TRACKING THE NUMBERS

Street Sleuth

REITs Spread to Timber Industry

As Paper Market Struggles, Firms Adopt New Structure In Bid to Boost Share Prices

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SEATTLE -- Real estate investment trusts, or REITs, have swept through property sectors such as commercial construction, hotels and warehouses. Now REITs are spreading through the timber industry.

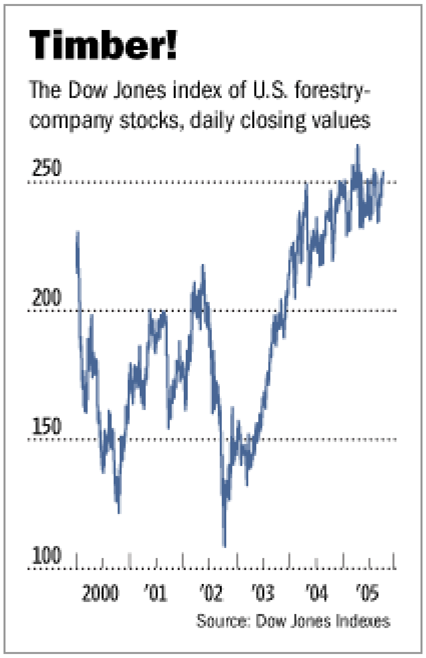
Timber firm Plum Creek Timber Co. helped spark the trend in 1999, when it converted from a limited partnership to a REIT. Last year, rival Rayonier Inc. changed into a timberland REIT. In July, paper-products company Longview Fibre Co. announced it would convert to a REIT in 2006. And Potlatch Corp. said in September that it, too, would make the switch.

With growth in the paper market sluggish and the timber market battered by cutthroat competition, timber companies have been looking for ways to boost their share prices and stand out with investors. For the companies, a big advantage to becoming a REIT is that they no longer have to pay corporate income tax on earnings from land holdings.

Integrated forest-product companies once tried to do it all: own land, harvest trees and produce paper and other wood products. Today, under pressure from shareholders who want them to maximize the value of their timberland, companies are being forced to restructure. Some, such as International Paper Co., are selling off forest land and noncore businesses and focusing on a few core businesses, such as papers and packaging. Others are focusing mainly on their timberland holdings, and becoming REITs. A few, such as Potlatch, are putting their timberland holdings into a REIT structure to try to increase return to shareholders, but keeping industrial operations in a fully taxable subsidiary.

To become a REIT, a company must derive at least 75% of its operating income from real-estate property or interest on mortgages. It also must have no more than 20% of its assets in areas such as manufacturing.

REITs typically pay out hefty dividends, because they are required to pass 90% of their earnings to shareholders. And because earnings from timberland REITs are considered capital gains, their dividends are taxed at a lower rate -- a maximum of 15%, compared with up to 35% for other REITs, whose earnings don't all qualify as capital gains.



The share prices of some timber REITs have risen sharply since their conversion. Seattle-based Plum Creek, for instance, jumped nearly 50% in the five years through Oct. 31, compared with a 15% drop in the Standard & Poor's 500-stock index in the same period and moderate to flat growth in the forest-products sector overall. After Rayonier announced in August 2003 that it would convert to a REIT, its shares jumped 12% within 24 hours. The shares have nearly doubled since then after a three-for-two stock split last month and a stock dividend in November 2003.

Timber REITs "have served investors very well," says Steven Chercover, an analyst at D.A. Davidson & Co. in Portland, Ore.

Timber REITs have performed so well that some non-REIT timber companies have faced investor pressure to do more to keep up, analysts say. Mr. Chercover says some companies are lobbying Congress for changes in the law so their timber operations would be "taxed on a level playing field with the REITs."

But the growth of timber REITs has some on Wall Street worried. These REITs make money buying and selling timberland real estate to property developers. If the housing market cools and land sales decline, timber REITs may see their earnings suffer. In addition, a real-estate downturn could chill demand for wood for building houses, which also could hurt timber REITs.

"We are in a very strong market for wood, but that's not going to last forever," says Richard Schneider, an analyst at UBS Warburg.

Ben Inker, director of asset allocation at investment firm Grantham, Mayo, van Otterloo in Boston, says the REIT structure isn't ideal for all timber companies. Once a company converts, he says, it may feel pressure from shareholders to produce steady revenue, which could force it to cut down trees even if demand for wood dries up.

Plum Creek's chief executive, Rick Holley, pushed the company to convert to a REIT as part of his strategy to gain access to more capital. Plum Creek, which primarily had been involved in logging, raised enough capital from its REIT conversion to begin buying and selling large swaths of timberland real estate. In 2001, it merged with Georgia-Pacific Corp.'s land-owning unit, The Timber Co., doubling its timberland holdings to more than seven million acres. In 2004, the company acquired an additional 45,000 acres of forest land in Maine, giving it almost a million acres of timber there. It is now one of the country's largest private timberland owners. And since converting to a REIT in 1999, Plum Creek's net income more than quadrupled to $362 million in 2004.

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