) | — | — | (28) | (124) |
| Balance, September 30, 2016 | 122,876,035 | $707,977 | $683,596 | ($30,388) | $87,396 | $1,448,581 |

See Notes to Consolidated Financial Statements.

3

Table of Contents

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2016 | 2015 |
| OPERATING ACTIVITIES | | |
| Net income | $167,261 | $34,501 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation, depletion and amortization | 83,685 | 85,784 |
| Non-cash cost of land and improved development | 10,111 | 9,532 |
| Stock-based incentive compensation expense | 3,894 | 3,522 |
| Deferred income taxes | 4,472 | (4,745) |
| Non-cash adjustments to unrecognized tax benefit liability | — | 135 |
| Amortization of losses from pension and postretirement plans | 1,881 | 2,818 |
| Gain on sale of large disposition of timberlands | (101,325) | — |
| Other | (251) | 2,336 |
| Changes in operating assets and liabilities: | | |
| Receivables | (3,897) | 1,895 |
| Inventories | (4,591) | (9,403) |
| Accounts payable | 583 | 1,854 |
| Income tax receivable/payable | (47) | (947) |
| All other operating activities | 2,132 | 16,121 |
| CASH PROVIDED BY OPERATING ACTIVITIES | 163,908 | 143,403 |
| INVESTING ACTIVITIES | | |
| Capital expenditures | (40,246) | (37,211) |
| Real estate development investments | (4,815) | (2,029) |
| Purchase of timberlands | (353,828) | (88,466) |
| Assets purchased in business acquisition | (1,113) | — |
| Net proceeds from large disposition of timberlands | 126,965 | — |
| Rayonier office building under construction | (3,933) | (369) |
| Change in restricted cash | 22,430 | (17,835) |
| Other | 444 | 3,039 |
| CASH USED FOR INVESTING ACTIVITIES | (254,096) | (142,871) |
| FINANCING ACTIVITIES | | |
| Issuance of debt | 694,096 | 379,027 |
| Repayment of debt | (454,419) | (300,871) |
| Dividends paid | (92,095) | (94,280) |
| Proceeds from the issuance of common shares | 889 | 1,322 |
| Repurchase of common shares made under share repurchase program | (690) | (73,621) |
| Debt issuance costs | (818) | (1,678) |
| Other | (139) | — |
| CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES | 146,824 | (90,101) |
| EFFECT OF EXCHANGE RATE CHANGES ON CASH | 1,626 | (6,234) |
| CASH AND CASH EQUIVALENTS | | |
| Change in cash and cash equivalents | 58,262 | (95,803) |
| Balance, beginning of year | 51,777 | 161,558 |
| Balance, end of period | $110,039 | $65,755 |

| | | |
|---|---|---|
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| Cash paid during the period: | | |
| Interest (a) | $23,540 | $21,944 |
| Income taxes | 495 | 421 |
| Non-cash investing activity: | | |
| Capital assets purchased on account | 4,376 | 1,945 |

(a) Interest paid is presented net of patronage payments received of $0.4 million and $1.3 million for the nine months ended September 30, 2016 and September 30, 2015, respectively. For additional information on patronage payments, see Note 5 — Debt in the 2015 Form 10-K.

See Notes to Consolidated Financial Statements.

4

Table of Contents

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 (“GAAP”) for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission (the “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, 2015, as filed with the SEC (the “2015 Form 10-K”).

Reclassifications

Certain 2015 amounts have been reclassified to conform with the current year presentation, including changes in balance sheet presentation. During the first quarter of 2016, the Company reclassified capitalized debt costs related to non-revolving debt from Other Assets to Long Term Debt as a result of the adoption of Accounting Standards Update (“ASU”) No. 2015-03, Interest - Imputation of Interest (Subtopic 835-50) - Simplifying the Presentation of Debt Issuance Costs, which is required to be applied on a retrospective basis. This reclassification is reflected in the September 30, 2016 and December 31, 2015 Consolidated Balance Sheets. A corresponding change has also been made to the Consolidated Statement of Cash Flows for both periods presented.

New Accounting Standards

In August 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses the diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. This Update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. ASU No. 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. ASU No. 2016-15 is required to be applied retrospectively to all periods presented beginning in the period of adoption. Early adoption is permitted. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. This update simplifies the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU No. 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Rayonier intends to adopt ASU No. 2016-09 in the Company’s first quarter 2017 Form 10-Q. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships, which clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under Topic 815 does not, in and of itself, require de-designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. ASU No. 2016-05 is effective for annual reporting periods beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Rayonier intends to adopt ASU No. 2016-05 in the Company’s first quarter 2017 Form 10-Q and does not expect it will have an impact on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessees to recognize most leases on their balance sheets related to the rights and obligations created by those leases. ASU No. 2016-02 also requires additional qualitative and quantitative disclosures related to the nature, timing and uncertainty of cash flows arising from leases. ASU No. 2016-02 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. ASU No. 2016-02 is required to be applied retrospectively to all periods presented beginning in the period of adoption. Early adoption is permitted. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

In May 2014, the FASB and International Accounting Standards Board ("IASB") jointly issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), a comprehensive new revenue recognition standard that will supersede current revenue recognition guidance. The guidance provides a unified model to determine when and how revenue is recognized and will require enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers - Deferral of the Effective Date. ASU No. 2015-14 provides a one-year deferral of the effective date of the new standard, with an option for organizations to adopt early based on the original effective date. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers—Identifying Performance Obligations and Licensing. The update clarifies the guidance for identifying performance obligations. In May 2016, the FASB issued ASU. No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients. The update clarifies the guidance for assessing collectibility, presenting sales taxes and other similar taxes collected from customers, noncash consideration, contract modifications at transition, completed contracts at transition and disclosing the accounting change in the period of adoption. This standard will be effective for Rayonier beginning January 1, 2018 and can be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements and has completed a preliminary analysis of the specific impacts to our Southern Timber, Pacific Northwest Timber, New Zealand Timber and Real Estate segments.

Subsequent Events

Disposition of 37,000 acres of Gulf states timberland

On October 21, 2016, the Company completed two separate transactions for the sale of 37,000 acres of timberland in Alabama and Mississippi for $77.8 million. The basis in these properties were classified as held for sale in the Consolidated Balance Sheet as of September 30, 2016. See Note 18 — Assets Held For Sale for additional information.

2. TIMBERLAND ACQUISITION

Menasha Acquisition

The Company and Forest Investment Associates ("FIA") formed Olympus Acquisition Company ("Olympus") to acquire all the outstanding common stock of Menasha Forest Products Corporation ("Menasha"), a privately held company with approximately 132,000 acres of timberland located in Oregon and Washington (the "Menasha Acquisition").

On May 10, 2016 (the "acquisition date"), essentially all of the net assets of Olympus were distributed to the Company and FIA, resulting in the Company owning an identified portfolio of 61,000 acres of the former Menasha timberland for a final purchase price of approximately $263 million.

Business Combination Accounting

The distribution of net assets from Olympus to Rayonier has been accounted for as a business combination. Accordingly, the consideration paid by the Company has been recorded to the assets acquired and liabilities assumed based upon their estimated fair values as of the date of acquisition. In determining the fair value of the timberlands, the Company utilized valuation methodologies including a discounted cash flow analysis. A sales comparison approach was utilized to determine the fair market value of property, plant and equipment. The carrying values for current assets and liabilities were deemed to approximate their fair values due to the short-term nature of these assets and liabilities. Rayonier's share of acquisition costs of $1.3 million is included in "Other operating income, net."

As of the filing date of this report, the Company has not completed its final accounting related to this acquisition. As a result, preliminary estimates have been recorded and are subject to change. Any necessary adjustments from the preliminary estimates will be finalized as soon as practicable but within one year from the date of acquisition. Measurement period adjustments will be recorded in the period in which they are determined, as if they had been completed at the acquisition date.

6

(Dollar amounts in thousands unless otherwise stated)

The Company is currently in the process of finalizing its valuations related to the following: Timber and timberlands, Property, plant and equipment, Other current and non-current assets and Other current and non-current liabilities. The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed at the acquisition date:

| | May 10, 2016 |
|---|---|
| Timber and timberlands (a) | $263,073 |
| Property, plant and equipment | 1,554 |
| Other current and non-current assets | 280 |
| Total identifiable assets acquired | 264,907 |
| Other current and non-current liabilities | 1,503 |
| Total liabilities assumed | 1,503 |
| Net identifiable assets (purchase price) | $263,404 |

(a) Timber and timberlands include $0.8 million of seeds and seedlings.

Operating Results and Unaudited Pro Forma Financial Information

The net income effect resulting from the Menasha acquisition for the three and nine months ended September 30, 2016 is impracticable to determine, as the Company immediately integrated Menasha into its ongoing operations. Additionally, pro forma information has not been provided, as the portion of Menasha acquired was a component of a larger legal entity and separate historical financial statements were not prepared. Since stand-alone financial information prior to the acquisition was not readily available, compilation of such data is impracticable.

Washington Disposition

In May 2016, the Company completed a disposition of approximately 55,000 acres located in Washington to FIA (the “Washington disposition”) for a sale price of approximately $130 million. The proceeds received from the disposition were used to finance a portion of the Menasha Acquisition. The remainder of the acquisition was financed by entering into an incremental term loan agreement with CoBank, ACB, as administrative agent, and a syndicate of Farm Credit institutions to provide a 10-year, $300 million incremental term loan. See Note 5 — Debt for additional information.

## 3. JOINT VENTURE INVESTMENT

Matariki Forestry Group

On March 3, 2016, the Company made a capital contribution into Matariki Forestry Group (the "New Zealand JV"), a joint venture that owns or leases approximately 0.4 million legal acres of New Zealand timberlands, for the purpose of refinancing approximately NZ$235 million of New Zealand JV indebtedness and paying related fees and expenses, including the costs of settling out-of-the-money interest rate swaps. As a result of the capital contribution, the Company's ownership interest in the New Zealand JV increased from 65% to 77%. As a result of the increase in ownership percentage, the pro-rata share of the New Zealand JV’s unrealized foreign currency and cash flow hedge losses were reallocated between the Company and the noncontrolling interest. In accordance with Accounting Standards Codification (“ASC”) 810-10-45-24, this reallocation resulted in a reduction to the common share balance. The Company maintains a controlling financial interest in the New Zealand JV and, accordingly, consolidates the New Zealand JV’s Balance Sheet and results of operations. The portions of the consolidated financial position and results of operations attributable to the New Zealand JV’s 23% noncontrolling interest are shown separately within the Consolidated Statements of Income and Comprehensive Income and Consolidated Statements of Shareholders’ Equity. Rayonier New Zealand Limited (“RNZ”), a wholly-owned subsidiary of Rayonier Inc., serves as the manager of the New Zealand JV.

7

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

4. SEGMENT AND GEOGRAPHICAL INFORMATION

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 segment operating income and Adjusted EBITDA. Asset information is not reported by segment, as the Company does not produce asset information by segment internally.

Operating income as presented in the Consolidated Statements of Income and Comprehensive Income (Loss) is equal to segment income. Certain income (loss) items in the Consolidated Statements of Income and Comprehensive Income (Loss) 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 and are included under “Corporate and other” or “unallocated interest expense and other.”

The following tables summarize the segment information for the three and nine months ended September 30, 2016 and 2015:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| SALES | 2016 | 2015 | 2016 | 2015 |
| Southern Timber | $27,826 | $34,797 | $102,205 | $103,009 |
| Pacific Northwest Timber | 16,139 | 21,549 | 52,316 | 57,805 |
| New Zealand Timber | 42,179 | 41,065 | 125,951 | 121,482 |
| Real Estate (a) | 60,626 | 35,232 | 211,296 | 65,968 |
| Trading | 24,651 | 19,014 | 76,046 | 59,500 |
| Total | $171,421 | $151,657 | $567,814 | $407,764 |

(a) The nine months ended September 30, 2016 include $129.5 million from the Washington disposition.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| OPERATING INCOME (LOSS) | 2016 | 2015 | 2016 | 2015 |
| Southern Timber | $8,183 | $10,504 | $34,976 | $34,694 |
| Pacific Northwest Timber | (3,293) | 3,081 | (874) | 7,356 |
| New Zealand Timber | 6,613 | (915) | 21,385 | 3,834 |
| Real Estate (a) | 43,078 | 20,001 | 152,997 | 34,004 |
| Trading | 481 | 428 | 1,456 | 614 |
| Corporate and other | (5,373) | (5,320) | (15,687) | (18,452) |
| Total Operating Income | 49,689 | 27,779 | 194,253 | 62,050 |
| Unallocated interest expense and other | (8,286) | (9,139) | (24,718) | (28,858) |
| Total Income before Income Taxes | $41,403 | $18,640 | $169,535 | $33,192 |

(a) The nine months ended September 30, 2016 include $101.3 million from the Washington disposition.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| DEPRECIATION, DEPLETION AND AMORTIZATION | 2016 | 2015 | 2016 | 2015 |
| Southern Timber | $9,988 | $14,404 | $37,102 | $41,356 |
| Pacific Northwest Timber | 6,668 | 4,189 | 14,978 | 10,920 |
| New Zealand Timber | 5,956 | 7,021 | 17,252 | 22,207 |
| Real Estate (a) | 9,260 | 6,269 | 35,988 | 11,087 |
| Trading | — | — | — | — |
| Corporate and other | 106 | 75 | 298 | 214 |
| Total | $31,978 | $31,958 | $105,618 | $85,784 |

(a) The nine months ended September 30, 2016 include $21.9 million from the Washington disposition.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| NON-CASH COST OF LAND AND IMPROVED DEVELOPMENT | 2016 | 2015 | 2016 | 2015 |
| Southern Timber | — | — | — | — |
| Pacific Northwest Timber | — | — | — | — |
| New Zealand Timber | — | — | 1,824 | — |
| Real Estate (a) | 4,336 | 4,594 | 10,092 | 9,532 |
| Trading | — | — | — | — |
| Corporate and other | — | — | — | — |
| Total | $4,336 | $4,594 | $11,916 | $9,532 |

(a) The nine months ended September 30, 2016 include $1.8 million from the Washington disposition.

## 5. DEBT

Rayonier's debt consisted of the following at September 30, 2016:

| | September 30, 2016 |
|---|---|
| Senior Notes due 2022 at a fixed interest rate of 3.75% | $325,000 |
| Term Credit Agreement borrowings due 2024 at a variable interest rate of 2.1% at September 30, 2016 | 350,000 |
| Incremental Term Loan Agreement borrowings due 2026 at a variable interest rate of 2.4% at September 30, 2016 | 300,000 |
| Mortgage notes due 2017 at fixed interest rates of 4.35% | 31,752 |
| Revolving Credit Facility borrowings due 2020 at a variable interest rate of 1.8% at September 30, 2016 | 25,000 |
| Solid waste bond due 2020 at a variable interest rate of 2.1% at September 30, 2016 | 15,000 |
| New Zealand JV noncontrolling interest shareholder loan at 0% interest rate | 22,022 |
| Total debt | 1,068,774 |
| Less: Current maturities of long-term debt | (31,752) |
| Less: Deferred financing costs | (3,734) |

| | |
|---|---|
| Long-term debt, net of deferred financing costs | $1,033,288 |

9

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

Principal payments due during the next five years and thereafter are as follows:

| | |
|---|---|
| 2016 | — |
| 2017 (a) | 31,500 |
| 2018 | — |
| 2019 | — |
| 2020 | 40,000 |
| Thereafter | 997,022 |
| Total Debt | $1,068,522 |

(a) The mortgage notes due in 2017 were recorded at a premium of $0.3 million as of September 30, 2016. Upon maturity the liability will be $31.5 million.

Incremental Term Loan Agreement

On April 28, 2016, the Company entered into an incremental term loan agreement with CoBank, ACB, as administrative agent, and a syndicate of Farm Credit institutions to provide a 10-year, $300 million incremental term loan. Proceeds from the term loan were used to fund Rayonier's portion of the Menasha acquisition net of the proceeds received from the Washington disposition, to repay approximately $105 million outstanding on the Company's revolving credit facility and for general corporate purposes. The Company has entered into interest rate swap transactions to fix the cost of the term loan over its 10-year term. The periodic interest rate on the incremental term loan agreement is LIBOR plus 1.900%. The Company receives annual patronage payments, which are profit distributions made by a cooperative to its member-users based on the quantity or value of business done with the member-user. The Company estimates the effective interest rate for the third quarter was approximately 2.8% after consideration of the estimated patronage payments and interest rate swaps.

Term Credit Agreement

On August 5, 2015, the Company entered into a credit agreement with CoBank, ACB, as administrative agent, and a syndicate of Farm Credit institutions and other commercial banks to provide $550 million of new credit facilities, including a five-year $200 million unsecured revolving credit facility (see below) and a nine-year $350 million term loan facility. The Company has entered into interest rate swap transactions to fix the cost of the term loan facility over its nine-year term. The periodic interest rate on the term credit agreement is LIBOR plus 1.625%. The Company estimates the effective interest rate for the third quarter was approximately 3.3% after consideration of the estimated patronage payments and interest rate swaps.

Revolving Credit Facility

In August 2015, the Company entered into a five-year $200 million unsecured revolving credit facility, replacing the previous $200 million revolving credit facility and $100 million farm credit facility, which were scheduled to expire in April 2016 and December 2019, respectively. The periodic interest rate on the revolving credit facility is LIBOR plus 1.250%, with an unused commitment fee of 0.175%.

Net borrowings of $25.0 million were made in the third quarter of 2016 on the revolving credit facility. At September 30, 2016, the Company had available borrowings of $169.5 million under the revolving credit facility, net of $5.5 million to secure its outstanding letters of credit.

Joint Venture Debt

On March 3, 2016, the Company used proceeds from the term loan facility to fund a capital contribution into the New Zealand JV. The New Zealand JV in turn used the proceeds for full repayment of the outstanding amount of $155 million under its Tranche A credit facility.

In June 2016, the New Zealand JV entered into a 12-month NZ$20.0 million working capital facility and an 18-month NZ$20.0 million working capital facility, replacing the previous NZ$40.0 million facility that expired in June 2016.

10

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

During the nine months ended September 30, 2016, the New Zealand JV made additional borrowings and repayments of $146.1 million on the facility. Draws totaling $29.2 million remain available on the working capital facilities at September 30, 2016. In addition, the New Zealand JV paid $2.6 million of its shareholder loan held with the non-controlling interest party during the nine months ended September 30, 2016. Changes in exchange rates increased debt on a U.S. dollar basis for its shareholder loan by $1.4 million.

Debt Covenants

In connection with the Company's $350 million term credit agreement, $300 million incremental term loan agreement and $200 million revolving credit facility, customary covenants must be met, the most significant of which include interest coverage and leverage ratios. In addition to these financial covenants, the mortgage notes, senior notes, term credit agreement, incremental term loan agreement and revolving credit facility include customary covenants that limit the incurrence of debt and the disposition of assets, among others. At September 30, 2016, the Company was in compliance with all applicable covenants.

## 6. HIGHER AND BETTER USE TIMBERLANDS AND REAL ESTATE DEVELOPMENT INVESTMENTS

Rayonier continuously assesses potential alternative uses of its timberlands, as some properties may become more valuable for development, residential, recreation or other purposes. The Company periodically transfers, via a sale or contribution from the real estate investment trust ("REIT") entities to taxable REIT subsidiaries ("TRS"), higher and better use ("HBU") timberlands to enable land-use entitlement, development or marketing activities. The Company also acquires HBU properties in connection with timberland acquisitions. These properties are managed as timberlands until sold or developed. While the majority of HBU sales involve rural and recreational land, the Company also selectively pursues various land-use entitlements on certain properties for residential, commercial and industrial development in order to enhance the long-term value of such properties. For selected development properties, Rayonier also invests in targeted infrastructure improvements, such as roadways and utilities, to accelerate the marketability and improve the value of such properties.

An analysis of higher and better use timberlands and real estate development costs from December 31, 2015 to September 30, 2016 is shown below:

| | Higher and Better Use Timberlands and Real Estate Development Investments | | |
|---|---|---|---|
| | Land and Timber | Development Investments | Total |
| Non-current portion at December 31, 2015 | $57,897 | $7,553 | $65,450 |
| Plus: Current portion (a) | 6,019 | 6,233 | 12,252 |
| Total Balance at December 31, 2015 | 63,916 | 13,786 | 77,702 |
| Non-cash cost of land and improved development | (1,612) | (151) | (1,763) |
| Timber depletion from harvesting activities and basis of timber sold in real estate sales | (1,123) | — | (1,123) |
| Capitalized real estate development investments (b) | — | 4,815 | 4,815 |
| Capital expenditures (silviculture) | 153 | — | 153 |
| Intersegment transfers | 4 | — | 4 |
| Total Balance at September 30, 2016 | 61,338 | 18,450 | 79,788 |
| Less: Current portion (a) | (3,930) | (5,534) | (9,464) |

| | | | |
|---|---|---|---|
| Non-current portion at September 30, 2016 | $57,408 | $12,916 | $70,324 |

(a) The current portion of Higher and Better Use Timberlands and Real Estate Development Investments is recorded in Inventory. See Note 16 — Inventory for additional information.
(b) Capitalized real estate development investments includes $0.1 million of capitalized interest.

(Dollar amounts in thousands unless otherwise stated)

7. COMMITMENTS

The Company leases certain buildings, machinery, and equipment under various operating leases. The Company also has long-term lease agreements on certain timberlands in the Southern U.S. and New Zealand. U.S. leases typically have initial terms of approximately 30 to 65 years, with renewal provisions in some cases. New Zealand timberland lease terms range between 30 and 99 years. Such leases are generally non-cancellable and require minimum annual rental payments.

At September 30, 2016, the future minimum payments under non-cancellable operating and timberland leases were as follows:

| | Operating Leases | Timberland Leases (a) | Commitments (b) | Total |
|---|---|---|---|---|
| Remaining 2016 | $518 | $3,838 | $5,120 | $9,476 |
| 2017 | 1,657 | 10,594 | 13,786 | 26,037 |
| 2018 | 902 | 9,443 | 9,193 | 19,538 |
| 2019 | 725 | 8,966 | 9,193 | 18,884 |
| 2020 | 605 | 8,553 | 9,193 | 18,351 |
| Thereafter (c) | 1,770 | 163,003 | 37,393 | 202,166 |
| | $6,177 | $204,397 | $83,878 | $294,452 |

(a) The majority of timberland leases are subject to increases or decreases based on either the Consumer Price Index, Producer Price Index or market rates.

(b) Commitments include payments expected to be made on derivative financial instruments (foreign exchange contracts and interest rate swaps), standby letters of credit fees for industrial revenue bonds and construction of the Company’s office building.

(c) Includes 20 years of future minimum payments for perpetual Crown Forest Licenses (“CFL”). A CFL consists of a license to use public or government owned land to operate a commercial forest. The CFL's extend indefinitely and may only be terminated upon a 35-year termination notice from the government. If no termination notice is given, the CFLs renew automatically each year for a one-year term. As of September 30, 2016, the New Zealand JV has four CFL’s under termination notice, terminating in 2034, two in 2044 and 2049 as well as two fixed-term CFL’s expiring in 2062. The annual license fee is determined based on current market rental value, with triennial rent reviews.

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

## 8. INCOME TAXES

The operations conducted by the Company's REIT entities are generally not subject to U.S. federal and state income tax. The New Zealand JV is subject to corporate level tax in New Zealand. Non-REIT qualifying operations are conducted by the Company's TRS. The primary businesses performed in Rayonier's TRS include log trading and certain real estate activities, such as the sale and entitlement of development HBU properties.

Provision for Income Taxes

The Company's effective tax rate is below the 35.0% U.S. statutory rate due to tax benefits associated with being a REIT. The income tax expense (benefit) for the three and nine months ended September 30, 2016 and 2015 are principally related to the New Zealand JV.

The table below reconciles the U.S. statutory rate to the Company's effective tax rate for each period presented:

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| Income tax expense at federal statutory rate | $14,491 | 35.0 % | $6,524 | 35.0 % |
| U.S. and foreign REIT income & U.S. TRS taxable losses | (11,487 ) | (27.7) | (9,259 ) | (49.6) |
| Foreign TRS operations | (312 ) | (0.8 ) | (1,466 ) | (7.9 ) |
| U.S. net deferred tax asset valuation allowance | (1,741 ) | (4.2 ) | 2,742 | 14.7 |
| Other | (70 ) | (0.2 ) | 90 | 0.5 |
| Income tax expense (benefit) before discrete items | $881 | 2.1 % | ($1,369) | (7.3 )% |
| CBPC[(a)] valuation allowance | — | — | 997 | 5.3 |
| Return-to-accrual adjustments | (171 ) | (0.4 ) | (169 ) | (0.9 ) |
| Other | 69 | 0.2 | — | — |
| Income tax expense (benefit) as reported | $779 | 1.9 % | ($541 ) | (2.9 )% |

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| Income tax expense at federal statutory rate | $59,337 | 35.0 % | $11,617 | 35.0 % |
| U.S. and foreign REIT income & U.S. TRS taxable losses | (55,801 ) | (32.9) | (16,260 ) | (48.9) |
| Foreign TRS operations | (626 ) | (0.4 ) | (3,029 ) | (9.1 ) |
| U.S. net deferred tax asset valuation allowance | 2,654 | 1.6 | 5,360 | 16.1 |
| Other | 137 | 0.1 | 175 | 0.5 |
| Income tax expense (benefit) before discrete items | $5,701 | 3.4 % | ($2,137 ) | (6.4 )% |
| CBPC[(a)] valuation allowance | — | — | 997 | 3.0 |
| Tax benefit recognized related to changes in the New Zealand JV deferred tax inventory | (1,833 ) | (1.1 ) | — | — |
| Purchase accounting deferred tax benefit | (1,423 ) | (0.9 ) | — | — |
| Return-to-accrual adjustments | (171 ) | (0.1 ) | (169 ) | (0.5 ) |
| Income tax expense (benefit) as reported | $2,274 | 1.3 % | ($1,309 ) | (3.9 )% |

(a) Cellulosic biofuels producer credit.

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

9. CONTINGENCIES

Following the Company’s November 10, 2014 earnings release and filing of the restated interim financial statements for the quarterly periods ended March 31, 2014 and June 30, 2014 (the “November 2014 Announcement”), shareholders of the Company filed five putative class actions against the Company and Paul G. Boynton, Hans E. Vanden Noort, David L. Nunes, and H. Edwin Kiker arising from circumstances described in the November 2014 Announcement, entitled respectively:

- Sating v. Rayonier Inc. et al, Civil Action No. 3:14-cv-01395; filed November 12, 2014 in the United States District Court for the Middle District of Florida;

- Keasler v. Rayonier Inc. et al, Civil Action No. 3:14-cv-01398, filed November 13, 2014 in the United States District Court for the Middle District of Florida;

- Lake Worth Firefighters’ Pension Trust Fund v. Rayonier Inc. et al, Civil Action No. 3:14-cv-01403, filed November 13, 2014 in the United States District Court for the Middle District of Florida;

- Christie v. Rayonier Inc. et al, Civil Action No. 3:14-cv-01429, filed November 21, 2014 in the United States District Court for the Middle District of Florida; and

- Brown v. Rayonier Inc. et al, Civil Action No. 1:14-cv-08986, initially filed in the United States District Court for the Southern District of New York and later transferred to the United States District Court for the Middle District of Florida and assigned as Civil Action No. 3:14-cv-01474.

On January 9, 2015, the five securities actions were consolidated into one putative class action entitled In re Rayonier Inc. Securities Litigation, Case No. 3:14-cv-01395-TJC-JBT, in the United States District Court for the Middle District of Florida. The plaintiffs alleged that the defendants made false and/or misleading statements in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The plaintiffs sought unspecified monetary damages and attorneys’ fees and costs. Two shareholders, the Pension Trust Fund for Operating Engineers and the Lake Worth Firefighters’ Pension Trust Fund moved for appointment as lead plaintiff on January 12, 2015, which was granted on February 25, 2015. On April 7, 2015, the plaintiffs filed a Consolidated Class Action Complaint (the “Consolidated Complaint”). In the Consolidated Complaint, plaintiffs added allegations as to and added as a defendant N. Lynn Wilson, a former officer of Rayonier. With the filing of the Consolidated Complaint, David L. Nunes and H. Edwin Kiker were dropped from the case as defendants. Defendants timely filed Motions to Dismiss the Consolidated Complaint on May 15, 2015. After oral argument on Defendants' motions on August 25, 2015, the Court dismissed the Consolidated Complaint without prejudice, allowing plaintiffs leave to refile. Plaintiffs filed the Amended Consolidated Class Action Complaint (the “Amended Complaint”) on September 25, 2015, which continued to assert claims against the Company, as well as Ms. Wilson and Messrs. Boynton and Vanden Noort. Defendants timely filed Motions to Dismiss the Amended Complaint on October 26, 2015. The court denied those motions on May 20, 2016. The case is now in the discovery phase. At this preliminary stage, the Company cannot determine whether there is a reasonable likelihood a material loss has been incurred nor can the range of any such loss be estimated.

On November 26, 2014, December 29, 2014, January 26, 2015, February 13, 2015, and May 12, 2015, the Company received separate letters from shareholders requesting that the Company investigate or pursue derivative claims against certain officers and directors related to the November 2014 Announcement. Although these demands do not identify any claims against the Company, the Company has certain obligations to advance expenses and provide indemnification to certain current and former officers and directors of the Company. The Company has also incurred expenses as a result of costs arising from the investigation of the claims alleged in the various demands. At this preliminary stage, the ultimate outcome of these matters cannot be predicted, nor can the range of potential expenses the Company may incur as a result of the obligations identified above be estimated.

The Company has also 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 pending 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.

(Dollar amounts in thousands unless otherwise stated)

10. GUARANTEES

The Company provides financial guarantees as required by creditors, insurance programs, and various governmental agencies.

As of September 30, 2016, the following financial guarantees were outstanding:

| Financial Commitments | Maximum Potential Payment | Carrying Amount of Associated Liability |
|---|---|---|
| Standby letters of credit (a) | $20,642 | $15,000 |
| Guarantees (b) | 2,254 | 43 |
| Surety bonds (c) | 771 | — |
| Total financial commitments | $23,667 | $15,043 |

(a) Approximately $15 million of the standby letters of credit serve as credit support for industrial revenue bonds. Approximately $3.8 million of the standby letters of credit serve as credit support for infrastructure at the Company's Wildlight development project. The remaining letters of credit support various insurance related agreements, primarily workers' compensation. These letters of credit will expire at various dates during 2016 and 2017 and will be renewed as required.

(b) In conjunction with a timberland sale and note monetization in 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 September 30, 2016, the Company has a de minimis 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. Rayonier has also obtained performance bonds to secure the development activity at the Company's Wildlight development project. These surety bonds expire at various dates during 2017 and are expected to be renewed as required.

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

## 11. EARNINGS PER COMMON SHARE

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net Income | $40,624 | $19,181 | $167,261 | $34,501 |
| Less: Net income (loss) attributable to noncontrolling interest | 1,269 | (488) | 3,613 | (1,379) |
| Net income attributable to Rayonier Inc. | $39,355 | $19,669 | $163,648 | $35,880 |
| | | | | |
| Shares used for determining basic earnings per common share | 122,597,927 | 125,143,706 | 122,574,094 | 126,125,802 |
| Dilutive effect of: | | | | |
| Stock options | 113,849 | 91,495 | 88,594 | 129,906 |
| Performance and restricted shares | 170,857 | 31,051 | 120,212 | 37,064 |
| Assumed conversion of Senior Exchangeable Notes (a) | — | 39,720 | — | 477,931 |
| Shares used for determining diluted earnings per common share | 122,882,633 | 125,305,972 | 122,782,900 | 126,770,703 |
| | | | | |
| Basic earnings per common share attributable to Rayonier Inc.: | $0.32 | $0.16 | $1.34 | $0.28 |
| | | | | |
| Diluted earnings per common share attributable to Rayonier Inc.: | $0.32 | $0.16 | $1.33 | $0.28 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Anti-dilutive shares excluded from the computations of diluted earnings per share: | | | | |
| Stock options, performance and restricted shares | 745,878 | 994,549 | 863,244 | 906,582 |
| Assumed conversion of exchangeable note hedges (a) | — | 39,720 | — | 477,931 |
| Total | 745,878 | 1,034,269 | 863,244 | 1,384,513 |

(a) Rayonier did not issue additional shares upon maturity of the Senior Exchangeable Notes due August 2015 (the "2015 Notes") due to offsetting hedges. ASC 260, Earnings Per Share required the assumed conversion of the 2015 Notes to be included in dilutive shares if the average stock price for the period exceeded the strike price, while the conversion of the hedges was excluded since they were anti-dilutive. The full dilutive effect of the 2015 Notes was included for the prior period presented.

Rayonier did not distribute additional shares upon the February 2016 maturity of the warrants sold in conjunction with the 2015 Notes as the stock price did not exceed $28.11 per share. The warrants were not dilutive for the nine months ended September 30, 2016 and 2015 as the average stock price for the periods the warrants were outstanding did not exceed the strike price.

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

12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

The Company is exposed to market risk related to potential fluctuations in foreign currency exchange rates and interest rates. The Company 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 derivative 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. Gains and losses on derivatives that are designated and qualify for net investment hedge accounting are recorded as a component of AOCI and will not be reclassified into earnings until the Company’s investment in its New Zealand operations is partially or completely liquidated. The ineffective portion of any hedge, 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. The Company’s hedge ineffectiveness was de minimis for all periods presented.

Foreign Currency Exchange and Option Contracts

The functional currency of Rayonier’s wholly owned subsidiary, Rayonier New Zealand Limited, and the New Zealand JV is the New Zealand dollar. The New Zealand JV is exposed to foreign currency risk on export sales and ocean freight payments which are mainly denominated in U.S. dollars. The New Zealand JV typically hedges 35% to 90% of its estimated foreign currency exposure with respect to the following three months forecasted sales and purchases, 25% to 75% of forecasted sales and purchases for the forward three to 12 months and up to 50% of the forward 12 to 18 months. Foreign currency exposure from the New Zealand JV’s trading operations is typically hedged based on the following three months forecasted sales and purchases. As of September 30, 2016, foreign currency exchange contracts and foreign currency option contracts had maturity dates through November 2017.

Foreign currency exchange and option contracts hedging foreign currency risk on export sales and ocean freight payments qualify for cash flow hedge accounting. 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.

The Company may de-designate these cash flow hedge relationships in advance or at the occurrence of the forecasted transaction. The portion of gains or losses on the derivative instrument previously accumulated in other comprehensive income for de-designated hedges remains in accumulated other comprehensive income until the forecasted transaction affects earnings. Changes in the value of derivative instruments after de-designation are recorded in earnings.

In August 2015, the Company entered into foreign currency option contracts (notional amount of $332 million) to mitigate the risk of fluctuations in foreign currency exchange rates when translating the New Zealand JV’s balance sheet to U.S. dollars. These contracts hedged a portion of the Company’s net investment in New Zealand and qualified as a net investment hedge. The fair value of these contracts was 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 hedges qualified for hedge accounting whereby fluctuations in fair market value during the life of the hedge are recorded in AOCI and remain there permanently unless a partial or full liquidation of the investment is made. At each reporting period, the Company reviews the hedges for ineffectiveness. Ineffectiveness can occur when changes to the investment or the hedged instrument are made such that the risk of foreign exchange movements are no longer mitigated by the hedging instrument. At that time, the amount related to the ineffectiveness of the hedge is recorded into earnings. The Company did not have any ineffectiveness during the life of the hedges. The foreign currency option contracts matured on February 3, 2016.

On February 1, 2016, the Company entered into foreign currency option contracts (notional amounts of $159.7 million and $154.6 million) to mitigate the risk of fluctuations in foreign exchange rates when funding the capital contribution to the New Zealand JV. On February 29, 2016, the contracts were settled for a net premium of $0.3 million. The gain on these contracts was recorded in “Other operating income, net” as they did not qualify for hedge accounting treatment.

On February 29, 2016, the Company purchased a foreign exchange forward contract (notional amount $159.5 million) to mitigate the risk of fluctuations in foreign exchange rate contracts when funding the capital contribution to the New Zealand JV. The contract matured on March 3, 2016, resulting in a gain of $0.9 million. The gain on this contract was recorded in “Other operating income, net” as it did not qualify for hedge accounting treatment.

(Dollar amounts in thousands unless otherwise stated)

Interest Rate Swaps

The Company used interest rate swaps to manage the New Zealand JV's exposure to interest rate movements on its variable rate debt attributable to changes in the New Zealand Bank bill rate. On March 3, 2016, as part of the capital contribution into the New Zealand JV, the Company settled all remaining New Zealand JV interest rate swaps for $9.3 million. Initially, these hedges qualified for hedge accounting; however, upon consolidation of the New Zealand JV in 2013, the hedges no longer qualified, requiring all future changes in the fair market value of the hedges to be recorded in earnings.

The Company is exposed to cash flow interest rate risk on its variable-rate Term Credit Agreement and Incremental Term Loan Agreement (as discussed below), and uses variable-to-fixed interest rate swaps to hedge this exposure. For these derivative instruments, the Company reports the gains/losses from the fluctuations in the fair market value of the hedges in AOCI and reclassifies them to earnings as interest expense in the same period in which the hedged interest payments affect earnings.

In August 2015, the Company entered into a nine-year interest rate swap agreement for a notional amount of $170 million. This swap agreement fixes the variable portion of the interest rate on the Term Credit Agreement borrowings due 2024 from LIBOR to an average rate of 2.20%. Together with the bank margin of 1.63%, this results in a rate of 3.83% before estimated patronage payments. This derivative instrument has been designated as an interest rate cash flow hedge and qualifies for hedge accounting.

Also, in August 2015, the Company entered into a nine-year forward interest rate swap agreement with a start date in April 2016 for a notional amount of $180 million. This swap agreement fixes the variable portion of the interest rate on the Term Credit Agreement borrowings due 2024 from LIBOR to an average rate of 2.35%. Together with the bank margin of 1.63%, this results in a rate of 3.97% before estimated patronage payments. This derivative instrument has been designated as an interest rate cash flow hedge and qualifies for hedge accounting.

In April 2016, the Company entered into two ten-year interest rate swap agreements, each for a notional amount of $100 million. These swap agreements fix the variable portion of the interest rate on the Incremental Term Loan borrowings due 2026 to an average rate of 1.60%. Together with the bank margin of 1.90%, this results in a rate of 3.50% before estimated patronage payments. These derivative instruments have been designated as interest rate cash flow hedges and qualify for hedge accounting.

On July 7, 2016, the Company entered into an interest rate swap agreement for a notional amount of $100 million through May 2026. This swap agreement fixes the variable portion of the interest rate on the Incremental Term Loan borrowings due 2026 from LIBOR to an average rate of 1.26%. Together with the bank margin of 1.90%, this results in a rate of 3.16% before estimated patronage payments. This derivative instrument has been designated as an interest rate cash flow hedge and qualifies for hedge accounting.

The following tables demonstrate the impact of the Company's derivatives on the Consolidated Statements of Income and Comprehensive Income for the three and nine months ended September 30, 2016 and 2015.

| | Income Statement Location | Three Months Ended September 30, 2016 | 2015 |
|---|---|---|---|
| Derivatives designated as cash flow hedges: | | | |
| Foreign currency exchange contracts | Other comprehensive income (loss) | $259 | ($289 ) |
| Foreign currency option contracts | Other comprehensive income (loss) | 635 | (788 ) |
| Interest rate swaps | Other comprehensive income (loss) | 3,529 | (13,644) |

| | | | |
|---|---|---|---|
| Derivatives designated as a net investment hedge: | | | |
| Foreign currency exchange contract | Other comprehensive income (loss) | — | 1,151 |
| Foreign currency option contracts | Other comprehensive income (loss) | — | 2,084 |
| Derivatives not designated as hedging instruments: | | | |
| Foreign currency option contracts | Other operating income, net | — | 847 |
| Interest rate swaps | Interest income and miscellaneous income (expense), net | — | (1,650) |

18

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

| | Income Statement Location | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|---|
| Derivatives designated as cash flow hedges: | | | |
| Foreign currency exchange contracts | Other comprehensive income (loss) | $2,075 | ($2,597) |
| Foreign currency option contracts | Other comprehensive income (loss) | 2,564 | (4,127) |
| Interest rate swaps | Other comprehensive income (loss) | (25,459) | (13,644) |
| Derivatives designated as a net investment hedge: | | | |
| Foreign currency exchange contract | Other comprehensive income (loss) | (4,606) | 4,258 |
| Foreign currency option contracts | Other comprehensive (loss) income | — | 2,084 |
| Derivatives not designated as hedging instruments: | | | |
| Foreign currency exchange contracts | Other operating income, net | 895 | — |
| Foreign currency option contracts | Other operating income, net | 258 | 1,394 |
| Interest rate swaps | Interest income and miscellaneous income (expense), net | (1,219) | 4,923 |

During the next 12 months, the amount of the September 30, 2016 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 gain of approximately $1.8 million.

The following table contains the notional amounts of the derivative financial instruments recorded in the Consolidated Balance Sheets:

| | Notional Amount September 30, 2016 | December 31, 2015 |
|---|---|---|
| Derivatives designated as cash flow hedges: | | |
| Foreign currency exchange contracts | $25,390 | $21,250 |
| Foreign currency option contracts | 70,500 | 107,200 |
| Interest rate swaps | 650,000 | 350,000 |
| Derivatives designated as net investment hedges: | | |
| Foreign currency option contracts | — | 331,588 |
| Derivative not designated as a hedging instrument: | | |
| Interest rate swaps | — | 130,169 |

Table of Contents
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 Sheets:

| | Location on Balance Sheet | Fair Value Assets / (Liabilities) (a) | |
|---|---|---|---|
| | | September 30, 2016 | December 31, 2015 |
| Derivatives designated as cash flow hedges: | | | |
| Foreign currency exchange contracts | Other current assets | $1,173 | $43 |
| | Other assets | 142 | — |
| | Other current liabilities | (342) | (1,449) |
| | Other non-current liabilities | — | (219) |
| Foreign currency option contracts | Other current assets | 1,909 | 560 |
| | Other assets | 243 | 408 |
| | Other current liabilities | (173) | (1,393) |
| | Other non-current liabilities | (59) | (217) |
| Interest rate swaps | Other non-current liabilities | (35,655) | (10,197) |
| Derivatives designated as net investment hedges: | | | |
| Foreign currency option contracts | Other current assets | — | 4,630 |
| | Other current liabilities | — | (24) |
| Derivative not designated as a hedging instrument: | | | |
| Interest rate swaps | Other non-current liabilities | — | (8,047) |
| Total derivative contracts: | | | |
| Other current assets | | $3,082 | $5,233 |
| Other assets | | 385 | 408 |
| Total derivative assets | | $3,467 | $5,641 |
| Other current liabilities | | (515) | (2,866) |
| Other non-current liabilities | | (35,714) | (18,680) |
| Total derivative liabilities | | ($36,229) | ($21,546) |

(a) See Note 13 — Fair Value Measurements for further information on the fair value of the Company’s 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.

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

## 13. FAIR VALUE MEASUREMENTS

Fair Value of Financial Instruments

A three-level hierarchy that prioritizes the inputs used to measure fair value was established in the Accounting Standards Codification 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. (a)

The following table presents the carrying amount and estimated fair values of financial instruments held by the Company at September 30, 2016 and December 31, 2015, using market information and what the Company believes to be appropriate valuation methodologies under generally accepted accounting principles:

| | September 30, 2016 | | | December 31, 2015 | | |
|---|---|---|---|---|---|---|
| Asset (Liability) (a) | Carrying Amount | Fair Value | | Carrying Amount | Fair Value | |
| | | Level 1 | Level 2 | | Level 1 | Level 2 |
| Cash and cash equivalents | $110,039 | $110,039 | — | $51,777 | $51,777 | — |
| Restricted cash (b) | 1,095 | 1,095 | — | 23,525 | 23,525 | — |
| Current maturities of long-term debt | (31,752) | — | (32,403) | — | — | — |
| Long-term debt (c) | (1,033,288) | — | (1,049,210) | (830,554) | — | (830,203) |
| Interest rate swaps (d) | (35,655) | — | (35,655) | (18,244) | — | (18,244) |
| Foreign currency exchange contracts (d) | 973 | — | 973 | (1,625) | — | (1,625) |
| Foreign currency option contracts (d) | 1,920 | — | 1,920 | 3,964 | — | 3,964 |

(a) The Company did not have Level 3 assets or liabilities at September 30, 2016.

(b) Restricted cash is recorded in "Other Assets" and represents the proceeds from like-kind exchange sales deposited with a third-party intermediary and cash held in escrow for a real estate sale. See Note 17 — Restricted Deposits for additional information regarding restricted cash.

(c) The carrying amount of long-term debt is presented net of capitalized debt costs on non-revolving debt. See Note 1 — Basis of Presentation for additional information.

(d) See Note 12 — 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 option contracts is based on a mark-to-market calculation using the Black-Scholes option pricing model.

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

14. EMPLOYEE BENEFIT PLANS

The Company has one qualified non-contributory defined benefit pension plan covering a portion of its employees and an unfunded plan that provides benefits in excess of amounts allowable under current tax law in the qualified plan. Currently, the pension plan is 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. In 2016, the Company has no mandatory pension contribution requirement.

The net pension and postretirement benefit costs that have been recorded are shown in the following table:

| | Pension Three Months Ended September 30, | | Postretirement Three Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Components of Net Periodic Benefit Cost | | | | |
| Service cost | $327 | $371 | $2 | $3 |
| Interest cost | 869 | 830 | 12 | 13 |
| Expected return on plan assets | (1,008 ) | (1,007 ) | — | — |
| Amortization of prior service cost | — | 3 | — | — |
| Amortization of losses | 632 | 950 | — | 3 |
| Net periodic benefit cost | $820 | $1,147 | $14 | $19 |

| | Pension Nine Months Ended September 30, | | Postretirement Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Components of Net Periodic Benefit Cost | | | | |
| Service cost | $980 | $1,113 | $5 | $8 |
| Interest cost | 2,606 | 2,489 | 36 | 39 |
| Expected return on plan assets | (3,023 ) | (3,020 ) | — | — |
| Amortization of prior service cost | — | 10 | — | — |
| Amortization of losses (gains) | 1,893 | 2,799 | (12 ) | 9 |
| Net periodic benefit cost | $2,456 | $3,391 | $29 | $56 |

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

15. OTHER OPERATING INCOME, NET
Other operating income, net comprised the following:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Lease income, primarily from hunting leases | $3,769 | $4,349 | $13,991 | $14,348 |
| Other non-timber income | 666 | 581 | 1,721 | 2,634 |
| Foreign currency income (loss) | 533 | (149 ) | 34 | 67 |
| Gain on sale or disposal of property and equipment | 58 | 4 | 81 | 6 |
| Loss on foreign currency exchange and option contracts | (333 ) | (2,297 ) | (1,406 ) | (3,290 ) |
| Deferred payment related to a prior land sale | — | — | 4,000 | — |
| Costs related to acquisition | (91 ) | — | (1,306 ) | — |
| Gain on foreign currency derivatives (a) | — | — | 1,153 | — |
| Gain on sale of carbon credits | 359 | — | 1,113 | 352 |
| Miscellaneous income, net | 538 | 367 | 1,486 | 1,450 |
| Total | $5,499 | | | |