

Sumitomo Forestry Group
Financial Results for the First Quarter Ending December 2021
Conference Call with Analysts and Institutional Investors - Q&A

Time and date: 4:30 p.m.– 5:30 p.m., Friday, April 30, 2021

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

Q

Can you tell us about the impact of the cold wave in Texas? Were there any sales delays?

A

There were some temporary construction delays due to restricted supplies of feed pipes and delays in deliveries of supplies to job sites, but currently everything has returned to normal. Aside from the impact of the cold wave, there is concern that construction periods may be prolonged by shortages of supplies due to the favorable housing market, so we will have to keep an eye on the situation.

Q

Timber prices have increased in the detached housing business in the United States. Have you been able to pass that on in selling prices? Also, have you been reviewing your timber suppliers?

A

In regard to properties sold in the first quarter, the situation varies depending on the building lot for sale, but basically, we have responded by revising prices. However, timber prices have currently risen higher than we initially anticipated, and it is difficult to predict how long this trend will continue, so that is a cause for concern in the future. Under the circumstances, we will not be taking on the unnecessary risk of reviewing our suppliers.

Q

Will the increase in timber prices lead to improved performance in the Timber and Building Materials Business?

A

It's safe to say that rising prices will lead to higher sales and profit in the Timber and Building Materials Business. However, there have been construction delays and order control measures at some detached spec home builders due to supply shortages. If there is an industry-wide decrease in construction starts, it could have a negative impact on our Timber and Building Materials Business. In some ways, it's difficult to see into the future, but we will keep a close eye on the market situation.

Q

The sales plan for the detached housing business in the United States is for 11,000 houses. As of the beginning of the year, the backlog of orders was around 70%. Could you tell us what is the status of progress on that as of the end of the first quarter?

A

Orders are progressing favorably in the United States, and the backlog of orders at the end of the first quarter was around the same level as the beginning of the year.

Q

It seems the increase in timber prices after signing the contract would have a negative impact on the profits of properties that have been ordered but not yet started on. What is your outlook on how the increase in prices will impact profits?

A

The purchase price of timber is decided after the start of construction, so the increase in timber prices is factored in to an extent at the time the contract is signed, and selling prices have come up since. However, if the prices increase more than anticipated, that could decrease profitability compared to when the contract was signed.

Q

There are concerns of a timber shortage in Japan. What will the impact be on your Housing and Construction Business? Also, have there been any positive impacts from your efforts in the Timber and Building Materials Business and owning forests in Japan and other countries?

A

The structural materials for our custom-built detached houses are primarily imported from Europe not our forests. The base of our Timber and Building Materials Business is there, so currently there are no issues with the supply. Speaking of our overseas forest management, our subsidiary exporting timber to China from our plantation forests in New Zealand has benefited from the rising prices resulting from increased demand for timber in China.

Q

It seems that orders are strong in the detached housing business in the United States. Is there any risk that sales will fall short of the forecast of 11,000 houses in the current fiscal year due to supply shortages arising from delays in material procurement caused by soaring timber prices?

A

At this time, we do not anticipate that sales will fall short of the forecast. In the United States, some companies are importing and using European timber in addition to North American timber, so at this

point in time, it is unlikely that there will be an interruption in the supply of timber itself. However, the number of housing starts in the United States in March came to 1.7 million on an annual basis, rising to where it was at prior to the global financial crisis in 2008 triggered by the Lehman Brothers bankruptcy. As such, we will have to pay close attention to the material supply situation going forward.

Q

What is the leasing status and your outlook on achieving the full-year plan for the nine properties from Crescent's sales plan for the year ending December 2021?

A

While there are developments happening in each project, such as some getting moved forward and others being pushed back in relation to the sales schedule, we expect full-year sales of nine properties as planned at the beginning of the year. As for the leasing situation, there have been some reports of delays of rent payment, but in our Group's business, at this time there has been no impact, and we do not see any problems.

Q

Might you use domestic timber as a substitute for imported timber, which is rising in price, when procuring timber for the domestic housing business? Also, to what extent do you see costs increasing as a result of rising timber prices?

A

The percentage of domestic timber used in our Big-Frame construction method is around 50%. There are two problems when it comes to using it as a substitute, namely strength and steady supply. For example, European timber is used as the structural material for houses built using the Big-Frame construction method, because laminated Japanese cedar is not strong enough. Meanwhile, the problem with Japanese cypress is more ensuring a stable supply than its strength. However, utilizing domestic timber is particularly important as timber prices rise globally, so we hope to be proactive in this regard. We haven't clearly calculated the level to which timber prices could rise in the future, but we see it as a major cause for concern.

Q

The first quarter results were strong in terms of the number of units sold in the detached housing business in the United States. Could you tell us what you anticipate as the trend in future quarterly sales?

A

Generally, in the past, the number of units sold has tended to be slightly lower from January to March and higher in October to December. We don't actually have a precise outlook for the fiscal year ending

December 2021, but the number of units sold will likely remain at the same level as the first quarter in the second and third quarters and then increase in the fourth quarter.

Q

Is there a sense of a slowdown in the housing markets in the United States and Australia?

A

The US housing market remains strong, so there is no sense of a slowdown there. However, there is an accumulating backlog of orders, so there is some concern that deliveries may not be possible at the customer's desired timing due to problems with construction capacity. As such, some of our companies are taking steps to keep sales down. In Australia, there was a certain amount of last-minute demand in December 2020 and March 2021 in conjunction with the deadline for contracts under the government's subsidy program, so the market may slow down in April or thereafter.

Q

In the detached housing business in the United States, what percentage of the properties planned for sale has timber already been procured for?

A

The timber market is fluctuating violently, so we are avoiding long-term timber procurement contracts. Other than properties that were started in the first quarter, going forward we will have to procure timber for most future properties.

Q

Compared to January-March in the same period of the previous year, it would seem that the first quarter results in the Housing and Construction Segment are down. What is your outlook for the future? How much of an impact do you see the rise in European material prices having on profit?

A

At this time, we do not anticipate that the number of houses sold will fall short of the full-year forecast. However, although there is no doubt that soaring timber prices will have a negative impact on future profitability, there are many uncertainties when it comes to the specific degree of impact, so there is no way to make an accurate prediction in that regard.

Q

What is the current situation, outlook, and the impact on business performance of the percentage of ZEH in the domestic custom-built housing business?

A

The current ZEH percentage has risen to around 60%. As the trend toward decarbonization progresses,

the number of customers who looking for ZEH is expected to increase steadily due in part to growing environmental awareness among consumers. We have put forth a target of 80% ZEH for fiscal 2021, and we will be working on further increasing the percentage of ZEH. As for the impact on performance, selling prices will increase with the inclusion of environmental equipment, so we expect to see a positive impact.

Q

Have rising timber prices had an impact on the biomass power generation business? If not, could there be an impact in the future?

A

At this point there has not been an impact. The main factors behind this wood shock were the favorable housing market in the United States and the increase in demand due to the economic recovery in China. It did not impact wood pellets, unused timber from forests, or construction waste used in the biomass power generation business. We do not foresee any particular problems in the future.

Q

Will rising timber prices affect orders in the domestic Housing and Construction Business? For example, might it lead to order control or price increases? Could you also touch on what's happening with your competitors?

A

The current increase in timber prices will likely end up bringing about a review of selling prices. There are many uncertainties, but rising timber prices could have a negative impact on orders received. However, since it's not just wood but steel frames, cement, and other materials, competitors such as steel-frame prefabricated housing builders are probably facing a similar situation, so it is likely that our competitors will be revising their prices, too. We will be working on landing orders while engaging in efforts to reduce costs.