

FURTHER ENHANCE OUR STRENGTH TO  
BECOME A TOTAL HOUSINGLIFE SPECIALIST





# LEARNING FROM THE WOOD, CULTIVATING THE WOOD, MAKING THE MOST USE OF THE WOOD

Wood is a renewable natural material. Wood is essential to the lives of people. For over 300 years Sumitomo Forestry has been accumulating knowledge and technology by learning from the wood, cultivating the wood, and making the most use of the wood. 31 years ago we launched our wooden housing business which brings out the prominent features of wood. Currently, as a “total housing and living-related business” which is involved in all aspects from upstream to downstream, the mission of the Sumitomo Forestry Group is to make the most use of wood to contribute to the creation of a prosperous society through all types of services related to the living environment.



\* The mark shown above signifies the “sustainable” efforts of Sumitomo Forestry.

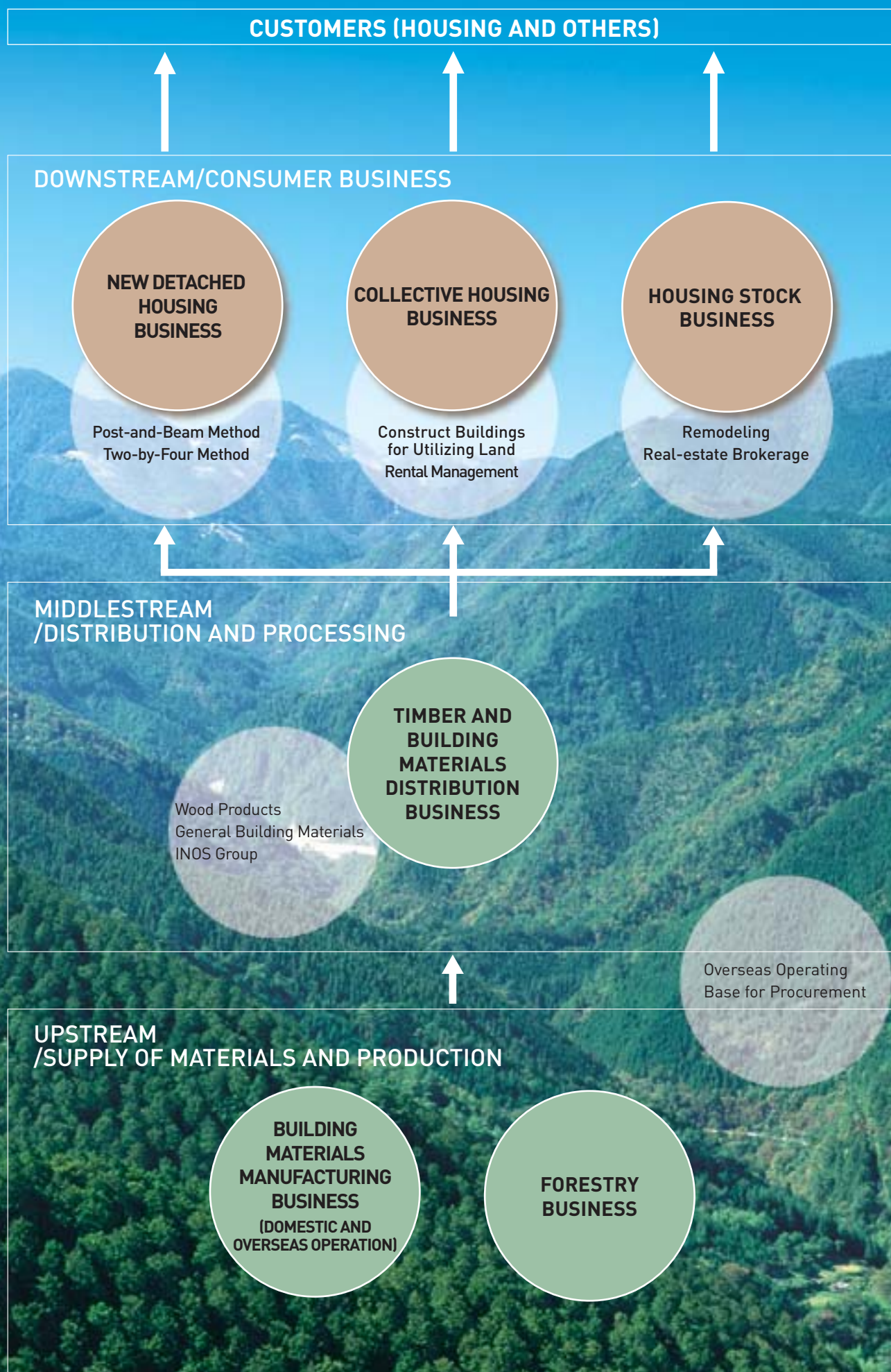
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## FORWARD-LOOKING STATEMENTS

Statements in this annual report with respect to Sumitomo Forestry’s plans, strategies, and objectives as well as other statements that are not historical facts are forward-looking statements, based on management’s assumptions and beliefs formed in the light of information available as of the production of this report. Actual results may differ from those discussed in these forward-looking statements owing to the impact of various factors, including but not limited to changes in the business environment, general economic conditions, and customer preferences.

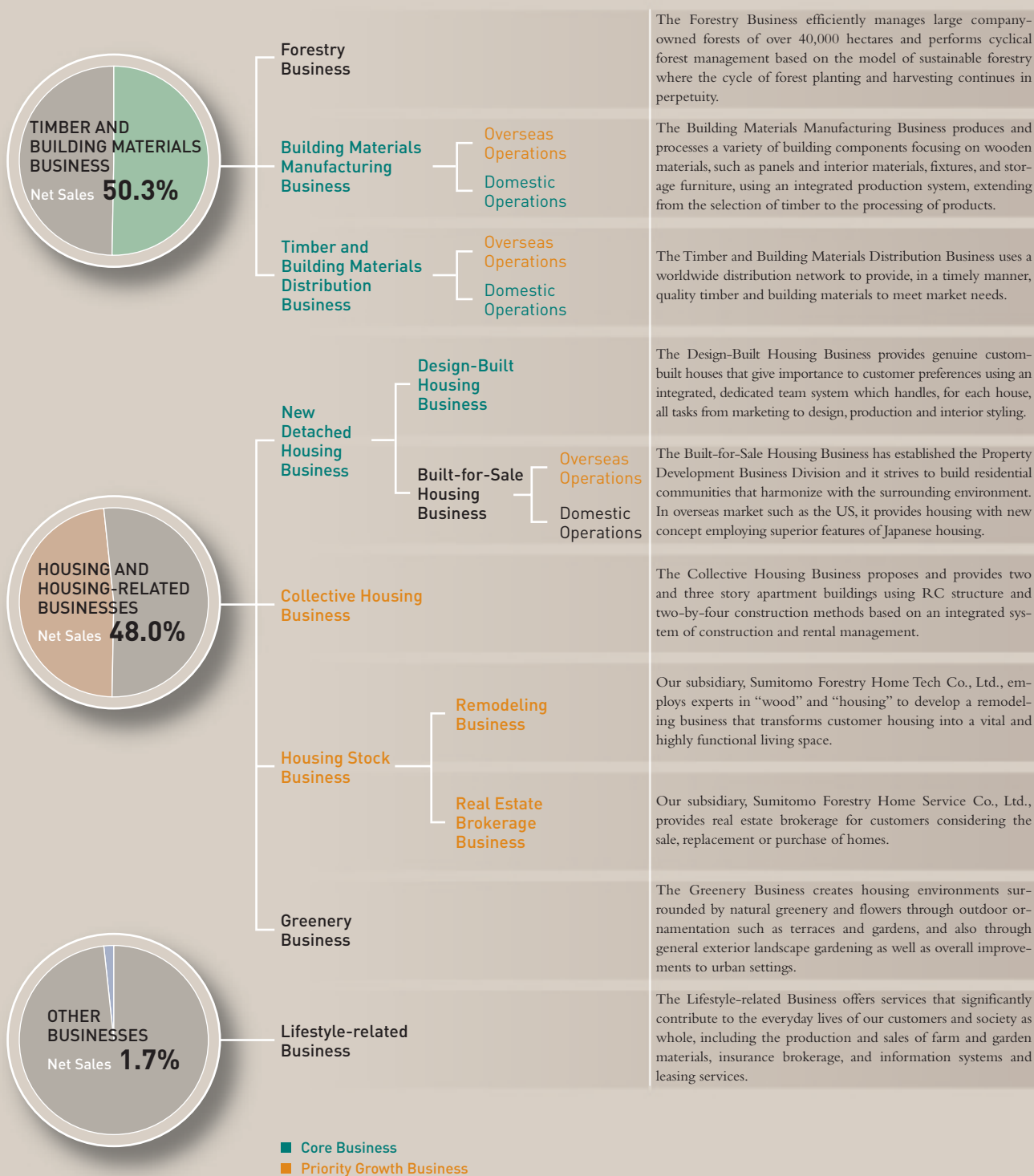




## AT A GLANCE

### BUSINESS STRUCTURE OF SUMITOMO FORESTRY

The Sumitomo Forestry Group sees timber as a blessing of nature that brings prosperity to society and our daily lives, and with this understanding, has developed a number of wood and housing related businesses. These include timberland management, production, processing and sales of timber and building materials, the construction and sales of wooden housing, and remodeling and existing home brokerage.





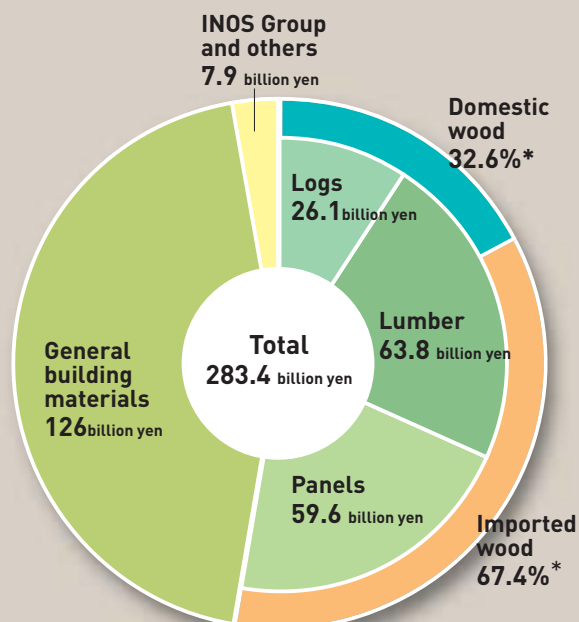
## NO. 1 SALES VOLUME OF TIMBER AND BUILDING MATERIALS IN JAPAN

The Sumitomo Forestry Group began with its Forestry Business and has expanded its business to include everything from the distribution business of timber and building materials to the manufacturing business of them in domestic and overseas. Its network is now spread around the world encompassing North America, Russia, Southeast Asia, China, Oceania, and Europe.

Our fusion of the quantity of information obtained, made possible by incorporating all aspects of the business from upstream to downstream, and the expertise of each individual employee fully utilizing that information, provide effective solutions to the industry from procurement proposals for new materials to a distribution system that provides expertise that goes beyond just materials.

This enormous network for timber and building materials is supporting our position of having the No.1 transaction volume in Japan.

## Product Share within Net Sales and Purchase Ratio in Timber and Building Materials Distribution Business (non-consolidated)



\* The supplier ratio is calculated from the proportions of three products in total sales —logs, lumber and panels.

(FY 2005)

## NO.1 IN DESIGN-BUILT WOODEN HOUSING

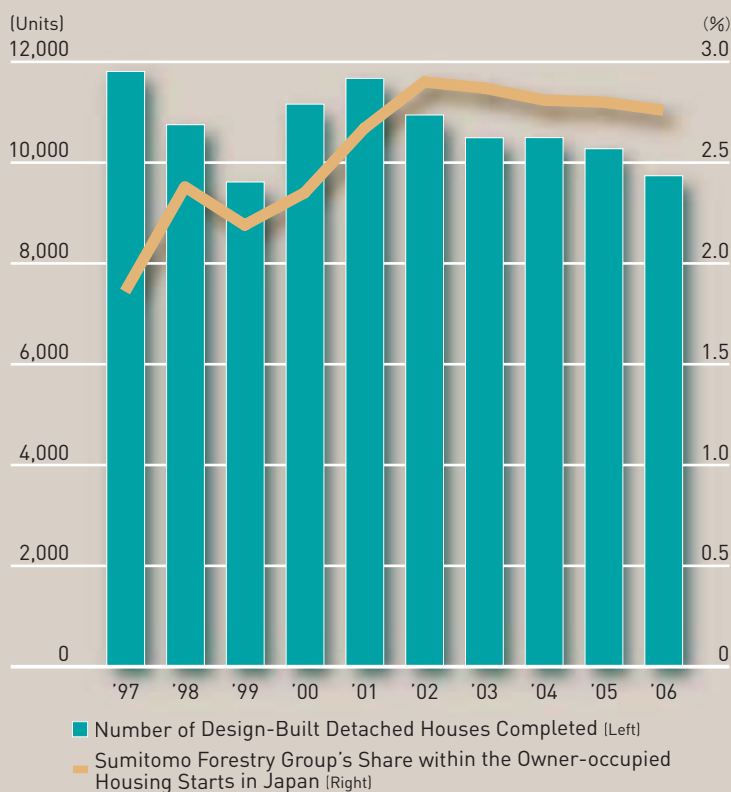
As a expert in “wood” and “housing”, the Group is providing design-built wooden houses.

Our “wooden homes” created by applying all of our “wood” expertise and technology are born from meticulous home-building based on free design adapted to the dreams and lifestyle of each customer.

Our achievement of becoming No.1 in design-built wooden housing\* was supported only by the reputation of our customers for our home-building.

\*Jutaku Sangyo Kenkyujo Co., Ltd.

## Number of Design-Built Detached Houses Completed and Market Share



((Years ended March 31))

# FINANCIAL HIGHLIGHTS

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
Years ended March 31

	2006	2005	2004	2003	2002	2006
	Millions of yen					Thousands of U.S. dollars*1
Operating Results:						
Net sales and contract revenues	¥ 791,128	¥ 723,193	¥ 673,779	¥ 645,100	¥ 644,730	\$ 6,704,477
Gross profit	127,853	125,582	120,778	109,631	109,437	1,083,504
Selling, general and administrative expenses (SG&A expenses)	112,407	107,116	103,201	100,858	106,397	952,603
Operating income	15,446	18,466	17,577	8,772	3,040	130,901
Recurring income*2	16,800	18,692	17,074	9,721	3,731	142,371
Net income (loss)	10,842	8,014	9,870	(15,439)	465	91,880
Financial Position:						
Total assets	464,193	370,684	369,755	357,322	365,531	3,933,836
Interest-bearing debt	22,067	15,580	19,929	16,497	18,124	187,010
Total shareholders' equity	175,206	152,500	146,269	129,727	147,440	1,484,797
Cash Flows:						
Cash flows from operating activities	16,626	6,685	25,962	19,734	17,332	140,900
Cash flows from investment activities	(8,998)	(12,895)	(7,646)	2,026	(16,439)	(76,258)
Cash flows from financing activities	(14,039)	(7,087)	(735)	(8,171)	(9,716)	(118,972)
	Yen					U.S. dollars*1
Per Share Data:						
Net income (loss)	¥ 61.28	¥ 45.28	¥ 55.81	¥ (87.53)	¥ 2.64	\$ 0.52
Shareholders' equity	996.03	866.47	830.50	736.42	835.07	8.44
Cash dividends	13.00	13.00	13.00	10.00	10.00	0.11
	%					
Financial Ratios:						
Operating income margin	2.0	2.6	2.6	1.4	0.5	
Return on assets (ROA)*3	4.0	5.0	4.7	2.7	1.0	
Return on equity (ROE)*3	6.6	5.4	7.2	(11.1)	0.3	
Shareholders' equity ratio	37.7	41.1	39.6	36.3	40.3	
Interest-bearing debt ratio*4	11.2	9.3	12.0	11.3	10.9	
	Units					
State of Orders (on a unit basis):						
Custom-built detached housing	9,251	10,076	10,529	10,538	10,685	
Collective housing	1,288	1,776	1,655	1,227	1,075	
State of Sales (on a unit basis):						
Detached housing	9,807	10,319	10,542	10,552	11,008	
Collective housing	1,082	1,571	1,266	1,220	822	
Reference Market Data:						
New housing starts (nationwide)	1,249,366	1,193,038	1,173,649	1,145,553	1,173,170	
New housing starts (Tokyo metropolitan district)	432,005	419,088	422,750	393,296	393,625	
Owner-occupied housing starts (nationwide)	352,577	367,233	373,015	365,507	377,066	

Notes: 1. Japanese yen amounts have been translated into U.S. dollar amounts, for the reader's convenience only, at the rate of ¥118=US\$1, the approximate exchange rate prevailing in the Japanese foreign exchange market at March 31, 2006.

2. Recurring income = Operating income + Non-operating income – Non-operating expenses

Non-operating income includes interest income, purchase discounts, dividends income, exchange gains, miscellaneous gains, and other income generated from normal business activities. Non-operating expenses include interest expense, sales discounts, loss on devaluation of property, plant and equipment, exchange losses, miscellaneous expenses, and other expenses from normal business activities.

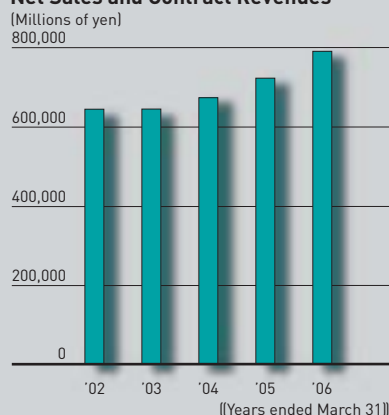
3. ROA and ROE are calculated using the simple average of beginning and end of term balance sheet figures.

ROA = Recurring income / Total assets

ROE = Net income (loss) / Shareholders' equity

4. Interest-bearing debt ratio = Interest-bearing debt / [Interest-bearing debt + Shareholders' equity]

### Net Sales and Contract Revenues



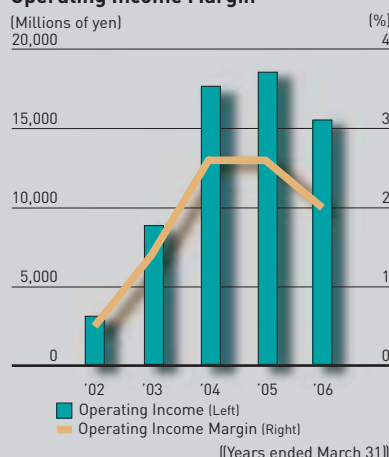
### Net Sales

Net sales for the Timber and Building Materials segment increased 28.7% over the previous fiscal year, due mainly to the contribution of ¥98.7 billion from the consolidation of Ataka Kenzai Co., Ltd., and Toyo Plywood Co., Ltd., as new subsidiaries. On the other hand, net sales for the Housing and Housing-Related Businesses segment fell 5.8% year on year.

### Operating Income and Operating Income Margin

Operating income decreased by ¥3.0 billion and the operating income margin dropped 0.6 of a percentage point, due to a year on year fall of 5.2% in the number of custom-built detached houses sold, in spite of the active recruitment of manpower to reinforce our sales force and the proactive expansion of business bases for future business growth.

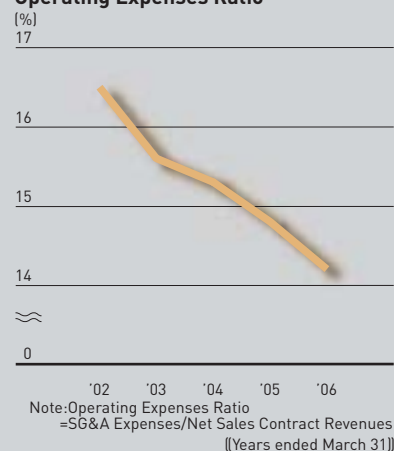
### Operating Income and Operating Income Margin



### ROA and ROE

Return On Assets fell 1.0 percentage points from the previous fiscal year as recurring income dropped 10.1% year on year while total assets increased. Return On Equity rose 1.2 percentage points, with net income increasing by ¥2.8 billion.

### Operating Expenses Ratio



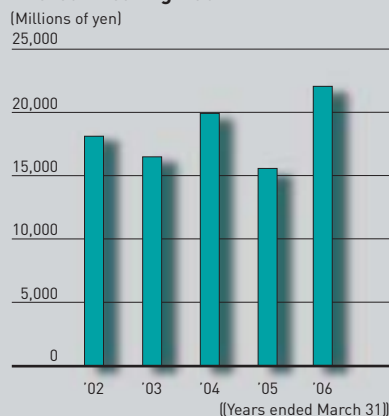
### ROA and ROE



### Interest-Bearing Debt

Interest-bearing debt increased by ¥6.4 billion, short-term debts in the main, due to the addition of debts of newly consolidated subsidiaries Ataka Kenzai and Toyo Plywood.

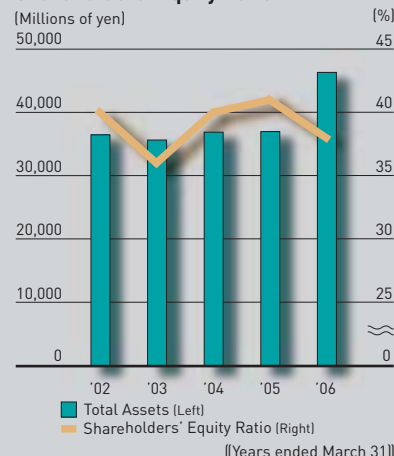
### Interest-Bearing Debt



### Total Assets and Shareholders' Equity Ratio

Total assets rose by ¥93.5 billion, thanks to higher market prices of securities holdings due to stock price rises, as well as the addition of operating receivables due to newly consolidated companies. The shareholders' equity ratio declined 3.4% due to increases in both total assets and liabilities.

### Total Assets and Shareholders' Equity Ratio



## TO OUR STAKEHOLDERS

In fiscal 2005, we shifted our operating strategy to a more “proactive” footing after implementing a series of management structural reforms over the three preceding years. This shift was based on the idea of returning to our original policy of “providing the best living environments to all our customers using the maximum potential of timber.” Since this shift, we have channeled management resources into the following areas: (1) strengthening our sales capabilities and competitive products and (2) developing Priority Growth Business. We will steadily move forward for sustainable future growth.

Ryu Yano  
President / Director



### A LOOK BACK ON FISCAL 2005

#### [Outline of Consolidated Business Performance]

#### Harsh Environment Persists as Owner-Occupied Housing Starts Decline

In fiscal 2005, the Japanese economy showed an expansion of corporate profits and capital investment as well as signs of recovery in the employment and personal consumption. In the housing industry, the buying trend of first-time homebuyers grew further due to low interest rates, falling land prices, and improvements in the employment and income environment. As a result, built-for-sale houses, particularly condominiums, increased 6.0% year on year. Demand for rented houses also increased 10.8% from last year owing to the growth of real estate funds and other factors. Against this background, new housing starts grew by 4.7% year on year to 1.249 million, the highest level since fiscal 1997. However, owner-occupied housing starts, where the Group is deeply involved, declined 4.0% year on year to 352,000 units. Further, the environment for the timber and building materials industry grew harsh as soaring prices of logs and crude oil pushed profits down.

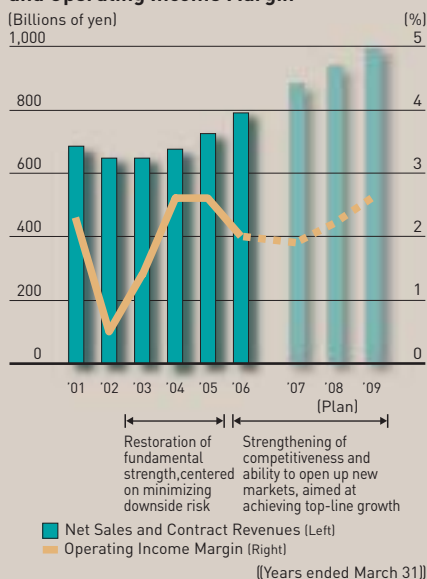
#### Sales Gains from M&A but a Decline in Profits

Amid this harsh environment, net sales and contract revenues of the Group increased 9.4% year on year to ¥791.1 billion. However, approximately ¥100 billion of these sales were attributable to the impact of M&As on our Timber and Building Materials Business, which left us with the view that sales generated by existing businesses saw sluggish growth.

As for profits, the actuarial difference in retirement benefit accounting resulted in a gain of ¥2.8 billion, but operating income declined 16.4% year-on-year to ¥15.4 billion and recurring income declined by 10.1% to ¥16.8 billion due to sluggish growth of existing businesses, a rise in raw materials costs, and prior investments of ¥4.2 billion for expanding our core and priority growth businesses. Net income, however, increased 35.3% year on year to ¥10.8 billion as a result of a reduction in corporate tax after reporting a tax loss due to a withdrawal from wooden component housing business that took place in the preceding fiscal year.



### Net Sales and Contract Revenues and Operating Income Margin



### [Outline of Segment Results]

#### Timber and Building Materials Business—

#### Major Expansion of Business Sphere through M&As

Net sales in our Timber and Building Materials segment grew 31.1% year on year to ¥395.6 billion and operating income declined to ¥2.8 billion, a 39.2% decrease. Amid the accelerated reorganization of the timber and building materials distribution business in Japan, we made Ataka Kenzai Co., Ltd. a subsidiary in October 2005 in order to secure a new customer base and expand the product lineup. Boasting strengths in community-based marketing and in the handling of ceramic building materials, a significant synergistic effect is expected between this company and the Group. In our Building Materials Manufacturing Business, we made Toyo Plywood Co., Ltd., a manufacturer of wood-based building materials, a subsidiary in June 2005. This was conducted in order to channel management resources into the wood-based building materials manufacturing business and thereby strengthen and expand it. The expansion of the scope of our business through M&A activities such as these has boosted net sales in the Timber and Building Materials Business. Nevertheless, because of the sluggish demand as seen in the decline in owner-occupied housing starts, we were unable to pass on completely the soaring costs of raw materials to our selling prices. Thus this segment's operating income has declined substantially.

#### Housing and Housing-Related Businesses—

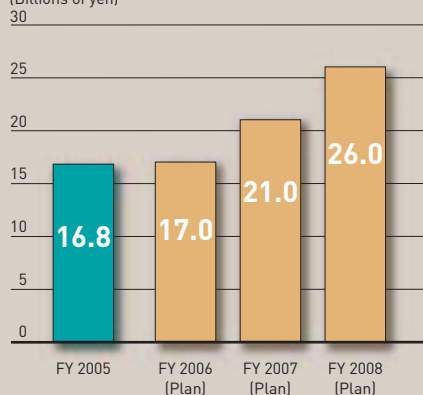
#### Focusing Effort on a Qualitative Shift in our Marketing Approach

Net sales and contract revenues in the Housing and Housing-Related segment declined 6.2% year on year to ¥392.1 billion and operating income fell to ¥16.3 billion, a 6.6% decrease. Orders for custom-built detached houses also declined, falling 8.2% to 9,251 units. We invested aggressively in this segment, increasing the number of sales staff and expanding office and sales networks. On the other hand, in the environment marked by an increase in first-time homebuyers and intensifying competition from other firms in the industry, we began to face a lengthening of the period between contract closing and the start of construction, and an increase in the number of projects cancelled due to changes in plans after contract conclusion. We thus pushed forward the “qualitative shift in marketing approach” in order to increase the number of contracts leading to construction starts. Although this qualitative shift resulted in a temporary decline in new orders, the measure has led to an increase in unit price per order for custom-built houses. This simultaneous implementation of investment and a “qualitative shift in marketing approach” has the potential to increase the number of high-quality orders (orders with a high probability of reaching construction).

A priority growth business in the Housing and Housing-Related segment is the collective housing business. We have beefed up this segment by strengthening our integrated system of construction and rental management and by increasing personnel. Due to stronger competition with leading construction firms in the large-scale project market, however, the number of orders declined 27.5% to 1,288 units, and order volume fell 21.5% to ¥13.7 billion, year on year. In our housing stock business, which we are also expanding, net sales and contract revenues in the remodeling business declined 6.7% year on year to ¥23.7 billion. However, if the sales transfers of guaranteed work for custom-built detached houses are excluded, the remodeling business saw a revenue increase. On the other hand, our real estate brokerage business, for which we strengthened marketing capabilities in the Tokyo Metropolitan Area, enjoyed a 5.0% year-on-year rise in sales to ¥6.9 billion thanks to an increase in the brokerage of large-scale projects.

### Management Profit Goal (Recurring Income)

(Billions of yen)



## CONCEPTS AND GOALS OF OUR MIDTERM MANAGEMENT PLAN (FISCAL 2006 TO FISCAL 2008)

### Aiming to Become a Company that Operates Total Housing-Related Business with Diverse Income Sources

In the three-year period up to fiscal 2004, the Group implemented management structural reforms and improved our earnings structure, primarily by reducing the cost of housing production by more than ¥15 billion. We are aiming to shift away from a dependency on custom-built houses to become a company that operates total housing and living-related business with diverse income sources, by reorganizing our earnings structure, which is often affected by the structural problems of the Japanese market, such as the downtrend in owner-occupied housing starts. In order to achieve this goal, we have identified the following three businesses as priority growth areas and are actively strengthening them. The three businesses are overseas operation, collective housing business, and housing stock business including remodeling and brokerage operations. For expanding profit and strengthening Priority Growth Business, we are focusing effort on three key issues: (1) expanding the share of detached houses, (2) boosting profitability in the Timber and Building Materials Business and (3) fostering our three priority areas of business.

### Outlook for Fiscal 2006—

#### Gradual Appearance of Results from Our “Proactive” Strategy

As for the business environment for fiscal year 2006, we predict that owner-occupied housing starts, which had declined 4% from the preceding fiscal year, will increase 2% to 360,000 units. Our forecast is based on observations, such as the rise in demand triggered by the expected rise in interest rates owing to economic recovery and rise in second-generation baby boomers’ propensity to purchase houses, despite the continued presence of factors such as soaring price of raw materials. As these developments unfold, we expect that the fruits of the strategy we have implemented up to now will gradually emerge. Our forecast for fiscal 2006 is an 11.2% increase in net sales and contract revenues to ¥880 billion and a 1.2% rise in recurring income to ¥17 billion, year-on-year. This would be a ¥3.2 billion increase in recurring income if the effect of posting a ¥3 billion actuarial difference in retirement benefit accounting were excluded.

### Objective for Fiscal 2008—

#### Establishing A Balanced Earnings Structure and Achieving a New Profit Record

Our three-year Midterm Management Plan including fiscal 2006, aims to achieve a new profit record of ¥26 billion in fiscal 2008, surpassing the previous recurring

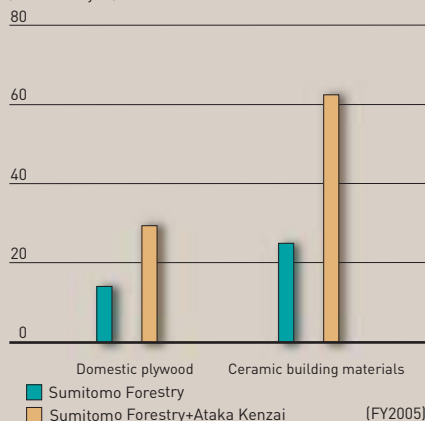
### Recurring Income (100 Millions of Yen)

		FY 2004	FY 2005		FY 2006 (Expectation)	FY 2007 (Expectation)	FY 2008	
							Midterm plan	
Core Business	Domestic Operations of Timber and Building Materials Distribution Business	41	36	The sharp global rise in timber prices cannot be completely passed along in sales prices.	44	51	62	
	Domestic Operations of Newly-Constructed Detached Housing Business	176	148	Our marketing strategy targeting first-time homebuyers fell short of success at 9,401 completed units.	166	188	215	
Priority Growth Business	Collective Housing Business	8	(1)	When reinforcing our staff, time must be put into developing potential.	7	11	13	
	House Stock Business	11	6		9	11	14	
	Overseas Business	18	10	Manufacturing costs increased due to problems at manufacturing plants and higher crude oil prices.	12	27	37	
	Others	(67)	(31)	Actuarial differences in retirement benefits of ¥3 billion reduced expenses.	(67)	(78)	(81)	
	Total	187	168		170	210	260	



### Synergistic Effect Achieved by Merging with Ataka Kenzai Co., Ltd.

(Annual net sales and contract revenues)  
(Billions of yen)



income record of ¥25.5 billion set in fiscal 1996. We believe that attaining this level of profit will require not only a larger share of owner-occupied housing but also an expansion of our priority growth businesses such as remodeling in order to bring the balance in our earnings structure between the custom-built detached housing segment and other segments into a 1:1 ratio in future.

## BASIC STRATEGY OF MIDTERM MANAGEMENT PLAN

### 1. Expansion of the Share of Detached Housing—

#### Commitment to our goal of 10,000 Units for Sale

Although the owner-occupied housing market has been on a moderate downtrend over the long term, at present, annual demand of approximately 350,000 units is projected to be the bottom level. We believe that the strength of our brand will enable us to reach 10,000 units for sale or more (the non-consolidated fiscal 2005 result was 9,401), and we will continue to build up our efforts to receive orders that lead to project completion through our product and regional strategy.

#### (1) Product strategy

Our product strategy rests on our new product “MyForest” launched in October 2005, whose basic concepts are “co-existence with the environment” and “a passion for wood,” as the culmination of our 30 years in the housing business. This strategic product offers a style of living based on the design techniques of Japan’s traditional wooden houses, which take advantage of natural breezes and lighting. It has been highly rated by mid- to high-end customers. In order to promote the appeal of “MyForest” to a wider age group, we offer various plans for exteriors and overall house layout, aiming to expand orders.

#### (2) Regional strategy

Our regional strategy seeks to capture the top share in owner-occupied housing in Tokyo. We are promoting community-based marketing by optimizing the scale of business bases in order to facilitate implementation of the regional strategy by branch managers. The results of this strategy have already emerged, and in fiscal 2005, when the overall growth of housing orders was sluggish, the number of units ordered in Tokyo rose 3.1% year on year. While aiming to capture the top share in owner-occupied housing in the crucial Tokyo area, we are also working to expand our share by strengthening our sales system in other urban areas.

#### (3) Participation in the built-for-sale detached housing business

In December 2005, we began full-scale participation in the built-for-sale detached housing business by establishing the Property Development Business Division as an independent business unit. Targeting particularly first-time homebuyers, we plan to build a business system that will enable us to approach the market from two sides, owner-occupied housing and built-for-sale housing.

### 2. Strengthening our Timber and Building Materials Business— A Further Scaling Up

Thanks to the merger with Ataka Kenzai Co., Ltd. in April 2006, our Timber and Building Materials Business has taken a clearly dominant position in sales and contracts handled and has strengthened its marketing system. Going forward, we plan to deepen our collaboration with other business segments as a “timber professional” operating upstream, mid-stream and downstream, with a view to expanding our sales and profits.

Aiming to achieve significant growth globally, we also plan in fiscal 2006 to reorganize our structure and establish the Business Development Headquarters which integrates domestic and overseas production and housing related business.

### 3. Developing New Areas of Business—

#### Expanding our Three Priority Growth Businesses

##### (1) Collective housing business

We are working to expand the customer base of our collective housing business by collaborating with Sun Step, Co., Ltd., the rental management company that

Target Values of the  
Midterm Management Plan

	Difference from FY 2005	
	<b>+26</b>	Creating synergies through the merger with Ataka Kenzai. Improving the earnings capacity of domestic manufacturing companies.
	<b>+67</b>	Reaching a level of 10,000 annual completions. Strengthening our product competitiveness and ability to propose solutions.
	<b>+14</b>	Strengthening our added staff's potential. Strengthening our proposal capabilities of wooden framework products
	<b>+8</b>	Strengthening our added staff's potential. Leveraging earthquake-resistant remodeling products.
	<b>+27</b>	Improving the earnings capacity of manufacturing companies. Strengthening overseas distribution bases
	<b>(51)</b>	
	<b>+92</b>	

joined our Group in 2003, and to strengthen our sales capabilities with the enhanced personnel from fiscal 2005. Other measures to expand business include improving the design and performance of wooden apartment buildings using our unique technology and swiftly providing land owners with proposals through a simplified estimate preparation system.

## **(2) Housing stock business**

In anticipation of the expansion of the remodeling market, which is forecasted to reach ¥8 trillion in 2010 (in contrast to ¥6 trillion in fiscal 2004), the Group is adding personnel and expanding its business bases. The Group has a significant advantage in the remodeling market, in which majority of the housing stock consists of wooden housing. For example, we are focusing our efforts in technical development on earthquake-resistant renovation projects, where demand is expected to grow. In February 2006, our original earthquake-resistant renovation technology, the “Sumirin REP construction method” was selected by the Tokyo Metropolitan Government as low-cost, reliable earthquake-resistance improvement technology and equipment. To develop closer ties with communities, our renovation subsidiary Sumitomo Forestry Home Tech Co., Ltd. will collaborate closely with Sumitomo Forestry offices nationwide.

## **(3) Overseas operations**

The performance of the manufacturing side of our overseas operations has been depressed due to the rising cost of principal raw materials, sluggish growth of the sales volume, falling sales prices and machine troubles. However, for the Group to achieve sustainable growth over the medium- to long-term, we believe we must not depend solely on the Japanese market and should develop overseas markets as well. To achieve this, we will place engineered wood products such as MDF (medium density fiberboard), particle board and plywood using afforested trees at the core, and develop our overseas markets, differentiating ourselves with high value-added products optimized for the needs of various regions.

## **IN CONCLUSION**

### **Returning Profits to Shareholders**

We regard providing our shareholders with an adequate return as an important management responsibility, and our basic policy is to distribute a stable and continuous return. In fiscal 2005, as in the preceding fiscal year, we paid a dividend of ¥13 per share relative to our performance results. As our future policy, we intend to ensure that the results of our strategy are returned to our shareholders, after considering our need for long term investment.

### **Sales of One Trillion Yen by Fiscal 2010**

A glimmer of light has begun to appear in the owner-occupied housing market thanks to the economic recovery, but with the sufficiency of housing stock and the arrival of an era of low birth rates, aging of society, and declining population, structural changes in the housing industry are inevitable in the long term. In this circumstances, we need to decide which way to proceed in order to achieve sustainable growth. We have absolute confidence in the expertise in “wood” we have accumulated by operating in a business domain extending from upstream to downstream. Overcoming problems associated with growth in a mature market will require product strength that fully utilizes our expertise, the marketing prowess to market this strength to customers, and efforts to build trust with more customers. In keeping with this approach, by returning to our basic belief in the worksite, where “genuine effort always brings reward” and continuing to challenge for better society. In conclusion, I humbly ask for your continued support and honest counsel.

July 2006  
Ryu Yano  
President / Director





## SPECIAL FEATURE

# LONG-TERM OUTLOOK PROMISES SUCCESS FOR THE SUMITOMO FORESTRY GROUP

Japan is now in the midst of a demographic wave characterized by low birth rates and an aging population, and its population has been declining since 2005. Owing to this trend, it is expected that growth in new housing starts will slow moderately over the long term. Nevertheless, the children of the baby boomers will now step forward to drive the market and stable demand for detached housing is forecasted for the time being. As society passes into a new era, peoples' values toward housing are changing, and demand is expected to increasingly focus on the replacement, reconstruction and renovation of homes. On the basis of this long-term outlook, the Sumitomo Forestry Group intends to leverage its strengths as a wood expert to respond to diverse needs concerning housing and living and thereby build a business base for sustainable growth.



## CONTENTS

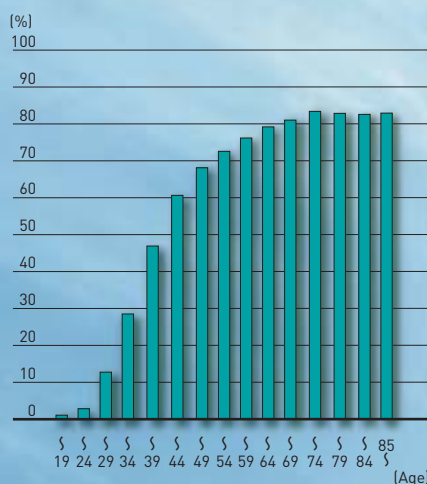
<b>12</b>	<b>14</b>	<b>16</b>	<b>18</b>
Outlook for the Detached Housing Industry	Three Strengths to Lead the Group to Success	Putting the Customer First	Reforms Underway in Marketing Operations

Using the recyclable resource timber, our BF (Big Frame) Construction Method—Japan's "Wooden Continuous Beam Type rahmen Structure"—uses only large cross-sectional posts and beams to firmly support the vertical load (building dead load, etc.) and horizontal load (lateral shaking from earthquakes, etc.) through a newly-developed steel-joint technology.



# OUTLOOK FOR THE DETACHED HOUSING INDUSTRY

Ratio of House Ownership by Age



■ House Ownership Rate  
(Ministry of Internal Affairs and Communications, National Census 2000)  
\*House Ownership: A housing wholly or partially owned by the household living there.

## PRESENT MARKET ENVIRONMENT

### Diminished Owner-Occupied Housing Market in an Adjustment Phase

After the collapse of the bubble economy in 1991, housing starts in Japan reached a peak of 1.63 million in fiscal 1996 when the consumption tax rate was raised, and then dropped dramatically to 1.14 million in fiscal 2002. Since then, amidst falling land prices, low interest rates, establishment of the housing acquisition promotion tax system, and growth of real estate funds, factors including the condominium boom and the expansion of the house rental market have driven the market, and in fiscal 2005, new housing starts rose 1.5% year on year to 1.24 million and remained steady. However, the owner-occupied housing market, which is the chief domain of the Group, has been on a persistent downtrend since fiscal 1996 when housing starts stood at 630,000. By fiscal 2005, this figure had fallen to 350,000, which represented a 4.0% decline from the preceding year. Despite these adverse conditions, the Group raised its share of owner-occupied housing starts from 1.86% in fiscal 1996 to 2.76% in fiscal 2005 while maintaining annual sales of more than 9,500 units, and thus has actually increased its presence in the market. From an analysis of both the “flow” market of newly-built houses and the “stock” market of existing houses described below, we at Sumitomo Forestry have taken the view that the currently diminished environment of the owner-occupied housing market represents an adjustment phase that will continue for the time being. Though this is a harsh environment, we are steadily implementing proactive structural reforms in line with our vision of the future.

## LONG-TERM OUTLOOK

It appears that new housing starts will gradually decline from the current annual level of 1.15–1.20 million units to 1 million units beginning in 2015 due to the increase in housing stock and vacant houses and the decline in the number of households. Japan’s housing market has been sufficient in quantitative terms but given that population has been declining since fiscal 2005, it is inevitable that the housing market will shrink moderately over the long term. However, it also appears that the amount of housing investment will follow increase slightly when looking at housing investment as a whole, owing to the increase in investment in remodeling and renovations. Even though housing is sufficient in quantitative terms, peoples’ values toward housing are changing due to transitions between life stages and changes in life styles and the social environment. At the same time, it is expected that in their pursuit of the ideal home, people will increasingly demand higher quality in housing and obtain it by relocating, replacing, reconstructing, or renovating homes. This demand is in step with economic recovery, and should gradually emerge. Therefore custom-built houses which leverage their strength in free design are expected to regain their presence in the market with Sumitomo Forestry leading the way.

## OUTLOOK FOR THE FLOW MARKET (NEW HOUSE CONSTRUCTION MARKET)

### With Falling Land Prices, the True Worth of Homebuilders will Come into Question

During the era of the bubble economy around 1990, ordinary wage earners found it extremely difficult to purchase detached houses (though they might have been able to afford to buy condominiums) in city centers due to the sharp rise in land prices. In fact, land inflation dominated peoples’ interest in terms of their motivation for purchasing detached houses, something far from the primary purpose of enjoying an affluent residential lifestyle. However, with the subsequent collapse of the bubble economy, land prices fell back to proper levels, and with the recovery of the economy, the employment and income environments improved, which sharply

Stock of Houses Built before 1980 and after 1981

(10 Thousands units)

	Survey in 1998		Survey in 2003		Compared to 1998	
	Total	House Ownership	Total	House Ownership	Total	House Ownership
Total Housing Stock	4,392	2,647	4,686	2,867	294	220
Built before 1980	2,122	1,408	1,760	1,220	-362	-188
Built after 1981	2,271	1,239	2,927	1,646	656	408

(source) Ministry of Internal Affairs and Communications (2003 Housing and Land Survey)



## Estimate of the Number of Wooden Detached Houses in Need of Seismic Upgrade

(10 Thousands units)

Research Agency	Degree of danger	The total number of wooden houses that need antiseismic reinforcement	The number of detached houses that need antiseismic reinforcement
Survey Result by Architectural Institute	Insufficient quake resistance	1,221	1,165
Mokutaikyo	Danger of partial or complete collapse	1,409	1,373
Reinforcement Business Cooperative Union	Could be totally destroyed	1,493	1,437

(source) Daily Timber Newspaper

## Trends in Employment and Wages

(Year on year: %)



Note: Employment and wages are calculated using a three-months moving average.  
(source) Health, Labour and Welfare Ministry (Monthly Labour Survey)

increased the purchasing power of consumers for detached houses. Against such a backdrop, we believe that the time will come when the true worth of home-builders, and therefore, the attractiveness of houses themselves, will come into question. From this perspective, it can be said that even though the absolute number of first-time homebuyers will shrink, the impact of the demographic wave described above will lead to a diversification of demand regarding housing, with some desiring a comfortable home where the family can live over the years and others stressing individuality. We predict that those housing companies capable of addressing the diverse values of consumers will increase their share in the market. A market structure of declining numbers of detached houses and expanding numbers of condominiums, a structure based on the massive supply of condominiums, will likely come to an end.

## The Expected Demand for Detached Houses to Replace Condominiums

A development which merits attention is potential demand starting around 2010 from second-time homebuyers among the children of the baby boomers who play a prominent role in the current condominium boom. Second-generation baby boomers are those who were born in the first half of the 1970's and make up a large proportion of the population, numbering approximately 9.8 million. In Japan, the traditional pattern of people's residential life has been to start with a rented house, move to a condominium, and then finally purchase a detached house in a bedroom community (a so-called housing *sugoroku*.) If this pattern continues, second-generation baby boomers are likely to begin selling their condominiums in city centers, whose liquidity is comparatively high, starting around the mid-2010s when they are aged 40 to 45. This should promote a conspicuous trend toward the purchase of detached houses as highly-valued assets that can be passed along to succeeding generations.

## OUTLOOK FOR THE MARKET FOR EXISTING STOCK (EXISTING HOUSES)

### Huge Potential Demand for Home Renovation and Reconstruction

Much of the current housing stock consists of houses built during the era of high economic growth before 1980 when emphasis was placed on relieving the housing shortage, leading to decrepit or obsolete houses due to a lack of adequate maintenance. Furthermore, despite the introduction of the new earthquake resistance standards after the major revision of the Building Standards Law in 1981, which set standards for earthquake resistance performance, many existing houses built before 1981 still do not meet the standards. The number of wooden houses that require earthquake resistance reinforcement is estimated at 12 million to 15 million. These houses constitute a huge potential demand for home renovation and reconstruction. In particular, the government establishes a tax system to promote earthquake retrofit in fiscal 2006 to appropriately update the housing stock market. Demand for renovation and reconstruction, however, will not focus solely on deteriorated portions of houses. Needs vary widely as people transit to new life stages and their lifestyles diversify. Such needs include the need for effective use of space, enhancement of comfort, and accommodation of the elderly. Since wooden houses account for more than 90% of the approximately 26 million units of detached housing stock in Japan, the Group, with our exhaustive knowledge of wood, cannot afford to overlook this growth market.

## Repair Cost per Household by Age of Householder

(Ratio calculated by setting the average of total householders as 100.)

Age	< 29	30 — 39	40 — 49	50 — 59	60 — 69	70 <
Repair and Maintenance Cost	60.3	81.5	86.0	108.7	218.2	271.8

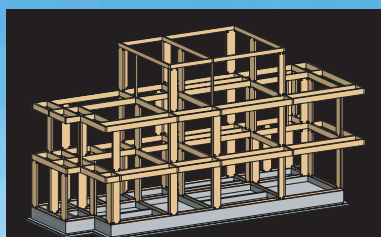
(source) Ministry of Internal Affairs and Communications, National Census 2000



## THREE STRENGTHS TO LEAD THE GROUP TO SUCCESS

As pointed out earlier, an expansion of flow in the housing market cannot be expected in the future because of factors including the sufficiency of stock and the declining population. However we believe that the Group can open new paths to growth as Japan's top custom-built wooden house company by further improving its three strengths as described below, and by communicating these strengths to as many customers as possible. In addition we will make the most of the effort for customers to build a long-term relationship of trust.

### "Big Frame Construction Method"



With conventional house construction methods, the vertical load (building dead weight) is supported by posts and beams, while the horizontal load (lateral shaking from earthquakes, etc.) is supported by bearing walls. In contrast, the Big Frame Construction Technology uses a column (thick glue laminated timber) and beams to support both the vertical and horizontal load.



BF steel joint developed on the basis of scientific analysis: By using a screw shape, looseness and warping are eliminated by increasing the surface area of contact with the wood stronger joints.

### 1. PRODUCT STRENGTH

#### Differentiation by Means of Our Dream-Fulfilling Unique Technologies

The natural blessing of wood has a deep connection with home life in Japan. Since our founding, the Group has been associated with forests for more than 300 years, and we have been seeking the benefit of wood for warmth and richness to residential life.

One major accomplishment in 2005 was the Big Frame Construction Method which has obtained structural type approval from the Minister of Land, Infrastructure and Transport. This method has applied innovation to wooden three-story house structures. It integrates our unique "Wooden Continuous Beam Type rahmen Structure" and steel joint technology, and achieves high earthquake resistance and rigidity without the need for bearing walls with posts and beams. It is an innovative construction method that can reduce the number of required walls and structures to less than half compared with conventional construction methods. By adopting this new method, wide open spaces, such as three-story well-hole types, can be designed, which was difficult with previous methods. Even with the small building sites commonly found in city centers, the method exploits sites' maximum potential and creates large spaces that give a feeling of openness. What's more, the method provides a high degree of variability that anticipates the transition between life stages and allows the building to be passed along to second and third generations as a high-quality asset. It was precisely such customer oriented ideas that brought about the Big Frame Construction Method.

Another product, *MyForest*, which was launched in fiscal 2005, incorporates a wealth of innovative technologies in order to bring out the highly refined atmosphere of wood. One example is Pure Molt Floor recovered and restored from one hundred-year-old white oak whiskey barrels. This floor not only offers great texture, but also boasts superb resistance to scratching. This material, however, is extremely difficult to obtain. To solve this problem, Sumitomo Forestry developed straightening equipment, to straighten curved barrel staves. Through this equipment, the Company has been able to obtain a stable supply of solid straight-grain board made of elegant hundred-year-old oak, which is something that other companies have not been able to produce.





A plan presentation by our expert design head at the "Sumai Haku" housing fair: Following the presentation, many visitors requested sketches.



Pre-cut timber: The connected part of timber pre-cut by machine is jointed using a traditional, ancient Japanese method. Strength is increased through the latest structural fittings.

## 2. PLANNING CAPABILITIES AND CREATIVITY IN FREE DESIGN

### Creating Homes that Embody the Values of Customers

The strengths of the Group in custom-built wooden houses include exhaustive knowledge of wood and the planning capabilities and creativity of free design to build entirely from scratch residential spaces that match each customer's ideal. Of the Group's 3,600 employees (non-consolidated, detached housing business) about 1,700 are architects. These experts assemble a dedicated team to handle design, construction, interiors and other tasks for each order received. This specialist team works to closely meet the needs of each customer and strives to create a completed home that embodies the values and completely matches the ideal of the customer. These teams can also handle difficult requests from customers, such as how to provide efficient floor planning with guarding each person's privacy. Such problems can be overcome using design skills gained through many years of experience that observe both the physical and psychological aspects of people.

In addition, the Company considers the demographic changes of decreasing birth rates and the aging of the population and provides solutions based on our unique idea of universal design. This means that in order to create homes where each family member can spend life in safety, convenience and comfort, a place where they can live over a long period of time, we respond to customers' personal requests down to the millimeter, from the width of hallways to the height of ceilings. Our full-time staff is also involved in technical development at the Tsukuba Research Institute.

## 3. COMPREHENSIVE STRENGTH

### Generating Vertical Synergies from Upstream to Downstream

As a total housing and living-related business company, the Group conducts a wide spectrum of wood-related operations. These include our Forestry Business, which owns and manages forests; our Timber and Building Materials Business, which provides optimal raw materials from countries around the world, processes or manufactures; our New House Construction Business, which builds freely-designed houses; and our Housing Stock Business, which restores freshness and functionality to living spaces. These businesses form a unique corporate group capable of providing integrated support for the entire life cycle of homes from upstream to downstream. Downstream, we track consumers' needs. Upstream and mid stream we procure optimal raw materials at low cost and rapidly develop products that meet market demand based on up-to-date information in the distribution market. This vertical comprehensive strength could rightly be termed the characteristic synergy of the Group.

The following is an example of how this synergy enhances our comprehensive strength. Sumitomo Forestry was the first company in the housing industry to use Japanese cypress laminated timber as a standard for posts and ground sill. We chose Japanese cypress because it is famous for its strength as the material used to support the Horyu-ji Temple, Japan's oldest wooden structure, for 1,300 years. Japanese cypress is indeed an extremely expensive wood, but we have managed to bring the cost down using our upstream resources. For example, we supply materials at low cost by effectively using Japanese cypress logs that are not long enough for solid posts through processing to make glue laminated materials, and by overcoming such flaws as bowing. In addition, pre-cut factories nationwide at the midstream level, which are business partners in the timber and building materials distribution business, perform processing tailored to customers' specifications. In this way, our vertical comprehensive strength allows high-priced Japanese cypress (laminated timber) to be used as a standard housing material.



# PUTTING THE CUSTOMER FIRST

Whenever customers submit applications for housing construction, we at Sumitomo Forestry follow the principle of putting the customer first of our code of conduct and assemble a team of professionals in areas including design, production and interiors to transform the customer's ideal home into reality. Even after the home is completed, we continue a sustainable relationship of trust with the customer through our efficient after-sales support system.



"The Sumitomo Forestry Home" model home

## Application System

Once we receive the ¥50,000 application fee, we assemble a dedicated team comprised of experts in sales, design and interiors. The team then begins to gather information through discussions with customers on subjects including exteriors, overall home layout, interiors, and outdoor layout to enable us to create an ideal home which fully satisfies the customer.



Site survey

## Surveys

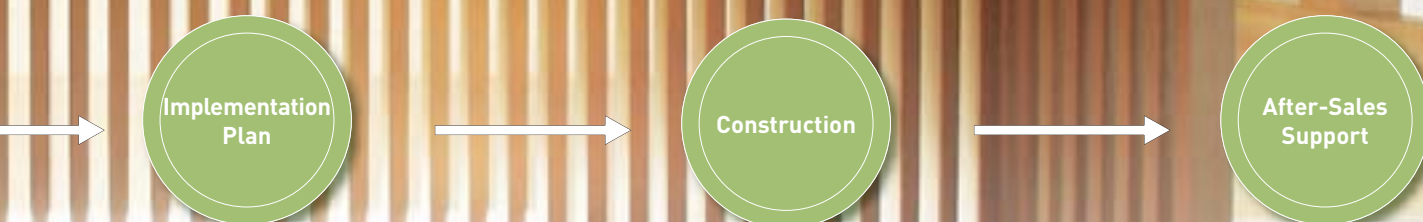
Before closing the contract with the customer, we first conduct a meticulous survey of the site so that we can propose an optimal plan. These detailed surveys include inspection of the ground, measurement of the site, investigations of legal requirements, differences of elevation with adjoining land, and surrounding conditions. These thoroughgoing preliminary surveys allow us to present an accurate plan and estimate to the customer.



Meeting of dedicated staff

## Proposal

Based on the customer's requests, the dedicated team carefully studies the plan from many angles and determines the course for building an ideal home. On this basis, the designer proposes an original plan, which on average is revised from three to five times until the customer's consent is given, at which time a construction contract is closed.



In order to share our customers' vision of their ideal home, floor plans are hand-sketched on the spot

### Implementation Plan

One of the strengths of the Sumitomo Forestry Group—the strength that characterizes our brand—is our ability to undertake the construction of custom-built homes based on a free design that meets all of the customer's requirements. Following closing of the contract, we invite the customer to our sample home gallery and hold detailed discussions regarding the exterior and interior design, fixtures and fittings, lighting, curtains and other features, and then design begins. Meanwhile, we conduct structural calculations, using our own CAD system. This enables us to assure the customer of the structural safety of the building and foundation.



The "Durable Floor Panel" plays a crucial role in dispersing the lateral shaking force of earthquakes without exerting a load on individual walls

### Construction

Prior to the start of construction, the construction superintendent first visits the site to prepare advance measures to deal with every possible problem, including any inconveniences that construction may cause to the neighborhood, as well as parking spaces for construction vehicles. After setting up a stringent management system for each stage of construction, which may cover up to 170 items, we start construction with great care by utilizing our own multi-balance construction method using high-precision materials. In addition, we provide an exclusive Internet website for customers so that they can check the progress of construction at home.



Customer center

### After-Sales Support

The Sumitomo Forestry Group has established a complete after-sales support service to help customers enjoy comfortable residential life and to enable us to build a relationship of trust with customers. This customer-first-oriented service includes a customer telephone center which answers questions from customers 24 hours a day, 365 days a year and a 60-year "long term support system", which includes regular inspections. Engineers are also available for consultations regarding home and facilities maintenance, renovation, gardening, and other matters.



# REFORMS UNDERWAY IN MARKETING OPERATIONS

Creating ideal, custom-built homes through free design requires more effective community-based marketing to obtain the sincere support of customers. We are putting effort into reforming our marketing operations with a view to gaining the respect of customers in the community.

## STRENGTHENING COMMUNITY-BASED MARKETING

### Introduction of a New Marketing System

We are reevaluating the management system for marketing offices based in model homes as part of efforts to strengthen community-based marketing. Specifically, we have introduced a new marketing manager system in order to implement an in-depth marketing strategy tailored to each area. The marketing manager at each model home not only carry out their regular management duties, but also communicate closely with the community as the head of marketing operations to ascertain the real needs of customers. Under this new marketing system, marketing managers also identify competitors, determine the way to increase their visibility in the community and plan and implement a strategy for each area.



“Machikado Ichiban” in Tokyo’s Setagaya ward

### Sales-Oriented Model Homes

One of the company priority is creating channels to attract customers apart from general model homes. To take advantage of the anticipated rebound of reconstruction demand, we plan to establish sales-oriented model homes named *Machikado Ichiban*. For *Machikado Ichiban*, we will construct one model home on residential streets. These model homes will be open to the people of the community so that they can view the features of the house and see how they blend into the townscape and surrounding environment. The homes can also be used as cooking or English conversation classrooms or for community meetings. Through these *Machikado Ichiban* homes, we are both providing an opportunity for people in the community to experience the charm of Sumitomo Forestry homes and working to secure reconstruction demand.





# REVIEW OF OPERATIONS



## CONTENTS

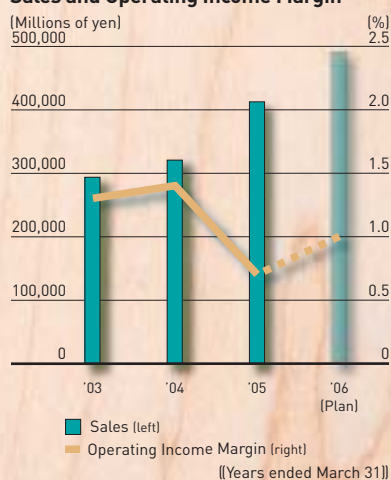
20	24	28
Timber and Building Materials Business	Housing and Housing Related Businesses	Other Businesses

BF (Big Frame) construction method, which requires absolutely no bearing walls, makes possible large openings from which light and air are drawn in to create vast spaces that bring the outdoors indoors.

# TIMBER AND BUILDING MATERIALS BUSINESS

The Timber and Building Materials segment has secured the number one position in Japan for timber and building materials sales thanks to its solution providing ability. Such expertise was brought about by a full range of operations covering products from timber to building materials through the Sumitomo Forestry Group's global network. We even more proactively pursue functionality and service in order to take even greater advantage of our economy of scale.

## Sales and Operating Income Margin



Maple floors: Maple has a pale white tonality on the surface which creates an expansive feeling of openness and clarity and enwraps spaces in an aura of dazzling freshness.

## Segment Performance Highlights

(Millions of yen)

	FY2003	FY2004	FY2005	FY2006(Plan)
Sales	293,220	320,255	412,182	490,000
Operating income	3,813	4,615	2,806	4,800
Assets	146,169	157,840	237,265	—
Capital expenditures	1,723	2,949	5,701	—

Note: The sales figures given include intersegment transactions. Operating income figures include internal profit prior to the deduction of amounts such as intersegment transactions and headquarters expenses that are not apportionable.

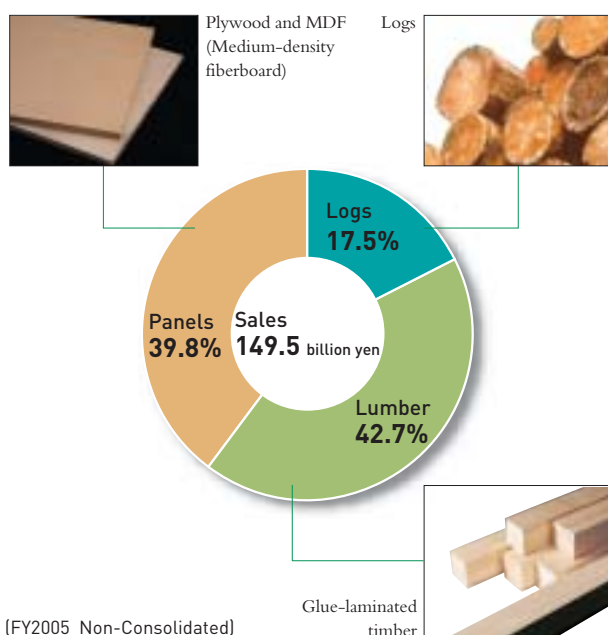
## Operating Income of Main Subsidiaries

(Millions of yen)

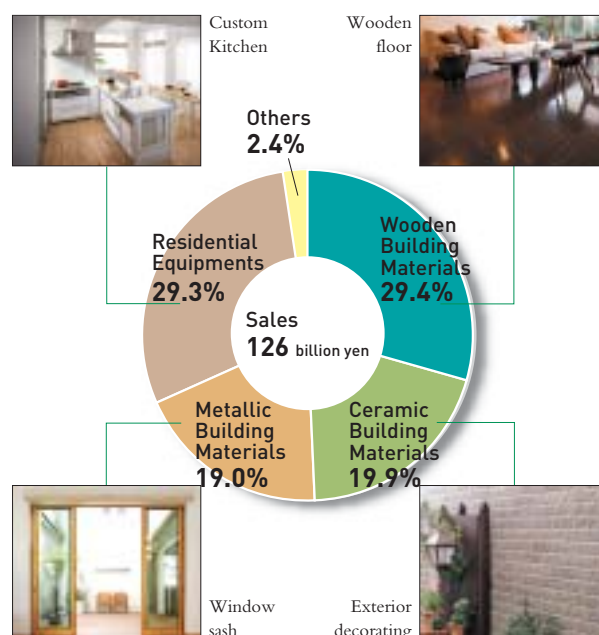
Company name	FY2004	FY2005	FY2006(Expectation)
Sumitomo Forestry Crest Co., Ltd.	841	252	570
Overseas Subsidiaries	FY2004	FY2005	FY2006(Expectation)
PT. Kutai Timber Indonesia (Indonesia)*	620	(56)	(110)
Alpine MDF Industries Pty Ltd (Australia)*	239	84	300
Nelson Pine Industries Limited (New Zealand)*	749	231	900

\* Calculations for overseas affiliated companies have been translated into Japanese yen at the following rates.  
 FY2004 US\$ =108.14 / AU\$=79.59 / NZ\$=71.76  
 FY2005 US\$ =110.17 / AU\$=83.91 / NZ\$=77.56  
 FY2006(Expectation) US\$=115.00 / AU\$=86.00 / NZ\$=78.00

## Sales Share of Wood Products



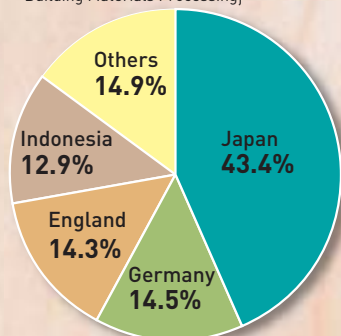
## Sales Share of General Building Materials





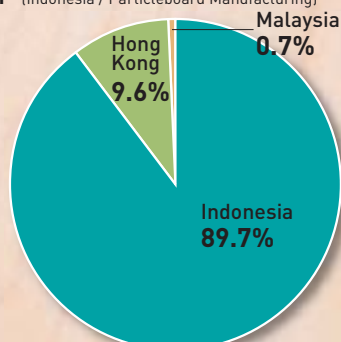
## Overseas Manufacturing Subsidiaries and Affiliated Company (Export Destination)

**KTI\*** (Indonesia / Plywood Manufacturing and Building Materials Processing)



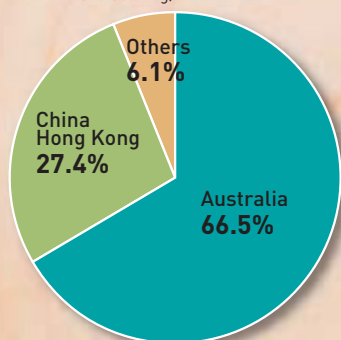
(FY2005 Based on Sales)

**RPI\*** (Indonesia / Particleboard Manufacturing)



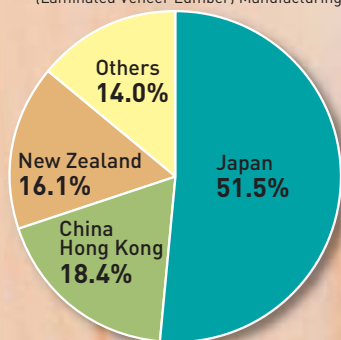
(FY2005 Based on Quantity)

**ALPINE\*** (Australia / MDF [Medium-Density Fiberboard] Manufacturing)



(FY2005 Based on Quantity)

**NPIL\*** (New Zealand / MDF and LVL [Laminated Veneer Lumber] Manufacturing)



(FY2005 Based on Quantity)

Note: KTI (PT. Kutai Timber Indonesia)  
RPI (PT. Rimba Partikel Indonesia)  
ALPINE MDF (Alpine MDF Industries Pty Ltd)  
NPIL (Nelson Pine Industries Limited)

## REVIEW OF FISCAL 2005

### Business Environment — Increasing Worldwide Demand for Timber, while Domestic Demand Stagnated

In the timber and building materials industry in fiscal 2005 there was a contrast between the domestic and overseas environment. In the overseas market the building boom continued and demand increased in China, which is achieving marked development as the “world’s factory,” and in the United States where housing investment was strong. On the other hand, in the domestic market, the number of wooden housing starts, which accounts for 44% of the total number of new housing starts, was at a low level of 545,000 starts, an increase of just 0.6% over the previous fiscal year.

### Summary of Business Results — Increase in the Cost of Raw Materials Leads to Large Decline in Operating Income

Sumitomo Forestry acquired Toyo Plywood Co., Ltd., and Ataka Kenzai Co., Ltd. and augmented its alliance in June 2005 and October 2005, respectively, to provide even more high value-added services than before and to enhance its marketing capabilities. As a result, in the field of domestic timber and building materials distribution business, Sumitomo Forestry became the “No.1 timber and building materials trading company in Japan” in terms of the richness of its product lineup and its transaction volume. On the other hand, the domestic manufacturing business environment, the major source of its sales, became even harsher exemplified by the increased cost of major raw materials, sluggish sales volumes and declining selling prices. On top of that incidents at its overseas manufacturing sites accelerated the decline in earnings. As a result of all these developments, sales in the Timber and Building Materials segment recorded an all-time high, due to the M&A of the two companies, of ¥395.65 billion (a 31.1% increase over the previous fiscal year) but operating income declined to ¥2.806 billion (a 39.2% decline from the previous fiscal year).

### Review of the Operations of Each Business Division

With overseas purchasing prices for timber products being driven upwards backed by increased demands in China and U.S. it remained difficult to pass on 100% of these costs to domestic distribution prices. Due to this difficulty and sluggish domestic demand, timber sales\* declined 2.1% year on year to ¥90.867 billion. The building materials business, however, continued to enhance its relationships with major suppliers, nationwide wholesalers, and regional leading stores, and was able to increase sales for all of the four product lines of general building materials (wooden building materials, ceramic building materials, metal building materials, and housing equipment). As a result, sales of building materials\* increased 3.7% year on year to ¥192.569 billion.

\* Composition of sales: Timber in the form of log, lumber, etc; building materials in the form of wood-based panels, general building materials and INOS, etc.

## PRIORITY POLICIES IN FISCAL 2006

### 1. Responding to Diversifying Customer Needs Using our Abundant Knowledge /Information and Expertise

The Sumitomo Forestry Group is operating its business through an integrated structure starting from log procurement to the sale of wooden housing, so the employees in the Timber and Building Materials segment are not only very well versed in the situation regarding timber and building materials in each region of the world, they are also able to promptly obtain accurate information about the end users. This segment utilizes full of this real-time information on both sides of the demand and supply needs and its advantages as a group of timber and building materials experts to appropriately respond to diversifying customer needs and to expand both its existing trading areas and its customer base acquired through M&A to unprecedented levels.



## Glue-Laminated Timber

Glue-laminated timber effectively utilizes relatively narrow or short logs and when it is bonded with finger joints,\* which have excellent bonding strength, it boasts outstanding dimensional stability and great strength. Currently wood with coarse grain that warps easily is on the increase and there are a growing number of customer complaints about the construction of houses. Also due to the increasing popularity of precutting, in which timber is automatically processed with machines, house construction schedules are shortening and sometimes timber is being delivered to the construction site before it has been sufficiently dried, and this undried timber becomes a problem. Sumitomo Forestry took the lead in creating glue-laminated timber as one solution to these problems. Because of uniform quality and high-strength, the rate of use of glue-laminated timber as a construction material in houses constructed with the wooden post-and-beam architectural method is rapidly increasing. Its rate of use in posts is approximately 70% and its rate of use in beams is approximately 45%.



\* Finger joint (manufacturing process for glue-laminated timber): Parts to be cut are cut into gear-like shapes, and both fingers are firmly joined to make boards of glued-laminated timber.



Overseas manufacturing operations: KTI an Indonesian plywood plant, ships products around the world.



Entranceways proposed by Toyo Plywood Co., Ltd.: These naturally designed entranceways are adorned with attractive vertical lattice sliding doors to impart a modern Japanese taste.

## 2. Expanding Domestic Business through Utilization of our Foreign Product Procurement Capacity

Sumitomo Forestry Group has leverage to procure foreign products through its global network. In particular we aim to expand our handling of glue-laminated timber,\* which is being used more and more due to widespread applications of the wooden post-and-beam architectural method, by about 20% a year. We will provide competitive business development to our distributors, who are our business partners, through dividing roles with timber distributors and precutting factories which have outstanding functionality and facilities.

## 3. Maximization of the Benefits from M&A

Fiscal 2006 is the first year of our unification with Toyo Plywood Co., Ltd. and Ataka Kenzai Co., Ltd. We will focus on maximizing the synergistic effects from these two M&As.

### (1) Enhancement of the business structure of Toyo Plywood

In June 2005, Sumitomo Forestry acquired Toyo Plywood Co., Ltd., a manufacturer of total wooden building materials, by way of Sumitomo Forestry Crest Co., Ltd. which shoulders the work of building materials manufacturing within the group. Toyo Plywood specializes in its unique product development ability to procure and utilize sustainable plantation timber.\* Furthermore, there is very little overlap between the clients and factory locations of the two companies so we are in an ideal complementary relationship. In fiscal 2006 we will prioritize business enhancement of Toyo Plywood. Specifically we will enhance its marketing capabilities outside its base central Japan region, introduce Sumitomo Forestry Crest's follow-up system, and carry out reforms of its production, quality and warranty systems.

\* Plantation timber: It is not natural timber such as tropical rainforests but timber from planned afforested trees such as poplar in China.

### (2) Synergistic effects generated by fusion with the community-based marketing expertise of Ataka Kenzai

In the timber and building materials distribution business, in April 2006 we merged with building materials trading company Ataka Kenzai Co., Ltd. (¥123.3 billion in fiscal 2005 sales, ¥600 million in operating income). Sumitomo Forestry is superior in handling wooden building materials whereas Ataka Kenzai is superior in handling ceramic building materials. Furthermore, we also enjoy complementary relationships in the customer bases of the two companies. Of course the benefits of the merger go beyond just scaling up the size of our business. Ataka Kenzai's marketing approach of being community-based and providing service in order to build long-term trusting and close relationships with a wide range of clients has been highly respected in the industry. For Sumitomo Forestry Group, whose priority issue is to enhance its marketing capabilities, it is anticipated that extremely large synergistic effects will be realized from this merger with Ataka Kenzai, a company with a tradition of community-based marketing. Going forward, we will integrate the Sumitomo Forestry Group's global network and Ataka Kenzai Co., Ltd.'s community-based marketing. In the current fiscal year we will divide Japan into four area divisions and aim for higher value-added services in each division.

## 4. Enhancement of our ability to meet the market demand for reassurance and safety

As a result of last year's scandal over buildings built based on fabricated earthquake-resistance data, demand for reassurance and safety has rapidly grown stronger. We are enhancing our capability to respond to these demands through the INOS Group Business.\* Specifically we provide a system for reas-

## [INTERVIEW WITH A PERSON AT THE FOREFRONT OF THE NEW ORGANIZATIONAL STRUCTURE]

I have worked at Ataka Kenzai for 20 years, dealing not only in plywood but also a wide range of building materials products while maintaining a stronger and more substantial relationship with suppliers and clients. Now I have assumed a manager position of the Domestic Plywood Team which has been newly established on the occasion of the merger. When competing with other companies, sophisticated expertise and abundant information about each of the timber products the company handles are important advantages. Now as a member of the Sumitomo Forestry Group, we are able to exchange information with the Log Group which sells logs to our clients, the domestic plywood manufacturers. Furthermore, we are working on the development of applications for domestic plywood jointly with the Imported Plywood Team and Medium-Density Fiberboard (MDF) Team, and I strongly feel that now we have various functions and advantages that Ataka Kenzai could not have had alone. Now we intend to fully utilize these advantages, meet the needs of customers with greater value-added services than ever before, and aim to be number one in the industry in terms of domestic plywood transaction volume.

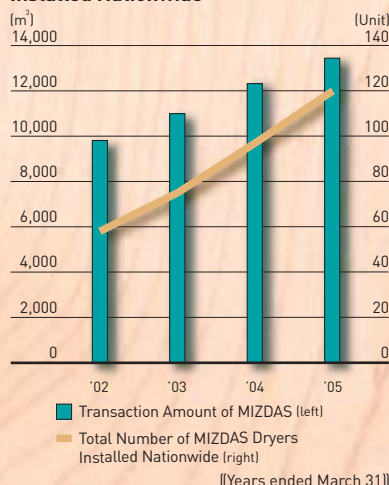


Team Manager  
Panel Group Plywood Team  
Wood Products  
Trading Division,  
Business Headquarters  
**Tsunekatsu  
Kubota**



MIZDAS drying system: Whole materials are completely opened to allow exposure to air, and sawn timber is piled up and then put into the dryer.

**Transaction Amount of MIZDAS and  
Total Number of MIZDAS Dryers  
Installed Nationwide**



insurance and safety based on our CAD system based-design, construction date, and technical expertise to INOS member(local housing construction companies) throughout Japan as an effective solution for end users. We aim for the expansion of the INOS business network.

\* A business that has built a network consisting of outstanding local housing construction companies (INOS member companies) throughout Japan which are in partnership with Sumitomo Forestry. Sumitomo Forestry Group aims to establish a new distribution system that not only offers materials but also provides technology and expertise through this network.

## RESEARCH AND DEVELOPMENT

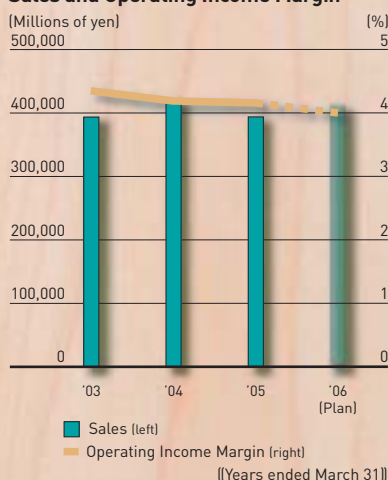
### Development of New Functionality for MIZDAS, our Timber Drying System

Sawn timber from Japanese cedar or Japanese cypress tends to have many cracking during the drying process. Sumitomo Forestry's Tsukuba Research Institute has been conducting research into a solution to this problem. In October 2000, it completed development of the timber drying system MIZDAS. This system uses sensors attached to the timber to measure how dry the timber is in real time and to create appropriate temperature, humidity, and air flow conditions inside the drying kiln. MIZDAS provides us with high-quality, dried timber with a moisture content of 15% or less within a short period of time. Then in March 2006, we added a new functionality of controlling the drying conditions to the MIZDAS and succeeded in development of a high-accuracy drying technology that controls timber cracking even better than ever before. This new technology directly measures the contraction and expansion of the timber and reduces the incidents of cracking by predicting the timing of cracking during the drying process. Thanks to these technical developments not only will cracking be reduced but also there will be fewer irregularities such as twisting, warping and less discoloration in the timber than before. Improvement in the yield rates and quality of dried timber can also be expected. Going forward we will disseminate the new and improved MIZDAS among timber processing companies and sawmills across Japan and will establish a stable supply structure for low cost and high quality domestically-produced dried timber. We will also work to increase the volume of our MIZDAS timber.



## HOUSING AND HOUSING-RELATED BUSINESSES

### Sales and Operating Income Margin



In this segment, as a leading company in the custom-built wooden housing market, we provide the high-quality “wooden house” with the benefit of “wood”. That beauty is derived from our unique technology built on our knowledge of everything there is to know about “wood” and our comprehensive strength stemming from our capacity to integrally cover the whole process from materials procurement to design, construction and after-sales service. On the back of this strength, we are also striving to reinforce our business domains such as collective housing and housing stock businesses.

### Segment Performance Highlights

(Millions of yen)

	FY2003	FY2004	FY2005	FY2006(Plan)
Sales	393,616	418,313	393,868	410,000
Operating income	17,150	17,530	16,370	16,500
Assets	108,160	108,705	105,579	—
Capital expenditures	3,162	4,403	3,737	—

Notes: The sales figures given include intersegment transactions. Operating income figures include internal profit prior to the deduction of amounts such as intersegment transactions and headquarters expenses that are not apportionable.

### Operating Income of Main Subsidiaries

(Millions of yen)

	FY2004	FY2005	FY2006(Expectation)
Sumitomo Forestry Two-By-Four Homes Co., Ltd.	(586)	(487)	20
Sumitomo Forestry Home Service Co., Ltd.	406	423	540
Sumitomo Forestry Home Tech. Co., Ltd.	711	195	350
Sumirin Construction Co., Ltd.	522	515	780
Sun Step Co., Ltd.*	351	281	400

\* Because the accounting year ended March 2005 was changed from the year ended in December to the year ended in March, the settlement of accounts for the year ended March 2005 posts the results for a 15-month period.

## REVIEW OF FISCAL 2005

### Business Environment

#### —the Owner-Occupied Housing Market Remains Stagnant

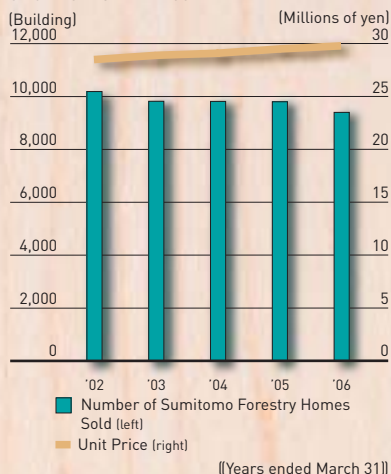
Amid firming prospects for an economic recovery in Japan, the number of new housing starts increased 4.7% over the previous fiscal year to 1,249,000 units, driven by apartments and rental housing. However, starts of owner-occupied houses, which are closely related to our Housing and Housing-Related Businesses segment, declined 4.0% to 352,000 units, due mainly to reduced tax breaks for housing loans. Meanwhile, the market for houses to rent rose 10.8% to 510,000 units to post the positive growth for the third consecutive year, spurred by increased asset management by landowners and rising demand for units for single-person households. In the remodeling market, we saw not only replacement demand from owners of aging houses but also rising demand for higher-quality housing against the backdrop of an aging society.

### Earnings Overview—Upfront Investment for Future Growth Lowers Income

In the business environment described above, net sales for this segment fell 6.2% from the previous year to ¥392,131 million and operating income declined 6.6% to ¥16,370 million. Sales of detached houses, our main line of business, dipped 5.0% to 9,807 units. The lower income on lower net sales resulted chiefly from our proactive upfront investment for securing future growth, including an augmentation of our sales force and business networks.

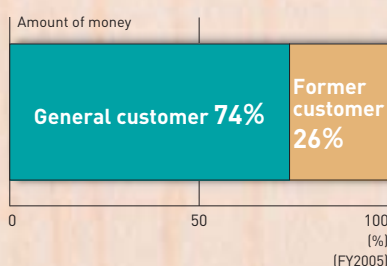
Maple floors: Maple has a pale white tonality on the surface which creates an expansive feeling of openness and clarity and enwraps spaces in an aura of dazzling freshness.

**Number of Sumitomo Forestry Homes Sold and their Unit Price**



These original tiles developed by Sun Step accentuate design.

**Ratio of General Customers in Total Contracts Made by Sumitomo Forestry Home Tech Co., Ltd.**



## Business Overview by Sector

### New Detached house business—efforts made to strengthen competitiveness

In the post-and-beam detached house business, we strove to enhance our competitiveness by proactively emphasizing our unique strength in order to secure future sales of a stable number of houses even within the maturing market.

First of all, in a bid to strengthen competitiveness in urban areas which still have high potential even within the maturing market, we revamped our organization and boosted manpower in the Tokyo metropolitan area. Next, we launched the new product, MyForest, which puts a maximum emphasis on the mastering of the full beauty of “wood” in order to have customers clearly understand the “way of living” we are proposing. Furthermore, regarding contracts with customers, we sought a qualitative change in sales efforts through a thorough review of contract details in a manner that would lead to increased construction starts.

Since we were still only halfway through our efforts to enhance competitiveness, however, the number of orders decreased 9.3% from the previous year to 8,890 units, with the value of completed units dipping 3.2% to ¥280,312 million. Nonetheless, the ratio of gross income to net sales remained at a high level as we made continued efforts to reduce production costs, and the value of order per unit rose 5.7% over the previous year to ¥30.9 million thanks to beefed-up sales efforts and the introduction of new products.

In our two-by-four housing business undertaken by Sumitomo Forestry Two-By-Four Homes Co., Ltd., order receipts increased by a sharp 31.3% over the previous year to ¥11,561 million, while the value of completed units also expanded 22.8% to ¥10,222 million as a shift in strategy toward mid- and high-end products paid off.

### Collective housing business—personnel development took much time

In the collective housing business, we tried to increase order receipts by boosting personnel and making strategic investments. But we faced a very tough market environment as it took much time to train personnel hired for reinforcement, and competition with major general contractors became more intensified in the market for big-ticket transactions. Consequently, orders received dropped 21.5 % from the previous year to ¥13,733 million, while the value of completed housing also declined 31.2% to ¥11,492 million. However, the backlog of orders at the end of the year rose 16.5% over a year before, with a higher ratio of orders for construction to be completed in the next fiscal year. Going forward, we will seek to increase orders and raise the rate of return by taking a business strategy that makes better use of the Group’s comprehensive strength, such as improving our information-gathering capability through community-based business collaboration with group companies and putting particular emphasis on the cost performance of post-and-beam houses.

### Housing-related businesses

#### —Housing stock business— We continued proactive upfront investment

In the remodeling business, Sumitomo Forestry Home Tech Co., Ltd. actively increased staff with a view to expanding order receipts. This pushed up selling and administrative expenses by ¥900 million from the year-before level. With gross income rising only ¥400 million over the previous year, however, operating income declined by ¥500 million.

Going forward, we aim for operational efficiency with the beefed-up logistical support system and for higher value added to our services in order to capitalize on our specialist strength that almost all of our employees in the sales and design sections are at least second-class registered architects. By making better use of our technological prowess accumulated in the detached house business, we will seek to expand order receipts, needless to say from our for-





MyForest

mer customers who ordered housing to Sumitomo Forestry, but also from other general customers for remodeling wooden housing.

#### —Property development business division—

##### We entered the built-for-Sale detached house market

In December 2005, we entered the build-for-sale detached house market in earnest by establishing the “Property Development Business Division” as an independent organization to push ahead with the built-for-sale detached house business. We will promote the building of communities by valuing harmony with ambient surroundings while setting great store by our mid- to high-end product image and introducing products with particular emphasis on design. We will build our business structure that allows us to approach first-time home buyers from both fronts of owner-occupied houses and built-for-sale houses.

## PRIORITY POLICIES IN FISCAL 2006

### Key Objectives

#### Marketing the Allure of “MyForest” to a Broad Range of Customers

We launched the new product, MyForest, in October 2005 with the concepts of “harmonious coexistence with the global environment” and “mastering of the wood and mastering of living.” The new product, MyForest, is the culmination of our technology through wooden custom-built housing business, as well as Sumitomo Forestry Group’s comprehensive strength. MyForest is the embodiment of livable, healthy, reassuring and safe house that makes the most of the strength of wood with the traditional Japanese wooden house design approach, not driven chiefly by air-conditioning requirements. Already, MyForest has found a favorable reception with mid- and high-end customers at our model home display centers, and we will now strive to receive orders from a broader range of customers by expanding the product lineup for the young and first-time homebuyers.

For the interior of MyForest, a variety of trees with distinct characteristics, such as oak, teak, maple and bamboo, which only the Sumitomo Forestry Group with an extensive global network can procure stably, are used to suit varied modes of the way of living. One of the features of the wooden house, for example, is that the face of the interior space changes in response to sunlight or lighting. Further-

## Sales Performance by Business Divisions

(Millions of yen)

				2003	2004	2005	2006	2007(Expectation)
	Sumitomo Forestry	Amount	283,798	285,513	289,564	280,312	290,000	
			Unit	9,824	9,817	9,805	9,401	9,300
		Sumitomo Forestry Two-By-Four Homes	Amount	10,905	10,297	8,325	10,222	12,700
			Unit	446	394	279	338	410
		Sumitomo Forestry system house	Amount	5,538	6,970	4,711	—	—
			Unit	223	285	191	—	—
	Detached order housings in total	Amount	300,242	302,780	302,600	290,534	302,700	
		Unit	10,493	10,496	10,275	9,739	9,710	
	Detached sales housings in total	Amount	1,119	973	907	1,421	1,900	
		Unit	59	46	44	68	80	
Detached housings in total		Amount	301,362	303,753	303,507	291,955	304,600	
		Unit	10,552	10,542	10,319	9,807	9,790	
	RC apartment	Amount	7,415	11,086	13,163	6,670	9,400	
		Unit	720	856	1,134	461	870	
	Wooden apartment	Amount	4,129	3,346	3,534	4,822	7,300	
		Unit	500	410	437	621	810	
	Collective housings in total		Amount	11,545	14,432	16,697	11,492	16,700
			Unit	1,220	1,266	1,571	1,082	1,680

((Years ended March 31))

## [INTERVIEW WITH THE MANAGER OF A MODEL HOME]

In this area 70% of new owner-occupied housing is newly-built. Most of our customers are young first-time buyers so their total budgets including land acquisition cost are concentrated within a certain price range. The feature of visitors for consultations at our center is that most of them are appreciative of authenticity of housing and have very distinguished tastes about even the smallest details of their future homes. In response we proudly promote our products by appealing to the wonderful “homes fully accentuating the warmth of wood” which are the advantage of Sumitomo Forestry and provide advice to them about all aspects of housing life including floor plans that take maximum advantage of limited floor space, and tax strategy.

We are also making steady efforts to cultivate demand so that when prospects actually make up their mind to rebuild their houses, they will choose Sumitomo Forestry without question. Likewise, we are actively playing the role of a mediator for building land allocation by maintaining close relationships with local real estate agent and gathering information efficiently. As manager of this model home, I will make this center the No.1 housing company in our region through formulating and implementing a more specific regional strategy, and encourage everyone on the team to challenge themselves and have satisfaction with his or her job.



Manager of the  
Kamitsuruma  
Model Home  
Southern Tokyo Branch  
Housing Headquarters

Taku Ogihara



An experiment in concrete foundation reinforcement using band steel and aramid fiber: Aramid fiber is extremely strong and has excellent durability, and is used in cutting-edge fields such as the aerospace industry and aviation.

more, Japanese cedar is used as an “accent” for the exterior, which makes the house blend with the cityspace and gives out a sense of nostalgia but yet maintains the air of substance and superior quality that the genuine wood can only provide. We truly take pride in the MyForest as the “wooden house” with high property that can be built only by the Sumitomo Forestry Group.

On top of this, the quake-resistance of MyForest is the product of the combination of high-performance materials (please see P.33 for explanations about respective materials) and optimum basic foundation design for each house. Full-scale oscillation tests have confirmed that the structural skeleton of MyForest can withstand the oscillation 1.2 times as strong as the maximum ground acceleration observed in the Great Hanshin-Awaji Earthquake without sustaining any damage. This is the “reassuring and safe” housing even under the circumstance of natural disasters.

We also launched the three-story house Prodio-BF that adopts a “Wooden Continuous Beam Type rahmen Structure” for the first time in Japan in the Kinki and Chukyo regions following its debut in the Tokyo metropolitan area. We hope the Prodio-BF will help us gain a bigger share of the three-story housing market where demand is fairly strong particularly in city centers with limited availability of residential land.

## RESEARCH AND DEVELOPMENT

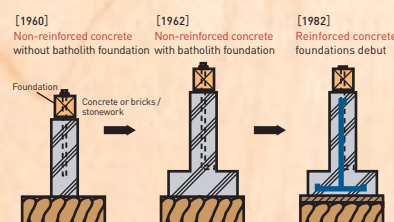
### Developed Breakthrough Quake-Resistant Remodeling Technology

In the housing stock business, the remodeling company Sumitomo Forestry Home Tech. Co., Ltd. has developed a new quake-resistant remodeling technology, the Sumirin REP method, which makes it possible to build a structure with strong quake-resistance by reinforcing walls without dismantling existing floors or ceilings while creating expansive open space and securing enough daylight.

In particular, the Sumirin ARC method, a construction technique for foundation reinforcement, is a breakthrough technology that realizes both the enhanced quake-resistance as well as shorter work periods and lower costs by reinforcing the house with band steel and aramid fiber. We are hoping the new technology will promote the growth of our remodeling business. According to an estimate by the Ministry of Land, Infrastructure and Transport\*, of about 24.5 million wooden detached houses in 2003, some 10 million units (about 40% of the total) were built in 1981 or before and are believed to lack sufficient levels of quake-resistance, with many of them having weak foundations based on unreinforced concrete.

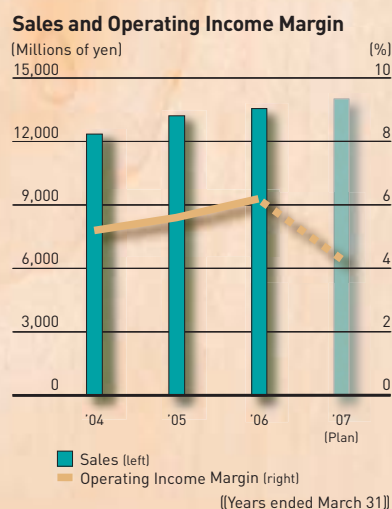
\* The ministry of land, infrastructure and transport made the estimate based on the housing and land survey conducted in 2003 by the ministry of internal affairs and communications.

### Changes in Building Foundations





## OTHER BUSINESSES



The Company manages the Takinomiya Country Club for effective use of land unsuitable for forestry management at Niihama in Ehime Prefecture where the Company started forestry business.

In addition to providing comfortable homes, the Sumitomo Forestry Group offers multi-faceted services in order to help customers enjoy rich residential lives and to contribute to their community environment. These services include the production and sales of farm and garden materials, insurance brokerage, and information systems and leasing services.

### Segment Performance Highlights

(Millions of yen)

	FY2003	FY2004	FY2005	FY2006[Plan]
Sales	12,350	13,185	13,549	14,000
Operating income	644	738	841	600
Assets	7,893	8,650	9,139	—
Capital expenditures	999	754	980	—

Notes: The sales figures given include intersegment transactions. Operating income figures include internal profit prior to the deduction of amounts such as intersegment transactions and headquarters expenses that are not apportionable.

### REVIEW OF FISCAL 2005

Sales of this segment increased 2.8% year on year to ¥13,549 million. These revenue gains were attributable to healthy sales of fire insurance to housing customers by Sumirin Enterprises, Ltd., which provides services including insurance agency business and leasing, and also due to a sharp increase in customers visiting a golf course managed by Kawanokita Development Co., Ltd. at Niihama in the Ehime Prefecture. Operating income rose 13.9% year on year to ¥841 million.

### PRIORITY POLICIES IN FISCAL 2006

In this segment, the services are aimed primarily at the Group. For this reason, effort is being channeled into systems development in order to contribute to the smooth implementation of business activities within the Group and to enhance the profitability of the Group as a whole. With regard to Sumirin Enterprises, Ltd., we aim to increase its profitability by expanding its share of the fire insurance sold to Sumitomo Forestry housing customers, which was about 40% in fiscal 2005.

# CORPORATE SOCIAL RESPONSIBILITY



## CONTENTS

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Free indoor spaces improved by eliminating the need for bearing walls impart a feeling of vertical and horizontal spaciousness that seems to exceed actual floor space. Furthermore, the deep eaves made possible by the BF (Big Frame) construction method provide a highly expressive exterior view and also reduce heat by blocking direct light when the angle of the sun is high in summer.



## DIRECTORS



**Hitoshi Hayano**  
Managing Executive Officer

**Mamoru Inoue**  
Managing Executive Officer

**Hideki Nose**  
Managing Executive Officer

**Ryu Yano**  
President and Executive Officer

**Shigehiko Shiozaki**  
Managing Executive Officer

**Hideyuki Kamiyama**  
Managing Executive Officer

**Shoichi Takahashi**  
Senior Managing Executive Officer

### Directors

*President/Director	Ryu Yano
*Director	Shoichi Takahashi
Director	Hideki Nose
Director	Hideyuki Kamiyama
Director	Mamoru Inoue
Director	Shigehiko Shiozaki
Director	Hitoshi Hayano
(*Representative Director)	

### Statutory Auditors

Senior Statutory Auditor	Shuji Kitamura
Statutory Auditor	Toshio Kohigashi
*Statutory Auditor	Hiroshi Miki
*Statutory Auditor	Satohiko Sasaki
(*Outside Corporate Directors under the Commercial Code)	

### Executive Officers

*President and Executive Officer	Ryu Yano	
*Senior Managing Executive Officer	Shoichi Takahashi	Executive Manager, Business Headquarters
*Managing Executive Officer	Hideki Nose	Executive Manager, Collective Housing Headquarters
*Managing Executive Officer	Hideyuki Kamiyama	Executive Manager, Housing Headquarters
*Managing Executive Officer	Mamoru Inoue	Executive Manager, Business Development Headquarters
*Managing Executive Officer	Shigehiko Shiozaki	General Manager, Personnel Division
*Managing Executive Officer	Hitoshi Hayano	General Manager, Corporate Planning Division
Managing Executive Officer	Hiroshi Ando	Assistant Executive Manager, Business Headquarters
Executive Officer	Ryuichi Takayama	Sumitomo Forestry Landscaping Co., Ltd., President
Executive Officer	Yasuyoshi Ishiwatari	Sumirin Enterprises Ltd., President
Executive Officer	Masahiro Nishimura	Sumitomo Forestry Home Tech. Co., Ltd., President
Executive Officer	Josuke Toyoda	General Manager, Information Systems Division
Executive Officer	Kaoru Takeshita	Sumitomo Forestry Two-By-Four Homes Co., Ltd., President
Executive Officer	Koji Takahashi	Sumitomo Forestry Crest Co., Ltd., President
Executive Officer	Hideo Watabe	Assistant Executive Manager, Collective Housing Headquarters; General Manager, Tokyo Sales Office (Collective Housing Headquarters)
Executive Officer	Yasuyuki Yamamoto	Assistant Executive Manager, Collective Housing Headquarters; General Manager, Technology Division and Product Development Division (Collective Housing Headquarters)

(\*Doubles as Director and Executive Officer)

(As of June 27, 2006)

# THE MANAGEMENT SYSTEM OF SUMITOMO FORESTRY

## Corporate Philosophy

The Sumitomo Forestry Group utilizes timber as a renewable, healthy, and environmentally friendly natural resource, and contributes to a prosperous society through all types of housing-related services.

## Action Guidelines

### Sumitomo Spirit

We conduct business based on principles of integrity and sound management.

### Respect for Humanity

We create an open and inclusive corporate culture that instills a strong sense of pride and motivation in employees.

### Environmental Protection

We contribute to the protection of the environment and our fellow beings through responsible business practices.

### Putting the Customers First

We act with customer satisfaction first and foremost in mind

## MANAGEMENT CONTROL AND PROMOTION SYSTEM

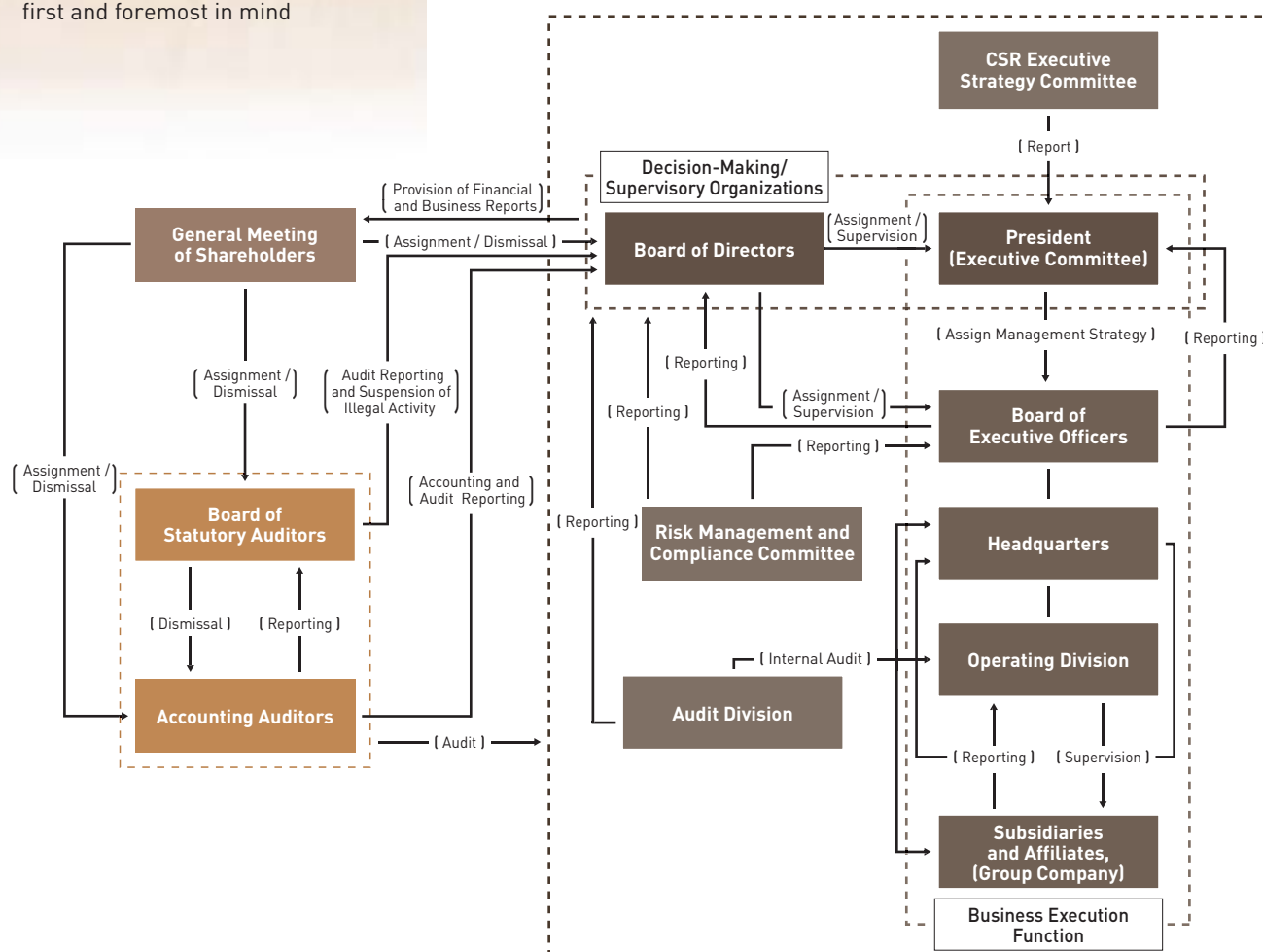
The Sumitomo Forestry Group, as a provider of a wide spectrum of services for living spaces, has a close interrelationship with society. We regard enhancing and strengthening our systems of corporate governance and compliance as an ongoing effort which leads to the continuous improvement of our corporate value.

In order to build and maintain an open-minded corporate culture in which each employee works with motivation and pride, we have adopted a management philosophy in which the Sumitomo Spirit, respect for humanity, environmental protection, and putting customer first orientation constitute our code of conduct. We continuously promote the importance of this philosophy to all employees through public relations channels.

## CORPORATE GOVERNANCE

In June 2002, we introduced the executive officer system and separated the “decision-making and supervisory functions” from “business execution functions.” By doing so, we are working to improve the speed of management to enhance supervisory functions, and clarify where the responsibility for business execution lies.

## Business Execution and Management Supervision Mechanism





### **Board of directors**

To keep pace with the rapidly changing management environment, the Board of Directors meets once a month and the Executive Committee meets twice a month. The Board of Directors makes decisions regarding important management matters and reviews business results. The Board also performs supervisory functions related to business execution. The Executive Committee determines the Group's management strategies. The Board of Executive Officers, which consists of all executive officers (16 as of June 27, 2006) reports on the status of operations.

### **Auditing system**

Under our auditing system, there are currently four statutory auditors, including two outside statutory auditors. The statutory auditors attend the Board of Directors and the Executive Committee meetings. They also meet once every three months to exchange views with the representative directors regarding improvements to the auditing environment and meet once every three months to exchange information with the auditors of the main Group companies. Through these meetings, the auditors work to enhance the effectiveness of auditing.

### **Investor relations (IR) activities**

In order to increase the transparency of management and build a solid relationship of trust with our shareholders, we perform appropriate information disclosure through IR activities. In order to make general meetings of shareholders more productive and to facilitate the exercise of voting rights we send out invitation notices three weeks prior to general meetings of shareholders. We also present an English translation of these invitations on our home page.

## **COMPLIANCE AND RISK MANAGEMENT**

In 2005, the housing industry faced a number of regrettable issues, such as asbestos and a data fabrication scandal, which caused a loss of confidence in the industry and engendered unease and mistrust among customers. To address issues such as these and restore customers' trust, the Group has reaffirmed its mission of providing safe, secure and comfortable living spaces and will build a solid business framework with compliance as one of our most important issues.

As a result of research into the use of asbestos, we confirmed that as of 2005, no asbestos-containing building materials were in use. Although some asbestos-containing building materials were in use in the period prior to November 2002 (May 2004 in the case of collective housing), the asbestos in these materials was fixed in cement or other material and was resistant to dispersal as dust. Thus, it was confirmed that asbestos used in ordinary housing life posed no threat of dispersal. The results of this research have been presented on our home page and in information pamphlets distributed to customers. Customers can also ask questions and obtain advice at our customer service centers.

To deal with risk management issues, we have established a Risk Management and Compliance Committee, headed by the General Manager of the General Administrative Division. We have also established a rule that emergency situations must be reported to the president within two hours. Thus, we have created a system under which the top management takes the initiative in our efforts to manage risk.

# CORPORATE SOCIAL RESPONSIBILITY (CSR)



For further details regarding Sumitomo Forestry's corporate social responsibility efforts, please refer to the Environmental and Social Report 2006.

Throughout a history spanning more than 300 years, the Group has practiced “sustainable forestry,” and a corporate philosophy of sustainability continues to this day as part of the DNA of Sumitomo Forestry.

We regard CSR as “returning to the starting point and reexamining this corporate philosophy of sustainability.” Our aim is to continue to be recognized as a company essential to society.



Providing high-quality homes with high resistance to earthquakes is the responsibility of a housing company. Through our multibalanced construction method that achieves a sturdy structural balance between foundation, floors, posts and walls, Sumitomo Forestry builds wooden, earthquake-resistant houses.

## ENVIRONMENTAL EFFORTS THROUGH OUR BUSINESS

### Environmental vision

In 2005, the Group established a Medium-Term Environmental Management Policy. This policy places “environmental symbiosis” at the cornerstone of management and seeks to achieve consistency between protecting the environment and promoting business operations. Under this policy, we can reduce the burden on the environment while cutting operating costs. Through a strategy of differentiation on environmental issues, we can simultaneously contribute to society and improve our business performance. We regard the plan as one that realizes true environmental management. Specifically, we are engaged in the following undertakings in the course of our business operations.

### 1. Promoting the use of domestic timber

With forests covering a little under 70% of its land area, of which 10 million hectares, or about 40%, are planted forests, Japan is blessed with abundant timber resources. Due to increased imports of overseas-grown timber, however, care of our forests has become inadequate, and forests are increasingly left without thinning or pruning.

Forests perform functions that benefit us all, such as land conservation and absorbing CO<sub>2</sub>. Logging trees when they are ready and using the timber planted about 60 years ago appropriately can help to revitalize our mountain forests and facilitate forest development. We contribute to the care of our forests by making extensive use of domestic timber in housing construction. Domestic timber is used for 51% of the main construction materials for our “MyForest” homes, which were launched in 2005.

### Use of Domestic Timber as Main Construction Material for “MyForest”

Use / Name of material	Domestic timber used	Characteristics
Bases for walls “Cross Panels”	Japanese cedar, Japanese larch	High earthquake absorption functions and air permeability through thin panels linked in reticular pattern
Posts and foundations “Super Cypress”	Japanese cypress	By laminating with glue, succeed to realize better durability and precision than solid materials while maintaining the positive features of cypress
Bases for floors “Durable Floor Panels”	Japanese cedar	Achieves a highly durable floor structure with plywood using Japanese cedar





*Kikorin*

## 2. Environmental management

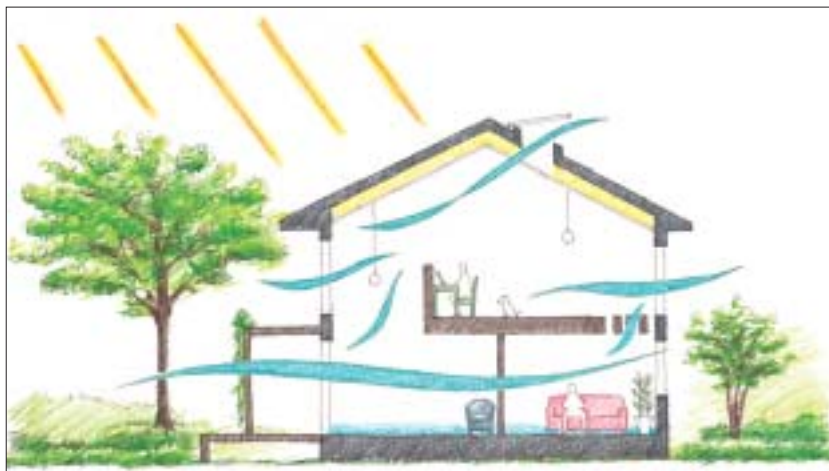
One of the first in the housing industry to obtain ISO14001 certification, we are making efforts to reduce the burden on the environment through an integrated company-wide management system. We have identified the risks that have a critical impact on our business activities, such as waste, asbestos, illegal logging and soil pollution, and are responding by ascertaining the nature of these risks and developing countermeasures for each risk.

In order to prevent purchases of illegally logged timber, we are establishing timber procurement standards, scheduled for completion in 2006, to certify the legality of the timber and timber products we handle. Although we are confirming the legality of products for which standards have been established, such confirmation can be made difficult by circumstances in the producing countries. For such products, staff posted to these countries are investigating the legality of our business partners and products, and are working to complete the setting of these standards at an early stage.

## 3. Prevention of global warming

We believe that reducing CO<sub>2</sub> emissions is an important social responsibility and are working to reduce these emissions by taking a broad approach that targets not only emissions generated by our business operations but also emissions generated when homes are occupied by customers.

We have made estimates of the amount of CO<sub>2</sub> emitted from MyForest homes over their entire 30-year life cycle, from production of materials to construction, residence, recovery and disposal, and found that the period of residence accounts for 65% of emissions. In order to reduce the energy consumption during the period of residence together with our customers, we have developed “Ryo-on-bo” as our design concept that utilizes natural energy as in traditional Japanese housing. Since fiscal 2005, we have established specification standards for insulation performance that meet the Next-Generation Energy Conservation Standards, reducing energy use by 29% compared with the previous 1992 Energy Conservation Standards.



“Ryo-on-bo”: To allow people to spend each day in health and comfort, this type of housing skillfully incorporates the power and rhythm of nature. The approach toward homes that the Japanese have developed and built over centuries is realized through modern technology.

## COMMUNICATION WITH STAKEHOLDERS

We have created the tree spirit *Kikorin*, a new character to symbolize our commitment to sustainability. Creating a pleasant image of a future where people and nature co-exist, this character will convey the spirit of Sumitomo Forestry in a friendly way.



### 1. Working with business partners

We have laid out our Green Procurement Guidelines and are working with our suppliers and contractors who are our business partners to achieve environmental conservation. We have also established the Safety and Sanitation Control Regulations and are working with builders to reduce labor accidents at construction sites.

### 2. Working with our customers

We believe that it is important not only to provide high-quality housing and services but also to meet customers' expectations from a long-term perspective. For this reason, we have established a 60-year "Long-Term Support System" for customers after they occupy their homes, and have set up a system to provide consultation 24 hours a day, 365 days a year. We also are working to improve customer satisfaction by listening to their concerns through questionnaire surveys conducted at the time of regular inspections.

### 3. Working with society

In order to operate as a company that is open to society and to be a good corporate citizen, we invite students on tours of company and hold seminar lectures to explain our company's convictions to society.

We also put emphasis on communication between the company and society. Since fiscal 2005, we have participated in the Nikkei CSR Project sponsored by the *Nihon Keizai Shimbun* and in the Sustainable Japan program sponsored by the *Asahi Shimbun*. Through these activities, we communicate information aimed at creating a sustainable society.

### 4. Working with our employees

We believe that employees are treasured company assets. In order to attain the code of conduct whereby each employee create an open and inclusive corporate culture that instills a strong sense of pride and motivation, we have adopted a personnel system incorporating the following basic guidelines.

- Encourage reform of our corporate culture and promote corporate vitality.
- Strengthen human resources development and training, and provide opportunities to motivated and capable employees, in order to achieve a more proactive and independent corporate group
- Reward results fairly
- Firmly establish transparency and in-house consensus, and achieve a workplace brimming with vitality and possessing a high awareness of its goals

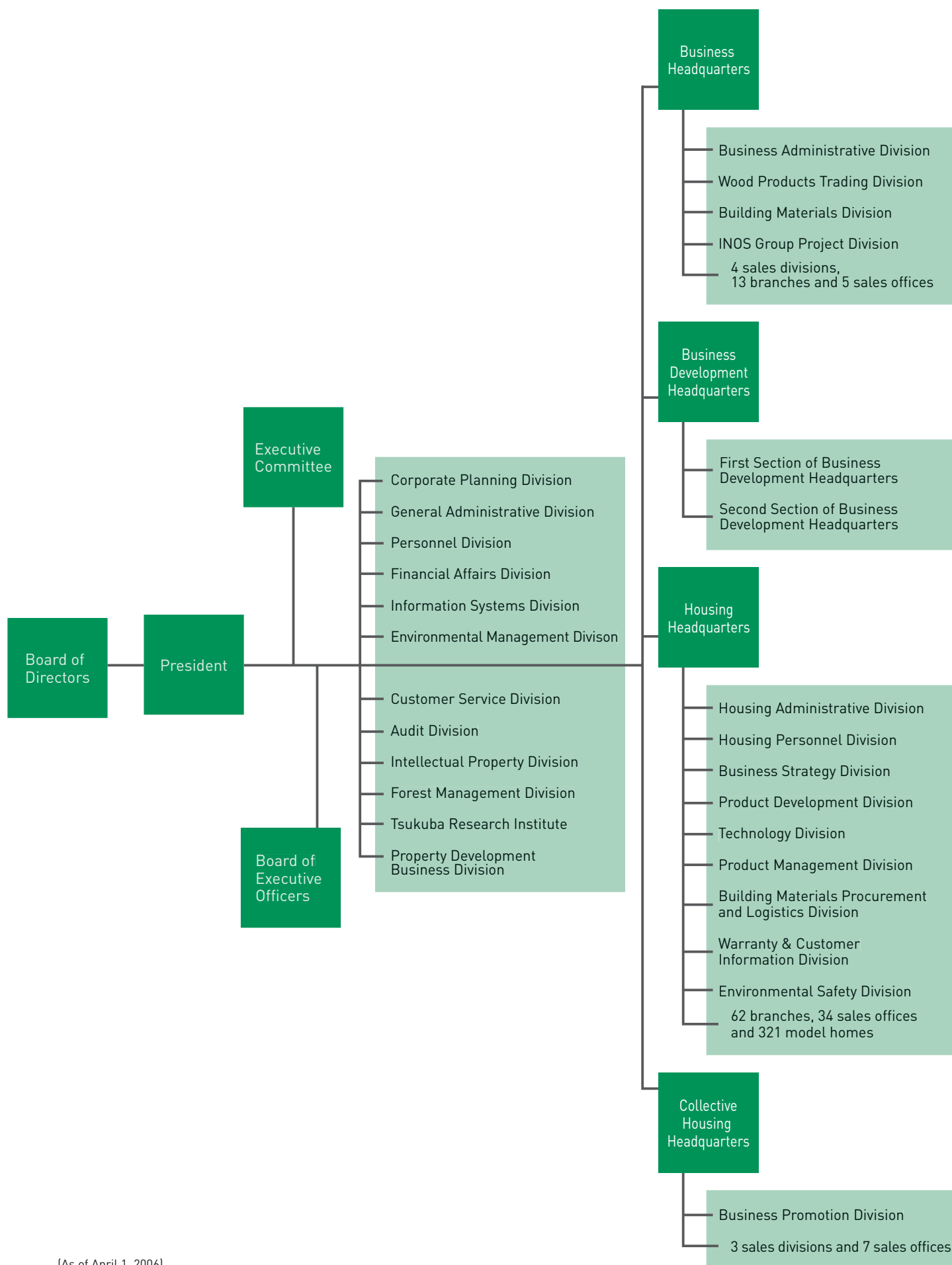
Our hiring plan for 2006 sees our ideal employee as "mentally tough and fair".

### 5. Working with shareholders

We are working to improve the quality of management by increasing transparency through appropriate information disclosure. We are also actively carrying out publicity and IR activities to build a good relationship of trust with our shareholders and investors. As the issue of Socially Responsible Investment (SRI) draws interest, we have been included in the FTSE 4 Good Global Index since 2004. In 2005, we also have been included in Morningstar Socially Responsible Investment Index (MS-SRI) and in the Dow Jones Sustainability World Index (DJSI World).



# ORGANIZATION CHART



(As of April 1, 2006)

# OVERSEAS NETWORK

## OVERSEAS OFFICES AND SUBSIDIARIES

### 1. Seattle Office/Sumitomo Forestry Seattle, Inc.

11235 SE 6th Street, Suite 120,  
Bellevue, Washington 98004, U.S.A.  
Tel: 1-425-454-2355  
Fax: 1-425-454-1106  
E-mail: sfs@sumiforsea.com

### 2. Vancouver Office

460, 1140 West Pender Street,  
Vancouver, British Columbia,  
Canada, V6E 4G1  
Tel: 1-604-681-8184  
Fax: 1-604-681-6568  
E-mail: sfc1@sfcvcr.com

### 3. Amsterdam Office

Rivierstaete Building, 3rd Floor  
No. 22, Amsteldijk 166 1079LH,  
Amsterdam, The Netherlands  
Tel: 31-20-646-4140  
Fax: 31-20-646-5372  
E-mail: sfc3@smtforams.nl

### 4. Jakarta Office

Summitmas II, 8th Floor, Jl. Jend.  
Sudirman Kav. 61-62, Jakarta 12190,  
Indonesia  
Tel: 62-21-5200268  
Fax: 62-21-5202069  
E-mail: sfcjkt@cbn.net.id

### 5. Singapore Office/Sumitomo Forestry (Singapore) Ltd.

6 Raffles Quay #14-04/05,  
John Hancock Tower,  
Singapore 048580  
Tel: 65-6435-0150  
Fax: 65-6435-0151  
E-mail: adm@sfspace.com.sg

### 6. Khabarovsk Office

Room 1007, Hotel Intourist, 2,  
Amurskiy Blvd, Khabarovsk,  
68000, Russia  
Tel: 7-4212-41-33-60  
Fax: 7-4212-41-33-62  
E-mail: sfc@sovintel.ru

### 7. Dalian Office

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147 Zhongshan Road,  
Xigang District, Dalian, 116011, PRC  
Tel: 86-411-8367-8060  
Fax: 86-411-8367-8061  
E-mail: dalian@sfc-cn.com

### 8. Tawau Office

TB3473, 6th Floor, Wisma Indotani,  
Jalan Masjid, Tawau, Sabah, Malaysia  
Tel: 60-89-772979  
Fax: 60-89-761060

### 9. Kota Kinabalu Office

Suite 1, 8th Floor,  
Wisma Perindustrian, Jalan Istiadat,  
Likas, 88400 Kota Kinabalu,  
Sabah, Malaysia  
Tel: 60-88-242031  
Fax: 60-88-268031  
E-mail: sfcwu@tm.net.my

### 10. Miri Office

P. O. Box. 493, 98007, Lot 231  
No.15, Hokkien Road, Miri,  
Sarawak, Malaysia  
Tel: 60-85-413459  
Fax: 60-85-413598  
E-mail: sfcmiri@tm.net.my

### 11. Sibul Office

P. O. Box. 1563, 96008, No. 11,  
2nd Floor, Lane 1, Jalan Rakyat,  
Sibu, Sarawak, Malaysia  
Tel: 60-84-312777  
Fax: 60-84-317635

### 12. Auckland Office/Sumitomo Forestry NZ Limited

P. O. Box. 91219, Auckland Mail  
Centre, Level 11,  
Rifleman Tower 120 Albert Street,  
Auckland, New Zealand  
Tel: 64-9-309-0012  
Fax: 64-9-309-0014  
E-mail: sfnz@xtra.co.nz/

### 13. Nelson Pine Industries Limited

P. O. Box. 3049, Lower Queen  
Street, Richmond,  
Nelson, New Zealand  
Tel: 64-3543-8800  
Fax: 64-3543-8890  
E-mail: sfc@nelsonpine.co.nz

### 14. PT. Kutai Timber Indonesia

P. O. Box. 6913/JKSST,  
Summitmas II, 8th Floor,  
Jl. Jend. Sudirman Kav. 61-62,  
Jakarta 12190, Indonesia  
Tel: 62-21-2521260  
Fax: 62-21-5200313  
E-mail: ktijkt@cbn.net.id

### 15. Probolinggo Factory

P. O. Box. 101 Probolinggo,  
Jl. Tanjung Tembaga Baru,  
Pelabuhan, Probolinggo, Jawa  
Timur, Indonesia  
Tel: 62-335-42-2412  
Fax: 62-335-42-1669  
E-mail: pr@kti.co.id

### 16. Surabaya Branch

P. O. Box. 306, Surabaya, Jl. Kusuma  
Bangsa No. 19, Surabaya 60272,  
Jawa Timur, Indonesia  
Tel: 62-31-5343835  
Fax: 62-31-5343838  
E-mail: ktisby@kti.co.id

### 17. Samarinda Branch

Jl. Manggis Mo. 48/40  
Samarinda 75123,  
Kalimantan Timur, Indonesia  
Tel: 62-541-741966/737926/748116  
Fax: 62-541-741967

### 18. Alpine MDF Industries Pty Ltd.

Lot-1 Crosher Lane, Wangaratta  
VIC 3677, Australia  
Tel: 61-3-5721-3522  
Fax: 61-3-5721-3588  
Email: enquiries@alpinemdf.com.au

### 19. Pacific Wood Products L.L.C.

16310 NE 85th Street, Suite 100,  
Redmond, Washington 98052, U.S.A.  
Tel: 1-425-885-1777  
Fax: 1-425-885-0057  
E-mail: sfs@sumiforsea.com

## AFFILIATES

### 20. PT. Rimba Partikel Indonesia

P. O. Box. 127 KENDAL  
Desa. Mororejo, Kaliwungu, Kendal,  
Jawa Tengah, Indonesia  
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Fax: 62-24-8662988/8662993  
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### 21. Jakarta Office

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Jakarta 11410, Indonesia  
Tel: 62-21-5321637  
Fax: 62-21-5301313  
E-mail: rimbajkt@cbn.net.id

### 22. PT. AST Indonesia

KITW Technopark Blok A-01,  
Jl. Raya Semarang-Kendal Km.12,  
Semarang, Indonesia  
Tel: 62-24-8664800  
Fax: 62-24-8664801  
E-mail: asti@ast.co.id

### 23. Bennett-SFS L.L.C.

c/o Sumitomo Forestry Seattle, Inc.  
11235 SE 6th Street, Suite 120,  
Bellevue, Washington 98004, U.S.A.  
Tel: 1-425-454-2355  
Fax: 1-425-454-1106  
E-mail: sfs@sumiforsea.com

### 24. Paragon Wood Product(Dalian) Co., Ltd.

15E Shum Yip Building, #2  
Gangwan Street, Zhongshan  
District, Dalian, 116001, PRC  
Tel: 86-411-82720838  
Fax: 86-411-82720698  
E-mail: paragonkenji@aol.com

### 25. Paragon Wood Product (Shanghai) Co., Ltd.

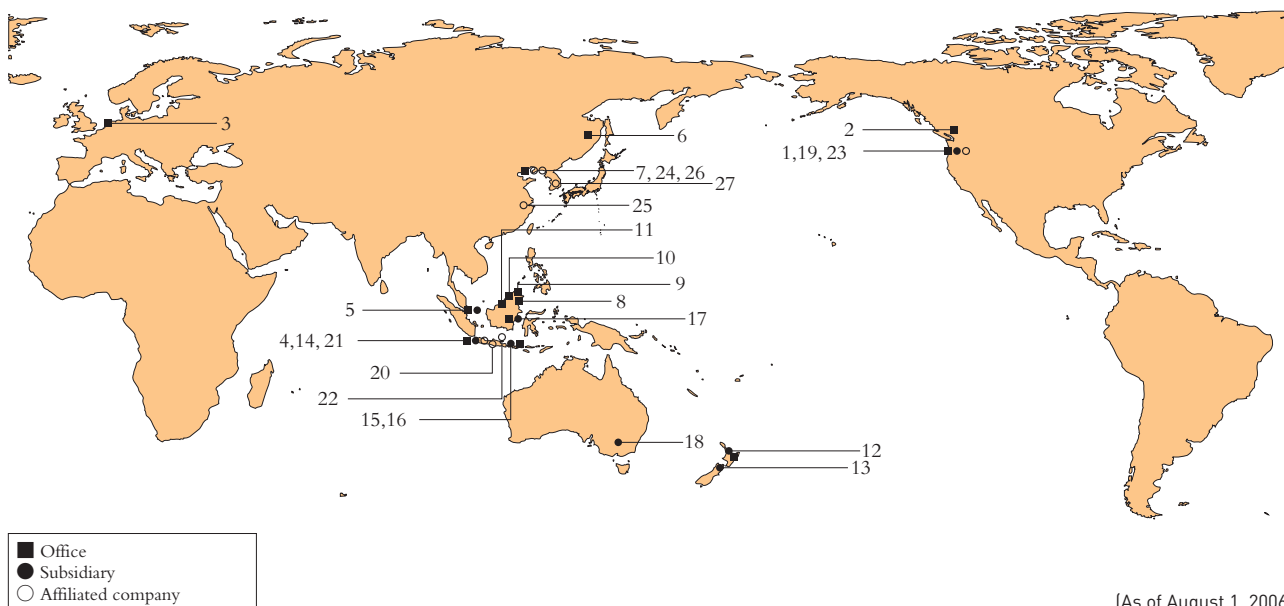
1st Floor, Building No.5, Lane 415,  
Gulang Road, Shanghai, 200331, PRC  
Tel: 86-21-52842873  
Fax: 86-21-52842853  
E-mail: paragonkenji@aol.com

### 26. Dalian Sumirin Information Technology Service Co., Ltd.

5F-E, International Finance Tower, 15 Renmin  
Road, Zhongshan District Dalian 116001, China  
Tel: 86-411-8250-6071  
Fax: 86-411-8250-6072  
E-mail: sfdln@sfits-cn.com

### 27. Dongwha SFC Housing (Korea) Co., Ltd.

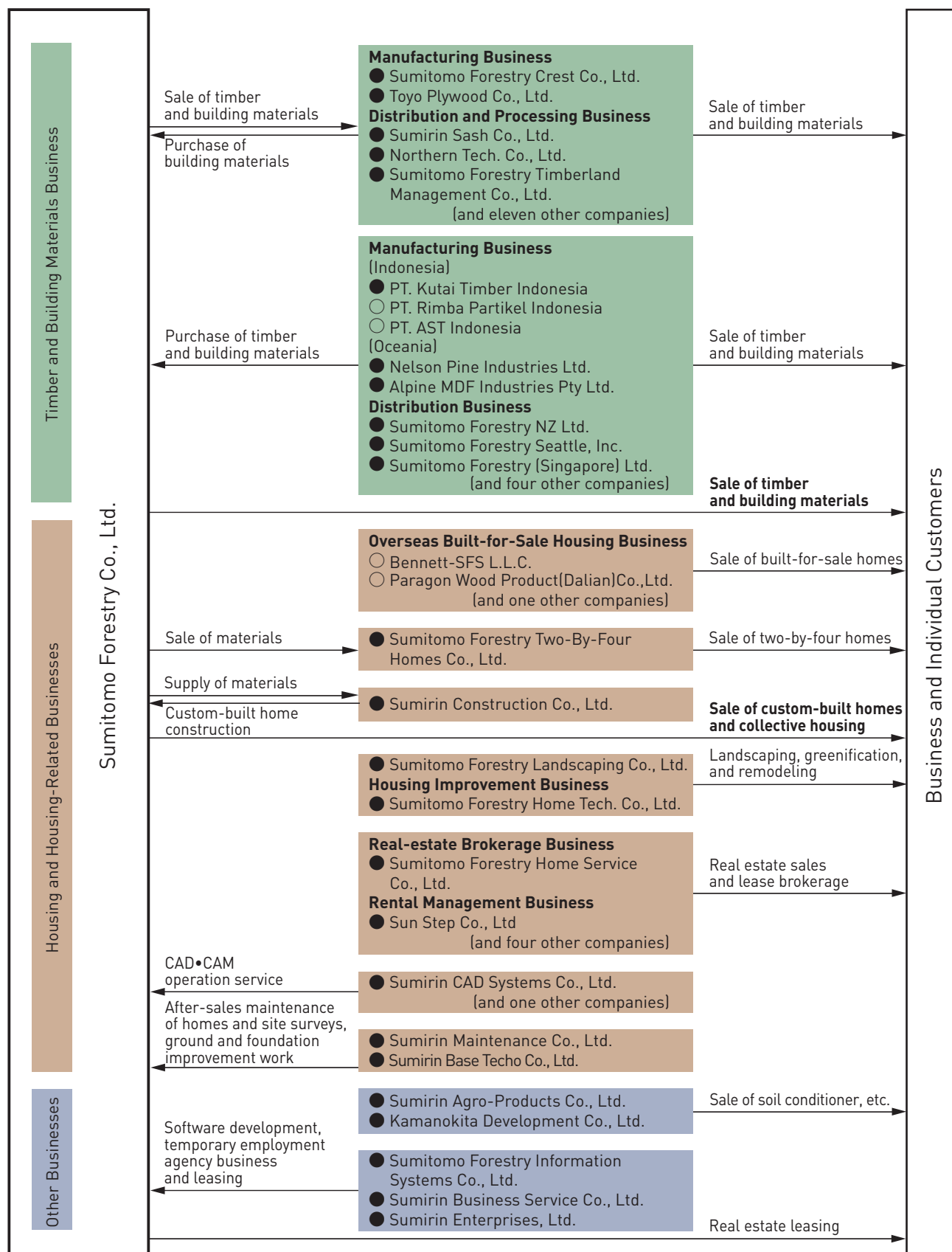
Dongwha Bldg. 192-4, Nonhyeon-Dong,  
Gangnam-Gu, Seoul, 135-010, Korea  
Tel: 86-2-3218-8970  
Fax: 82-2-3445-2891



(As of August 1, 2006)



# SUBSIDIARIES AND AFFILIATES



● Consolidated subsidiary  
○ Equity-method affiliate

(As of April 1, 2006)

# FINANCIAL SECTION

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Consolidated Statements of Shareholders' Equity	Consolidated Statements of Cash Flows	Notes to Consolidated Financial Statements	Report of Independent Auditors



# TEN-YEAR SUMMARY

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
Years ended March 31

	Millions of yen (Unless otherwise specified)		
	2006	2005	2004
<b>Operating Results:</b>			
Net sales and contract revenues	¥ 791,128	¥ 723,193	¥ 673,779
Timber and building materials Business* <sup>1</sup>	412,182	320,255	293,220
Housing and Housing-Related Businesses* <sup>1</sup>	393,868	418,313	393,616
Other Businesses	13,549	13,185	12,350
Elimination and/or corporate	(28,471)	(28,560)	(25,408)
Gross profit	127,853	125,582	120,778
Selling, general and administrative expenses	112,407	107,116	103,201
Operating income	15,446	18,466	17,577
Timber and building materials Business* <sup>1</sup>	2,806	4,615	3,813
Housing and Housing-Related Businesses* <sup>1</sup>	16,370	17,530	17,150
Other Businesses	841	738	644
Elimination and/or corporate	(4,571)	(4,418)	(4,030)
Recurring income* <sup>2</sup>	16,800	18,692	17,074
Net income (loss)	10,842	8,014	9,870
<b>Financial Position:</b>			
Total assets	¥ 464,193	¥ 370,684	¥ 369,755
Working capital* <sup>3</sup>	68,037	67,579	66,377
Interest-bearing debt	22,067	15,580	19,929
Total shareholders' equity	175,206	152,500	146,269
<b>Cash Flows:</b>			
Cash flows from operating activities	¥ 16,626	¥ 6,685	¥ 25,962
Cash flows from investment activities	(8,998)	(12,895)	(7,646)
Cash flows from financing activities	(14,039)	(7,087)	(735)
Cash and cash equivalents at the end of the year	49,628	55,928	69,312
<b>Capital Investment: *<sup>4</sup></b>			
Tangible fixed assets	¥ 8,132	¥ 7,016	¥ 4,040
Software	1,857	1,673	1,468
Others	454	549	883
Total	10,443	9,237	6,392
Depreciation and amortization	6,403	6,452	6,447
<b>Per Share Data:</b>			
		Yen	
Net income (loss)	¥ 61.28	¥ 45.3	¥ 55.8
Shareholders' equity	996.03	866.5	830.5
Cash dividends	13.00	13.00	13.00
<b>Financial Ratios:</b>			
		%	
Gross income margin	16.2	17.4	17.9
Operating income margin	2.0	2.6	2.6
Recurring income margin	2.1	2.6	2.5
Return on asset (ROA)* <sup>5</sup>	4.0	5.0	4.7
Return on equity (ROE)* <sup>5</sup>	6.6	5.4	7.2
Shareholders' equity ratio	37.7	41.1	39.6
Interest-bearing ratio* <sup>6</sup>	11.2	9.3	12.0
Current ratio	129.3	137.4	135.7
Interest coverage ratio [times]	10.8	18.6	21.9

Notes: 1.Starting in fiscal 2001, the profits from transactions in housing materials have been included in the Housing and Housing-Related segment; they were previously included in the Timber and Building Materials segment.

2.Recurring income = Operating income + Non-operating income - Non-operating expenses

Non-operating income includes interest income, purchase discounts, dividends income, exchange gains, miscellaneous gains, and other income generated from normal business activities. Non-operating expenses include interest expense, sales discounts, loss on devaluation of property, plant and equipment, exchange losses, miscellaneous expenses, and other expenses from normal business activities.

Millions of yen (Unless otherwise specified)						
2003	2002	2001	2000	1999	1998	1997
¥ 645,100	¥ 644,730	¥ 682,375	¥ 699,594	¥ 620,615	¥ 713,728	¥ 817,949
283,517	270,856	279,811	340,988	294,411	333,941	402,795
370,421	381,978	405,150	370,692	335,782	380,781	412,124
17,882	18,050	16,978	15,481	13,900	10,818	17,072
[26,721]	[26,154]	[19,565]	[27,568]	[23,480]	[11,812]	[14,043]
109,631	109,437	118,064	112,269	99,692	107,877	124,586
100,858	106,397	102,065	98,720	93,481	102,072	100,949
8,772	3,040	15,999	13,549	6,210	5,805	23,637
2,238	1,882	5,128	14,770	11,341	6,870	15,380
9,920	4,961	16,631	5,141	942	1,832	13,155
415	579	519	569	1,315	985	1,425
[3,802]	[4,384]	[6,279]	[6,933]	[7,388]	[3,882]	[6,324]
9,721	3,731	16,908	12,541	6,305	6,694	25,500
[15,439]	465	6,994	5,708	134	2,145	13,158
¥ 357,322	¥ 365,531	¥ 371,102	¥ 360,935	¥ 346,293	¥ 341,325	¥ 430,217
60,260	60,477	61,319	68,892	71,746	62,992	56,099
16,497	18,124	24,517	35,720	40,059	47,188	54,076
129,727	147,440	150,979	144,914	139,301	140,357	139,353
¥ 19,734	¥ 17,332	¥ 3,468	¥ [3,281]	¥ 26,715	¥ 9,561	¥ 20,946
2,026	[16,439]	[1,960]	[3,330]	2,068	[6,200]	2,952
[8,171]	[9,716]	[13,873]	[5,351]	[8,257]	[9,100]	1,597
52,029	38,873	47,476	59,916	71,971	51,302	57,090
¥ 2,761	¥ 7,705	¥ 4,448	¥ 4,373	¥ —	¥ —	¥ —
2,077	2,194	1,889	1,264	—	—	—
283	225	252	303	—	—	—
5,123	10,124	6,590	5,941	4,556	13,172	11,448
5,985	5,289	4,551	4,756	5,060	5,057	4,944
Yen						
¥ [87.5]	¥ 2.6	¥ 39.6	¥ 32.4	¥ 0.8	¥ 12.2	¥ 74.6
736.4	835.1	854.9	821.6	789.8	795.8	790.1
10.00	10.00	10.00	10.00	10.00	10.00	12.00
%						
17.0	17.0	17.3	16.0	16.1	15.1	15.2
1.4	0.5	2.3	1.9	1.0	0.8	2.9
1.5	0.6	2.5	1.8	1.0	0.9	3.1
2.7	1.0	4.6	3.5	1.8	1.7	6.2
[11.1]	0.3	4.7	4.0	0.1	1.5	9.8
36.3	40.3	40.7	40.1	40.2	41.1	32.4
11.3	10.9	14.0	19.8	22.3	25.2	28.0
132.6	131.8	131.1	137.7	141.6	137.4	121.0
18.3	7.8	22.6	18.6	5.8	4.3	17.5

3. Working capital = Current assets – Current liabilities

4. Disclosure of capital investment was not institutionalized prior to fiscal 2000, thus data for the first five years from fiscal 1995 are partly lacking.

5. ROA and ROE are calculated using the simple average of beginning and end of term balance sheet figures.

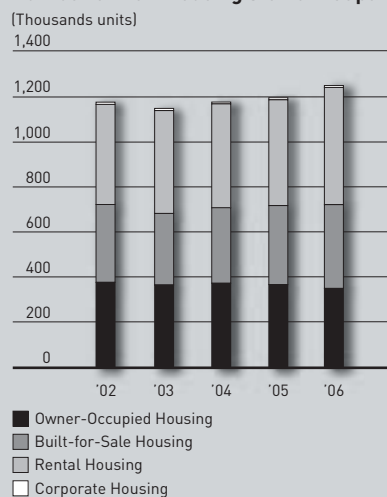
ROA = Recurring income / Total assets

ROE = Net income (loss) / Shareholders' equity

6. Interest-bearing debt ratio = Interest-bearing debt / (Interest-bearing debt + Shareholders' equity)

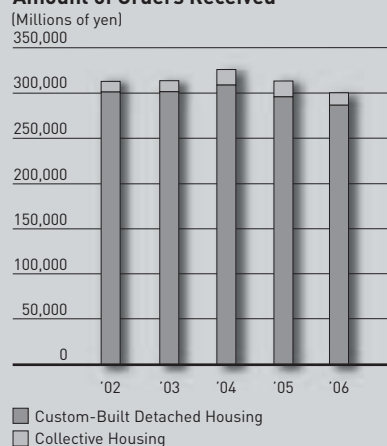
# MANAGEMENT'S DISCUSSION & ANALYSIS

**Number of New Housing Starts in Japan**



(Years ended March 31)

**Amount of Orders Received**



(Years ended March 31)

## MARKET OVERVIEW

In the term ended March 2006, the Japanese economy staged a moderate recovery, showing increases in both corporate earnings and capital investment, which led to an improvement in employment conditions and an uptrend in personal income and consumption. However factors that cloud the future, such as soaring crude oil prices and concerns about a rise in interest rates, remained.

In the housing sector, thanks to the support of low interest rates, falling land prices and the strong propensity of first-time homebuyers to purchase homes, the number of new housing starts increased by 4.7% over the previous fiscal year to 1,249,000 units. However, owner-occupied housing starts declined by 4.0% to 352,000.

Throughout the year, Timber and Building Materials operated in an exceptionally harsh environment due to the sharp rise in the prices of raw timber and crude oil.

## CONSOLIDATED OPERATING RESULTS

### 1. Orders Received and Net Sales

Sales rose by 9.4% over the previous fiscal year to ¥791.128 billion. This is mainly due to the establishment of two consolidated subsidiaries in Timber and Building Materials Business. As for the Timber and Building Materials Distribution Business, we have made Ataka Kenzai Co., Ltd., our consolidated subsidiary to secure a new customer base and to enhance our line-up of products. As for the Building Materials Manufacturing Business, we have made Toyo Plywood Co., Ltd. our consolidated subsidiary to focus our management resources on the production of wood-based building materials. Orders for custom-built detached houses were disappointing, falling by 3.1% in terms of value to ¥286.519 billion and by 8.2% in terms of units to 9,251, due to the impact of the phasing out of housing mortgage tax breaks.

### 2. Selling, General and Administrative Expenses

Selling, general and administrative expenses amounted to ¥112.47 billion, a 4.9% increase. This rise was due to an aggressive expansion of business bases and personnel in Housing and Housing-Related Businesses for the purpose of expanding business fields, along with two special factors: (1) a ¥5.752 billion rise in expenses for the two new subsidiaries and (2) a ¥2.765 billion decline in the actuarial difference relating to retirement benefits accounting.

### 3. Operating Income

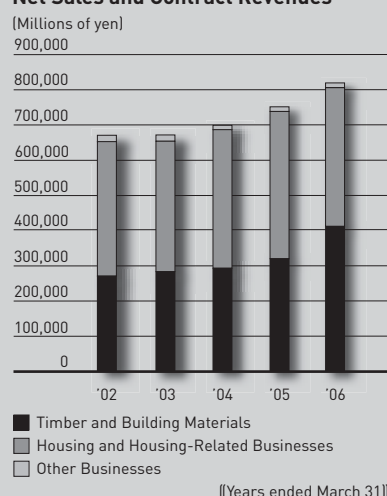
Owing to the above, operating income declined by 16.4% from the previous fiscal year to ¥15.446 billion. A breakdown by segment indicates that operating income declined in both of our core businesses: the Timber and Building Materials Business and the Housing and Housing-Related Businesses.

### 4. Non-Operating Income and Expenses and Recurring Income

Non-operating income and expenses improved by ¥1.127 billion, due to the posting of insurance premium income. As a result, non-operating income and expenses scored a net profit of ¥1.353 billion and recurring income declined 10.1% to ¥16.8 billion.



## Net Sales and Contract Revenues



## 5. Special Gains and Losses

Special gains and losses improved by ¥2.261 billion over the previous fiscal year, bringing the net loss in the current period to ¥765 million. The major reasons for this figure included a loss of ¥492 million from the sale of fixed assets that accompanied the liquidation of the wooden component housing business last term and a loss of ¥455 million from expenses associated with the integration of Ataka Kenzai Co., Ltd. Other significant factors were ¥229 million booked for business relocation profits.

## 6. Net Income

Net income rose by 35.3% to ¥10.842 billion. This is due to the partial withdrawal of deferred tax assets, which led to an increase in income taxes-deferred. On the other hand, we reported a tax loss due to completion of liquidation of a sales subsidiary in the wooden component housing business, and as a result, the corporate tax declined. Along with this, net income per share rose ¥16 to ¥61.28 and return on equity (ROE) increased 1.2 percentage points to 6.6%.

## SEGMENT INFORMATION

### 1. Timber and Building Materials Business

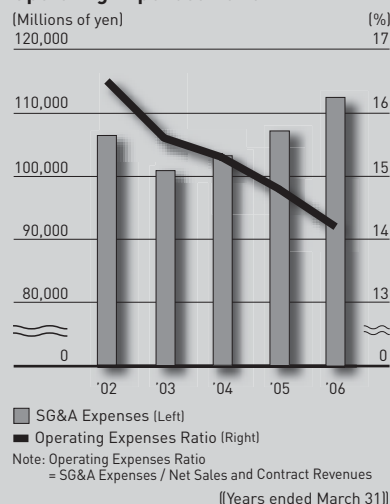
Net sales in Timber and Building Materials Business increased by 28.7% over the previous fiscal year to ¥412.182 billion and operating income fell 39.2% to ¥2.806 billion. As special factors, the consolidation of the two new subsidiaries contributed significantly to the increase in the sales (¥99.382 billion).

Although sales of timber declined due to the downturn in imported materials such as logs, brisk sales of panels and general building materials offset the slump in timber. However, operating income declined due to the downward pressure on profits applied by the soaring cost of raw materials borne by our various overseas production subsidiaries. As a result, revenue increased but profit decreased.

### 2. Housing and Housing-Related Businesses

Net sales for the Housing and Housing-Related Businesses declined by 5.8% over the previous fiscal year to ¥393.868 billion and operating income declined by 6.6% to ¥16.370 billion despite our efforts for aggressive expansion of personnel and business bases to boost sales competitiveness and expand business fields. The principal factors that led to this decline in profit were: (1) 5.2% decrease in units ordered due to the phasing-out of housing mortgage tax breaks and fierce competition, and (2) the extremely harsh environment for the collective housing business in the large-scale project market, where competition with major construction firms has intensified.

## SG&A Expenses and Operating Expenses Ratio



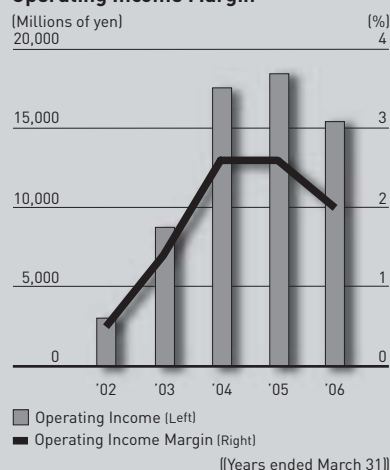
## Business Results by Segment

[[Years ended March 31]]

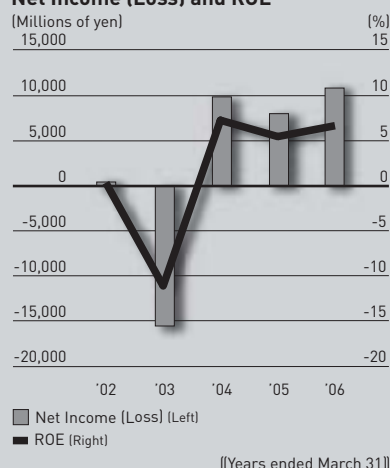
(Millions of yen)	Timber and Building Materials Business		Housing and Housing-Related Businesses		Other Businesses	
	2006	2005	2006	2005	2006	2005
Net sales	412,182	320,255	393,868	418,313	13,549	13,185
Operating income	2,806	4,615	16,370	17,530	841	738
Operating income margin	0.7%	1.4%	4.2%	4.2%	6.2%	5.6%

Note: The sales figures given above include intersegment transactions. Operating income figures include internal profit prior to the deduction of amounts such as intersegment transactions and headquarters expenses that are not apportionable.

### Operating Income and Operating Income Margin



### Net Income (Loss) and ROE



## FINANCIAL POSITION AND CASH FLOWS

### 1. Financial Position

Total assets at the end of fiscal 2006 increased ¥93.59 billion over the previous fiscal year to ¥464.193 billion. Current assets increased ¥52.365 billion to ¥300.431 billion and fixed assets increased by ¥41.143 billion to ¥163.761 billion. The major reason behind the increase of current assets was the growth in operating receivables associated with the recent establishment of new consolidated subsidiaries. The rise in fixed assets was primarily due to the increase in the market value of the capital holdings associated with the rebound of stock prices.

Total liabilities increased by ¥68.199 billion to ¥285.862 billion. Current liabilities increased by ¥51.907 billion to ¥232.394 billion due to the above mentioned growth in the operating receivables associated with the recent establishment of new consolidated subsidiaries. Long-term liabilities rose by ¥16.293 billion to ¥53.469 billion, mainly due to the increase in deferred tax assets accompanying a rise in the market value of capital holdings. The balance of interest-bearing debt rose by ¥6.487 billion to ¥22.067 billion.

Total shareholders' equity increased by ¥22.706 billion to ¥175.206 billion, due to the appreciation of marketable securities to ¥12.882 billion in addition to an increase in retained earnings.

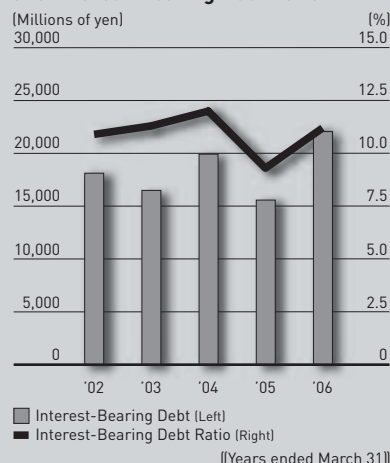
### 2. Cash Flows

Net cash provided by operating activities increased by ¥9.942 billion year on year to ¥16.626 billion. This net increase was due to factors including the decrease in construction fees paid up to the end of the term because there was no year-on-year growth in completions at the end of December from the effect of housing mortgage tax breaks and a decrease in the amount of corporate tax paid. Net cash used in investment activities increased by ¥3.897 billion to ¥8.998 billion. This was due to the acquisition of stock of Toyo Plywood Co., Ltd. and Ataka Kenzai Co., Ltd. and the purchase of land for commercial use and rental real estate by subsidiaries. Net cash used in financing activities increased by ¥6.952 billion to ¥14.039 billion. This was due to the payment of dividends and repayment of interest-bearing debt of subsidiaries. The balance of cash and cash equivalents at the end of the year totaled ¥49.628 billion, a ¥6.3 billion decrease compared with the previous fiscal year.

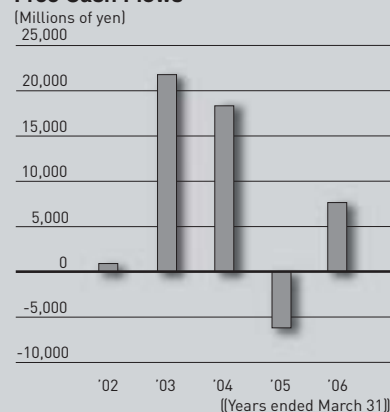
## BUSINESS RISK AND RISK MANAGEMENT

The business results of the Sumitomo Forestry Group are subject to fluctuations in interest rates, land prices and exchange rates and can be influenced by changes in the tax system and legal regulations in addition to market trends for housing, timber and building materials. The Group continually works to minimize these risks by (1) making ongoing improvements to product competitiveness; (2) cost reductions; (3) diversification of operating regions and business fields; and (4) the use of forward exchange contracts. It must be recognized, however, that we cannot completely avoid these risks.

### Interest-Bearing Debt and Interest-Bearing Debt Ratio



### Free Cash Flows



## 1. Fluctuations in Interest Rates, Land Prices, and Exchange Rates

Interest rate increases, particularly long-term interest rates, can have an adverse effect on demand as they cause an increase in total payments for customers purchasing detached housing, many of whom take out loans for the purchase, and for customers who build collective housing for the effective use of their land. A forecasted rise in interest rates can result in a surge in home purchases as consumers seek to avoid high loan costs. This, however, may be followed by a backlash after the rush has ended. Rising land prices can have a negative effect on consumer appetite to purchase land; conversely, falling land prices can cause a decline in demand for home reconstruction as a result of asset deflation.

Exchange rate fluctuations can affect business results when production costs are temporarily influenced by them or when the currency of a country in which we manufacture products appreciates in relation to the currency of a country to which we export those products.

## 2. Changes in Tax Systems and Legal Regulations

Laws and regulations surrounding the housing business include the newly introduced Personal Information Protection Act, in addition to the Building Standards Law, Construction Industry Law, Building Lots and Building Transaction Business Law, Urban Planning Law, National Land Use Planning Law, Housing Quality Assurance Law, and Waste Disposal and Public Cleaning Law (laws concerning the procedures for waste disposal and site clean-up). These laws and regulations can substantially influence product content and construction methods. There is the possibility that the business results of the Sumitomo Forestry Group might be substantially affected in the event of the abolition, revision and enactment of laws and regulations. Moreover, changes in mortgage tax breaks and consumption tax rates have a significant effect on fluctuations in orders for the Sumitomo Forestry Group.



# CONSOLIDATED BALANCE SHEETS

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
As of March 31, 2006 and 2005

ASSETS	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
<b>Current assets:</b>			
Cash and time deposits (Note 11)	¥ 44,720	¥ 25,188	\$ 378,986
Marketable securities (Note 5)	5,000	31,045	42,372
Receivables—			
Notes and accounts, trade	138,260	90,321	1,171,692
Loans and other	51,226	46,638	434,121
Inventories—			
Finished goods, logs and lumber	22,413	19,757	189,940
Developed land and housing for sale	10,071	10,775	85,345
Land and housing projects in progress	15,628	14,171	132,443
Deferred income taxes (Note 8)	7,597	8,513	64,381
Other current assets	6,429	2,349	54,489
Allowance for doubtful accounts	(913)	(692)	(7,741)
Total current assets	300,431	248,066	2,546,028
<b>Property, plant and equipment, at cost less accumulated depreciation (Note 7):</b>			
Land	19,973	17,542	169,261
Buildings and structures	36,882	29,735	312,557
Machinery and equipment	60,054	51,208	508,936
Timberland (Note 6)	11,136	11,094	94,372
Construction in progress	4,426	2,206	37,505
	132,470	111,785	1,122,631
Less accumulated depreciation	(58,538)	(46,679)	(496,084)
Net property, plant and equipment	73,933	65,106	626,547
<b>Intangible assets, net of amortization:</b>			
Consolidation goodwill	1,532	1,434	12,986
Other intangible assets	5,575	5,454	47,246
Total intangible assets	7,107	6,887	60,232
<b>Investments and other assets:</b>			
Investment securities (Note 5)	71,413	40,485	605,198
Long-term loans and receivables	2,436	1,881	20,646
Deferred income taxes (Note 8)	1,242	1,193	10,528
Other assets	9,727	8,627	82,431
Allowance for doubtful accounts	(2,097)	(1,561)	(17,773)
Total investments and other assets	82,722	50,625	701,030
	¥ 464,193	¥ 370,684	\$ 3,933,836

See accompanying notes to consolidated financial statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
<b>Current liabilities:</b>			
Payables—			
Notes and accounts, trade	¥ 154,024	¥ 110,653	\$ 1,305,289
Other	6,679	5,289	56,598
Short-term debt (Note 7)	11,106	6,395	94,119
Current portion of long-term debt (Note 7)	2,113	956	17,909
Advances received from customers	37,920	35,285	321,355
Accrued income taxes	1,596	4,197	13,529
Accrued employees' bonuses	8,078	7,518	68,459
Other current liabilities (Note 8)	10,877	10,194	92,179
Total current liabilities	232,394	180,487	1,969,437
<b>Long-term liabilities:</b>			
Long-term debt (Note 7)	8,848	8,229	74,983
Deferred income taxes (Note 8)	15,136	2,259	128,268
Accrued employees' retirement benefits (Note 16)	15,875	13,915	134,538
Other	13,610	12,772	115,335
Total long-term liabilities	53,469	37,176	453,124
<b>Minority interests in consolidated subsidiaries</b>	<b>3,124</b>	<b>521</b>	<b>26,478</b>
<b>Contingent liabilities</b> (Note 14)			
<b>Shareholders' equity</b> (Note 12):			
Common stock—			
Authorized: 400,000,000 shares			
Issued and outstanding: 176,603,881 shares	27,672	27,672	234,509
Capital surplus	25,655	25,654	217,415
Retained earnings	99,319	90,807	841,686
Unrealized gain on available-for-sale securities	22,125	9,243	187,500
Foreign currency translation adjustments	1,052	(380)	8,914
Treasury stock (761,629 shares in 2006 and 653,288 shares in 2005)	(617)	(496)	(5,227)
Total shareholders' equity	175,206	152,500	1,484,797
	¥ 464,193	¥ 370,684	\$ 3,933,836

# CONSOLIDATED STATEMENTS OF INCOME

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
Sales:			
Net sales	¥ 439,516	¥ 356,686	\$ 3,724,716
Contract revenues	351,612	366,507	2,979,761
Total	791,128	723,193	6,704,477
Cost of sales:			
Cost of sales	408,124	329,631	3,458,680
Cost of contracts completed	255,151	267,980	2,162,293
Total	663,275	597,611	5,620,973
Gross profit	127,853	125,582	1,083,504
Selling, general and administrative expenses (Note 10)	112,407	107,116	952,603
Operating income	15,446	18,466	130,901
Other income (expenses):			
Interest and dividends income	781	437	6,622
Interest expense	(1,094)	(752)	(9,272)
Equity in earnings of affiliates	327	329	2,772
Loss on devaluation of investment securities	(15)	(5)	(128)
Loss on devaluation of real estate for sale and other assets	(19)	(47)	(164)
Impairment loss	—	(36)	—
Moving expense of the head office	—	(509)	—
Loss on business restructuring	—	(3,284)	—
Insurance income	419	—	3,555
Income on transfer of business by spin-off	229	—	1,937
Integration costs	(455)	—	(3,860)
Other gains, net (Note 9)	416	1,066	3,529
Total	589	(2,800)	4,991
Income before income taxes and minority interests	16,035	15,666	135,892
Income taxes (Note 8):			
Current	2,254	7,688	19,102
Deferred	2,705	(161)	22,922
Total	4,959	7,528	42,024
Minority interests	235	124	1,988
Net Income	¥ 10,842	¥ 8,014	\$ 91,880
	Yen		U.S. dollars (Note 4)
Per share of common stock:			
Net Income (Note 18)	¥ 61.28	¥ 45.28	\$ 0.52
Cash dividends	13.00	13.00	0.11

See accompanying notes to consolidated financial statements.



# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 2006 and 2005

	Millions of yen						
	Number of Shares of Common Stock	Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain on Available- for-Sale Securities	Foreign Currency Translation Adjustments	Treasury Stock at Cost
Balance as of March 31, 2004	176,603,881	¥ 27,672	¥ 25,651	¥ 85,148	¥ 8,972	¥ (811)	¥ (363)
Net income	—	—	—	8,014	—	—	—
Changes in unrealized gain on available-for-sale securities, less applicable taxes	—	—	—	—	271	—	—
Changes in foreign currency translation	—	—	—	—	—	431	—
Cash dividends (¥13.00 per share)	—	—	—	(2,289)	—	—	—
Bonuses to directors	—	—	—	(66)	—	—	—
Gain on sale of treasury stock	—	—	3	—	—	—	—
Treasury stock acquired, net (123,205 shares)	—	—	—	—	—	—	(133)
Balance as of March 31, 2005	176,603,881	¥ 27,672	¥ 25,654	¥ 90,807	¥ 9,243	¥ (380)	¥ (496)
Net income	—	—	—	10,842	—	—	—
Changes in unrealized gain on available-for-sale securities, less applicable taxes	—	—	—	—	12,882	—	—
Changes in foreign currency translation	—	—	—	—	—	1,432	—
Cash dividends (¥13.00 per share)	—	—	—	(2,287)	—	—	—
Bonuses to directors	—	—	—	(43)	—	—	—
Gain on sale of treasury stock	—	—	1	—	—	—	—
Treasury stock acquired, net (108,341 shares)	—	—	—	—	—	—	(121)
Balance as of March 31, 2006	176,603,881	¥ 27,672	¥ 25,655	¥ 99,319	¥ 22,125	¥ 1,052	¥ (617)
Thousands of U.S. dollars (Note 4)							
		Common Stock	Capital Surplus	Retained Earnings	Unrealized Gain on Available- for-Sale Securities	Foreign Currency Translation Adjustments	Treasury Stock at Cost
Balance as of March 31, 2005		\$ 234,549	\$ 217,403	\$ 769,554	\$ 78,329	\$ (3,222)	\$ (4,200)
Net income		—	—	91,880	—	—	—
Changes in unrealized gain on available-for-sale securities, less applicable taxes		—	—	—	109,169	—	—
Changes in foreign currency translation		—	—	—	—	12,136	—
Cash dividends (\$0.11 per share)		—	—	(19,381)	—	—	—
Bonuses to directors		—	—	(367)	—	—	—
Gain on sale of treasury stock		—	12	—	—	—	—
Treasury stock acquired, net (108,341 shares)		—	—	—	—	—	(1,027)
Balance as of March 31, 2006		\$ 234,509	\$ 217,415	\$ 841,686	\$ 187,500	\$ 8,914	\$ (5,227)

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
For the years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars (Note 4)
	2006	2005	2006
<b>Cash flows from operating activities:</b>			
Income (loss) before income taxes and minority interests	¥ 16,035	¥ 15,666	\$ 135,892
Adjustments—			
Depreciation and amortization	6,403	6,452	54,262
Impairment loss	—	36	—
Write-down of consolidation goodwill	566	450	4,800
Provision for (reversal of) doubtful account	15	(294)	129
Provision for (reversal of) severance indemnities, less payments	(1,044)	2,500	(8,849)
Interest and dividends income	(781)	(437)	(6,622)
Interest expense	1,094	752	9,272
Equity in earnings of affiliates	(327)	(329)	(2,772)
Losses on devaluation of marketable securities and investment securities	15	5	128
Losses (gains) on sales of marketable securities and investment securities, net	(53)	(770)	(446)
Losses (gains) on disposal of fixed assets, net	575	350	4,874
Income on transfer of business by spin-off	(229)	—	(1,937)
Changes in assets and liabilities:			
Notes and accounts receivable, trade	1,165	(3,906)	9,871
Inventories	1,590	(5,562)	13,475
Other current assets	(5,051)	3,198	(42,806)
Notes and accounts payable, trade	2,929	688	24,826
Advances received from customers	2,067	(2,515)	17,521
Other current liabilities	(222)	1,537	(1,885)
Other	(261)	168	(2,216)
Total	24,487	17,989	207,521
Interest and dividends income received	1,008	477	8,544
Interest paid	(1,008)	(746)	(8,545)
Income taxes paid, net	(7,861)	(11,036)	(66,620)
Net cash provided by operating activities	16,626	6,685	140,900
<b>Cash flows from investment activities:</b>			
Proceeds from sales of marketable securities	247	158	2,093
Payments for purchases of fixed assets	(12,554)	(10,217)	(106,391)
Proceeds from sales of fixed assets	7,496	3,905	63,526
Payments for purchases of intangible assets	(1,872)	(1,746)	(15,866)
Payments for purchases of investment securities	(3,569)	(4,254)	(30,244)
Proceeds from sales of investment securities	93	1,437	791
Payments for long-term loans receivable	(50)	(81)	(426)
Repayments of long-term loans receivable	589	256	4,990
Decrease (increase) in short-term loans receivable	801	(1,702)	6,792
Payments for purchase of stock in subsidiaries newly consolidated	(1,921)	—	(16,282)
Proceeds from purchase of stock in subsidiaries newly consolidated	1,316	—	11,154
Other	425	(651)	3,605
Net cash provided by (used in) investment activities	(8,998)	(12,895)	(76,258)
<b>Cash flows from financing activities:</b>			
Proceeds from long-term debt	842	165	7,136
Repayments of long-term debt	(6,700)	(2,721)	(56,782)
Increase (decrease) in short-term borrowings	(5,770)	(2,095)	(48,897)
Dividends paid	(2,287)	(2,289)	(19,381)
Other	(124)	(147)	(1,048)
Net cash used in financing activities	(14,039)	(7,087)	(118,972)
<b>Effect of exchange rate changes on cash and cash equivalents</b>	111	(87)	942
<b>Net increase (decrease) in cash and cash equivalents</b>	(6,300)	(13,384)	(53,388)
<b>Cash and cash equivalents at the beginning of the year</b>	55,928	69,312	473,967
<b>Cash and cash equivalents at the end of the year (Note 11)</b>	¥ 49,628	¥ 55,928	\$ 420,579

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Sumitomo Forestry Co., Ltd. and Consolidated Subsidiaries  
As of March 31, 2006 and 2005

## 1. Nature of Operations

Sumitomo Forestry Co., Ltd. (the “Company”) and its Group companies are involved in various business activities related to wood and houses, with timberland operations serving as the foundation of its business. Specifically, the Company’s operations encompass forest management as well as timber and building materials related operations, including the procurement, manufacture and sale of timber and building materials; housing-related operations, including the construction, sale, after-sales maintenance and landscaping of custom-built and other homes and sale and brokerage of real estate; and other lifestyle related businesses, including the leasing and golf course management.

## 2. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of the Company and consolidated subsidiaries (together, the “Companies”) are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to the application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Securities and Exchange Law of Japan. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The accompanying consolidated financial statements incorporate certain reclassifications and rearrangements in order to present these statements in a form which is more familiar to the readers of these statements outside Japan. In addition, the notes to consolidated financial statements include information which is not required under generally accepted accounting principles in Japan but is presented herein as additional information.

As permitted amounts of less than one million yen are rounded in this annual report.

## 3. Summary of Significant Accounting Policies

### (a) Basis of consolidation and investments in affiliates

The consolidated financial statements include the accounts of the Company and, with exceptions which are not material, those of its subsidiaries. All significant intercompany transactions and accounts and unrealized intercompany profits are eliminated on consolidation.

The material difference between the cost and underlying net equity of investments in consolidated subsidiaries is deferred and amortized over a five-year period. Immaterial difference are expensed when incurred.

Investments in affiliates (15 to 50 percent-owned companies except subsidiaries) in which the ability to exercise significant influence exists are stated at cost plus equity in undistributed earnings (losses). Net consolidated income includes the Company’s share of the current net earnings (losses) of such companies, after elimination of unrealized intercompany profits.

### (b) Translation of foreign currency transactions and accounts

Current and long-term receivables and payables in foreign currencies are translated into Japanese yen at the exchange rates at the balance sheet date.

The Company translates the revenue and expense accounts of the foreign consolidated subsidiaries at the average rates of exchange in effect during the year. The balance sheet accounts, except for the components of shareholders’ equity, are also translated into yen at the rates of exchange in effect at the balance sheet date. The components of shareholders’ equity are translated at their historical rates.

### (c) Statements of cash flows

Cash and cash equivalents include all highly liquid investments, generally with original maturities of three months or less, that are readily convertible to known amounts of cash and are so near maturity that they present only an insignificant risk of changes in value.

### (d) Allowance for doubtful accounts

The allowance for doubtful accounts is stated based on the default ratio sustained over a specific period in the past and the estimated uncollectible amount based on the analysis of certain individual accounts, including probable bad debts and claims in bankruptcy.

This amount is considered sufficient to cover possible losses on collection.



**(e) Accrued employees' bonuses**

Accrued employees' bonuses are provided based on estimated bonuses to be paid to employees, which should be charged to income in the current year.

**(f) Warranty reserve for completed construction**

A warranty reserve is provided for repair costs which may be required for completed construction. The reserve is estimated based on past experience and future estimates.

The warranty reserve for completed construction is included in other current liabilities.

**(g) Accrued employees' retirement benefits**

Accrued employees' retirement benefits are provided based on the projected retirement benefit obligation and the plan assets at year-end.

Unrecognized actuarial gains (losses) are amortized in the fiscal year in which they arise.

**(h) Accrued retirement benefits to directors and corporate auditors**

Accrued retirement benefits to directors and corporate auditors of some subsidiaries are provided based on the amount required for the year-end in accordance with the established internal regulations. The Company abolished its retirement benefits system to directors and corporate auditors at the annual general meeting of shareholders on June 29, 2005. The amount of accrued retirement benefits to the Company's directors and corporate auditors for their term of service up to June 29, 2005 is included in "Other" of Long-term liabilities.

**(i) Reserve for restructuring costs**

The allowance for restructuring costs is stated at the estimated loss on restructuring of discontinued operation at the end of the fiscal year.

The balance of this reserve at March 31, 2006, which was included in other current liabilities on the accompanying consolidated balance sheets, was ¥844 million (US \$7,151 thousand).

**(j) Marketable securities and investments**

Marketable securities and investments are classified and accounted for, depending on management's intent, as follows: i) held-to-maturity debt securities, which are expected to be held to maturity with the positive intent and ability to hold to maturity, are reported at amortized cost; and ii) available-for-sale securities, which are not classified as either of the aforementioned securities, are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity.

The Company determines cost of securities sold by the moving average method.

**(k) Inventories**

Inventories other than finished goods are stated at cost, which is determined by the specific identification method.

Finished goods are stated at moving average cost.

**(l) Property, plant and equipment**

Property, plant and equipment, including significant renewals and additions, are capitalized at cost. Maintenance and repairs and minor renewals and improvements are charged to income. Depreciation is computed, with minor exceptions, by the declining balance method at rates based on the estimated useful lives of the assets according to general class, type of construction and use. In the case of retirement or disposal, the difference between the net book value and salvage or sales proceeds is charged or credited to income.

**(m) Timberland**

Timberland consists of standing timber and related land. Standing timber, consisting of timber stock in natural forests, purchased forests and planted forests, is classified either as mature timber or growing timber. Mature timber represents costs related to trees that are 21 or more years old, of which costs have been transferred from growing timber. Growing timber represents costs of trees less than 21 years old (see Note 6).

The timber stock from both natural forests and purchased forests is carried at the specific acquisition cost.

The timber stock from planted forests is stated at cost, which consists of sowing, seeding and planting.

Intensive forest management generally practiced in Japan results in high yields of quality logs. Such management, implemented by the Company, includes the following procedures:

Age in Years	Procedures
0	Sowing, seeding at nursery
1	Planting after land preparation
1—6	Weeding
8	Vine cutting
10—14	Salvage cutting
14	Pruning
16—25	Thinning and debranching
Over 50	Final cutting

The charges for weeding, vine cutting, salvage cutting, pruning and thinning and debranching are charged to selling, general and administrative expenses as incurred.

When finally harvested from timberland for sale, the harvested timber has its cost calculated based on the proportion of metric volume of the timber harvested to that of the particular area, applied to the book value of the area. The calculated cost is the cost of sales.

**(n) Revenue recognition**

Sales are generally recognized at the time the goods are delivered to the customers.

Sales of precut timber, building materials and certain housing equipment, such as system kitchens, system furniture, bathtubs, sinks and other, which are purchased by the Company and sold to building contractors for use in house building projects specifically subcontracted from the Company, are recognized upon completion and acceptance of the completed houses by the customers, with the related cost being included in cost of contracts completed.

Contract revenues, representing revenues from custombuilt houses, are recorded when the completed houses are accepted by customers.

**(o) Finance leases**

Finance leases of the Companies, other than those where ownership of the lease assets is transferred to the lessee, are accounted for as operating leases.

**(p) Income taxes**

The Companies accrue income taxes based on taxable income. The Companies include many items for financial reporting purposes which, in the case of expenses, are not currently deductible and, in the case of income, are not currently taxable.

Income taxes based on temporary differences between tax and financial reporting purposes are reflected as deferred income taxes in the consolidated financial statements using the asset and liability method.

**(q) Appropriations of retained earnings**

Appropriations of retained earnings reflected in the accompanying consolidated financial statements are recorded upon approval by the shareholders as required under Japanese law.

**(r) Earnings per share of common stock**

The computation of net income and cash dividends per share is based on the average number of shares outstanding during each period.

**(s) Reclassifications**

Certain accounts in the consolidated financial statements for the year ended March 31, 2005 have been reclassified to conform to presentation in 2006.

## **4. U.S. Dollar Amounts**

The U.S. dollar amounts are included solely for convenience and have been translated, as a matter of arithmetical computation only, at the rate of ¥118=US\$1, the approximate exchange rate prevailing in the Japanese foreign exchange market at March 31, 2006. This translation should not be construed as a representation that the yen amounts actually represent, or have been or could be converted into, U.S. dollars.

## 5. Securities

The carrying amount and aggregate fair value of the securities classified as available-for-sale and held-to-maturity at March 31, 2006 and 2005 were as follows:

Millions of yen				
2006				
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	¥ 26,053	¥ 41,718	¥ (92)	¥ 67,679
Debt securities	—	—	—	—
Held-to-maturity:				
Debt securities	¥ 5,290	¥ —	¥ —	¥ 5,290

Millions of yen				
2005				
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	¥ 21,385	¥ 15,751	¥ (249)	¥ 36,886
Debt securities	—	—	—	—
Held-to-maturity:				
Debt securities	¥ 31,334	¥ —	¥ —	¥ 31,334

Thousands of U.S. dollars				
2006				
	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Securities classified as:				
Available-for-sale:				
Equity securities	\$ 220,784	\$ 353,546	\$ (776)	\$ 573,554
Debt securities	—	—	—	—
Held-to-maturity:				
Debt securities	\$ 44,831	\$ —	\$ —	\$ 44,831

Proceeds from sales of available-for-sale securities and the corresponding gross gains and losses, which are included in other gains (losses), net in the accompanying consolidated statements of income for the year ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Proceeds	¥ 93	¥ 1,437	\$ 791
Gross gains	53	806	446
Gross losses	—	36	—

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale and held-to-maturity at March 31, 2006 were as follows:

	Millions of yen		Thousands of U.S. dollars	
	2006			
	Available- for-Sale	Held-to- Maturity	Available- for-Sale	Held-to- Maturity
Due within one year	¥ —	¥ 5,000	\$ —	\$ 42,373
Due after one year				
through five years	—	290	—	2,458
	¥ —	¥ 5,290	\$ —	\$ 44,831

The difference between the above cost and the amounts shown in the accompanying consolidated balance sheets principally consisted of non-marketable securities and equity securities of unconsolidated subsidiaries and affiliates.

## 6. Timberland

The investment in timberland at March 31, 2006 and 2005 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Standing timber:			
Mature timber	¥ 10,723	¥ 10,572	\$ 90,872
Growing timber	413	522	3,500
	11,136	11,094	94,372
Land	477	478	4,040
	¥ 11,613	¥ 11,572	\$ 98,412

The timberland accounts at March 31, 2006 and 2005 were reduced by ¥268 million (US \$2,274 thousand) and ¥268 million in aggregate, representing the accumulated deferred gains from disposals of timberland.



## 7. Short-Term and Long-Term Debt

Short-term debt at March 31, 2006 and 2005 generally represented short-term borrowings which bore interest of 4.37% and 3.30% per annum, respectively. Long-term debt at March 31, 2006 and 2005 were summarized as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Loans, principally from banks and insurance companies, due 2007 to 2011 with interest of 6.30%:			
Secured	¥ 7,560	¥ 6,600	\$ 64,071
Unsecured	3,181	2,305	26,956
Debtenture bonds:			
0.35 basis points	120	180	1,017
0.64 basis points	100	100	847
	10,961	9,185	92,891
Portion due within one year	2,113	956	17,909
	¥ 8,848	¥ 8,229	\$ 74,983

The following assets were pledged to secure bank loans and long-term debt at March 31, 2006 and 2005:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Receivables-			
Notes and accounts, trade	¥ 523	¥ 518	\$ 4,432
Finished goods, logs and lumber	1,246	1,022	10,557
Land	269	1,454	2,280
Buildings and structures	3,765	3,683	31,910
Machinery and equipment	8,141	9,315	68,989
Timberland	2,309	2,199	19,570
Investment securities	3,344	—	28,336
Other	27	—	230
	¥ 19,624	¥ 18,191	\$ 166,304

The aggregate annual maturities of long-term debt at March 31, 2006 were as follows:

YEARS ENDING MARCH 31	Millions of yen	Thousands of U.S. dollars
2007	¥ 2,113	\$ 17,909
2008	6,777	57,433
2009	1,927	16,331
2010	104	880
2011	40	338
Thereafter	—	—
	¥ 10,961	\$ 92,891

## 8. Income Taxes

Income taxes in Japan applicable to the Companies generally comprise Corporation Tax, Enterprise Tax and Prefectural and Municipal Inhabitants Taxes. The effective statutory tax rate for fiscal 2006 was 40.0%.

The chart below shows the differences in the statutory tax rate and effective income tax rate.

	2006	2005
Statutory tax rate	40.0%	40.0%
Non-deductible expense for purposes	1.5	1.2
Per capita portion of Inhabitant Tax	1.6	1.7
Amortization of consolidation differences	1.4	1.1
Valuation allowance	(14.5)	6.5
Special deduction on corporate income taxes	—	(1.7)
Other	0.9	(0.7)
Effective income tax rate	30.9%	48.1%

The significant components of deferred tax assets and liabilities at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Deferred tax assets:			
Accrued employees' bonuses	¥ 3,484	¥ 3,006	\$ 29,526
Provision for guarantee			
for after-cost of construction	511	406	4,332
Advances received	394	413	3,343
Accrued enterprise taxes	119	325	1,009
Devaluation of real estate			
for sale and other assets	4,160	4,428	35,253
Devaluation of property,			
plant and equipment	342	550	2,897
Impairment loss	1,693	2,082	14,350
Pension and severance costs	6,293	6,401	53,334
Unrealized intercompany profit	399	471	3,386
Tax loss carryforward	3,186	2,045	27,002
Loss on business restructuring	338	747	2,860
Other	2,518	2,404	21,339
Gross deferred tax assets	23,438	¥ 23,279	198,632
Valuation allowance	(8,802)	(6,552)	(74,596)
Total deferred tax assets	14,636	16,728	124,036
Deferred tax liabilities:			
Deferred gains on sales of property	(966)	(1,091)	(8,183)
Unrealized gain on			
available-for-sale securities	(16,604)	(6,197)	(140,712)
Gain on securities contributed to			
employee retirement			
benefit trust	(1,590)	(1,590)	(13,478)
Land valuation difference	(1,230)	—	(10,423)
Other	(543)	(403)	(4,601)
Gross deferred tax liabilities	(20,933)	(9,281)	(177,397)
Net deferred tax assets	¥ (6,297)	¥ 7,447	\$ (53,361)

Net deferred tax assets were included in the consolidated balance sheets at March 31, 2006 and 2005 as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current assets-			
Deferred income taxes	¥ 7,597	¥ 8,513	\$ 64,381
Investment and other assets-			
Deferred income taxes	1,242	1,193	10,528
Current liabilities-			
Other	(0)	—	(2)
Long-term liabilities-			
Deferred income taxes	(15,136)	(2,259)	(128,268)
Net deferred tax assets	¥ (6,297)	¥ 7,447	\$ (53,361)

## 9. Other Gains (Losses), Net

Other gains (losses), net, for the years ended March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Gain on sales of property,			
plant and equipment	¥ 82	¥ 37	\$ 694
Gain on sales of			
investment securities	53	806	446
Loss on sales of property,			
plant and equipment	(492)	—	(4,170)
Loss on sales of			
investment securities	—	(36)	—
Loss on disposal of property,			
plant and equipment	(165)	—	(1,398)
Other, net	939	259	7,957
	¥ 416	¥ 1,066	\$ 3,529

## 10. Research and Development Expenses

Research and development expenses charged to selling, general and administrative expenses for the year ended March 31, 2006 and 2005 were ¥993 million (US \$8,414 thousand) and ¥883 million, respectively.

## 11. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2006 and 2005 consisted of the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Cash and time deposits	¥ 44,720	¥ 25,188	\$ 378,986
Short-term investments	5,000	30,798	42,372
Less: Cash deposits and			
short-term investments			
which mature or become			
due over three months after			
the date of acquisition	(92)	(59)	(779)
Cash and cash equivalents	¥ 49,628	¥ 55,928	\$ 420,579

## 12. Shareholders' Equity

Under the Japanese Commercial Code (the "Code"), at least 50% of the issue price of new shares is required to be designated as the common stock account. The portion to be designated as the common stock account is determined by resolution of the Board of Directors. Proceeds in excess of the amounts designated as the common stock account are credited to capital surplus account.

The Code provides that an amount equivalent to a minimum of 10% of cash dividends and other distributions from retained earnings paid by the Companies be appropriated as a legal reserve. No further appropriation is required when the total amount of capital surplus account and legal reserve equals 25% of the common stock account. The balance of the reserve may be used to reduce a deficit and/or may be transferred to the common stock account.

The Code also provides that, to the extent the sum of capital surplus account and legal reserve exceeds 25% of the common stock account, the amount of any such excess is available for appropriation by resolution of the shareholders meeting.

The balances of the legal reserve of the Company at March 31, 2006 and 2005, which were included in retained earnings on the accompanying consolidated balance sheets, were ¥2,857 million (US \$24,213 thousand) and ¥2,857 million, respectively.

Year-end dividends are approved by the shareholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. In addition, semi-annual interim dividends may be paid upon resolution of the Board of Directors, subject to limitations imposed by the Code. Year-end dividends are reflected in the consolidated statements of shareholders' equity when authorized.

## 13. Finance Leases

(Lessee)

Finance leased charges to the Companies for the years ended March 31, 2006 and 2005 were ¥4,366 million (US \$37,004 thousand) and ¥4,798 million, respectively.

The leased assets and related expenses of the Companies' finance leases, other than those where the ownership of the lease assets is transferred to the lessee, are being accounted for as operating leases. If capitalized, the following amounts would be recorded in the financial statements (in equivalent amounts):

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Buildings and structures	¥ 11,318	¥ 10,081	\$ 95,919
Machinery and equipment	5,823	5,885	49,348
Other	188	101	1,593
Accumulated depreciation	(7,898)	(8,118)	(66,935)
Accumulated Impairment loss	(4)	(12)	(37)
	¥ 9,427	¥ 7,938	\$ 79,888

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Depreciation	¥ 4,224	¥ 4,604	\$ 35,797
Interest expenses	142	164	1,200

Depreciation costs are calculated based on the straightline method over the lease periods of the leased assets, with no residual value of the assets at the end of the lease periods.

Interest expenses are calculated by subtracting the amount equivalent to the acquisition cost from the total lease fee. The resulting differences, which are of an amount equivalent to the total interest payments over the lease periods, are allocated to each period by the interest method. The present values of future lease payments of the Companies as at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current obligation	¥ 3,768	¥ 3,409	\$ 31,932
Long-term obligation	5,754	4,637	48,766
Present value of lease payments	¥ 9,522	¥ 8,046	\$ 80,698
Impairment loss on leased assets	¥ 2	¥ 7	\$ 18



(Lessor)

Finance lease fee income of the Companies credited to income for the years ended March 31, 2006 and 2005 were ¥131 million (US \$1,111 thousand) and ¥149 million, respectively. The leased assets and related expenses of the Companies' finance leases other than those where the ownership of the leased assets is transferred to the lessee and are being accounted for as operating leases at March 31, 2006 and 2005 comprised the following:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Machinery and equipment	¥ 469	¥ 497	\$ 3,977
Other	36	11	309
Accumulated depreciation	(249)	(265)	(2,108)
	¥ 257	¥ 243	\$ 2,178

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Depreciation	¥ 111	¥ 128	\$ 941
Interest income	16	18	136

Interest income is calculated by subtracting the amount equivalent to the acquisition cost from the total lease fee. The resulting differences, which are of an amount equivalent to the total interest receipts over the lease periods, are allocated to each period by the interest method. The present values of future lease receipts for the Companies at March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current obligation	¥ 87	¥ 86	\$ 734
Long-term obligation	167	156	1,412
Present value of lease receipts	¥ 253	¥ 242	\$ 2,146

## 14. Contingent Liabilities

Contingent liabilities as at March 31, 2006 and 2005, for loans guaranteed amounted to ¥20,880 million (US \$176,948 thousand) and ¥11,490 million, and for notes discounted and endorsed in the ordinary course of business amounted to ¥363 million (US \$3,072 thousand) and NIL, respectively.

## 15. Derivatives and Hedging Activities

The Companies use derivative financial instruments to manage their exposure to fluctuations in foreign exchange and interest rates. Foreign exchange forward contracts, foreign currency swaps, and interest rate swaps are utilized by the Companies to reduce foreign currency exchange and interest rate risks. The Companies do not enter into derivatives for trading or speculative purposes.

## 16. Severance Indemnity Benefits and Pension Plans

The Company and some of its domestic consolidated subsidiaries offer their employees both a lump-sum benefit at retirement and a non-contributory funded defined benefit pension plan. Others offer a lump-sum benefit at retirement only.

These systems are open to employees who meet set conditions, but substantially all employees are eligible.

Retirement benefits are calculated based on the employees basic rate of pay, length of service, termination circumstance and other factors. The employees of the companies that adopt defined-benefit pension plan may opt for either a lump-sum payment or annuity payments.

In March 2004, the Company and some of its domestic consolidated subsidiaries revised their non-contributory funded defined benefit pension plan and decided to introduce a cash balance pension plan.

Under the cash balance pension plan, each participant is given an account into which is credited the amount calculated yearly based on the re-evaluation rate which is derived from current compensation and market interest rate. This revision of the plan brought about a reduction in the employee retirement benefit obligation of the Company and some of its domestic consolidated subsidiaries.

The liability for employee's retirement benefits at March 31, 2006 and 2005 consisted of the following:

	Millions of yen	Thousands of U.S. dollars
	2006	2005
Projected benefit obligation	<b>¥(48,162)</b>	¥(38,546)
Fair value of plan assets	<b>32,286</b>	24,631
Unrecognized actuarial loss	—	—
Unrecognized prior service cost	—	—
Prepaid pension cost	—	—
Net liability for retirement benefits	<b>¥(15,875)</b>	¥(13,915)

The components of net periodic benefit costs for the year ended March 31, 2006 and 2005 were as follows:

	Millions of yen	Thousands of U.S. dollars
	2006	2005
Service cost	<b>¥ 2,930</b>	¥ 2,949
Interest cost	<b>830</b>	777
Expected return on plan assets	<b>(167)</b>	(150)
Recognized actuarial gain (loss)	<b>(2,973)</b>	(209)
Amortization of prior service cost	—	—
Net periodic benefit costs	<b>¥ 619</b>	¥ 3,367

Certain consolidated subsidiaries have adopted the conventional method in calculating their projected benefit obligation.

Assumptions used for the year ended March 31, 2006 and 2005 were set forth as follows:

	2006	2005
Discount rate	<b>1.9%</b>	2.0%
Expected rate of return on plan assets	<b>0.7%</b>	0.7%
Recognition period of actuarial gain/loss	<b>1year</b>	1year

## 17. Segment Information

### a) Industry segment information—

The Companies' business is classified into the following three segments based on the similarities of the types and nature of business:

Timber and building materials: manufacturing or purchasing and sale of timber and building materials

Housing: construction of houses, buildings and their exteriors, gardening, planting, sale of interiors and brokerage of real estate

Other: leasing, golf course management and other

The tables below present sales, operating expenses and operating income information by segment.

Millions of yen						
YEAR ENDED MARCH 31, 2006	Timber and building materials	Housing	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:						
Unaffiliated customers	¥ 395,650	¥ 392,131	¥ 3,347	¥ 791,128	¥ —	¥ 791,128
Intersegment transfers	16,532	1,737	10,202	28,471	(28,471)	—
Total	412,182	393,868	13,549	819,600	(28,471)	791,128
Operating expenses	409,376	377,498	12,708	799,582	(23,900)	775,682
Operating income	¥ 2,806	¥ 16,370	¥ 841	¥ 20,018	¥ (4,571)	¥ 15,446
Identifiable assets, depreciation and capital investment:						
Identifiable assets	¥ 237,265	¥ 105,579	¥ 9,139	¥ 351,982	¥ 112,210	¥ 464,193
Depreciation and amortization	2,906	2,336	686	5,928	475	6,403
Impairment loss	—	—	—	—	—	—
Capital investment	5,701	3,737	980	10,418	25	10,443

Millions of yen						
YEAR ENDED MARCH 31, 2005	Timber and building materials	Housing	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:						
Unaffiliated customers	¥ 301,696	¥ 418,031	¥ 3,466	¥ 723,193	¥ —	¥ 723,193
Intersegment transfers	18,559	281	9,719	28,560	(28,560)	—
Total	320,255	418,313	13,185	751,753	(28,560)	723,193
Operating expenses	315,640	400,783	12,447	728,869	(24,142)	704,727
Operating income	¥ 4,615	¥ 17,530	¥ 738	¥ 22,884	¥ (4,418)	¥ 18,466
Identifiable assets, depreciation and capital investment:						
Identifiable assets	¥ 157,840	¥ 108,705	¥ 8,650	¥ 275,196	¥ 95,488	¥ 370,684
Depreciation and amortization	3,113	2,270	601	5,985	468	6,452
Impairment loss	—	—	—	—	36	36
Capital investment	2,949	4,403	754	8,107	1,131	9,237



YEAR ENDED MARCH 31, 2006	Thousands of U.S. dollars					Consolidated
	Timber and building materials	Housing	Other	Total	Elimination and / or corporate	
Sales and contract revenues:						
Unaffiliated customers	\$ 3,352,969	\$ 3,323,143	\$ 28,365	\$ 6,704,477	\$ —	\$ 6,704,477
Intersegment transfers	140,101	14,723	86,459	241,283	(241,283)	—
Total	3,493,070	3,337,866	\$ 114,824	6,945,760	(241,283)	6,704,477
Operating expenses	3,469,286	3,199,135	107,697	6,776,118	(202,542)	6,573,576
Operating income	\$ 23,784	\$ 138,731	\$ 7,127	\$ 169,642	\$ (38,741)	\$ 130,901
Identifiable assets, depreciation and capital investment:						
Identifiable assets	\$ 2,010,718	\$ 894,736	\$ 77,446	\$ 2,982,900	\$ 950,936	\$ 3,933,836
Depreciation and amortization	24,624	19,800	5,816	50,240	4,022	54,262
Impairment loss	—	—	—	—	—	—
Capital investment	48,315	31,672	8,302	88,289	213	88,502

b) Geographical segment information—

The Companies' business is classified into the two segments based on geographic proximity. Other includes Asia, North America and Oceania.

YEAR ENDED MARCH 31, 2006	Millions of yen				Consolidated
	Domestic	Other	Total	Elimination and / or corporate	
Sales and contract revenues:					
Unaffiliated customers	¥ 773,221	¥ 17,907	¥ 791,128	¥ —	¥ 791,128
Intersegment transfers	2,276	8,005	10,280	(10,280)	—
Total	775,497	25,912	801,409	(10,280)	791,128
Operating expenses	755,595	25,960	781,556	(5,874)	775,682
Operating income	¥ 19,901	¥ (48)	¥ 19,853	¥ (4,407)	¥ 15,446
Identifiable assets, depreciation and capital investment:					
Identifiable assets	¥ 318,973	¥ 38,212	¥ 357,184	¥ 107,008	¥ 464,193

Millions of yen					
YEAR ENDED MARCH 31, 2005	Domestic	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:					
Unaffiliated customers	¥ 705,184	¥ 18,009	¥ 723,193	¥ —	¥ 723,193
Intersegment transfers	1,775	16,341	18,116	(18,116)	—
Total	706,959	34,350	741,309	(18,116)	723,193
Operating expenses	685,231	33,196	718,427	(13,699)	704,727
Operating income	¥ 21,727	¥ 1,155	¥ 22,882	¥ (4,416)	¥ 18,466
Identifiable assets, depreciation and capital investment:					
Identifiable assets	¥ 246,885	¥ 32,518	¥ 279,403	¥ 91,281	¥ 370,684
Thousands of U.S. dollars					
YEAR ENDED MARCH 31, 2006	Domestic	Other	Total	Elimination and / or corporate	Consolidated
Sales and contract revenues:					
Unaffiliated customers	<b>\$ 6,552,719</b>	<b>\$ 151,758</b>	<b>\$ 6,704,477</b>	<b>\$ —</b>	<b>\$ 6,704,477</b>
Intersegment transfers	<b>19,286</b>	<b>67,837</b>	<b>87,123</b>	<b>(87,123)</b>	<b>—</b>
Total	<b>6,572,005</b>	<b>219,595</b>	<b>6,791,600</b>	<b>(87,123)</b>	<b>6,704,477</b>
Operating expenses	<b>6,403,348</b>	<b>220,004</b>	<b>6,623,352</b>	<b>(49,776)</b>	<b>6,573,576</b>
Operating income	<b>\$ 168,657</b>	<b>\$ (409)</b>	<b>\$ 168,248</b>	<b>\$ (37,347)</b>	<b>\$ 130,901</b>
Identifiable assets, depreciation and capital investment:					
Identifiable assets	<b>\$ 2,703,158</b>	<b>\$ 323,829</b>	<b>\$ 3,026,987</b>	<b>\$ 906,849</b>	<b>\$ 3,933,836</b>

c) Overseas sales information—

As the total overseas sales were less than 10% of consolidated net sales, overseas sales information has been omitted.

## 18. Net Income Per Share

The computation of net income per share for the year ended March 31, 2006 and 2005 were as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Numerator for net income per share:			
Net income	¥ <b>10,842</b>	¥ 8,014	\$ 91,880
Income not available to common stockholders	<b>(62)</b>	(44)	(529)
Income available to common stockholders	<b>10,779</b>	7,971	91,351
Denominator for net income per share:			
Weighted average number of shares issued	<b>175,891,228</b>	176,015,931	

## Report of Independent Auditors

The Board of Directors  
Sumitomo Forestry Co., Ltd.

We have audited the accompanying consolidated balance sheets of Sumitomo Forestry Co., Ltd. (the “Company”) and consolidated subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders’ equity, and cash flows for the years then ended, all expressed in yen. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sumitomo Forestry Co., Ltd. and consolidated subsidiaries at March 31, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

The U.S. dollar amounts in the accompanying consolidated financial statements with respect to the year ended March 31, 2006 are presented solely for convenience. Our audit also included the translation of yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made on the basis described in Note 4.

June 27, 2006

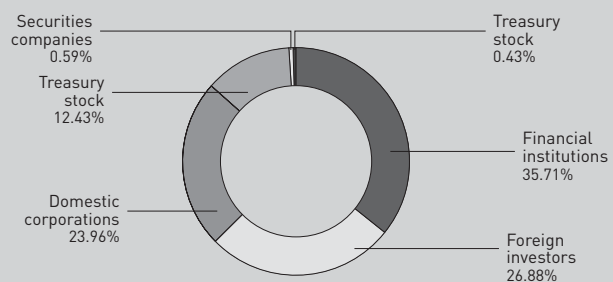
*Ernst & Young Shin Nihon*



# STOCK INFORMATION

Stock Exchange Listings:	Tokyo, Osaka
Common Stock Authorized:	400,000,000 shares
Issued:	176,603,881 shares
Number of Shareholders:	11,663
General Meeting of Shareholders:	June

## Breakdown of Shareholders:



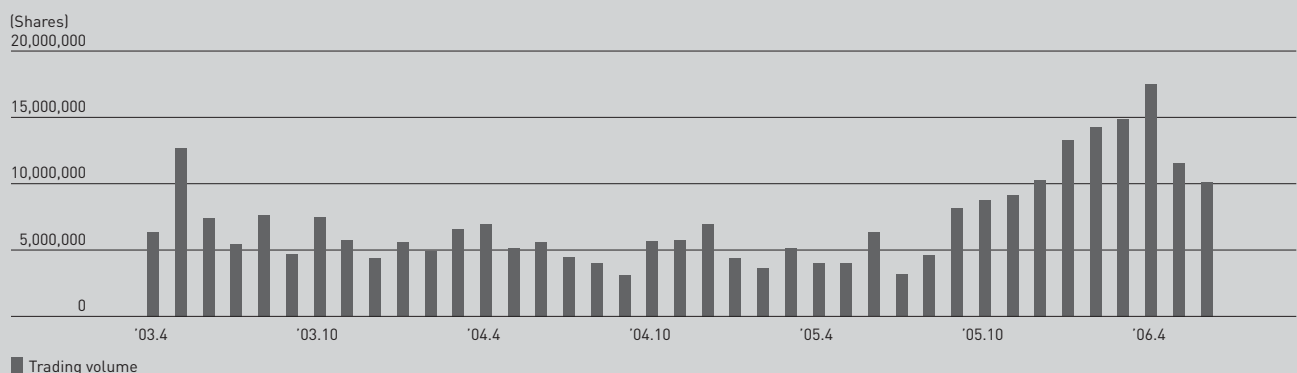
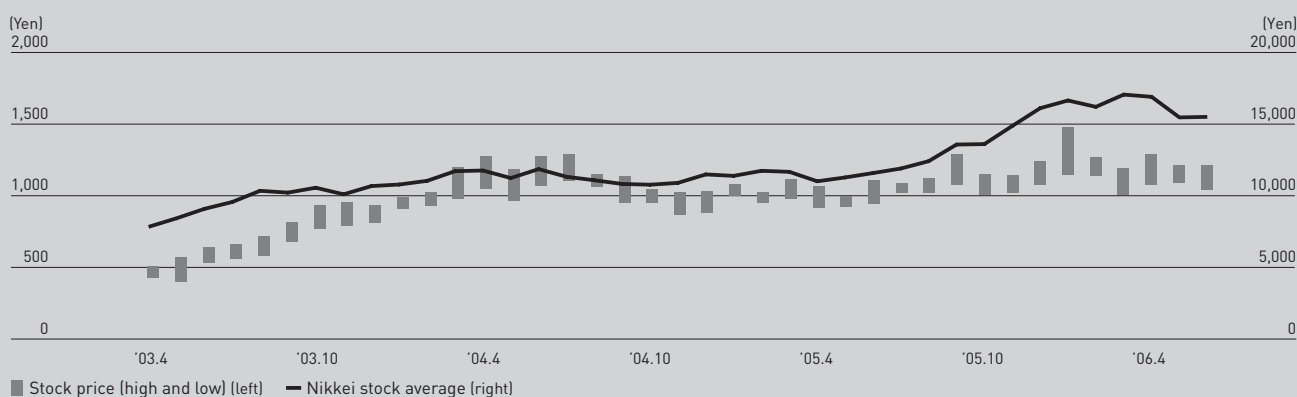
(As of March 31, 2006)

## Major Shareholders:

Shareholders	Number of shares held (Thousand shares)	Shareholding ratio (%)
The Master Trust Bank of Japan, Ltd. (trust account)	13,063	7.40
Sumitomo Metal Mining Co., Ltd.	10,110	5.72
The Iyo Bank, Ltd.	5,850	3.31
State Street Bank and Trust Company	4,702	2.66
Japan Trustee Service Bank, Ltd. (trust account)	4,396	2.49
Sumitomo Corporation	4,383	2.48
Sumitomo Life Insurance Company	4,227	2.39
The Hyakujushi Bank, Ltd.	4,198	2.38
Sumitomo Mitsui Banking Corporation	4,136	2.34
The Sumitomo Trust and Banking Co., Ltd. (investment account)	3,408	1.93

(As of March 31, 2006)

## Stock Price and Trading Volume: (Osaka Securities Exchange)



## CORPORATE DATE

Company Name:	Sumitomo Forestry Co., Ltd.
Founded:	1691
Incorporated:	1948
Paid-in Capital:	¥27,672 million
Head Office:	Marunouchi Trust Tower North 8-1, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8270, Japan Tel: 81-3-6730-3500 Fax: 81-3-6730-3504
Consolidated Subsidiaries:	47 (Overseas 12)
Associated Companies:	6 (Overseas 5)
Number of Employees (Consolidated):	11,997
Homepage:	<a href="http://www.sfc.co.jp/e">http://www.sfc.co.jp/e</a>
Independent Auditors:	SHIN NIHON & CO.
Transfer Agent and Registrar:	The Sumitomo Trust and Banking Co., Ltd. Stock Transfer Agency Department 4-4, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-8233, Japan

[As of March 31, 2006]

**For further information, please contact:**

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URL: <http://www.sfc.co.jp/e>