

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.



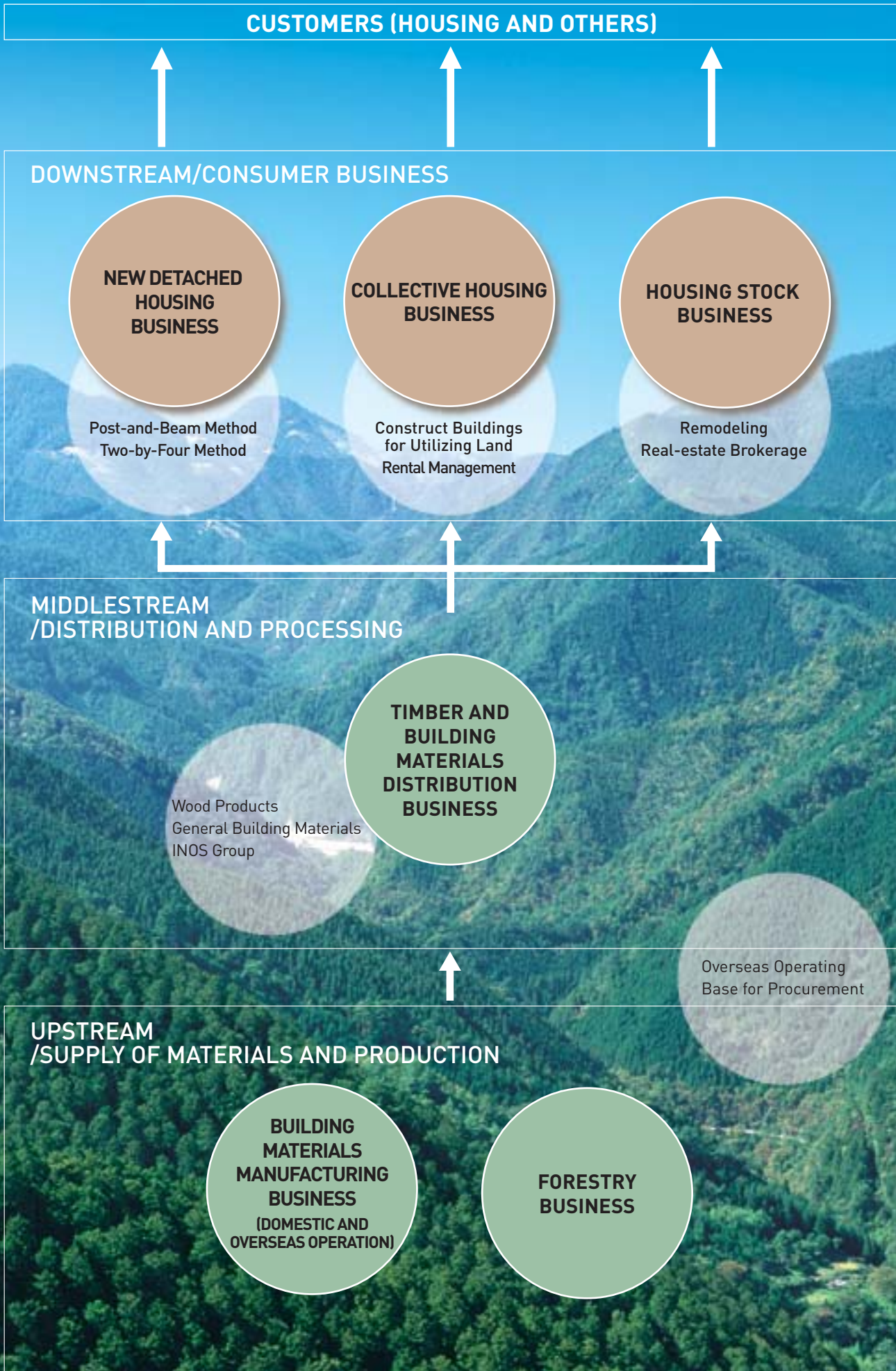
* The mark shown above signifies the “sustainable” efforts of Sumitomo Forestry.

CONTENTS

2 At a Glance	4 Financial Highlights	6 To Our Stakeholders	11 Special Feature	19 Review of Operations	29 Corporate Social Responsibility
36 Organization Chart	37 Overseas Network	38 Subsidiaries and Affiliates	39 Financial Section	64 Stock Information	65 Corporate Data

FORWARD-LOOKING STATEMENTS

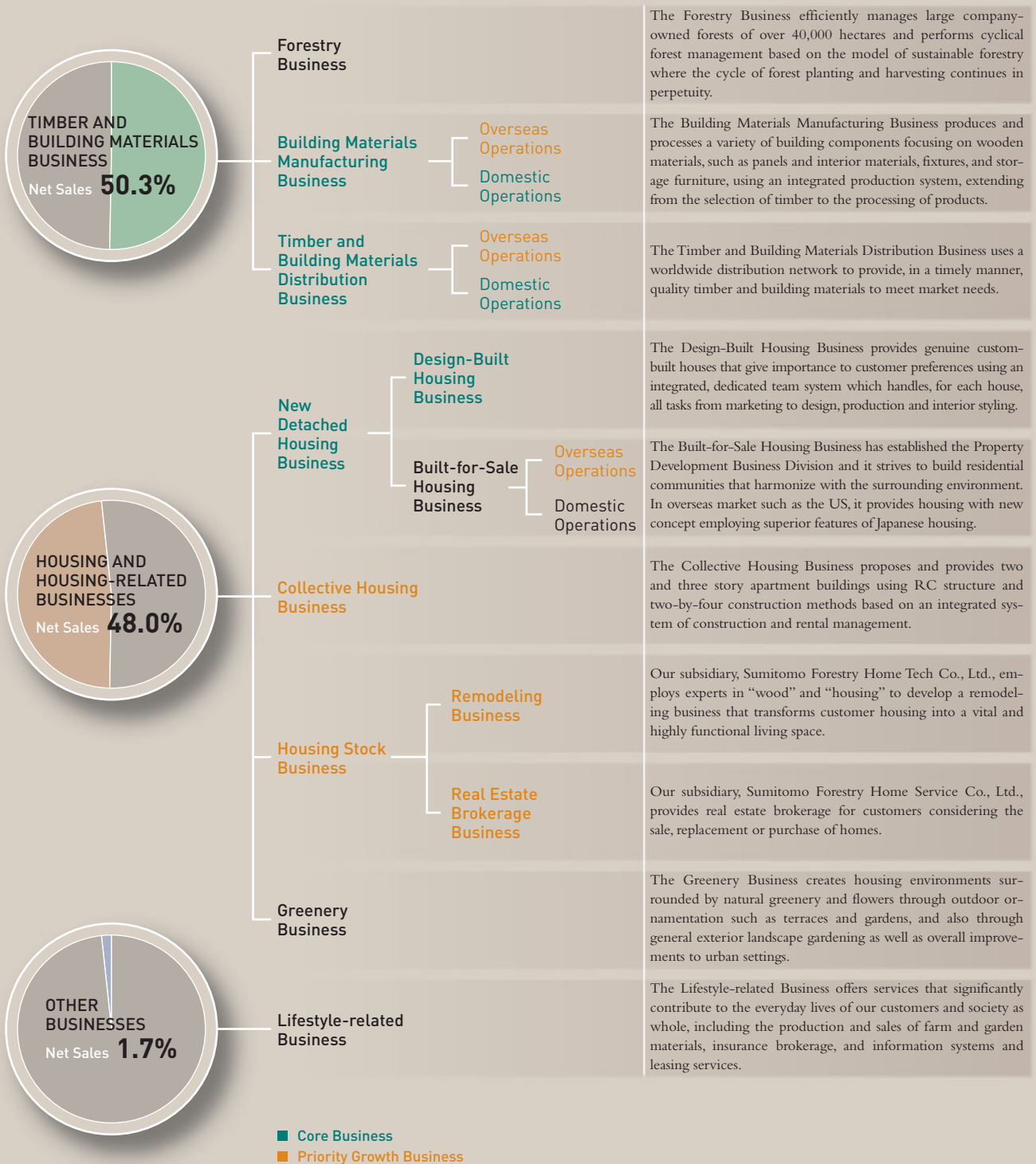
Statements in this annual report with respect to Sumitomo Forestry’s plans, strategies, and objectives as well as other statements that are not historical facts are forward-looking statements, based on management’s assumptions and beliefs formed in the light of information available as of the production 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.



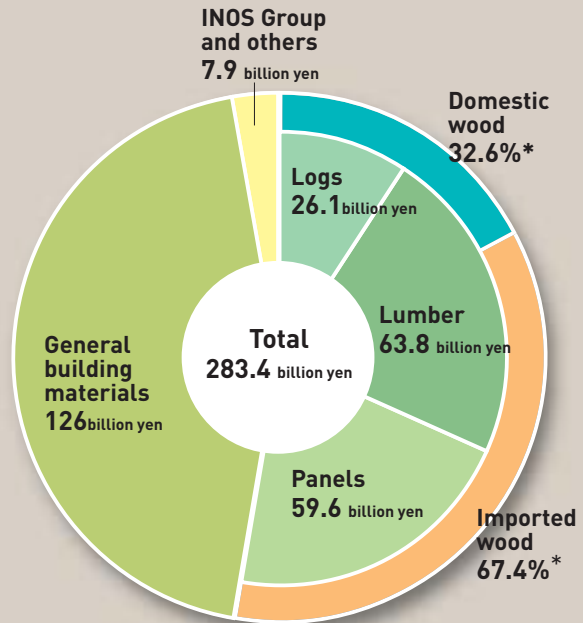
NO. 1 SALES VOLUME OF TIMBER AND BUILDING MATERIALS IN JAPAN

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

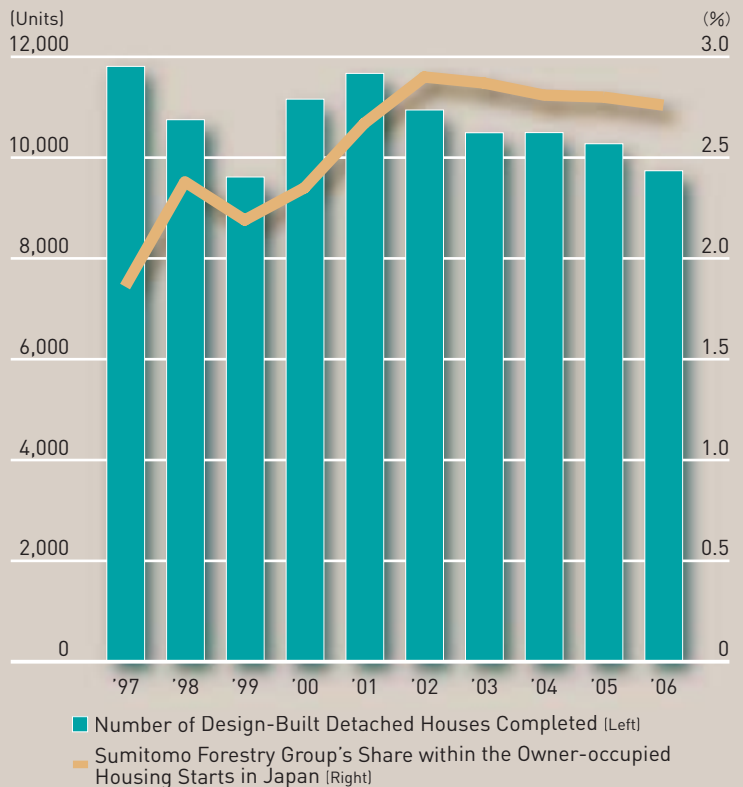
As an expert in “wood” and “housing”, the Group is providing design-built wooden houses.

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.

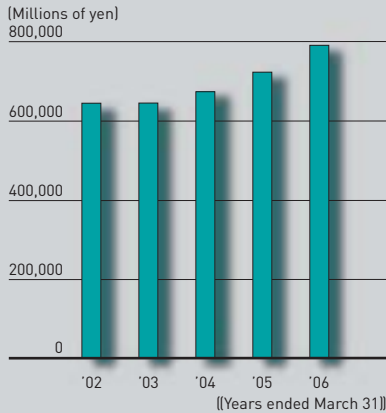
3. ROA and ROE are calculated using the simple average of beginning and end of term balance sheet figures.

ROA = Recurring income / Total assets

ROE = Net income (loss) / Shareholders' equity

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

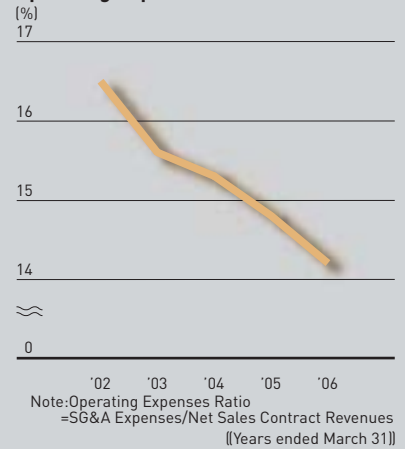
Net Sales and Contract Revenues



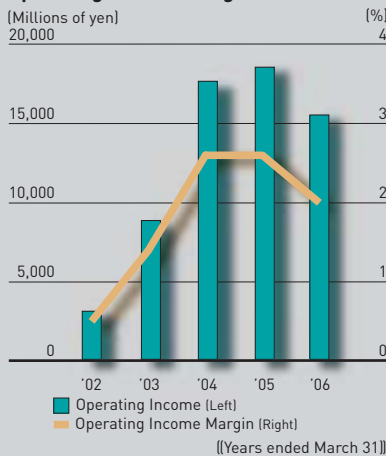
Net Sales

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 Expenses Ratio



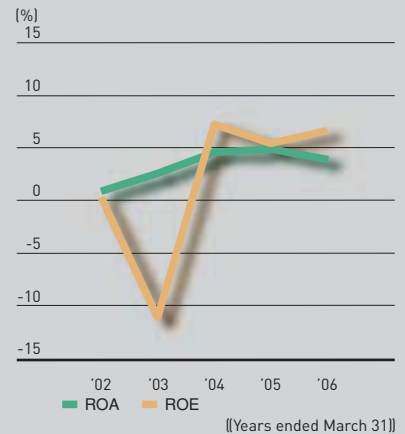
Operating Income and Operating Income Margin



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.

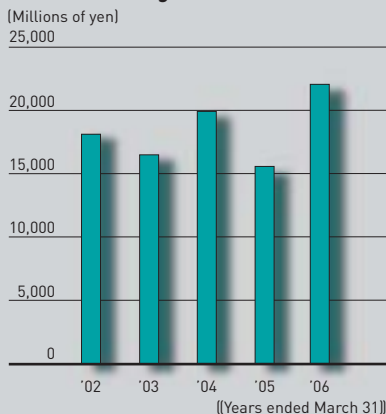
ROA and ROE



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.

Interest-Bearing Debt



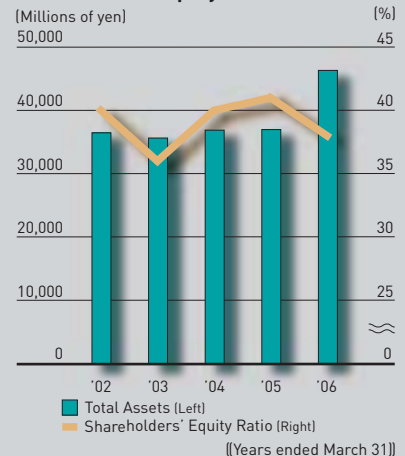
Interest-Bearing Debt

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.

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

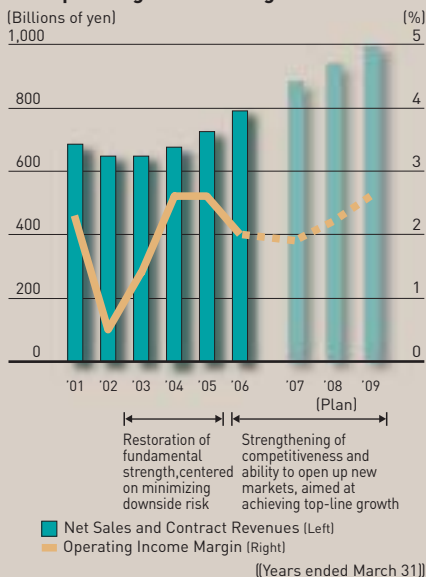
In fiscal 2005, the Japanese economy showed an expansion of corporate profits and capital investment as well as signs of recovery in the employment and personal consumption. In the housing industry, the buying trend of first-time homebuyers grew further due to low interest rates, falling land prices, 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.

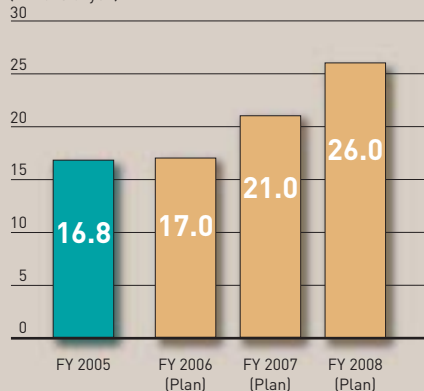
Housing and Housing-Related Businesses— Focusing Effort on a Qualitative Shift in our Marketing Approach

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

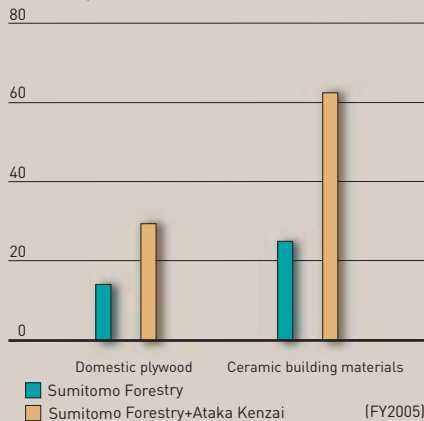
Our three-year Midterm Management Plan including fiscal 2006, aims to achieve a new profit record of ¥26 billion in fiscal 2008, surpassing the previous recurring

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

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

