RAYONIER INC
Form 10-K
February 27, 2009

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the year ended December 31, 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 No. 13-2607329

50 NORTH LAURA STREET,

JACKSONVILLE, FL 32202

(Principal Executive Office)

Telephone Number: (904) 357-9100

Securities registered pursuant to Section 12(b) of the Exchange Act,

all of which are registered on the New York Stock Exchange:

Common Shares

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES x NO ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. YES ¨ NO x

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 ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 ¨	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

The aggregate market value of the Common Shares of the registrant held by non-affiliates at the close of business on June 30, 2008 was $3,309,277,244 based on the closing sale price as reported on the New York Stock Exchange.

As of February 23, 2009, there were outstanding 78,964,045 Common Shares of the registrant.

Portions of the registrant s definitive proxy statement to be filed with the Securities and Exchange Commission in connection with the 2009 annual meeting of the shareholders of the registrant scheduled to be held May 21, 2009, are incorporated by reference in Part III hereof.

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* Included pursuant to Instruction 3 to Item 401(b) of Regulation S-K.

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INDEX TO FINANCIAL STATEMENT SCHEDULES

All other financial statement schedules have been omitted because they are not applicable, the required matter is not present, or the required information has been otherwise supplied in the financial statements or the notes thereto.

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PART I

When we refer to we , us , our , the Company , or Rayonier , we mean Rayonier Inc. and its consolidated subsidiaries. References herein to N
Financial Statements refer to the Notes to the Consolidated Financial Statements of Rayonier Inc. included in Item 8 of this Report.

Item 1. BUSINESS

General

We are a leading international forest products company primarily engaged in activities associated with timberland management, the sale and entitlement of real estate, and the production and sale of high value specialty cellulose fibers and fluff pulp. We own, lease or manage approximately 2.6 million acres of timberland and real estate located in the United States and New Zealand. We believe that Rayonier is the seventh largest private timberland owner in the U.S. Included in this property is over 200,000 acres of high value real estate located primarily along the coastal corridor from Savannah, Georgia to Daytona Beach, Florida. We own and operate two specialty cellulose mills in the United States. In addition, we manufacture lumber in three sawmills in Georgia and engage in the trading of logs and wood products. For information on sales, operating income and identifiable assets by reportable segment, see Item 7 *Management s Discussion and Analysis of Financial Condition and Results of Operations* and Note 3 *Segment and Geographical Information.*

Our corporate strategy is to:

- Increase the size and quality of our timberland holdings through cash-accretive timberland acquisitions while selling timberland that no longer meets our strategic or financial return requirements.

- Extract maximum value from our higher and better use (HBU) properties. We will continue entitlement activity on development property while maintaining a rural HBU program of sales for conservation, recreation and industrial uses.

- Continue to differentiate our Performance Fibers business by developing and improving customer specific applications. We will also emphasize operational excellence to ensure quality, reliability and efficiency.

We originated as the Rainier Pulp & Paper Company founded in Shelton, WA in 1926. In 1937, we became Rayonier Incorporated, a public company traded on the New York Stock Exchange (NYSE), until 1968 when we became a wholly-owned subsidiary of ITT Corporation (ITT). On February 28, 1994, Rayonier again became an independent public company after ITT distributed all of Rayonier s Common Shares to ITT stockholders. Our shares are publicly traded on the NYSE under the symbol **RYN**. We are a North Carolina corporation with executive offices located at 50 North Laura Street, Jacksonville, FL 32202. Our telephone number is (904) 357-9100.

The Company is a real estate investment trust (REIT). Under this structure, we are generally not required to pay federal income taxes on our earnings from timber harvest operations and other REIT-qualifying activities contingent upon meeting applicable distribution, income, asset, shareholder and other tests.

Our principal businesses are conducted through two entities. Our U.S. timber operations are primarily conducted by a wholly-owned REIT subsidiary, Rayonier Forest Resources, L.P. (RFR). Our non REIT-qualifying operations, which are subject to corporate-level tax on earnings, are held by our wholly-owned taxable subsidiary, Rayonier TRS Holdings Inc. (TRS). These operations include our Performance Fibers, Wood Products and trading business, as well as the sale and entitlement of higher value real estate and non-strategic timberlands.

Timber

Our Timber segment owns, leases or manages approximately 2.5 million acres of timberlands, and sells standing timber (primarily at auction to third parties) and delivered logs. We also generate non-timber income from other land related activities. See chart in Item 2 *Properties* for additional information.

Our Eastern U.S. timberland holdings consist of approximately 1.8 million acres in Alabama, Arkansas, Florida, Georgia, Louisiana, New York, Oklahoma and Texas. End-use markets for this timber include pulp, paper and wood products facilities. The predominant tree species across these timberlands are loblolly and slash pine. Hardwoods include red oak, sweet gum, black gum, red maple, cypress, black cherry, sugar maple and yellow birch.

Our Western U.S. timberlands consist of 413,000 acres of primarily softwood second growth timber in western Washington with approximately 55 percent hemlock, 31 percent douglas-fir and the remainder western red cedar and spruce. Our hardwood timber stands consist principally of red alder and maple.

In addition, we have a 40 percent interest in a New Zealand joint venture which owns or leases approximately 329,000 acres of primarily radiata pine timberland, which we manage. In August 2008, the joint venture partners decided to offer the business for sale and the sale process is ongoing. Accordingly, we classified our interest in the New Zealand joint venture as held for sale and its operations are shown as discontinued operations in the Consolidated Balance Sheet and Consolidated Statements of Income and Comprehensive Income, respectively. See Note 7 *Assets Held for Sale* for additional information.

We manage our U.S. timberlands in accordance with the requirements of the Sustainable Forestry Initiative® (SFI) program. Through application of our site-specific silvicultural expertise and financial discipline, we manage timber in a way that optimizes site preparation, tree species selection, competition control, use of fertilization and timing of thinning and final harvest. We also have a genetic tree improvement program aimed to enhance the productivity and quality of our timber. In addition, non-timber income opportunities associated with our timberlands such as recreational licenses and specialty forest products as well as considerations for the future higher and better uses of the land are an integral part of our site-specific management philosophy. All these activities are designed to maximize value while complying with SFI requirements.

The average rotation (final harvest) age for timber from the Eastern U.S. (primarily Southern pine) excluding New York, is between 21 to 24 years. Our Eastern U.S. timber is primarily a mix of sawtimber and pulpwood. Due to slower timber growth rates, the harvest age on the New York timberlands ranges widely from 40 to 80 years. Rotation age for timber from the Western U.S. (primarily hemlock and douglas-fir) ranges from 40 to 50 years, and is primarily composed of sawtimber.

Softwood merchantable timber inventory is an estimate of timber volume based on the earliest economically harvestable age. Hardwood inventory is an estimate of timber volume available for harvest. Estimates are based on an inventory system that involves periodic statistical sampling. Adjustments are made on the basis of growth estimates, harvest information, environmental restrictions and market conditions. Timber located in swamplands, restricted or environmentally sensitive areas is not included in the merchantable inventory shown below.

The following table sets forth the estimated volumes of merchantable timber in the U.S. by location and type, as of December 31, 2008:

Location	Softwood	Hardwood	Total	Equivalent total, in thousands of short green tons	%
Eastern, in thousands of short green tons	32,080	22,446	54,526	54,526	85
Western, in millions of board feet	1,300	79	1,379	9,929	15
				64,455	100

Real Estate

Our Real Estate subsidiary owns approximately 67,000 acres of land. We segregate our real estate holdings into three groups: HBU development, HBU rural and non-strategic timberlands. Development properties are predominantly located in the eleven coastal counties between Savannah, GA and Daytona Beach, FL. In 2008 we continued our strategy to pursue and obtain entitlements for selected development properties. Additionally, we began a strategy of selling non-strategic timberland holdings that do not meet our investment criteria, which enables us to redeploy capital to higher value assets and upgrade our timberland portfolio. A decrease in demand for our development properties due to the weakening economic conditions, combined with the new strategy of selling non-strategic timberlands resulted in a change in sales mix in 2008.

Performance Fibers

We are a leading manufacturer of high value specialty cellulose fibers and absorbent materials with production facilities in Jesup, GA and Fernandina Beach, FL, which have a combined annual capacity of approximately 740,000 metric tons. These facilities are manufacturing more than 25 different grades of fibers. The Jesup facility can produce approximately 590,000 metric tons, or 80 percent of our total capacity, and the Fernandina Beach facility can produce approximately 150,000 metric tons, or 20 percent of our total capacity.

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This segment has two major product lines Cellulose Specialties and Absorbent Materials.

Cellulose Specialties We are one of the world s leading producers of specialty cellulose products, most of which are used in dissolving chemical applications that require a highly purified form to produce cellulose acetate and ethers that create high value, technologically demanding products. Our products are used in a wide variety of end uses such as: cigarette filters, liquid crystal display (LCD) screens, acetate textile fibers, pharmaceuticals, cosmetics, rigid packaging, photographic film, impact-resistant plastics, high-tenacity rayon yarn for tires and industrial hoses, detergents, food casings, food products, thickeners for oil well-drilling muds, lacquers, paints, printing inks, and explosives. In addition, cellulose specialties include high value specialty paper applications used for decorative laminates, automotive air and oil filters, shoe innersoles, battery separators, circuit boards and filter media for the food industry.

Absorbent Materials We are a producer of fibers for absorbent hygiene products. These fibers are typically referred to as fluff fibers and are used as an absorbent medium in products such as disposable baby diapers, feminine hygiene products, incontinence pads, convalescent bed pads, industrial towels and wipes and non-woven fabrics.

Sixty-three percent of Performance Fibers sales are exported, primarily to customers in Asia and Europe. Ninety-four percent of Performance Fibers sales are made directly by Rayonier personnel, with the remainder through independent sales agents. We have long-term contracts with the world s largest manufacturers of acetate-based products and other key customers that extend into 2011 and represent nearly all of our high value cellulose specialties production.

Wood Products

Our Wood Products business segment manufactures and sells dimension lumber. We operate three lumber manufacturing facilities in the U.S. that produce Southern pine lumber, which is generally used for residential and industrial construction. Located in Baxley, Swainsboro and Eatonton, GA, the mills have a combined annual capacity of approximately 370 million board feet of lumber and 685,000 tons of wood chips. In the fourth quarter of 2008, we curtailed production at our sawmills due to decreased demand from a weak housing market. We may temporarily suspend production at one or more of our mills in 2009 unless market conditions improve.

Lumber sales are primarily made by Rayonier personnel to customers in the southeastern U.S. Approximately 70 percent of our lumber mills wood chip production is sold at market prices to our Jesup, GA performance fibers facility. In 2008, these purchases represented approximately 13 percent of that facility s total wood consumption.

Other

The primary business of our Other segment is trading logs and wood products.

Discontinued Operations and Dispositions

In August 2008, the New Zealand joint venture partners decided to offer the business for sale and the sale process is ongoing. Accordingly, we classified our interest in the joint venture as held for sale and its operations are shown as discontinued operations in the Consolidated Balance Sheet and Consolidated Statements of Income and Comprehensive Income, respectively (see Note 7 *Assets Held for Sale*). As a result, the operations that were previously included in the Timber and Other segments have been segregated from continuing operations in the Consolidated Statements of Income and Comprehensive Income and reported as discontinued operations for all periods presented. The assets and liabilities have been classified as Assets Held for Sale and Liabilities Associated with Assets Held for Sale at December 31, 2008 in the Consolidated Balance Sheets. Additionally, we classified our International Wood Products (IWP) log trading operations, which was closed in 2007, as discontinued operations for all periods presented.

Included in the Consolidated Balance Sheets are environmental liabilities relating to prior dispositions and discontinued operations; our Port Angeles, WA performance fibers mill that was closed in 1997; our wholly-owned subsidiary, Southern Wood Piedmont Company (SWP), which ceased operations other than environmental investigation and remediation activities in 1989; our Eastern Research Division (ERD), which ceased operations in 1981; and other miscellaneous assets held for disposition. See Note 15 *Liabilities for Dispositions and Discontinued Operations* for additional information.

Foreign Sales and Operations

Sales from non-U.S. operations comprised less than one percent of consolidated 2008 sales. See Note 3 *Segment and Geographical Information* for additional information.

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Intellectual Property

We own numerous patents, trademarks, trade secrets and know-how, particularly relating to our Performance Fibers business. We intend to continue to take such steps as are necessary to protect our intellectual property, including filing patent applications for inventions that are deemed important to our business operations. Our U.S. patents generally have a duration of 20 years from the date of filing.

Competition

Our U.S. timberlands are located in three major timber-growing areas (the northwest U.S., known as our Western region and the northeast and the southern U.S., known as our Eastern region), where timber markets are fragmented. In the Western region, Weyerhaeuser, Hancock Timber Resource Group, Green Diamond Resource Company, Longview Timber, Port Blakely Tree Farms, Pope Resources and the State of Washington Department of Natural Resources are significant competitors. Other competition in the Western U.S. arises from log imports from Canada. In the Eastern region, we compete with Plum Creek Timber Company, Timberland Investment Management Organizations (TIMOs) such as Hancock Timber Resource Group, Resource Management Services, Forest Investment Associates and the Campbell Group as well as other numerous large and small privately held timber companies. In all markets, price is the principal method of competition.

In Performance Fibers, we market high purity, specialty cellulose fibers worldwide against strong competition from domestic and foreign producers. Major competitors include Buckeye Technologies Inc., Borregaard, and Sappi Saiccor. Product performance, technical service and price are principal methods of competition. During 2005, Sappi Saiccor announced a 200,000 ton per year expansion at its cellulose specialty pulp mill in South Africa, and Sateri International announced construction of a 360,000 ton per year cellulose specialty pulp mill in Bahia, Brazil. These facilities commissioned their production in 2008 and small amounts are undergoing testing and qualification procedures by our customers. Somewhat offsetting this additional capacity, Borregard announced the closure of its Atizholz mill in late 2008 and other smaller competitors have recently announced market production curtailments. The aggregate impact of potential facility closures and new market capacity is not expected to adversely affect the results of our Performance Fibers segment in 2009. However, it is difficult to determine whether and to what extent these market dynamics may impact our business in 2010 and beyond.

Our Wood Products business competes with a number of lumber producers throughout the U.S. and Canada, but particularly with sawmills throughout Georgia and Florida. Our Wood Products business represents less than one-half of one percent of North American capacity.

Customers

In 2008, a group of customers under the common control of Eastman Chemical Company (and its affiliates) and Celanese represented approximately 19 and 16 percent of our Performance Fibers segment s sales and 12 and 10 percent of consolidated sales, respectively. An additional customer of the Performance Fibers segment comprised 14 percent of the segment s sales. One customer represented 10 percent of our Timber segment s sales. The loss of any of these customers could have a material adverse effect on the Company and the respective segments results of operations.

Seasonality

Our Timber segment sales are generally lower in the third quarter due to greater availability of non-Rayonier timber during the drier summer harvesting period, particularly in the Western U.S. Our Wood Products segment may experience higher seasonal demand in the second quarter when demand for new housing has typically increased. Our Performance Fibers and Real Estate segments results are normally not impacted by seasonal changes.

Environmental Matters

See Item 7 *Management s Discussion and Analysis of Financial Condition and Results of Operations Environmental Regulation*, Note 15 *Liabilities for Dispositions and Discontinued Operations*, and Note 16 *Contingencies.*

Raw Materials

The manufacture of our performance fibers products and lumber requires significant amounts of wood. Timber harvesting can be restricted by stringent regulatory requirements, adverse weather conditions, legal challenges and pressure from various environmental groups. The supply of timber is directly affected by price and demand fluctuations in wood products and pulp and paper markets.

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Our Performance Fibers and lumber mills obtain their logs through open market purchases made by our wood procurement organization, which negotiates prices and volumes with independent third party suppliers who deliver to our facilities. In some cases, we obtain logs through third party logging contractors who have purchased timber cutting rights from our timberlands in Georgia and Florida (generally through a sealed bid process).

Performance Fibers manufacturing uses a substantial amount of residual biomass to produce its own energy, but also requires significant amounts of fuel oil and natural gas. These raw materials are subject to significant changes in prices and availability, which could adversely impact our future operating results. To reduce variability and cost, we completed a number of capital projects to reduce fossil fuel consumption, including a power boiler replacement at our Fernandina Beach, FL facility, which consumes primarily wood waste. We continually pursue reductions in usage and costs of other key raw materials, supplies and contract services at our Performance Fibers and lumber mills and do not foresee any material constraints in the near term from pricing or availability.

Research and Development

The research and development efforts of our Performance Fibers business are primarily directed at further developing existing core products and technologies, improving the quality of cellulose fiber grades, absorbent materials and related products, improving manufacturing efficiency and environmental controls, and reducing fossil fuel consumption.

The research and development activities of our timber operations include genetic tree improvement and applied silvicultural programs to identify management practices that will improve financial returns from our timberlands.

Employee Relations

We currently employ approximately 1,950 people, of whom approximately 1,850 are in the United States. Approximately 900 of our hourly Performance Fibers employees are covered by collective bargaining agreements. The majority of our hourly employees are represented by one of several labor unions. We believe relations with our employees are satisfactory.

On June 30, 2008, the collective bargaining agreements covering approximately 700 hourly employees at our Jesup mill expired. The parties have worked without an agreement since that time while negotiations take place. On February 11, 2009, an initial vote on the proposed contract was taken and the proposal was rejected by the unions. While there can be no assurance, we expect to reach mutually satisfactory agreements with our unions in the first quarter of 2009. Any failure to do so accompanied by a work stoppage could have a material adverse effect on our business, results of operations and financial condition. In December of 2005, two labor unions representing approximately 230 hourly employees at our Fernandina mill approved a four-year contract, which expires on April 30, 2010.

Sustainable Forestry

While it is our objective to maximize future wood supply through forest management programs that increase timberland productivity, we have a longstanding commitment to meet the highest levels of forest stewardship and to promote sustainable forestry practices throughout the industry. We subscribe to the SFI program, a comprehensive system of environmental principles, objectives and performance measures that combines the perpetual growing and harvesting of trees with the protection of wildlife, plants, soil and water quality. Most of our U.S. timberlands and wood procurement practices have been audited and certified by an independent third party under the SFI program. We have over 2 million acres enrolled in the SFI program. Annually we undergo third-party surveillance audits across our land-base. This independent certification verifies that we meet strict requirements for growing and harvesting trees in an environmentally responsible manner that protects natural resources, renews forests, ensures sustainable harvest levels, creates biological diversity, and enhances wildlife protection.

Availability of Reports and Other Information

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and amendments to those reports filed or furnished pursuant to Sections 13(a) or 14 of the Securities Exchange Act of 1934 are made available to the public free of charge in the Investor Relations section of our website (*www.rayonier.com*), shortly after we electronically file such material with, or furnish them to, the SEC. Our corporate governance guidelines and charters of all Committees of our Board of Directors are also available on our website. These documents are also available in print, free of charge, to any investor upon request to: Investor Relations Department, Rayonier Inc., 50 North

Laura Street, Jacksonville, Florida 32202.

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Item 1A. RISK FACTORS

Certain statements in this document regarding anticipated financial outcomes including earnings guidance, if any, business and market conditions, outlook and other similar statements relating to Rayonier s future financial and operational performance, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and other federal securities laws. These forward-looking statements are identified by the use of words such as may, will, should, expect, estimate, believe, anticipate similar language. Forward-looking statements are not guarantees of future performance and undue reliance should not be placed on these statements. The following risk factors, among others, could cause actual results to differ materially from those expressed in forward looking statements that are made in this document.

Our operations are subject to a number of risks, including those listed below. When considering an investment in our securities, you should carefully read and consider these risks, together with all other information in this report. If any of the events described in the following risk factors actually occur, our business, financial condition or operating results, as well as the market price of our securities, could be materially adversely affected. Rayonier assumes no obligation to update these statements except as is required by law.

Business and Operating Risks

The current global economic downturn and turmoil in the global credit markets could limit demand for our products and real estate, and affect the overall availability and cost of credit for Rayonier and its customers and suppliers.

The global economic downturn and unprecedented deterioration of the global credit markets has adversely affected, and could further adversely affect, various aspects of our business and the businesses of our customers and suppliers. At this time, it is impossible to predict the outcome of various actions taken by the U.S. government, including the passage of the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009, and whether these and other measures currently being implemented or contemplated by the government will mitigate the effects of the crisis. With respect to Rayonier, while we have no immediate need to access the credit markets, the impact of the current crisis on our ability to obtain financing in the future, and the cost and terms of that financing, is unclear. Similarly, the inability of our customers and suppliers to obtain financing could adversely affect our business if their ability to operate or fund transactions (such as real estate purchases) is impacted. We have already seen a small number of our customers file for bankruptcy protection due to economic conditions or the inability to refinance debt, although the effects of these bankruptcies to Rayonier have not been significant to date. No assurances can be given that the effects of the current economic downturn and deterioration of the credit markets will not have a material adverse effect on our business, financial condition and results of operations.

The precipitous decline in the stock market has impacted our pension plan investment performance and, absent a significant recovery in the market or additional federal legislation, may require us to make significant additional cash contributions to our plans.

We sponsor several defined benefit pension plans, which cover many of our salaried and hourly employees. Due to the precipitous decline in the stock market (the Dow Jones Industrial Average declined approximately 32 percent in 2008), the value of our pension plan equity assets has also dropped significantly. However, the Federal Pension Protection Act of 2006 (the PPA) requires that certain capitalization levels be maintained in each of these plans. Recognizing that this issue affects much of Corporate America, in December 2008 federal legislation was passed (as part of the Worker, Retiree, and Employer Recovery Act of 2008) which provides short term relief to plan sponsors by allowing them to phase in the funding requirements of the PPA over three years, among other things. Because it is unknown how the stock market will perform over the next 12 to 24 months and whether additional legislation will be passed to address this issue, no assurances can be given that any additional plan contributions required by applicable law will not be material.

The cyclical nature of our businesses could adversely affect our results of operations.

Our financial performance is affected by the cyclical nature of the forest products and real estate industries. The markets for timber, real estate, performance fibers and wood products are influenced by a variety of factors beyond our control. For example, the demand for real estate can be affected by changes in interest rates, availability and terms of financing, local economic conditions, new housing starts, population growth and demographics. The demand for sawtimber is primarily affected by the level of new residential and commercial construction activity. Both our Real Estate and Timber

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businesses have been negatively impacted by the current economic downturn, primarily due to the decline in housing starts and the deterioration of the credit markets. The supply of timber and logs has historically increased during favorable pricing environments, which then causes downward pressure on prices.

The forest products and real estate industries are highly competitive.

Some of our competitors in the forest products businesses have greater financial and operating resources and own more timberlands than we do. Some of our forest products competitors may also be lower-cost producers in some of the businesses in which we operate. In addition, wood products are subject to significant competition from a variety of non-wood and engineered wood products. We are also subject to competition from various forest products, including logs, imported from foreign countries to the United States as well as to the export markets served by us. To the extent there is a significant increase in competitive pressures from substitute products or other domestic or foreign suppliers, our business could be adversely affected. With respect to our real estate business, one of our key strategies is to engage in activities that add long term value to our properties, including obtaining entitlements and entering into joint venture type arrangements. Many of our competitors in this segment have greater experience in real estate entitlement and development than we do.

Changes in energy and raw materials prices could impact our operating results and financial condition.

Energy and raw material costs, such as oil, natural gas, wood, and chemicals are a significant operating expense, particularly for the Performance Fibers and Wood Products businesses. The prices of raw materials and energy can be volatile and are susceptible to rapid and substantial increases due to factors beyond our control such as changing economic conditions, political unrest, instability in energy-producing nations, and supply and demand considerations. For example, in 2008, we experienced significant volatility in energy, chemicals, transportation and other input costs. Oil and natural gas costs have also increased substantially in recent years and we have experienced, at times, a limited availability of hardwood which has resulted in increased production costs for some Performance Fibers products. Increases in production costs could have a material adverse effect on our business, financial condition and results of operations. In addition, in our Timber, Performance Fibers and Wood Products businesses, the rising cost of fuel, and its impact on the cost and availability of transportation for our products, both domestically and internationally, and the cost and availability of third party logging and trucking services, could have a material adverse effect on our business, financial condition and results of operations.

Changes in global economic conditions, market trends and world events could impact customer demand.

The global reach of our business, particularly the Performance Fibers business and our interest in the New Zealand joint venture, causes us to be subject to unexpected, uncontrollable and rapidly changing events and circumstances in addition to those experienced in the U.S. The current global economic and financial market crises are examples of such changes. Adverse changes in the following factors, among others, could have a negative impact on our business and results of operations:

- exposure to currencies other than the United States dollar;
- regulatory, social, political, labor or economic conditions in a specific country or region; and,
- trade protection laws, policies and measures and other regulatory requirements affecting trade and investment, including loss or modification of exemptions for taxes and tariffs, and import and export licensing requirements.

The impacts of climate initiatives, at the international, federal and state levels, are uncertain at this time.

Currently, there are numerous international, federal and state-level initiatives and proposals addressing global climate issues. Within the U.S., most of these proposals would regulate and/or tax, in one fashion or another, the production of carbon dioxide and other so-called greenhouse gases. Moreover, the results of the recent federal election will likely result in a shift to a more aggressive approach on the federal level in addressing climate change issues. It is likely that future legislative and regulatory activity in this area will impact Rayonier, but it is unclear at this time whether such impact will be, in the aggregate, positive or negative. For example, while Rayonier s Performance Fibers mills produce greenhouses gases and utilize fossil fuels, they also generate a substantial amount of their energy from wood fiber (often referred to as biomass), which is favored under most current legislative proposals. In addition, our extensive timber holdings and the biomass they produce may provide opportunities for us to benefit from new legislation and regulation, especially in states that have implemented renewable portfolio standards that mandate the use of non-fossil fuels by electricity generators. We continue to monitor political and regulatory developments in this area, but their overall impact on Rayonier is uncertain at this time.

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Our businesses are subject to extensive environmental laws and regulations that may restrict or adversely impact our ability to conduct our business.

If regulatory and environmental permits are delayed, restricted or rejected, a variety of our operations could be adversely affected. In connection with a variety of operations on our properties, we are required to seek permission from government agencies in the states and countries in which we operate to perform certain activities. Any of these agencies could delay review of, or reject, any of our filings. In our Timber business, any delay associated with a filing could result in a delay or restriction in replanting, thinning, insect control, fire control or harvesting, any of which could have an adverse effect on our operating results. For example, in Washington State, we are required to file a Forest Practice Application for each unit of timberland to be harvested. These applications may be denied, conditioned or restricted by the regulatory agency or appealed by other parties, including citizen groups. Appeals or actions of the regulatory agencies could delay or restrict timber harvest activities pursuant to these permits. Delays or harvest restrictions on a significant number of applications could have an adverse effect on our operating results. In our Performance Fibers and Wood Products businesses, many modifications and capital projects at our manufacturing facilities require an environmental permit, or an amendment to an existing permit. Delays in obtaining these permits could have an adverse effect on our results of operations.

Environmental groups and interested individuals may seek to delay or prevent a variety of operations. We expect that environmental groups and interested individuals will intervene with increasing frequency in the regulatory processes in the states and countries where we own, lease or manage timberlands, and operate mills. For example, as described in more detail in Note 16 *Contingencies*, the Altamaha Riverkeeper, a non-profit environmental group, has alleged noncompliance by our Jesup mill with certain laws relating to its effluent discharge, and has threatened to file a citizen suit against Rayonier pursuant to the provisions of the Clean Water Act if the group s concerns are not addressed to their satisfaction. In Washington State, environmental groups and interested individuals may appeal individual forest practice applications or file petitions with the Forest Practices Board to challenge the regulations under which forest practices are approved. These and other challenges could materially delay or prevent operations on our properties. Delays or restrictions due to the intervention of environmental groups or interested individuals could adversely affect our operating results. In addition to intervention in regulatory proceedings, interested groups and individuals may file or threaten to file lawsuits that seek to prevent us from obtaining permits or implementing capital improvements or pursuing operating plans. Any lawsuit or even a threatened lawsuit could delay harvesting on our timberlands, or impact how we operate or our ability to invest in our mills. Among the remedies that could be enforced in a lawsuit is a judgment preventing or restricting harvesting on a portion of our timberlands, or adversely affecting the projected operating benefits or cost of capital projects at our mills.

The impact of existing regulatory restrictions on future harvesting activities may be significant. Federal, state and local laws and regulations, as well as those of other countries, which are intended to protect threatened and endangered species, as well as waterways and wetlands, limit and may prevent timber harvesting, road building and other activities on our timberlands. The threatened and endangered species restrictions apply to activities that would adversely impact a protected species or significantly degrade its habitat. The size of the area subject to restriction will vary depending on the protected species at issue, the time of year and other factors, but can range from less than one to several thousand acres. A number of species that naturally live on or near our timberlands, including the northern spotted owl, marbled murrelet, bald eagle, several species of salmon and trout in the Northwest, and the red cockaded woodpecker, bald eagle, wood stork, red hill salamander, and flatwoods salamander in the Southeast, are protected under the Federal Endangered Species Act or similar state laws. As we gain additional information regarding the presence of threatened or endangered species on our timberlands, or if other regulations, such as those that require buffers to protect water bodies, become more restrictive, the amount of our timberlands subject to harvest restrictions could increase.

Our manufacturing operations, and in particular our Performance Fibers and Wood Products mills, are subject to stringent environmental laws and regulations concerning air emissions, wastewater discharge, water usage and waste handling and disposal. Many of our operations are subject to stringent environmental laws and regulations and permits which contain conditions that govern how we operate our facilities and, in many cases, how much product we can produce. These laws, regulations and permits, now and in the future, may restrict our current production and limit our ability to increase production, and impose significant costs on our operations with respect to environmental compliance. It is expected that, overall, these costs will likely increase over time as environmental laws, regulations and permit conditions become more stringent, and as the expectations of the communities in which we operate become more demanding.

We currently own or may acquire properties which may require environmental remediation or otherwise be subject to environmental and other liabilities. We currently own, or formerly operated, manufacturing facilities and discontinued operations, or may acquire timberlands and other properties, which are subject to environmental liabilities, such as

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remediation of hazardous material contamination and other existing or potential liabilities. The cost of investigation and remediation of contaminated properties could increase operating costs and adversely affect financial results. Although we believe we have adequate reserves for the investigation and remediation of our current properties, there can be no assurance that actual expenditures will not exceed our expectations, or that other unknown liabilities will not be discovered in the future.

Environmental laws and regulations are constantly changing, and are generally becoming more restrictive. Laws, regulations and related judicial decisions and administrative interpretations affecting our business are subject to change and new laws and regulations that may affect our business are frequently enacted. These changes may adversely affect our ability to harvest and sell timber, operate our manufacturing facilities, remediate contaminated properties and/or develop real estate. These laws and regulations may relate to, among other things, the protection of timberlands, endangered species, timber harvesting practices, recreation and aesthetics, protection and restoration of natural resources, air and water quality, and remedial standards for contaminated property and groundwater. Over time, the complexity and stringency of these laws and regulations have increased markedly and the enforcement of these laws and regulations has intensified. Moreover, we believe that environmental policies of the current administration are likely to be, in the aggregate, more restrictive for industry and landowners than those of the previous administration. Nonetheless, irrespective of any particular presidential administration, environmental laws and regulations will likely continue to become more restrictive and over time could adversely affect our operating results.

Entitlement and development of real estate entails a lengthy, uncertain and costly approval process.

Entitlement and development of real estate entails extensive approval processes involving multiple regulatory jurisdictions. It is common for a project to require various approvals, permits and consents from federal, state and local governing and regulatory bodies. For example, in Florida, real estate projects must generally comply with the provisions of the Local Government Comprehensive Planning and Land Development Regulation Act (the Growth Management Act) and local land use and development regulations. In addition, in Florida, development projects that exceed certain specified regulatory thresholds require approval of a comprehensive Development of Regional Impact (DRI) application. Compliance with the Growth Management Act, local land development regulations and the DRI process is usually lengthy and costly and significant conditions can be imposed on a developer with respect to a particular project. In addition, development of properties containing delineated wetlands may require one or more permits from the federal government. Any of these issues can materially affect the cost and timing of our real estate projects.

The real estate entitlement process is frequently a political one, which involves uncertainty and often extensive negotiation and concessions in order to secure the necessary approvals and permits. A significant amount of our development property is located in counties in which local governments face challenging issues relating to growth and development, including zoning and future land use, public services, infrastructure and funding for same, and the requirements of state law, especially in the case of Florida under the Growth Management Act and DRI process. In addition, anti-development groups are active, especially in Florida, in seeking constitutional amendments, legislation and other anti-growth limitations on real estate development activities. We expect this type of activity to continue in the future.

Issues affecting real estate development also include the availability of potable water for new development projects. For example, in Georgia, the Legislature enacted the Comprehensive Statewide Watershed Management Planning Act (the Watershed Management Act), which, among other things, created a governmental entity called the Georgia Water Council which was charged with preparing a comprehensive water management plan for the state and presenting it to the Georgia Legislature. It is unclear at this time how the plan will affect the cost and timing of real estate development along the I-95 coastal corridor in southern Georgia, where the Company has significant real estate holdings.

Changes in the interpretation or enforcement of these laws, the enactment of new laws regarding the use and development of real estate, changes in the political composition of state and local governmental bodies, and the identification of new facts regarding our properties could lead to new or greater costs, delays and liabilities that could materially adversely affect our business, profitability or financial condition.

Changes in demand for our real estate and delays in the timing of real estate transactions may affect our revenues and operating results.

A number of factors, including changes in demographics, tightening of credit, and a slowing of commercial or residential real estate development, particularly along the I-95 coastal corridor in Florida and Georgia, could reduce the demand for our properties and negatively affect our results of operations. The current decline in the economy generally and in the housing market in particular, together with the deterioration of the credit markets, has certainly had such an effect in 2008 and is expected to continue into 2009.

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In addition, there are inherent uncertainties in the timing of real estate transactions that could adversely affect our operating results. Delays in the completion of transactions or the termination of potential transactions can be caused by factors beyond our control. These events have in the past and may in the future adversely affect our operating results.

Our joint venture partners may have interests that differ from ours and may take actions that adversely affect us.

We participate in a joint venture in New Zealand, and may enter into other joint venture projects: for example, as part of our real estate strategy. A joint venture involves potential risks such as:

- not having voting control over the joint venture;
- the venture partner at any time may have economic or business interests or goals that are inconsistent with ours;
- the venture partner may take actions contrary to our instructions or requests, or contrary to our policies or objectives with respect to the investment; and,
- the venture partner could experience financial difficulties.

Actions by our venture partners may subject property owned by the joint venture to liabilities greater than those contemplated by the joint venture agreement or to other adverse consequences.

We may be unsuccessful in carrying out our acquisition strategy.

We have pursued, and intend to continue to pursue, acquisitions of strategic timberland and real estate properties that meet our investment criteria. Our timberland and real estate acquisitions may not perform in accordance with our expectations. We anticipate financing any such acquisitions through cash from operations, borrowings under our credit facilities, proceeds from equity or debt offerings or proceeds from asset dispositions, or any combination thereof. The failure to identify and complete suitable timberland and real estate properties, and the failure of any acquisitions to perform to our expectations, could adversely affect our operating results.

Our failure to maintain satisfactory labor relations could have a material adverse effect on our business.

Approximately 48 percent of our work force is unionized. These workers are exclusively in our Performance Fibers business. As a result, we are required to negotiate the wages, benefits and other terms with these employees collectively. Our financial results could be adversely affected if labor negotiations were to restrict the efficiency of our operations. In addition, our inability to negotiate acceptable contracts with any of these unions as existing agreements expire could result in strikes or work stoppages by the affected workers. For example, we are currently engaged in collective bargaining agreement negotiations with unions representing substantially all of the hourly employees at our Jesup mill. If the unionized employees were to engage in a strike or other work stoppage, or other employees were to become unionized, we could experience a significant disruption of our operations, which could have a material adverse effect on our business, results of operations and financial condition.

Weather and other natural conditions may limit our timber harvest and sales.

Weather conditions, timber growth cycles and restrictions on access may limit harvesting of our timberlands, as may other factors, including damage by fire, insect infestation, disease, prolonged drought and natural disasters such as wind storms and hurricanes.

We do not insure against losses of timber from any causes, including fire.

The volume and value of timber that can be harvested from our timberlands may be reduced by fire, insect infestation, severe weather, disease, natural disasters, and other causes beyond our control. A reduction in our timber inventory could adversely affect our financial results and cash flows. As is typical in the industry, we do not maintain insurance for any loss to our timber, including losses due to these causes.

A significant portion of the timberland that we own, lease or manage is concentrated in limited geographic areas.

We own, lease or manage approximately 2.6 million acres of timberland and real estate located primarily in the United States and New Zealand. Over 75 percent of our timberlands are located in four states: Alabama, Florida, Georgia and Washington. Accordingly, if the level of production from these forests substantially declines, or if the demand for timber in those regions declines, it could have a material adverse effect on our overall production levels and our revenues.

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We are dependent upon attracting and retaining key personnel.

We believe that our success depends, to a significant extent, upon our ability to attract and retain key senior management and operations management personnel. Our failure to recruit and retain these key personnel could adversely affect our financial condition or results of operations.

Market interest rates may influence the price of our common shares.

One of the factors that may influence the price of our common shares is our annual dividend yield as compared to yields on other financial instruments. Thus, an increase in market interest rates will result in higher yields on other financial instruments, which could adversely affect the price of our common shares.

We have a significant amount of debt and the capacity to incur significant additional debt.

As of December 31, 2008, we had $771 million of debt outstanding. See Item 7 *Management s Discussion and Analysis of Financial Condition and Results of Operations Contractual Financial Obligations* for the payment schedule of our long-term debt obligations. We expect that existing cash, cash equivalents, marketable securities, cash provided from operations, and our bank credit facilities will be sufficient to meet ongoing cash requirements. Moreover, we have the borrowing capacity to incur significant additional debt and may do so if we enter into one or more strategic, merger, acquisition or other corporate or investment opportunities, or otherwise invest capital in one or more of our businesses. However, failure to generate sufficient cash as our debt becomes due, or to renew credit lines prior to their expiration, may adversely affect our business, financial condition, operating results, and cash flow.

REIT and Tax-Related Risks

If we fail to qualify as a REIT or fail to remain qualified as a REIT, we will have reduced funds available for distribution to our shareholders because our timber-related income will be subject to taxation.

We intend to operate in accordance with REIT requirements pursuant to the Internal Revenue Code of 1986, as amended (the Code). For example, as a REIT, we generally will not pay corporate-level tax on income we distribute to our shareholders (other than the income of TRS) as long as we distribute at least 90 percent of our REIT taxable income (determined without regard to the dividends paid deduction and by excluding net capital gains). Qualification as a REIT involves the application of highly technical and complex provisions of the Code, which are subject to change, perhaps retroactively, and which are not entirely within our control. We cannot assure that we will qualify as a REIT or be able to remain so qualified or that new legislation, U.S. Treasury regulations, administrative interpretations or court decisions will not significantly affect our ability to qualify as a REIT or the federal income tax consequences of such qualification.

If in any taxable year we fail to qualify as a REIT, we will suffer the following negative results:

- we will not be allowed a deduction for dividends paid to shareholders in computing our taxable income; and,

- we will be subject to federal income tax on our REIT taxable income.

In addition, we will be disqualified from treatment as a REIT for the four taxable years following the year during which the qualification was lost, unless we are entitled to relief under certain provisions of the Code. As a result, our net income and the cash available for distribution to our shareholders could be reduced for up to five years or longer.

If we fail to qualify as a REIT, we may need to borrow funds or liquidate some investments or assets to pay the additional tax liability. Accordingly, cash available for distribution to our shareholders would be reduced.

The extent of our use of taxable REIT subsidiaries may affect the price of our common shares relative to the share price of other REITs.

We conduct a portion of our business activities through one or more taxable REIT subsidiaries. Our use of taxable REIT subsidiaries enables us to engage in non-REIT qualifying business activities such as the production and sale of performance fibers and wood products, real estate sales of HBU property and timberlands (as a dealer) and sales of logs. Taxable REIT subsidiaries are subject to corporate-level tax. Therefore, we pay income taxes on the income generated by our taxable REIT subsidiaries. Under the Code, no more than 20 percent (25 percent beginning in calendar year 2009) of the value of the gross assets of a REIT may be represented by securities of one or more taxable REIT subsidiaries. This

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limitation may affect our ability to increase the size of our taxable REIT subsidiaries operations. Furthermore, our use of taxable REIT subsidiaries may cause the market to value our common shares differently than the shares of other REITs, which may not use taxable REIT subsidiaries as extensively as we use them.

Lack of shareholder ownership and transfer restrictions in our articles of incorporation may affect our ability to qualify as a REIT.

In order to qualify as a REIT, an entity cannot have five or fewer individuals who own, directly or indirectly after applying attribution of ownership rules, 50 percent or more of its outstanding voting shares during the last six months in each calendar year. Although it is not required by law or the REIT provisions of the Code, almost all REITs have adopted ownership and transfer restrictions in their articles of incorporation or organizational documents which seek to assure compliance with that rule. While we are not in violation of the ownership rules, we do not have, nor do we have any current plans to adopt, share ownership and transfer restrictions. As such, the possibility exists that five or fewer individuals could acquire 50 percent or more of our outstanding voting shares, which could result in our disqualification as a REIT.

We may be limited in our ability to fund distributions using cash generated through our taxable REIT subsidiaries.

The ability for the REIT to receive dividends from taxable REIT subsidiaries is limited by the rules with which we must comply to maintain our status as a REIT. In particular, at least 75 percent of gross income for each taxable year as a REIT must be derived from passive real estate sources including sales of our standing timber and other types of qualifying real estate income and no more than 25 percent of our gross income may consist of dividends from our taxable REIT subsidiaries and other non-qualifying income.

This limitation on our ability to receive dividends from our taxable REIT subsidiaries may impact our ability to fund cash distributions to stockholders using cash flows from our taxable REIT subsidiaries. We can, however, under current law, issue stock dividends for up to 90 percent of our regular dividend distribution for 2009. The net income of our taxable REIT subsidiaries is not required to be distributed, and income that is not distributed will not be subject to the REIT income distribution requirement.

Certain of our business activities are potentially subject to prohibited transactions tax.

As a REIT, we will be subject to a 100 percent tax on any net income from prohibited transactions. In general, prohibited transactions are sales or other dispositions of property to customers in the ordinary course of business. Sales of performance fibers and wood products which we produce and sales of logs constitute prohibited transactions. In addition, sales of timberlands or other real estate (as a dealer) and certain development activities relating to real estate could, in certain circumstances, constitute prohibited transactions.

We intend to avoid the 100 percent prohibited transactions tax by conducting activities that would otherwise be prohibited transactions through one or more taxable REIT subsidiaries. We may not, however, always be able to identify timberland properties that will become part of our dealer real estate sales business. Therefore, if we sell timberlands which we incorrectly identify as property not held for sale to customers in the ordinary course of business or which subsequently become properties held for sale to customers in the ordinary course of business, we face the potential of being subject to the 100 percent prohibited transactions tax.

We may have adjustments to deferred and contingent tax liabilities.

The IRS may assert liabilities against us for corporate income taxes for taxable years prior to the time we qualified as a REIT, in which case we will owe these taxes plus interest and penalties, if any. Moreover, any increase in taxable income for those years will result in an increase in accumulated earnings and profits, or E&P, which could cause us to pay an additional taxable distribution to our then-existing shareholders within 90 days of the relevant determination.

Our cash dividends are not guaranteed and may fluctuate.

Generally, REITs are required to distribute 90 percent of their taxable income. However, REITs are required to distribute only their ordinary taxable income and not their net capital gains income. Accordingly, we do not believe that we are required to distribute material amounts of cash since substantially all of our taxable income is treated as capital gains income. Our Board of Directors, in its sole discretion, determines the amount of quarterly dividends to be provided to our

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stockholders based on consideration of a number of factors. These include, but are not limited to, our results of operations, cash flow and capital requirements, economic conditions, tax considerations, borrowing capacity and other factors, including debt covenant restrictions that may impose limitations on cash payments, future acquisitions and divestitures, harvest levels, changes in the price and demand for our products and general market demand for timberlands including those timberland properties that have higher and better uses. Consequently, our dividend levels may fluctuate.

We may not be able to complete desired like-kind exchange transactions for timberlands and real estate we sell.

When we sell timberlands and real estate, we generally seek to match these sales with the acquisition of suitable replacement real estate. This allows us like-kind exchange treatment for these transactions under section 1031 and related regulations of the Code. This matching of sales and purchases provides us with significant tax benefits, most importantly the deferral of any gain on the property sold until ultimate disposition of the replacement property. While we attempt to complete like-kind exchanges wherever practical, we will not be able to do so in all instances due to various factors, including the lack of availability of suitable replacement property on acceptable terms, our inability to complete a qualifying like-kind exchange transaction within the time frames required by the Code and if we incorrectly identify real estate as property not held for sale to customers in the ordinary course of business or which subsequently becomes real estate held for sale to customers in the ordinary course of business. The inability to obtain like-kind exchange treatment would result in the payment of taxes with respect to the property sold, and a corresponding reduction in earnings and cash available for distribution to shareholders as dividends.

Item 1B. UNRESOLVED STAFF COMMENTS

None.

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Item 2. PROPERTIES

The following table details the significant properties we own, lease, or manage by reportable segment:

Segment	Location	Total Acres	Fee-Owned Acres	Long-Term Leased Acres	Managed Acres
Timber	Eastern U.S.	1,764,494	1,479,347	285,147	
	Western U.S.	412,769	412,106	663	
	New Zealand *	329,061			329,061
	Total Timber Acres	2,506,324	1,891,453	285,810	329,061
Real Estate	Eastern U.S.	58,892	58,892		
	Western U.S.	8,784	8,784		
	SWP	864	864		
	Total Timberland and Real Estate Acres	2,574,864	1,959,993	285,810	329,061

		Capacity/Function	Owned/Leased
Performance Fibers	Jesup, Georgia	590,000 metric tons of pulp	Owned
	Fernandina Beach, Florida	150,000 metric tons of pulp	Owned
	Jesup, Georgia	Research Facility	Owned
Wood Products **	Baxley, Georgia	160 million board feet of lumber	Owned
	Swainsboro, Georgia	120 million board feet of lumber	Owned
	Eatonton, Georgia	90 million board feet of lumber	Owned
Wood Fiber Facilities	Offerman, Georgia	650,000 short green tons of wood chips	Owned
	Eastman, Georgia	350,000 short green tons of wood chips	Owned
	Barnesville, Georgia	350,000 short green tons of wood chips	Owned
	Jarrat, Virginia	250,000 short green tons of wood chips	Owned
Corporate and Other	Jacksonville, Florida	Corporate Headquarters	Leased

* Acres under Rayonier management, owned by the New Zealand joint venture (Rayonier owns a 40 percent interest).

** These locations also have a combined annual production capacity of approximately 685,000 short green tons of wood chips.

Our manufacturing facilities are maintained through ongoing capital investments, regular maintenance and equipment upgrades. During 2008, our manufacturing facilities produced at planned capacity levels for most of the year. In the first quarter, both performance fibers mills had unplanned downtime due to operational issues.

Item 3. LEGAL PROCEEDINGS

We are engaged in various legal actions, including certain environmental proceedings that are discussed more fully in Note 15 *Liabilities for Dispositions and Discontinued Operations* and Note 16 *Contingencies.*

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

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders of Rayonier during the fourth quarter of 2008.

Item 4A. EXECUTIVE OFFICERS OF RAYONIER

Lee M. Thomas, 64, Chairman, President and Chief Executive Officer Mr. Thomas joined Rayonier in 2006 as a Director, was named President and Chief Executive Officer on March 1, 2007 and became Chairman effective July 1, 2007. Prior to joining Rayonier, Mr. Thomas served as President of Georgia-Pacific Corporation, beginning in September 2002, and as

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its Chief Operating Officer, beginning in March 2003, until his retirement in December 2005. Prior to becoming President and Chief Operating Officer, Mr. Thomas served in a number of management positions with Georgia-Pacific, including President-Building Products and Distribution from March 2002 until September 2002, Executive Vice President-Consumer Products from August 2000 until March 2002 and Executive Vice President-Paper and Chemicals from December 1997 until August 2000. Mr. Thomas previously served as chairman and chief executive officer of Law Companies Environmental Group Inc., administrator of the U.S. Environmental Protection Agency, executive deputy director of the Federal Emergency Management Agency and director of the Division of Public Safety Programs Office of the Governor of South Carolina. Mr. Thomas serves on the boards of Airgas Inc., Regal Entertainment Group and the Federal Reserve Bank of Atlanta. He holds a bachelor s degree from the University of the South and a M.Ed. from the University of South Carolina.

Paul G. Boynton, 44, Senior Vice President, Performance Fibers and Wood Resources Mr. Boynton joined Rayonier in 1999 as Director, Specialty Pulp Marketing and Sales. He was elected Vice President, Performance Fibers Marketing and Sales in October 1999, Vice President, Performance Fibers in January 2002, Senior Vice President, Performance Fibers effective July 2002 and to his current position effective January 2008. Prior to joining Rayonier, he held positions with 3M Corporation from 1990 to 1999, most recently as Global Brand Manager, 3M Home Care Division (global manufacturer and marketer of cleaning tool products). He holds a B.S. in mechanical engineering from Iowa State University, an M.B.A. from the University of Iowa, and graduated from the Harvard University Graduate School of Business Advanced Management Program.

Timothy H. Brannon, 61, Senior Vice President, Forest Resources Mr. Brannon joined Rayonier in 1972 at its Southern Wood Piedmont subsidiary (SWP). He was named Vice President and Chief Operating Officer of SWP in 1983 and President in 1992. Mr. Brannon was elected Rayonier s Vice President and Director, Performance Fibers Marketing and Sales in 1994, Vice President, Asia Pacific and Managing Director, Rayonier New Zealand in 1998 and to his current position effective March 2002. He holds a B.A. in psychology from Tulane University and graduated from the Harvard University Graduate School of Business Advanced Management Program.

W. Edwin Frazier, III, 51, Senior Vice President, Chief Administrative Officer and Corporate Secretary Mr. Frazier joined Rayonier in 1999 as Assistant General Counsel, was promoted to Associate General Counsel in 2000 and elected Corporate Secretary in 2001. He was named Vice President, Governance and Corporate Secretary in 2003, Senior Vice President, Administration and Corporate Secretary in July 2004 and was promoted to his current position in January 2008. From 1991 to 1999, Mr. Frazier was a member of the legal department of Georgia-Pacific Corporation (a global manufacturer and marketer of tissue, packaging, paper, building products and related chemicals), last serving as Chief Counsel, Corporate. Prior to that, he practiced corporate law with Troutman Sanders in Atlanta. Mr. Frazier holds a B.S. in Business Administration from the University of Tennessee, a J.D. from Emory University and graduated from the Harvard University Graduate School of Business Advanced Management Program.

Carl E. Kraus, 61, Senior Vice President, Finance and Acting President of TerraPointe LLC Mr. Kraus joined Rayonier in 2005, was named Senior Vice President, Finance and Chief Investment Officer of TerraPointe LLC in October 2005 and was elected to his current position in July 2007. Prior to joining Rayonier, he served as Senior Vice President, Chief Financial and Investment Officer and Treasurer of Kramont Realty Trust (a shopping center REIT) from 2002 until it was acquired in 2005 and as Chief Financial Officer for Philips International Realty Corp. (a shopping center REIT) from 1999 to 2002. Mr. Kraus graduated from Temple University and is a Certified Public Accountant.

Charles Margiotta, 56, Senior Vice President, Business Development and President of TerraPointe Services Inc. Mr. Margiotta joined Rayonier in 1976, was named Managing Director, Rayonier New Zealand in 1992, Vice President, Forest & Wood Products in 1997, Vice President, Corporate Development & Strategic Planning in 1998, Senior Vice President, Business Development and President of TerraPointe LLC in May 2005 and was elected to his current position in July 2007. Mr. Margiotta holds a B.B.A. from Pace University and graduated from the Harvard University Graduate School of Business Advanced Management Program.

Hans E. Vanden Noort, 50, Senior Vice President and Chief Financial Officer Mr. Vanden Noort joined Rayonier as Corporate Controller in 2001, elected Senior Vice President and Chief Accounting Officer effective August 2005 and was elected to his current position in July 2007. Prior to joining Rayonier, he held a number of senior management positions with Baker Process, a division of Baker Hughes, Inc. (manufacturer of oilfield service equipment and supplies), most recently as Vice President of Finance and Administration. Prior to that, he was with the public accounting firm of Ernst & Young. Mr. Vanden Noort holds a B.B.A. in accounting from the University of Cincinnati, an M.B.A. from the University of Michigan and is a Certified Public Accountant.

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Michael R. Herman, 46, Vice President, General Counsel and Assistant Secretary Mr. Herman joined Rayonier in 2003 as Vice President and General Counsel and was elected to his current position in October 2003. Prior to joining Rayonier, he served as Vice President and General Counsel of GenTek Inc. (a publicly-traded global manufacturing conglomerate) and in other positions in GenTek s legal department from 1992 to August 2003. Mr. Herman was previously counsel to IBM s Integrated Systems Solutions Corporation and an associate with the law firm of Shearman & Sterling. He holds a B.A. in Economics and English from Binghamton University and a J.D. from St. John s University School of Law.

Joseph L. Iannotti, 49, Vice President and Corporate Controller Mr. Iannotti joined Rayonier in April 2001 as Assistant Controller, Financial Reporting. Prior to joining Rayonier, Mr. Iannotti was with Bowater Incorporated for 13 years, the last eight as Director, Corporate Accounting and Reporting. Prior to that, he was an Audit Associate with PricewaterhouseCoopers in Stamford, CT. Mr. Iannotti is a Certified Public Accountant, holds a BS in Accounting from Sacred Heart University and a Master of Finance from Fairfield University.

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PART II

Item 5. MARKET FOR THE REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Prices of our Common Shares; Dividends

The table below reflects the range of market prices of our Common Shares as reported in the consolidated transaction reporting system of the New York Stock Exchange, the only exchange on which our shares are listed, under the trading symbol **RYN**.

	High	Low	Dividends
2008			
Fourth Quarter	$ 47.09	$ 26.58	$ 0.50
Third Quarter	$ 49.54	$ 40.60	$ 0.50
Second Quarter	$ 48.00	$ 41.88	$ 0.50
First Quarter	$ 47.37	$ 35.36	$ 0.50
2007			
Fourth Quarter	$ 49.16	$ 42.46	$ 0.50
Third Quarter	$ 49.55	$ 38.17	$ 0.50
Second Quarter	$ 45.77	$ 42.35	$ 0.47
First Quarter	$ 46.31	$ 39.83	$ 0.47

For information about covenants for our credit facility that could restrict our ability to pay cash dividends in the future, see Item 7 *Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Liquidity Facilities.*

On February 24, 2009, the Company announced a first quarter dividend of 50 cents per share payable March 31, 2009, to shareholders of record on March 10, 2009. There were approximately 10,340 shareholders of record of our Common Shares on February 23, 2009.

Issuer Repurchases

The following table provides information with respect to share repurchases by the Company during the fourth quarter of 2008.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs*
October 1, 2008 to October 31, 2008	7,800	$ 30.93	7,800	2,463,289
November 1, 2008 to November 30, 2008				
December 1, 2008 to December 31, 2008				
Total	7,800		7,800	2,463,289

*

In 1996, we began a Common Share repurchase program to minimize the dilutive effect on earnings per share of our employee incentive stock plans. This program limits the number of shares that may be purchased each year to the greater of 1.5 percent of outstanding shares at the beginning of the year or the number of incentive shares issued to employees during the year. In October 2000 and July 2003, our Board of Directors authorized the purchase of additional shares totaling 1.4 million. These shares were authorized separately from the 1.5 percent of outstanding shares anti-dilutive program, neither of which have expiration dates. In 2008, there were 12,800 shares repurchased under these plans.

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Stock Performance Graph

The following graph compares the performance of Rayonier s Common Shares (assuming reinvestment of dividends) with a broad-based market index (Standard & Poor s 500), and two industry-specific indices (the Standard & Poor s Super Composite Paper and Forest Products Index and the National Association of Real Estate Investment Trusts (NAREIT) Equity REIT Index).

The table and related information shall not be deemed to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that the Company specifically incorporates it by reference into such filing.

The data in the following table was used to create the above graph:

	31-Dec-03	31-Dec-04	31-Dec-05	31-Dec-06	31-Dec-07	31-Dec-08
Rayonier Inc.	$ 100	$ 124	$ 159	$ 171	$ 206	$ 144
S&P 500®	$ 100	$ 111	$ 116	$ 135	$ 142	$ 90
S&P© SuperComposite Paper & Forest Products Index	$ 100	$ 111	$ 107	$ 113	$ 112	$ 46
NAREIT Equity REIT	$ 100	$ 132	$ 148	$ 199	$ 168	$ 105

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Item 6. SELECTED FINANCIAL DATA

The following financial data should be read in conjunction with our Consolidated Financial Statements.

	Year Ended December 31,				
	2008	2007	2006	2005	2004
	(dollar amounts in millions, except per share data)				
Profitability:					
Sales(1)	$ 1,232	$ 1,171	$ 1,122	$ 1,062	$ 1,028
Operating income(1) (6)	223	245	223	173	168
Income from continuing operations(1) (5)	160	173	165	149	187
Net income	152	174	176	178	157
Income from continuing operations:					
Per share Diluted(1) (2)	2.01	2.19	2.11	1.93	2.44
Per share Basic(1) (2)	2.03	2.23	2.15	1.98	2.51
Net income					
Per share Diluted(2)	1.91	2.21	2.26	2.29	2.05
Per share Basic(2)	1.94	2.25	2.31	2.35	2.11
Financial Condition:					
Total assets	$ 2,091	$ 2,079	$ 1,965	$ 1,841	$ 1,944
Total debt	771	750	659	559	659
Shareholders equity	924	981	918	894	810
Shareholders equity per share(2)	11.72	12.54	11.94	11.74	10.81
Cash Flows:					
Cash provided by operating activities	$ 340	$ 324	$ 307	$ 254	$ 292
Cash used for investing activities	(330)	(126)	(385)	(24)	(179)
Cash used for financing activities	(128)	(58)	(30)	(216)	(52)
Capital expenditures	105	97	105	85	88
Purchase of timberlands, real estate and other	234	27	299	24	89
Depreciation, depletion and amortization	168	165	136	147	146
Cash dividends paid	157	151	144	129	111
Non-GAAP Financial Measures:					
EBITDA(3)	$ 395	$ 412	$ 374	$ 339	$ 323
Debt to EBITDA	2.0 to 1	1.8 to 1	1.8 to 1	1.6 to 1	2.0 to 1
Performance Ratios (%):					
Operating income to sales	18	21	20	16	16
Return on equity(4)	17	18	18	17	25
Return on capital(4)	9	10	11	10	13
Debt to capital	45	43	42	38	45
Other:					
Timberland and real estate acres owned, leased, or managed, in thousands of acres	2,575	2,545	2,681	2,473	2,155
Dividends paid per share	$ 2.00	$ 1.94	$ 1.88	$ 1.71	$ 1.49

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	Year Ended December 31,				
	2008	**2007**	**2006**	**2005**	**2004**
Selected Operating Data:					
Timber					
Timber sales volume					
Western U.S. in millions of board feet	232	254	274	263	285
Eastern U.S. in thousands of short green tons	6,824	6,168	4,740	4,832	4,291
Real Estate acres sold					
Development	501	4,356	9,377	6,036	4,786
Rural	15,845	12,817	16,874	23,990	31,120
Non-Strategic Timberlands	49,801				
Total Real Estate Sales	66,147	17,173	26,251	30,026	35,906
Performance Fibers					
Sales volume (thousands of metric tons)					
Cellulose Specialties	471	467	474	470	453
Absorbent Materials	253	259	272	276	266
Total	724	726	746	746	719
Wood Products					
Lumber sales volume in millions of board feet	321	329	350	351	347
Timber					
Sales					
Western U.S.	$ 78	$ 104	$ 109	$ 99	$ 81
Eastern U.S.	112	105	88	86	77
Total	$ 190	$ 209	$ 197	$ 185	$ 158
Operating Income (Loss)					
Western U.S.	$ 12	$ 49	$ 60	$ 55	$ 42
Eastern U.S.(6)	21	9	31	30	24
Other	(2)	(1)	(2)	(1)	(1)
Total	$ 31	$ 57	$ 89	$ 84	$ 65
EBITDA(3)					
Timber	$ 116	$ 146	$ 152	$ 147	$ 128
Real Estate	101	98	91	68	80
Performance Fibers	205	209	153	121	125
Wood Products	(1)	(2)	4	(12)	19
Other operations	3	(3)	2	2	7
Corporate and other(7)	(29)	(36)	(28)	13	(36)
Total	$ 395	$ 412	$ 374	$ 339	$ 323

(1)

Results from New Zealand and IWP operations from 2004 through 2008 have been reclassified to discontinued operations. See Item 1 *Business Discontinued Operations*.

(2) 2004 was restated to reflect the October 17, 2005 three-for-two stock splits.

(3) EBITDA is defined as earnings before interest, taxes, depreciation, depletion and amortization. EBITDA is a non-GAAP measure of the operating cash generating capacity of the Company.

EBITDA by segment is a critical valuation measure used by the Chief Operating Decision Maker, existing shareholders and potential shareholders to measure how management is performing relative to the assets with which they have been entrusted. See page 22 for a reconciliation of Cash Provided by Operating Activities to EBITDA in total and by segment.

(4) Return on equity is calculated by dividing income from continuing operations by the average of the opening (1/1/XX) and ending (12/31/XX) shareholders equity for each period presented. Return on capital is calculated by dividing income from continuing operations by the sum of average shareholders equity and average outstanding debt.

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(5) Included in the calculation of income from continuing operations are certain items that are infrequent in occurrence. We believe these items are important to understand the financial performance or liquidity of the Company in the comparative annual periods being reported. These items of interest and their effect on income from continuing operations for the periods presented were as follows:

Items of interest, net of tax:	Increase/(decrease) to Income from Continuing Operations for the Year Ended December 31, 2008	2007	2006	2005	2004
Forest fire loss(a)	$	$ (10.9)	$	$	$
Prior years IRS audit settlements including resulting adjustments to accrued interest and deferred taxes(b)			9.0	24.9	
Reversal of deferred tax(c)					77.9

(a) Losses sustained from wildfires in southeast Georgia and northeast Florida.
(b) Tax benefits from the favorable resolution of tax audits for prior years and related interest.
(c) Reversal of timber-related deferred taxes not required after REIT conversion.

(6) The 2007 results include a $10.9 million loss from wildfires on timberlands in southeast Georgia and northeast Florida.
(7) Corporate and other includes a $7.8 million gain from the partial sale of JV investment (2006) and a $37 million gain from the sale of New Zealand timberlands (2005).

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Reconciliation of Cash Provided by Operating Activities by Segment to EBITDA by Segment

(dollars in millions)

		Timber	Real Estate	Performance Fibers	Wood Products	Other	Corporate and Eliminations	Total
2008								
Cash provided by (used for) operating activities		$ 114.4	$ 115.2	$ 190.9	$ (2.0)	$ 10.3	$ (88.6)	$ 340.2
Less:	Non-cash cost basis of real estate sold		(11.1)					(11.1)
Add:	Income tax expense						31.4	31.4
	Interest, net						42.5	42.5
	Other balance sheet changes	1.2	(2.7)	13.9	1.3	(7.3)	(14.9)	(8.5)
EBITDA		$ 115.6	$ 101.4	$ 204.8	$ (0.7)	$ 3.0	$ (29.6)	$ 394.5
2007								
Cash provided by (used for) operating activities		$ 136.8	$ 101.2	$ 228.2	$ (0.1)	$ (9.1)	$ (133.0)	$ 324.0
Less:	Non-cash cost basis of real estate sold		(8.4)			(0.2)		(8.6)
Add:	Income tax expense						23.8	23.8
	Interest, net						48.6	48.6
	Other balance sheet changes	9.0	5.0	(18.8)	(2.2)	6.1	24.8	23.9
EBITDA		$145.8	$97.8	$209.4	$(2.3)	$(3.2)	$(35.8)	$411.7
2006								
Cash provided by (used for) operating activities		$ 149.8	$ 103.0	$ 127.3	$ 5.6	$ 13.6	$ (92.4)	$ 306.9
Less:	Non-cash cost basis of real estate sold		(12.3)			(0.1)		(12.4)
Add:	Income tax expense						22.3	22.3
	Gain on sale of portion of New Zealand JV						7.8	7.8
	Interest, net						39.1	39.1
	Other balance sheet changes	2.1	(0.1)	25.4	(1.5)	(11.6)	(3.9)	10.4
EBITDA		$151.9	$90.6	$152.7	$4.1	$1.9	$(27.1)	$374.1
2005								
Cash provided by (used for) operating activities		$ 164.8	$ 80.8	$ 132.4	$ 22.3	$ (4.6)	$ (133.8)	$ 261.9
Less:	Non-cash cost basis of real estate sold		(11.0)			(0.8)		(11.8)
	Income tax benefit						(30.6)	(30.6)
Add:	Gain on New Zealand timberland sale						36.9	36.9
	Interest, net						38.8	38.8
	Other balance sheet changes	(17.7)	(1.7)	(11.0)	(34.2)	7.0	101.4	43.8
EBITDA		$ 147.1	$ 68.1	$ 121.4	$ (11.9)	$ 1.6	$ 12.7	$ 339.0
2004								
Cash provided by (used for) operating activities		$ 126.2	$ 83.9	$ 125.8	$ 22.6	$ 17.8	$ (80.9)	$ 295.4
Less:	Non-cash cost basis of real estate sold		(10.5)			(0.5)		(11.0)
	Income tax benefit						(33.4)	(33.4)
Add:	Interest, net						44.1	44.1

Other balance sheet changes	2.1	6.3	(0.7)	(3.3)	(10.4)	33.9	27.9
EBITDA	$ 128.3	$ 79.7	$ 125.1	$ 19.3	$ 6.9	$ (36.3)	$ 323.0

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Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Executive Summary

Our revenues, operating income and cash flows are primarily derived from three core business segments: Timber, Real Estate and Performance Fibers. We own or lease (under long-term agreements) approximately 2.2 million acres of timberland and real estate in Alabama, Arkansas, Florida, Georgia, Louisiana, New York, Oklahoma, Texas, and Washington. We believe we are the seventh largest private landowner in the United States. Our Real Estate business seeks to maximize the value of our properties which are more valuable for development, recreational or conservation uses than for growing timber, and sell our non-strategic timberland. Our Performance Fibers business has been a supplier of premier cellulose specialty grades of pulp for over eighty years.

We have consistently generated strong cash flows and operating results by focusing on the following critical financial measures: segment operating income and EBITDA, cash available for distribution in total and on a per-share basis, debt to EBITDA ratio, debt to capital ratio, return on equity, return on fair market value (Timber and Real Estate) and return on capital employed (Performance Fibers). Key non-financial measures include safety and environmental performance, quality, production as a percent of capacity and various yield statistics.

Our focus is on cash generation, prudent allocation of capital and maximizing returns for shareholders. Our strategy consists of the following key elements:

- Increase the size and quality of our timberland holdings through cash-accretive timberland acquisitions while selling timberland that no longer meets our strategic or financial return requirements. This strategy, which requires a disciplined approach and rigorous adherence to strategic and financial metrics, can result in significant year-to-year variation in timberland acquisitions and divestitures. For example, we acquired 110,000 acres of timberland in 2008, 6,000 acres in 2007 and 228,000 acres in 2006. In 2008, we sold approximately 49,000 acres of non-strategic timberland. Also, the New Zealand timberland joint venture, in which we own a 40 percent interest, has been offered for sale and potential buyers are conducting due diligence. If this sale is completed, Rayonier acreage owned or managed will decrease by 329,000 acres.

- Extract maximum value from our higher and better use (HBU) properties. We will continue entitlement activity on development property while maintaining a rural HBU program of sales for conservation, recreation and industrial uses.

- Continue to differentiate our Performance Fibers business by developing and improving customer specific applications. We will also emphasize operational excellence to ensure quality, reliability and efficiency.

We continuously evaluate our capital structure. Our debt-to-capital ratio was 45 percent and our debt-to-EBITDA ratio was 2.0 at December 31, 2008. We believe that a debt-to-EBITDA ratio of up to three times is appropriate to keep our weighted-average cost of capital low while maintaining an investment grade debt rating as well as retaining the flexibility to actively pursue growth opportunities.

We have historically had conservative leverage and believe in having ample liquidity. Maintaining an investment grade debt rating has been a key element of this overall financial strategy as it historically allowed access to corporate debt markets even in difficult economic conditions. The recent, extreme turmoil in the financial markets resulted in the corporate debt markets being temporarily closed, even for investment grade companies. Recently, these markets have begun to open, but the cost of borrowing is high compared to recent years. We have no major debt coming due until December 31, 2009 when $122 million in installment notes will mature. Our preference would be to refinance these notes by accessing the corporate debt markets this year. However, if the markets are closed or the cost of borrowing is prohibitive, we expect to refinance these installment notes by borrowing under our revolving bank facility which currently has $144 million of remaining capacity. In 2009, if we are successful in selling our New Zealand joint venture interest noted above, the proceeds may be used to reduce debt.

We maintain four qualified defined benefit plans and one unfunded plan to provide benefits in excess of amounts allowable under current law. The recent stock market decline has decreased the value of our pension assets by $73 million from year end 2007. Our minimum pension contribution in 2009 is $6 million, slightly below the $8 million of discretionary contributions we made in 2008. We may elect to contribute more to the plans depending on market conditions.

Our strategic capital allocation will be primarily in Timber, with the remainder in Real Estate and Performance Fibers. We do not expect to significantly reduce debt in 2009 and, in connection with appropriate growth opportunities, may incur additional debt that causes us to exceed the debt-to-capital ratio mentioned above.

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In 2008, our annual dividend was $2.00 per share, a three percent increase over 2007. Our 2009 dividend payments are expected to total $158 million assuming no change in the current rate.

Overall, we believe we have adequate liquidity and sources of capital to run our businesses efficiently and effectively and to maximize the value of assets under management. We expect cash flow from operations to adequately cover planned capital expenditures, interest expense, pension contributions and dividends in 2009.

Operational Strategies

Timber is sold primarily through an auction process, although it is also marketed through log supply agreements, particularly in the Western region. We operate Timber as a stand-alone business, requiring our mills to compete with third-party bidders for timber, primarily at auction. This promotes realizing market value, generating a true measure of fair value returns in Timber and minimizing the possibility of our manufacturing facilities being subsidized with below market-cost wood. We also focus on optimizing Timber returns by continually improving productivity and yields through advanced silvicultural practices which take into account soil, climate and biological considerations. We also actively pursue other non-timber sources of income, primarily hunting and other recreational licenses. Finally, we evaluate timberland acquisitions and pursue those that meet various financial and strategic criteria.

A significant portion of our acreage is more valuable for development, recreational or conservation purposes than for growing timber. To maximize the value of our development properties, our strategy is to engage in value-added entitlement activities versus selling real estate in bulk. We continue to seek entitlements for holdings in the Southeast and currently have approximately 8,000 acres of entitled land in Georgia. We may enter into joint ventures with recognized developers to maximize the value of our properties. Additionally, in 2008 we began a strategy of selling non-strategic timberland holdings that do not meet our investment criteria, which enables us to redeploy capital to higher value assets and upgrade our timberland portfolio.

In Performance Fibers, the focus has been to improve our position as a premier supplier of cellulose specialties. We are a market leader in cellulose specialties, utilizing our considerable technical applications expertise to customize products to exacting specifications, which allows differentiation from most competitors. Fluff pulp is a semi-commodity with opportunity for differentiation by price and customer service, although we do explore other ways to enhance the value of these fibers. There are a number of much larger companies in the fluff pulp market and we are not a market leader. We have been successful in executing a strategy of shifting production from absorbent materials to cellulose specialties. In 2008, 65 percent of our sales volume was cellulose specialties, versus 61 percent in 2003.

Cost control is a critical element to remaining competitive in the Performance Fibers markets. The keys to success are operating continuously, safely, and efficiently while closely managing raw materials and conversion costs. Capital expenditures typically are directed toward cost reduction, product enhancements, environmental requirements and efficiency projects. Historically, we have used a significant amount of fossil fuels to operate our mills. To reduce variability and cost, we completed a number of capital projects to reduce fossil fuel consumption, including a power boiler replacement at our Fernandina Beach, FL facility, which consumes primarily wood waste.

Our capital expenditures totaled $105 million in 2008. For 2009, capital expenditures (excluding strategic acquisitions) are expected to range from $95 million to $98 million.

Industry and Market Conditions

Timber markets continued to soften in 2008 caused by the declining demand for lumber due to considerably weakened housing and construction markets, offset partly by increased pulpwood demand. Lumber prices were unchanged in 2008 and remain near fifteen-year lows. As we enter 2009, these markets remain weak and we expect volumes and prices to be below 2008 levels.

In Real Estate, our sales mix shifted as demand for non-strategic timberlands held steady, while demand for development property softened due to the weak housing market and overall economic decline. We expect similar conditions in the near term.

In Performance Fibers, acetate market demand remains strong. Sales are typically made under one to five year contracts which establish prices and target volumes at the beginning of the year and buffer some of the changes in supply and demand typically seen in worldwide commodity pulp and paper markets. We have long-term contracts with the world s largest manufacturers of acetate-based products and other key customers that extend into 2011 and represent nearly all of our high value cellulose specialties production. Our recognized technical and market leadership has allowed us to maintain strong

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pricing across our cellulose specialties product lines. In 2008, new capacity from competitors in the Southern hemisphere came on-line and their product is being sampled and tested by our customers. This new volume did not affect our 2008 results, and we do not expect this new capacity to adversely impact our results in 2009; however, it is unclear how these market dynamics may impact our business in 2010 and beyond. Also in the first half of 2008, we experienced unprecedented cost increases in raw materials, chemicals, fuel and transportation. While these cost increases began to subside in the second half of the year, our largest single chemical cost, caustic, may increase by as much as $70 million in 2009 from 2008.

Absorbent materials price increases through the first three quarters of 2008 were slightly offset by price declines in the fourth quarter. Prices are expected to continue to decline in 2009 reflecting the weakening global economy. Sales of absorbent materials are typically made with an annual volume agreement that allows price to move with the market during the year.

Critical Accounting Policies and Use of Estimates

The preparation of financial statements requires us to make estimates, assumptions and judgments that affect the assets, liabilities, revenues and expenses, and to disclose contingent assets and liabilities, reported in our Annual Report on Form 10-K. We base these estimates and assumptions on historical data and trends, current fact patterns, expectations and other sources of information we believe are reasonable. Actual results may differ from these estimates under different conditions.

Merchantable inventory and depletion costs as determined by forestry timber harvest models

Significant assumptions and estimates are used in the recording of timberland inventory cost and depletion. We employ a forestry technical services group at each of our timberland management locations. Merchantable standing timber inventory is estimated annually, using industry-standard computer software. The inventory calculation takes into account growth, in-growth (annual transfer of oldest pre-merchantable age class into merchantable inventory), timberland sales and the annual harvest specific to each business unit. The age at which timber is considered merchantable is reviewed periodically and updated for changing harvest practices, future harvest age profiles and biological growth factors.

An annual depletion rate is established at each business unit for their particular regions by dividing merchantable inventory book cost by standing merchantable inventory. Pre-merchantable records are maintained for each planted year age class, recording acres planted, stems per acre, and costs of planting and tending. Changes in the assumptions and/or estimations used in these calculations may affect our results, in particular, timber inventory and depletion costs. Factors that can impact timber volume include weather changes, losses due to natural causes, differences in actual versus estimated growth rates and changes in the age when timber is considered merchantable. A three percent company-wide change in estimated standing merchantable inventory would cause 2008 depletion expense to change by approximately $2.6 million.

An acquisition of timberlands can also affect the depletion rate. Upon the acquisition of timberland, the Company makes a determination on whether to combine the newly acquired merchantable timber with an existing depletion pool or to create a new separate pool. The determination is based on the geographic location of the new timber, the customers/markets that will be served, relative profit margins, and species mix compared to its existing timberland holdings. During the second quarter of 2008, Rayonier acquired approximately 56,300 acres of timberland located in Washington State resulting in a higher depletion rate. Depletion expense increased by approximately $6.4 million in 2008 and we anticipate 2009 depletion expense in our Western region to be approximately $10.6 million higher due to the higher rate.

Depreciation and impairment of long-lived assets

Depreciation expense is computed using the units-of-production method for the Performance Fibers plant and equipment and the straight-line method on all other property, plant and equipment over the useful economic lives of the assets involved. We believe that these depreciation methods are the most appropriate under the circumstances as they most closely match revenues with expenses versus other generally accepted accounting methods. Long-lived assets are periodically reviewed for impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Cash flows used in such impairment analyses are based on long-range plan projections, which take into account recent sales and cost data as well as macroeconomic drivers including customer demand and industry capacity. The physical life of equipment, however, may be shortened by economic obsolescence caused by environmental regulation, competition and other causes.

We may temporarily suspend production at one or more of our lumber mills in 2009 if the current lumber markets do not improve. We performed an impairment analysis and estimate that our carrying amount is recoverable through future operations.

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Environmental costs associated with dispositions and discontinued operations

At December 31, 2008, we had $105 million of accrued liabilities for environmental costs relating to past dispositions and discontinued operations. Numerous cost assumptions are used in estimating these obligations. Factors affecting these estimates include significant changes in contamination, 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 governmental agencies. We periodically review our environmental liabilities and also engage third party consultants to assess our ongoing remediation of contaminated sites. A significant change in any of the estimates could have a material effect on the results of our operations. Typically, these cost estimates do not vary significantly on a quarter to quarter basis. The most recent material change in estimate occurred in 2006, when reserves decreased by $8 million primarily due to revised estimates of remediation costs required at certain Southern Wood Piedmont sites.

Expenditures for environmental costs at these sites totaled $8 million in 2008. Annual expenditures in 2009, 2010 and 2011 are expected to be approximately $8 million, $10 million and $11 million, respectively.

Determining the adequacy of pension and other postretirement benefit assets and liabilities

We have four qualified benefit plans which cover substantially our entire U.S. workforce and an unfunded plan to provide benefits in excess of amounts allowable under current tax law to certain participants in the qualified plans. Pension expense for all plans was $9 million in 2008. Numerous estimates and assumptions are required to determine the proper amount of pension and postretirement liabilities and annual expense to record in our financial statements. The key assumptions include discount rate, return on assets, salary increases, health care cost trends, mortality rates, longevity and service lives of employees. Although there is authoritative guidance on how to select most of these assumptions, we exercise some degree of judgment when selecting these assumptions based on input from our actuary. Different assumptions, as well as actual versus expected results, would change the periodic benefit cost and funded status of the benefit plans recognized in the financial statements.

In determining pension expense in 2008, a $21 million return was assumed based on an expected long-term rate of return of 8.5 percent. The actual return for 2008 was a loss of $73 million, or 29 percent, due to the significant decline in the stock market in the fourth quarter. Our long-term return assumption was established based on historical long-term rates of return on broad equity and bond indices, discussions with our actuary and investment advisors and consideration of the actual annualized rate of return from 1994 (the date of our spin-off from ITT Corporation) through 2008. At the end of 2008, we reviewed this assumption for reasonableness and determined that the 2008 long-term rate of return assumption should remain at 8.5 percent. At December 31, 2008, our asset mix consisted of 66 percent equities, 31 percent bonds and three percent real estate. We do not expect this mix to change materially in the near future.

The Company s pension plans were underfunded by $102 million at December 31, 2008, a $92 million decrease in funding status from December 31, 2007 due primarily to the unfavorable asset returns. There were no minimum funding requirements for the 2008 plan year. Discretionary contributions of $8 million, $20 million and $13 million were made in 2008, 2007 and 2006, respectively. In 2009, we are required to contribute approximately $6 million but may elect to contribute more. Future requirements will vary depending on actual investment performance, changes in valuation assumptions, interest rates, requirements under the recently enacted Pension Protection Act, and other employee related matters. See Item 1A *Risk Factors* for more information about the potential risk of increased funding requirements.

In determining future pension obligations, we select a discount rate based on information supplied by our actuary. The actuarial rates are developed by models which incorporate high quality (AAA and AA rated), long-term corporate bond rates into their calculations. The discount rate at December 31, 2008 of 6.15 percent increased slightly over the 6.0 percent rate used at December 31, 2007.

We expect 2009 pension expense to increase to $10 million from $9 million in 2008 primarily due to the unfavorable return on assets over the past year. Future pension expense will be impacted by many factors including actual investment performance, changes in discount rates, timing of contributions and other employee related matters. For example, plan benefits may change as part of the negotiations for the Jesup collective bargaining agreement, which may impact our pension expense in future years.

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The sensitivity of pension expense and projected benefit obligation to changes in economic assumptions is highlighted below:

	Impact on:	
Change in Assumption	**Pension Expense**	**Projected Benefit Obligation**
25 bp decrease in discount rate	+1.0 million	+8.9 million
25 bp increase in discount rate	-0.9 million	-8.4 million
25 bp decrease in long-term return on assets	+0.6 million	
25 bp increase in long-term return on assets	-0.6 million	

In September 2008, the Company changed its postretirement medical plan for active and retired salaried employees to shift retiree medical costs to the plan participants over a three year phase-out period. Accordingly, at the beginning of 2012, the Company s intent is to no longer incur retiree medical costs for retired salary plan participants. The change was accounted for as a negative plan amendment and curtailment which resulted in a reduction to the retiree medical liability. The net impact of the reduction was an unrecognized gain in accumulated other comprehensive income of $8 million which will be amortized over 1.9 years, the average remaining service period of the remaining active participants, and a $24 million decrease to the Company s postretirement liability.

Realizability of both recorded and unrecorded tax assets and liabilities

As a REIT, certain operations are generally not subject to taxation. Our taxes can vary significantly based on the mix of income between our REIT and TRS businesses, thereby impacting our effective tax rate and the amount of taxes paid during various fiscal periods. Also, our projection of estimated tax for the year and our provision for quarterly taxes, in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109)*,* may have significant variability. Similarly, the assessment of the ability to realize certain deferred tax assets, or estimated deferred tax liabilities, may be subjective.

We have recorded certain deferred tax assets that we believe will be realized in future periods. These assets are reviewed periodically in order to assess their realizability. This review requires us to make assumptions and estimates about future profitability affecting the realization of these tax benefits. If the review indicates that the realizability may be less than likely, a valuation allowance is recorded at that time.

In the first quarter of 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). In accordance with the provisions of FIN 48, we recognize the impact of a tax position if a return s position is more likely than not to prevail.

Deferred income taxes are provided using the asset and liability method under the provisions of SFAS 109 and FIN 48. An estimate of the U.S. income taxes on foreign operations has been provided based upon our best estimate of the ultimate liability.

Revenue Recognition

Revenue recognition policies are critical to the preparation of our financial statements in accordance with generally accepted accounting principles. The Company generally recognizes revenues when the following criteria are met: (i) persuasive evidence of an agreement exists, (ii) delivery has occurred, (iii) the Company s price to the buyer is fixed and determinable, and (iv) collectibility is reasonably assured.

Revenue from the sale of timber is recorded when title passes to the buyer. Timber sales in the Eastern and Western regions are primarily made on a pay-as-cut basis. These contracts generally require a minimum 15 percent initial payment and title and risk of loss are transferred when the timber is cut.

Real estate sales are recorded when title passes and when full payment or a minimum down payment of 25 percent is received and full collectibility is assured, in compliance with SFAS 66, *Accounting for Sales of Real Estate*. If a down payment of less than 25 percent is received at closing or if full collectibility is not reasonably assured, the Company records revenue based on the installment method or cost recovery method. The Company follows the same revenue recognition policy when recording intercompany real estate sales from the REIT to the TRS and eliminates these transactions on a consolidated basis.

Revenue from domestic sales of Performance Fibers products is recorded when title passes which, depending on the contract, is either at time of shipment or when the customer receives goods. Foreign sales of Performance Fibers products are recorded when the customer or agent receives the goods and title passes.

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Summary of our results of operations for the three years ended December 31, 2008

Financial Information (in millions)(1)	2008	2007	2006
Sales			
Timber	$ 190	$ 209	$ 197
Real Estate			
Development	5	37	72
Rural	48	79	40
Non-Strategic Timberlands	74		
Total Real Estate Sales	127	116	112
Performance Fibers			
Cellulose Specialties	600	539	500
Absorbent Materials	198	183	172
Total Performance Fibers	798	722	672
Wood Products	86	88	111
Other Operations	31	36	30
Total Sales	$ 1,232	$ 1,171	$ 1,122
Operating Income (Loss)			
Timber(2)	$ 31	$ 57	$ 89
Real Estate	80	93	89
Performance Fibers	149	141	80
Wood Products	(7)	(8)	(3)
Other Operations		(2)	3
Corporate and Other Expenses/Eliminations	(30)	(36)	(35)
Operating Income	223	245	223
Interest Expense	(45)	(56)	(49)
Interest/Other Income	2	7	9
Income Tax Expense	(20)	(23)	(18)
Income from Continuing Operations	$ 160	$ 173	$ 165
(Loss) Income from Discontinued Operations, net of tax(3)	(8)	1	11
Net Income	$ 152	$ 174	$ 176

(1) The 2007 and 2006 results from our New Zealand and IWP operations have been reclassified to discontinued operations (See Item 1 *Business, Discontinued Operations and Dispositions*).
(2) Includes a $10.9 million charge in 2007 for losses from wildfire damage on timberlands in southeast Georgia and northeast Florida.
(3) 2008 includes a $9.7 million charge for taxes related to the decision to offer our New Zealand operations for sale.

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Results of Operations, 2008 versus 2007

Timber

Sales (in millions)	2007	Changes Attributable to: Price	Changes Attributable to: Volume/ Mix	2008
Total Sales	$ 209	$ (35)	$ 16	$ 190

In 2008, timber sales decreased $19 million, or nine percent, from the prior year primarily due to the results in the Western region as sawlog prices declined due to the weak housing market and an oversupply of salvaged timber from a December 2007 storm.

In the Eastern region, volumes improved by 11 percent from 2007 as a result of strong pulpwood demand which more than offset lower average prices due to the weak sawlog market and a shift in sales mix to lower priced pulpwood.

Operating Income (in millions)	2007	Changes Attributable to: Price	Changes Attributable to: Volume / Costs*	Changes Attributable to: Other	2008
Total Operating Income	$ 57	$ (35)	$ 5	$ 4	$ 31

* 2007 included a $10.9 million charge for wildfires on timberlands in southeast Georgia and northeast Florida.

Operating income decreased from the prior year due to depressed sawlog prices and the impact of salvaged timber in the Western region. Excluding the 2007 fire losses, costs increased mostly from higher depletion expense in the Western region related to a second quarter timberlands acquisition. The 2008 results also include higher other income in the Eastern region resulting from improved recreational license profits.

Real Estate

Our HBU real estate holdings are primarily in the southeastern U.S. We segregate these real estate holdings into two groups: development and rural properties. Development properties are predominantly located in the eleven coastal counties between Savannah, GA and Daytona Beach, FL, while the rural properties essentially include the balance of our ownership. In addition, in 2008, we began selling non-strategic timberland holdings that did not meet our investment criteria, which enabled us to redeploy capital to higher value assets and upgrade our portfolio.

Sales (in millions)	2007	Changes Attributable to: Price	Changes Attributable to: Volume/ Mix	2008
Development	$ 37	$ 1	$ (33)	$ 5
Rural	79	(50)	19	48
Non-Strategic Timberlands			74	74
Total Sales	$ 116	$ (49)	$ 60	$ 127

In 2008, real estate sales improved by $11 million from the prior year. Favorable demand for non-strategic timberlands offset lower average rural prices and reduced development sales due to the weak housing market. The lower average rural prices reflect the impact of a 2007 rural sale of 3,100 acres at $15,000 per acre to an industrial buyer. Excluding the impact of the 2007 industrial buyer sale, average rural prices declined $306 per acre, or nine percent, from the prior year mostly due to a change in geographic sales mix.

		Changes Attributable to:		
Operating Income (in millions)	**2007**	**Price**	**Volume/ Mix**	**2008**
Total Operating Income	$ 93	$ (49)	$ 36	$ 80

Operating income declined $13 million due to a change in sales mix from higher-margin development properties to lower-margin non-strategic timberlands.

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Performance Fibers

Sales (in millions)	2007	Changes Attributable to: Price	Volume/ Mix	2008
Cellulose Specialties	$ 539	$ 57	$ 4	$ 600
Absorbent Materials	183	17	(2)	198
Total Sales	$ 722	$ 74	$ 2	$ 798

In 2008, sales increased $76 million from the prior year largely due to higher prices. For cellulose specialties, average prices rose $119 per ton, or approximately 10 percent, resulting from strong market demand and a cost-related surcharge for cellulose specialty shipments effective September 1, 2008. Additionally, volumes for cellulose specialties improved slightly due to timing of customer shipments.

Average prices for absorbent materials increased $68 per ton, or 10 percent, from the prior year, which more than offset lower volume due to unplanned mill outages that occurred earlier in the year.

Operating Income (in millions)	2007	Changes Attributable to: Price	Volume	Mix/Costs	2008
Total Operating Income	$ 141	$ 74	$ 1	$ (67)	$ 149

Operating income in 2008 improved from the prior year as higher sales prices and lower depreciation expense more than offset significant increases in wood, chemical, energy, maintenance and transportation costs and mark-to-market losses on fuel oil hedges.

Wood Products

Sales (in millions)	2007	Changes Attributable to: Price	Volume	2008
Total Sales	$ 88	$	$ (2)	$ 86

Lumber prices were comparable while volume declined two percent from the prior year as a result of continued weak demand in the housing market.

Operating Loss (in millions)	2007	Changes Attributable to: Price	Costs	2008
Total Operating Loss	$ (8)	$	$ 1	$ (7)

Operating loss declined from 2007 primarily due to lower log costs resulting from weaker demand. Additionally, beginning in the fourth quarter 2008, we curtailed production due to the weak market conditions. We may temporarily suspend production at one or more of our mills in 2009 unless market conditions improve.

Other Operations

Sales decreased in 2008 reflecting reduced log sales in the northwest U.S., while operating results improved to breakeven as a result of lower expenses.

Corporate and Other Expenses/Eliminations

Corporate and Other Expense decreased $6 million in 2008 primarily due to lower incentive compensation expense and cost reduction measures.

Interest and Other Income/Expense

In comparison to the prior year, interest expense decreased $11 million primarily due to lower average rates and a favorable IRS settlement related to an uncertain tax position, partly offset by higher average debt balances used to partially finance strategic timberland acquisitions.

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The $5 million decline in interest and other income in 2008 largely resulted from reduced average cash balances in 2008 compared to 2007.

Income Tax Expense

Our 2008 effective tax rate before discrete items was 15.2 percent compared to 13.3 percent in 2007. The increase was due to proportionately higher earnings from the Company s taxable REIT subsidiary. Including discrete items, the effective tax rate was 11.3 percent compared to 11.8 percent in 2007.

See Note 9 *Income Taxes* for additional information regarding the provision for income taxes.

Outlook

Despite uncertain economic times, we expect our diverse mix of businesses to generate cash flows in excess of our $2.00 per share dividend. With conservative debt levels, manageable debt maturities and a solid balance sheet, we should have significant operating flexibility.

Due to the weak economy, we anticipate 2009 results will be below 2008 across our three major business units. We expect that the weakened housing market will negatively impact our timber and real estate businesses, but anticipate continued interest in our non-strategic timberlands. In Performance Fibers, earnings are expected to be solid although below 2008 as demand for our cellulose specialties products is more than offset by higher costs and weakening fluff prices.

Results of Operations, 2007 versus 2006

Timber

Sales (in millions)	2006	Changes Attributable to: Price	Changes Attributable to: Volume/ Mix	2007
Total Sales	$ 197	$ (17)	$ 29	$ 209

In 2007, timber sales increased $12 million, or six percent, from the prior year.

In the Eastern region, volumes improved primarily due to strong demand for pulpwood. Average prices declined from the prior year due to the higher mix of lower-value pulpwood and sales of salvage timber from the forest fires in southeast Georgia and northeast Florida. Sawlog prices were also lower due to the downturn in the housing market.

In the Western region, prices and volumes declined by two percent and seven percent, respectively, from 2006 due to the weak housing market.

Operating Income (in millions)	2006	Changes Attributable to: Price	Changes Attributable to: Volume/ Mix	Changes Attributable to: Costs/ Other*	2007
Total Operating Income	$ 89	$ (17)	$ 12	$ (27)	$ 57

* Includes a $10.9 million charge for wildfires on timberlands in southeast Georgia and northeast Florida.

Operating income decreased from the prior year due to increased sales of lower-margin pulpwood, reduced sawlog demand and a $10.9 million fire loss charge.

Real Estate

		Changes Attributable to:		
Sales (in million)	**2006**	**Price**	**Volume/ Mix**	**2007**
Development	$ 72	$ 4	$ (39)	$ 37
Rural	40	48	(9)	79
Total Sales	$ 112	$ 52	$ (48)	$ 116

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Operating Income (in millions)	2006	Changes Attributable to: Price	Volume/ Mix	2007
Total Operating Income	$ 89	$ 52	$ (48)	$ 93

In 2007, real estate sales and operating income each improved by $4 million from 2006 primarily due to increased HBU rural land prices driven by our third quarter sale of approximately 3,100 rural acres in west central Florida at $15,000 per acre. Sales of HBU development properties were lower compared to 2006 due to the weakened housing market; however, in line with our strategy, we successfully entitled 3,300 acres along the I-95 corridor near Savannah, Georgia.

Performance Fibers

Sales (in millions)	2006	Changes Attributable to: Price	Volume/ Mix	2007
Cellulose Specialties	$ 500	$ 47	$ (8)	$ 539
Absorbent Materials	172	18	(7)	183
Total Sales	$ 672	$ 65	$ (15)	$ 722

In 2007, sales increased $50 million from the prior year largely due to higher prices resulting from strong market demand. For cellulose specialties, average prices rose $101 per ton, or approximately 10 percent, which more than offset the decline in volume resulting from the timing of customer shipments and unplanned mill outages that occurred at our Jesup and Fernandina mills late in the year.

Average prices for absorbent materials increased $71 per ton, or 12 percent, from the prior year, which more than offset lower volume due to increased scheduled maintenance downtime and the unplanned mill outages.

Operating Income (in millions)	2006	Changes Attributable to: Price	Volume	Mix/Costs	2007
Total Operating Income	$ 80	$ 65	$ (2)	$ (2)	$ 141

Operating income in 2007 improved by $61 million, or 76 percent, from 2006 primarily due to price increases. Costs were higher in 2007 as we realized a $5 million favorable property tax settlement in 2006.

Wood Products

Sales (in millions)	2006	Changes Attributable to: Price	Volume	2007
Total Sales	$ 111	$ (16)	$ (7)	$ 88

Lumber prices and volume declined 16 percent and six percent, respectively, from the prior year as a result of reduced demand in the housing market.

		Changes Attributable to:		
Operating Income/(Loss) (in millions)	**2006**	**Price**	**Costs**	**2007**
Total Operating Income/(Loss)	$ (3)	$ (16)	$ 11	$ (8)

Operating income decreased from 2006 as a result of lower selling prices partly offset by reduced costs. Costs were down from the prior year as log prices declined in response to the weak housing market.

Other Operations

Sales increased in 2007 resulting from higher log sales and increased trading activity while operating income declined primarily due to the absence of coal royalties.

Corporate and Other Expenses/Eliminations

Corporate and Other Expenses increased $1 million in 2007 primarily due to increased legal fees and incentive compensation expense, partly offset by reduced strategic business development expenses.

Interest and Other Income/Expense

In comparison to the prior year, interest expense increased $7 million primarily due to higher debt levels resulting from a $300 million debt issuance in the fourth quarter and interest accrued related to uncertain tax positions, partly offset by reduced rates.

The $2 million decline in interest and other income in 2007 largely resulted from reduced average cash balances for the year versus 2006.

Income Tax Expense

Our 2007 effective tax rate before discrete items was 13.3 percent compared to 16.6 percent in 2006. The decrease was primarily due to higher REIT income. Including discrete items, the effective tax rate was 11.8 percent compared to 10.1 percent in 2006.

See Note 9 *Income Taxes* for additional information regarding the provision for income taxes.

Liquidity and Capital Resources

Historically, our operations have generally produced consistent cash flows and required limited capital resources. Short-term borrowings have helped fund cyclicality and seasonality in working capital needs and long-term debt has been used to fund major acquisitions. While we have no major debt coming due until December 31, 2009 when $122 million in installment notes will mature, the current turmoil in the financial markets may impact our ability to obtain, and may increase the costs of, short-term and long-term borrowings. We anticipate refinancing these notes by accessing the corporate debt markets, or by borrowing under our revolving bank facility which has $144 million of capacity. See Item 1A *Risk Factors* for more information.

Summary of Liquidity and Financing Commitments (in millions of dollars)

	As of December 31, 2008	As of December 31, 2007	As of December 31, 2006
Cash and cash equivalents	$ 62	$ 181	$ 40
Total debt	771	750	659
Shareholders equity	924	981	918
Total capitalization (total debt plus equity)	1,695	1,731	1,577
Debt to capital ratio	45%	43%	42%

Cash and cash equivalents consisted primarily of marketable securities with maturities at date of acquisition of 90 days or less.

Results, 2008 versus 2007

Cash Provided by Operating Activities (in millions of dollars)

	2008	2007	Increase
Year Ended December 31,	$ 340	$ 324	$ 16

The increase in cash provided by operating activities was a result of lower working capital requirements for 2008 partly offset by lower 2008 earnings. The reduction in working capital requirements resulted primarily from the timing of interest and tax payments.

Cash Used for Investing Activities (in millions of dollars)

	2008	**2007**	**Increase**
Year ended December 31,	$ (330)	$ (126)	$ (204)

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Cash used for investing activities was above 2007 mainly resulting from the purchase of $230 million of timberlands in 2008 versus $23 million in 2007 (See Note 6 *Timberland Acquisitions)*. Capital expenditures of $105 million in 2008 were above 2007 expenditures of $97 million.

Cash Used for Financing Activities (in millions of dollars)

	2008	2007	Increase
Year ended December 31,	$ (128)	$ (58)	$ (70)

The increase of $70 million was mainly due to lower net borrowings in 2008. Net borrowings increased $21 million in 2008 versus an increase of $89 million in 2007.

Our debt-to-capital ratio increased from prior year end as a result of lower equity primarily from foreign currency translation adjustments and a decline in pension assets. See Note 14 *Accumulated Other Comprehensive Income/(Loss)* for additional information.

Results, 2007 versus 2006

In 2007, cash provided by operating activities from continuing operations of $324 million increased $17 million from 2006. The increase was a result of higher cash earnings partly offset by greater working capital requirements and an increase in discretionary pension contributions. The increase in working capital resulted primarily from the timing of interest payments, reductions in accounts payable and accounts receivable, and an increase in inventory, partly offset by lower tax payments.

In 2007, cash used for investing activities of $126 million was $259 million below 2006 mainly resulting from a reduction in timberland acquisitions ($272 million in 2006). The 2006 results also included $22 million of proceeds from the sell down of our interest in the New Zealand joint venture. Capital expenditures of $97 million in 2007 were below 2006 expenditures of $105 million, which included costs for a power boiler at our Fernandina mill.

Cash used for financing activities was $58 million and $30 million in 2007 and 2006, respectively. The increase was mainly due to debt issuance costs, the net cost of the hedge and warrants associated with the exchangeable notes and an increase in dividends of $7 million. Net debt increased $89 million from 2006 mainly due to the issuance of $300 million of Senior Exchangeable Notes, offset by the repayment of a $113 million note maturing in December 2007 and other debt repayments. See Note 12 *Debt* for additional information.

Our 2007 debt-to-capital ratio of 43 percent increased slightly from 42 percent at prior year end as a result of higher debt as discussed above. As of December 31, 2007, cash and cash equivalents were $181 million, a $141 million increase from the prior year. The cash equivalents consist of marketable securities with maturities at the date of acquisition of 90 days or less.

Expected 2009 Expenditures

Capital expenditures in 2009 are forecasted to be between $95 million and $98 million. Our 2009 dividend payments are expected to increase from $157 million to $158 million assuming no change in the quarterly dividend rate of $0.50 per share. Cash payments for income taxes in 2009 are anticipated to be between $11 million and $15 million. We made discretionary pension contributions of $8 million and $20 million in 2008 and 2007 respectively, and we have mandatory pension contributions of approximately $6 million in 2009, although we may elect to increase contributions. Expenditures for environmental costs related to our dispositions and discontinued operations of $8 million are expected. See *Environmental Regulation* below for further information.

Liquidity Performance Indicators

The discussion below is presented to enhance the reader s understanding of our liquidity, ability to generate cash and satisfy rating agency and creditor requirements. This information includes two measures of financial results: Earnings before Interest, Taxes, Depreciation, Depletion and Amortization (EBITDA), and Adjusted Cash Available for Distribution (Adjusted CAD). These measures are not defined by Generally Accepted Accounting Principles (GAAP) and the discussion of EBITDA and Adjusted CAD is not intended to conflict with or change any of the GAAP disclosures described above. Management

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considers these measures to be important to estimate the enterprise and shareholder values of the Company as a whole and of its core segments, and for allocating capital resources. In addition, analysts, investors and creditors use these measures when analyzing our financial condition and cash generating ability. EBITDA is defined by the Securities and Exchange Commission. Adjusted CAD as defined, however, may not be comparable to similarly titled measures reported by other companies.

EBITDA is a non-GAAP measure of operating cash generating capacity. In 2008, EBITDA was $395 million, a $17 million decrease from 2007 primarily due to lower operating results in our Timber Segment. In 2007, EBITDA was $412 million, a $38 million increase over 2006 primarily due to higher operating results in our Performance Fibers segment.

Below is a reconciliation of Cash Provided by Operating Activities to EBITDA for the five-year period ended December 31, 2008 (in millions of dollars):

	2008	2007	2006	2005	2004
Cash provided by operating activities	$ 340.2	$ 324.0	$ 306.9	$ 261.9	$ 295.4
Gain on sale of New Zealand timber assets			7.8	36.9	
Non-cash cost basis of real estate sold	(11.1)	(8.6)	(12.4)	(11.8)	(11.0)
Income tax expense (benefit)	31.4	23.8	22.3	(30.6)	(33.4)
Interest, net	42.5	48.6	39.1	38.8	44.1
Other balance sheet changes	(8.5)	23.9	10.4	43.8	27.9
EBITDA	$ 394.5	$ 411.7	$ 374.1	$ 339.0	$ 323.0

A non-cash expense critical to the economics of both our Timber and Real Estate core businesses is the non-cash cost basis of real estate sold. EBITDA plus the non-cash cost basis of real estate sold for the five years ended December 31, 2008, 2007, 2006, 2005 and 2004 totaled $406 million, $420 million, $387 million, $351 million and $334 million, respectively.

Adjusted CAD is a non-GAAP measure of cash generated during a period that is available for dividend distribution, repurchasing common shares, debt reduction and for strategic acquisitions net of associated financing (e.g. realizing LKE tax benefits). We define Cash Available for Distribution (CAD) as Cash Provided by Operating Activities less capital spending, adjusted for the tax benefits associated with certain strategic acquisitions, the change in committed cash, less cash provided by discontinued operations and other items which include proceeds from matured energy forward contracts and the change in capital expenditures purchased on account. Committed cash represents outstanding checks that have been drawn on our zero balance bank accounts but have not been paid. In compliance with Securities and Exchange Commission requirements for non-GAAP measures, we reduce CAD by mandatory debt repayments which results in the measure entitled Adjusted CAD.

Below is a reconciliation of Cash Provided by Operating Activities to Adjusted CAD for the five-year period ended December 31, 2008 (in millions):

	2008	2007	2006	2005	2004
Cash provided by operating activities	$ 340.2	$ 324.0	$ 306.9	$ 261.9	$ 295.4
Capital spending, net	(104.8)	(97.0)	(105.5)	(85.3)	(87.7)
LKE tax benefits on third party real estate sales*	(12.1)	(3.9)	(4.8)	(3.2)	(11.3)
Change in committed cash	(10.0)	16.9**	(19.1)	1.8	(3.5)
Other	(2.9)	(4.5)	(14.2)	(14.9)	(13.8)