

Sumitomo Forestry Group
Financial Results for the Fiscal Year Ended December 31, 2023
Conference Call with Analysts and Institutional Investors – Transcript
Progress on Medium-Term Management Plan and Initiatives for the Future

Time and date: 13:00–14:30, Thursday, February 15, 2024

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

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The Group is currently working on its long-term vision, Mission TREEING 2030, which outlines its vision of what it should be by 2030, the target year of the SDGs, with the year 2022 as the first year. In our long-term vision, we aim to achieve ordinary income of 250 billion yen by 2030, based on four business policies, including the “Maximizing the value of forests and wood to realize decarbonization and a circular bioeconomy”. We would like to contribute to the realization of decarbonized society through the “wood cycle” of our business activities.

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In 2023, the US housing market, which has a significant impact on our business performance, turned around from the market slump caused by rising mortgage rates that began in second half of 2022, and demand began to recover. By implementing measures in line with market trends as appropriate, we were able to generate earnings that exceeded our forecast at the beginning of the period. In Japan, although the business environment in the housing business was very difficult, the profit margin improved, partly due to the effect of price revisions implemented in the previous year. As a result, the entire company posted sales and ordinary income well above initial forecasts.

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In FY2024, we plan to continue to drive our performance with the global construction and real estate business, including our US housing business, and expect net sales to exceed 2 trillion yen for the first time for our group.

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I will explain the progress of our medium-term management plan, which started in 2022 and will end this fiscal year, FY2024. This corresponds to the first three years of the long-term vision, with 2030 as the goal, and is positioned as phase one. Although we were affected by the significant rise in mortgage interest rates in the U.S. housing market, which was not assumed when the plan was formulated, we plan to achieve the ordinary income target of the medium-term management plan with ordinary income of 173.0 billion yen for this fiscal year 2024.

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From here, I would like to discuss the initiatives of each business. First, let's look at the market environment for the US detached housing business. The US housing market was expected to face a challenging environment in 2023 due to higher mortgage rates starting in 2022, but demand for new homes increased against the backdrop of a decline in the number of existing homes in circulation, and the market has remained stronger than expected since the beginning of the year.

This is due to the fact that the U.S. population of millennials, or Generation Z, in their 20s to 40s, is growing and that there is a shortage of 4 to 6 million housing units due to the shortage of housing starts since the Lehman Shock, resulting in very strong demand for housing.

In addition to the chronic shortage of housing supply, another factor contributing to the strong demand for new housing is the large decline in the number of existing home inventories, which have accounted for about 90% of all home sales. Approximately 70% of current mortgage borrowers have opted for a 30-year fixed, and two out of three of them have a borrowing rate of 4% or less.

On the other hand, with current mortgage rates hovering in the mid-6% range, few people are going out of their way to re-mortgage at higher rates, leading to a decline in the number of existing home inventories, the so-called lock-in effect.

Since the number of existing home inventories is currently at a historically very low level of about 1 million units, and mortgage rates are unlikely to fall in the short term to the 3% range that many people are borrowing at, it is unlikely that the lock-in effect will be immediately resolved, and the structure of the housing shortage is expected to continue for the foreseeable future, with continued solid demand for new housing expected.

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Mortgage rates reached the high 7% range in October 2023 and rose to nearly 8%, resulting in a slight slowdown in orders in Q4 of last fiscal year. However, loan rates have recently dropped to the mid-6% range, and we expect a boost in the spring season after late February, the demand season, and plan to receive more orders in 2024 than in the previous year. We expect the US detached housing market to continue to grow, basically against the backdrop of a structural housing shortage.

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In the US, we have set a goal of selling 23,000 detached houses by 2030, and are promoting strategies to build a structure to achieve this goal. The first step is to expand the deployment area. Last year, we welcomed to our group Southern Impression Homes, a company that mainly builds and sells single-family rent housing and develops residential land in Florida, which is the second-largest state in the US in terms of the number of housing starts permitted. This established a base in Florida, where we had not yet entered the market.

Subsequently, existing housing group companies Brightland and DRB have opened branches in Florida and will expand in the spec home business. Next, we aim to provide a range of products

tailored to various customer needs, such as affordable housing and single-family rental homes that match the market environment, and to improve the environmental performance of our homes.

Another major strength of the company is its efforts to improve financial soundness by promoting rationalization using integrated construction with trusses called FITP, wall panels, and other materials, shortening of construction times, and cost reductions, and the securement of land with more than about 70,000 blocks that secures necessary land supply for future business expansion.

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I would like to explain our current focus on the FITP business. The FITP business provides integrated panel design, manufacturing, delivery, and installation services for housing, which can shorten construction times and streamline construction, contributing significantly to cost reductions.

We believe that this initiative, which will help to address labor shortages and stabilize the supply chain in building a future system to sell 23,000 detached houses per year in the US, will contribute to strengthening the earnings base of our housing business in the US. As of the end of December 2023, five manufacturing facilities for roof trusses, walls, floor panels, and other products were already in operation in Maryland, on the East Coast, and Texas. A new plant is scheduled to begin operations in North Carolina in March of this year, further expanding our coverage in the future.

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I will explain our US real estate development business. The real estate development market continues to face a challenging environment, especially for office properties, due to soaring interest rates and declining demand for office space. Despite these conditions, leasing of rental housing has remained strong in terms of both occupancy rates and rents, especially in the Sunbelt area where the Group operates.

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In November 2023, the Group acquired JPI, a major real estate developer of rental housing, as a subsidiary. JPI's housing starts were approximately 4,000 in 2022, and together with existing group companies such as Crescent, that is more than 8,000 housing starts annually, which is equivalent to the sixth largest in the United States. Crescent specializes in high-value-added, high-priced properties and develops office and logistics facilities in addition to multi-family housing, while JPI focuses on relatively affordable multi-family housing and has its own in-house design and construction functions. JPI has a base of operations in California, where our group companies have not yet entered, and has a wealth of experience in construction, as well as development management, management of construction, asset management, and other functions, which are expected to generate synergies with existing group companies. We are building up a track record in medium- to large-scale wooden constructions, and have also established expertise in forming real estate investment funds. We intend to expand the scale of our business both domestically and internationally by bringing the know-how

we have accumulated overseas to Japan.

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With the addition to the Group of JPI, which is primarily active in Texas and California, the Group's real estate development area has expanded westward. Currently, the environment surrounding the real estate development business is difficult, but since this business requires three to four years from start to payback, now is the time to pursue the commercialization of prime properties from a medium- to long-term perspective.

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In the Australian market, the problems of high material prices and labor shortages are finally easing, and the backlog of orders that surged as a result of the subsidy policy for the purchase of new homes implemented as an economic stimulus measure during the coronavirus pandemic has been completed and sold, resulting in positive net sales and ordinary income compared to the previous year.

On the other hand, customers continue to take a wait-and-see attitude toward interest rates that have remained high, and conditions remain difficult in terms of orders. Rising building materials prices and a shortage of craftspeople are being resolved, and by area, the population inflow is expanding especially in Perth, on the west coast, and orders have been rapidly recovering since Q2 of the previous fiscal year at our group companies.

Going forward, we will develop and promote affordable products in custom-built housing, efficiently procure land for profitable spec homes, establish a stable material supply system and promote rationalization of construction, and pursue profitable growth in landscape, residential land development, and medium- and large-scale wooden constructions combined.

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Development efforts in Asia are currently focused on Indonesia, Vietnam, and Thailand. The ASEAN area is expected to experience economic development and strong demand for housing against a backdrop of population growth, and with growing environmental awareness, environmentally conscious housing is beginning to attract attention. In the ASEAN region, which has high growth potential, we will continue to supply high-quality, decarbonized housing by utilizing the design approach and other housing know-how that we have cultivated in Japan.

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This section summarizes the Group's approach to M&A strategy. Mainly in the US and Australia, the Company has been pursuing growth through mergers and acquisitions to date, bringing leading local companies into the group. We hold discussions with M&A partners prior to joint ventures to ensure that we share the same corporate philosophy before welcoming them into the group.

In the event of an M&A, we do not hold 100% of the equity from the beginning, but rather ask a partner with business ambition to hold a certain amount of shares. By doing so, the company becomes

jointly managed for a certain period of time, sharing risks and returns, and sharing motivation and management responsibility for business expansion with each side in a win-win situation. We will continue to develop promising overseas markets with this trust-based form of management.

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The domestic housing business continued to face a challenging environment as the number of owner-occupied housing starts declined for the 25th consecutive month, but the profit margin improved due to cost reductions, implementation of operational efficiency measures and the effect of price revisions. In addition to our efforts to promote ZEH specifications, which contribute to decarbonization and reduce energy costs, we worked to ensure that our customers feel a higher level of satisfaction by renewing our one-story product GRAND LIFE to incorporate an integrated house and garden design and an efficient housekeeping flow line.

Going forward, we will strive to improve profitability through operational efficiency and other measures, as well as develop products that appeal to a wide range of customers in terms of price by reducing design costs, and strengthen measures for land for residential construction. We will also strive to promote orders for three-story wooden apartment buildings and strengthen the business of each group company, including the remodeling and renovation business.

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I would like to talk about the progress of projects that lead to decarbonization through the wood cycle, Sumitomo Forestry's value chain. In terms of acceleration of the cyclical forest business, we are currently acquiring target forest assets, mainly in North and Central America, for the forest fund we established in June 2023 with a total investment of 60 billion yen. We are also beginning to consider a second fund.

Next, in terms of promoting “wood change,” we are working on a timber industrial complex in Shibushi City, Kagoshima Prefecture, and have begun research and development to promote a biorefinery business using woody biomass as raw material. A biorefinery is a technology to produce chemicals and fuel from biomass as raw materials, and is an initiative with great potential to contribute to the decarbonization of society as a whole in the future.

In terms of standardizing carbon neutral design, we are promoting the construction of medium- to large-scale wooden constructions and promoting One Click LCA, a software program that visualizes CO2 emissions, or embodied carbon, at the time of construction. At the same time, we will support the acquisition of Environmental Product Declaration labels and promote efforts throughout the supply chain to realize a decarbonized society.

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The recent spate of corporate scandals in the news has made corporate governance even more scrutinized. We have a brand that we have inherited from our Sumitomo predecessors and built up over years. Strengthening governance is essential to protect this. In the US, governance has become

increasingly important as multiple companies with different corporate cultures have been grouped together in a relatively short period of time.

Sumitomo Forestry America, the controlling company in the US, plays a central role, and representatives dispatched to each company maintain close communication with local management to build open, communicative relationships. We have established an internal control system, introduced J-SOX, and have a representative in the US dedicated to internal audits, as part of a system we are building that ensures a high level of governance.

The Board of Directors of Sumitomo Forestry itself plans to add one outside director at the General Meeting of Shareholders in March, bringing the total number of directors to 10, four of whom will be outside directors. As a result, the percentage of outside directors on the Board of Directors will go from 33% to 40%.

In addition, the significance of holding cross-shareholdings is determined from time to time, and in 2023, we sold eight stocks, of which six stocks were reduced to zero. As of December 31, 2023, the ratio of policy-holding shares to net assets was below 10%. We will continue to strengthen governance and enhance management soundness to ensure corporate transparency and fairness.

[Conclude]

Finally, I would like to explain our shareholder return policy. Regarding dividends, we plan to increase the dividend by 5 yen per share to an annual dividend of 130 yen per share, since we plan to increase sales and profits this fiscal year and achieve the recurring income target set in our medium-term management plan.

The Company recognizes that returning profits to shareholders is one of its highest priorities and makes it a basic policy to do so in a continuous and stable manner. We will continue to enhance our capital adequacy and return profits to shareholders at an appropriate level according to the status of profits, taking into consideration the overall balance of financial conditions, cash flow, and other factors.

Thank you very much for your attention.

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