

Sumitomo Forestry Group
Financial Results for the Fiscal Year Ended December 31, 2023
Conference Call with Analysts and Institutional Investors – Q&A

Time and date: 1:00 p.m. – 2:30 p.m., Thursday, February 15, 2024

Answers:

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

Tatsumi Kawata, Executive Vice President and Representative Director, Sumitomo Forestry Co., Ltd.

Q

Could you tell us the current order status in the US single family homes business?

The number of orders in 4Q FY12/23 fell by 2,042 units. As a result, the backlog landed at 3,339 units (+440 units compared to the previous fiscal year). Is it possible to achieve the forecasted number of units sold of 11,785 units for FY12/24 (+1,564 year on year)?

A

Orders for single family homes in the U.S. performed extremely well in 1Q and 2Q of FY12/23. However, as the interest rate for 30-year fixed-rate loans rose to almost 8% from October to November, customers adopted a wait-and-see attitude, resulting in a decline in orders in 3Q and 4Q.

However, partly because mortgage rate settled at the mid-6% level from the end of 2023 to January 2024, we are seeing improvements in the number of people visiting model homes.

With regard to the first quarter of FY12/24, local Group companies are reporting unit selling price and recurring income ratio that are on par with, or slightly higher than, the forecasted figures. As long as interest rates do not rise rapidly again, the spring season is about to get into full swing, and we believe that we are off to a good start.

To secure the number of units sold, we are expecting about 12,000 units in FY12/24 on an order basis. Looking at the current situation, we believe that this is a fully achievable figure.

As for sales, backlog at the beginning of FY12/24 increased by 440 units year on year (from 2,899 units to 3,339 units) while completed inventory increased by 366 units (from 1,206 units to 1,572 units). Furthermore, we plan to significantly increase the number of construction starts in anticipation of market stabilization going forward, and have planned to increase the number of housing starts by 1,400 units year on year between January and March in time for completion within the fiscal year. As such, the number of sales units forecasted for this fiscal year is fully achievable.

Q

Although the target ROE has been set at 15% or higher, the ROE forecasted for FY12/24 is 13.3%.

Could you tell us in greater detail about the “effective investment with an eye to the future, keeping in mind our target of achieving ROE of 15% or higher” mentioned in the presentation materials?

Regarding returns to shareholders, the dividend payout ratio for FY12/24 is 25.2%, which is trending at a lower level than your competitors. What is the company considering in order to improve it?

A

While we have predicted ROE to be 13.3% in FY12/24, we have planned for 300 billion yen in investments and loans leading up to FY12/24 in our Medium-Term Management Plan. The total amount of investments and loans for the two years of FY12/22 and FY12/23 was 178.7 billion yen, leaving us approximately 120 billion yen to reach the target of 300 billion yen. We plan to undertake investments and loans above that level in our plans for this fiscal year; if these are carried out as planned, the total amount will exceed 300 billion yen. We aim to maintain a certain level of capital surplus while keeping ROE at an appropriate level.

Based on our basic policy of paying dividends continuously and in a stable manner, we have increased dividends for FY12/24 by 5 yen to 130 yen.

We also welcome opinions from investors on the setting of dividend payout ratio and other subjects through IR interviews. In conjunction with the announcement of Phase 2 of the Medium-Term Management Plan, which will commence from FY12/25, we will continue to review our approach to dividends.

Q

You have explained that the market conditions for the US single family homes business is on a recovery trend, but could you tell us your thoughts on the outlook for FY12/24? In addition, in the hypothetical event that interest rates do not fall as far as anticipated going forward, could you tell us what countermeasures the company will take?

A

In the US single family homes business, due to the population composition and housing supply shortage, the robust demand for new housing is expected to continue going forward. The population of the U.S. was approximately 300 million when the Lehman Shock happened, and it has increased by more than 10% to about 338 million by 2022. There is a particularly high proportion of millennials and Gen Z, who form the core of the home-buyer group, so there are continued and stable housing needs. According to Standard & Poor's Case-Shiller Home Price Indices, housing prices are rising, and household incomes are also rising. Looking at the average for the whole of the U.S., housing prices are at an extremely healthy level, trending at around six times that of the annual household income. Moreover, although attention is on delinquency rate for housing loans in light of the experiences drawn from the time of the Lehman Shock, delinquency figures have also remained at a very low level, so the housing market remains in a state of low risk. In the event of persistently high interest rates, we

will put in place measures to encourage housing demand where necessary, such as by offering incentives in the form of a rate buydown.

The Federal National Mortgage Association (Fannie Mae) and Mortgage Bankers Association (MBA) have predicted that the interest rate for 30-year fixed-rate mortgages will fall to a level between 5.8% to 6.2% by the end of this year. If mortgage rates converge at around 6%, affordability will improve, and we can then anticipate further growth in housing sales.

Q

Could you tell us about the roadmap toward realizing 23,000 units sold in the US single family homes business in 2030, which the company has established as its target?

A

We are currently expanding the housing business through five housing subsidiaries in the U.S. extending from Washington State across the East Coast, with a focus on the Sun Belt where economic growth is significant. We have established three bases in Orlando, Jacksonville, and Tampa in the state of Florida, which is a previously untapped area for Sumitomo Forestry. Our Group companies, Brightland and DRB, have already purchased land and are moving forward with housing starts with a view to expanding our business area. Going forward, we aim to achieve our goal of 23,000 units sold through organic growth in areas that builders from the five Group companies already cover, as well as through continued M&A activities if there are good acquisition targets.

The Group's M&A strategy is to engage in thorough discussions with the M&A target before a merger takes place and share our management philosophies, before welcoming the company into the Group. Rather than owning 100% of the interests in the company from the start, we ensure that the partner also owns shares and manages the company jointly with us for a certain period of time. By doing so, we work to expand the business while mutually sharing management responsibilities as well as our motivation for expanding the business. Among the five Group companies, there are companies that have already become wholly owned subsidiaries of the Sumitomo Forestry Group. Going forward, we will continue to advance with M&A activities in this manner with a view to expanding our business.

Q

Am I right to understand that six sales were transacted in FY12/23 in the US real estate business? Could you also tell us the forecasted number of sales for FY12/24 and the probability of completing these sales?

A

In FY12/23, the number of sales made in the US real estate business was six, of which five were properties under Crescent Communities.* JPI became a consolidated subsidiary in the previous fiscal year, and although its general contractor fees were included in Sumitomo Forestry's revenue

immediately after the acquisition, it is now launching new projects as a new organization, so we expect that it will take two to three years before it generates revenue from the sale of properties.

We forecast 14 property sales in FY12/24. First, we have forecasted 10 sales for multi-family housing, of which eight are developed by Crescent Communities and the remaining two are developed by Sumitomo Forestry jointly with other developers. We have forecasted four sales by Crescent Communities for commercial and mixed use complexes, which include mixed use complexes for business, life sciences, and commercial uses. However, as the sale of these properties is expected to take place in the fourth quarter of 2024, we may decide not to force ourselves to sell them during FY12/24 if interest rates rise rapidly or we face difficulties in negotiating with the buyers.

Regarding the profitability of the US real estate business in FY12/24, while the majority of the recurring income of 12.5 billion yen is expected to come from property sales by Crescent Communities, the figure also includes fee revenue from JPI and about 2.5 to 3 billion yen in profits from Mark III, a company that reclaims land for single family housing. Goodwill amortization for JPI is not included.

*The remaining sale is the sale of a project under the umbrella of Sumitomo Forestry America, our US subsidiary. Although it has been included in the number of sales, the gains from sale are not attributed to the US real estate development business, but are instead included in “Other and Adjustment” of the global construction and real estate business.

Q

Regarding the FY12/24 forecasts, could you tell us why net income for the year is expected to be lower despite recurring income surpassing the figures at the time the Medium-Term Management Plan was prepared? Moreover, ROE is also below the 15% target established during the formulation of the Medium-Term Management Plan. How will this shortfall be covered? Is the company considering share repurchase as an option?

A

We are also conscious of net income, and since we achieved a certain level of ability that allows us to attain 100 billion yen in a stable manner, we are also increasing the amount of dividends.

However, in the case of net income, there are elements that are beyond our control, particularly in aspects that are related to taxes. For example, in FY12/22, due to a slump in profits in the domestic housing business caused by the “wood shock,” our standards for recording the deferred tax assets of Sumitomo Forestry on a non-consolidated basis were lowered, making it necessary to reverse deferred tax assets. Tax costs increased temporarily partly because of this. Furthermore, when we conduct M&A in the U.S. and Australia, we engage in business jointly with our partners while keeping them on as shareholders, and it is difficult at present to predict when these companies will become wholly owned subsidiaries. This is one of the reasons that make it difficult to predict net income attributable to owners of parent. As such, despite difficult aspects that are beyond our control, we aim to make a recovery

during this fiscal year, including achieving ROE of 15% or higher. The first step is to increase profits, which is a numerator that makes up ROE. If we are able to recover profits, we will reconsider aspects such as the amount of dividends for FY12/24. However, we are not currently considering a share repurchase.

Q

In the US single family homes business, the company has established the housing supply target of 23,000 units by 2030. Since unit selling price is currently on the rise, is it possible for the company to reduce the target supply in consideration of the fact that you will be able to achieve the target profit even if the target supply were reduced? In addition, if it is possible to achieve the target supply of 23,000 units, will it also be possible to aim for a higher profit target? What are your views on income levels?

A

Concerning the number of units sold, we do not think there is a need to lower the sales target of 23,000 units at present. As for income levels, we plan to conduct a careful examination of the figures toward the formulation of our Medium-Term Management Plan, "Mission TREEING 2030 Phase 2." With regard to the US single family homes business, we expect the robust demand to continue going forward. Salary incomes are rising in the U.S., and in consideration of economic growth in tandem with the current inflation rate of 2% to 3%, a fall in housing prices alone or surplus in supply seem unlikely. At the current income level per unit of single family homes in the U.S., if we achieve sales of 23,000 units, we may be able to achieve our 2030 recurring income target of 250 billion yen with the US housing business alone. Unless there are unexpected changes in the economic environment, we believe we will be able to increase profits commensurate with 23,000 units.

Q

You mentioned that the FITP business will contribute to cost reductions. How will Sumitomo Forestry differentiate itself from other companies in order to enhance competitiveness? If there are examples of other companies in the U.S., could you tell us about these as well?

A

In the FITP business, we are currently operating five factories as production bases for roof trusses and wall panels, among other products. We are working to expand the business with plans to start the operation of a new factory in North Carolina this fiscal year.

The roof trusses and wall panels produced by each factory will be supplied not only to Sumitomo Forestry's housing companies, but will also be sold to other housing companies.

In the U.S., NVR, Inc, which carries the Ryan-homes brand, does not hold any land inventory but

promotes the housing business in the form of asset rights, which involves purchasing only the land necessary for options contracts. It is also focusing on the FITP business and working to streamline and enhance business efficiency. A characteristic of the FITP business is that it not only manufactures parts needed for housing construction, but also carries out installation. The FITP business offers significant benefits in the aspect of reducing construction time; there is data showing that construction period can be reduced by about one week, in estimations prepared based on a two-story model home of about 2,000 square feet. Moreover, it is also effective in reducing the number of industrial accidents and waste at the construction sites, alongside improving quality. Going forward, we aim to develop group synergy in collaboration with our Group companies through the FITP business, toward achieving the sales target of 23,000 units.

Q

You have spoken about the strong single family homes market in the U.S. Could you tell us, quantitatively, about initiatives in the areas of single family rentals and affordable housing?

A

We are selling about 600 units of single family rentals in the U.S. per year through Southern Impression Homes, which we acquired in January 2023.

In addition to that, we are developing multi-family housing projects, centered mainly around Crescent Communities, and we aim to establish a system that can supply 3,000 units per year in the future. According to actual current figures, we have reached a level of about half of that number.

In San Antonio, Texas and Salt Lake, Utah, we are also rolling out products for each area, including condominiums and town houses.

The target of supplying 23,000 units of housing in the U.S. by 2030 also includes the sale of spec homes and single family rentals, and we are progressing according to plan.

Q

Orders for the domestic housing business in FY12/23 were 7,318 units (down 8.9% year on year). Could you tell us the measures aimed at recovering order volume to the level of 7,800 units forecasted for FY12/24?

A

A reason for the decline in orders is that within the unit selling price range of below 35 million yen, a rise in housing prices will mean that construction plans (surface area) and price are no longer commensurate with each other. As a countermeasure, we are reviewing sales techniques from both the aspects of price and specifications, alongside expanding the options available to customers, so as to satisfy customers considering purchases within this price range. These are applicable to “Forest Selection,” our plan-based built-to-order product, and “Premal,” a fully standard product.

We will also promote measures to boost land purchases, such as by assigning land specialists, introducing dedicated systems, and the purchase of completed residential lots at the authority of each branch office manager.

On the other hand, with regard to the medium to high price ranges, we have relaunched the “Grand Estate Design Project” released in 2014 to draw renewed attention to our strengths primarily in metropolitan areas, such as through the new establishment of the Osaka Architectural Design Center, which mainly handles projects worth 60 million yen and above.

Q

Could you tell us the progress status of the acquisition of forestry assets under the Forestry Fund, as well as the approximate IRR?

A

At present, we have successfully closed approximately 37,000 hectares of forestry assets in the state of New York. This comes to approximately 80,000 hectares if we include projects for which negotiations are ongoing. We expect to acquire about a quarter of the surface area set out in our initial plans, and we consider the purchase of assets to be proceeding smoothly. The areas are primarily in the U.S. and Canada, but projects in some parts of Central America also under consideration. While the amount is approximate as there are differences in value depending on the asset and the presence or absence of carbon businesses, it comes to approximately US\$1 million, which is equivalent to a quarter of the 60 billion yen fund. We have to refrain from disclosing concrete IRR figures due to our duty of confidentiality to our investors. However, investors participate in the Forestry Fund with the understanding that it is an alternative investment target that adds credit value in the sense of real asset growth.

(End)