Seeking Alpha
**Transcripts** | **Financial**

# Weyerhaeuser Company (WY) CEO Devin Stockfish on Q3 2019 Results - Earnings Call Transcript

Oct. 25, 2019 5:11 PM ET7 comments | 5 Likes
by: SA Transcripts

Q3: 10-25-19 Earnings Summary

*Press Release* SEC *10-Q* *Slides*

EPS of $0.08 misses by $-0.03 | Revenue of $1.67B (-12.51% Y/Y) misses by $-36.96M

## Earning Call Audio

Subscribers Only

00:00 -57:25

Weyerhaeuser Company (NYSE:WY) Q3 2019 Earnings Conference Call October 25, 2019 10:00 AM ET

**Company Participants**

Beth Baum - Vice President, Investor Relations

Devin Stockfish - Chief Executive Officer

Russell Hagen - Chief Financial Officer

**Conference Call Participants**

George Staphos - Bank of America

Brian Maguire - Goldman Sachs

Anthony Pettinari - Citi

Mark Wilde - BMO Capital Markets

Mark Weintraub - Seaport Global

Collin Mings - Raymond James

Mark Connelly - Stephens Inc.

Chip Dillon - Vertical Research Partners

Steve Chercover - Davidson

Paul Quinn - RBC Capital Markets

**Operator**

Ladies and gentlemen, thank you for standing by, and welcome to Weyerhaeuser Third Quarter 2019 Earnings Conference Call. At this time, all participant lines are in a listen-only mode. After the speakers’ presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to hand the conference over to Ms. Beth Baum, Vice President of Investor Relations. Please go ahead.

**Beth Baum**

Thank you. Good morning, everyone. Thank you for joining us today to discuss Weyerhaeuser's third quarter 2019 earnings. This call is being webcast at www.weyerhaeuser.com. Our earnings release and presentation materials can also be found on our website. Please review the warning statement in our press release and on the presentation slides concerning the risks associated with forward-looking statements, as forward-looking statements will be made during this conference call. We will discuss non-GAAP financial measures and a reconciliation of GAAP can be found in the earnings materials on our website.

On the call, this morning, are Devin Stockfish, Chief Executive Officer; and Russell Hagen, Chief Financial Officer.

I will now turn the call over to Devin Stockfish.

**Devin Stockfish**

All right. Thanks, Beth. Good morning, everyone, and thank you for joining us today. This morning Weyerhaeuser reported third quarter net earnings of $99 million or $0.13 per diluted share on net sales of $1.7 billion. Excluding a net benefit to $40 million from special items, we earned $59 million or $0.08 per diluted share. Adjusted EBITDA totaled $308 million. Our businesses continued to deliver strong operating performance despite challenging market conditions. And in a moment, I'll dive into our business results.

But, first, let me set the stage with some brief comments on the housing market. U.S. housing activity continued to improve in the third quarter, led by stronger activity in the important single-family segment. Single-family permits and starts have now increased for five months in succession. Additionally, seasonally adjusted single-family starts exceeded 900,000 units in back-to-back months in August and September, which we haven't seen since 2007.

Total U.S. housing starts have also strengthened totaling 1.28 million in the third quarter compared with 1.26 million in the second quarter and 1.21 million in the first. As we look forward, many indicators point to continued improvement in housing activity. Wage growth remained solid and the unemployment rate is at a 50-year low. Mortgage rates are hovering near 3.5% significantly lower than late 2018. Consumer confidence surveys indicate a positive view of current and future conditions. Homebuilder sentiment has increased for four straight months and sits at the highest level since February 2018. And builders continue to ship more product to serve the significant demand for affordable housing.

That said, several supply side headwinds for housing remain. Builders continue to face a series of challenges including labor and lot availability and regulatory burdens as they seek to bring affordable housing to market. Additionally there is a degree of uncertainty regarding the outlook for U.S. economic growth that could impact buyer sentiment. While these challenges will continue to affect the housing market, we believe that the supported fundamentals outweigh the headwinds.

Entering the fourth quarter, our builder customers tell us their demand continues to improve and they intend to maintain strong building activity until winter weather no longer permits. Going into next year, we continue to anticipate increasing momentum in the single-family housing market and a modest growth trajectory for U.S. housing.

Turning now to our third quarter business results, I'll begin the discussion with Timberlands charts 4 through 6. Timberlands contributed $72 million to third quarter earnings and $154 million to adjusted EBITDA. Western Timberlands EBITDA decreased by $30 million compared with the second quarter due to seasonally lower harvest volumes and lower average realizations for domestic and export logs.

Western fee harvest volumes decreased 11% compared with the second quarter and 5% compared with year ago, as we intentionally brought less wood to market during the seasonal peak in supply. Log and haul costs also increased as we typically shift to higher elevation logging during the summer months. In the Western domestic market, mills entered the third quarter with full inventories in preparation for summer fire season. However, as summer weather in the Pacific Northwest, was wetter than normal there was no notable fire activity and logging conditions remained favorable.

Log supply increased seasonally as private nonindustrial landowners brought their logs to market and mill log decks remained at comfortable levels through July and August. Domestic log prices trended modestly lower through the summer months, but started to firm up at the end of August, as demand and pricing for Douglas fir lumber began to improve. Log supply tightened in September with the early arrival of the fall rainy season and log pricing increased in the quarter. Moving to the export markets, in Japan, post-and-beam housing starts were up 1% year-to-date.

Demand for our customers' Douglas fir lumber products remained solid. And our third quarter log sales volumes to Japan were comparable to the second quarter. Average sales realizations were modestly lower, due to pressure from unfavourable foreign exchange rates and U.S. domestic pricing trends.

In China, overall log inventories decreased by 15% during the third quarter, and totaled 3.5 million cubic meters at the end of September. Chinese demand for our Douglas fir and hemlock logs, remained generally steady compared with the second quarter.

Our third quarter log sales volumes to Japan -- to China increased, but this was primarily due to timing of vessel sailings. Average realizations for our China export logs, decreased modestly compared with the second quarter, due to mix and competition from lower priced species, which pressure pricing for our hemlock and Douglas fir.

Overall, third quarter log export revenues were lower than the year ago quarter, due to lower realizations for our Japan and China logs. And moderately lower sales volumes to China.

For Western Timberlands as a whole, EBITDA is significantly lower than a year ago, due to lower prices for domestic and export logs. Moving to the South, Southern Timberlands EBITDA increased by $5 million compared with the second quarter, as higher fee harvest volumes were partially offset by seasonally higher forestry spending.

Third quarter weather was generally drier than second quarter this resulted in good operability, and strong log production across our southern regions. Our fee harvest volume increased 7% as we benefited from the improved weather, and also caught up on thinning activity postponed during the unusually wet conditions earlier this year.

Average realizations for our Southern logs decreased 1% compared with the second quarter, due to mix as the increasing thinning activity resulted in a higher proportion of fiber logs.

Average realizations for our Southern sawlogs increased due to improved pricing in the mid-South, where markets remained relatively strong due to wetter conditions. Realizations for our fiber logs were comparable to the second quarter.

On the export side, we have been operating our Southern export business at minimal volume since Chinese tariffs were applied to the Southern yellow pine logs in 2018. Less than 0.5% of 1% of our Southern fee harvest volumes are, sold to expert customers.

Comparing overall Southern Timberlands results with the year ago quarter EBITDA increased by $11 million, due to higher average log sales realizations, and higher fee harvest volumes.

Northern Timberlands EBITDA increased by $3 million compared with the second quarter, and was comparable to a year ago. Compared with the second quarter, fee harvest volumes increased seasonally, as the northern operations emerged from spring break-up.

Real Estate Energy and Natural Resources charts seven and eight. Real estate and ENR contributed $32 million to third quarter earnings, and $60 million to adjusted EBITDA.

Third quarter EBITDA was $11 million lower than the second quarter, and $26 million lower than a year ago. As expected, the number of acres sold decreased significantly compared with the second quarter, and the year ago quarter.

As we previously indicated, our 2019 real estate sales are heavily weighted toward the first half of the year, whereas in 2018, most of our sales occurred in the third and fourth quarters.

Average price per acre was roughly two times that of the second quarter, and the year ago quarter due to geographic mix. Approximately 85% of our third quarter acres sold were in the South and West.

In contrast, over half the acres sold in the second quarter of 2019, and third quarter of 2018, were located in Montana, where Timberland prices are regionally lower. Wood Products charts nine and 10.

Wood Products contributed $75 million to third quarter earnings before special items, and $123 million to adjusted EBITDA. Earnings and EBITDA were nearly comparable to the second quarter, on flat average realizations for our commodity products.

EBITDA for lumber increased $5 million due to lower Western and Southern log costs. Lumber pricing declined at the outset of the third quarter, then reversed course in mid-August as improved housing activity drove incremental demand, and previously announced mill curtailments began to reduce supply.

On average, the framing lumber composite price increased 3% in the third quarter compared with the second. Our average log -- lumber realizations were comparable to the second quarter as our mix of production is weighted more heavily to Southern Yellow Pine.

Third quarter sales volumes were flat with the second quarter. Our lumber mills ran very well again this quarter even with some modest hurricane-related downtime in our Southern operations.

Unit manufacturing costs for lumber increased slightly due to that downtime as well as hurricane preparation activities. Comparing third quarter results with the year ago quarter, lumber EBITDA was significantly lower due to a 21% decrease in average sales realizations, partially offset by lower log and manufacturing costs.

EBITDA for the third quarter of 2019 includes charges of $4 million for countervailing and antidumping duties on Canadian softwood lumber. In OSB, EBITDA increased by $5 million compared with the second quarter due to lower fiber and unit manufacturing costs.

As with lumber, third quarter OSB pricing vary by region. Although pricing in the benchmark north central region increased significantly during the third quarter, pricing in several other regions trended materially lower. The OSB composite price which includes all producing regions was flat in the third quarter compared with the second.

Our third quarter realizations trended in line with the OSB composite price which is a better proxy for our geographic mix. Our OSB sales and production volumes were comparable to the second quarter. Comparing our third quarter results to the year ago quarter, EBITDA was significantly lower due to a 33% decrease in average sales realizations, partially offset by higher sales volumes as our Grayling Michigan mill was down for a scheduled press replacement in the third quarter of 2018.

Engineered Wood Products EBITDA decreased by $9 million compared with the second quarter. Average sales realizations for I-Joists products were flat with the second quarter and average realizations for solid section decreased by 1% due to product and geographic mix.

Sales volumes for I-Joists increased 4% and production volumes were comparable to the second quarter. Sales volumes for solid section products increased 3%. Solid section production declined 12% as we completed scheduled annual maintenance shutdowns at two mills and continue to draw down our first quarter inventory build.

Unit manufacturing costs increased due to lower operating rates and higher maintenance expense resulting from these scheduled shutdowns. Fiber costs declined due to lower cost per logs in oriented strand board web stock.

Compared with the year ago quarter, EBITDA for Engineered Wood Products increased due to lower cost per logs and oriented strand board. Distribution EBITDA was comparable to the second quarter and significantly higher than year ago due to improved margins.

Third quarter results for Wood Products include one special item a pretax benefit of $68 million from insurance recoveries related to our Flak Jacket product remediation. To-date we have received $93 million of insurance proceeds and we continue to expect a significant portion of the remediation cost will be covered by insurance.

I'd like to now turn to operational excellence. Our businesses continue to make good progress on operational excellence and we are on track to achieve our 2019 target of $80 million to $100 million.

Year-to-date our operational excellence initiatives in timberlands have been focused on log marketing and merchandising, optimizing silviculture spend, reducing growth costs, and improving log and hauling efficiencies across all geographies.

In Wood Products, our OpEx initiatives are focused on reducing our controllable manufacturing costs, increasing our high-value product mix, and improving log recovery across our operations. Our real estate business is also on track to meet or exceed its targeted 30% premium to timber value.

I'll now turn it over to Russell to discuss some financial items and our fourth quarter outlook.

**Russell Hagen**

Thanks Devin. Good morning. Key outlook items for the fourth quarter are presented on Chart 13 of the earnings slides. In our Timberlands business, we expect our fourth quarter earnings will be comparable to the third quarter and adjusted EBITDA will be slightly lower.

In our Western Timberland operations, we expect domestic log sales volumes will decline modestly in the fourth quarter. Wet operating conditions reduced log supply late in the third quarter and inventories tightened. We anticipate domestic log sales realizations will improve modestly in the fourth quarter as a result of steady domestic demand and the continued seasonal reduction in supply from non-industrial landowners.

As is typical for this time of the year, we expect our Western road and unit logging costs will be lower compared to the third quarter. Demand for our Japanese export logs remains solid and we expect fourth quarter sales realizations to be flat with the third quarter. Fourth quarter sales volumes are expected to decline due to the timing of shipping schedules.

Chinese export log sales volumes are expected to be comparable with the third quarter and we anticipate average sales realizations will decline modestly in the fourth quarter. We're taking advantage of our ability to allocate volumes between the domestic and China markets to capture the highest margin opportunity.

In the South, operating conditions have been favorable for the past several months and log inventories have returned to healthy levels. We expect fourth quarter average log sales realizations will be slightly lower than the third quarter and fee harvest volumes will decline.

In the North, we expect fourth quarter EBITDA to decline due to the seasonally lower fee harvest volumes and a partial quarter of Michigan results. In September, we announced an agreement to sell our 555,000 acres of Michigan Timberlands for $300 million. This transaction is expected to close in the fourth quarter and these assets are now listed on our balance sheet as held-for-sale.

Turning to our Real Estate Energy and Natural Resources segment, as previously discussed the pace of our real estate sales is more heavily weighted to the first half of the year in 2019. Market conditions remain positive and high net worth individuals, recreational and conservation buyers are all active.

We expect fourth quarter earnings for Real Estate Energy and Natural Resources segment will be approximately $10 million lower than the third quarter. We continue to expect full year 2019 adjusted EBITDA of approximately $270 million and anticipate land basis as a percentage of real estate sales will be between 50% and 55% for both the fourth quarter and the full year.

For Wood Products, we expect lower sales volumes across most product lines, as building activity typically declines in the fourth quarter as we move into the winter months. Our channel inventories have tightened, buyers continue to limit purchases to immediate needs. We anticipate higher Western log cost, partially offset by modestly improved operating cost as we continue to capture operational excellence improvements.

Fourth quarter earnings and adjusted EBITDA for Wood Products segment are expected to be approximately $25 million lower than the third quarter before any benefit from improvement in sales realizations.

For lumber, fourth quarter to-date average sales realizations are $5 higher than the third quarter average. Current realizations are comparable with the third quarter average. Oriented strand board fourth quarter to-date average sales realizations and current realizations are both $5 below third quarter average.

As a reminder for lumber every $10 change in realizations is approximately $11 million of EBITDA on a quarterly basis. And for OSB every $10 change in realizations is approximately $8 million of EBITDA on a quarterly basis.

Chart 11 outlines the major components of our third quarter unallocated items. The contribution to earnings before special items improved $3 million due to a non-cash benefit from elimination of inter-segment profit in inventory and LIFO compared with the second quarter.

Third quarter special items include a $15 million pre-tax legal charge stemming from the judgment in a suit related to Flak Jacket. We're appealing this ruling.

Our third quarter non-cash, non-operating pension and post-retirement benefit cost was comparable to the second quarter. We continue to expect to record approximately $60 million of expense for the full year 2019.

Turning to our key financial items, which are summarized on chart 12, we ended the third quarter with a cash balance of $153 million. Cash from operations during the third quarter was $292 million.

Turning to cash from investing. Our capital expenditures in the third quarter totaled $98 million. We continue to expect total CapEx for 2019 will be approximately $380 million nearly $120 million for Timberlands, $250 million for Wood Products and approximately $10 million from planned corporate IT system upgrades.

As a reminder, the fourth quarter is historically the highest quarter of capital spending. We also expect to receive $300 million of cash in the fourth quarter as we close on the sale of our Michigan Timberlands.

Moving on to financing. In the third quarter, we paid $302 million to extinguish the debt of a variable interest entity that was established as part of the timber installment sale in the early 2000s. This is the last of these entities and we'll receive $362 million of cash in the first quarter of 2020 when the related financial investment matures.

We ended the quarter with approximately $6.6 billion of total debt outstanding this includes a $440 million balance on our line of credit, a portion of which was used to bridge the temporary cash outflow associated with the variable interest entity debt maturity. We have no debt maturities until 2021. We expect our fourth quarter interest expense to be comparable to the third quarter bringing the full year 2019 to approximately $370 million, excluding special items.

I'll close my comments with taxes. Excluding special items in the third quarter we recorded a $10 million income tax benefit. On a year-to-date basis, our effective tax rate before special items was a benefit of 15%. We expect our full year 2019 effective tax benefit to be similar to the 15% we have booked year-to-date though will be somewhat sensitive to fourth quarter lumber and oriented strand board pricing.

Turning to cash taxes. We expect to pay minimum cash taxes in 2019, due to an anticipated fourth quarter refund for prior overpayments. We've also filed a $90 million refund associated with our 2018 pension contribution that claim is still in process and so we're unlikely to receive that cash in 2019.

Now, I'll turn the call back over to Devin and look forward to your questions.

**Devin Stockfish**

Thank you, Russell. In closing, I am extremely proud of the work that our people are doing all across the company. Our teams are delivering strong operational performance in each of our businesses despite challenging market conditions. In every area that we can control, our employees are driving solid execution each and everyday. We remain intently focused on serving our customers and delivering operational excellence in every aspect of our business.

Looking forward, we continue to expect that U.S. housing will follow a modest growth trajectory, which should ultimately support improved pricing across our commodity products. And with our businesses running well, we're well positioned to capture the full benefits of an improved housing environment. But as we continue to improve our operating performance and optimize our portfolio, we will also position the company to deliver superior value to our shareholders across the range of market conditions.

And now, I'd like to open the floor for questions.

**Question-and-Answer Session**

**Operator**

[Operator Instructions] And your first question is from the line of George Staphos with Bank of America. Please go ahead.

**George Staphos**

Thank you. Good morning, Russell. Good morning, Devin. How are you? Hi, Beth. Thanks for all the details. A couple of questions here and then we'll turn it over. First of all and this comes up periodically on the conference calls, why do you think at this juncture we haven't seen that expected uptick in Southern Timberlands pricing or timber pricing? Obviously, you're seeing a pick up in demand your outlook for next year is moderately positive in terms of housing. Canada has been having difficulty supplying logs into the U.S. Why are we seeing that uptick in your view? Any updated thoughts on Southern timber pricing here? And what we can expect looking out into 2020?

**Devin Stockfish**

Yeah. Sure, George. And I think I would note that we have seen an uptick in the first half of the year that really sort of translated all the way into Q3 on Southern sawlog prices. So we have seen a bit of an uptick this year. Now, candidly some of that had to do with the rain that we had in the first part of the year, the tension in some of the wood baskets, but I think we have seen some improvement year-over-year.

But ultimately, what it comes down to is supply and demand within the region, and this has been a long story in terms of getting the Southern sawlog prices up. But ultimately what gives us confidence that ultimately we are going to see the improvement is the improved capacity that we're seeing coming into the U.S. South 5.5 billion board feet of incremental capacity coming in. When we look at the wood baskets where the new mills have come in we have seen tensioning within those wood baskets. And as that capacity continues to come in and get online you see that tensioning effect.

Additionally, on the pulp side, we've seen a number of pellet mills come in. In fact, Enviva just broke ground on a new pellet mill in Mississippi. And so it takes time for each of those mills to come in, get up to speed and start taking logs. But again, as we've seen these mills come in, in the specific wood baskets where we've seen incremental capacity you see a tensioning effect. And over time that brings up the demand across the system.

The other thing I would just note is, over time we also think there is an opportunity for an export program to really develop out of the U.S. South. Pre-tariffs, we were really working to build up that program and making some good headway in terms of exporting logs out of the U.S. South. I think ultimately when the tariff dispute ultimately comes to resolution we're going to see that opportunity open back up. And so it takes time, it's been slower than we would have expected or like, but I think we're on the right trajectory over time.

**George Staphos**

Okay. Devin, I mean, relatedly and you're correct there has been a little bit of a bump this year, but certainly timber prices are nowhere where anyone would have expected a few years ago at least I don't think in the South or also where they are right now. The capacity that's gone in at 5.5 billion square feet few years ago, it was 3 billion square feet and 4 billion square feet. So you've seen more converting capacity go in. We haven't seen the price really lift. At this juncture, they just -- housing has been a little bit slower to come back and that is the reason why you haven't seen that tensioning.

And then relatedly -- and again, thanks for all the detail that you put in the slide deck, you have one of the best in the industry. It's kind of interesting how we've seen the Western Timberland EBITDA decline almost in half relative to where it was to begin 2018. From your vantage point, where are the big buckets? And what changes that trajectory over the next couple of periods and years? Is it really just trade getting back to normal, or is there something else in your view that would be helpful there.

**Devin Stockfish**

Yeah. I think a couple of things on the Western market. Ultimately, the Western system is a very tensioned market. And so I think the biggest driver that you see in terms of Western log prices is what's going on with the Western lumber prices. And so when you have mills that see lumber prices reduce dramatically, there's a limit to how much they can pay for logs and keep those cash flow positive.

So I'd say that's been the biggest driver. There have been a couple of other things around the margins the trade dispute with China. We continue to ship logs to our customers in China, but I do think a number of other landowners in the Pacific Northwest have kept some of that supply in the domestic market.

A little bit around the margins, there were some wind damage in South Oregon. And so there's been a little bit to salvage activity there that's been a little bit of headwind down in that market, but overall the big driver has really just been Western lumber prices.

And so as we look forward sitting where we are today, we're moving into the rainy season here in the Pacific Northwest. In fact, last few weeks it has been pretty rainy up here, and that typically will take the non-industrial landowners out of the system. It will reduce log flow. And so provided that we can keep Western lumber prices at these levels or even get some uptick, I think that bodes well for improved log prices in the west.

**George Staphos**

Okay. Last quick one for me. Just timberland transactions have been again a little bit slow this year at least from our vantage point. What do you think if you grew the premise? And maybe you disagree, what do you think has been driving that? Thanks and good luck in the quarter.

**Russell Hagen**

Yeah, George, this is Russell. I'll take that question. I don't think much has changed since the last time we talked last quarter in the timberland's market. We're a little closer to be year-end. I think we've seeing about $750 million worth of transactions closed. As we look in the pipeline, there's probably another $750 million that will close.

So the full year we'll expect to see in the U.S. about $1.5 billion worth of transactions. That's definitely lower than kind of what we would expect on a run rate of $2 billion to $2.5 billion. That doesn't include any large transactions like the PotlatchDeltic transaction last year.

So definitely, we're a little lighter this year than I think we would have expected given what we've seen in prior years, but I really don't think that's a reflection on the market per se. I think it's just a timing issue.

There is still a lot of demand for quality timberlands, the transactions that are coming out get a lot of attention. And so I would expect to see us return to a more kind of normal run rate basis going forward.

**George Staphos**

All right. Thank you very much guys.

**Devin Stockfish**

Thank you.

**Operator**

Your next question is from the line of Brian Maguire with Goldman Sachs. Please go ahead.

**Brian Maguire**

Hi. Good morning guys.

**Devin Stockfish**

Good morning, Brian.

**Brian Maguire**

Just a follow-up on those comments Russell and the prior comments just on the lower Western log price realizations. Why do you think that we haven't seen some of the Western land transaction prices come down some timber or the lower log price realization? Is it just not as tether to like current EBITDA and cash flows as a lot of other asset classes? Or do you think we're just seeing maybe lower interest rates and cap rates kind of offset the lower kind of EBITDA that you're getting of that land these days?

**Russell Hagen**

Brian, there's kind of two points. The first is, timberland values typically don't trade kind of correlated to log pricing. When you're going into acquire timberland asset you're thinking over a longer-term period of time than just the immediate log price dynamics. And so I think that's factored into the overall investment and valuations.

The second is in the West. As Devin mentioned, that's a very tensioned market. And part of that is the ownership structure is very different than say in the South. There's fewer private owners in the West, there's more federal and state ownership. And so, you really just don't have the same kind of number of available transactions in the market that you see in the South plus.

The West is really an excellent timber base. The trees are high valued Doug fir, primarily grown for a sawlog-type product. And so, they really are of a high value. And I think, again, as you see any Western timberlands come to market you're going to see a lot of demand, particularly of their high-quality timberlands.

**Brian Maguire**

Okay. I appreciate that. Just to switch over to wood products, just wondered if you could provide some comments and your thoughts on where inventory sits in the channel? And in light of some of the recent capacity closure announcement in both lumber and OSB now, any thoughts on if there's enough tension in the market, especially if the kind of recent starts activity continues?

**Devin Stockfish**

Yes. Well, starting off with the question on inventories in the channel, it's really been the story of the year. We've seen customers carrying relatively low inventories. I would say that's the case now, generally speaking, across the system, really in lumber, OSB and EWP, fairly lean inventories across the system.

And I think that's just a reflection of the fact that for the majority of the year, the supply has been adequate. So people can buy on an as-needed basis and that really has enforced people to carry material inventories. And so, that's currently the case.

What I would say from a broader perspective, I think, there is reason to believe that you're going to see some upward pricing pressure. We've seen a fair amount of curtailment activity over the course of this year, even some more announced just recently.

And importantly, we've seen the continued improvement in housing and importantly the single-family segment. And so, to us, to the extent that you see this building activity continue in the strong level that we've seen here of late and we can keep that going for a while longer before the winter weather sets in, combined with the capacity curtailments that have been announced, I think that really bodes well for pricing as we head into the end of the year.

But certainly, I would say, even and over and above that as we think about the 2020 building season, which is a little ways out, but it's always worth thinking about, I think we're setting up really well to have a materially different view next year on what pricing looks like and what 2019 look like.

**Brian Maguire**

Okay. Thanks very much. I'll turn it over.

**Devin Stockfish**

Thanks.

**Operator**

Your next question is from the line of Anthony Pettinari with Citi. Please go ahead.

**Anthony Pettinari**

Good morning.

**Devin Stockfish**

Good morning, Anthony.

**Anthony Pettinari**

Just following up on Brian's question and maybe just zooming in on OSB, you do have a number of competitors that are taking curtailments. I think your production has kind of moved up over the course of the year.

I'm wondering if you can talk about where your operating rates are in OSB? Where do you think you may be on the cost curve? And just generally, how you're positioned in the OSB market, given there're some pretty significant regional differences I think that you talked about earlier?

**Devin Stockfish**

Yes. Sure. From an operating perspective, we're sort of in that mid to upper-90s percent range, which is more or less where we were in Q2 as well. And I think, at a high level it's important to remember when you're thinking about our OSB business.

Number one, we typically are a little bit more heavily weighted to the higher value products and so a little less of a participant in the commodity sheathing portion of the business. And I think importantly, we've been very, very focused on our cost structure and that's true across all of our manufacturing assets.

Certainly, that's the case in our OSB business as well. And so, to the extent that you've got higher-value products and you've got a lower cost structure, I think that's really what gives you the ability to continue to run and generate cash where that may not be the case for some others.

And that was certainly the case for us in OSB in Q3. We were cash flow positive in all of our mills in each of the months, except for one mill that had some scheduled maintenance downtime. And so, we're thoughtful about our operating posture, we're always looking to match our supply with profitable demand and generate appropriate returns over time. But, I think, as I mentioned, just the product mix and the cost structure give us a little bit more flexibility in that respect.

**Anthony Pettinari**

Okay. That's really helpful. And then, you announced the Michigan sale during the quarter, I am wondering if there is any detail you can give us on that property in terms of species, age class earnings contribution relative to kind of the northern region timberlands that you have? And then, do you see further opportunities that are comparable, whether it's in the North or in other regions?

**Russell Hagen**

Yeah. Anthony, this is Russell. So we did announce the 555,000 acres sale to Lyme timber for $300 million at $540 an acre. And that represents our total Michigan ownership. We have a mix of hardwood logs and pulpwood, so we service both some saw milling and then also pulp activities up there and then there is also a softwood component. We're on target to close in the fourth quarter and so we're very pleased with the overall transaction and the outcome.

As far as other Northern Timberlands, I won't comment on specifics, but as we demonstrated, we continue to look at the portfolio. Our goal is to optimize the portfolio over time and the Michigan sale was part of that ongoing effort. So it's a key strategic driver of ours to make sure that we have the right mix of acres that will drive the highest return to the shareholders over time. So we're constantly looking at all of our regions and it's something we're always evaluating, both on the buy side and on the sell side.

So as part of that process, we're going to identify certain timberlands that may not be strategic for us and we'll act on those appropriately. And on the buy side, we can be very patient. We have 12 million acres. We're in every operating region in the United States. And so we can be patient and make sure that anything that we contemplate creates shareholder value over time.

**Anthony Pettinari**

Okay. That's helpful. I'll turn it over.

**Operator**

Your next question is from the line of Mark Wilde with BMO Capital Markets. Please go ahead.

**Mark Wilde**

Good morning, Devin, good morning, Russ.

**Devin Stockfish**

Good morning, Mark.

**Russell Hagen**

Good morning, Mark.

**Mark Wilde**

I'd like to just come back on that Michigan land. So Russell, can you just -- can help us at all thinking about the earnings impact from that sale? My own work would suggest it's about 20% to 25% of your land base, but as I understand, it's probably a bigger portion of the earnings in that segment?

**Russell Hagen**

Yeah, Mark, we don't break out the specific earnings in a segment. But you're right, it's about 25% of the total acres in the North. I think for context, last year we generated $19 million to $20 million of EBITDA out of the Northern Timberland operation. So that can kind of give you an idea of generally what the contribution was.

**Mark Wilde**

So you're saying the contribution last year would have only been about let's say $4 million?

**Russell Hagen**

Probably a little higher than that.

**Mark Wilde**

Okay. All right. And just again to kind of come back on the issue of how Northern Timberland is identified, if we look at the South and the West, you're really a plantation forestry company and much of what you got kind of across the North is just kind of natural regeneration. So does that make the North different for you from kind of a strategy standpoint?

**Russell Hagen**

Mark as we've said in the past, our focus has definitely been kind of in the West and in the South. When you think of the North, it's -- the West it's pretty consistent I guess growing areas primarily Doug fir, primarily the sawlog outcome; in the South, it's Southern Yellow Pine, pine plantation. When you look in the North, we really have four distinct kind of areas. We have Montana and Michigan, Maine and then West Virginia and each one of them have distinct products, distinct customers, distinct strategies. And so, I would say that you do need to look at it on an individual kind of region basis in the North or in the North it's not as comparable clearly to the West or the South.

**Mark Wilde**

Okay. And the last one on the Northern Timberland, just we have a lot of carnage right now in the hardwood lumber business and I'm understanding some really underperforming properties on the timberland side in hardwood. What effect is that having on you? And also does that create any potential opportunities?

**Devin Stockfish**

Yes, Mark. This is Devin. No question, the China trade dispute has had a negative impact on the hardwood sawtimber market and I think you're seeing that really across the board. I think certainly as we think about going forward to the extent that the trade dispute can get resolved, I think that will be alleviated, but it's going to be some tough sledding in that market until that ultimately does happen. In terms of specific opportunities, I don't know that there is anything that we would highlight right now. We're watching the market across the board that's true both in the hardwood business and really the rest of our ownerships, so nothing specific to highlight on that right now.

**Mark Wilde**

Okay. And then Devin just last one for me. Just over on the Wood Products side of your portfolio, we've been hearing for several months more positive commentary and results from the homebuilders but it really hasn't to this point kind of flowed through to the suppliers to the homebuilders. How do you interpret that?

**Devin Stockfish**

Yes, Mark. I think part of this earlier in the summer, when we really started to see a little bit of pickup in the activity was there was a bit of destocking. I think there was probably a bit more spec home inventory in the system that had to be worked through. And so not all of that pickup in activity really translated into actual Wood Products demand pull through.

I think you're starting to see that get more into balance. And as we see the starts activity and the new home sales activity continue to improve that should have more pull through. The other thing I think that's been really hard in terms of dialing in the supply-demand dynamic is with all of the curtailment activity that we've seen that introduces noise into the system.

And so when you see some of these mills take indefinite or permanent shutdowns, there is an inventory flushing that typically occurs in the system. And I think that's part of what we saw in Q3 as some of these mills closed down and we're really eliminating the inventory.

You probably saw a little bit more of that flushing through that had a bit of a dampening effect on pricing. But ultimately there is no question as we continue to see housing improve and if this trend continues which we think it will that ultimately will result in more Wood Products demand. And you combine that with the curtailment activity, put the noise aside that will be I think a positive for commodity pricing across the board.

**Mark Wilde**

Yes. It definitely looks like it when we look at these SPF prices the last couple of weeks Devin. I'll turn it over.

**Devin Stockfish**

Yes, thanks, Mark.

**Operator**

Your next question is from the line of Mark Weintraub with Seaport Global. Please go ahead.

**Mark Weintraub**

Thank you. One or two follow ups. First just on the Michigan sale, so you've got $250 million on assets for sale you're selling it for $300 million. So can we conclude it's a $50 million gain on that sale? And I assume that's not included in any of your guidance, so I assume you're going to take that out as a non-recurring item when you report for the fourth quarter?

**Russell Hagen**

Yes Mark. That's correct.

**Mark Weintraub**

Okay. And then there has been some chatter about opening federal forests to logging. Any perspectives on the likelihood of that happening and/or potential impact if it were to?

**Devin Stockfish**

Yes, Mark. Honestly, I don't think we're overly concerned about that. There are a lot of impediments to rapidly increasing logging of federal land, the litigation environment, frankly the capacity in the system to do that. So it's not something that we're particularly concerned about. I think even if we do see a little bit of an uptick it's not going to have a material impact on any of our businesses.

**Mark Weintraub**

Okay. And then lastly, obviously, this year the tax rate has been pretty unusual. Kind of on a go-forward basis is there a formula or way that we should be thinking about? Does it go back to the way it used to be or is there kind of a different way to be thinking about the tax rate for 2020 as well?

**Russell Hagen**

Mark, the provision for income tax is this year has been primarily driven by the performance in the TRS and primarily Wood Products performance. As you're aware, we calculate the estimated annual tax rate on a consolidated basis, so combining the REIT and tax for REIT subsidiary, because we don't pay taxes on the REIT income. We get a lot of volatility in the effective tax rate, particularly when the other proportion of earnings between the REIT and the TRS changes, which is really what you're seeing this year.

So, as we've said, the fourth quarter rate is going to be highly dependent on Wood Products pricing just as a function of that proportion. I think as we come into 2020, we should start seeing that tax rate normalize as we have improved performance, particularly in the Wood Products operations.

**Mark Weintraub**

So is it fair to basically use zero on the timber earnings and 20%-or-so for whatever we estimate the TRS might be which will be largely the Wood Products business?

**Russell Hagen**

Yes. I mean, we don't pay tax coming out of the REIT. So on the TRS, probably more of an all-in rate of around 25%. Again we'll provide guidance in February when we update our guidance for 2020 for you.

**Mark Weintraub**

Okay, super. Thank you.

**Russell Hagen**

You bet.

**Operator**

Your next question is from the line of Collin Mings with Raymond James. Please go ahead.

**Collin Mings**

Thanks. Good morning, everyone.

**Russell Hagen**

Good morning, Collin

**Devin Stockfish**

Good morning, Collin.

**Collin Mings**

First question for me. Just, Devin, going back to your prepared remarks on the Japan market, can you just maybe expand on the demand trends you're seeing there? It looks like wooden construction starts actually fell there year-over-year in August? And then with the consumption tax increase, it would just be helpful if we could get your latest read on that market and maybe how you expect that to evolve?

**Devin Stockfish**

Yeah, sure. Yeah, I think the important thing for us when we think about the Japan housing market is the post and beam market. And so that really is where our product feeds into the construction activity and that's been up 1% year-to-date. And so that has remained a pretty strong market for us. Our customers in Japan have had steady demand and we continue to see that.

I think as you think over time the one piece that is always a little bit of a variable is just with currency. That market is served by European supply and U.S. supply. But our customers are doing well. They have had strong demand, good activity there. And so we're seeing good solid activity into that market and anticipate that continuing.

**Collin Mings**

Okay, thank you. And then switching to real estate, Russell just given some of the recent headlines in both Florida and Maine as it relates to warehouse or in zoning, can you maybe just update us on your thoughts on how important pursuing entitlement is in select markets to your strategy of creating value and extracting a premium to core timberland?

**Russell Hagen**

Sure. So specific to the Florida headline that's a relatively small development area. It's been about 1,700 acres. We've been pursuing entitlement over a number of years. As you're aware, the entitlement process can be a bit of a bumpy road. And so I think that's really what you're saying, but that really is not a significant contributor to our overall performance on the overall real estate program.

As far as Maine, we completed that entitlement back in 2012. Since that time, we really haven't seen that market materialize for development. And so we're opting to seek to convert that back into timberlands and manage it on a sustainable basis like we manage all of our timberlands. Again that really isn't a significant contributor to the overall real estate performance going forward.

As far as the entitlement, I mean it's a relatively low cost way of taking properties up the value curve. And so we're seeing opportunity to entitle a property and then divest it to a developer or another party, we're going to pursue that and we think through every one of our opportunities pretty clear understanding that it just takes time, but ultimately we're trying to seek the highest value for those lands that we've identified for development outcomes and then also for HBU sales.

**Collin Mings**

Got it. So it sounds like again it will be basically a selective process of what you actually decide to pursue as far as the entitlement front. But I guess to your point, it's relatively low cost way of maybe adding some value in some select markets, is that fair?

**Russell Hagen**

Yeah that's fair. Again it is very -- it’s a relatively small subset of our overall AVO portfolio. And again it's a low cost way of taking that property up the value curve.

**Collin Mings**

Okay. Thank you, Russell.

**Russell Hagen**

You bet.

**Operator**

Your next question is from the line of Mark Connelly with Stephens Inc. Please go ahead.

**Mark Connelly**

Just a couple of things. How much of the additional saw milling capacity that's still to come in the south is in places where it's going to have a direct impact on you? My recollection is that we've already seen a pretty good portion of what's going to hit you directly, is that right?

**Devin Stockfish**

Yeah. I think as you think about the 5.5 billion board feet that are coming in, I would say we're good way down the path on that starting up operations, and it's differential as you mentioned by region. I think there are still a few mills that are coming in that will have an impact on us others less so. But generally speaking, we have operations in all major wood baskets. And so we may be a little bit more heavily weighted to some states versus the other, but there will be some impact really across the board in each of those new mills coming into place.

**Mark Connelly**

Okay. That's helpful. And just one last thing. Russell, you mentioned that buyers are still limiting inventory and we're clearly seeing that. Last quarter you characterized the inventory level as fairly normal. Would you still say it's relatively normal or is it starting to get lower?

**Devin Stockfish**

Yeah. Just to clarify, are you talking about within the Wood Products channel?

**Mark Connelly**

Yeah, yeah. Sorry, sorry. Yeah.

**Devin Stockfish**

Yeah. I would say that they are still relatively lean across the system and that's true for lumber OSB and EWP.

**Mark Connelly**

Super. Thank you.

**Devin Stockfish**

Thank you.

**Operator**

Your next question is from the line of Chip Dillon with Vertical Research Partners. Please go ahead.

**Chip Dillon**

Yes, good morning Devin, Russell and Beth. Thanks for all the details.

**Devin Stockfish**

Good morning.

**Chip Dillon**

First question is -- I will say that our base case is that the Wood Products business will certainly not be as good as it was last year, but better than this year, next year and that should allow you to pretty much cover your dividend just with cash flow. But I am encouraged and just want to make sure I'm on the right path. It's about $1 billion a year at the current rate, and it looks like if I'm doing my numbers right that you are probably three quarters of the way there not that this is how we should look at it, but with the Michigan sale, the last tranche of the variable entity payment next year that gives us $302 million. You mentioned $90 million I think you're looking for from 2018 in terms of a tax refund. So I add that up, and I'm in the $700 million range. My question is what is the refund that you're looking to get for the overpayment this year?

**Russell Hagen**

For this overpayment, it's about $40 million to $45 million.

**Chip Dillon**

Okay. And I take it, the path, I just went down is the right way to look at things that. You're looking at north of $700 million of inflows from all these activities?

**Russell Hagen**

Yes. It's correct.

**Chip Dillon**

Okay, all right. That's helpful. And then just shifting gears, I noticed two of the businesses that six, seven years ago that seem to really be struggling had -- basically were the bright spots of the quarter from one I can tell, and that of course would be the distribution business and especially engineered wood products. And I didn't know if there is anything unusual in this quarter or if we should sort of hang our hat on how well these businesses are performing? I note that both can receive certain cost benefits from the timing of raw material changes. So, I didn't know, for example, the low OSB prices were boosting EWP unusually and maybe the same in distribution if you had inventory gains?

**Devin Stockfish**

Yeah. I would say there is always a minor benefit when OSB prices go down to our EWP business, because the web stock is one of the products that goes into the end-use. But I would say at a higher level, this is the case really across all of our manufacturing businesses. We have been doing a lot of work to improve our operating performance and to improve our cost structure, and that's true in EWP. It's true in our distribution business. And although we've seen product pricing a bit challenging this year, I would say that's equally true for lumber and OSB. These businesses are operating as well as they ever have, and that has been a really important focus for us in our overall business strategy.

And so, you're seeing that now. I think as we alluded to earlier, when the businesses are operating well and we're continuing to prove -- improve every day. When we do see an uptick in the housing activity and the commodity prices, we're really well positioned to generate a lot of value from these assets.

**Chip Dillon**

Great. Thank you very much.

**Devin Stockfish**

Thank you.

**Operator**

Your next question is from the line of Steve Chercover with Davidson. Please go ahead.

**Steve Chercover**

Thanks. Good morning, everyone.

**Devin Stockfish**

Good morning.

**Steve Chercover**

Just a quick one on OSB. I mean I have a sense that your system is low cost, and I'm just wondering is that due to your fiber baskets in which you operate, the equipment or maybe the proximity to markets? And I understand that you are making some premium products.

**Devin Stockfish**

Yeah. What I would really attribute that to you is all of the work that we've done to improve efficiencies, improve recovery, the operating performance, the continued focus on cost generally. I mean amongst our various manufacturing assets, some are maybe a little bit better located relative to fiber than others. I wouldn't say that in and of itself is the key driver, it's really just been the continued focus on improving our operations and keeping a very tight control on cost. And that ultimately has been the big driver for us.

**Steven Chercover**

Okay. And then in honor of the World Series, I've got a curveball for you. And it does kind of center on control. So in Oregon you have an office manager who stole $4.5 million from you over 15 years. And I assume it's an isolated incident. But are you putting in safeguards to ensure that this can't happen again?

**Devin Stockfish**

Yeah. Well as you can imagine, this case is currently under criminal investigation by the U.S. Attorney. So there is a limited amount we can really comment on. But what I would say is, it's very disappointing.

The employee obviously no longer works for us. We've instituted appropriate controls to ensure that this doesn't happen again. And so, that's really what we can say there, very disappointing situation.

**Steven Chercover**

Okay, thanks a lot.

**Devin Stockfish**

Yeah. Thank you.

**Operator**

Today's final question will come from the line of Paul Quinn with RBC Capital Markets. Please go ahead.

**Paul Quinn**

Yeah thanks and good morning guys.

**Devin Stockfish**

Good morning.

**Paul Quinn**

Just a question on U.S. South log pricing, and Devin you mentioned that the 5.5 billion board feet of lumber capacity adds. When I take a look at WWPA data on South production, over the last 5.5 years, it's kind of up 3.5 billion board feet. So, just wondering where that disconnect?

Is that two billion, expected to come over the next couple of years? And what's your -- Weyerhaeuser has done a number of upgrades. What I'm hearing from other companies is that, it's taking longer in the sawmill ramp ups to get to the design capacity. Have you experienced the same thing?

**Devin Stockfish**

Yeah. You know I think the important thing to remember on that, 5.5 billion is that announced capacity. And so that's just been coming in tranches over the last several years. And we still have a little bit left to go.

And to your point, once you actually commission a sawmill to the point where it's running full, and you start adding the second shift that's a process that can take six to 12 months frankly.

And so, we've seen certain of our competitors that have put in mills. And it can take a little longer at times. I will say for our two mills in particular Millport and Dierks, we've actually done a really nice job in getting those mills up the start-up curve.

Ultimately that will add around 300 million board feet of incremental capacity to those two mills. And so, it's a complex process to get mills up and running, after you get them started. And really get them fully operational. And that does take some time.

But we're confident that all of that, 5.5 billion is ultimately going to come in. This is one of the best wood baskets to manufacture lumber certainly in North America, if not the world. And so, we think that's going to continue to happen here in the near-term.

**Paul Quinn**

All right, best of luck. Thanks.

**Devin Stockfish**

All right, thank you.

**Devin Stockfish**

All right, well I think that was the last question. So I'll just say thanks to everyone for joining us this morning. And thank you for your interest in Weyerhaeuser. And have a great day.

**Operator**

Ladies and gentlemen, this does conclude the Weyerhaeuser Third Quarter 2019 Earnings Conference Call. Thank you for your participation. You may now disconnect.