

# ensuring sustainable growth

ANNUAL REPORT 2003  
YEAR ENDED MARCH 31, 2003

**Since its establishment in 1691**, Sumitomo Forestry Co., Ltd. has maintained the responsible management of woodlands as the heart of its operations and activities. With “Sustainable Forestry” as our underlying philosophy, we have endeavored to ensure stable forests through a deliberate process of afforestation and trimming. Based on centuries of unbroken tradition, the Sumitomo Forestry Group will continue to focus on sustainability as its management core and fulfill its social responsibilities through activities in harmony with society, the economy, and the environment.

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# Financial Highlights

| YEARS ENDED MARCH 31                  | MILLIONS OF YEN |          |          |          |          | THOUSANDS OF<br>U.S. DOLLARS |
|---------------------------------------|-----------------|----------|----------|----------|----------|------------------------------|
|                                       | 2003            | 2002     | 2001     | 2000     | 1999     | 2003                         |
| Net sales and contract revenues ..... | <b>¥645,100</b> | ¥644,730 | ¥682,375 | ¥699,594 | ¥620,615 | <b>\$5,375,833</b>           |
| Operating income .....                | <b>8,772</b>    | 3,040    | 15,999   | 13,549   | 6,210    | <b>73,100</b>                |
| Net (loss) income .....               | <b>(15,439)</b> | 465      | 6,994    | 5,708    | 134      | <b>(128,658)</b>             |
| Total assets .....                    | <b>357,322</b>  | 365,531  | 371,102  | 360,935  | 346,293  | <b>2,977,683</b>             |
| Total shareholders' equity .....      | <b>129,727</b>  | 147,440  | 150,979  | 144,914  | 139,301  | <b>1,081,058</b>             |
| ROE (%) .....                         | <b>(11.1)</b>   | 0.3      | 4.7      | 4.0      | 0.1      | —                            |

|                                   | YEN              |        |         |         |        | U.S. DOLLARS     |
|-----------------------------------|------------------|--------|---------|---------|--------|------------------|
| Net (loss) income per share ..... | <b>¥ (87.53)</b> | ¥ 2.64 | ¥ 39.64 | ¥ 32.36 | ¥ 0.76 | <b>\$ (0.72)</b> |
| Cash dividends per share .....    | <b>10.00</b>     | 10.00  | 10.00   | 10.00   | 10.00  | <b>0.08</b>      |

Note: Yen amounts have been translated for convenience only, at ¥120=US\$1.

## MANAGEMENT PRINCIPLES

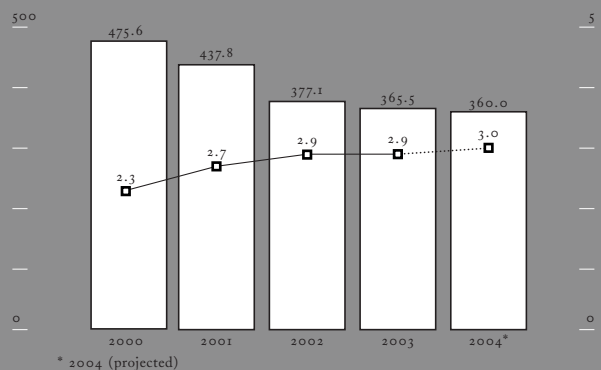
*“Building Trust through a Commitment to Customers and Unwavering Corporate Governance and Compliance”*

Based on government statistics in 1999, 88.5% of the Japanese people identified wood as their preferred material in housing construction, an increase of 6.6 percentage points compared with a decade earlier. Wood has long been valued as a natural material, closely associated with health, comfort, and ease of application. In recent years, amid increased concerns over global warming and other environmental issues, wood has been the focus of much attention.

Since its establishment, Sumitomo Forestry has been engaged in a variety of business fields focused on wood and wood products. With the management of woodlands as our underlying platform, and by way of activities from upstream through downstream including forestry, supplying and manufacturing timber and building materials, and housing, our mission is to give people more opportunities to benefit from the natural aspects of wood in an effort to provide well-being and comfort. Our business development and these activities are founded on the principles of “customer first” and “compliance.” Through an unwavering commitment to these principles, Sumitomo Forestry works to the highest standards and contributes to society as a responsible corporate citizen.



OWNER-OCCUPIED HOUSING STARTS AND COMPANY'S SHARE (CONSOLIDATED) (Thousands of units, %)



## OPERATING ENVIRONMENT

**MEDIUM- AND LONG-TERM OUTLOOK** *Despite a drop in the number of households brought on by the decline in population, demand for the renovation of existing residences continues to rise.*

In 1998, government statistics identified the total number of households in Japan at 44,359,000. Today, the number of dwellings is estimated at 50,246,000, which is considered more than sufficient for the country's needs. In addition, a government-related research institute has forecast Japan's population to decline from 2007 and the number of households to decrease from 2015.

On the other hand, 1998 statistics also identified that 48.4% of dwellings in Japan had been constructed prior to 1981, when revisions were made to the Building Standard Law, requiring more stringent construction against earthquake damage. In reference to this report, experts have highlighted significant safety concerns in connection with Japan's housing market. Moreover, as demand for greater floor space per household increases, and people focus on the problem of small rental accommodation, we anticipate renewed demand for reconstruction and major refurbishment as consumers look toward improving their living standards.

**CONDITIONS IN FISCAL 2003** *Sumitomo Forestry's operating environment is characterized by a shrinking housing market owing to weak personal consumption and prolonged downturn in the Japanese economy.*

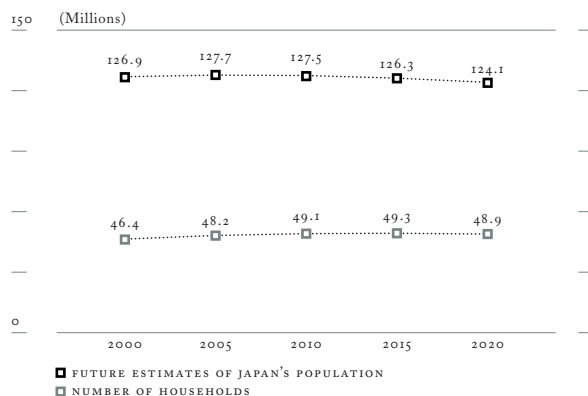
During fiscal 2003, ended March 31, 2003, the Japanese economy remained mired in difficult operating conditions, characterized by record unemployment and stagnant private sector capital investment.

In the housing industry, general economic downturn and prolonged anxiety over job and income security further dampened consumers' eagerness to purchase homes. New housing starts during the period declined 2.4% compared with the previous fiscal year to 1,145,533 units, and new housing starts of owner-occupied homes, a segment closely related to the Group's core business, declined 3.1% year on year to 365,507 units. The timber and building materials industry, which is extremely vulnerable to fluctuations in the housing market, also experienced a downward turn.

## FISCAL 2003 MANAGEMENT POLICIES AND BUSINESS RESULTS

**OVERVIEW** Despite this challenging environment, Sumitomo Forestry focused on streamlining production costs and reducing selling, general and administrative (SG&A) expenses.

### FUTURE ESTIMATES OF JAPAN'S POPULATION AND NUMBER OF HOUSEHOLDS



As a result, operating income surged 188.6% year on year to ¥8,772 million, on total sales in line with the previous fiscal year. In the absence of any prospects for significant recovery in our operating environment, we booked an extraordinary loss of ¥38.8 billion in an effort to strengthen our corporate structure and to ensure financial health. After recording an extraordinary gain and adjusting for income taxes, which will be outlined in more detail later, Sumitomo Forestry posted a net loss of ¥15.4 billion for the period. For the immediate future, we have identified the Group's core businesses as the overseas business and the existing housing business, and are actively nurturing and hastening expansion in these fields.

**STRENGTHENING FINANCIAL POSITION AND BOOSTING EARNINGS** *We are looking to strengthen our financial position through our Management Restructuring Plan, and achieve increased profits following an earnings recovery.*

Against the backdrop of a harsh operating environment, the Sumitomo Forestry Group has shifted its management focus from expanding sales to enhancing earnings. We have continued to promote those initiatives identified in the Company's Management Restructuring Plan, formulated at the end of fiscal 2002, and are working to establish a corporate structure capable of generating an annual increase in income based on a sustained level of completed projects of 10,000 units per year. In the fiscal year under review, we introduced an executive officer system and at the same time reviewed our headquarters organization with the aim of responding quickly to changes in the

operating environment. The next step has been to strengthen our profit structure by streamlining SG&A expenses, cutting production costs in our Housing business, enhancing product development, and reforming sales staff training in an effort to bolster marketing capabilities. As a result, consolidated total sales edged up 0.1% compared with the previous fiscal year to ¥645.1 billion, while operating income jumped 188.6% year on year to ¥8,772 million, despite a cutback in owner-occupied new housing starts.

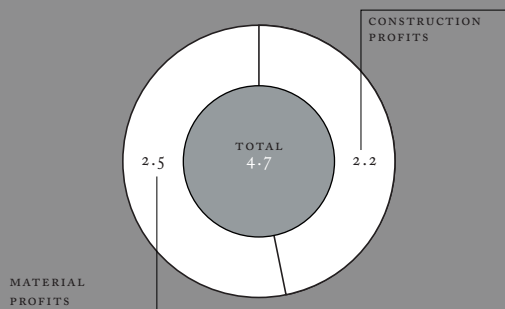
On a parent company basis, Sumitomo Forestry Co., Ltd. was successful in reducing SG&A expenses by ¥3.6 billion, in line with initial targets, and production costs by ¥4.7 billion, slightly less than the initial target of ¥5.0 billion. The Company has left no stone unturned in its efforts to address pressing issues and has contributed significantly to earnings growth.

**STRENGTHENING FINANCIAL POSITION** *The Sumitomo Forestry Group recorded an extraordinary loss, which included transaction difference of new accounting standard for retirement benefit and a write-down on the value of a portion of equity holdings, with the aim of igniting strong operating recovery and eliminating future destabilizing factors.*

The Sumitomo Forestry Group has adopted a number of initiatives including the write-down of real estate for sale, redemption of bonds, and the repayment of debt in an effort to combat growing uncertainty in the economic environment. The Group has also actively pursued initiatives geared toward strengthening its consolidated financial position and

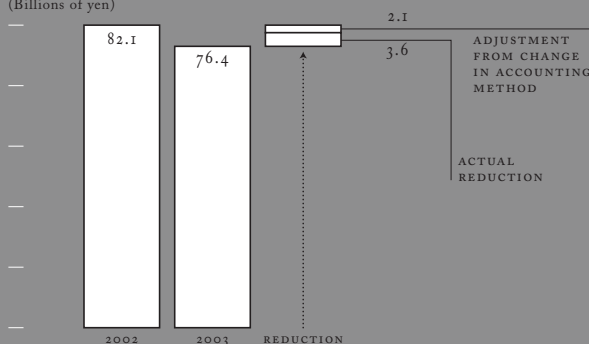
**COST REDUCTIONS IN PRODUCTION (NON-CONSOLIDATED)**

(Billions of yen)



**REDUCTION IN SELLING, GENERAL AND ADMINISTRATIVE EXPENSES (NON-CONSOLIDATED)**

(Billions of yen)



offsetting the impact of asset devaluation and movements in the cost of financial instruments.

Specifically, the Sumitomo Forestry Group shifted from recognizing the actuarial difference attributed to the adoption of a new accounting standard for retirement benefits on a straight-line basis over five years commencing the following year in which the difference arises to recognizing a lump-sum loss in the year in which the difference occurs. In addition, we reduced the discount rate in calculating projected benefit obligation from 3.5% to 2.5%. Accordingly, the total extraordinary loss relating to retirement benefits amounted to ¥22,659 million. Moreover, the Group recorded an extraordinary devaluation loss relating to Group company-provided employee housing and dormitories earmarked for future sale, and idle assets such as land identified for plant construction, totaling ¥10,093 million. At the same time, the Group incurred a loss on devaluation of investment securities of ¥2,580 million. As a result, the total extraordinary loss for the period came to ¥38,776 million. In extraordinary gains, we posted ¥7,157 million representing the partial refund in lieu of welfare pension. As a result of all these factors, the net extraordinary loss for the fiscal year under review was ¥31,618 million.

The Sumitomo Forestry Group is committed to establishing a stable operating platform and ensuring significant increase in operating income. We are confident that concrete steps have been taken to achieve these objectives, but not however without a price. In our efforts to enhance the Group's financial health and standing, we have incurred significant extraordinary losses. As a result, the Sumitomo Forestry Group recorded a net loss for the period of ¥15,439 million.

**CORE BUSINESSES FOR FUTURE GROWTH** *The Group's future is linked to the expansion of its overseas and existing housing businesses, and to restructuring business portfolios to combat overemphasis on domestic new housing starts.*

Currently, the Group's core activities comprise the Timber and Building Materials business and the Housing business. The Timber and Building Materials business principally provides materials to the building industry, and the Housing business engages mainly in the construction of dwellings in Japan. Accordingly, both rely heavily on the domestic market, particularly on new housing starts.

Moreover, we have positioned the overseas and existing housing businesses as the foundation for the next stage of growth, and through a review of our existing business portfolio, we plan to establish a more balanced earnings platform.

In the fiscal year under review, we actively worked to expand production and sales, develop new products, and cultivate new markets in our overseas business. Presently, about three-fifths of wood building materials, including plywood, particleboard, medium density fiberboard (MDF) and laminated veneer lumber (LVL), produced by our overseas manufacturing plants are shipped to countries other than Japan. In the future, we will continue to allocate management resources to business opportunities outside Japan, focusing on growth markets such as North America, China and ASEAN countries, Oceania and the Pacific Rim.



Sumitomo Forestry is aggressively investing in opportunities that promote the expansion of the Home Remodeling and Real Estate Brokerage businesses, which deal with existing housing, and has positioned second-hand homes as a core business. We have also linked home remodeling with new housing construction with the aims of increasing brand awareness and enhancing market efficacy and development. The Home Remodeling business, however, does not limit itself to the approximately 150,000 units the Group has constructed, but targets existing housing nationwide. In fiscal 2003, we increased the number of sales outlets by seven and have expanded business steadily. In the Real Estate Brokerage business, we are focusing on the major metropolitan areas and the development of a marketing process closely linked to the unique characteristics of each particular region.

## OUTLOOK

*We are working to increase profit based on the Group's Management Restructuring Plan.*

For the fiscal year commencing April 1, 2003, the housing market is anticipated to remain weak, battered by overall harsh economic and operating conditions.

Although we will continue to reform our organization and systems, reduce production costs and SG&A expenses, and fortify marketing capabilities while working to expand business scale in the relatively steady fields of rental housing and our overseas and existing housing businesses, we see fiscal 2004 as

the year in which our Management Restructuring Plan initiatives will bear fruit.

In particular, we expect to start realizing the positive effects of the Network Aided Construction Support System (NACSS), an IT production support system introduced nationwide in June 2002. This system supports the Group's post and beam construction custom-built housing, which comprises more than 90% its housing business and is expected to generate production cost savings of ¥5.0 billion.

As a result of all these factors, we forecast sales for the fiscal year ending March 31, 2004 of ¥660.0 billion, a year-on-year increase of 2.3%, operating profit of ¥12.0 billion, an increase of 36.8%, and net income of ¥7.0 billion, a turnaround of ¥22.4 billion.

## TOWARD SUSTAINABLE MANAGEMENT

*We will address all frontline issues with unwavering dedication in an effort to ensure sustained business development.*

The Sumitomo Forestry Group has been principally engaged in woodlands management for over three centuries. The Group owns an area of timberland that accounts for approximately one-thousandth of Japan's total landmass. Managed under a policy of sustainable forestry management, Sumitomo Forestry combines environmental and commercial concerns to ensure continuity and sustainability of both the forest ecosystem and business growth.



Our scope of operations currently comprises overseas business, timber and building materials, and housing and housing-related businesses underpinned by a theme of sustainability and harmonious coexistence with nature, society and industry. Our focus is not limited to environmental conservation, but includes business development in harmony with the regions in which we operate, delivering to consumers a better quality of life through high-quality products, contributing to society as a whole in accordance with accepted practice and custom, and providing employment opportunities for the community at large including positive action initiatives. Sumitomo Forestry is constantly reviewing its responsibilities to society and based on a diversity of themes, is committed to fulfilling expectations. Some examples of the Group's recent corporate citizenship activities include the establishment of an educational foundation through our subsidiary P.T. Kutai Timber Indonesia (KTI)—a manufacturer of high-quality plywood—providing education funding to under-privileged children, and restoration support in instances of natural disaster. Sumitomo Forestry has also contributed to society in Japan through volunteer forestation programs such as the rehabilitation of typhoon-damaged forests located at the foot of Mt. Fuji. In addition, based on a total commitment to customer-first principles and as part of our efforts to review the Group's after-service systems, we established a 24-hour, 365-day direct access call center, a first for the industry, to quickly respond to consumer complaints and inquiries. In our in-house activities, we established a compliance desk,

headed by the General Manager, Administration and the Group's legal counsel, in December 2002, to revitalize our organization and enhance self-regulation. In April 2003, we began a fundamental reform of human resource policies including the evaluation system and compensation structure shifting from a seniority-based system to a performance-based system. In every aspect, Sumitomo Forestry is diligently working to address the needs of current society.

As Chief Executive Officer, I am aware that the solutions to the Group's various challenges and issues lie in the frontline. It is therefore imperative that we maintain constant direct contact with those working on the frontline, and that we remain vigilant in our approach to the market and its needs. I am confident that with this focus we will resolve outstanding issues and effectively implement measures to achieve our objectives.

As our initiatives take root and progressively bear fruit, we will achieve a symbiosis among the environment, society, and the economy. Based on a philosophy of sustainable management, Sumitomo Forestry is dedicated to fulfilling its social responsibilities.



Ryu Yano

*President and Chief Executive Officer*



*Against the backdrop of a persistently difficult operating environment during the fiscal year under review, the Sumitomo Forestry Group steadily implemented a seven-point management restructuring plan. While intended to improve the operating performance and strengthen the financial position of the Company, the plan above all is geared toward achieving sustainable profitability moving forward. The following paragraphs summarize the progress achieved in the first year of the plan.*

## 1.

### Reforming the Management Structure

Following the Company's ordinary general meeting of shareholders, held on June 27, 2002, Sumitomo Forestry reduced the number of directors from 18 to seven. At the same time, we introduced an executive officer system that separates decision-making and other executive functions from operational management functions, in addition to delineating accountability with regard to both the executive and management functions. These moves have already helped to accelerate the decision-making process.

## 2.

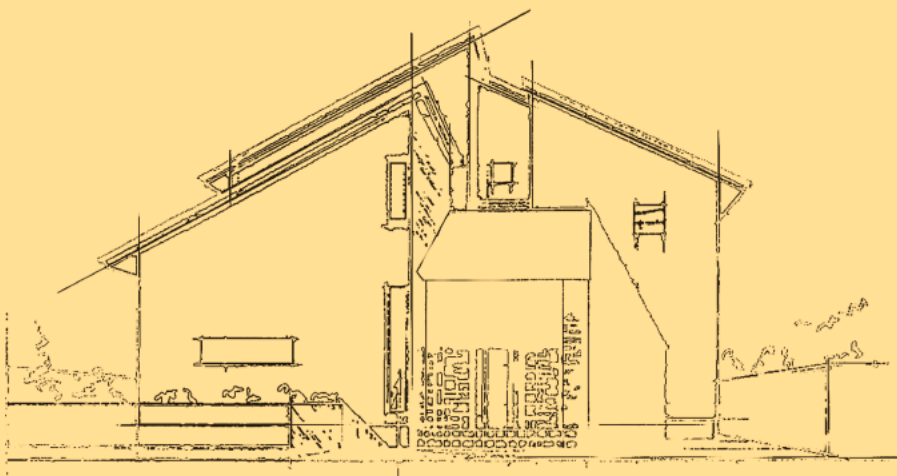
### Revamping the Headquarters Organization

In April 2002, the Company consolidated the budget allocation, investor relations (IR) and other strategic functions under the Corporate Planning Division with the aim of creating a management structure capable of responding more deftly to sudden changes in the operating environment. At the same time, we set up a legal counsel and a risk management group within the General Administrative Division, and in May we established a Risk Management Committee chaired by the General Manager Administration. Moreover, in December 2002 we established a compliance desk, responsible for the entire Group and headed by the General Manager Administration and our legal counsel.

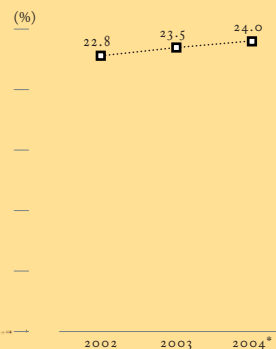
## 3.

### Cutting Production Costs

In the fiscal year under review, Sumitomo Forestry worked to lower materials procurement costs and to streamline the production process in an effort to improve profitability in the Housing segment. As a result, the Company achieved a ¥4.7 billion reduction in production costs in Housing and Housing-Related businesses and, accordingly, the gross profit margin rose to 23.5% for the year, up from 22.8% in fiscal 2002. We are targeting further reductions in production costs of ¥5.0 billion in each of the next two fiscal years for a total reduction of ¥10.0 billion.



GROSS PROFIT ON SALES\*



\* Housing and Housing-Related Business of Sumitomo Forestry Co., Ltd.

\*\* 2004 (projected)

# Undertaking 7 measures toward

# 4.

## Reducing Operating Expenses

Sumitomo Forestry implemented Groupwide initiatives to streamline selling, general and administrative (SG&A) expenses in an effort to raise operating efficiency. As a result, the Company achieved a ¥3.6 billion year-on-year decrease in operating expenses related primarily to personnel and advertising and promotion, excluding the impact of changes in accounting standards applicable to retirement benefit allowances.

The principal components in the reduction of SG&A expenses during the year were ¥1.3 billion in personnel expenses (including bonuses and other), ¥2.0 billion in advertising and promotional expenses, ¥0.3 billion in leasing fees (including office rental and other expenses) and ¥0.4 billion in consumables.

### COST REDUCTIONS AT SUMITOMO FORESTRY

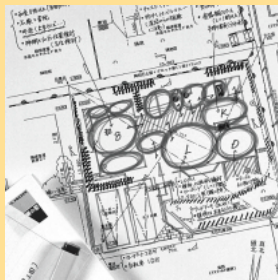
(Billions of yen)

|                    |     |
|--------------------|-----|
| PERSONNEL EXPENSES | 1.3 |
| ADVERTISING COSTS  | 2.0 |
| LEASING FEES       | 0.3 |
| CONSUMABLES        | 0.4 |

# 5.

## Enhancing Product Development

In April 2002, the Company established a new department dedicated to monitoring market demand shifts with an eye to both accelerating and enhancing product development in the domestic housing business. In the fiscal year under review, we launched six new products in response to market trends, namely, Super Natural 500 Oak, GODAI One's Story Grand Life, Proudio Three-Story, the Rialt series for first-time home buyers, GODAI Waraku (a traditional Japanese-style model), and GODAI One's Story II, an upgraded version of our mainstay GODAI One's Story model.



# 6.

## Strengthening the Collective Housing Business

In the collective housing business, we worked to attract orders by flexibly providing solutions matching the specific requirements of individual projects, from reinforced concrete structures to two-by-four wood-frame buildings. During the year, we concentrated on developing and marketing innovative structural solutions for such facilities as day-care centers for the elderly and dormitories for students of music performance. As a result of these and other activities, sales of completed projects in the collective housing business totaled ¥11,545 million in fiscal 2003, an increase of 33.4% over the previous fiscal year's result.



# 7.

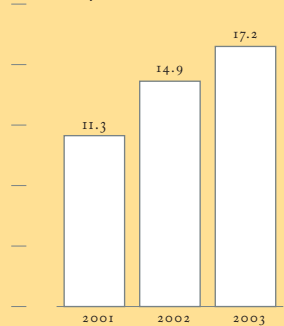
## Sharpening our Focus on New Core Businesses

During the year under review, Sumitomo Forestry newly designated two core businesses for future growth: (1) overseas operations and (2) activities related to existing housing in Japan. In overseas operations, the Company strengthened its foothold in the U.S. market with the purchase of a U.S.-based building materials importer. Moreover, we began construction on a pilot housing project after establishing a new joint venture with a U.S.-based housing company. We also acquired an Australia-based MDF manufacturer.

In business activities related to existing housing in the domestic market, Sumitomo Forestry steadily expanded its operations in the home remodeling and real estate brokerage businesses. The Company now boasts a network of 41 stores in its home remodeling business, seven more than at the end of the previous fiscal year, and 46 stores in its real estate brokerage business, an increase of three stores.

### SALES IN HOME REMODELING BUSINESS\*

(Billions of yen)



\* Sales of Sumitomo Forestry Home Tech. Co., Ltd.

*sustainable profitability*