

CREATIVITY-DRIVEN GROWTH KNOWS NO END



Annual Report 2005

 SUMITOMO FORESTRY CO.,LTD.

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→ C R E A T I N G T O M O R R O W

Forward-Looking Statements

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

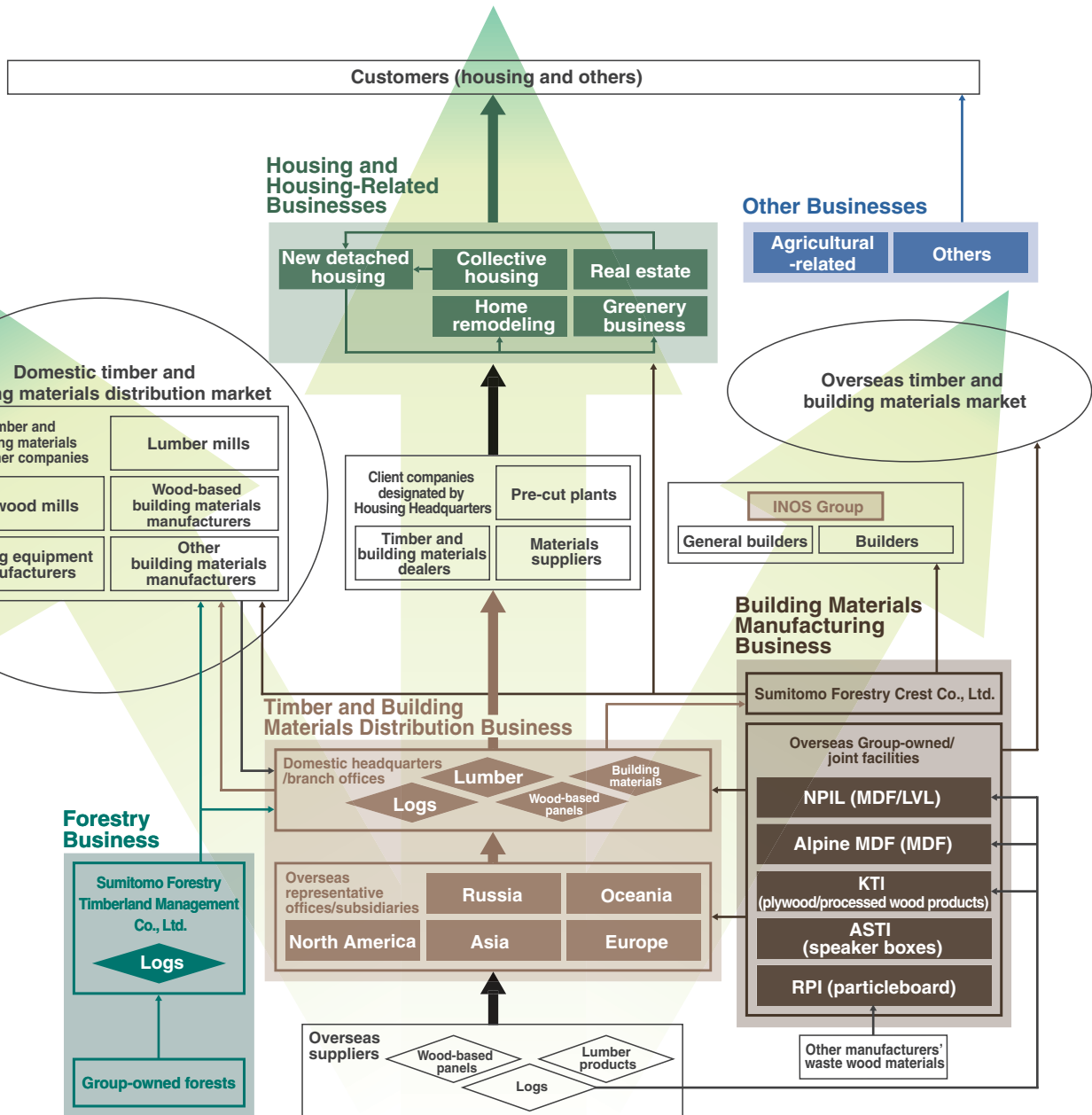


FOR ALL STAKEHOLDERS

Comprehensive Strength is Our Focus

We at Sumitomo Forestry have won the support of our customers because of our solid expertise and technical skill deriving from our centuries of experience with the wood that provides warmth and a sense of security to the living space. We believe our customers' trust is the result of our comprehensive strength regarding wood and housing, from upstream to downstream.

Rising to the top by maximizing comprehensive strength and synergies between businesses



Maximizing differentiation in all areas, from upstream to downstream, has enabled a steady increase in market share

A materials procurement network that spans the globe

- Among Japan's leaders in log, lumber, plywood, and MDF purchasing volume
- One of the highest volume MDF-producing mills in the Pacific Rim
- Highest particleboard production volume in Indonesia

Sound product strength, supported by technological strength and strict standards

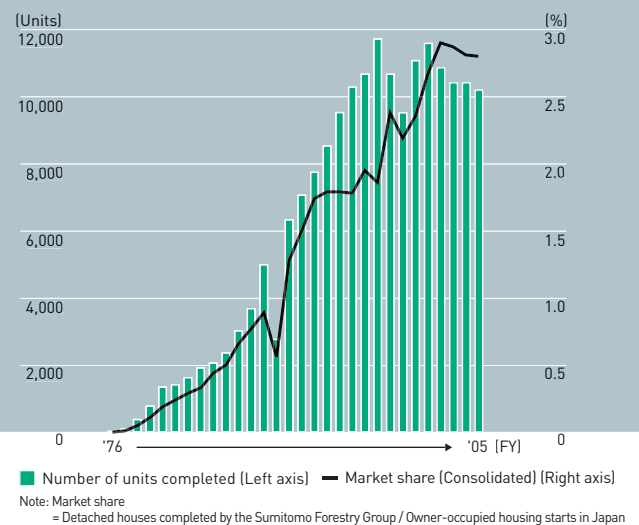
- No. 1 custom-built wooden homebuilder in number of completions*
- Highest in the number of in architects among major homebuilders

* Jutaku Sangyo Kenkyujo Co., Ltd.

A service system that fully grasps customer needs

- METI Minister Award for Exemplary Consumer Focus received in fiscal 2005
- No.1 ranking in 2003 Nikkei Business after-sales service survey, housing division

Number of Detached Houses Completed and Market Share

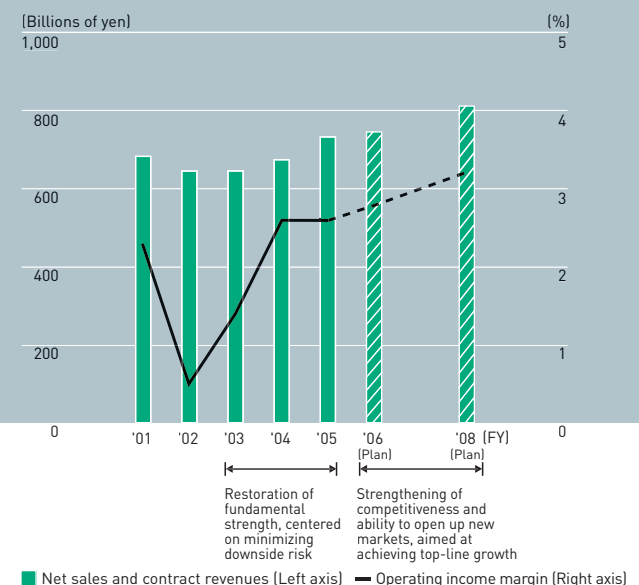


Now that we have restored profitability, we are redoubling efforts to increase earnings sustainability and growth potential

The management structural reforms we implemented from fiscal 2003 through fiscal 2005 have provided us with a firm foundation for our next growth phase. Specifically, it has resulted in (1) a ¥15.6 billion reduction in housing production costs (exceeding our target); (2) improved financial structure; and (3) a firm foothold in priority growth businesses.

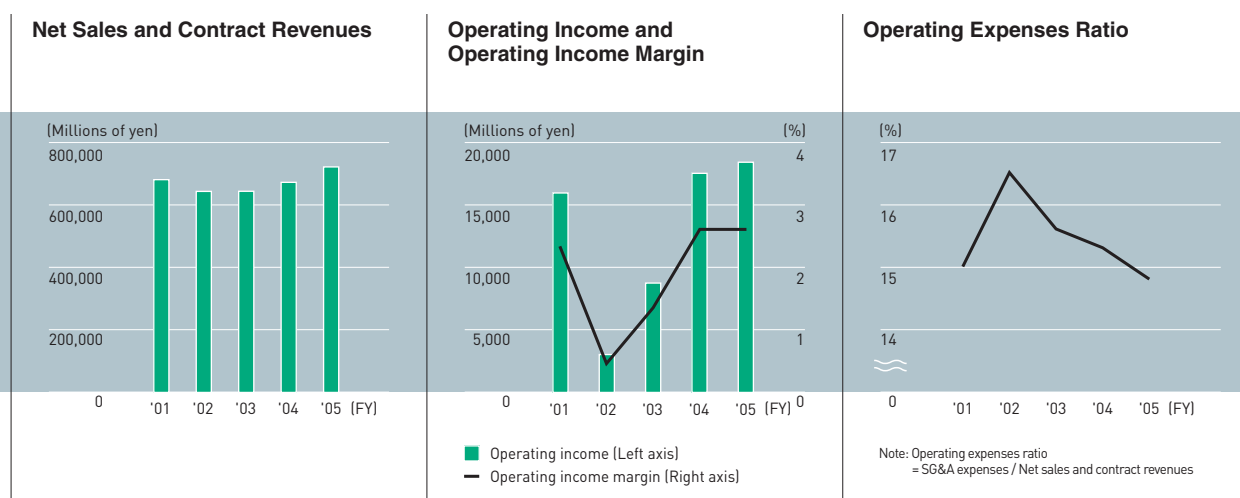
With this as a base, in fiscal 2006 and thereafter we will intensify our efforts to achieve sustainable growth. We consider the two main drivers of top-line growth to be (1) substantially increasing market share in mainstay businesses; and (2) expanding operations in priority growth businesses.

Net Sales and Contract Revenues and Operating Income Margin



Financial Highlights

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

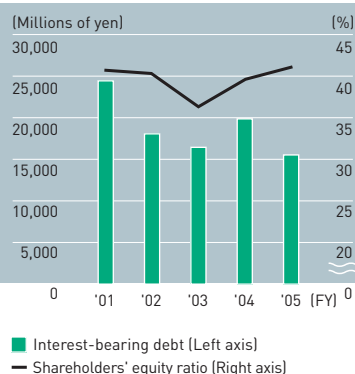


	2005	2004	2003	2002	2001	2005
	Millions of yen					Thousands of U.S. dollars*1
Operating Results:						
Net sales and contract revenues	¥ 723,193	¥ 673,779	¥ 645,100	¥ 644,730	¥ 682,375	\$ 6,758,817
Gross profit	125,582	120,778	109,631	109,437	118,064	1,173,666
Selling, general and administrative expenses (SG&A expenses)	107,116	103,201	100,858	106,397	102,065	1,001,087
Operating income	18,466	17,577	8,772	3,040	15,999	172,579
Recurring income*2	18,692	17,074	9,721	3,731	16,908	174,694
Net income (loss)	8,014	9,870	(15,439)	465	6,994	74,900
Financial Position:						
Total assets	370,684	369,755	357,322	365,531	371,102	3,464,338
Interest-bearing debt	15,580	19,929	16,497	18,124	24,517	145,607
Total shareholders' equity	152,500	146,269	129,727	147,440	150,979	1,425,234
Cash Flows:						
Cash flows from operating activities	6,685	25,962	19,734	17,332	3,468	62,474
Cash flows from investment activities	(12,895)	(7,646)	2,026	(16,439)	(1,960)	(120,516)
Cash flows from financing activities	(7,087)	(735)	(8,171)	(9,716)	(13,873)	(66,231)
Per Share Data:						
	Yen					U.S. dollars*1
Net income (loss)	¥ 45.28	¥ 55.81	¥ (87.53)	¥ 2.64	¥ 39.64	\$ 0.42
Shareholders' equity	866.47	830.50	736.42	835.07	854.91	8.10
Cash dividends	13.00	13.00	10.00	10.00	10.00	0.12

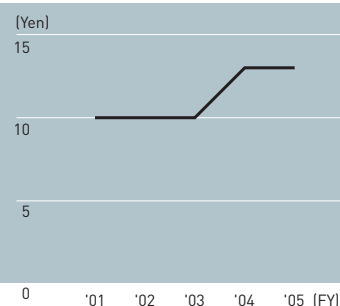
ROA and ROE



Interest-Bearing Debt and Shareholders' Equity Ratio



Cash Dividend per Share



	2005	2004	2003	2002	2001
	%				
Financial Ratios:					
Operating income margin	2.6	2.6	1.4	0.5	2.3
Return on assets (ROA)* ³	5.0	4.7	2.7	1.0	4.6
Return on equity (ROE)* ³	5.4	7.2	(11.1)	0.3	4.7
Shareholders' equity ratio	41.1	39.6	36.3	40.3	40.7
Interest-bearing debt ratio* ⁴	9.3	12.0	11.3	10.9	14.0
	Units				
State of Orders (on a unit basis):					
Custom-built detached housing	10,076	10,529	10,538	10,685	11,377
Collective housing	1,776	1,655	1,227	1,075	719
State of Sales (on a unit basis):					
Detached housing	10,319	10,542	10,552	11,008	11,710
Collective housing	1,571	1,266	1,220	822	893
Reference Market Data:					
New housing starts (nationwide)	1,193,038	1,173,649	1,145,553	1,173,170	1,213,157
New housing starts (Tokyo metropolitan district)	419,088	422,750	393,296	393,625	395,086
Owner-occupied housing starts (nationwide)	367,233	373,015	365,507	377,066	437,789

- Notes: 1. Japanese yen amounts have been translated into U.S. dollar amounts, for the reader's convenience only, at the rate of ¥107=US\$1, the approximate exchange rate prevailing in the Japanese foreign exchange market at March 31, 2005.
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.
3. 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
4. Interest-bearing debt ratio = Interest-bearing debt / (Interest-bearing debt + Shareholders' equity)

To All Our Stakeholders

Our competitive edge and brand value lie in our ability to provide a variety of services related to the living environment, always from the customer's perspective as professionals in wood and housing imbued with the richness that wood adds to peoples' lives. We at Sumitomo Forestry have cultivated this ability through living with and learning from forests ever since our foundation more than 300 years ago.

Through management structural reforms conducted over the past three years, we have steadily bolstered our management base, enabling us to take a more aggressive stance. We are now at the point where we can accelerate the opening of new markets, with the goal of providing a broader range of customers with the expertise, technology, and services that set the Sumitomo Forestry Group apart from the competition.

We strongly believe that the possibilities for creating markets and added value are unlimited, and we are working to further increase the Group's profitability and corporate value by winning the maximum possible support and confidence from all our stakeholders.

Business Performance in Fiscal 2005 (April 2004-March 2005)

Strength of Recovery Weak Overall

In fiscal 2005, ended March 31, 2005, the Japanese economy saw exports and production trend upward, fueled by growth in the global economy, and positive signs were seen in corporate profits, employment, and personal spending. However, the domestic economy slowed in the latter half of the year, owing to inventory adjustments among IT-related companies and weakness in exports. Consequently, the outlook for the economy remained cloudy. In the housing industry, demand for built-for-sale houses and rented houses increased, but owner-occupied housing starts—the factor with the greatest impact on Sumitomo Forestry's earnings—returned to negative growth, falling 1.6% year on year, to 367,000 units. In the timber and building materials market, prices for some products rose, thanks in part to an overall increase in new housing starts, but in the second half, there was a reversal in prices due to oversupply and the market price trend remained weak.

Steady Growth Independent of the Macro Economy

In spite of this stagnant operating environment, the Group achieved a third consecutive year of positive earnings growth in fiscal 2005, with net sales and contract revenues totaling ¥723.2 billion, up 7.3% year on year. Profit growth was even stronger and recurring income rose 9.5%, totaling ¥18.7 billion, as ongoing production cost and operating expense reductions offset a sharp rise in materials costs and an increase in sales promotion expenses. To accelerate the process of exercising selectivity in our business portfolio, and to help concentrate management resources on growth fields going forward, we withdrew from the wooden component housing business, and in connection with this recorded an extraordinary loss of just over ¥3.2 billion. Consequently, net income fell 18.8%, to ¥8.0 billion.

Profitability Up in All Business Segments

Sales and profits rose in all business segments. In the Timber and Building Materials segment, there was a sharp recovery in earnings, with segment sales and operating income up 9.2% and 21.0% year on year, respectively. This was attributable in part to the improved performance of our overseas building materials manufacturing operations (earnings from which were poor in fiscal 2004), where market prices recovered and overseas group companies worked to streamline their manufacturing. In the Housing and Housing-Related Businesses segment, sales rose 6.3%, largely attributable to (1) an increase in unit prices, despite no growth in the number of completions, stemming from the success of the Group's ongoing strategy of shifting to high value-added products; and (2) steady growth in the housing stock business which includes the remodel-



Ryu Yano
President and Chief Executive Officer

ing and real estate transaction businesses, and is an area that the Group considers to be a new growth driver and is aggressively working to expand by adding personnel and business bases. Although the segment achieved ¥3.7 billion in cost reductions, segment operating income rose only 2.2%. This was attributable to (1) aggressive spending on sales promotion, aimed at fostering future growth; (2) cost increases associated with enhancing product competitiveness; and (3) sharply higher materials costs and expenses related to recovering from natural disasters such as typhoons and earthquakes.

A Look Back at Our Three-Year Management Structural Reform Efforts (Fiscal 2003-2005)

Over three-years, ended in fiscal 2005, we aimed at strengthening the Group's structure to enable a new growth phase, and implemented group-wide management structural reforms. We fully intend to be one of the winners in our field, able to maintain growth even in a challenging operating environment. Our goal is to achieve truly excellent management, impervious to changes in the macro environment —indeed, we consider this a prerequisite for being one of the industry winners. We call the three qualities that must be in place in order to achieve excellent-company status “Strong (Strength), Big (Size), and Good (Quality).” By “Strong,” we mean having a solid corporate structure. By “Big,” we mean increasing the scale of the Group. By “Good,” we mean conducting our operations in a way that benefits society. Although we are still only half way on our journey toward excellent-company status, our reform efforts over the past three years have generated steady results, and our management base is vastly stronger than before. As a result, over the past three years our operating income and net income have increased six-fold and 17-fold, respectively.

Strong: Adopting a Muscular Earnings Structure

We have worked to reduce operating expenses and housing production costs to achieve solid profitability that is less susceptible to fluctuations in economic conditions. Specifically, we have vastly improved manufacturing efficiency by (1) reducing material waste and inefficient processes through a review of construction methods and the use of the Network Aided Construction Support System (NACSS), a house construction management system that uses IT to unify the management of specifications and construction progress; and (2) developing materials that are both lower in cost and higher in performance. As a result, over the past three years we were able to reduce housing production costs by more than our initial goal of ¥15.0 billion. Furthermore, by increasing product quality without raising product prices, we improved customer satisfaction and increased our operating income margin by 2.1 percentage points compared to fiscal 2002. Moreover, we lowered personnel costs by reforming our retirement-benefits system and reduced operating expenses by controlling leasing costs and advertising and promotion expenses. This enabled us to lower our operating expenses ratio by 1.7 percentage points compared to fiscal 2002.

Big: Nurturing New Businesses to Accelerate Growth

Not all of the moves we carried out in the three-year management structural reforms were defensive in nature. Particularly in the latter half of the period, we invested resources in three priority growth businesses (overseas operations, housing stock, and collective housing) in preparation for taking a more aggressive management stance in fiscal 2006 and beyond. As a result, the aggregate sales and recurring income of these three businesses have doubled over the past three years.

Good: Creating a Sound Management System

Along with our efforts to increase the soundness and transparency of our management system, we have tried to improve the quality of management through a review of strategic functions and operations. We worked to further strengthen our already solid financial structure by solving the shortage of accrued retirement benefits in fiscal 2003, and adopting fixed-asset impairment accounting in fiscal 2004 ahead of it becoming mandatory. All this helped to make our balance sheet sounder and more transparent. In addition, as part of our effort to exercise greater selectivity and focus in our business portfolio, we withdrew from unprofitable businesses as discussed earlier.

Among organizational developments, we introduced an executive officer system in fiscal 2003 and concentrated strategic and policymaking functions with the Corporate Planning Division, with the goal of speeding up the Company's decision-making capabilities. We also worked to enhance the Company's compliance and risk management and improve its ability to quickly respond to changes in the business environment. Moreover, to increase employee motivation and bring out their latent productivity, we established a new personnel system in fiscal 2004, with the goal of shifting from outdated personnel practices such as the seniority system and lifetime employment to a practical job grading system that emphasizes the capabilities and performance of the individual employee.

Future Strategies —Going All Out to Enable More Aggressive Management

Working to Increase Top-Line Growth

Over the past three years, we have worked to improve profitability mainly by reducing production costs and have established a solid corporate structure that is less susceptible to fluctuations in the economy. However, we cannot strengthen our profit-generating capability in a sustainable manner or increase our corporate value by defensive efforts alone. For that reason, in fiscal 2006 we are shifting our management stance from “defense” to “offense.” Based on the brand strength we have accumulated over the years as well as the strong profitability and solid management system we have put in place over the past three years, we will go all out to further develop both existing and new markets. Specifically, we will take the following steps to accelerate our top-line growth, with the goal of exceeding the current recurring income record of ¥25.5 billion by fiscal 2008.

1. Increasing Market Share in Core Businesses

Latent demand in the domestic market for newly constructed detached housing is growing, thanks in part to the growing stock of houses approaching replacement age. However, this latent demand has yet to emerge, so the outlook for the market remains cloudy. That said, in large urban areas the potential for market growth is significant, with land prices in certain areas now rising. For that reason, we will for the time being place priority on large urban areas and work to increase market share in these places. In Tokyo, we are stepping up our efforts to achieve the top share in owner-occupied housing within two years. In fiscal 2005, we laid the groundwork for achieving this goal by launching new three-story housing products as well as reinforcing our sales offices and sale staff. In fiscal 2006, we established a new Tokyo Housing Business Division and conducted an organizational review in April 2005. In addition, we will add employees and business bases. We will also bolster land-related initiatives, with the goal of tapping demand among first-time homebuyers, and will continue to put effort into our built-for-sale housing business, which was strengthened starting in fiscal 2005. At the same time, we will continue working to maintain and improve our business structure as a means of bringing down housing production costs.

In the timber and building materials industry, competition for mere survival is intensifying, and industry realignment including mergers among competitors is accelerating. We are formulating a marketing strategy to respond to these major changes and are considering specific capital and operating alliances. In fiscal 2006, as a part of this effort, we have purchased stock in Toyo Plywood Co., Ltd., a manufacturer of housing equipment and building materials, and have approved a plan to purchase stock in Ataka Kenzai Co., Ltd., a building materials trading company. In the area of imported lumber and wood building materials, we are leveraging our purchasing bases spread over a number of regions worldwide to significantly increase our market share in high-quality, directly imported products, including logs, lumber, plywood, and MDF.

Summary of Management Structural Reforms (Fiscal 2003-2005)

1. Efforts to Increase Profitability

Housing production cost reductions	Cost management and streamlining construction processes Result: Costs reduced ¥15.6 billion (versus target of ¥15.0 billion)	
Operating expense reductions	<ul style="list-style-type: none"> • Operating expenses cut by ¥3.6 billion in fiscal 2003 (operating expenses increased in fiscal 2004-2005 owing to investment in priority growth businesses) • Leasing expenses and sales and promotion costs reduced • Risk of sharp increase in personnel expenses lowered thanks to reform of personnel system 	
Financial structure improvements	<ul style="list-style-type: none"> • Shortage in accrued retirement benefits reserve solved (fiscal 2003) • Revaluation loss on real estate for sale recorded (fiscal 2003) • Early adoption of fixed asset-impairment accounting (fiscal 2004) • Retirement benefits system reformed (cash balance plan introduced) (fiscal 2004) • Withdrawal from unprofitable businesses (fiscal 2005) etc. 	

* Operating expenses ratio = SG&A expenses / Net sales and contract revenues

2. Efforts to Improve the Management Structure

Management organization improvements	<ul style="list-style-type: none"> • Executive Officer System introduced (fiscal 2003) • Number of directors reduced, Board of Directors reformed (fiscal 2003) • Board of Managing Executive Officers replaced by Executive Committee (fiscal 2003)
Administrative organization improvements	<ul style="list-style-type: none"> • Budget compilation, performance supervision, IR, and other strategic functions concentrated within the Corporate Planning Division (fiscal 2003) • Risk Management Committee (now Risk Management and Compliance Committee) established (fiscal 2003) • Compliance Counter established (fiscal 2003) • Full-scale adoption of CSR management (CSR Promotion Office established in April 2005)

3. Efforts to Accelerate Growth of Priority Growth Businesses

(Billions of yen)	FY2002		FY2005		Change	
	Sales	Recurring income	Sales	Recurring income	Sales	Recurring income
Overseas operations	29.3	1.5	43.5	1.8	+14.2	+0.3
Housing stock	20.2	0.6	32.0	1.1	+11.8	+0.5
Collective housing	8.7	(0.4)	48.0	0.8	+39.3	+1.2
Total	58.2	1.7	123.5	3.7	+65.3	+2.0

Note: All figures are on a simple aggregate basis (i.e., prior to consolidation adjustments).

In domestic building materials, we are redoubling our efforts to conduct community-based marketing, as well as to strengthen our dealings with major wholesalers and manufacturers.

2. Expanding the Scale of Our Three Priority Growth Businesses

To improve our business structure, which is currently highly dependent on the domestic market for owner-occupied housing, and to create a more solid management base, we are investing resources in a concentrated manner in three priority growth businesses in which we can leverage the technologies and expertise we have accumulated in our existing core businesses. We consider expanding the scale of these businesses a high priority, and are taking the following steps to make this happen.

In overseas operations, we intend to further strengthen and expand the scale and geographic scope of existing operations, and to grow new operations. Among new operations, in overseas housing sales, we plan to increase the number of built-for-sale housing sold in North America from 52 in fiscal 2005 to 85 in fiscal 2006 and around 120 in fiscal 2007. We have also started such operations in China and plan to aggressively expand into other regions. Our target for overseas operations is to increase recurring income on a simple aggregate basis from ¥1.8 billion in fiscal 2005 to ¥3.7 billion by fiscal 2008. Our goal is to “become a corporate group that operates total housing and living-related business on a global basis.” To that end, we are working aggressively to open up new markets, to establish as quickly as possible a corporate structure in which it is possible for one-third of total Group profits to be generated by overseas operations.

In the housing stock business which includes the remodeling and real estate transaction businesses, our goal is to increase sales from ¥32.0 billion (with ¥1.1 billion in recurring income on a simple aggregate basis) in fiscal 2005 to ¥45.0 billion (with ¥2.3 billion in recurring income) by fiscal 2008. In the remodeling business, we intend to aggressively expand sales routes through differentiation in planning capabilities and our technological strength including our forte renovation of large wooden properties. By doing so, we believe we can bring our renovation subsidiary Sumitomo Forestry Home Tech Co., Ltd. to the top of the industry. In the real estate transaction business, we plan to add four business bases to the network of real estate transaction subsidiary Sumitomo Forestry Home Service Co., Ltd., bringing the total to 55 in fiscal 2006.

In the collective housing business, our goal is to increase sales from ¥48.0 billion in fiscal 2005 to ¥54.0 billion (with ¥1.5 billion in recurring income on a simple aggregate basis) by fiscal 2008. We are aggressively making priority investments in various marketing activities, such as adding personnel and business bases. In addition, we are working to execute a product strategy that leverages the Sumitomo Forestry brand, in part by increasing the ratio of wooden post-and-beam apartment sales, an area in which we can utilize the expertise we already possess, including that related to lowering costs.

In Conclusion

We are not simply working to be a group that generates strong profits; we are working to create win-win relationships with all our stakeholders with a thoroughgoing Customer First mindset. We believe that only those companies that enjoy widespread support and are truly needed by society can achieve sustainable growth. And, by achieving this sort of sustainable growth, we are working to expand our total housing and living-related businesses on a global basis, and to establish a presence as a corporate group indispensable to peoples' daily lives.

The success of our management structural reforms over the past three years would not have been possible without the assistance of our customers and shareholders, or without our employees, who carry out their duties with a sense of independence and professionalism. Now, to achieve our new goals, all employees and executives will need to have an even more challenging spirit than before. Through enhanced education and training, as well as a Sumitomo Forestry mindset shared by all Group employees, we will make a concerted effort to achieve our goals.

In conclusion, I humbly ask for your continued support and honest counsel going forward.

August 2005
Ryu Yano
President and Chief Executive Officer

