

Sumitomo Forestry Group
Financial Results for the First Quarter of the Fiscal Year Ending December 31, 2023
Conference Call with Analysts and Institutional Investors - Q&A

Time and date: 4:30 p.m.– 5:30 p.m., Wednesday, April 27, 2023

Answers: Tatsumi Kawata, Director and Senior Managing Executive Officer, Sumitomo Forestry Co., Ltd.

Q

With regard to orders received in the United States, could you tell us the number of orders received by Southern Impression Homes and its impact on profit and loss? Please also tell us the reasons why profit margin for US housing companies, at 14.9%, performed better than expected.

A

The number of orders received for Southern Impression Homes was about 60 units. We are still calculating but we believe that the impact on overall profit and loss will be minor, given that there is also goodwill amortization this fiscal year.

Our profit margin forecast for the full year ending December 2023 was 12.9%, but actual profit margin for the first quarter of FY12/2023 was 14.9%. Unit selling price has increased by 1.1% year-on-year on a local currency basis. Costs were also lower than anticipated, despite the impact of the persistently high prices for construction material and rising labor costs, and we were able to keep incentives lower than expected. As a result, the decline in profit margin was suppressed at about 5 points compared to the same period last year when performance was strong.

Q

I get the impression that the number of orders received by Sumitomo Forestry has declined by a smaller amount in comparison with other builders. Could you tell us again what your company's strengths are?

A

Our strength lies in the premise that we expand our business in regions with growing populations and robust housing demand. Although we had no choice but to restrict the number of housing starts due to the market decline last year, we were able to process contract cancellations at an early stage for properties that failed to pass their loan screening, which helped us to secure spec homes inventory. As a result, we were able to secure an appropriate volume of inventory available on hand to sell when customers started to make purchasing moves this year. We believe this is one of the major factors behind the current strong order performance. The number of housing starts is already starting to

increase now against the backdrop of a strong market. In terms of area, the East Coast is experiencing less decline and overall recovery, which we believe is contributing to boosting the overall performance.

Q

Looking at the explanation of the business results on p.11 of the PowerPoint presentation, while real estate development sales fell only marginally to 11.5 billion yen, recurring income is in the red at 1.0 billion yen. Could you tell us the reason behind these figures? In addition, could you also tell us the outlook for the eight properties expected to be sold, in light of the current financial unrest?

A

The real estate development plans for FY12/2023 include the sale of eight properties in the second half of the fiscal year.

The US real estate development business involves forming and investing in many joint ventures. In such cases, they become affiliated companies accounted for using the equity method. Hence, when properties are sold, they are not recorded as sales. Instead, only the profits are recorded as non-operating income or loss. For this reason, even if sales are at the same level as last year, the absence of property sales in the first quarter of FY12/2023 put us in the red on a recurring income basis.

Due to the impact of the financial crisis, local banks are now taking a tougher stance on lending. Investors also tend to be more cautious when forming joint ventures.

Of the eight property sales we are planning for the second half of the fiscal year, seven are multi-family housing properties. Although conditions are difficult for office sales in the current market, we have heard that conditions are relatively stable for multi-family housing. Going forward, however, we think it will be necessary to continue closely monitoring the financial situation, including the banking situation.

Q

Orders for the US housing business appear to be improving and on a recovery trend, so could you tell us why the full year plans have remained unchanged?

A

The current order situation is progressing better than anticipated, but we have left the full year forecast unchanged due to the strong uncertainty with regard to the financial outlook, such as the possibility of financial unrest in the U.S. and further interest rate hikes.

Q

Recovery seems to be increasingly distinct for the US single family homes business, as signaled by the year-on-year increase in the number of orders for March this year. Could you tell us about the current inventory strategy and your approach to land acquisition? The balances of real estate for sale and real estate for sale in process at the end of the first quarter have increased slightly compared to the end of FY12/2022.

□A

The current number of orders received is higher than expected, but there are no changes to our approach to acquiring new land, which is to carefully select the target lot before proceeding. We are not proactively acquiring new land for the present. On the other hand, we continue to hold close to 70,000 purchased lots in inventory, including land under purchase contracts. Where necessary, we will move forward with the takedown of purchase contracts, among other measures. The slight increase in the balances of real estate for sale and real estate for sale in process, in comparison with the end of the previous period, is due to the impact of Southern Impression Homes, which was newly consolidated in January this year. If we were to exclude its impact, the balances will be substantially lower than at the end of the previous period.

□Q

Could you tell us why recurring income ratio in the first quarter (14.9%) had fallen from the first quarter results in the previous year (19.6%)? Recurring income ratio in the first quarter of 14.9% and unit selling price of US\$494,000, excluding the impact of exchange rates, are higher than the full year forecasts of 12.9% and US\$481,000. Despite that, recurring income ratio has fallen by close to 5 points year-on-year. Could you tell us the concrete reasons behind the increase in costs?

□A

Although timber prices have fallen, the prices of construction materials other than timber are soaring, such as for concrete and gypsum board. In addition to that, labor costs have also risen on the back of wage increase in the U.S. These are the factors behind the increase in costs compared to the previous fiscal year.

□Q

With regard to the number of orders received in the first quarter for the US single family home business, please explain the factors behind the rapid recovery from the fourth quarter of FY12/2022 in greater detail, alongside the contents of incentives.

□A

A certain number of contract cancellations took place in the fourth quarter of FY12/2022. Although

the number of units ordered fell significantly after the contract cancellations, we made progress in the sale of these same properties, which contracts were cancelled for, in the first quarter of FY12/2023. In addition, with widespread recognition among customers that mortgage rates will not rise above the current levels, contracts are being concluded even at rates of around 6%. Another factor is the relatively strong demand for new builds as the number of existing homes in circulation remains low. Many existing homeowners had purchased their properties in times of low mortgage rates, so they would need to convert to mortgages with a higher interest rate if they were to sell their current homes. For this reason, they are not willing to sell and the existing homes market has become extremely sluggish. Incentives that are being implemented include partial subsidies for mortgage interest or providing free options such as furniture. Incentives have been implemented since April 2022 when the housing market deteriorated, but the implementation of incentives for the first quarter of this year did not go as far as expected at the beginning of this fiscal year. Therefore, the strengthening of incentives has not necessarily contributed to an improvement in orders.

Q

With regard to the contract cancellation rate for the US single family homes business, could you tell us the figures for the fourth quarter of FY12/2022 and the first quarter of FY12/2023 respectively? In the case of resale after contract cancellations, are the properties being sold at the selling price after deducting the cancellation fees?

A

Contract cancellation rate for FY12/2022 was about 32% for the full year but increased further in the fourth quarter. Cancellation rate in the first quarter of FY12/2023 was 19%, below the usual level of 20%.

With regard to resale prices after contract cancellation, while I believe there are also cases where the properties sold at prices after the deduction of cancellation fees, these are likely to be rare in keeping with the sale prices of neighboring lots. We determine selling prices appropriately while observing the market situation of various communities.

Q

Concerning the provision of incentives to customers in the US single family homes business, in the case of partial subsidies for mortgage interest, for example, will it put pressure on costs and expenses in the future if these costs are incurred even after delivery?

A

Our company will not incur costs after delivery. The costs related to incentives are all settled at the

point of handover. As for whether it will be calculated as a part of costs or SG&A expenses, this is not uniform and differs depending on the contents and between each subsidiary.

Q

There appears to be variations between areas with regard to the sales situation for the US single family homes business. Could you tell us what the situation is like?

A

Customer trends, competition, inventory, and management styles vary by area and by subsidiary, so the sales situation is not uniform. Depending on the community, decisions on the implementation of price increases, for example, are made depending on the situation at each site.

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