

Sumitomo Forestry Group
Financial Results for the Second Quarter of the Fiscal Year Ending December 31, 2021
Conference Call with Analysts and Institutional Investors - Q&A

Time and date:

1:00 p.m.– 2:00 p.m., Wednesday, August 11, 2021

Respondents:

Toshiro Mitsuyoshi, President and Representative Director, Sumitomo Forestry Co., Ltd.

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

Q

I understand that you are allocating 32.3 billion yen of the funds from the capital increase through public offering to operations related to purchasing real estate for sale and repayment of long-term debt in the United States. What is your view on future returns? Also, with the ups and downs in the real estate market, do you have any measures to avoid risks in your portfolio, such as choosing option agreements for land purchases?

A

I believe there are various approaches to returns. For example, the ROA and inventory turnover at our local headquarters, which is over our US housing subsidiary, in the fiscal year ended December 2020 were at high levels compared to listed builders in the United States. We will continue to pursue capital efficiency while monitoring indicators such as this.

As of the end of the second quarter of the year under review, there is about six years' worth of land inventory in the United States. This is based on the current sales plan, which includes land owned by the Company that will last about three years and land in option contracts that will last about three years.

Q

What is the average lead time and current status of orders received in the detached housing business in the United States?

A

Timber prices went up, but there have been no delays in timber purchases, so there have been no construction delays. The lead time from start of construction to delivery varies from company to company, but it is around six months.

As for orders received, housing demand remains firm, so the environment remains favorable. Since May, when timber prices peaked, construction had been temporarily putting a hold on new orders and making

adjustments to promote construction starts on properties for which orders were already received. Thereafter it has been progressing to an extent, and currently, marketing activities are proceeding as normal.

The backlog as of the end of June is at around 70% of the full-year sales forecast of 11,050 units. The ratio of properties built after sale is increasing, but considering the risk of costs increasing after the contract is concluded, we hope to increase the ratio of ready-built houses by continuing to work on a certain volume of sales.

Q

Timber prices had been rising sharply in the United States, but they have begun to come down. Has the selling price of detached houses in the United States come down in response? What is your outlook?

A

Timber futures peaked in May at around 1,600 dollars per thousand board feet, but they are currently down below 500 dollars per thousand board feet. The background behind this is thought to be that supply has stabilized and price adjustments have taken place with the increased production capacity of sawmills and influx of European timber. The important thing is affordability, which represents the ease of purchasing a home. As long as mortgage interest rates do not rise rapidly, buyer motivation will not dissipate rapidly. Falling timber prices and other costs do not necessarily translate directly to lower selling prices.

Q

For July, the year-on-year change in orders received for custom-built detached housing in Japan was -4%. The contract deadline for the special extension of reduced taxes on mortgages is the end of September. What is your outlook for future orders?

A

Orders received in July 2020 were very strong, owing in part to pent-up demand from April and May, which were impacted by COVID-19. For that reason, they were down year-on-year in July 2021, but we do not get a sense from the front lines that demand for custom-built housing has waned. The special extension of the mortgage tax reduction and the cash back incentive for home buying will no longer apply to contracts made after the end of September. In addition, housing eco-points and the tax exemption limit for monetary gifts to buy a home will gradually be eliminated and will no longer apply to contracts made after December. However, we feel that demand for detached homes in the suburbs will remain high, and it will not shrink immediately when the government support measures end. We will continue to focus on digital marketing and other such efforts to keep building up orders received in October and beyond.

Q

The capital increase through public offering will not bring equity ratio to the target of 40% or higher. Is the plan to get there over the next two or three years?

A

Currently, our aim is to achieve equity ratio of 40% or higher in the medium to long term, and the capital increase through public offering will get us close. As for the future outlook, we will provide another explanation with the next medium-term management plan.

Q

In April to June 2021, the number of houses sold in the United States was up 45% year on year (compared to April to June 2020). That's a very high growth rate. Is it possible that the growth may slow in July to September 2021?

A

We put a temporary hold on new orders as we monitored the trend in timber prices, but the environment has not deteriorated. At this point, we do not know what the level will be for July to September 2021, but the backlog as of the end of June was sufficient at around 8,000 units. We expect to be able to achieve the full-year forecast of 11,050 units for the fiscal year ending December 2021.

Q

You have been working on M&A with builders in the United States since around 2013. What criteria have you been using to make judgments?

A

To make our judgments, we have held discussions with owners of the target builder companies about such things as their track records in their respective areas, whether they share a common culture with us, whether their business model can ensure sustainable sales and profits, and whether they can share a future growth scenario. We believe that we have executed our M&As at appropriate prices by analyzing EBITDA, know-how concerning purchasing land in each area, etc. and considering them from various points of view, including whether synergy can be achieved with the Company. In February 2021, we set up operations in the Denver area of Colorado in the United States and are working to build a structure for business development, primarily in the growth area known as the Sun Belt. We will continue to engage in business development based on organic growth.

Q

In regard to orders received for custom-built detached houses in Japan, I believe that the situation has been favorable, including in July. It also appears that the number of one-story houses has increased. What kind of a sales strategy have you adopted?

A

The number of visitors to housing display centers decreased due to COVID-19, but our online strategy, including MYHOME PARK, has been successful. In addition, I feel that ascertaining customer needs through digital marketing has led to improvements in our sales methods, design capabilities, and the level of our products. Moreover, I believe that engaging in sales development according to demand in each region has contributed to the acquisition of orders in addition to product proposals corresponding to the new normal.

Q

What was the impact of the wood shock on the Housing and Construction Business in Japan in the fiscal year ending December 2021?

A

There was almost no impact on first half results. Going forward, as of the end of June, we anticipate an increase in costs for around 5,000 properties that are under contract but have not yet been started. The full-year forecasts include a certain level of impact on the balance sheet in the second half. It is very difficult to determine the trend in prices of timber imported to Japan from Europe, but we could see high-priced European timber coming in until January to March of 2022. For June and beyond, we are working on price revisions while striving to reduce costs and hope to keep the impact of the rise in timber prices as small as possible.

Q

Do you anticipate any upswings or downswings in the full-year forecasts for the fiscal year ending December 2021?

A

At the beginning of the year, we expected the recurring income margin for the full year to be 12.0% at US housing companies in the Overseas Housing and Real Estate Business, which heavily impacts consolidated results. However, the increase in selling prices has exceeded the increase in timber prices, so the ratio came to 16.3% in the first half. We believe the rise in prices will slow a little in the second half, so for the full year, we are forecasting 14.9%. In that regard, we believe the possibility of a significant downswing from the full-year forecasts to be small at this point in time.

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