

# HONDA

Investors and Analyst Session for the Fiscal Third Quarter Ended December 31, 2024

Financial Results Q&A

Date/Time : February 13, 2025, 17:35-18:40

Speakers :

Shinji Aoyama            Director, Executive Vice President and Representative Executive Officer

Eiji Fujimura            Director, Managing Executive Officer

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Q: Analyst A

I would like to know your evaluation of the current October to December financial results. I don't think there are any major one-time items, though. Then, I would appreciate a few comments on the financial outlook for Q4 in terms of risks and opportunities.

A: Aoyama

From a numerical point of view, the Q3 results were almost in line with the plan, except for the impact of foreign exchange rates. Although we have not announced the specifics of our plan, our true feeling is that our original plan for Japan was too aggressive. The part that was planned in Japan caused a slight decrease in the number of units. On the other hand, the extremely strong sales of motorcycles, including some cost reductions, offset the negative impact of the Japanese market. The other positive factor was the foreign exchange rate, and the fact that there were no major one-time quality costs in Q3 also contributed to the fact that the results were in line with the plan. For Q4, in terms of risks, we have not included the new administration-related issues, such as the Mexico/Canada issues, which has been postponed to March 1, or rather, extended slightly. In that sense, I think it is safe to say that this is a risk. Also, there is a matter related to battery EVs, especially battery EVs in the US. I mentioned at the time of the Q2 results that there would be an impact of approximately JPY100 billion on the previous forecast, but that impact itself has been slightly reduced in the current situation.

On the other hand, we have included a reduction in the supply of GM, our supplier, as one of the reducing factors, and this includes some compensation on which we have to negotiate. We have not included this in the figures yet, and I think this is another risk. In terms of opportunities, in Q4 and for the full year as well, JPY152 in the foreign exchange rates may be an opportunity. We would also like to see a further increase in the volume of motorcycles, but it is true that we have put the volume of motorcycles in a lot this time here, so I do not think it will turn out to be like that.

Q: Analyst B

I would like to have a little update on battery EV's strategy or approach over the next fiscal year, to the extent possible. You are currently reducing the supply from GM, and I have the impression that you would like to allocate expenses during this fiscal year so that you can continue this reduced volume into the next fiscal year. In addition, I think that new administration is making it more likely that battery EVs will slow down. To the extent possible, I would appreciate an update on your battery EV strategy for the next fiscal year, especially in North America.

A: Aoyama

The battery EV strategy for the next fiscal year is a very difficult one, especially for the US. In the US, it is really difficult to predict what policies the current administration will come up with. However, as you pointed out, we are planning to develop the models supplied by GM in a more focused manner in the next fiscal year.

On the other hand, the 0 series which has been announced at CES and other events and Acura's new battery EV based on it will be launched in the late H2 of the next fiscal year, which means that it will be launched during the next fiscal year. Right now, of course, we are working toward that, and our joint venture with LGES, a joint venture battery plant, is starting to operate at the end of 2025. We are still in the process of discussing the volume and other aspects in this area, and it is very difficult to clearly state how we would like to do at this point. As is the case with the joint venture with LGES, we would like to ensure a certain level of sales once we start, but in fact, the situation is very uncertain, including the IRA tax credit. We would like to be able to respond flexibly while keeping a close eye on the situation. Also, in terms of battery EV strategy, in China, it is true that sales of gasoline-powered vehicles have been declining for some time, and we will finally launch a battery EV model this March and April. The styling and interior space of the battery EV model have been highly acclaimed so far, but we would like to make sure to what extent this will be a viable business.

Q: Analyst C

1.

You will continue to buy back your own shares this time. What are your thoughts on this? I think that there was some discussion in the market that the share buyback would be cancelled if the MOU for a business integration was terminated.

2.

I would like to know if you could tell me how you will compete in the US this year. According to your plan, you are aiming for sales of 1.5 million units, up 5% from the previous year, so I would like to know the situation in the US, including incentive controls, model plans and current incentives.

A: Fujimura

1.

As for the share buyback, we announced it on December 23, and basically the timing of December 23 was just right to be insider free. If we miss that timing, we will not be able to buy back any of our own shares until the summer of 2026, when the management integration will be completed, because we will have insider information again. It was only possible at that point in time. In order to achieve a P/B ratio of 1x, we had to quickly eliminate the accumulation of 2.5 months of net cash, which is JPY3.8 trillion. We have been aware of the need to promptly resolve this issue even before the integration. To achieve this, we announced the share buyback at the timing of being insider free, and the management integration had nothing to do with the financial strategy. Therefore, we will continue to do so this time. After completing the JPY1.1 trillion share buyback, the net cash level will be about one month's worth of sales, which is about what we are aiming for. Since the denominator of the capital adequacy ratio is large, it will take time to correct the situation.

The reason we are able to do this is partly due to the volume of cash on hand but also due to our ability to earn cash in the future. The reason we are able to do this is partly due to the volume of cash on hand but also due to our ability to earn cash in the future. This year, as of the end of the first nine months, operating cash flows before R&D reached JPY1.9 trillion, and for this fiscal year, the earning power will be about JPY3 trillion as planned. For the future, we will invest in battery EVs. In the meantime, the operating profit of ICEs and HEVs is actually about 8%, as I mentioned earlier.

We believe that ICEs and HEVs alone have considerable earning power and that cash for investment for growth can be generated in automobiles alone. We are confident that our ability to earn such cash has increased, and we intend to achieve JPY1.1 trillion in this way. As of the end of January, we achieved about 17% of our JPY1.1 trillion goal. We will achieve this goal fairly soon. In any case, we will proceed as planned.

A: Aoyama

2.

As for how we will do in the US in 2025, we are actually in a trough in terms of our mainstay models. Of course, there are mainstay models, and for this year, subcompact Acura SUV will be introduced. The announcement has already been made. Or as a new model, Passport is going to be sold in earnest. It is a large two-row SUV. These are the main focus. We have also the Civic Hybrid, which was introduced in the middle of last year, and this will have a full effect. In the US, we will steadily sell these main models including CR-V, HR-V, and Civic. We will sell them with a focus on hybrids. In terms of profit forecast for this fiscal year, if we deduct the battery EV business, including development costs and sales, the ICE business, including hybrids, is actually at a level where we can generate an operating profit of approximately 8%. We recognize that this is a considerable improvement over the past. We would like to steadily sell hybrids in the US this year as well. In North America alone, we will sell approximately 400,000 units of hybrids in the fiscal year ending March 31, 2025. For the next fiscal year, we aim to sell approximately 500,000 hybrids, which means that our current expectation is to increase the number of hybrids by about 100,000 units. In terms of incentives, hybrids are still doing business with about half the incentives compared to regular gasoline vehicles. As a result, in terms of profitability, gasoline vehicles and hybrids are generally the same, so we would like to focus on hybrids, which have a strong demand. The current level of incentives has been slightly higher than last year, including procurement costs. However, the overall data that you see in Autodata includes the battery EVs, so if you exclude them, they are USD1,100 for Honda-branded ICEs or HEVs, excluding Acura. Of that, those for HEVs alone are less than USD850. For gasoline vehicles, incentives are now around USD1,400.

Q: Analyst D

1.

I would like to ask you about North America, especially for the regulatory-related matters. The acquisition of credits, including battery EVs supplied by GM this fiscal year, means that you would prepare for the future. On the other hand, I think that the situation will get tougher, although I am not sure how CAFE, GHG, and other factors will change under new administration. I have heard comments from other companies that the cost of compliance with North American regulations will grow a little from the next fiscal year onward. I would like to know about your current situation and whether the cost of complying with these regulations will be a hindrance to your business in the next fiscal year.

2.

I believe that the motorcycle business was also very profitable in this Q3 alone. There have been reports of a slight slowdown in the motorcycle market in Indonesia and some other emerging ASEAN countries, so I would like to ask you to comment on the current situation and the outlook for the motorcycle business for the next fiscal year.

A: Aoyama

1.

About North American regulations, which is about CAFE, GHG, and ACCII, first, speaking in general, I think that ACCII is a higher hurdle than CAFE and GHG. Not only for Honda but for the market as a whole, ACCII is a significant hurdle. In fact, I think that the hurdle is quite high and far from the actual situation. In this sense, it is very difficult to say, but we believe that ACCII itself will have to become more realistic. However, as we enter the ACCII stage starting with the 2026 model year, we have been planning our unit sales based on the assumption that we must sell a considerable number of vehicles in the ZEV states, but now we are watching the trend closely and are prepared to change flexibly. We will announce our plan for the next fiscal year at some stage, but at this point, we do not have an exact plan for battery EVs for the next fiscal year, especially in terms of unit sales, as of today. However, as for preparations, the factory as a joint venture with LGES will finally be launched and run in the fall, and we are ready to do so. Several models of battery EVs will be launched in the next fiscal year and beyond. We are taking a flexible approach, and while we will naturally improve business feasibility compared to the battery EVs currently supplied by GM, we would also like to pay a close attention to regulatory trends to operate flexibly. I am sorry that this is not a clear answer, but that is how we see it now. I am also very concerned about USD7,500 related to IRA, but I can't give you a precise answer because we can't see it.

2.

As for motorcycles with high profitability, in India, we have finally come to the level where we will take the number one position in terms of market share. The reality is that in some months in the past year, the volume has been higher than that of Hero MotoCorp, the number one company. I believe that we will be number one in India this year or so, and our profitability in India has also improved significantly compared to the past. The current situation in India is that it has become easier to take the lead in terms of price, including the implication that the leading position is becoming much stronger. In addition, Vietnam is a very profitable market to begin with. Last year and the year before, Vietnam had a very difficult time from a macro perspective with its export industry slumping, and we were very cautious about 2024. However, from the middle of the year, there has been a sense that the economy is making a strong comeback,

and we expect it to continue in 2025. Although we recognize that the economy in the south, centering on Ho Chi Minh City, is still a bit stagnant, we believe that Vietnam is very promising. Brazil is also earning high profits market. Once the market in the late 2010s became very sluggish, we streamlined our production capacity to the point where we could not produce much. The result is that supply is now having a hard time keeping up with demand. Toward the end of this fiscal year, we plan to raise production capacity from the existing level of 1.35 million units to about 1.4 million units, and then, I think it is safe to say that we plan to raise capacity again to about 1.6 million units by the end of next fiscal year. Currently, our market share is slightly below 70%, but we believe that our potential is close to 80%, so there is still a great deal of room for growth in the next fiscal year. The Philippines, Pakistan, and other markets that have not been major players in the past are booming, and we can expect further expansion in these areas as well. That is all.

Following question on 1.

You mentioned 400,000 to 500,000 hybrid units in the US, so am I correct in assuming that under the current situation, you will be able to meet the CAFE and GHG regulations?

A: Aoyama

We are not that worried about CAFE and GHG yet in the short term, but it is true that in the long term we need to worry. We are still not really sure how that will change in new administration.

Q: Analyst E

1.

For example, you are undertaking a large survey for the connecting rods in the US. What are your thoughts on the higher quality costs, and how will you control the increase in quality costs in the future?

2.

From what I have been hearing, I am concerned that your company's strategy for SDV is very self-supporting. I definitely appreciate the ability to make money with hybrids and ICEs, but this SDV strategy doesn't seem to be convincing. If possible, I would like to know a little bit about your thoughts on this.

A: Aoyama

1.

As for the V6 engine issue that you mentioned, as far as we are aware, NHTSA is investigating whether the scope of recalls in the past, RQ9(Recall Query), was correct. This is different from the so-called open deficiency investigation. Rather, we recognize that this is part of the post-measures verification process. However, there are no guidelines at all on how long the survey will take, so we are actually not sure how it will turn out. We are cooperating fully with the NHTSA investigation, and our current understanding is that nothing major will happen as far as our analysis is concerned.

A: Fujimura

1.

The amount of money became larger because it was shared. Recently, we have seen that the number of affected vehicles has increased due to the multiplication of the number of units because they are shared. We have begun to take measures to deal with quality issues by upgrading the quality division to a higher level in the form of a reform headquarters, which includes quality governance. As quality professionals, they are taking measures to reduce the number of quality problems that may occur in the future from the stage of development.

A: Aoyama

1.

Just in terms of specific numbers, or in terms of the level not including reimbursement, it varies from year to year, but in the last fiscal year, it was a few percentage points above 2% in gross. For the current fiscal year, we currently see it as 1.5% in gross. 1.4% to 1.5% depending on the year. Therefore, we cannot necessarily say that the past two to three years have seen high percentages. However, as Fujimura mentioned earlier, it is true that as a single standard tends to become more common and it spans multiple models and regions, the scale is becoming larger.

2.

As for SDV, in terms of how we have the ability to develop software, for example, as I have said before, we have a development team of about 10,000 people for around 2030. The development team includes cooperating partners, and about 5,000 of them are Honda's internal personnel. The remaining 5,000 are from SCSK, KPIT in India, and other places. We are now in the process of proposing to divide upstream, midstream, and downstream software development among them and to work in each of these areas. Recently, Honda announced that

it is working with Renesas to develop a new generation of battery-powered EVs for the late 2020s or a generation that goes even further, which is centralized ECU-oriented. We have also said that we are going to work with Renesas to develop a SoC with Honda's own design. I think it's more like an initiative to improve software development capabilities and the cost competitiveness of software-related electronic components in the course of software-centered development. In the area of raising the competitiveness of electronic components in software, for example, the reason why we want to develop our own SoCs is because it is not cost-effective to use general-purpose SoCs from companies like Qualcomm in terms of power efficiency and cost per processing capacity.

Q: Analyst F

The operating profit for ICEs and hybrids is calculated to be about JPY1.1 trillion when the operating profit margin is 8% and the automobile business is about JPY14 trillion. However, the automobile business for this year is probably around JPY500 billion, so that would mean a loss of JPY600 billion for battery EVs, which I think is indeed too large. I'm not sure if this number is some kind of calculation error, or if you were talking about the situation in a couple more years, when you sell a few more 200,000 or 300,000 battery EVs. I would like to confirm what you said about ICEs and hybrids being about the same 8% operating margin right now.

A: Aoyama

The factors behind the battery EV deficit include, of course, the fact that battery EVs cannot earn gross profit, and the biggest factor is development costs. In terms of development costs, with regard to the 0 series from the 2026 model year, some of these are in the final stages of development now and some are still in the process of development. Added to that is the next generation of battery EVs. We are planning for 2029 or later, but we are now starting to develop for it. Therefore, there is really no other way but to understand that the development costs of battery EVs are quite high. It is indeed too big, but we have to balance that. Under the current new administration, with regard to regulations you just asked about such as GHG, ACCII, and the value chain in Canada that has been announced, I think the current trend is that we need to change what needs to be changed speedily while keeping an eye on the overall picture.

A: Fujimura

In the future, we would like to consider how disclosure should be done. When looking at things from the perspective of P&L, we may make mistakes, but we must not hesitate to do for the future. As mentioned earlier, we have been focusing on ICE business until 2025, so we have been trying hard to increase the profitability of ICEs and HEVs, and we have been focusing on ROS and profit in our KPIs. However, I believe that we are now entering a stage where we will



be looking more closely at cash flow, including how much cash flow can be earned and how much of it can be allocated. I believe that resilience will not be enhanced without considerable management flexibility in the area of money as well. We must expect the changes that lie ahead, and from the point of view of our original plan to spend JPY10 trillion over 10 years, we are now at a stage where this shift is becoming more difficult, and I feel that we may have to delay it for a long time. In the meantime, if ICEs and HEVs are sold, the amount of profit from them will increase. It is very difficult, but we manage the Company in a balanced, sustainable way. On the other hand, if we do not make or sell battery EVs because the demand for battery EVs and the market demand is declining, we will have no place to fight in 2035 or so. Again, we are trying to make a balance in this area while preparing strategies for technology, business, finance, and so on. We would like to share more about this in our business update and report on the next fiscal year.