HONDA

Investors and Analyst Session for FY24 2nd Quarter Financial Results Q&A

Date/Time : November 9, 2023, 17:00-18:00

Speakers :

Shinji Aoyama	Director, Executive Vice President and Representative Executive Officer
Eiji Fujimura	Executive Officer, CFO
Masao Kawaguchi	Operating Executive, Head of Accounting and Finance Supervisory Unit

----

Q : Analyst A

1. Please give us your assessment of the results for 1H. You have revised your FY2024 forecasts upward, although warranty expenses have incurred. Please explain your evaluation of 1H compared to your estimates of three months ago, including one-time costs and gains.
2. It seems that FY2024 forecast for profit of equity method has been revised downward quite substantially. Please explain this along with the situation in China. Please tell us about updates, such as strategy for the next fiscal year in China, including price competition.

A : Aoyama

1. About our evaluation on 1H results, we could not call it one-time factor, but there was a favorable currency effect, although the provision for warranty expenses was unexpected. We could suppose that the reform of the basic business structurer has been progressing as planed mainly due to structuring of lean fixed cost in automobile business, pricing that reflects cost hike and improving profitability of the new platform after the '21-year-model r. In that sense, we evaluate the 1H results positively.

A : Fujimura

2. The profit of equity method is negative because we have revised FY2024 forecast downward by 300k units, considering the 1H situation in China. As you all know, the market share of NEVs has been increasing. That made it difficult for us to compete in ICE market.
   We had estimated negative impact in the 1Qbudget to some extent at the beginning of the fiscal year. In the 2Q, the impact has become much more severe. This is due to the shrinking ICE market and, the fact that we faced higher competition especially in the B and C segment of SUVs. Sales volume has decreased more than expected and the FY2024 sales volume forecast has been revised downward by 300 thousand units to 1.1 million units.
   Therefore, retained earnings was decreased by JPY110.0B. It does not include the impact of one-time structural reform, but include the decrease of sales volume in China and the increase in incentive for supporting sales.

In addition, domestic affiliated companies have been considerably dependent on the market in China, and its negative impact is also included.

Although motorcycle business in Indonesia was strong, that was originally included in the budget to some extent. The negative JPY110.0B is mainly due to China.

As for the one-off factor of structural reforms, we have a production capacity of more than 1.7 million units including the BEV plant that will start up in 2024. Considering that the sales forecast for this year is 1.1 million units, and probably 1.1 million units in the next fiscal year and beyond, with the addition of NEVs, there is no denying that we have an excess of production capacity. We are considering taking some steps to address this issue. Since we need to proceed in careful dialogue with our partners.

Therefore, such related loss costs are not yet included in the forecast and we do not yet know whether they will be incurred in the current or next fiscal year.

Following question on 1.

Could you please provide some digital explanation? For example, all the higher-than-expected warranty expenses were offset by foreign currency effects, or so.

A : Aoyama

Following question on 1.

Effect of warranty expenses was offset by the exchange rate effect.

A : Fujimura

Following question on 1.

As for a numerical explanation, by comparing the forecast and actual results, the negative impact of warranty expenses is about JPY115B, and the positive impact of exchange rates is JPY125B; the balance is about positive JPY10B.

The approximately JPY50B impact on operating profit because of lower volume in North America and China was mostly offset by the positive impact of raw materials and selling prices. Positive JPY10B from the difference between foreign exchange effects and warranty expenses is added. 1H of the fiscal year was about JPY10 billion above the forecast.

Q : Analyst B

1. Please explain the situation in China.

The number of units was returning gradually. It seems that things were getting a little better, even if taking seasonality into account. However, according to the figures given to us, the forecast for the full year is 1.1 million units, which means the forecast for November and beyond is 360k units, as the result for April to October was probably about 740k units. In other words, over the next five months, it looks like it will drop considerably to about 70k units per month again. Please tell us a little more about the current situation. For example, forecasting very conservatively, or the figure will decline because of the considerable discounting?

2. Update on the demand environment in North America, including retail demand, mix and the demand shifting toward cheaper products. Also, please tell us about the situation at your company, including, for example, pre-order volumes and incentives. You mentioned that there is almost no room for production increase for 2H. If the demand for ICEs and HEVs increases further, how do you plan to respond?

A：Aoyama

1. In terms of the current situation in China, broadly speaking, brother models such as CIVIC's and INTEGRA, CR-V and BREEZE, ACCORD and INSPIRE are still extremely fresh right now. Although the ICE market is declining, the situation appears to be a bit better, partly because the models are fresh. On the other hand, the ratio of NEV, while not a perfect outlook, is currently in the high 30% range, up to about 37%. We see a very strong sense of slowdown in ICE. Since our focus is on ICEs and HEVs, we had to be a little more stringent in our forecast to make it realistic, and that made the forecast of 1.1 million units.
2. Regarding North America, we do not see much change in the mix in the market. The C-segment SUVs and CR-V are the focus, and among our products, HRV in North America, which is called ZRV in Japan, are performing well in the slightly lower segments.
   Regarding incentives, while data from Autodata and other sources differ slightly from the numbers we have, broadly speaking, the budget used in 1H was less than our original estimate of about USD1,000 per unit. We plan to prepare incentives with some leeway in 2H. On an annual basis, we estimate incentives to be a little more than USD1,000 per unit.
   We have already sent out a message that if the demand for ICE increased our factories would not be able to meet the demand. One of the 2 lines at the Marysville plant was shut down to prepare for the shift to BEVs. The total annual production capacity in North America at present is 1.65 million units, and the annual forecast of 1.62 million units is very closed to the full capacity, so we cannot increase production.
   Pre-orders are on a decreasing trend as semiconductors have recovered and production has picked up. They are currently in the range of 30k to 40k units.

Following question on 2.

If production capacity becomes tighter, is there a possibility that you will consider bridging with Japan again?

A: Aoyama

Following question on 2.

There is no possibility of that in the short term. For this year, it is not possible.

Following question on 2.

In the medium to long term, will you respond flexibly while keeping an eye on EV demand and actual demand?

A: Aoyama

Following question on 2.

We would like to consider such things.

Q：Analyst C

1. I would like to know the risks and opportunities for the revised forecast. I would like to know where you feel there is an upside or a downside risk for the plan that you have. In addition, during the media session, it was explained that one-time factor is also incorporated into 2H. I would like to know what is being factored in and image of impact.
2. I would like to know the demand for motorcycles and your company's concept of profitability. Although the plan has been lowered this time, there was talk during the media session that business in Vietnam will recover. It may be too early to say, but could you give us an idea of what kind of market environment you envision over the next fiscal year? On top of that, I think you probably have a very high profitability for motorcycles in 1H as well, excluding warranty expenses. I would also appreciate an explanation of how this might proceed.

A: Aoyama

1. Regarding the overall risks and opportunities, an opportunity is of course the impact of currency exchange rates. For this time, forecast was made with the assumption of$1=yen140. If this exchange rate continues, this will certainly be an opportunity. However, we expect the current trend of yen depreciation to change slightly in 4Q and thereafter. Also, although it's a little hard to tell, I do think there is some upside to the outlook for other currencies. Furthermore, as we have already seen in our results, we can expect some upside in the market for materials, especially precious metals. On the other hand, the downside factor that we have factored in is the sales volume of automobiles in China. As mentioned earlier, production capacity for automobiles in North America is full for 2H. 1H was also quite close to the upper limit of production capacity, but due to a delay in the supply of parts other than semiconductors, we were unable to produce a little over 20k units. While we would like to make a full effort to make improvement in those areas, there is a bit of a downside concern. As for North America, there are concerns about the world being in recession, but it is hard to say at this point how much of an impact it will have. Furthermore, we basically assume that the wage rate will increase, as in the UAW case. We are somewhat

concerned about those things as downside factors.

2. With regard to the concept of demand and profitability of motorcycles over the next fiscal year, as I mentioned in the media session, the market in Vietnam has been in a major decline since around the beginning of this fiscal year, mainly due to a slowdown in the export industry, amidst a deteriorating macroeconomic situation. The business in Vietnam is highly profitable, so the decrease in volume will have a significant impact on earnings. We are now of the opinion that the macroeconomic situation will begin to recover around 4Q. Increase in Brazil, where profitability is also high, is more than supplementing the demand in Vietnam. Brazil is extremely profitable, and with demand being extremely strong, our production is not keeping pace. In response, we will expand capacity, in 2H while keeping fixed costs as lean as possible. In this context, we expect upside in Brazil for motorcycles from the end of this fiscal year to the next.

   In addition, the current business situation in the developed countries such as Japan, Europe, and North America is very good, especially in Europe, where sales trends for new products are very strong. The balance between regions is extremely good right now.

A: Kawaguchi

Following question on 1.

Regarding one-time factors in 2H, we have reflect the reorganization of Yachiyo Industry Co., Ltd. Related expenses, which Mr. Fujimura explained briefly in the media session. As we have announced, Honda will once acquire Yachiyo through TOB, and then will sell it to SMRC Automotive Holdings Netherlands B.V. As a result of this process, Yachiyo Industry is included in our consolidated financial statements, and its book value, or shareholders' equity, is included in our balance sheet.

since the TOB price is published, you can roughly estimate it. The 2H plan reflects an impairment loss on fixed assets of approximately JPY40B to JPY50B , which is the largest one-time factor in 2H.

Following question on 2.

Regarding profitability, you explained that it is currently a little too good, probably at about 20%. Am I correct in understanding that this trend may continue in next fiscal year?

A: Aoyama

Following question on 2.

In Asia, I think we can maintain high profitability, although there will be increases and decreases.

In Brazil, we should be able to have high profitability in the medium term. However, our performance in developed countries tends to be affected by the performance of models, and they are quite dependent on how the freshness of a new model changes. If those factors in the developed world are working well, I think it will reach close to 20%, but without it, profitability will stabilize at the range of 15% to 16%.

Q：Analyst D

1. About the warranty expenses, it is explained that they are one-timefactors. However, the amount of money is quite large this time, including motorcycles. Please tell us the content. Is this an item related to a recall, or did you increase reserves? In addition, I would like to ask which region the warranty expenses were recorded for.
2. Regarding the factors behind the revision of the full-year forecast, the selling price and cost impact was revised upward by JPY129B. I understand that both the settling of raw material prices and selling price increase have a positive impact. However, I would appreciate a specific breakdown. As for the price increase, please also tell us in which areas the price increase being more widespread than in the past.

A：Aoyama

1. Warranty expenses are due to manufacturing defects related to engines with respect to automobiles and are mainly in North America. The recall was reported on November 8th, US time, which is today in Japan. This is a manufacturing defect related to the crank pin of the engine. For motorcycles, our understanding is that it is a market measure called a PUD, not a recall. This is a scooter-type specification problem in Indonesia because of a response to frame rust.

A：Fujimura

1. I would like to add something about PUD. Although the region where the motorcycle claims occurred was Asia, the cases were related to defects in product specifications, and since the counterparty was an affiliate company, the claims were underwritten by Honda, and the geographic segment was Japan. Regarding the impact of selling price and cost compared to the previous year, the largest impact is from lowering raw materials price, which amounted to about JPY80B. This is mainly due to precious metals, which affect all regions, but in terms of area, North America is mostly affected. There is also a JPY50B impact of cost increase to support suppliers as we did last year, due in part to inflation-related factors. This i affects the Japan and US segments.

   The increase in selling prices is about JPY100B from motorcycle sales in Asia and automobiles in North America. About JPY50B is the impact of selling price costs, and about JPY80B is the impact of raw materials, so all together, JPY130B in total.

Following question on 2.

In terms of raising the selling price, do you consider that you have already recovered most of the inflation and other increases that have been made so far? Or is your stance that the collection is still insufficient, so you are going to raise the price for the next fiscal year?

A：Aoyama

Following question on 2.

The collection in Japan is still insufficient. We would like to work a little harder to make the pricing commensurate with the improvement in product attractiveness.

Q：Analyst E

1. I would like to ask about the cash. Free cash flow from automobiles has been quite high through 1H, exceeding JPY700B, and at this pace, net cash from the automobile business will probably exceed JPY3.5 trillion at the end of the fiscal year. I think the share buyback announced at the beginning of the period is going well. Once again, please tell us your thought on shareholder returns in the future.

   Earlier you mentioned a bit about the need for structural reform, including in China. In addition to that, I would like to know in what way you will use the cash.
2. I believe there are reports on whether there is a collaboration with GM on so-called EVs in the mass-market segment. There is a talk that you will continue to collaborate on so-called large vehicles, including the Prologue and ZDX, but that your company will develop the mass-market segment on its own. Can you give us some background on this? Since your company is on track to develop its own so-called electric platform, is it your judgment that you can do it on your own? In predicting your company's electrification strategy for 2026 and beyond, I would like you to explain, to the extent possible, the background that led you to this direction.

A：Aoyama

1. In terms of shareholder returns, we maintain the concept of stable dividends and a dividend payout ratio of around 30% in the short term. We view the JPY200B share buyback in the current fiscal year as a possibility in the future from a short- to medium-term perspective.

   However, from a medium- to long-term perspective, considerable funds will be needed for battery EVs from the late 2020s onward, or for software defined battery EVs, or for resource circulation, the formation of ecosystems centered on battery EVs, and the expansion of value chains. It is clear that a significant amount of money will be needed. We have JPY3.5 trillion, but we would like to make a prudent decision while taking into account the necessary funds.

   2. As for the GM matter, of course Honda will proceed on its own, but the background behind

the discontinuation of development is difficult to put into a few words. In discussions about cost and merchantability, we came to a point of disagreement. The cost and merchantability of the product were ultimately cancelled from the standpoint of business feasibility, but on the other hand, there has been no change in the basic idea that we must develop a more affordable product in terms of price range. In addition to the unique platform for the next 25 years and beyond that we are currently working on, we are also in the process of deepening our discussions on the development of next-generation EV products.
Development costs are also expected to increase slightly if we are to go it alone, but we would like to shift resources appropriately, including the development costs of existing ICEs.However, there is no change in the fact that we would like to collaborate with GM in areas where we can achieve a win-win situation from a broad perspective, such as the fuel cell and automated driving-related discussions.

A：Fujimura

Following question on 1.

Regarding cash, net cash at the end of this quarter was JPY3.3 trillion, and free cash flow for operating companies was JPY700B for the half year, a level I certainly do not recall.
However, JPY700B does not mean JPY1.4 trillion for the full year. I appreciate you saying that it is about over JPY3.5 trillion. However, operating cash flow does not include losses, such as warranty expenses, for example, in 1H. It comes in as a negative cash flow in 2H.
Also, considering investments, R&D expenses, and, although we do not disclose it, investment-related expenses, the negative cash flow from investing activities will be much larger in 2H. With respect to this JPY730B free cash flow, we are projecting a level not exceeding JPY1 trillion for the full year.
In addition, there are various other factors in other areas, and I think net cash is around JPY3.3 trillion.
As Mr. Aoyama mentioned earlier, we would like to maintain our dividend policy of 30% continuous and stable dividends to shareholders. I would like to repeat the policy of continuing stability. We will also consider share buyback flexibly, considering the situation at the time.

Following question on 2.

As for the matter with GM, you say that the partnership will not change. Does it mean there will beno change regarding battery procurement, for example Ultium.

A：Aoyama

Following question on 2.

There is no change.

Q：Analyst F

1. Can you tell us again about your business in China? I am very aware that it is difficult because there is the other party. I would like to get some hints as to what steps can be taken with joint venture partners in response to the volume of 1.1-million-unit level plus the new EV base that will be built next year. Of course, there will be cost considerations, increased sales, exports, etc. I would like to have an update on China again.
2. The figure has now been revised to JPY1.2 trillion. However, if we consider about JPY50 billion for Yachiyo Industry and JPY115 billion for warranty expenses, can we assume that the actual value excluding foreign exchange and other costs is at the level of about JPY1.36 trillion or JPY1.37 trillion? Or, if there are other factors that may be contributing to the increase or decrease, I would be happy to know.

A：Aoyama

1. I commented earlier that we will increase the production capacity of battery EV in addition to 1.1 million units for next year in our China business. In reality, 1.1 million units almost consist of ICEs and Hybrids.
   If we apply the current market slowdown as it is, the volume of 1 million units for ICE alone will be quite challenging. We will be launching a total of four battery EV models next year, so the extent to which they sell in the market will determine how much we can add.
   To put it a little more simply, ICE products are on pace to reach less than 1 million units for the next fiscal year. I believe the success or failure of the battery EV will reveal how far up the volume will go in addition to that.
   We are also planning some exports, but in any case, there is no doubt that the fixed cost portion of ICE is getting heavier. Discussions are needed with joint venture partners on how to control fixed costs.
2. As for operating profit of, especially when compared to the previous year, the actual values have generally reached that level. In particular, the competence value of the automobile business is increasing. Apart from China, I believe the competence value of the automobile business is increasing in North America, Japan, and Asia.

Following question on 1.

Can you give us an update on China, for example, how competitive the market is in terms of price, or what the inventory situation is like?

A：Aoyama

Following question on 1.

Regarding the price aspect, the reality is that almost all companies are now spending more than CNY20,000 for sales incentives, the so-called "commercial policy" in China. It depends on the freshness and competitiveness of the model, of course, but for us, too, for the most part, we are losing sales incentives of about CNY20,000 per unit.

Naturally, if we raise the price, the volume will recover accordingly, but we are still considering the overall balance. There is some thought that we should increase the number of units even if we increase that more for the next fiscal year, but I think it is just a matter of overall balance. We do not plan to push forward with price competition unnecessarily.

Regarding the inventory situation, the inventories in our stores and at our manufacturing facilities tended to expand a little, but we are now trying to reduce them. This time 1.1 million units also incorporate such a perspective.

Inventory clearance peaked in early spring of this year, and compared to that, both store inventories and factory inventories are currently declining. However, the level remains high.

Q：Analyst G

1. You say that there is not enough capacity in North America, demand is weak in China, and probably because some of the semiconductors that were planned to be used in China are being transferred to Japan, so the number of units in Japan is increasing. Please tell me if we do not have to think any more that you could have made more than 4.1 million units without the semiconductor factor. This is a question about the balance between demand and the volume forecast.
2. I would appreciate an update on your company's perception of the current demand environment in the US. You have said a lot aboutbig picture, but can you tell us if you are aware that demand is still strong?

A：Aoyama

1. The semiconductor factor was still somewhat present in 1H from April to June, especially around 1Q, but now there is basically no longer a shortage of semiconductors that prevents production. Direct communication with semiconductor manufacturers and the development of alternative components are now fully functional, so this is no longer a problem at all.
2. Regarding the update on US demand, our macro-outlook is not perfect. On the other hand, Honda is currently in a good position in the model cycle, and the CR-V, CIVIC, HR-V (ZR-V in Japan) are doing very well. In particular, the hybrid CR-V and the hybrid ACCORD account for more than 50% of total sales. These models are performing well as planned.
   As for the in-store inventory, inventories of CR-V and HR-V are still very low.

Following question on 1.

Before the COVID-19 pandemic, your company originally reorganized its plants and built up a capacity of a little over 5 million units. The volume forecast for the current fiscal year is 4.1

million units, and the problem on the parts procurement side has been eliminated. If so, it appears that your ability has been declining from the ability of your company to meet the demand level of 1 million units that you have been seeing for some time.

Of course, I understand that you are struggling in China and this was not predicted at the time. Other than that, are there any other markets or areas where your company is aware of challenges?

A：Aoyama

Following question on 1.

In terms of recognition of issues, each country in Asia has its own production base and its own production capacity, and we have always felt that Asia is not making full use of its capacity.

However, in India, where there is a large gap between production capacity and the actual situation, we were finally able to launch a hot-selling SUV in the second half of the first half, and we expect this to continue for some time after the next fiscal year, so we are making such allowances in India, for example.

In Japan, semiconductors were not able to be turned around in the current fiscal year, especially in the first quarter. Daily production was also a little sluggish in the first half of the year. In that sense, the first half results for Japan were a little weak. However, from the second half of the year, we have been at full production. From the second half of the year, we will respond to back orders for vehicles that are currently awaiting delivery.