

# HONDA

Investors and Analyst Session for FY24 Financial Results Q&A

Date/Time: March 10, 2024, 17:00-18:00

Speakers:

Toshihiro Mibe, Director, President and Representative Executive Officer

Shinji Aoyama, Director, Executive Vice President and Representative Executive Officer

Eiji Fujimura, Managing Executive Officer, CFO

---

Q : Analyst A

1. You have mentioned that you aim to achieve OPM 7% one year ahead of schedule. Do you intend to increase the margin further, or will 7% be the cap for the margin, and you will enter a phase of so-called stable earnings where you will use the excess portion of profit for research and development expenses? Please give your thoughts on the future ROS assuming the current exchange rate to be 140 yen or so.
2. Price/cost impact was about 500 billion yen for both your results and forecast. The budgeted amount seems well-founded, but because the numbers are large, please explain the specifics. Other OEMs are taking a very hard look at the new fiscal year in terms of selling prices and the impact of inflation, so I would like to know more about the basis for the figures.

A : Mibe

1. I mentioned that we will achieve ROS 7% this fiscal year, but if we look at the previous fiscal year, our ROS was 6.8%. I believe that we have made considerable progress in terms of our ability to generate cash. We will maintain this level of overall output while we proceed to invest in R&D and capex towards 2 million units EVs by 2030. For FY24, both ROIC and ROE were above 9%. We may have a phase in the future where ROIC will be slightly below the cost of capital. However, we have set a target of having a structure that can earn money from the EV business toward 2030, specifically, a ROS of 5%. We believe that we will build the EV business by considering our resources, including cash, as input resources. I will explain how much investment we will make in the EV business at the "Business Update" on May 16<sup>th</sup>. Two years ago, I mentioned that we would invest 5 trillion yen for electrification and software by 2030. Since then, we have slightly changed our plan. In particular, we have

decided that we should aim for vertical integration in the area of electrification, and our recent announcement in Canada is a part of this plan. To realize this, we will have to increase development costs, including battery development. Also, we are planning to bring battery production in-house. This will increase the initial amount. I will explain in more detail on the 16<sup>th</sup>.

A: Fujimura

2. First, let me talk about the cost reduction area before the selling price. As you may recall, labor costs have increased for both domestic and overseas production, partly due to the impact in Japan and the UAW in the U.S. The total negative impact is a little more than 100 billion yen. However, we have been able to reduce costs in real terms, and we have been moving toward stable production, and we are continuing to reduce costs in the motorcycle business in Asia. Also, Civic has been on the market for a long time, so a decrease in depreciation will begin this year. A 500 billion yen increase in Price/cost impact is indeed large. The 100 billion increase in labor costs and inflation mentioned earlier is basically offset in this way, so that we have about 30 billion left over.

As I mentioned in the media session, the division of roles between dealers and manufacturers has been reorganized in the U.S. in anticipation of the age of electrification, and dealer margins have been changed. This difference of 470 billion includes about 80 billion of the profit on new vehicles that was previously given to dealers, but which is now returned to us.

And, as for the positioning of another box, the exchange rate impact is 200 billion, which is also a large negative. This includes about 100 billion from Argentina and Turkey, which will be from the impact of exchange rates and inflation. Basically, since this is an inflationary situation, we are thinking that the selling price will absorb the impact of inflation, so the 470 billion includes, to some extent, the recovery of exchange rates and inflation in these countries, which amounted to approximately 100 billion yen. Therefore, excluding the 80 billion change in dealer margins in the U.S. and the roughly 100 billion from the roughly 470 billion, I would like you to understand that the impact of selling prices is about 300 billion out of the total. In addition, in terms of budgeting, there are incentives for sales impact. In response to the recent situation, the incentive in North America was about US\$1,000 per unit in the previous fiscal year, however the budget has been set to with the assumption it will rise to US\$1,700 per unit. Whether to raise the selling price and add incentives or not, or not to raise the selling price and keep the

incentives low is something that we will work on together with American Honda during the budget process. So in short, this is how I position the selling price cost impact of 500 billion yen.

Q : (follow up to question 1)

As for the ROS part, I would like to know if you are assuming that the increase of those HEVs in the future will improve the overall profitability, and that the advantages of those EVs will be compensated for, and that we can maintain this 7% or so to some extent as we move toward 2030, or do you envision something a bit like a trough?

Q : (follow up to question 2)

Regarding the change in dealer margins in the U.S., would it be correct to say that to some extent the dealer profit level itself is at a higher level than before Covid-19 pandemic, and that even if the margin changes are made, the relationship with the dealers remains basically good.

A: Aoyama

1 Follow up

Basically, at this point in time, as of FY25, it can be said that the profitability of hybrids has increased considerably compared to the 2018 model. We will continue to sell hybrids that maintain the current rate of return until around 2026, and for the 2027 model year, we will introduce hybrids that will further improve product quality while also improving cost and profitability. In terms of hybrid sales alone, we will increase profitability towards 2030. However, we expect to increase sales of battery EVs so the sales volume for hybrid will slightly decrease.

As for whether or not there will be a trough, we are planning to start production and sales of full-scale battery EVs from the 2026 model year and at this point there is a possibility that there will be a slight trough around 2026 or 2027, but we are working on a plan to avoid this as much as possible. We believe that there is a possibility that there will be a slight dip between 2026 and 2028.

① Follow up

Regarding dealer margins, first of all, the relationship with dealers is fine. Now, compared to the past, in terms of in-store inventory, the dealer burden from inventory is considerably reduced - compared to the previous situation. In this and other ways, the dealers' business has not deteriorated at all, and in fact, they are in a better position than before.

Q : Analyst B

1. I think the 300 billion yen share buyback this time is a very large scale. Considering the sizeable increase in investment and R&D, I think it is a very high level and shareholder returns have been enhanced. It would very veery helpful if you could explain the background, etc., that led you to this.
2. The other day you announced an alliance with Nissan. I would like to know what you are actually seeking to do, what areas or timing, what projects, and what you are thinking about right now. I believe that this will be a very important project. In addition, you have gone so far as to talk about the vertical integration of batteries. I have the impression that you originally advocated a horizontal division of labor, so I would like you to explain what kind of change in strategy you have made.

A: Fujimura

1. Regarding the share buyback, as I have mentioned in the past, I have presented a separate analysis of P/B ratio of 1x in terms of the past, present, and future. The past is the time when capital-to-asset ratio was increasing, which needs to be restructured, the present is our waiting for the recovery of automobile earnings, and the future is the part that relates to further clarification of how we will shift to electrification.

The ROS for the fiscal year ended March 31, 2024 was 6.8%, which showed that 7% is almost in sight, but excluding quality-related factors and the impairment loss of Yachiyo Industry, the result would have been 7.3%.

We felt a good response at the ability to generate cash. Business cash flows rose to 1.4 trillion yen. About the future profitability, we will be using cash for R&D and other future

activities, so there will be periods of leveling off.

In order to show our earning power, we have presented the figures of operating cash flows after R&D adjustment. It was 2 trillion yen in the fiscal year before last and 3 trillion yen in the previous fiscal year and we are aiming for the same level this fiscal year. I believe that we are in a situation where we can finally make bold investments for growth. However, in terms of past accumulation, it is very important to optimize capital, given the current increase in profits. We have also announced a share buyback of 300 billion yen in order to strike a good balance between the current cash flow and the future situation. We are managing our business with great attention to capital efficiency, and with ROIC at 9.1% and ROE at 9.3%, we feel that we have been able to achieve figures that exceed the cost of capital. Since balance is important in everything, we would like to flexibly implement shareholder returns, especially share buybacks, while keeping a close eye on the situation. I hope you will understand that this is a strong message from management.

A: Mibe

2. When I became president three years ago, the idea was to produce EVs in a manner similar to the horizontal division of labor in order to first aim to stabilize battery procurement in each region. Later, when considering various EV expansion strategies, we realized that it would be difficult to gain profits if we had to procure batteries, which account for 30% to 40% of the cost of a single vehicle. There are a variety of battery performance differences, and in many ways, if Honda cannot properly control the performance of the battery, it will not lead to product competitiveness. In terms of stable procurement, we will not be able to achieve our goal of vertically integrating batteries unless we not only manufacture batteries ourselves but also take a vertically integrated approach that includes procurement of upstream materials. I hope you will understand that Canada, which we announced the other day, is a part of this integration. We would like to follow this approach in North America and Japan, but China has its own particularities, so for now, we would like to expand procurement with a focus on CATL. We are currently studying strategies for Asia and other regions, and we would like to talk about them when we have a clear direction, but basically, we would like to continue to proceed with a vertically integrated battery business.

Regarding the alliance with Nissan, on March 15th, we announced that we would comprehensively consider the possibility of an alliance in the areas of in-vehicle software,

components related to battery EVs, and mutually complementary products. Since then, we have divided things up and have been meeting with several groups on a frequent basis. As of today, we do not have a definite answer to your question, but there are some possibilities, such as batteries as I mentioned earlier, and in the area of software, we are looking into the possibility of developing a system that includes automated driving in preparation for software-defined vehicles, or semiconductors to run such software. Engineers in charge of each area are currently working on the details of how we can create a win-win situation for both companies, including the batteries and software for software-defined vehicles as well as semiconductors to run the software. In the future, I will be able to elaborate on the areas where we have reached the conclusion that we can make this work, but as of today, I would like to ask for a little more time. Please note, however, that we are highly focused on reaching a conclusion in the short term and have no intention of stretching talks out just for the sake of finding some way that Nissan and Honda can work together. In addition, we are considering how to proceed with an alliance, taking into account the possibility that vehicles will change considerably, including the value of software-defined vehicles at a specific point in time like 2030.

Q : Analyst C

1. Regarding hybrids sales, I heard a figure of 800,000 units at present, which will be increased to 1 million units, and 2 million units in the future. I would like to confirm when the timing of these respective figures. Also, when is the peak expected to be reached? In addition, you said that the profit ratio is equal, but that the profit of hybrids is higher than ICE when considered in terms of revenue base.
2. My understanding is that the actual profit margin for the current ICE and hybrid automobile business in FY24 is about 8%, so if I roughly calculate backwards I see a deficit of about 350 billion yen, or perhaps an up-front cost, due to the upfront investment in EVs. If this is correct, to what level will this upfront investment in EVs expand toward 2026? You mentioned that there is still upside to this 8% ICE and hybrid profit margin, but I would like a more in-depth explanation of where this driver lies.

A: Aoyama

1. Regarding hybrids, the current budget for FY25 calls for approximately 1 million units, or 25% of all vehicles, or one in four vehicles, mainly in North America. The future sales volume of 2 million units was a slight exaggeration, but we currently foresee the peak at between 1.7 and 1.8 million units in 2030 or in the 2029-30 timeframe. The number of BEVs in that 2030 timeframe will exceed 2 million units. From that point onward, we are assuming that battery EVs volume will increase further, so the position of hybrids will gradually decline. The current situation is such that hybrid models are set at a trim level with a higher price, so the rate of return is the same, but the amount of return appears to be larger for a hybrid. As for hybrids, the current rate of return is positioned to be about the same as ICE, and development is now underway with plans to make hybrids even more cost competitive from the 2027 model year onward. We are currently developing the 2027 model on the premise that we will increase cost competitiveness and improve product appeal, so hybrids will become even more attractive. So, the business potential of hybrids is expected to improve even more in the late 2020s.

A: Fujimura

2. I do not think that the position will change much, but I mentioned 8% on a FY25 basis, and I think that the upfront investment and R&D portion of EV will naturally appear as such if we calculate backwards, but I think that we are spending a little more on R&D expenses, although the way in which R&D expenses are allocated is also a matter of debate. Toyota recently said that it would spend 1.7 trillion yen, so we looked at how much we are spending. If we include investments and other items, as well as investments related to the future, such as the investment related to Canada, the cash level is roughly around 1 trillion yen, which is the total amount of resources we plan to invest in current fiscal year. For further details, I would appreciate it if you could wait until May 16.

Q: Analyst D

1. With regard to China, the impact on profit of equity method will deteriorate considerably in the current year's plan, but I would like to ask whether it will fall in the area of pure business operations and lower prices, or whether it includes some restructuring such as one-time costs. If possible, I would also like to know the number of units planned for the joint venture in China.

2. In the fourth quarter of the last fiscal year, the motorcycle business maintained very high profitability despite the seasonal decline in sales. Please explain the direction of profits in the motorcycle business for the current fiscal year. We would also like to receive additional comments on how you see the volume of motorcycles in each region and country this fiscal year.

A: Aoyama

1. You are right that the situation is worsening in terms of profit of equity method. First of all, we are planning to somehow maintain break-even in the business. In terms of the number of units, we have set a plan of 1.06 million units for this fiscal year, of which 90% or slightly less than 1 million units are so-called ICE sales.

It is difficult to foresee how far NEV sales will grow, as it seemed to approach 50% in March and April but has been in the low 40% range since the second half of April. We expect the ratio of NEVs to rise to the mid-40% range, and we will continue to sell ICE models while maintaining a firm share of the market. As for electric vehicles, the e:N2 series will be rolled out first in H1, followed by the new Ye series in H2. We would like to gradually increase the number of units, mainly in that Ye series, to secure a level of 1.2 million units in the future.

Since we have included some one-time costs in the forecast, profit of equity method will be negative for the China business in general. However, it incorporates one-time costs mainly for production optimization and production process cost optimization.

2. Regarding motorcycles, we will basically maintain high profitability. Drivers that maintain high profitability are Brazil, Vietnam, and Thailand. Profitability in these three countries will remain extremely high, and even within these countries, there is still room for further growth in Brazil. After the Lehman Brothers collapse, the market temporarily fell sharply, and at that time, we undertook a large-scale restructuring in 2010s to narrow our production capacity.

In contrast, the market is now on the road to recovery again, but we will be cautious about making significant capital investments. The operations in Brazil have a very high ratio of in-house production, and we will increase our production capacity by successfully turning some of it over to outside production. With this, we hope to increase our



production capacity from just under 1.3 million units in FY2024 to 1.4 million units by the end of FY2025, and to produce at full capacity.

While Brazil, which has high profitability, will steadily increase its production volume, we are looking at a slight decrease in Thailand due to some finance related risks, but we will maintain high profitability.

In terms of concerns, the macroeconomic situation in Vietnam has not returned to normal. This year, we made our plan on the assumption that the macroeconomic return would probably be in 2025.

Separately, we are planning to increase the total number of motorcycle sales by about 1 million units for this FY. In the first half of FY24, the volume in India was slightly sluggish due to measures taken to ensure regulatory compliance and other factors, but this will not be the case in FY25, and the current situation is such that the company will go all out. In terms of business, the current situation is that double-digit profit margins for motorcycles in India are now within sight.

#### A: Fujimura

1. As explained by Mr. Aoyama, with respect to China, we have reduced employee headcount by 3,000 including natural attrition at GHAC, WDHAC and also at our subsidiaries as we stated we would last fiscal year. As a result of the budgeted allowances for impairment losses and non-natural personnel cutbacks in order to reduce the production capacity to 1.2-million-unit level for this fiscal year, we are basically planning for a two-digit billion-yen loss for the China business. Excluding the one-time costs I just mentioned, the result will be almost same for this fiscal year, together with the parts business, compared to less than 1.2 million units up to last year. We will have to do it again if the volume drops further in the next fiscal year and thereafter, but if we can achieve this volume assumption, we plan to be in a positive position from the next fiscal year onward because we will benefit from the fixed cost reductions.

Profit of equity method is planned at JPY10 billion. Although until now we have only had to consider the China business, I would like to explain a little about its composition. As before, the motorcycle business in Indonesia has a profit of roughly JPY40 billion, while in China there is a two-digit billion-yen loss this time around. Another point for the time being is that Sony Honda Mobility is in the development stage for a while, so Sony and we will be charging development costs. I can't give you figures because we have

counterparts, but the negative figure will also come in for a while. We hope you will understand that the future equity interest will be structured in this way.

Q: Analyst E

1. Looking at the incentive figures from external data such as Autodata, Toyota, which claims to be strong in hybrids, is still holding back on incentives, while your company's incentives are quite high compared to the previous briefing, despite the fact that we were told at the last briefing that your incentives for hybrid vehicles are half those for gasoline vehicles. Since you mentioned that you have budgeted about \$1,700 for this fiscal year, I wonder if you could be more specific about how this actually works out in practice.

2. I would like to reconfirm the strength of your company having motorcycle business. Since I have been covering your company, I have heard that the motorcycle business is great and the automobile business is a bit unsteady, and that together, they are now aiming for an operating margin of 7%, for example. It is difficult to see what kind of synergies have been generated between motorcycles and automobiles, except for those that are easy to see from the outside. I believe that it would be a shame if resources are being utilized in this way but fail to be reflected in the stock price simply because they are not adequately communicated to the public. For example, Vice President Aoyama has a history of laying the foundation of the motorcycle business in India, and I would like to know more about how the strengths of the motorcycle business can be applied to the automobile business.

A: Aoyama

1. Regarding the profitability of our hybrid business, hybrids in the U.S. are currently performing very well. In FY24, there was a slight problem related to parts logistics, including for PCUs and power control units. It could be said that we didn't have a sufficient supply of parts. If we look at the current ratio, the CR-V, which is our main product, hybrids account for about 55%, while the ACCORD accounts for less than 40%. Since some of the sales have been shifted to the CR-V, about half of the sales are hybrids. We plan to launch a Civic hybrid model in June of this year, and the three

hybrids are positioned to increase in terms of both profitability and the amount of revenue.

To be honest, I have not always been able to explain well why Honda's incentive figures are high in relation to Toyota's figures for Autodata in this context. However, our actual spending figures are not unreasonable, and last year's results show that the spending per unit for hybrid was approximately half of what we spent for a gasoline model. This is the trend that we plan to follow this year as well. However, in terms of the total amount, the actual incentive for the Honda brand alone was approximately \$900 in FY24. In terms of budget appropriations for FY25, we have budgeted \$1,300. Since battery EVs will be added to this amount, the average incentive for the Honda brand will be 1,400 dollars. For the US as a whole last year, it was just under USD1,100, and this year's plan is about USD1,700 per unit. I am not able to answer the question about the comparison with Toyota when it comes to Autodata, but I hope you understand what I'm trying to say.

A: Mibe

2. As you pointed out, unfortunately, we have not achieved much in the way of synergy effects with our past and present products, to be honest.

We are engaged in various activities to create synergy between motorcycles, automobiles, and power products in the area of research activities, including the Monozukuri Center and HG's research laboratories. For example, we now have a motorcycle engineer in the HG Research Institute, and we are developing technologies to use electrification technology for both motorcycles and automobiles for the future. For example, the all solid-state battery now under development has a very high density of output capacity and is particularly suited for motorcycles. We are developing such products with using them for two-wheeled and four-wheeled vehicles in mind.

We are also researching paint-less resins that can produce beautiful colors without painting, for example. We are thinking that such things could also be used for motorcycles and automobiles. We are also researching aluminum resin and steel as sustainable materials, and such materials could be used commonly for both motorcycles and automobiles. We will continue to develop such common technologies in the future. So, in the area of R&D, we believe that Honda's strength of having both motorcycles and automobiles can be gradually demonstrated in the future toward 2030.

We are also talking about the possibility of standardizing digital twin development

methods and development tools. We will continue to move forward strongly to maximize synergy effects. We would like to move forward so that we can say that we have achieved overwhelming competitiveness through these wonderful synergies by around 2030.

Q : (Follow up to question 2)

I believe that having motorcycles is one way to differentiate your company in the four-wheel business, so if you are working on such a plan, please be proactive and incorporate it into the dialogue.

A: Mibe

2 Follow up

I hope to be able to tell you about such planned effects as soon as possible.

Q : Analyst F

1. I would like to ask you to reiterate the risks and opportunities in the company's plan for the new fiscal year. Since we have received a message that the operating margin is 7%, I think it is safe to understand that the plan is reasonable to some extent, but if there are areas where there is a possibility of a slight upward swing, or conversely, concerns about a downward swing, other than foreign exchange assumptions, I would appreciate it if you could provide some detail.

A: Aoyama

1. First of all, we are assuming 140 yen for the exchange rate. However, while many other companies have set the exchange rate at 145 yen, there is a possibility of 70 billion yen only against the U.S. dollar alone.

However, it is difficult to know what will happen with other currencies or cross rates, so we have indicated a negative impact of about 200 billion yen in terms of earnings change

from FY24 to FY25, as shown here. I think we can say that there is a possibility of such a return depending on the situation of other currencies.

Furthermore, there is an upside in the expectation of various tax refunds and other benefits. The downside, however, is that there is no end to the list of possibilities and although we were not talking about the exchange rate earlier, we cannot deny that if the yen moves in the opposite direction, the yen could rapidly appreciate in the opposite direction, such as if the U.S. government were to cut interest rates to an extreme degree and the yen appreciates even further. In terms of our core business, our automobile business is in an extremely difficult position in the Asian and Chinese markets. We cannot deny the possibility that competition will intensify, and we see this as a downside possibility.