

## Sumitomo Forestry Group

### Financial Results for First Quarter Fiscal Year Ending March 31, 2020 Conference Call with Analysts and Institutional Investors - Q&A

Time and date: 10:00 a.m.–11:00 a.m., Wednesday, July 31, 2019

Briefer: Tatsumi Kawata, Director and Managing Executive Officer

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Q

Can you tell us about your outlook for the future business environment of custom-built detached houses in Japan and the efforts you are making to increase orders?

A

The effects of the sharp reactive decline in response to the consumption tax hike have come to the surface to an extent. However, they are more subdued than the last time the consumption tax was increased. Going forward, there will be more activity among customers benefiting from the government's measures to address the sharp reactive decline. We will work to build up orders by continuing to strengthen our approach with respect to customers purchasing land and constructing custom-built detached house through promotional campaigns during the Obon season.

Q

In regard to the domestic custom-built detached housing business, orders received were favorable in the previous year, so first quarter sales seem low. Are there extraordinary factors for this, such as construction delays?

A

Most of the orders received at the end of the previous year are scheduled to be completed and delivered in the second quarter and thereafter. There are no particular problems such as construction delays.

Q

How are the Apartments Construction business and Renovations business being affected by the consumption tax hike?

A

There are no governmental measures in place with respect to apartments to address the sharp reactive decline, so the last-minute demand and sharp reactive decline are more seen than with custom-built

detached houses. On the other hand, the number of projects is bouncing back, so we will continue to work on strengthening our sales capabilities under the branch structure in order to increase sales, particularly in metropolitan areas. The Renovations business has also been affected by a sharp reactive decline. A large percentage of our Renovations business are large in scale with longer construction periods, and these are relatively more susceptible to the effects of consumption tax increases.

Q

What were the factors behind the improvement of the non-consolidated Housing and Construction Business gross profit ratio in the first quarter?

A

The main factor is that net sales associated with buying and selling of interior products are offset due to the changes in accounting policy. Under the previous standards, the profit ratio is at the same level as the same period of the previous year.

Q

The forecast for the non-consolidated full-year gross profit ratio in the Housing and Construction Business of 23.7% is lower than the previous year (24.2%). In the first quarter, it was around the same level as the same period of the previous year. What is the background behind the forecast for a lower ratio on a full-year basis?

A

Labor costs are rising year after year, and we are revising the unit prices for orders placed with partner contractors every year. The unit prices from the previous year have been applied to most of the property constructions in the first quarter. Because there will be more properties to which the new unit prices are applied in the second quarter and beyond, we expect the full-year gross profit ratio to fall short of the previous year's.

Q

With the changes in accounting policy, some properties under construction at the end of the year in the Housing and Construction Business will be recognized as profit that were not before. Is it correct to say that the changes in accounting policy will have the effect of boosting full-year net sales and recurring income?

A

Construction properties that have yet to be delivered as of the end of this year will be recognized as

revenue depending on the progress. On the other hand, revenue corresponding to progress on properties that were under construction as of the end of the previous year has been added to retained earnings on the balance sheet at the beginning of this year and will not be recognized as revenue for this year. As such, looking at the full year, there is no impact.

Q

In regard to Overseas Housing and Real Estate Business in the first quarter, can you tell us about the scale of the spec homes business in the United States? Also, what were the factors behind the increase in recurring income in Australia in the first quarter, and what is your outlook with respect to the future business environment?

A

Recurring income at the five companies in the United States that are part of the spec homes business was around 6 billion yen in the first quarter. As anticipated at the beginning of the year, the Australian market remains in an adjustment phase, but recurring income increased owing to an increase in equity in earnings of affiliates of several hundred million yen.

Q

Labor, materials, and other costs in the United States have been increasing since the second half of the previous year. What is the current situation?

A

There have not been any significant changes to the situation as anticipated at the beginning of the year. The outlook for the full year is uncertain due to the impact of trade friction between the United States and China, but basically, we see this trend continuing.

Q

How much did Crescent contribute to income in the Overseas Housing and Real Estate Business in the first quarter? Also, what is the scale of residential land sales?

A

We are not expecting a major contribution to income from Crescent this year, and the same goes for the first quarter results. Residential land sales vary by company, but sales at Mark III, which is engaged in land development and was added to the scope of consolidation in the previous year, were around 2 billion yen.

Q

What was the impact of the increase in “Other, consolidated adjustments, etc.,” which includes amortization of goodwill and headquarters administrative expenses, in the Overseas Housing and Real Estate segment in the first quarter? Will this trend continue on a full-year basis?

A

The increase in goodwill is associated with the subsidiaries that were added to the scope of consolidation in the second and third quarters of the previous year, so the negative impact on income from the increase in amortization will be smaller on a full-year basis compared to the first quarter. We also do not expect headquarters administrative expenses increasing substantially.

Q

In regard to Overseas Housing and Real Estate Business, motivation to buy a house and housing prices are expected to go up in conjunction with the lowering of interest rates in the United States. If that happens, will it also improve the gross margin in your spec homes business?

A

Affordability may increase with lower interest rates, but housing prices are already continuing at a high level, so we do not believe that it will lead to immediate increases in unit selling prices or improvement in the gross margin ratio.

Q

What were the factors behind the decrease in income in the Timber and Building Materials Business in the first quarter?

A

In the overseas manufacturing business, manufacturing costs are on the rise at Nelson Pine Industries in New Zealand, and the MDF shipment volume to Japan is decreasing. Moreover, sales of imported plywood in the distribution business have slowed compared to the previous year. These factors were behind the decrease in income.

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