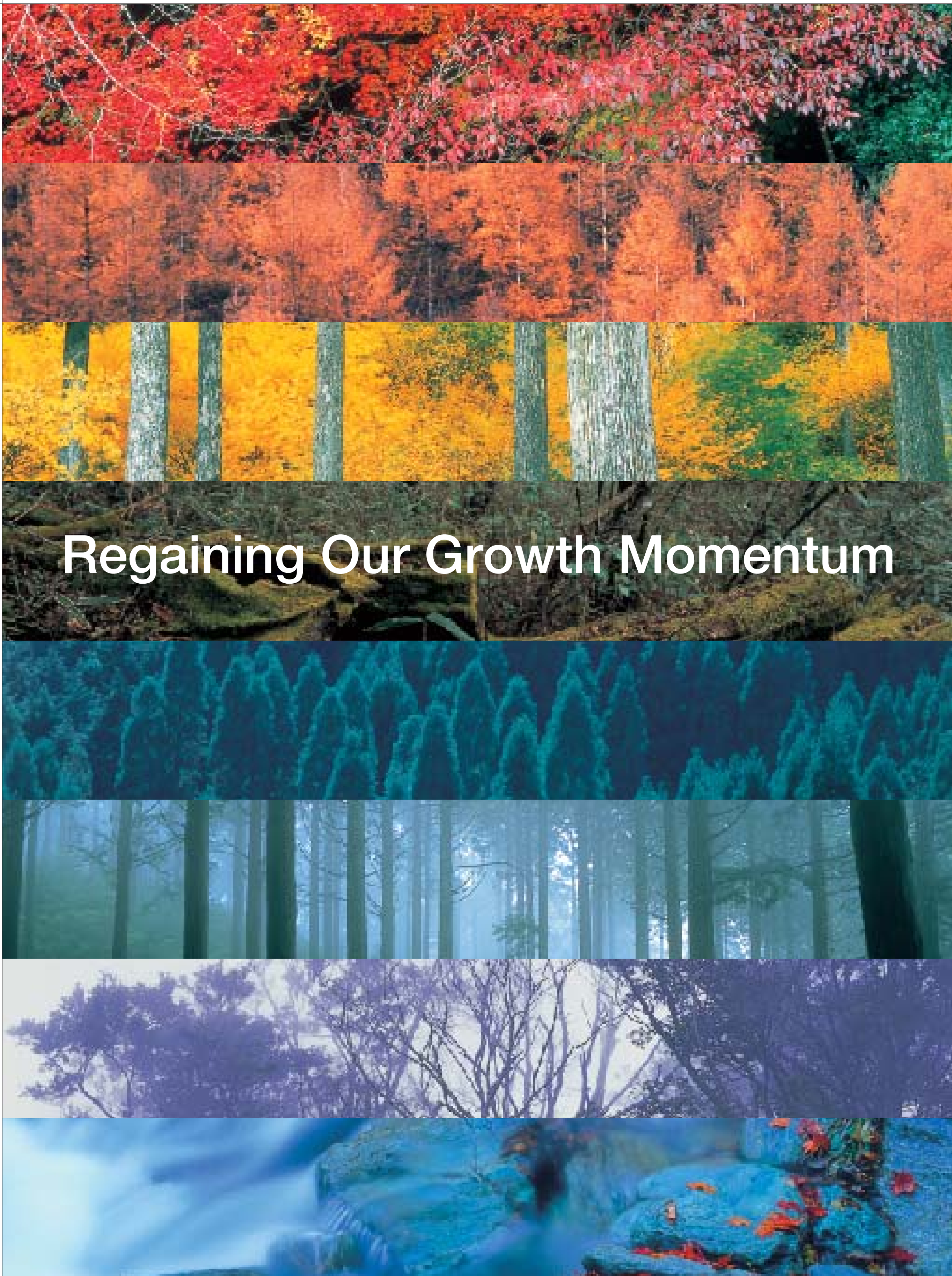
Annual Report 2004

Year Ended March 31, 2004



SUMITOMO FORESTRY CO.,LTD.

Profile

Since its establishment in 1691, Sumitomo Forestry Co., Ltd. has accumulated a rich knowledge of wood and wood products based on an underlying business philosophy of sustainable forestry. Over the centuries, we have extended our activities to a wide variety of timber-related businesses from upstream to downstream, including forestry, supplying and manufacturing timber and building materials, housing and housing-related businesses, and the environmental conservation activities. Focusing today on the housing business, we offer a broad range of products and services suited to individual customer lifestyles, drawing both on our proprietary know-how and on synergies deriving from the various strengths of the Sumitomo Forestry Group. In all of our activities, we strive to contribute to society and maximize our corporate value.

Contents

Forward-Looking Statements
Statements in this annual report with respect to Sumitomo Forestry's plans, strategies, and objectives as well as other statements that are not historical facts are forward-looking statements, based on management's assumptions and beliefs formed in the light of information available as of the production of this report. Actual results may differ from those discussed in these forward-looking statements owing to the impact of various factors, including but not limited to changes in the business environment, general economic conditions, and customer preferences.

The front cover is designed using pictures of Sumitomo Forestry-ownd forests.

Financial Highlights

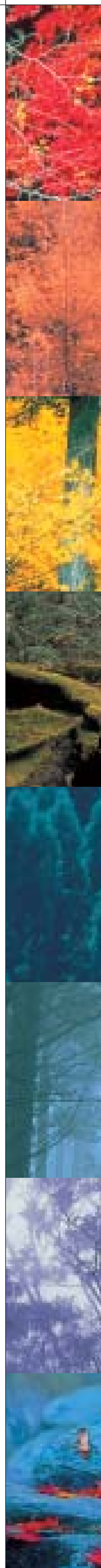
Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries
Years ended March 31

	Millions of yen (Unless otherwise specified)					Thousands of U.S. dollars*1 (Unless otherwise specified)
	2004	2003	2002	2001	2000	2004
For the year:						
Net sales and contract revenues	¥673,778	¥645,100	¥644,730	¥682,375	¥699,594	$6,356,396
Operating income	17,576	8,772	3,040	15,999	13,549	165,811
Recurring income*2	17,073	9,721	3,731	16,908	12,541	161,066
Net income (loss)	9,869	(15,439)	465	6,994	5,708	93,103
At year-end:						
Total assets	369,754	357,322	365,531	371,102	360,935	3,488,245
Total interest-bearing debt	19,928	16,497	18,124	24,517	35,720	188,000
Total Shareholders' equity	146,268	129,727	147,440	150,979	144,914	1,379,886
Per share:	Yen					U.S. dollars*1
Net income (loss)	¥ 55.81	¥ (87.53)	¥ 2.64	¥ 39.64	¥ 32.36	$ 0.52
Shareholders' equity	830.50	736.42	835.07	854.91	821.61	7.83
Cash dividends	13.00	10.00	10.00	10.00	10.00	0.12
Ratio:						
Operating income margin	2.6%	1.4%	0.5%	2.3%	1.9%	—
Return on equity (ROE)*3	7.2%	(11.1%)	0.3%	4.7%	4.0%	—
Shareholders' equity ratio	39.6%	36.3%	40.3%	40.7%	40.1%	—

*1: The Japanese yen amounts for the year ended March 31, 2004 have been translated into U.S. dollar amounts, for the reader's convenience only, at the rate of ¥106.00=U.S.$1.00.

*2: Recurring income = operating income + non-operating income - non-operating expenses
Major non-operating income includes interest income, purchase discounts, dividends income, exchange gains, miscellaneous gains, and other income generated from normal business activity. Major non-operating expenses include interest expense, sales discounts, loss on devaluation of property, plant and equipment, exchange losses, miscellaneous expenses, and other expenses from normal business activity.

*3: ROE is calculated using the simple average of beginning and end of term balance sheet figures.



To Our Shareholders and Customers

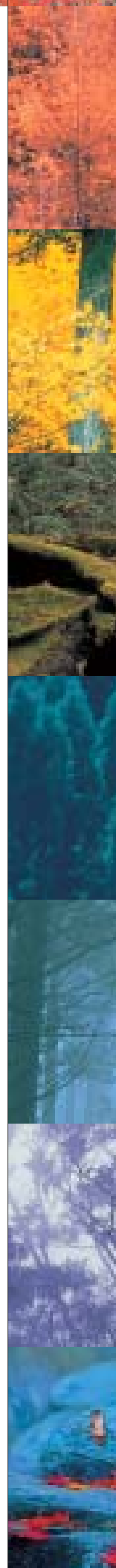
Ryu Yano
President and Chief Executive Officer

Business Environment in Fiscal 2004 (April 2003-March 2004)

In fiscal 2004, ended March 31, 2004, the Japanese economy showed signs of recovery, with real GDP growing for the second consecutive year. It is likely to be some time, however, before clear improvements in employment conditions and personal spending emerge, providing a full sense of recovery.

The housing industry benefited from the expiration of a housing loan-related tax break tentatively set for at the end of December 2003, which sparked a surge in home purchases. For the fiscal period as a whole, however, consumer demand for housing remained lackluster amid lingering concerns about job and household income stability. The number of new housing starts during the period improved 2.5% year on year, to 1,173 thousand units. Of this total, owner-occupied housing starts were up 2.1%, to 373 thousand units. While this marked the first increase in four years for both of these statistics, the growth was at a low level. The timber and building materials markets, on the other hand, remained relatively robust. Although we saw a few negative factors, including temporary weakness prior to the amendment of the Building Standards Law effective July 2003 as well as a spike in maritime freight costs, these were more than offset by such positive factors as the aforementioned surge in home purchases related to the planned expiration of a housing-related tax break and steady expansion in the home remodeling market.

Fiscal 2004 Consolidated Business Results: Healthy Increase in Sales and Sharp Rise in Profitability



In this business environment, Sumitomo Forestry's net sales and contract revenues increased 4.4% compared with the previous fiscal year, to ¥673.8 billion. Looking at results by segment, sales and contract revenues of the Housing and Housing-Related Businesses segment were up 6.4%, to ¥393.5 billion. This segment was able to achieve a sales increase thanks largely to two factors: additional sales resulting from the consolidation of Sun Step Co., Ltd., and a strong performance by consolidated subsidiary Sumitomo Forestry Home Tech. Co., Ltd., stemming from improved home remodeling demand. In the Timber and Building Materials segment, sales rose 4.1% year on year, to ¥277.0 billion.

Operating income surged to ¥17.6 billion, a 100.4% increase over the previous fiscal year. Recurring income similarly expanded, reaching ¥17.1 billion, a 75.6% rise and a new five-year high, exceeding the ¥16.9 billion recorded in fiscal 2001. This strong performance was attributable to a ¥7.2 billion reduction in housing production costs, well over our initial target of ¥5.0 billion, as well as to higher income at some subsidiaries. Since April 2002, the Company has focused on streamlining housing production costs and reducing selling, general and administrative (SG&A) expenses. Our cost-reduction efforts bore fruit during the period: the cost-to-sales ratio declined 0.9 percentage point year on year and the SG&A ratio showed a 0.3-percentage-point contraction.

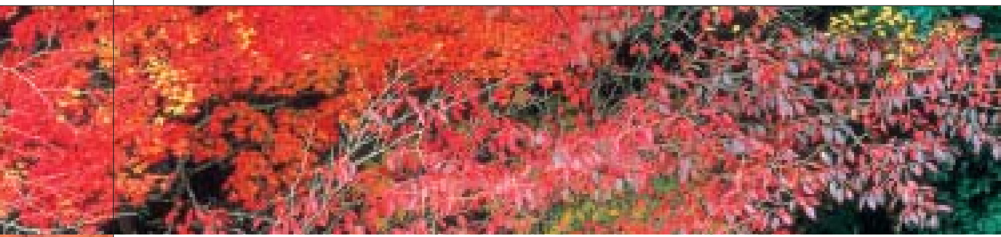
A revision to the retirement benefits accounting system, which reduced employees' retirement benefit obligations, coupled with an improved investing environment for our pension funds, enabled us to post an extraordinary gain of ¥13.9 billion for the fiscal year under review. At the same time, we posted extraordinary losses of ¥5.9 billion mainly owing to our advanced application of fixed asset impairment accounting. As a result, net income for the period was ¥9.8 billion, up ¥25.3 billion over the previous year, when we declared a significant extraordinary loss in an effort to improve our financial position. We raised cash dividends per share for the full fiscal year to ¥13.0, compared with ¥10.0 for fiscal 2003. While still maintaining our conventional stance not to fluctuate cash dividends, from fiscal 2004 we started to more widely reflect profitability achievement of the year in determinatioon of cash dividens.

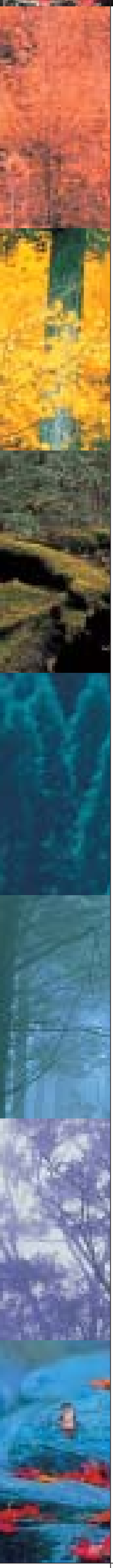
In addition to implementing measures aimed at improving profitability, we continued efforts designed to further buttress our financial position and reduce its susceptibility to changes in the economic environment. Specifically, we introduced cash balance pension plans whereby the balance of retirement benefits and pensions varies in line with market interest rates, effectively reducing employees' retirement benefit obligations. As a result, accrued employees' retirement benefit obligations declined ¥12.7 billion.

As part of our three-year Management Restructuring Plan, we reformed our personnel system during fiscal 2004 by adopting a job grading system, following on the previous fiscal year's introduction of an executive officer system. These consecutive reforms were implemented with the aims of accelerating the business decision-making process and clarifying business responsibility as well as enhancing each employee's awareness of his or her specific job-related objectives and performance, in line with our goal of building an organization capable of continuous improvements in business performance. We believe that these reforms have succeeded in fostering a spirit of innovation among all employees of Sumitomo Forestry. To ensure the Group's success in the competitive housing-related market and to attain the firm position as an excellent company, I believe that each member of the Group must enthusiastically implement his or her assignment with a spirit of innovation and thus be a driving force for positive change.

Outlook for Fiscal 2005: Implementing Both "Defense and Offense" Strategies

In fiscal 2005, ending March 31, 2005, we are focusing not





only on ensuring the accomplishment of the current Management Restructuring Plan, but also on gaining a footing for aggressive business development starting from fiscal 2006. Against the backdrop of Japan's increasingly aging society, the number of new housing starts is expected to remain flat at the one-million-unit level per year. In other words, we cannot expect any further quantitative expansion of the domestic housing market. Considering the reality of this mature market, we are committed to continue steady improvements in our profit margin and develop new markets to achieve further growth.

Regarding the enhancement of profitability, our intention is to continue to reform our profit structure so that we are able to realize steady earnings on our current annual sales level of 10,000 housing units. We aim to cut our housing production costs by ¥4.5 billion in fiscal 2005, thereby achieving a ¥16.4 billion cumulative cost cut during the Plan's three-year period, exceeding our original target by ¥1.4 billion.

In terms of developing new markets, we are accelerating activities directed at three new core businesses: collective housing business, housing stock business, and overseas operations. These will be our new footholds in growth from fiscal 2006. At the same time, we are making strategic investments to reinforce existing core businesses.

Strategies for Existing Core Businesses

In Housing and Housing-Related Businesses, we are strengthening our operations by more thoroughly incorporating our customer-first policy. For example, this is embodied in such services as our Long Support System, introduced in fiscal 2003, which guarantees customer support for 60 years from the time of a home purchase. In our product development activities, we will upgrade our portfolio of unique, quality offerings and further explore the potential of wooden houses in order to better meet diversifying and sophisticated customer needs. Our key marketing strategy is to expand housing orders in major urban areas. Accordingly, we are redoubling our marketing efforts in major cities, with a specific goal of gaining the No. 1 position among providers of owner-occupied housing in the Tokyo metropolitan area. To achieve this goal, we focus on increasing and reconstructing our model-home displays, buttressing our sales force, and intensifying advertising and other promotional activities.

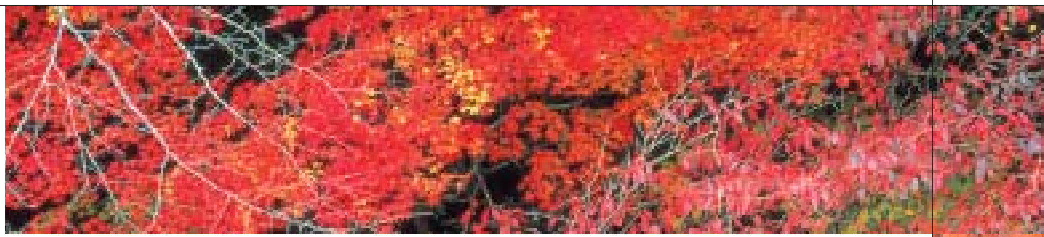
Regarding Timber and Building Materials businesses, we established the Business Administrative Division within the Business Headquarters in April 2004 with the goal of revamping our marketing strategies in response to the recent market reorganization. Amid an accelerating industry-wide reshuffle, we intend to take this opportunity as the market leader to further expand our business capacity and strengthen our business foundations by leveraging business and capital partnerships and opening up new sales channels via strategic M&A activities.

Fostering New Core Businesses

By intensively allocating management resources to our three new core businesses of collective housing, housing stock, and overseas operations, our Group is working to nurture its next generation of earnings drivers.

In the collective housing business, we recently purchased 63% of the outstanding shares of Sun Step Co., Ltd., Japan's ninth largest rental property management company with approximately 20,000 rental housing units under management. This acquisition has enabled us to offer integrated services ranging from construction to rental management. At the same time, it has expanded our marketing and sales capacities. We are advancing fully into the collective housing market, which continues to show stable growth especially in urban areas, by applying our design expertise to the creation of high-value-added collective housing. To support our forward advance, we are fostering personnel with strong consulting capabilities on land use while at the same time strengthening our information-gathering capacity, another key to success in this business.

The home remodeling business, a component of the housing stock business, has been on an upward trend in recent years, reflecting both the protracted period of deflation and the increasing longevity of existing housing stock. The



home remodeling market is expected to grow to a size of ¥10 trillion annually by 2020. Sumitomo Forestry Home Tech. Co., Ltd., our subsidiary in charge of this business, has tripled the number of orders received to 9,207 over the last five years. Sumitomo Forestry Home Tech.'s sales figures have shown steady growth as well, reaching ¥20.9 billion in fiscal 2004, up 22% from ¥17,1 billion from the previous fiscal year. We have already established a nationwide sales network for the home remodeling business, nearly doubling the number of sales offices over the past five years, to 44. While we remain among the second-tier companies in the home remodeling industry, we are keenly focused on attaining a spot among the market leaders, whose sales are currently at the ¥30.0 billion level. To reach this goal as quickly as possible, we are capitalizing on our strengths in design and large-scale remodeling work, backed by an extremely high percentage of qualified architects among our sales personnel.

In the real estate brokerage business, the second component of our housing stock business, Sumitomo Forestry Home Service Co., Ltd. moved its headquarters from Osaka to Tokyo as the first step in rebuilding a new operational base in Japan's largest metropolitan market. In fiscal 2005, six sales offices will be added, bringing the total to 52 offices. Although the number of lease brokerage transactions has remained almost unchanged over the past five years, sales brokerage transactions have increased approximately 70% over the same period. In fiscal 2005, we intend to substantially increase our number of transactions in both the sales and lease brokerage businesses based on our reformed business infrastructure.

In overseas operations, we are expanding sales volume of wood-based panels and building materials, particularly in Pacific Rim countries, including Japan, where we are able to take full advantage of our overseas manufacturing bases. To accelerate expansion of our overseas operations, we established the International Business Headquarters in April 2004. For fiscal 2005, we aim to achieve a simple sum of recurring income of ¥1.3 billion at our overseas manufacturing subsidiaries and affiliates by revamping production processes and strengthening marketing capacity. In addition to the manufacture of wood-based panels and building materials, we will move ahead to establish a full-scale operation in the overseas housing business. Our pilot North American Housing Project, which kicked off in autumn 2002 in the suburbs of Seattle, Washington, reached a successful completion in fiscal 2004 paving the way for the commencement of marketing of built-for-sale houses. Meanwhile, we have started drawing up a business strategy for the Chinese market. We are, thus, expanding our overseas activities in terms of both business fields and geographic areas.

Maximizing Our Corporate Value

For the past two years, we have focused on strengthening our overall earnings power and business foundations by substantially reducing housing production and SG&A costs and by launching high-value-added products and services. Now, we are turning our sights to more aggressive business development. Our strategies moving forward will be based on further implementing our customer-first policy and enhancing the brand value of Sumitomo Forestry's Home by emphasizing those attributes that differentiate us from the competition. By carrying out these strategies, we intend to create a win-win business model whereby we provide highly comfortable housing and personalized services to our customers, and competitive investment value to our shareholders. It is my hope that you have gained a clearer picture of our business strategies. I thank you sincerely for your understanding and support of our business activities to date, and I humbly request your continued support as Sumitomo Forestry moves into the future.

Ryu Yano

Ryu Yano
President and Chief Executive Officer

Three-Year Management Restructuring Plan Covering Fiscal 2003 - Fiscal 2005

To increase its earnings power amid an unfavorable business environment, the Sumitomo Forestry Group formulated a seven-point Management Restructuring Plan at the end of fiscal 2002. The Group's efforts in the last two years have yielded steady results. Of particular note is the fact that we reduced housing production costs by ¥4.7 billion in fiscal 2003, and in fiscal 2004 we achieved a ¥7.2 billion reduction, exceeding the annual target of a ¥5.0 billion reduction. In fiscal 2005, the final year of the Plan, we are striving to continue reducing housing production costs, and are working to strengthen our earnings structure further. In addition, in preparation for taking a more aggressive management stance in fiscal 2006 and beyond, we are endeavoring to accelerate the development of new core businesses as well as revamp our existing businesses.

State of Progress After Two Years

Item	State of Progress
1. Reforming the Management Structure	June 2002: Executive officer system introduced This move was intended to separate decision-making and supervisory functions from executive functions, strengthen supervisory functions on business execution, and clarify responsibility for business execution. June 2002: The Board of Directors reformed The number of directors was reduced from 18 to seven as a means of increasing the board's vitality and speeding up procedures.
2. Revamping the Headquarters Organization	April 2002: Budget and earnings management duties of Finance and Accounting Division transferred to Corporate Planning Division This created a system for setting policy in a unified manner, from basic budget allocation policy to earnings management and IR policy. It also strengthened the headquarters' strategy formation capabilities and business division supervisory and control functions. April 2002: Risk Management Committee established December 2002: Compliance Counter* established
3. Reducing Housing Production Costs	Working to reduce housing production costs by maximizing cost management and streamlining construction processes, with a goal to lower costs by ¥5.0 billion per year and ¥15.0 billion over three years. • Costs decreased by ¥4.7 billion in fiscal 2003 and ¥7.2 billion in fiscal 2004. • Operating income margin increased from 1.4% in fiscal 2002 to 2.6% in fiscal 2004. • We plan to lower costs by ¥4.5 billion in fiscal 2005, which would result in a three-year reduction of ¥16.4 billion.
4. Reducing Operating Expenses	Endeavoring to streamline SG&A expenses at the parent company. • We introduced a cash balance plan, in which retirement benefits and pension funds earn in line with market interest rates, thereby reducing interest rate risk. • We worked to minimize the risk related to personnel expenses by revising our personnel system and introducing a job grade system. • We increased the efficiency of ordering and billing operations by introducing the Rakutto web-based EDI system.
5. Strengthening of Housing Product Development	Striving to enhance our responsiveness to changes in the operating environment and customer needs and to accurately reflect customer preferences in the development of new products. April 2002: Product Development Division established August 2002: Rialt launched, aiming at first-time homebuyers in their 20s and 30s (The Rialt has grown into a hit product, accounting for 44% of total housing orders in fiscal 2004) Strategic products introduced, bringing out the best in characteristics of wood —Super Natural Teak launched in fiscal 2004, as part of the Super Natural series which has introduced a new product once a year since fiscal 2003.
6. Strengthening of the Collective Housing Business	Working to establish a system for flexibly providing solutions matching construction site conditions including the selection of construction method (reinforced concrete structures or the two-by-four). We are also working to differentiate our products and strengthen our marketing capabilities. August 2003: Sun Step Co., Ltd., a real estate rental management company acquired. By integrating rental management and marketing, we intend to increase orders. We are also pursuing synergies such as referral business and product development that incorporates customer data. November 2003: Satellite offices established inside or close to the branch offices of our Housing Headquarters. By enabling a close exchange of customer data with the Housing Headquarters, we intend to increase business information volume and orders.
7. Accelerating the Development of New Core Businesses	Focusing on increasing the profitability of overseas operations and housing stock operations, which we view as core next-generation businesses together with the collective housing business. • An Australian MDF manufacturing company acquired • Housing business launched in North America. • A feasibility study in preparation for entering the Chinese market started • Number of business offices increased in our remodeling business and our real estate brokerage business — Remodeling: From 34 offices in fiscal 2002 to 44 in fiscal 2004 — Real estate: From 43 offices in fiscal 2002 to 46 in fiscal 2004 (and an increase to 52 planned for fiscal 2005).

* Compliance Counter serves as the primary contact point for employees reporting illegal acts and ethical misconducts without violating their privacy.

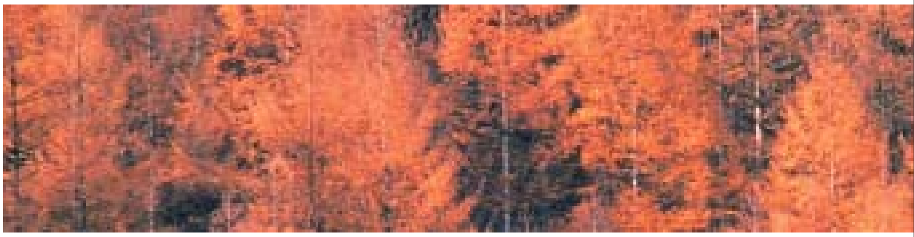
Progress in Strengthening Our Earnings Structure

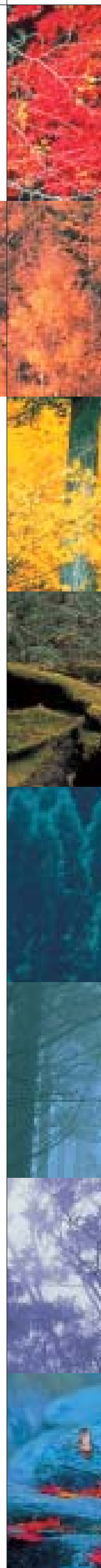
Housing Production Cost Reduction

With strengthening our profitability as a top priority, the Plan calls for housing production costs to be reduced ¥5.0 billion annually and ¥15.0 billion over the three years of the Plan.

Even by using pre-cut components, the post-and-beam architectural method still has the disadvantage of taking more effort and time compared to prefabricated home construction. With the goal of reducing the average construction period by ten days and housing production costs by 10%, we launched the Network Aided Construction Support System (NACSS) on a nationwide basis in May 2002. NACSS makes our housing production more efficient through management of construction processes on a daily basis.

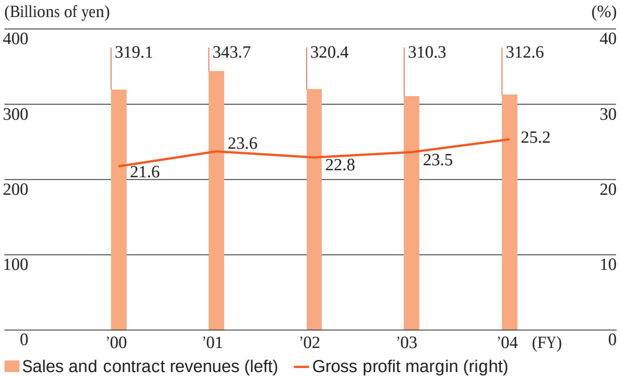
NACSS enables integrated management of data from the more than a dozen companies that typically are involved in the construction process of a house, including data on the type of work being carried out and the status of various processes. NACSS sends an e-mail to the cellular phones of each construction chief to confirm the progress of work and details about the job, and based on their feedback we plan the next phase of work and order the necessary components. This enables work to be carried out far more efficiently.



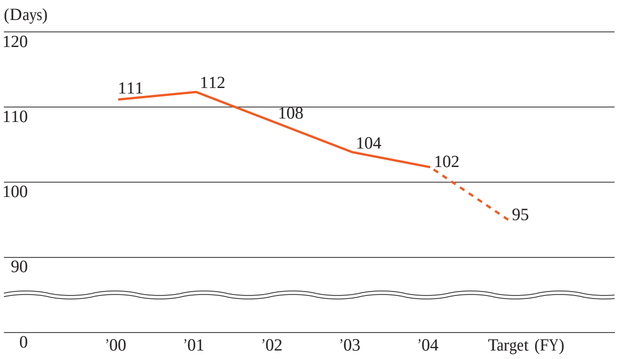


In fiscal 2001 the average construction period was 112 days, but this has been reduced to 102 days at present, and we intend to lower this further to 95 days. We lowered housing production costs by ¥4.7 billion in fiscal 2003, the initial year of the Plan, and by an additional ¥7.2 billion in fiscal 2004, exceeding the annual target of ¥5.0 billion. As a result, we have been able to reward customers by offering better products without raising prices, and at the same time have increased our gross profit margin of Housing and Housing-Related Businesses segment by 2.4 percentage points from fiscal 2002. We plan to lower housing production costs by another ¥4.5 billion in fiscal 2005, which would result in a three-year reduction of ¥16.4 billion, exceeding the target for the three-year period by ¥1.4 billion.

Sales and Contract Revenues and Gross Profit Margin
(Housing and Housing-Related Businesses, Non-Consolidated)



Average Construction Period Per Cutom-Built House



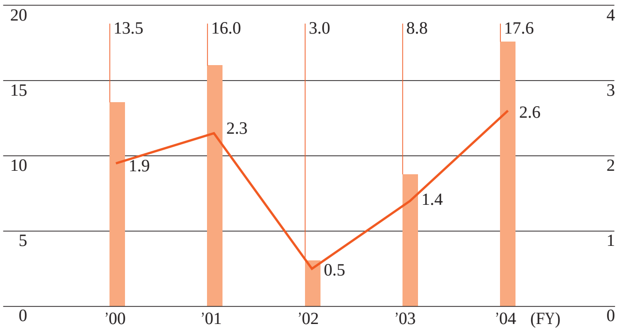
Operating Expense Reduction

In fiscal 2004, we were able to reduce non-consolidated sales, general and administrative (SG&A) expenses by ¥1.4 billion year on year by controlling expenses related to rent, sales, and advertising and promotion. Although SG&A expenses increased by ¥2.3 billion at the consolidated level, this was in line with our initial projections because of the planned investments in new core businesses and in newly consolidated subsidiaries. Indeed, we were able to steadily reduce both the cost of sales and daily expenses, achieving on operating income margin of 2.6% in fiscal 2004 with an improvement of 2.1 percentage points from fiscal 2002. As a result of strengthening the earnings structures of all Group companies, in fiscal 2004 we recorded consolidated operating income of ¥17,576 million, an increased of 478.2% from fiscal 2002, and return on equity (ROE) recovered to 7.2%.

In fiscal 2005, the final year of the Plan, we will endeavor to manage our financial resources from both a "defensive" and an "offensive" perspective. We not only continue to strengthen our existing business base, but have embarked

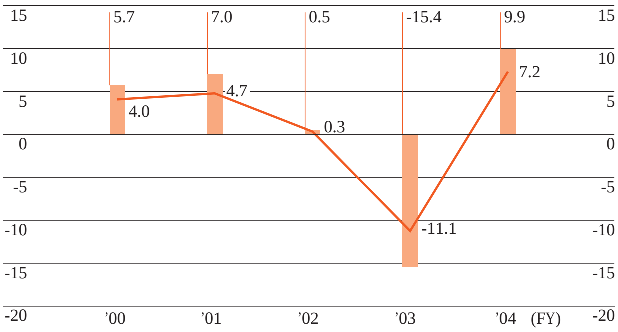
on preparations for a major leap forward in fiscal 2006 and beyond. We will carry out measures to increase house orders in the Tokyo metropolitan area and pursue policies aimed at developing our new core businesses (the collective

Operating Income and Operating Income Margin



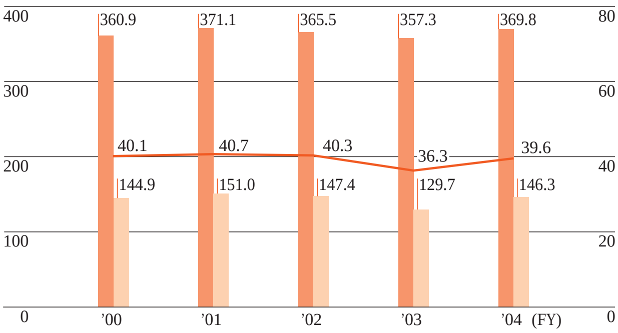
Operating income (left) — Oprating income margin (right)

Net Income (Loss) and ROE



Net income (left) — ROE (right)

Total Assets, Total Shareholders' Equity, and Shareholders' Equity Ratio



Total assets (left) Total shareholders' equity (left)
— Shareholders' equity ratio (right)

housing business, the housing stock business, and overseas operations). For that reason, we plan to increase strategic spending aimed at expanding operations and we expect consolidated SG&A expenses to increase ¥3.8 billion year on year in fiscal 2005.

Progress in Fortifying Our Financial Structure

To cope with uncertainties in the business environment and to further strengthen our corporate structure, we must fortify our financial structure while improving profitability. It is thus essential that we get rid of any burdensome underperforming assets, and since fiscal 2003 we have taken a number of steps to improve our balance sheet.

In fiscal 2003, we altered our accounting policies and began to write off pension accounting-related actuarial differences in the fiscal year that they arise, rather than amortizing them. Also in fiscal 2003, we returned the substitution portion of welfare pension funds previously managed on behalf of the government, lowered the discount rate used in calculating pension benefit obligations, and established a system for reducing the pension burden over the long term. In conjunction with this, we decided to post valuation losses on real estate for sale, idle real estate, and investment securities. As a result, we booked ¥38.8 billion in extraordinary losses in fiscal 2003.

In fiscal 2004, we introduced a cash balance plan, in which retirement benefits and pension funds earn in line with market interest rates, thereby reducing our retirement benefit obligations and creating a system that is less vulnerable to changes in interest rates. In addition, we opted for early adoption of fixed-asset impairment accounting, and recorded an impairment loss of around ¥5.5 billion, primarily on golf courses.

Owing to the large extraordinary losses resulting from these measures, shareholders' equity declined sharply in fiscal 2003, and the term-end shareholders' equity ratio fell to 36.3%, from 40.3% at the end of fiscal 2002. However, the shareholders' equity recovered to 39.6% at the end of fiscal 2004, or nearly to where it was at the end of fiscal 2002. Going forward, we intend to increase profits sharply, thereby enhancing shareholders' equity.