

# FINANCIAL SECTION

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# TEN-YEAR SUMMARY

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

	Millions of yen (Unless otherwise specified)		
	2006	2005	2004
<b>Operating Results:</b>			
Net sales and contract revenues	¥ 791,128	¥ 723,193	¥ 673,779
Timber and building materials Business*1	412,182	320,255	293,220
Housing and Housing-Related Businesses*1	393,868	418,313	393,616
Other Businesses	13,549	13,185	12,350
Elimination and/or corporate	(28,471)	(28,560)	(25,408)
Gross profit	127,853	125,582	120,778
Selling, general and administrative expenses	112,407	107,116	103,201
Operating income	15,446	18,466	17,577
Timber and building materials Business*1	2,806	4,615	3,813
Housing and Housing-Related Businesses*1	16,370	17,530	17,150
Other Businesses	841	738	644
Elimination and/or corporate	(4,571)	(4,418)	(4,030)
Recurring income*2	16,800	18,692	17,074
Net income (loss)	10,842	8,014	9,870
<b>Financial Position:</b>			
Total assets	¥ 464,193	¥ 370,684	¥ 369,755
Working capital*3	68,037	67,579	66,377
Interest-bearing debt	22,067	15,580	19,929
Total shareholders' equity	175,206	152,500	146,269
<b>Cash Flows:</b>			
Cash flows from operating activities	¥ 16,626	¥ 6,685	¥ 25,962
Cash flows from investment activities	(8,998)	(12,895)	(7,646)
Cash flows from financing activities	(14,039)	(7,087)	(735)
Cash and cash equivalents at the end of the year	49,628	55,928	69,312
<b>Capital Investment:*4</b>			
Tangible fixed assets	¥ 8,132	¥ 7,016	¥ 4,040
Software	1,857	1,673	1,468
Others	454	549	883
Total	10,443	9,237	6,392
Depreciation and amortization	6,403	6,452	6,447
<b>Per Share Data:</b>			
		Yen	
Net income (loss)	¥ 61.28	¥ 45.3	¥ 55.8
Shareholders' equity	996.03	866.5	830.5
Cash dividends	13.00	13.00	13.00
<b>Financial Ratios:</b>			
		%	
Gross income margin	16.2	17.4	17.9
Operating income margin	2.0	2.6	2.6
Recurring income margin	2.1	2.6	2.5
Return on asset (ROA)*5	4.0	5.0	4.7
Return on equity (ROE)*5	6.6	5.4	7.2
Shareholders' equity ratio	37.7	41.1	39.6
Interest-bearing ratio*6	11.2	9.3	12.0
Current ratio	129.3	137.4	135.7
Interest coverage ratio [times]	10.8	18.6	21.9

Notes: 1.Starting in fiscal 2001, the profits from transactions in housing materials have been included in the Housing and Housing-Related segment; they were previously included in the Timber and Building Materials segment.

2.Recurring income = Operating income + Non-operating income - Non-operating expenses

Non-operating income includes interest income, purchase discounts, dividends income, exchange gains, miscellaneous gains, and other income generated from normal business activities. 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 activities.

Millions of yen (Unless otherwise specified)

2003	2002	2001	2000	1999	1998	1997
¥ 645,100	¥ 644,730	¥ 682,375	¥ 699,594	¥ 620,615	¥ 713,728	¥ 817,949
283,517	270,856	279,811	340,988	294,411	333,941	402,795
370,421	381,978	405,150	370,692	335,782	380,781	412,124
17,882	18,050	16,978	15,481	13,900	10,818	17,072
[26,721]	[26,154]	[19,565]	[27,568]	[23,480]	[11,812]	[14,043]
109,631	109,437	118,064	112,269	99,692	107,877	124,586
100,858	106,397	102,065	98,720	93,481	102,072	100,949
8,772	3,040	15,999	13,549	6,210	5,805	23,637
2,238	1,882	5,128	14,770	11,341	6,870	15,380
9,920	4,961	16,631	5,141	942	1,832	13,155
415	579	519	569	1,315	985	1,425
[3,802]	[4,384]	[6,279]	[6,933]	[7,388]	[3,882]	[6,324]
9,721	3,731	16,908	12,541	6,305	6,694	25,500
[15,439]	465	6,994	5,708	134	2,145	13,158
¥ 357,322	¥ 365,531	¥ 371,102	¥ 360,935	¥ 346,293	¥ 341,325	¥ 430,217
60,260	60,477	61,319	68,892	71,746	62,992	56,099
16,497	18,124	24,517	35,720	40,059	47,188	54,076
129,727	147,440	150,979	144,914	139,301	140,357	139,353
¥ 19,734	¥ 17,332	¥ 3,468	¥ [3,281]	¥ 26,715	¥ 9,561	¥ 20,946
2,026	[16,439]	[1,960]	[3,330]	2,068	[6,200]	2,952
[8,171]	[9,716]	[13,873]	[5,351]	[8,257]	[9,100]	1,597
52,029	38,873	47,476	59,916	71,971	51,302	57,090
¥ 2,761	¥ 7,705	¥ 4,448	¥ 4,373	¥ —	¥ —	¥ —
2,077	2,194	1,889	1,264	—	—	—
283	225	252	303	—	—	—
5,123	10,124	6,590	5,941	4,556	13,172	11,448
5,985	5,289	4,551	4,756	5,060	5,057	4,944
Yen						
¥ [87.5]	¥ 2.6	¥ 39.6	¥ 32.4	¥ 0.8	¥ 12.2	¥ 74.6
736.4	835.1	854.9	821.6	789.8	795.8	790.1
10.00	10.00	10.00	10.00	10.00	10.00	12.00
%						
17.0	17.0	17.3	16.0	16.1	15.1	15.2
1.4	0.5	2.3	1.9	1.0	0.8	2.9
1.5	0.6	2.5	1.8	1.0	0.9	3.1
2.7	1.0	4.6	3.5	1.8	1.7	6.2
[11.1]	0.3	4.7	4.0	0.1	1.5	9.8
36.3	40.3	40.7	40.1	40.2	41.1	32.4
11.3	10.9	14.0	19.8	22.3	25.2	28.0
132.6	131.8	131.1	137.7	141.6	137.4	121.0
18.3	7.8	22.6	18.6	5.8	4.3	17.5

3. Working capital = Current assets – Current liabilities

4. Disclosure of capital investment was not institutionalized prior to fiscal 2000, thus data for the first five years from fiscal 1995 are partly lacking.

5. ROA and ROE are calculated using the simple average of beginning and end of term balance sheet figures.

ROA = Recurring income / Total assets

ROE = Net income (loss) / Shareholders' equity

6. Interest-bearing debt ratio = Interest-bearing debt / (Interest-bearing debt + Shareholders' equity)

# MANAGEMENT'S DISCUSSION & ANALYSIS

## MARKET OVERVIEW

In the term ended March 2006, the Japanese economy staged a moderate recovery, showing increases in both corporate earnings and capital investment, which led to an improvement in employment conditions and an uptrend in personal income and consumption. However factors that cloud the future, such as soaring crude oil prices and concerns about a rise in interest rates, remained.

In the housing sector, thanks to the support of low interest rates, falling land prices and the strong propensity of first-time homebuyers to purchase homes, the number of new housing starts increased by 4.7% over the previous fiscal year to 1,249,000 units. However, owner-occupied housing starts declined by 4.0% to 352,000.

Throughout the year, Timber and Building Materials operated in an exceptionally harsh environment due to the sharp rise in the prices of raw timber and crude oil.

### Number of New Housing Starts in Japan



(Years ended March 31)

## CONSOLIDATED OPERATING RESULTS

### 1. Orders Received and Net Sales

Sales rose by 9.4% over the previous fiscal year to ¥791.128 billion. This is mainly due to the establishment of two consolidated subsidiaries in Timber and Building Materials Business. As for the Timber and Building Materials Distribution Business, we have made Ataka Kenzai Co., Ltd., our consolidated subsidiary to secure a new customer base and to enhance our line-up of products. As for the Building Materials Manufacturing Business, we have made Toyo Plywood Co., Ltd. our consolidated subsidiary to focus our management resources on the production of wood-based building materials. Orders for custom-built detached houses were disappointing, falling by 3.1% in terms of value to ¥286.519 billion and by 8.2% in terms of units to 9,251, due to the impact of the phasing out of housing mortgage tax breaks.

### 2. Selling, General and Administrative Expenses

Selling, general and administrative expenses amounted to ¥112.47 billion, a 4.9% increase. This rise was due to an aggressive expansion of business bases and personnel in Housing and Housing-Related Businesses for the purpose of expanding business fields, along with two special factors: (1) a ¥5.752 billion rise in expenses for the two new subsidiaries and (2) a ¥2.765 billion decline in the actuarial difference relating to retirement benefits accounting.

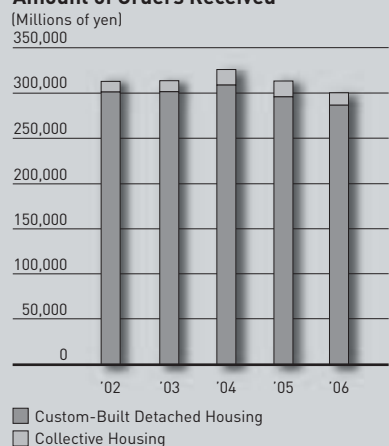
### 3. Operating Income

Owing to the above, operating income declined by 16.4% from the previous fiscal year to ¥15.446 billion. A breakdown by segment indicates that operating income declined in both of our core businesses: the Timber and Building Materials Business and the Housing and Housing-Related Businesses.

### 4. Non-Operating Income and Expenses and Recurring Income

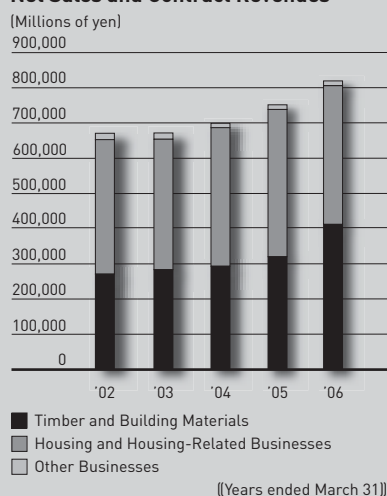
Non-operating income and expenses improved by ¥1.127 billion, due to the posting of insurance premium income. As a result, non-operating income and expenses scored a net profit of ¥1.353 billion and recurring income declined 10.1% to ¥16.8 billion.

### Amount of Orders Received



(Years ended March 31)

## Net Sales and Contract Revenues



## 5. Special Gains and Losses

Special gains and losses improved by ¥2.261 billion over the previous fiscal year, bringing the net loss in the current period to ¥765 million. The major reasons for this figure included a loss of ¥492 million from the sale of fixed assets that accompanied the liquidation of the wooden component housing business last term and a loss of ¥455 million from expenses associated with the integration of Ataka Kenzai Co., Ltd. Other significant factors were ¥229 million booked for business relocation profits.

## 6. Net Income

Net income rose by 35.3% to ¥10.842 billion. This is due to the partial withdrawal of deferred tax assets, which led to an increase in income taxes-deferred. On the other hand, we reported a tax loss due to completion of liquidation of a sales subsidiary in the wooden component housing business, and as a result, the corporate tax declined. Along with this, net income per share rose ¥16 to ¥61.28 and return on equity (ROE) increased 1.2 percentage points to 6.6%.

## SEGMENT INFORMATION

### 1. Timber and Building Materials Business

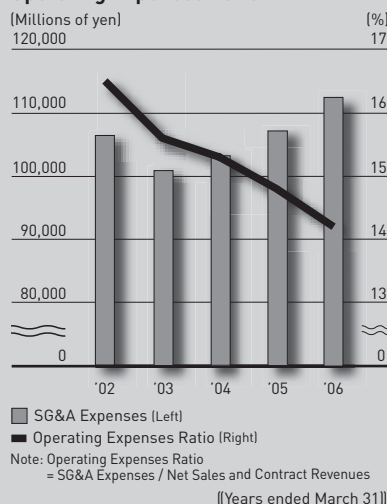
Net sales in Timber and Building Materials Business increased by 28.7% over the previous fiscal year to ¥412.182 billion and operating income fell 39.2% to ¥2.806 billion. As special factors, the consolidation of the two new subsidiaries contributed significantly to the increase in the sales (¥99.382 billion).

Although sales of timber declined due to the downturn in imported materials such as logs, brisk sales of panels and general building materials offset the slump in timber. However, operating income declined due to the downward pressure on profits applied by the soaring cost of raw materials borne by our various overseas production subsidiaries. As a result, revenue increased but profit decreased.

### 2. Housing and Housing-Related Businesses

Net sales for the Housing and Housing-Related Businesses declined by 5.8% over the previous fiscal year to ¥393.868 billion and operating income declined by 6.6% to ¥16.370 billion despite our efforts for aggressive expansion of personnel and business bases to boost sales competitiveness and expand business fields. The principal factors that led to this decline in profit were: (1) 5.2% decrease in units ordered due to the phasing-out of housing mortgage tax breaks and fierce competition, and (2) the extremely harsh environment for the collective housing business in the large-scale project market, where competition with major construction firms has intensified.

## SG&A Expenses and Operating Expenses Ratio



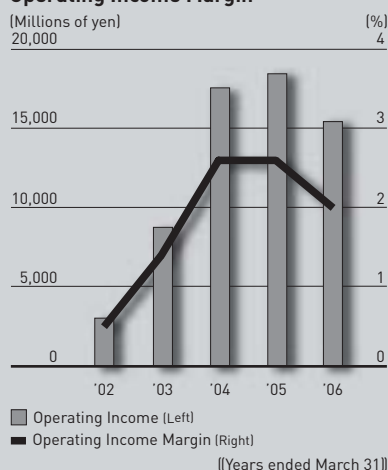
## Business Results by Segment

[[Years ended March 31]]

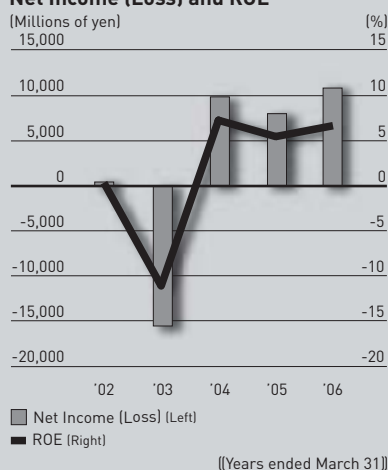
(Millions of yen)	Timber and Building Materials Business		Housing and Housing-Related Businesses		Other Businesses	
	2006	2005	2006	2005	2006	2005
Net sales	412,182	320,255	393,868	418,313	13,549	13,185
Operating income	2,806	4,615	16,370	17,530	841	738
Operating income margin	0.7%	1.4%	4.2%	4.2%	6.2%	5.6%

Note: The sales figures given above include intersegment transactions. Operating income figures include internal profit prior to the deduction of amounts such as intersegment transactions and headquarters expenses that are not apportionable.

### Operating Income and Operating Income Margin



### Net Income (Loss) and ROE



## FINANCIAL POSITION AND CASH FLOWS

### 1. Financial Position

Total assets at the end of fiscal 2006 increased ¥93.59 billion over the previous fiscal year to ¥464.193 billion. Current assets increased ¥52.365 billion to ¥300.431 billion and fixed assets increased by ¥41.143 billion to ¥163.761 billion. The major reason behind the increase of current assets was the growth in operating receivables associated with the recent establishment of new consolidated subsidiaries. The rise in fixed assets was primarily due to the increase in the market value of the capital holdings associated with the rebound of stock prices.

Total liabilities increased by ¥68.199 billion to ¥285.862 billion. Current liabilities increased by ¥51.907 billion to ¥232.394 billion due to the above mentioned growth in the operating receivables associated with the recent establishment of new consolidated subsidiaries. Long-term liabilities rose by ¥16.293 billion to ¥53.469 billion, mainly due to the increase in deferred tax assets accompanying a rise in the market value of capital holdings. The balance of interest-bearing debt rose by ¥6.487 billion to ¥22.067 billion.

Total shareholders' equity increased by ¥22.706 billion to ¥175.206 billion, due to the appreciation of marketable securities to ¥12.882 billion in addition to an increase in retained earnings.

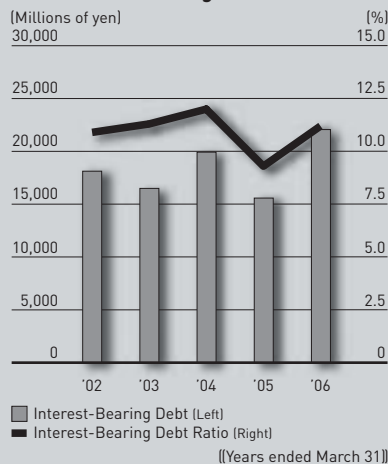
### 2. Cash Flows

Net cash provided by operating activities increased by ¥9.942 billion year on year to ¥16.626 billion. This net increase was due to factors including the decrease in construction fees paid up to the end of the term because there was no year-on-year growth in completions at the end of December from the effect of housing mortgage tax breaks and a decrease in the amount of corporate tax paid. Net cash used in investment activities increased by ¥3.897 billion to ¥8.998 billion. This was due to the acquisition of stock of Toyo Plywood Co., Ltd. and Ataka Kenzai Co., Ltd. and the purchase of land for commercial use and rental real estate by subsidiaries. Net cash used in financing activities increased by ¥6.952 billion to ¥14.039 billion. This was due to the payment of dividends and repayment of interest-bearing debt of subsidiaries. The balance of cash and cash equivalents at the end of the year totaled ¥49.628 billion, a ¥6.3 billion decrease compared with the previous fiscal year.

## BUSINESS RISK AND RISK MANAGEMENT

The business results of the Sumitomo Forestry Group are subject to fluctuations in interest rates, land prices and exchange rates and can be influenced by changes in the tax system and legal regulations in addition to market trends for housing, timber and building materials. The Group continually works to minimize these risks by (1) making ongoing improvements to product competitiveness; (2) cost reductions; (3) diversification of operating regions and business fields; and (4) the use of forward exchange contracts. It must be recognized, however, that we cannot completely avoid these risks.

### Interest-Bearing Debt and Interest-Bearing Debt Ratio



### 1. Fluctuations in Interest Rates, Land Prices, and Exchange Rates

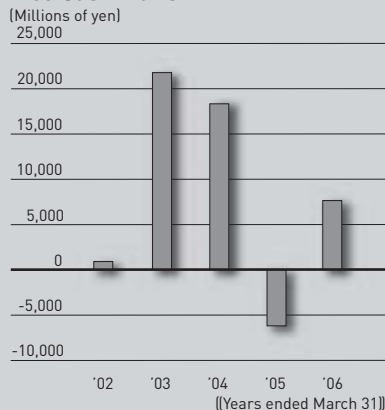
Interest rate increases, particularly long-term interest rates, can have an adverse effect on demand as they cause an increase in total payments for customers purchasing detached housing, many of whom take out loans for the purchase, and for customers who build collective housing for the effective use of their land. A forecasted rise in interest rates can result in a surge in home purchases as consumers seek to avoid high loan costs. This, however, may be followed by a backlash after the rush has ended. Rising land prices can have a negative effect on consumer appetite to purchase land; conversely, falling land prices can cause a decline in demand for home reconstruction as a result of asset deflation.

Exchange rate fluctuations can affect business results when production costs are temporarily influenced by them or when the currency of a country in which we manufacture products appreciates in relation to the currency of a country to which we export those products.

### 2. Changes in Tax Systems and Legal Regulations

Laws and regulations surrounding the housing business include the newly introduced Personal Information Protection Act, in addition to the Building Standards Law, Construction Industry Law, Building Lots and Building Transaction Business Law, Urban Planning Law, National Land Use Planning Law, Housing Quality Assurance Law, and Waste Disposal and Public Cleaning Law (laws concerning the procedures for waste disposal and site clean-up). These laws and regulations can substantially influence product content and construction methods. There is the possibility that the business results of the Sumitomo Forestry Group might be substantially affected in the event of the abolition, revision and enactment of laws and regulations. Moreover, changes in mortgage tax breaks and consumption tax rates have a significant effect on fluctuations in orders for the Sumitomo Forestry Group.

### Free Cash Flows



# CONSOLIDATED BALANCE SHEETS

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
As of March 31, 2006 and 2005

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
<b>Current assets:</b>			
Cash and time deposits (Note 11)	¥ 44,720	¥ 25,188	\$ 378,986
Marketable securities (Note 5)	5,000	31,045	42,372
Receivables—			
Notes and accounts, trade	138,260	90,321	1,171,692
Loans and other	51,226	46,638	434,121
Inventories—			
Finished goods, logs and lumber	22,413	19,757	189,940
Developed land and housing for sale	10,071	10,775	85,345
Land and housing projects in progress	15,628	14,171	132,443
Deferred income taxes (Note 8)	7,597	8,513	64,381
Other current assets	6,429	2,349	54,489
Allowance for doubtful accounts	(913)	(692)	(7,741)
Total current assets	300,431	248,066	2,546,028
<b>Property, plant and equipment, at cost less accumulated depreciation (Note 7):</b>			
Land	19,973	17,542	169,261
Buildings and structures	36,882	29,735	312,557
Machinery and equipment	60,054	51,208	508,936
Timberland (Note 6)	11,136	11,094	94,372
Construction in progress	4,426	2,206	37,505
	132,470	111,785	1,122,631
Less accumulated depreciation	(58,538)	(46,679)	(496,084)
Net property, plant and equipment	73,933	65,106	626,547
<b>Intangible assets, net of amortization:</b>			
Consolidation goodwill	1,532	1,434	12,986
Other intangible assets	5,575	5,454	47,246
Total intangible assets	7,107	6,887	60,232
<b>Investments and other assets:</b>			
Investment securities (Note 5)	71,413	40,485	605,198
Long-term loans and receivables	2,436	1,881	20,646
Deferred income taxes (Note 8)	1,242	1,193	10,528
Other assets	9,727	8,627	82,431
Allowance for doubtful accounts	(2,097)	(1,561)	(17,773)
Total investments and other assets	82,722	50,625	701,030
	¥ 464,193	¥ 370,684	\$ 3,933,836

See accompanying notes to consolidated financial statements.



LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
<b>Current liabilities:</b>			
Payables—			
Notes and accounts, trade	¥ 154,024	¥ 110,653	\$ 1,305,289
Other	6,679	5,289	56,598
Short-term debt (Note 7)	11,106	6,395	94,119
Current portion of long-term debt (Note 7)	2,113	956	17,909
Advances received from customers	37,920	35,285	321,355
Accrued income taxes	1,596	4,197	13,529
Accrued employees' bonuses	8,078	7,518	68,459
Other current liabilities (Note 8)	10,877	10,194	92,179
Total current liabilities	232,394	180,487	1,969,437
<b>Long-term liabilities:</b>			
Long-term debt (Note 7)	8,848	8,229	74,983
Deferred income taxes (Note 8)	15,136	2,259	128,268
Accrued employees' retirement benefits (Note 16)	15,875	13,915	134,538
Other	13,610	12,772	115,335
Total long-term liabilities	53,469	37,176	453,124
<b>Minority interests in consolidated subsidiaries</b>	<b>3,124</b>	<b>521</b>	<b>26,478</b>
<b>Contingent liabilities</b> (Note 14)			
<b>Shareholders' equity</b> (Note 12):			
Common stock—			
Authorized: 400,000,000 shares			
Issued and outstanding: 176,603,881 shares	27,672	27,672	234,509
Capital surplus	25,655	25,654	217,415
Retained earnings	99,319	90,807	841,686
Unrealized gain on available-for-sale securities	22,125	9,243	187,500
Foreign currency translation adjustments	1,052	(380)	8,914
Treasury stock (761,629 shares in 2006 and 653,288 shares in 2005)	(617)	(496)	(5,227)
Total shareholders' equity	175,206	152,500	1,484,797
	¥ 464,193	¥ 370,684	\$ 3,933,836

# CONSOLIDATED STATEMENTS OF INCOME

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
<b>Sales:</b>			
Net sales	¥ 439,516	¥ 356,686	\$ 3,724,716
Contract revenues	351,612	366,507	2,979,761
Total	791,128	723,193	6,704,477
<b>Cost of sales:</b>			
Cost of sales	408,124	329,631	3,458,680
Cost of contracts completed	255,151	267,980	2,162,293
Total	663,275	597,611	5,620,973
Gross profit	127,853	125,582	1,083,504
Selling, general and administrative expenses (Note 10)	112,407	107,116	952,603
Operating income	15,446	18,466	130,901
<b>Other income (expenses):</b>			
Interest and dividends income	781	437	6,622
Interest expense	(1,094)	(752)	(9,272)
Equity in earnings of affiliates	327	329	2,772
Loss on devaluation of investment securities	(15)	(5)	(128)
Loss on devaluation of real estate for sale and other assets	(19)	(47)	(164)
Impairment loss	—	(36)	—
Moving expense of the head office	—	(509)	—
Loss on business restructuring	—	(3,284)	—
Insurance income	419	—	3,555
Income on transfer of business by spin-off	229	—	1,937
Integration costs	(455)	—	(3,860)
Other gains, net (Note 9)	416	1,066	3,529
Total	589	(2,800)	4,991
Income before income taxes and minority interests	16,035	15,666	135,892
<b>Income taxes (Note 8):</b>			
Current	2,254	7,688	19,102
Deferred	2,705	(161)	22,922
Total	4,959	7,528	42,024
Minority interests	235	124	1,988
Net Income	¥ 10,842	¥ 8,014	\$ 91,880
<b>Per share of common stock:</b>			
Net Income (Note 18)	¥ 61.28	¥ 45.28	\$ 0.52
Cash dividends	13.00	13.00	0.11

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 2006 and 2005

	Millions of yen						
	Number of Shares of Common Stock	Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain on Available-for-Sale Securities	Foreign Currency Translation Adjustments	Treasury Stock at Cost
<b>Balance as of March 31, 2004</b>	176,603,881	¥ 27,672	¥ 25,651	¥ 85,148	¥ 8,972	¥ (811)	¥ (363)
Net income	—	—	—	8,014	—	—	—
Changes in unrealized gain on available-for-sale securities, less applicable taxes	—	—	—	—	271	—	—
Changes in foreign currency translation	—	—	—	—	—	431	—
Cash dividends (¥13.00 per share)	—	—	—	(2,289)	—	—	—
Bonuses to directors	—	—	—	(66)	—	—	—
Gain on sale of treasury stock	—	—	3	—	—	—	—
Treasury stock acquired, net (123,205 shares)	—	—	—	—	—	—	(133)
<b>Balance as of March 31, 2005</b>	176,603,881	¥ 27,672	¥ 25,654	¥ 90,807	¥ 9,243	¥ (380)	¥ (496)
Net income	—	—	—	10,842	—	—	—
Changes in unrealized gain on available-for-sale securities, less applicable taxes	—	—	—	—	12,882	—	—
Changes in foreign currency translation	—	—	—	—	—	1,432	—
Cash dividends (¥13.00 per share)	—	—	—	(2,287)	—	—	—
Bonuses to directors	—	—	—	(43)	—	—	—
Gain on sale of treasury stock	—	—	1	—	—	—	—
Treasury stock acquired, net (108,341 shares)	—	—	—	—	—	—	(121)
<b>Balance as of March 31, 2006</b>	<b>176,603,881</b>	<b>¥ 27,672</b>	<b>¥ 25,655</b>	<b>¥ 99,319</b>	<b>¥ 22,125</b>	<b>¥ 1,052</b>	<b>¥ (617)</b>

	Thousands of U.S. dollars [Note 4]						
	Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain on Available-for-Sale Securities	Foreign Currency Translation Adjustments	Treasury Stock at Cost	
<b>Balance as of March 31, 2005</b>	\$ 234,549	\$ 217,403	\$ 769,554	\$ 78,329	\$ (3,222)	\$ (4,200)	
Net income	—	—	91,880	—	—	—	
Changes in unrealized gain on available-for-sale securities, less applicable taxes	—	—	—	109,169	—	—	
Changes in foreign currency translation	—	—	—	—	12,136	—	
Cash dividends (\$0.11 per share)	—	—	(19,381)	—	—	—	
Bonuses to directors	—	—	(367)	—	—	—	
Gain on sale of treasury stock	—	12	—	—	—	—	
Treasury stock acquired, net (108,341 shares)	—	—	—	—	—	(1,027)	
<b>Balance as of March 31, 2006</b>	<b>\$ 234,509</b>	<b>\$ 217,415</b>	<b>\$ 841,686</b>	<b>\$ 187,500</b>	<b>\$ 8,914</b>	<b>\$ (5,227)</b>	

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
<b>Cash flows from operating activities:</b>			
Income (loss) before income taxes and minority interests	¥ 16,035	¥ 15,666	\$ 135,892
Adjustments—			
Depreciation and amortization	6,403	6,452	54,262
Impairment loss	—	36	—
Write-down of consolidation goodwill	566	450	4,800
Provision for [reversal of] doubtful account	15	(294)	129
Provision for [reversal of] severance indemnities, less payments	(1,044)	2,500	(8,849)
Interest and dividends income	(781)	(437)	(6,622)
Interest expense	1,094	752	9,272
Equity in earnings of affiliates	(327)	(329)	(2,772)
Losses on devaluation of marketable securities and investment securities	15	5	128
Losses (gains) on sales of marketable securities and investment securities, net	(53)	(770)	(446)
Losses (gains) on disposal of fixed assets, net	575	350	4,874
Income on transfer of business by spin-off	(229)	—	(1,937)
Changes in assets and liabilities:			
Notes and accounts receivable, trade	1,165	(3,906)	9,871
Inventories	1,590	(5,562)	13,475
Other current assets	(5,051)	3,198	(42,806)
Notes and accounts payable, trade	2,929	688	24,826
Advances received from customers	2,067	(2,515)	17,521
Other current liabilities	(222)	1,537	(1,885)
Other	(261)	168	(2,216)
Total	24,487	17,989	207,521
Interest and dividends income received	1,008	477	8,544
Interest paid	(1,008)	(746)	(8,545)
Income taxes paid, net	(7,861)	(11,036)	(66,620)
Net cash provided by operating activities	16,626	6,685	140,900
<b>Cash flows from investment activities:</b>			
Proceeds from sales of marketable securities	247	158	2,093
Payments for purchases of fixed assets	(12,554)	(10,217)	(106,391)
Proceeds from sales of fixed assets	7,496	3,905	63,526
Payments for purchases of intangible assets	(1,872)	(1,746)	(15,866)
Payments for purchases of investment securities	(3,569)	(4,254)	(30,244)
Proceeds from sales of investment securities	93	1,437	791
Payments for long-term loans receivable	(50)	(81)	(426)
Repayments of long-term loans receivable	589	256	4,990
Decrease (increase) in short-term loans receivable	801	(1,702)	6,792
Payments for purchase of stock in subsidiaries newly consolidated	(1,921)	—	(16,282)
Proceeds from purchase of stock in subsidiaries newly consolidated	1,316	—	11,154
Other	425	(651)	3,605
Net cash provided by (used in) investment activities	(8,998)	(12,895)	(76,258)
<b>Cash flows from financing activities:</b>			
Proceeds from long-term debt	842	165	7,136
Repayments of long-term debt	(6,700)	(2,721)	(56,782)
Increase (decrease) in short-term borrowings	(5,770)	(2,095)	(48,897)
Dividends paid	(2,287)	(2,289)	(19,381)
Other	(124)	(147)	(1,048)
Net cash used in financing activities	(14,039)	(7,087)	(118,972)
<b>Effect of exchange rate changes on cash and cash equivalents</b>	111	(87)	942
<b>Net increase (decrease) in cash and cash equivalents</b>	(6,300)	(13,384)	(53,388)
<b>Cash and cash equivalents at the beginning of the year</b>	55,928	69,312	473,967
<b>Cash and cash equivalents at the end of the year (Note 11)</b>	¥ 49,628	¥ 55,928	\$ 420,579

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
As of March 31, 2006 and 2005

## 1. Nature of Operations

Sumitomo Forestry Co., Ltd. (the “Company”) and its Group companies are involved in various business activities related to wood and houses, with timberland operations serving as the foundation of its business. Specifically, the Company’s operations encompass forest management as well as timber and building materials related operations, including the procurement, manufacture and sale of timber and building materials; housing-related operations, including the construction, sale, after-sales maintenance and landscaping of custom-built and other homes and sale and brokerage of real estate; and other lifestyle related businesses, including the leasing and golf course management.

## 2. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of the Company and consolidated subsidiaries (together, the “Companies”) are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The accompanying consolidated financial statements incorporate certain reclassifications and rearrangements in order to present these statements in a form which is more familiar to the readers of these statements outside Japan. In addition, the notes to consolidated financial statements include information which is not required under generally accepted accounting principles in Japan but is presented herein as additional information.

As permitted amounts of less than one million yen are rounded in this annual report.

## 3. Summary of Significant Accounting Policies

### (a) Basis of consolidation and investments in affiliates

The consolidated financial statements include the accounts of the Company and, with exceptions which are not material, those of its subsidiaries. All significant intercompany transactions and accounts and unrealized intercompany profits are eliminated on consolidation.

The material difference between the cost and underlying net equity of investments in consolidated subsidiaries is deferred and amortized over a five-year period. Immaterial difference are expensed when incurred.

Investments in affiliates (15 to 50 percent-owned companies except subsidiaries) in which the ability to exercise significant influence exists are stated at cost plus equity in undistributed earnings (losses). Net consolidated income includes the Company’s share of the current net earnings (losses) of such companies, after elimination of unrealized intercompany profits.

### (b) Translation of foreign currency transactions and accounts

Current and long-term receivables and payables in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date.

The Company translates the revenue and expense accounts of the foreign consolidated subsidiaries at the average rates of exchange in effect during the year. The balance sheet accounts, except for the components of shareholders’ equity, are also translated into yen at the rates of exchange in effect at the balance sheet date. The components of shareholders’ equity are translated at their historical rates.

### (c) Statements of cash flows

Cash and cash equivalents include all highly liquid investments, generally with original maturities of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present only an insignificant risk of changes in value.

### (d) Allowance for doubtful accounts

The allowance for doubtful accounts is stated based on the default ratio sustained over a specific period in the past and the estimated uncollectible amount based on the analysis of certain individual accounts, including probable bad debts and claims in bankruptcy.

This amount is considered sufficient to cover possible losses on collection.

**(e) Accrued employees' bonuses**

Accrued employees' bonuses are provided based on estimated bonuses to be paid to employees, which should be charged to income in the current year.

**(f) Warranty reserve for completed construction**

A warranty reserve is provided for repair costs which may be required for completed construction. The reserve is estimated based on past experience and future estimates.

The warranty reserve for completed construction is included in other current liabilities.

**(g) Accrued employees' retirement benefits**

Accrued employees' retirement benefits are provided based on the projected retirement benefit obligation and the plan assets at year-end.

Unrecognized actuarial gains (losses) are amortized in the fiscal year in which they arise.

**(h) Accrued retirement benefits to directors and corporate auditors**

Accrued retirement benefits to directors and corporate auditors of some subsidiaries are provided based on the amount required for the year-end in accordance with the established internal regulations. The Company abolished its retirement benefits system to directors and corporate auditors at the annual general meeting of shareholders on June 29, 2005. The amount of accrued retirement benefits to the Company's directors and corporate auditors for their term of service up to June 29, 2005 is included in "Other" of Long-term liabilities.

**(i) Reserve for restructuring costs**

The allowance for restructuring costs is stated at the estimated loss on restructuring of discontinued operation at the end of the fiscal year.

The balance of this reserve at March 31, 2006, which was included in other current liabilities on the accompanying consolidated balance sheets, was ¥844 million (US \$7,151 thousand).

**(j) Marketable securities and investments**

Marketable securities and investments are classified and accounted for, depending on management's intent, as follows: i) held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity, are reported at amortized cost; and ii) available-for-sale securities, which are not classified as either of the aforementioned securities, are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity.

The Company determines cost of securities sold by the moving average method.

**(k) Inventories**

Inventories other than finished goods are stated at cost, which is determined by the specific identification method.

Finished goods are stated at moving average cost.

**(l) Property, plant and equipment**

Property, plant and equipment, including significant renewals and additions, are capitalized at cost. Maintenance and repairs and minor renewals and improvements are charged to income. Depreciation is computed, with minor exceptions, by the declining balance method at rates based on the estimated useful lives of the assets according to general class, type of construction and use. In the case of retirement or disposal, the difference between the net book value and salvage or sales proceeds is charged or credited to income.

**(m) Timberland**

Timberland consists of standing timber and related land. Standing timber, consisting of timber stock in natural forests, purchased forests and planted forests, is classified either as mature timber or growing timber. Mature timber represents costs related to trees that are 21 or more years old, of which costs have been transferred from growing timber. Growing timber represents costs of trees less than 21 years old (see Note 6).

The timber stock from both natural forests and purchased forests is carried at the specific acquisition cost.

The timber stock from planted forests is stated at cost, which consists of sowing, seeding and planting.

Intensive forest management generally practiced in Japan results in high yields of quality logs. Such management, implemented by the Company, includes the following procedures:

Age in Years	Procedures
0	Sowing, seeding at nursery
1	Planting after land preparation
1—6	Weeding
8	Vine cutting
10—14	Salvage cutting
14	Pruning
16—25	Thinning and debranching
Over 50	Final cutting

The charges for weeding, vine cutting, salvage cutting, pruning and thinning and debranching are charged to selling, general and administrative expenses as incurred.

When finally harvested from timberland for sale, the harvested timber has its cost calculated based on the proportion of metric volume of the timber harvested to that of the particular area, applied to the book value of the area. The calculated cost is the cost of sales.

**(n) Revenue recognition**

Sales are generally recognized at the time the goods are delivered to the customers.

Sales of precut timber, building materials and certain housing equipment, such as system kitchens, system furniture, bathtubs, sinks and other, which are purchased by the Company and sold to building contractors for use in house building projects specifically subcontracted from the Company, are recognized upon completion and acceptance of the completed houses by the customers, with the related cost being included in cost of contracts completed.

Contract revenues, representing revenues from custombuilt houses, are recorded when the completed houses are accepted by customers.

**(o) Finance leases**

Finance leases of the Companies, other than those where ownership of the lease assets is transferred to the lessee, are accounted for as operating leases.

**(p) Income taxes**

The Companies accrue income taxes based on taxable income. The Companies include many items for financial reporting purposes which, in the case of expenses, are not currently deductible and, in the case of income, are not currently taxable.

Income taxes based on temporary differences between tax and financial reporting purposes are reflected as deferred income taxes in the consolidated financial statements using the asset and liability method.

**(q) Appropriations of retained earnings**

Appropriations of retained earnings reflected in the accompanying consolidated financial statements are recorded upon approval by the shareholders as required under Japanese law.

**(r) Earnings per share of common stock**

The computation of net income and cash dividends per share is based on the average number of shares outstanding during each period.

**(s) Reclassifications**

Certain accounts in the consolidated financial statements for the year ended March 31, 2005 have been reclassified to conform to presentation in 2006.

## **4. U.S. Dollar Amounts**

The U.S. dollar amounts are included solely for convenience and have been translated, as a matter of arithmetical computation only, at the rate of ¥118=US\$1, the approximate exchange rate prevailing in the Japanese foreign exchange market at March 31, 2006. This translation should not be construed as a representation that the yen amounts actually represent, or have been or could be converted into, U.S. dollars.

## 5. Securities

The carrying amount and aggregate fair value of the securities classified as available-for-sale and held-to-maturity at March 31, 2006 and 2005 were as follows:

Millions of yen				
2006				
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	¥ 26,053	¥ 41,718	¥ (92)	¥ 67,679
Debt securities	—	—	—	—
Held-to-maturity:				
Debt securities	¥ 5,290	¥ —	¥ —	¥ 5,290

Millions of yen				
2005				
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	¥ 21,385	¥ 15,751	¥ (249)	¥ 36,886
Debt securities	—	—	—	—
Held-to-maturity:				
Debt securities	¥ 31,334	¥ —	¥ —	¥ 31,334

Thousands of U.S. dollars				
2006				
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	\$ 220,784	\$ 353,546	\$ (776)	\$ 573,554
Debt securities	—	—	—	—
Held-to-maturity:				
Debt securities	\$ 44,831	\$ —	\$ —	\$ 44,831

Proceeds from sales of available-for-sale securities and the corresponding gross gains and losses, which are included in other gains (losses), net in the accompanying consolidated statements of income for the year ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Proceeds	¥ 93	¥ 1,437	\$ 791
Gross gains	53	806	446
Gross losses	—	36	—

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale and held-to-maturity at March 31, 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars	
	2006			
	Available-for-Sale	Held-to-Maturity	Available-for-Sale	Held-to-Maturity
Due within one year	¥ —	¥ 5,000	\$ —	\$ 42,373
Due after one year				
through five years	—	290	—	2,458
	¥ —	¥ 5,290	\$ —	\$ 44,831

The difference between the above cost and the amounts shown in the accompanying consolidated balance sheets principally consisted of non-marketable securities and equity securities of unconsolidated subsidiaries and affiliates.

## 6. Timberland

The investment in timberland at March 31, 2006 and 2005 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Standing timber:			
Mature timber	¥ 10,723	¥ 10,572	\$ 90,872
Growing timber	413	522	3,500
	11,136	11,094	94,372
Land	477	478	4,040
	¥ 11,613	¥ 11,572	\$ 98,412

The timberland accounts at March 31, 2006 and 2005 were reduced by ¥268 million (US \$2,274 thousand) and ¥268 million in aggregate, representing the accumulated deferred gains from disposals of timberland.



## 7. Short-Term and Long-Term Debt

Short-term debt at March 31, 2006 and 2005 generally represented short-term borrowings which bore interest of 4.37% and 3.30% per annum, respectively. Long-term debt at March 31, 2006 and 2005 were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Loans, principally from banks and insurance companies, due 2007 to 2011 with interest of 6.30%:			
Secured	<b>¥ 7,560</b>	¥ 6,600	<b>\$ 64,071</b>
Unsecured	<b>3,181</b>	2,305	<b>26,956</b>
Debtenture bonds:			
0.35 basis points	<b>120</b>	180	<b>1,017</b>
0.64 basis points	<b>100</b>	100	<b>847</b>
	<b>10,961</b>	9,185	<b>92,891</b>
Portion due within one year	<b>2,113</b>	956	<b>17,909</b>
	<b>¥ 8,848</b>	¥ 8,229	<b>\$ 74,983</b>

The following assets were pledged to secure bank loans and long-term debt at March 31, 2006 and 2005:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Receivables-			
Notes and accounts, trade	<b>¥ 523</b>	¥ 518	<b>\$ 4,432</b>
Finished goods, logs and lumber	<b>1,246</b>	1,022	<b>10,557</b>
Land	<b>269</b>	1,454	<b>2,280</b>
Buildings and structures	<b>3,765</b>	3,683	<b>31,910</b>
Machinery and equipment	<b>8,141</b>	9,315	<b>68,989</b>
Timberland	<b>2,309</b>	2,199	<b>19,570</b>
Investment securities	<b>3,344</b>	—	<b>28,336</b>
Other	<b>27</b>	—	<b>230</b>
	<b>¥ 19,624</b>	¥ 18,191	<b>\$ 166,304</b>

The aggregate annual maturities of long-term debt at March 31, 2006 were as follows:

YEARS ENDING MARCH 31	Millions of yen	Thousands of U.S. dollars
2007	<b>¥ 2,113</b>	<b>\$ 17,909</b>
2008	<b>6,777</b>	<b>57,433</b>
2009	<b>1,927</b>	<b>16,331</b>
2010	<b>104</b>	<b>880</b>
2011	<b>40</b>	<b>338</b>
Thereafter	—	—
	<b>¥ 10,961</b>	<b>\$ 92,891</b>

## 8. Income Taxes

Income taxes in Japan applicable to the Companies generally comprise Corporation Tax, Enterprise Tax and Prefectural and Municipal Inhabitants Taxes. The effective statutory tax rate for fiscal 2006 was 40.0%.

The chart below shows the differences in the statutory tax rate and effective income tax rate.

	2006	2005
Statutory tax rate	<b>40.0%</b>	40.0%
Non-deductible expense for purposes	<b>1.5</b>	1.2
Per capita portion of Inhabitant Tax	<b>1.6</b>	1.7
Amortization of consolidation differences	<b>1.4</b>	1.1
Valuation allowance	<b>( 14.5)</b>	6.5
Special deduction on corporate income taxes	—	(1.7)
Other	<b>0.9</b>	(0.7)
Effective income tax rate	<b>30.9%</b>	48.1%

The significant components of deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Accrued employees' bonuses	¥ 3,484	¥ 3,006	\$ 29,526
Provision for guarantee			
for after-cost of construction	511	406	4,332
Advances received	394	413	3,343
Accrued enterprise taxes	119	325	1,009
Devaluation of real estate			
for sale and other assets	4,160	4,428	35,253
Devaluation of property,			
plant and equipment	342	550	2,897
Impairment loss	1,693	2,082	14,350
Pension and severance costs	6,293	6,401	53,334
Unrealized intercompany profit	399	471	3,386
Tax loss carryforward	3,186	2,045	27,002
Loss on business restructuring	338	747	2,860
Other	2,518	2,404	21,339
Gross deferred tax assets	23,438	¥ 23,279	198,632
Valuation allowance	(8,802)	(6,552)	(74,596)
Total deferred tax assets	14,636	16,728	124,036
Deferred tax liabilities:			
Deferred gains on sales of property	(966)	(1,091)	(8,183)
Unrealized gain on			
available-for-sale securities	(16,604)	(6,197)	(140,712)
Gain on securities contributed to			
employee retirement			
benefit trust	(1,590)	(1,590)	(13,478)
Land valuation difference	(1,230)	—	(10,423)
Other	(543)	(403)	(4,601)
Gross deferred tax liabilities	(20,933)	(9,281)	(177,397)
Net deferred tax assets	¥ (6,297)	¥ 7,447	\$ (53,361)

Net deferred tax assets were included in the consolidated balance sheets at March 31, 2006 and 2005 as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current assets-			
Deferred income taxes	¥ 7,597	¥ 8,513	\$ 64,381
Investment and other assets-			
Deferred income taxes	1,242	1,193	10,528
Current liabilities-			
Other	(0)	—	(2)
Long-term liabilities-			
Deferred income taxes	(15,136)	(2,259)	(128,268)
Net deferred tax assets	¥ (6,297)	¥ 7,447	\$ (53,361)

## 9. Other Gains (Losses), Net

Other gains (losses), net, for the years ended March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Gain on sales of property,			
plant and equipment	¥ 82	¥ 37	\$ 694
Gain on sales of			
investment securities	53	806	446
Loss on sales of property,			
plant and equipment	(492)	—	(4,170)
Loss on sales of			
investment securities	—	(36)	—
Loss on disposal of property,			
plant and equipment	(165)	—	(1,398)
Other, net	939	259	7,957
	¥ 416	¥ 1,066	\$ 3,529

## 10. Research and Development Expenses

Research and development expenses charged to selling, general and administrative expenses for the year ended March 31, 2006 and 2005 were ¥993 million (US \$8,414 thousand) and ¥883 million, respectively.

## 11. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Cash and time deposits	¥ 44,720	¥ 25,188	\$ 378,986
Short-term investments	5,000	30,798	42,372
Less: Cash deposits and			
short-term investments			
which mature or become			
due over three months after			
the date of acquisition	(92)	(59)	(779)
Cash and cash equivalents	¥ 49,628	¥ 55,928	\$ 420,579

## 12. Shareholders' Equity

Under the Japanese Commercial Code (the "Code"), at least 50% of the issue price of new shares is required to be designated as the common stock account. The portion to be designated as the common stock account is determined by resolution of the Board of Directors. Proceeds in excess of the amounts designated as the common stock account are credited to capital surplus account.

The Code provides that an amount equivalent to a minimum of 10% of cash dividends and other distributions from retained earnings paid by the Companies be appropriated as a legal reserve. No further appropriation is required when the total amount of capital surplus account and legal reserve equals 25% of the common stock account. The balance of the reserve may be used to reduce a deficit and/or may be transferred to the common stock account.

The Code also provides that, to the extent the sum of capital surplus account and legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for appropriation by resolution of the shareholders meeting.

The balances of the legal reserve of the Company at March 31, 2006 and 2005, which were included in retained earnings on the accompanying consolidated balance sheets, were ¥2,857 million (US \$24,213 thousand) and ¥2,857 million, respectively.

Year-end dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. In addition, semi-annual interim dividends may be paid upon resolution of the Board of Directors, subject to limitations imposed by the Code. Year-end dividends are reflected in the consolidated statements of shareholders' equity when authorized.

## 13. Finance Leases

(Lessee)

Finance leased charges to the Companies for the years ended March 31, 2006 and 2005 were ¥4,366 million (US \$37,004 thousand) and ¥4,798 million, respectively.

The leased assets and related expenses of the Companies' finance leases, other than those where the ownership of the lease assets is transferred to the lessee, are being accounted for as operating leases. If capitalized, the following amounts would be recorded in the financial statements (in equivalent amounts):

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Buildings and structures	¥ 11,318	¥ 10,081	\$ 95,919
Machinery and equipment	5,823	5,885	49,348
Other	188	101	1,593
Accumulated depreciation	(7,898)	(8,118)	(66,935)
Accumulated Impairment loss	(4)	(12)	(37)
	¥ 9,427	¥ 7,938	\$ 79,888

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Depreciation	¥ 4,224	¥ 4,604	\$ 35,797
Interest expenses	142	164	1,200

Depreciation costs are calculated based on the straightline method over the lease periods of the leased assets, with no residual value of the assets at the end of the lease periods.

Interest expenses are calculated by subtracting the amount equivalent to the acquisition cost from the total lease fee. The resulting differences, which are of an amount equivalent to the total interest payments over the lease periods, are allocated to each period by the interest method. The present values of future lease payments of the Companies as at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current obligation	¥ 3,768	¥ 3,409	\$ 31,932
Long-term obligation	5,754	4,637	48,766
Present value of lease payments	¥ 9,522	¥ 8,046	\$ 80,698
Impairment loss on leased assets	¥ 2	¥ 7	\$ 18

(Lessor)

Finance lease fee income of the Companies credited to income for the years ended March 31, 2006 and 2005 were ¥131 million (US \$1,111 thousand) and ¥149 million, respectively. The leased assets and related expenses of the Companies' finance leases other than those where the ownership of the leased assets is transferred to the lessee and are being accounted for as operating leases at March 31, 2006 and 2005 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Machinery and equipment	¥ 469	¥ 497	\$ 3,977
Other	36	11	309
Accumulated depreciation	(249)	(265)	(2,108)
	¥ 257	¥ 243	\$ 2,178

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Depreciation	¥ 111	¥ 128	\$ 941
Interest income	16	18	136

Interest income is calculated by subtracting the amount equivalent to the acquisition cost from the total lease fee. The resulting differences, which are of an amount equivalent to the total interest receipts over the lease periods, are allocated to each period by the interest method. The present values of future lease receipts for the Companies at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current obligation	¥ 87	¥ 86	\$ 734
Long-term obligation	167	156	1,412
Present value of lease receipts	¥ 253	¥ 242	\$ 2,146

## 14. Contingent Liabilities

Contingent liabilities as at March 31, 2006 and 2005, for loans guaranteed amounted to ¥20,880 million (US \$176,948 thousand) and ¥11,490 million, and for notes discounted and endorsed in the ordinary course of business amounted to ¥363 million (US \$3,072 thousand) and NIL, respectively.

## 15. Derivatives and Hedging Activities

The Companies use derivative financial instruments to manage their exposure to fluctuations in foreign exchange and interest rates. Foreign exchange forward contracts, foreign currency swaps, and interest rate swaps are utilized by the Companies to reduce foreign currency exchange and interest rate risks. The Companies do not enter into derivatives for trading or speculative purposes.

## 16. Severance Indemnity Benefits and Pension Plans

The Company and some of its domestic consolidated subsidiaries offer their employees both a lump-sum benefit at retirement and a non-contributory funded defined benefit pension plan. Others offer a lump-sum benefit at retirement only.

These systems are open to employees who meet set conditions, but substantially all employees are eligible.

Retirement benefits are calculated based on the employees basic rate of pay, length of service, termination circumstance and other factors. The employees of the companies that adopt defined-benefit pension plan may opt for either a lump-sum payment or annuity payments.

In March 2004, the Company and some of its domestic consolidated subsidiaries revised their non-contributory funded defined benefit pension plan and decided to introduce a cash balance pension plan.

Under the cash balance pension plan, each participant is given an account into which is credited the amount calculated yearly based on the re-evaluation rate which is derived from current compensation and market interest rate. This revision of the plan brought about a reduction in the employee retirement benefit obligation of the Company and some of its domestic consolidated subsidiaries.

The liability for employee's retirement benefits at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Projected benefit obligation	<b>¥(48,162)</b>	¥(38,546)	<b>\$(408,150)</b>
Fair value of plan assets	<b>32,286</b>	24,631	<b>273,612</b>
Unrecognized actuarial loss	—	—	—
Unrecognized prior service cost	—	—	—
Prepaid pension cost	—	—	—
Net liability for retirement benefits	<b>¥(15,875)</b>	¥(13,915)	<b>\$(134,538)</b>

The components of net periodic benefit costs for the year ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Service cost	<b>¥ 2,930</b>	¥ 2,949	<b>\$ 24,830</b>
Interest cost	<b>830</b>	777	<b>7,035</b>
Expected return on plan assets	<b>(167)</b>	(150)	<b>(1,419)</b>
Recognized actuarial gain (loss)	<b>(2,973)</b>	(209)	<b>(25,198)</b>
Amortization of prior service cost	—	—	—
Net periodic benefit costs	<b>¥ 619</b>	¥ 3,367	<b>\$ 5,248</b>

Certain consolidated subsidiaries have adopted the conventional method in calculating their projected benefit obligation.

Assumptions used for the year ended March 31, 2006 and 2005 were set forth as follows:

	2006	2005
Discount rate	<b>1.9%</b>	2.0%
Expected rate of return on plan assets	<b>0.7%</b>	0.7%
Recognition period of actuarial gain/loss	<b>1year</b>	1year

## 17. Segment Information

### a) Industry segment information—

The Companies' business is classified into the following three segments based on the similarities of the types and nature of business:

Timber and building materials: manufacturing or purchasing and sale of timber and building materials

Housing: construction of houses, buildings and their exteriors, gardening, planting, sale of interiors and brokerage of real estate

Other: leasing, golf course management and other

The tables below present sales, operating expenses and operating income information by segment.

Millions of yen						
YEAR ENDED MARCH 31, 2006	Timber and building materials	Housing	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:						
Unaffiliated customers	¥ 395,650	¥ 392,131	¥ 3,347	¥ 791,128	¥ —	¥ 791,128
Intersegment transfers	16,532	1,737	10,202	28,471	(28,471)	—
Total	412,182	393,868	13,549	819,600	(28,471)	791,128
Operating expenses	409,376	377,498	12,708	799,582	(23,900)	775,682
Operating income	¥ 2,806	¥ 16,370	¥ 841	¥ 20,018	¥ (4,571)	¥ 15,446
Identifiable assets, depreciation and capital investment:						
Identifiable assets	¥ 237,265	¥ 105,579	¥ 9,139	¥ 351,982	¥ 112,210	¥ 464,193
Depreciation and amortization	2,906	2,336	686	5,928	475	6,403
Impairment loss	—	—	—	—	—	—
Capital investment	5,701	3,737	980	10,418	25	10,443
Millions of yen						
YEAR ENDED MARCH 31, 2005	Timber and building materials	Housing	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:						
Unaffiliated customers	¥ 301,696	¥ 418,031	¥ 3,466	¥ 723,193	¥ —	¥ 723,193
Intersegment transfers	18,559	281	9,719	28,560	(28,560)	—
Total	320,255	418,313	13,185	751,753	(28,560)	723,193
Operating expenses	315,640	400,783	12,447	728,869	(24,142)	704,727
Operating income	¥ 4,615	¥ 17,530	¥ 738	¥ 22,884	¥ (4,418)	¥ 18,466
Identifiable assets, depreciation and capital investment:						
Identifiable assets	¥ 157,840	¥ 108,705	¥ 8,650	¥ 275,196	¥ 95,488	¥ 370,684
Depreciation and amortization	3,113	2,270	601	5,985	468	6,452
Impairment loss	—	—	—	—	36	36
Capital investment	2,949	4,403	754	8,107	1,131	9,237

YEAR ENDED MARCH 31, 2006	Thousands of U.S. dollars					Consolidated
	Timber and building materials	Housing	Other	Total	Elimination and / or corporate	
Sales and contract revenues:						
Unaffiliated customers	\$ 3,352,969	\$ 3,323,143	\$ 28,365	\$ 6,704,477	\$ —	\$ 6,704,477
Intersegment transfers	140,101	14,723	86,459	241,283	(241,283)	—
Total	3,493,070	3,337,866	\$ 114,824	6,945,760	(241,283)	6,704,477
Operating expenses	3,469,286	3,199,135	107,697	6,776,118	(202,542)	6,573,576
Operating income	\$ 23,784	\$ 138,731	\$ 7,127	\$ 169,642	\$ (38,741)	\$ 130,901
Identifiable assets, depreciation and capital investment:						
Identifiable assets	\$ 2,010,718	\$ 894,736	\$ 77,446	\$ 2,982,900	\$ 950,936	\$ 3,933,836
Depreciation and amortization	24,624	19,800	5,816	50,240	4,022	54,262
Impairment loss	—	—	—	—	—	—
Capital investment	48,315	31,672	8,302	88,289	213	88,502

b) Geographical segment information—

The Companies' business is classified into the two segments based on geographic proximity. Other includes Asia, North America and Oceania.

YEAR ENDED MARCH 31, 2006	Millions of yen				Consolidated
	Domestic	Other	Total	Elimination and / or corporate	
Sales and contract revenues:					
Unaffiliated customers	¥ 773,221	¥ 17,907	¥ 791,128	¥ —	¥ 791,128
Intersegment transfers	2,276	8,005	10,280	(10,280)	—
Total	775,497	25,912	801,409	(10,280)	791,128
Operating expenses	755,595	25,960	781,556	(5,874)	775,682
Operating income	¥ 19,901	¥ (48)	¥ 19,853	¥ (4,407)	¥ 15,446
Identifiable assets, depreciation and capital investment:					
Identifiable assets	¥ 318,973	¥ 38,212	¥ 357,184	¥ 107,008	¥ 464,193

YEAR ENDED MARCH 31, 2005	Millions of yen				
	Domestic	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:					
Unaffiliated customers	¥ 705,184	¥ 18,009	¥ 723,193	¥ —	¥ 723,193
Intersegment transfers	1,775	16,341	18,116	(18,116)	—
Total	706,959	34,350	741,309	(18,116)	723,193
Operating expenses	685,231	33,196	718,427	(13,699)	704,727
Operating income	¥ 21,727	¥ 1,155	¥ 22,882	¥ (4,416)	¥ 18,466
Identifiable assets, depreciation and capital investment:					
Identifiable assets	¥ 246,885	¥ 32,518	¥ 279,403	¥ 91,281	¥ 370,684

YEAR ENDED MARCH 31, 2006	Thousands of U.S. dollars				
	Domestic	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:					
Unaffiliated customers	<b>\$ 6,552,719</b>	<b>\$ 151,758</b>	<b>\$ 6,704,477</b>	<b>\$ —</b>	<b>\$ 6,704,477</b>
Intersegment transfers	<b>19,286</b>	<b>67,837</b>	<b>87,123</b>	<b>(87,123)</b>	<b>—</b>
Total	<b>6,572,005</b>	<b>219,595</b>	<b>6,791,600</b>	<b>(87,123)</b>	<b>6,704,477</b>
Operating expenses	<b>6,403,348</b>	<b>220,004</b>	<b>6,623,352</b>	<b>(49,776)</b>	<b>6,573,576</b>
Operating income	<b>\$ 168,657</b>	<b>\$ (409)</b>	<b>\$ 168,248</b>	<b>\$ (37,347)</b>	<b>\$ 130,901</b>
Identifiable assets, depreciation and capital investment:					
Identifiable assets	<b>\$ 2,703,158</b>	<b>\$ 323,829</b>	<b>\$ 3,026,987</b>	<b>\$ 906,849</b>	<b>\$ 3,933,836</b>

c) Overseas sales information—

As the total overseas sales were less than 10% of consolidated net sales, overseas sales information has been omitted.

## 18. Net Income Per Share

The computation of net income per share for the year ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Numerator for net income per share:			
Net income	¥ <b>10,842</b>	¥ 8,014	\$ 91,880
Income not available to common stockholders	<b>(62)</b>	(44)	(529)
Income available to common stockholders	<b>10,779</b>	7,971	91,351
Denominator for net income per share:			
Weighted average number of shares issued	<b>175,891,228</b>	176,015,931	



## Report of Independent Auditors

The Board of Directors  
Sumitomo Forestry Co., Ltd.

We have audited the accompanying consolidated balance sheets of Sumitomo Forestry Co., Ltd. (the “Company”) and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders’ equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sumitomo Forestry Co., Ltd. and consolidated subsidiaries at March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 4.

June 27, 2006

*Ernst & Young Shin Nihon*

# STOCK INFORMATION

Stock Exchange Listings: Tokyo, Osaka

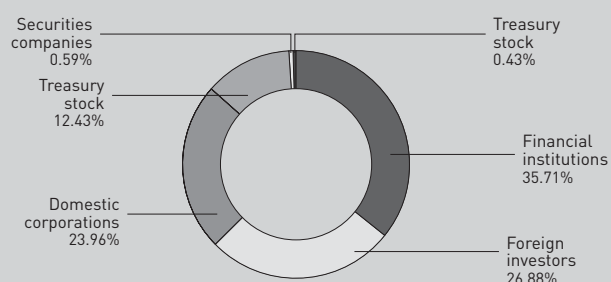
Common Stock Authorized: 400,000,000 shares

Issued: 176,603,881 shares

Number of Shareholders: 11,663

General Meeting of Shareholders: June

## Breakdown of Shareholders:



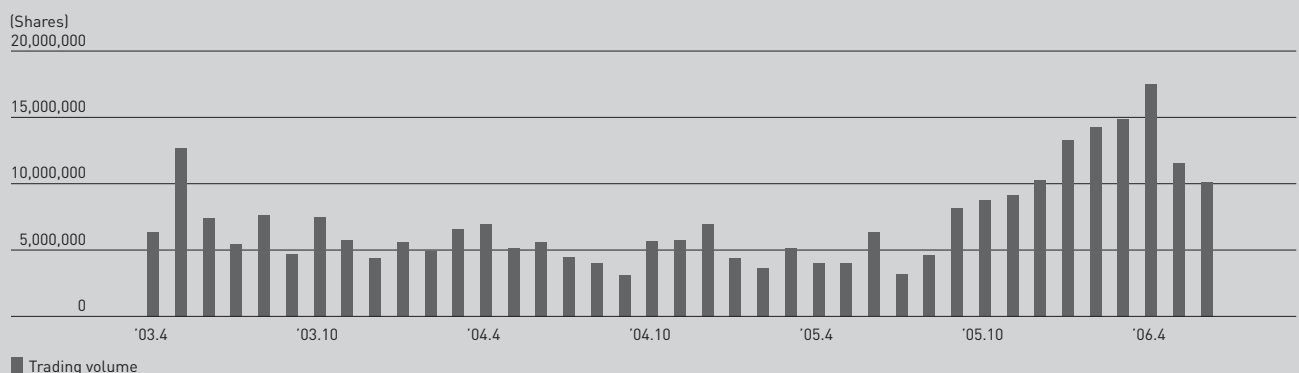
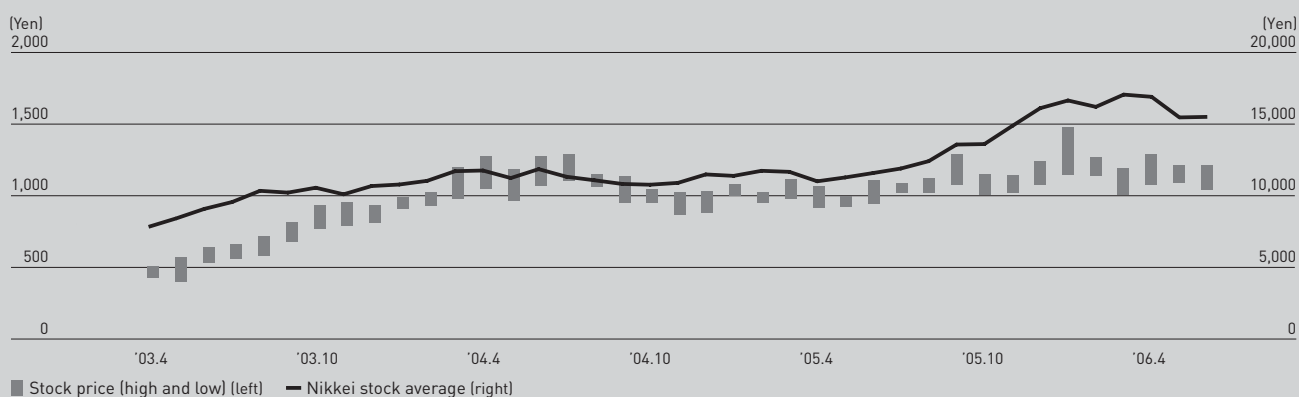
(As of March 31, 2006)

## Major Shareholders:

Shareholders	Number of shares held (Thousand shares)	Shareholding ratio (%)
The Master Trust Bank of Japan, Ltd. (trust account)	13,063	7.40
Sumitomo Metal Mining Co., Ltd.	10,110	5.72
The Iyo Bank, Ltd.	5,850	3.31
State Street Bank and Trust Company	4,702	2.66
Japan Trustee Service Bank, Ltd. (trust account)	4,396	2.49
Sumitomo Corporation	4,383	2.48
Sumitomo Life Insurance Company	4,227	2.39
The Hyakujushi Bank, Ltd.	4,198	2.38
Sumitomo Mitsui Banking Corporation	4,136	2.34
The Sumitomo Trust and Banking Co., Ltd. (investment account)	3,408	1.93

(As of March 31, 2006)

## Stock Price and Trading Volume: (Osaka Securities Exchange)



# CORPORATE DATE

Company Name:	Sumitomo Forestry Co., Ltd.
Founded:	1691
Incorporated:	1948
Paid-in Capital:	¥27,672 million
Head Office:	Marunouchi Trust Tower North 8-1, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8270, Japan Tel: 81-3-6730-3500 Fax: 81-3-6730-3504
Consolidated Subsidiaries:	47 (Overseas 12)
Associated Companies:	6 (Overseas 5)
Number of Employees (Consolidated):	11,997
Homepage:	<a href="http://www.sfc.co.jp/e">http://www.sfc.co.jp/e</a>
Independent Auditors:	SHIN NIHON & CO.
Transfer Agent and Registrar:	The Sumitomo Trust and Banking Co., Ltd. Stock Transfer Agency Department 4-4, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8233, Japan

[As of March 31, 2006]

**For further information, please contact:**  
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