

**Sumitomo Forestry Group First Quarter Financial Results
for Fiscal Year Ending December 31, 2022
Conference Call with Analysts and Institutional Investors - Q&A**

Time and date: 4:30 p.m.-5:30 p.m., Wednesday, April 27, 2022

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

Q

In regard to the Detached Housing Business in the United States, you said you have voluntarily limited new orders in preparation for the risk of a sharp rise in material prices. How will this impact future results, including the fiscal year ending December 2023?

A

In the United States, the populations of Millennials and Generation Z, which are home buyers, are high. And because housing inventory is low, we expect high demand going forward on a structural basis. The Group is engaged in business in highly affordable and high growth areas of the United States. Mortgage interest rates are above 5%, but there is currently no sense of slowing with respect to orders received and sales. The cancellation rate is also within the normal range of around 15%, so even if there were cancellations, we would be able to sell them right away to other customers. In the first quarter of the fiscal year ending December 31, 2022, in addition to the very high number of orders received in the same period of the previous year, we put a voluntary limit on presales in areas including Texas. As such, the numbers were down year on year, but the backlog of orders is over 7,000 units, and there are around 1,500 properties under construction that are intentionally without contract, so there will not be any problems with sales going forward.

Q

Compared to the first quarter of the previous fiscal year, the number of orders received is down 24.1% in the Detached Housing Business in the United States. Can you tell us about the amount of orders received and the unit prices?

A

I do not have data on the amount of orders received or the unit prices, but the sales amount and unit selling prices are up 35.0% and 44.2%, respectively, compared to the first quarter of the previous fiscal year, so those numbers are definitely not down from the previous year.

Q

Can you tell us what is behind detached housing unit selling prices in the United States being up 44.2% compared to the first quarter of the previous fiscal year?

A

Unit selling prices in the first quarter of the fiscal year ending December 31, 2022 were ¥56.9 million (up 44.2% year on year). One of the main factors was the exchange rate. The yen continued to depreciate. It was ¥106.03 to the dollar in the first quarter of the previous fiscal year, but in the first quarter of this fiscal year, it was ¥116.34 to the dollar. Excluding the minus ¥5 million impact of the exchange rate, unit selling prices were ¥52 million.

Q

Can you tell us about the background behind some subsidiaries in the Detached Housing Business in the United States limiting new contracts and what it would take for those limits to be lifted? Also, you said that you have 1,500 properties under construction without contract and that those will lead to future sales. Can you tell us the reason for that?

A

Some subsidiaries are limiting contracts to avoid the risk of a sharp rise in material prices. Amid strong housing demand, the percentage of presale properties remains high, but these contracts are signed prior to construction, and the selling price is fixed, so if material prices go higher than anticipated during construction, that could eat into profits. For that reason, we are limiting presales and, to a certain extent, increasing the number of properties that go under contract once costs are determined after construction. These properties under construction without contract are not properties for which we could not find buyers but are properties for which we intentionally did not sign contracts. Once construction is completed, the strong housing demand will lead to quick contract sales.

Q

What is the situation with material prices in the Detached Housing Business in the United States? Have you been able to absorb the increased costs?

A

Material prices are rising in the Detached Housing Business in the United States. However, selling prices are also rising against a backdrop of robust housing demand. As seen in the profit ratio, these increased costs are being absorbed to a sufficient degree.

Q

What do you envision as the risk scenario in the Detached Housing Business in the United States? How are you addressing the risk of soaring material prices in the event that housing demand becomes sluggish? Would you use the lots currently secured for detached spec homes or the spec homes not yet under contract as rental housing?

A

Structural demand remains firm, but as a risk scenario, we are considering a drop in home buying demand arising from lower affordability in conjunction with rising mortgage interest rates and lower profits resulting from a drop in selling prices.

With respect to lower affordability, we have begun offering townhouses and other products that have lower selling prices and costs Group-wide and are working to reduce costs by acquiring construction companies. In addition, with respect to a future drop in home buying demand, using lots and homes as rental housing is a possibility.

Out of the 7,707 unit backlog of orders, there are only 1,500 units for which construction has not started and are exposed to the risk of a sharp rise in material prices.

Q

In regard to the Housing Business in the United States, mortgage interest rates in the United States are over 5%, so why is home buying demand strong in the areas where Sumitomo Forestry is engaged in business? Some other companies are explaining that the risk of home loans being denied is small because they are targeting the wealthy or those who are upsizing. What do you see as the characteristics of your customers?

A

Those who purchase our homes are a diverse group, but in our price range, most are middle class, and there are considerable numbers upsizing in the areas where we do business. We believe that home buying demand will remain firm, as we have been expanding into growth areas where population growth is expected due to companies setting up operations there and other such factors.

Q

In the Housing and Real Estate Business in the United States, both the number of units sold and unit selling prices were up in the previous fiscal year, but in the first quarter of this fiscal year, despite a decrease in the number of units sold, unit selling prices are up. What is your outlook for the number of units sold and unit selling prices going forward?

A

The population of Millennials and Generation Z, which are home buyers, is high in the United States, and strong demand is expected from a structural standpoint. As such, even if there are temporary dips, we basically expect the number of units sold to grow. In the Medium-Term Management Plan (2022-2024), the annual target for number of units sold in the Detached Housing Business in the United States is 16,000, and we believe that is very achievable. However, if interest rates continue rising, we believe it will be difficult to keep increasing unit selling prices.

Q

The gross profit margin in the Housing and Construction Business was 18.3% in the first quarter of the fiscal year ending December 31, 2022, but it was 21.7% in the same period of the previous fiscal year. Can you tell us what the factors behind this decline were? Also, the full-year plan for the fiscal year says it will recover to 19.3%. Can you tell us what is behind this forecast?

A

The profit ratio is declining compared to the previous fiscal year due to the impact of soaring material prices. For the full year, we had initially anticipated that the impact of soaring timber prices would lessen during the year, but we have had to revise the profit ratio downward to reflect the impact of the situation in Ukraine and prolonged high prices of timber and other materials. However, selling prices were revised in the previous fiscal year, so we expect the profit ratio in the second quarter and beyond to improve compared to the first quarter. The price of materials other than timber has also risen sharply, so we will continue working to reduce costs, but where we fall short, we will consider revising selling prices again. Note that much of the impact of selling price revisions in the fiscal year ending December 31, 2022 in custom-built detached housing will be reflected in the results in the next fiscal year or later due to construction periods.

Q

My impression is that orders received were favorable in the Custom-Built Detached Housing Business in Japan up until last year but that this year they are weak. Can you tell us about current demand and your future measures?

A

Compared to the previous fiscal year when they were particularly favorable, they have dropped off, but the number of material requests remains at a high level, and demand has not dropped off significantly. It has already been decided that the tax deduction on mortgages will be extended, and at this time we do not expect government policies to boost orders received like they did in the previous fiscal year, but anticipation of an increase in interest rates might lead to increased orders. In addition to developing products with high environmental performance such as ZEH and our new LCCM homes and designable products that keep total prices down such as Forest Selection, we will continue to focus on our online strategy as we work to increase orders received.

Q

My impression is that when it comes to rising costs in the Custom-Built Detached Housing Business in Japan, the drop in the profit ratio is more significant than your competitors, perhaps because of the high SG&A ratio. It seems like something should be done. What kind of measures are you working on?

A

We do not produce things in a factory like a prefabricated housing manufacturer, and we need a certain number of personnel, so the percentage of our personnel costs might be a little higher. We are currently working on improving the efficiency of on-site work as well as looking into precut materials and reviewing the flow of operations.

Q

What kinds of materials other than timber are increasing in price in the Housing and Construction Business in Japan?

A

The prices of various materials, including sashes, plaster board, and unit reinforcements are on the rise, so we are keeping an eye on the trends.

Q

Will the situation with orders received in the Custom-Build Detached Housing Business in Japan improve going into the second half?

A

It has been widely reported that the prices of building materials such as timber are rising, and it seems that some customers are hesitant to buy a house under these circumstances. The environment may continue to be a little difficult when it comes to orders received, but we hope to secure orders by promoting housing with high environmental performance and Forest Selection, which offers a relatively low total price. We have a Timber and Building Materials Distribution Business Division, so there will not be a situation in which we are unable to build due to not being able to procure timber. We will communicate that sense of security to our customers.

Q

Has the price of wood chips also gone up sharply? Has that or other factors impacted the Wood Biomass Power Generation Business?

A

Prices of lumber products used for the structural material of buildings have risen, but the price of wood chips has not. At present, the wood biomass power generation business has not been impacted by soaring timber prices.

Q

What is the future outlook for the Environment and Resources Business in terms of expansion and such?

A

The Environment and Resources Business is an important segment in Mission TREEING 2030, the Group's long-term vision. We will work on growing it into a business that contributes to the realization of a decarbonized society, including by creating a forestry fund.

Q

What is the value of forest assets you manage and own in Japan and abroad? Also, what is the potential value of forests, including the creation of carbon credits derived from forests?

A

As of the end of the first quarter, the amount recorded for forests on the consolidated balance sheet was ¥40,315 million, which is the value of forest assets that we can present to the public. As for calculating carbon credits derived from forests, the international rules are currently being created, so it is difficult to specify an amount that includes that value.

Q

In regard to the full-year forecast for the fiscal year ending December 31, 2022, can you tell us why the forecasts for the Timber and Building Materials Business and the Real Estate Development Business in the United States, which performed well in the first quarter, have not been revised upward?

A

The Timber and Building Materials Business performed well owing to the impact of soaring timber prices in the first quarter, but it is unclear where timber prices are headed, so we have left the full-year plan as-is.

The Real Estate Development Business in the United States performed well owing to an uptick in selling prices and some sales being recorded ahead of schedule, but going forward, we anticipate that some property sales would be recorded late due to buyer wishes and other factors. As such, we have not revised the forecast upward.

Q

What is the impact of the exchange rate on the Timber and Building Materials and the Housing and Construction businesses?

A

In the Timber and Building Materials Business, we have basically entered into exchange contracts for imports, so there is no direct impact from exchange rate fluctuations. The price of timber imports has risen due to depreciation of the yen, but this has led to an increase in profits in our Timber and Building Materials Business, owing in part to high demand for domestic timber. The increased costs from higher material prices have had an impact on the Housing and Construction Business, and the sharp rise in material prices is partially due to the impact of higher import prices caused by depreciation of the yen.

Q

Can you tell us about sensitivity to the rate of exchange against the US dollar?

A

If there is a one yen depreciation, it pushes recurring income up around ¥1 billion. As for the full-year forecast, we are leaving the rate at ¥115 to the dollar as it remains unclear what will happen with the exchange rate.

Q

What is the plan for orders received this fiscal year in the collaboration with Kumagai Gumi?

A

We plan on combined orders received of ¥45 billion in the fiscal year ending December 31, 2022 (January to December).

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