Sumitomo Forestry Group

Medium-term Management Plan and Financial Results for the Fiscal Year Ended December 31, 2024

Conference Call with Analysts and Institutional Investors – Q&A

Time and date: 1:00 p.m. – 2:30 p.m., Friday, February 14, 2025

Answers: Toshiro Mitsuyoshi, Representative Director, President and Executive Officer, Sumitomo Forestry Co., Ltd.

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Q

Could you tell us about the current order status for the US single-family homes business and your outlook on the macro environment, including mortgage rates, housing supply and demand, and foreign exchange trends, in the Medium-term Management Plan (FY12/25-FY12/27)?

A

Orders in January 2025 were 856 units. We consider this somewhat weak for the spring season. Currently, US mortgage rates remain high at around 7%, and customers continue to maintain a wait-and-see attitude. Under these circumstances, we will continue to pursue order growth by providing incentives such as rate buydowns.

Regarding the US single-family homes business for FY12/25, we plan for a recurring income to net sales margin of 14.4%, which is conservative compared to 17.3% in FY12/24, while planning for increases in both the number of units sold and unit selling prices. We expect the recurring income to net sales margin to decline due to increased incentives and rising land acquisition costs. Furthermore, we expect mortgage rates to remain at around 7% until Q2 of FY12/25, which will suppress demand during that period. However, we believe steady demand will continue due to ongoing housing shortages driven by population growth in the US.

In terms of the macro environment, attention is currently focused on President Trump's policies regarding tariffs and illegal immigrant deportation. Regarding lumber, approximately 30% of lumber used for structural materials in US housing is said to be imported from Canada. Even if Canadian lumber prices rise due to increased tariffs, US domestic sawmills have excess production capacity, so we believe there won't be a significant impact on construction costs as we can shift to domestic lumber. On the other hand, there are concerns about labor shortages at construction sites due to the complete deportation of illegal immigrants. While monitoring related policy trends, we will work toward achieving our Medium-term Management Plan through our FITP business by improving construction efficiency, shortening construction periods, and reducing costs in the housing business.

Q

In the Medium-term Management Plan (FY12/25-FY12/27), you plan for recurring income of ¥225 billion in the Global Construction and Real Estate segment for FY12/27 (an increase of ¥77.5 billion from the previous Medium-term Management Plan). Could you tell us about your initiatives for achieving this target?

A

In the US, stable housing demand is expected to continue due to population growth and housing supply shortages. Our Group's five builders in the US will focus on organic growth in their covered areas, aiming to achieve sales of 17,700 units by 2027. To this end, we are actively acquiring land and have secured approximately 80,000 lots for development as of the end of FY12/24. Additionally, we will promote the expansion of our FITP business and improve profitability while rationalizing the construction process.

In the US real estate development business, property sales were delayed due to persistently high interest rates and expected yields, resulting in a significant decrease in recurring income in FY12/23 and FY12/24. However, during this period, approximately ¥138 billion was invested in advance in US real estate development, and the number of projects in development had reached 80 as of the end of FY12/24. Once market conditions recover, we expect the real estate development business to return to a recurring income level of ¥20 billion, similar to 2021 and 2022. In Australia, following the Metricon acquisition, we aim to leverage economies of scale to expand market share while improving profitability. We target sales of 8,200 units in FY12/27.

Overall, we aim to achieve our Medium-term Management Plan (FY12/25-FY12/27) targets through expanded single-family home sales in the US and Australia, realization of real estate sales from projects already in development, and expansion of the FITP business.

Q

Could you tell us about the impact of increased land costs and incentives on the profit margins of the US single-family homes business? Will it be necessary to strengthen rate buydowns going forward? Also, to achieve the FY12/25 sales target of 12,740 units, it seems orders would need to increase by about 20% compared to the previous period. How do you plan to balance maintaining profit margins with securing sales volume?

A

Regarding the recurring income margin for the US single-family homes business, based on interviews with our five local housing subsidiaries, land and building costs are expected to increase by about 3%. Regarding rate buydowns, while one company didn't use them at all in FY12/24 due to strong market conditions, the other four companies used them on 20% to 60-80% of their properties. In FY12/25, if

mortgage rates remain high at around 7%, we believe we will need to continue using rate buydowns similar to FY12/24. In terms of cost impact, rate buydowns are around $25,000 per unit, which we estimate will have an impact of slightly less than 5% against the average sales price of about $490,000. To achieve the FY12/25 sales target of 12,740 units, with an initial backlog of about 2,700 units, we will build up spec homes while controlling inventory to avoid excess, and sell them effectively using incentives.
Considering these cost-increasing factors including incentives, we plan for a recurring income margin of 14.4% in FY12/25.

Q
Regarding achieving the 15% ROE target, while the US single-family homes business seems capable of achieving its recurring income target if interest rates fall, do you have any plans for share buybacks if profits don't grow in businesses such as domestic housing?
A
We aim to achieve the 15% ROE target by building up profits. Regarding profit growth in domestic operations, in the domestic housing business, we plan to maintain 8,000 units in our core custom-built housing business while expanding related businesses such as spec homes, rental housing, renovation, and rental management. In the timber and building materials business, we plan for steady growth in domestic operations by expanding manufacturing operations both domestically and internationally and increasing sales of wood biomass fuel, among other initiatives.

Q
You mentioned that January orders for US single-family homes were lower than the previous year. What is the current order status and outlook? Also, are there concerns about tariffs and illegal immigration issues under a Trump administration?
A
Although housing orders in January this year decreased compared to the previous year, we expect first-quarter orders to maintain levels similar to the previous year due to the upcoming spring season when increased orders are anticipated. Interest rate reductions and sales strategies utilizing incentives will be important for future demand recovery. Also, in major states like Texas and Florida, immigrants are said to account for about 30% of construction site labor, and a reduction in these workers could lead to longer construction periods and more severe labor shortages, but it's very unclear whether these issues will actually materialize.

Q

Could you explain why the recurring income target for 2030 was revised upward from ¥250 billion to ¥350 billion? Also, does the 2030 target of 23,000 units for the US single-family homes business remain unchanged?

A

We increased the 2030 recurring income target by ¥100 billion from ¥250 billion to ¥350 billion. Breaking this down by segment, we aim to increase the Global Construction and Real Estate segment's recurring income from ¥225 billion in FY12/27 to ¥270 billion in 2030. For the US single-family homes business, we plan to grow annual unit sales from 17,700 units in FY12/27 to 23,000 units in 2030. This target assumes achievement through organic growth of our five builders rather than large-scale M&A.

For the Housing segment, we plan to grow recurring income from ¥35.2 billion in FY12/24 to ¥60 billion in 2030. This assumes maintaining 8,000 custom-built housing starts annually and growth in subsidiary businesses including renovation.

For the Timber and Building Materials segment, we aim to increase recurring income from ¥10 billion in FY12/24 to ¥25 billion in 2030. We plan to launch structural calculation support services in anticipation of Article 4 special provision reductions and provide value-added services for housing-related businesses, while improving and acquiring new manufacturing operations both domestically and internationally.

For the Resource and Environment segment, we plan for recurring income of ¥6 billion in 2030, anticipating improved profitability in biomass power generation business leveraging our wood fuel and pellet procurement capabilities, and recovery in forest management business.

We aim to achieve ¥350 billion in recurring income by 2030 through steady growth in each segment.

Q

Could you tell us about the future outlook for the US real estate development business?

A

In the US real estate development business, we plan to sell an average of 20 properties annually during the medium-term plan period, with 8 property sales expected in Q4 of FY12/25.

Currently, the situation with regional banks is improving, and there is increasing interest in properties even under high interest rates. However, we have postponed sales of some properties due to pricing issues. In FY12/25, rental housing deliveries will peak, and supply pressure will remain high, so we believe it's important to improve occupancy rates of rental properties to create favorable conditions for sales.

One of our two US real estate development companies has general contractor capabilities, allowing us to earn fee income in addition to income gains and capital gains. Going forward, we consider it very important to build a US real estate development business that can generate stable earnings.

Q

Regarding the FY12/25 plan for the Australian housing business, could you explain how you will achieve the ¥20 billion recurring income target, including the breakdown by group company and current conditions?

A

In the Australian housing business, the Scott Park Group in Western Australia is performing very well, and the Henley Group in Victoria is expected to achieve better results than the previous period. Regarding the Metricon Group, while profit margins were very low at the time of acquisition, the gross margin erosion caused by rising material and labor costs between contract and completion, as well as extended construction periods, are gradually stabilizing, and profitability is improving. Although goodwill amortization related to the Metricon Group acquisition will occur separately, we expect to achieve recurring income of ¥20 billion in FY12/25 through improved earnings from existing group companies in the Australian housing business combined with earnings from the Metricon Group.

Q

Regarding the recurring income margin for the US single-family homes business, while you plan for a decrease compared to the previous period in FY12/25 due to rising land prices and rate buydowns, what level of profit margin are you targeting on a normalized basis? Is it possible that the recurring income margin could fall below 10%, similar to other US builders, after using all of the approximately 80,000 lots currently held?

A

Regarding the recurring income margin for the US single-family homes business, while it was historically around 12%, it temporarily reached an exceptionally high level of about 20% during the COVID-19 pandemic and lumber shock when housing demand increased. The actual result for FY12/24 was 17.3%, and the plan for FY12/25 is 14.4%. Currently, sales prices have plateaued temporarily due to decreased affordability, but we expect them to rise eventually due to structural demand from inflation and housing shortages. After using all of the approximately 80,000 lots currently held, we will need to develop land purchased at higher costs, but we will maintain profit margins through cost reductions achieved through shortened construction periods and addressing rising labor costs through the promotion of the FITP business. For the FITP business, we will first realize group synergies through the supply of housing materials to our East Coast housing subsidiary

DRB, with plans to expand across the United States.

Q

The policy to reduce cross-shareholdings is welcomed. On the other hand, with rising stock prices, there is a higher possibility of cross-held shares being sold in the market. Have any specific measures been taken to address this?

A

The ratio of cross-shareholdings to net assets in FY12/24 was 7.7%. Due to various circumstances, companies may approach us about selling their shares, and if we reach an agreement through discussion, this leads to a sale. While we haven't taken any specific measures, we continuously check the rationality and necessity of holdings and will respond appropriately toward reduction.

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