

Sumitomo Forestry Group
Financial Results for the Fiscal Year Ended December 31, 2022
Conference Call with Analysts and Institutional Investors – Transcript
The progress of the long-term vision and
medium-term management plan announced February last year.

Time and date: 13:30–14:30, Wednesday, February 15, 2023

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please see page three on the bottom right of the slide. This is about the recognition of the business environment. Although the course of the COVID-19 pandemic is still unpredictable, the world is finally moving gradually toward normalization, and the international traffic in people and goods is now possible. However, the world economy is now at a major turning point, as Russia's invasion of Ukraine has triggered a widening division between the Western countries, mainly the US and Europe, and Russia, as well as China, causing inflation and rises in interest rates around the world.

The rises in interest rates have had a significant impact on market conditions in the US residential real estate business, which has contributed significantly to the growth of our business over the past several years, and we have started the current fiscal year with a completely different headwind from the previous fiscal years.

While the Japanese economy has seen a recovery in inbound demand and in domestic demand, the housing market continues to face uncertainties due to concerns like high resource prices and upward pressure on interest rates as a result of the weak Japanese yen.

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Please see pages four and five.

Despite this uncertain environment, the Group has set forth a long-term vision, Mission TREEING 2030, which outlines its ideal vision for the year 2030, the target year of the SDGs, and as its first phase, we are promoting the medium-term management plan, which will conclude in 2024.

Our long-term vision is to achieve recurring income of JPY250.0 billion by 2030, based on four business policies, including decarbonization and the establishment of a circular bio-economy that maximizes the value of forests and trees. By establishing and turning the wood cycle around trees, we will contribute to the decarbonization of society through our businesses.

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Please see page six. This is a summary of the financial results in the previous fiscal year. Senior Managing Executive Officer Kawata will explain the details later.

While the custom-built detached housing business in Japan was affected by soaring material prices, our overall performance grew significantly partly due to higher unit sales prices of houses and sales prices of real estate development properties in the US residential real estate business, as well as the yen's depreciation.

Recurring income increased 41.6% YoY to JPY195.0 billion, reaching a record high and surpassing the JPY173.0 billion target planned for 2024, the final year of the medium-term management plan. Among the target management indices, ROE was 19.4%, exceeding the target of 15%, and the equity capital ratio was 40.8%, almost the same as the target of 40%.

We expect income to decline this fiscal year due to the slowdown in the US housing market caused by rising interest rates, but we feel that the market will bottom out, with mortgage rates settling down as sales appearing to be hitting a plateau. The measures we have taken to date for M&A and construction rationalization in the US will bear fruit and accelerate the growth of our business performance, enabling us to implement our growth strategy to realize our long-term vision.

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I will now explain the progress of the three pillars of our decarbonization business set forth in our long-term vision.

First, I would like to discuss the acceleration of the cyclical forest business. To materialize forest funds, we established Eastwood Forests, a forest asset management company in the US, last October. Through the forest funds to be established in the future, the Company will manage forest assets and return profits from timber sales and carbon credits generated by the forests to investors, aiming to contribute to carbon offsetting for society as a whole.

Last December, we acquired 9,738 hectares of a protected mangrove forest in Kalimantan, Indonesia. In addition to aiming to create blue carbon credits, we will engage in a wide-area ecosystem conservation project that includes mangroves along the coast, peatlands in inland areas, and tropical forests.

In addition, we established NeXT FOREST in February of this year as a joint venture with IHI Corporation. Through our tropical peatland consulting business, we will embark on a business that contributes to the protection of peatlands while at the same time providing high-quality carbon credits.

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This is about promoting wood change.

By realizing a cascade use of trees from the manufacture of wood products to the use as fuel for biomass power generation, we aim to increase the competitiveness of local forest resources, and

contribute to improving the value, and promoting the utilization of domestic timber.

In order to realize the concept of a timber industrial complex, a project is underway in Shibushi City, Kagoshima Prefecture, as the site for the first such project.

Using raw materials that have been exported as logs at low cost, we aim to produce strong structural timber that can be used for non-residential properties.

We are currently studying several other candidate sites in addition to Shibushi in order to advance the concept of a new industrial complex.

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Next, I will discuss the standardization of decarbonized design.

With the future challenge of reducing CO2 emissions during construction, or embodied carbon, we have launched a Japanese version of One Click LCA, the software that calculates CO2 emissions during the procurement of raw materials, processing, transportation, construction, renovation, and disposal of construction materials to support the decarbonization in the construction industry.

We have also launched new software to save labor in obtaining EPDs, which are environmental certification labels for materials, and have begun providing training and application support for obtaining EPDs.

Medium and large-scale wooden buildings, for which demand is growing both in Japan and abroad to realize a decarbonized society, are also enjoying an increase in projects. Currently, construction is well underway on a 15-story wooden office building in Melbourne, Australia, and a six-story wooden office building in London, England.

New projects are also underway in Atlanta and Dallas, USA. Compared to steel and RC, wood construction can greatly reduce CO2 emissions during the construction process, or embodied carbon, and also can fix carbon in the wood to be used for a long time. We will continue to promote the use of environmentally-friendly wooden, medium and large-scale buildings in Japan and abroad.

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Please see page 12. The following section describes future initiatives for each of our businesses.

First is the timber and building materials business.

After the wood shock, the lumber market, which had remained at a high level until H1 of the previous fiscal year, has calmed down since H2 of the year, while prices for other major building materials have remained high, making the future of the market environment difficult to read.

In this context, in the current fiscal year, Sumitomo Forestry Forest Service will strengthen its timber

procurement function from public and private forests in each prefecture in Japan to promote the spread of domestic timber and will work to standardize components and develop supply chains to strengthen competitiveness in medium and large-scale wooden construction, for which the market has high potential for expansion.

In addition, to promote One Click LCA as a standard for carbon neutral design, we will call on a wide range of industry stakeholders to join our initiative and promote the acquisition of EPDs.

On the distribution side, we will strengthen our functions to solve issues faced by our business partners, such as increasing the volume of biomass power generation fuel, such as wood pellets, and building an information system infrastructure that directly links the entire supply chain of wood building materials.

To continue to be the driving force behind the wood cycle, we will continue to improve the profitability of our domestic and overseas manufacturing operations and promote wood-based industrial complexes as a leading company in the wood building materials industry.

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Next, I will explain the housing business.

In 2022, partly due to the COVID-19 pandemic, we made up for the declining number of visitors to model homes through digital marketing, and strived to differentiate our products and add value by increasing the ZEH ratio and through our PRIME WOOD strategy.

In order to maintain a high level of competitiveness in 2023, we will introduce DX in sales, promote integrated exterior construction contracts in close cooperation with Sumitomo Forestry Landscaping, and streamline construction.

In addition, an Innovation Promotion Department was established to promote radical structural reforms in all areas of sales, design, and construction. The department will reevaluate the way our businesses were conducted in the past and promote DX and other reform innovations throughout the business divisions.

In the renovation business, we have strengthened proposal-based sales to owners of Sumitomo Forestry houses, which has yielded positive results. To solve social problems in a mature society, we aim to increase the Group's earnings by expanding the rental housing business and maximizing the use of owner information.

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I will explain the global housing, construction, and real estate business.

In the fiscal year ended December 31, 2022, the business achieved significant YoY increases in sales and income as the detached housing business profited from soaring home prices, and the sale of an abundant order backlog, while the real estate development business was able to sell properties at favorable terms.

However, after April 2022, housing prices, which had been rising at a high pace during the two years of the COVID-19 pandemic, and the sharp rise in mortgage rates following the increase in policy interest rates to control inflation, reduced affordability, causing customers to take a wait-and-see attitude, resulting in a difficult business environment in the housing market.

Also, the US housing market is in a structural housing shortage of four million to six million units due to the decline in construction starts since the global financial crisis, compared to the active demand from possible homebuyers in their 20s to 40s.

In the medium to long term, the shortage of supply continues. Inflation has calmed down, mortgage rates have stabilized in the low 6% range, and indicators, such as the number of loan applications, show signs of bottoming out. Therefore, we believe it is important this year to control the inventory of spec properties, while watching the timing of the market reversal so as not to miss the wave of demand recovery that is to come.

On the other hand, demand for rental housing has remained steady due to the decline in housing affordability. As one of the measures to expand our business, we acquired a majority interest in Southern Impression Homes in Florida in January of this year to strengthen the foundation of our single-family rental homes business.

With the acquisition of Southern Impression Homes, the Group will expand the rental business, and at the same time, make the acquired company a business base in Florida, the second largest market for single-family homes in the US.

The Group is also promoting its FITP business, which provides integrated panel design, manufacturing, delivery, and installation services for homes. With the recently announced establishment of a panel and truss manufacturing plant in North Carolina, the Group has entered the framing and interior/exterior construction and component manufacturing business, including trusses and wall panels. We have succeeded in establishing a system to enable consistent control of inventory, reduce construction times, and rationalize construction in North Carolina.

In the real estate development business, the investment environment is changing due to soaring

interest rates, but there is a steady accumulation of favorable projects, such as apartment complexes, detached rental housing, logistics facilities, and life science-related facilities, et cetera.

For office projects, where demand needs to be assessed, we will promote a differentiation strategy through wood construction, etc. We will continue to closely monitor demand trends and will also use joint ventures and funds that utilize other people's capital and leverage to operate our business in a capital efficient manner.

In addition, starting this fiscal year, the Building Department, which had been part of the Housing Division in Japan, was integrated with the Overseas Division. The Group will now let the real estate development business, which has advanced overseas, share its technologies and expertise both domestically and internationally, and promote the development of medium and large-scale wooden structures, such as mass timber construction, on a global scale.

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We will provide a supplementary explanation regarding the US housing business, as it has a significant impact on our business performance.

For the current fiscal year, we plan to sell 9,000 units in our US single-family home business, mainly through our five existing housing subsidiaries. Prior to last year's mortgage rate increase, the presale ratio had grown more than normal, and the order backlog at the beginning of the period had built up to 7,087 units.

After the rate increase, the order backlog at the beginning of the period was only 2,899 units due to the slowdown in contracts and higher cancellation rates. The key to achieving the target annual number of units for sale will be the number of contracts to be signed during Q1 and construction starts of spec properties.

Regarding contracts, we believe it is possible to achieve the target number of units by offering incentives and making certain price adjustments.

In addition, since H2 of the previous year, there have been notable cases of cancellations due to sharply rising interest rates, but these have been sold as spec properties and have not led to an extreme buildup of inventory. There has also been a lull in the rises in interest rates, and the cancellation rate is returning to normal levels.

In addition, single month contracts for January 2023 have recovered to 70% of the level of the same month last year after deducting cancellations and withdrawals of contracts, due to stable mortgage rates. Compared to the situation up to last December, there are signs that the customers taking a wait-

and-see stance are slowly starting to move. For construction starts, it is necessary to have a certain level of building inventory, while at the same time, handling to control the excessive buildup of completed inventory. We already started construction of 12,000 units in the fiscal year ended December 31, 2021, and there is no major problem with our capacity to start construction. We will continue to start construction at an appropriate level, keeping a close eye on the progress of contracts.

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Next, I will explain our Australian and Asian residential real estate business.

The Australian housing market is struggling with declining profitability due to prolonged construction times, compounded by soaring material prices, a shortage of craftsmen, and delays in administrative procedures due to COVID-19.

In this context, we will promote efficiency through the use of satellite exhibition sites in areas where we have not yet entered, and the use of social media and digital marketing in advertising and promotion. To strengthen sales of spec homes, in addition to developing our own residential land, we will work to reduce costs and develop new land by securing land through off-balancing in cooperation with real estate developers.

In addition to seeking group synergies by integrating IT infrastructure among group companies and jointly purchasing materials, we will also address structural issues, such as labor shortages by, for example, bringing panel operations in-house.

In Asia, in January this year we announced the development and sale of 346 spec homes and houses combined with stores in the suburbs of Jakarta, Indonesia. The houses' design takes advantage of the natural environment, incorporates Japanese elements, has an earthquake-resistant structure, and also contributes to improving the country's living environment through the use of building materials with a low environmental impact to decarbonize the country.

We will continue to expand our housing business, including multi-family housing, in Vietnam, Thailand, Indonesia, and other areas of Asia.

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I would like to talk about shareholder returns.

As for dividends, we plan to continue to pay JPY125 per share for the current fiscal year, the same as in the previous fiscal year.

We recognize that returning profits to shareholders is one of our highest priorities, and our basic

policy is to do so in a continuous and stable manner. We will continue to strive to improve return on equity and enhance equity capital.

At the same time, we will return profits to shareholders at an appropriate level according to the status of profits, taking into consideration a comprehensive balance among the management base, financial condition, cash flows, and other factors.

Investments and loans are planned to total approximately JPY300.0 billion over the three years of the medium-term management plan, and we will continue to make investments to advance the businesses set forth in our long-term vision.

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Although the business environment in the current fiscal year 2023 is different from what we envisioned last year when we formulated our long-term vision and medium-term management plan, we believe that this is an opportunity to strengthen our business foundation and invest for the future. The global trend toward decarbonization is accelerating, and there are high expectations for our group to contribute to decarbonization through our businesses by turning the wood cycle around wood as a carbon-neutral material.

We have deep knowledge and experience in wood as a natural material, which we have consistently dealt with since our establishment, expertise in housing construction cultivated in Japan and overseas, a global network of timber building materials, and above all, abundant human resources who have been responsible for these activities.

Organically linking these management resources will be the driving force to realize the wood cycle. We will continue to make full use of the management resources of the entire Group to realize our long-term vision.

This concludes my explanation. Thank you very much for your attention.

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