

# HONDA

Investors and Analyst Session for Fiscal First Quarter Ended June 30, 2024

Financial Results Q&A

Date/Time : August 7, 2024, 17:00-18:00

Speakers :

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## Q: Analyst A

1. You have achieved a very high profit level in Q1. If you have any positive or negative aspects in your actual figures here, I would very much appreciate your explanation.
2. We are hearing concerns from your competitors about incentives and the level of inventory in the market. For your company, what is the current incentive situation? I would be very interested in your comment on whether the fundamentals remain strong in the US.

## A: Fujimura

1. Regarding the Q1 summary, we were able to demonstrate very strong motorcycle and automobile profitability. with a record quarterly profit of approximately JPY480 billion and ROS of 9%. Profits tend to be higher in Q1 due to the timing of expenses. Therefore, ROS 9% will not continue for a long time. However, in terms of the actual figures, the Q1 results were in line with our plan.

As for motorcycles, although Thailand has weakened, Vietnam, which had been a source of concern from the beginning, finally appears to have bottomed out. We have kept our full-year forecast for motorcycles to 19.8 million units , because we would like to be more cautious about the situation in Vietnam. However, the fact that the motorcycle business in Vietnam, which generates our highest profits, has bottomed out is a good sign. In addition, Brazil, India, and Turkey continue to lead the business. In India, we maintained its No.1 market share from April to July. These factors allowed us to achieve a record high of approximately 180 billion with a ROS of 18.9%, positioning us to exceed 5 million units per quarter for the first time since before COVID-19 pandemic, which was recorded in 2018.

As for automobiles, sales in North America have been firm, especially for hybrids. Incentives are rising, but the level has not been away from what we expected at the beginning of this fiscal year. We have reflected annual price increases for most models in Q1. As a result, operating profit was approximately JPY220 billion and ROS was 6.4%, which I think is a good figure. In terms of the actual figures, the negative factor is China. In China, we are struggling very hard. Originally, our sales plan for China was 1.06 million units for the year, but we need to reduce by 220,000 units, which resulted in a very large negative impact on

operating profit and equity method profit. While there are also some concerns in Asia, we will cover negative from Asia with the strong performance of Japan and the U.S. and complement each other on a consolidated basis.

As for the exchange rate, it is very difficult to read the future trends. There is no change from the initial forecast: JPY145 for H1, JPY135 for H2, and JPY140 for the full year. Therefore, for Q1, you can take the figures as they are. As you know, we factor 1.2% for quality costs, but the rate in Q1 was about 0.6%. We have factored 1.2% into the full-year forecast, but I'm not sure how this part of the forecast will be viewed in terms of the actual figures.

2. On the other hand, as I mentioned earlier, the situation in the US is progressing as planned. Market was on par with the previous fiscal year at the level of 4.1 million units per quarter. We achieved a retail sales increase of about 10,000 units to 402,000 units, but Q1 was affected by about 10,000 units due to the cyber-attack on the dealer management system manufactured by CDK, which also affected other companies. We will recover from this in the second quarter onward, but even taking this into account, we were able to produce a positive figure compared to the previous year.

Wholesales was affected by logistics problems, such as the impact of freight cars from Mexico, but we expect to make up for this during the year. We have launched the hybrid Civic in June, and we are aiming to sell more than 400,000 units of hybrid vehicles for the full year, an increase of 90,000 units YoY. Incentives are currently kept at a half to less than half for CR-V and Accord compared to PET models. We are selling at about 50% of the model mix, but we feel that demand is about 60%. In the meantime, due to restrictions on parts supply from various suppliers, we are not able to increase the number of hybrid units immediately. We will aim to expand our supply capacity over time.

As for the inventory situation, the lean inventory operation is progressing according to plan, from the 60-day inventory before COVID-19 pandemic to the 30-day inventory. As of the end of June, day supply increased slightly to the 34-day level but excluding the impact of the CDK cyber-attack I mentioned earlier, it was at the 30-day level, which is well under control. I know this is a bit of a back and forth, but I think this is the reason why we are able to keep a firm grip on incentives.

As for incentives, the cash level is roughly USD1,600 in Q1 at Honda management level. Last year, it was low in Q1, so this incentive has a large negative effect as a decrease factor for profit. However, we are proceeding as planned at the beginning of the fiscal year. If we divide the situation into Acura and Honda, we can say that Honda is doing a good job while keeping a firm grip on the situation. On the other hand, ZDX and Prologue, jointly developed by GM, are EVs that we are putting into the market in earnest. We were not able to achieve the volume in Q1 due to supply constraints and quality problems at the startup, but we were able to achieve the volume in July as planned and have sold slightly over 6,000 units for the

April to July in retail base. Other companies are offering considerable incentives for EVs, and we have to follow their lead to some extent, but we will do so while strengthening the quality of our sales in order to build a solid brand in the future.

Following question on 1.

If there is anything other than currency exchange that you think we should be looking at on the risk side for the remaining nine months of the year, could you please share one or two things?

A: Fujimura

Following question on 1.

In the Asian auto business, there is a continuing decline in volume due to the relationship with the Chinese OEM and intensified competition in the ICE, which is currently being covered by good sales in Japan and North America. Whether or not there will be further concerns in Asia, and whether or not there will be some difficulty in the positive results from Japan and North America, is a cause for concern. Since the term has just begun, I believe it is an area that must be firmly controlled.

The situation in China is very difficult to read. The ratio of NEVs is slightly above the level we have estimated. We were thinking that the percentage of NEVs would go to about 50% by the end of this fiscal year, but it already surpassed 50%. Also, we are facing discounts. The level of discounts offered by other companies is a little above our expectations, and we are concerned about this.

The economy is moving at the moment. There will also be an interest rate cut by FRB in September, so it could be a factor in keeping inflation under control and giving the economy a soft landing. I hope that the economy will not be affected by the considerable movement you saw this week.

A: Kawaguchi

Follow up.

Nobody knows if JPY135 for H2 is adequate.

Q: Analyst B

1. Hybrid sales were 200,000 units in the first quarter, which is perceived to be a little slow compared to your plan of 1 million units per year. Is okay because Civic is coming out, or if there are issues in the supply chain mentioned earlier? I think it would be quite profitable if you can increase the number of hybrid units, so please also explain if it would have a positive effect on the mix.
2. How you envision the reduction of software development costs in the alliance? For example,

you disclosed that you would spend 2 trillion yen over 10 years, or about 200 billion yen per year on software development, but are you talking about halving this amount, or how much will it contribute to cost reduction?

A: Fujimura

1. As for hybrids, we have disclosed them by powertrain. As for the position in relation to the 200,000-unit increase from the previous year and this year's annual sales plan of 1 million units, Accord was launched in the first quarter of the previous year, so the growth may not be enough compared to that. On the other hand, we will introduce CIVIC HEV in June, so our original plan was to reach 1 million units for the year, including this. I hope you can understand our positioning. The area that is becoming a bit difficult to read is China, and with the decline of the ICE market in China, this hybrid area is also becoming more difficult. This may have a slight negative impact on our hybrid sales plan, but the current Q1 growth was 16% excluding China. Moreover, 430,000 units are planned for North America, and the large growth in this area will greatly contribute to the number of hybrid vehicles. The performance of the hybrids has been improving. Therefore, not only because of the price of gasoline, but also because North American customers appreciate the hybrid as a car, I believe that our hybrid vehicles, which we have finally introduced in earnest, have been able to produce solid volume in North America.

Our hybrids use a new system that incorporates cost reduction. Incentives have been reduced by about half for the CR-V, for example. For Accord, the incentives have been kept much lower. We have focused on high-end models, and profitability is basically at the same level as that of petrol cars, or some models are better than petrol cars, based on the current situation.

2. Regarding the alliance, I think the expectations will be as you have asked, but we are still in the process of discussing what the burden will be here. JPY2 trillion or JPY10 trillion was from software, and therefore, if you split this according to the sales volume, it would be almost half. However, the details have not been decided, so I cannot give you any specific figures. The logic is that the advantage here is that we can split the development costs between us, and since Nissan has many excellent engineers, we are proceeding with this part of the project with the understanding that there is also an advantage in terms of speeding up the process.

Following question on 1.

Is it possible to flexibly transfer the units of the hybrid system that were not sold in China to the US or other regions where sales are strong?

A: Fujimura

Following question on 1.

We have identified parts that are restricted in supply for hybrids, we can complement each other despite the issues of production sites. I think we can successfully divert the parts that were not sold. In the case of semiconductors, we did this a while ago, and I think we will continue to do so while incorporating such ideas.

Q: Analyst C

1. I would like to ask you about your opportunity for the full-year plan. We have just heard about risks, and the future would be very uncertain, so I would like you to talk about opportunities that might be available if things go well. We have been told that Vietnam looks good and that quality issues do not seem to be appearing that much, so please summarize the opportunities here
2. I would like to know your thoughts on share buybacks. At the beginning of this fiscal year, you did not buy so much, or perhaps you did not do so because of a secondary offering, but in July, even in a short period of time, I think you bought a good amount. Are you considering buying at a high pace in the future, and depending on the situation, for example, adding to the JPY300 billion? It may be difficult to talk about specifics, but I would like to know the status of internal discussions.

A: Fujimura

1. I think the most important opportunity is in motorcycles. As for motorcycles, our target is 19.8 million units as announced at the beginning of the fiscal year, but we originally hoped to sell around 20 million units. We sold 5 million units in Q4, and I hope we can continue to do well. For Vietnam, we have been a little conservative due to its political uncertainty and economic anxiety. If we can be confident that Vietnam is bottoming out, we will probably be able to put in an upward turn at H1 financial results. If Vietnam's volume can be put on the upside, depending on the volume, it will be the biggest opportunity because it is a country where profits can be generated at the highest level.  
As for the quality issue, I am not sure from experience if I can call this an opportunity, because last year it was 0.6% in Q1, but it was raised in the end. Therefore, we hope you will understand that we have included it at 1.2% based on such experience. By the way, it was 0.6% in Q1, so if we maintain 1.2% for Q2 to Q4, the change for the first quarter would be roughly 30 billion yen.
2. As for share buybacks, we have only purchased a total of 20 billion shares by the end of July because of the secondary offering. We are now moving forward at that pace in August. We are proceeding to finish by the end of March as originally planned.  
As I have always said, we consider a P/B ratio of 1x to be an extremely important management responsibility. As I mentioned in the fiscal year results meeting in May, the

reason for our P/B ratio falling below 1x is due to our balance sheet management of the capital accumulated from the past. Currently, the low profit in the automobiles is mitigating, and in the future, we will work to eliminate the uncertainty caused by the shift to EVs and raise the resolution of the situation. Since share buybacks have an effect on the past, in cases where the share price is much lower than we expected, as in this case, we will consider flexible share buybacks as a message from management that a higher evaluation may be acceptable.

Q: Analyst D

1. At the beginning of the fiscal year, you mentioned that you are planning to change the so-called dealer margin in North America starting in May. With the competitive environment in North America becoming more and more severe, I would like to ask you about the current situation of dealer margins in terms of so-called dealer engagement. With the competitive environment, including incentives, becoming more and more severe, I would like to confirm whether or not the actual relationship with dealers or the sales aspect of the Company has been affected. Update on your perception of demand in the U.S. What is your view of the competitor's situation, the financing situation, and how you perceive this area?
2. About cash flow, the operating cash flow after adjusting for gross profit this time was about JPY430 billion. I think last year it was very strong, with over JPY3 trillion for the year. In the business update for 2030, I think it was assumed that cash flow would around JPY3 trillion. I think that cash flow generation is weak compared to operating income this fiscal year, but I would like to confirm that we can make solid progress from the second quarter onward and can assume a 3 trillion-yen level for the full year to some extent.

A: Fujimura

1. Regarding the change in dealer margins, we have been communicating carefully with dealers for quite some time now, and we are proceeding as planned. We are working with the dealers, communicating with them onsite to ensure that there are no problems with the relationship.
2. It was indeed at the JPY430 billion level, which cannot reach JPY3 trillion when multiplied by four. There was a so-called APA settlement among Japan, the U.S., and Canada, which is transitory and has cash outflow in corporate taxes. The effect of this APA settlement will eventually disappear, but there was a one-time negative amount in this quarter. If this is excluded, operating cash flow after R&D adjustment is approximately JPY600 billion for the quarter. Multiplied by four, it is roughly JPY2.4 trillion. Also, in terms of P&L, Q1 is always weak. The R&D portion comes into play, and Q1 is always rather low in terms of R&D adjusted profit. In light of this, we believe that the JPY3 trillion level can be achievable this fiscal year.

Following question on 2.

I understand that this cash flow will be generated this fiscal year, but is it safe to say that we can expect a sustainable JPY3 trillion level for the next few years? Can you please confirm again the balance between the investment of JPY10 trillion by 2030 and the returns?

A: Fujimura

Following question on 2.

With regard to the 10-year portion that we presented in the last Business Update, we will proceed in that manner. As for the capital allocation, there are of course areas where we need to be flexible, based on the assumption that major changes in the business environment will occur. We believe that we will be able to maintain the level of the previous proposal as far as our current forecast to 2030 is concerned.

Q: Analyst E

1. About China, what is the status of capacity reduction right now, how far are you in the discussion, and how are you going to do? To the extent possible, how will it be reduced? Will it be transferred, and if so, how will the sale price or something like that would be determined, or if there is to be a reduction in staff, how will the cost of such a program or something like that be paid for? First of all, please tell me whether the overall capacity will be reduced, and if so, I would like to know the process. If possible, please include the financial impact.
2. You mentioned Vietnam as an upside opportunity earlier, and it is true that the monthly figures indicate that it is starting to come back. What amount are you talking about for the upside of the profit in Vietnam? My recollection is that Vietnam's profits didn't drop that much when the volume dropped in the first place, and I was aware that profits were up steadily all last year for motorcycles. Are we talking about 10 or 20 billion yen in profits that will increase as Vietnam recovers, or are we looking at a situation where the record highs will be significantly higher? Please explain the scale of what we can expect in Vietnam that you mentioned in upward opportunity.

A: Fujimura

1. First, as for China's production capacity, although exact figures are not provided from Chinese government, it is clear that there is excess capacity, and I think it will be difficult to transfer the production capacity. Therefore, in our current budget, these capacity reductions are included, especially for equipment and buildings, in the form of so-called impairment. In the case of personnel reduction, we reduced the number of employees by 3,000 as of last year. We will do the same reduction or more this fiscal year. This includes natural

attrition.

In terms of specific difficulties, our partners themselves are under a lot of pressure. Since it is very imperative that they contribute to the country's GDP firmly, it is very difficult to decide things only based on the economic rationale of the joint ventures there. In this difficult area, the current general manager in China, who has been working in China since he was a young man, is now leading this effort. Anyway, I don't think I am answering your question very specifically, but that is the situation.

2. I think you may be saying that the drop in Vietnam's volume did not have that much of an impact last year, but last year, fortunately, other regions were able to cover the drop. The other regions I just mentioned included the resurgence of Brazil and the motorcycle market in Europe. In Europe, there were various situations in the motorcycle market after COVID-19, but in Europe, motorcycles sold well as cars became more expensive. In addition to this, we have been currently sending our products to Europe from Japan, so there is a contribution from the weak yen. Last year, we were able to achieve good figures by covering the decline in Vietnam, our largest profitable country, with other regions doing well.

As for the profit band in Vietnam, we are now generating OP margins at a high level, like 25% to 26%. Depending on the number of units, I think we can expect to generate about 10 billion, and since there will be room for cost reductions along with an increase in the number of units, I think that this is an opportunity.

Following question on 2.

10 billion means that, although it depends on the number of units, it will be about 10 billion above the plan.

A: Fujimura

Following question on 2.

I mean it against the plan. In Vietnam, the market is almost equal to Honda, so I think we will be able to clarify this issue at the H1 announcement after carefully examining the economic environment and other factors.

Following question on 2.

If we look at motorcycles, it looks as if the upward swing could be much larger than 10 billion yen. You just said is only about Vietnam, and if we add up other regions such as India and Brazil, motorcycles as a whole are doing even better. Is that correct?

A: Fujimura

Following question on 2.

Please understand that the 10 billion yen I mentioned is only for Vietnam.



Q: Analyst F

With China experiencing such a sudden decrease in volume, you mentioned earlier some of the impact on operating profit. I think the basic idea is the impact on the equity method profit, but let me check how much impact on royalties, components, and operating profit is there.

In addition, if we look at China's rapid decline over the medium to long term, how do you think about your company's cash allocation and other plans for 2030, which are based on the assumption that the number of sales unit will be around 5 million for automobiles.

Recently, not only in China, but except Japan and the US, sales have not been growing, as mentioned earlier in the section on risks. I would like to know if there are other areas where you have opportunities to make up for the decline in China, aiming for around 5 million units. Are you going to get it back in China or are there any other places where you could do better? Please explain this.

In addition, the Japanese business has been performing very well in recent years. The number of units has been revised upward again. I would like you to tell me more about the status of this Japanese business.

A: Kawaguchi

China's operating income impact.

Basically, as you mentioned, joint ventures will have a significant impact. We receive royalties based on local production volume, and although the number is small, we also have wholly owned subsidiaries, mainly parts companies, so if local operations are reduced, this will have an effect on profits. As for the amount that will be in effect, it is not more than JPY50 billion. I am now having an image of 2 to 30 as an impact on operating profit at this point.

As we have left operating profit unchanged this time, we will continue to take various opportunities during the next nine months, and we will also take various measures, so I think the impact on operating profit will be within the scope of what we can absorb in our future operations.

A: Fujimura

Regarding the medium- to long-term perspective, three years ago, right after Mibe took office as president, he said that in order to achieve carbon neutrality by 2050, all vehicles on the market must be electrified by 10 years before that date, so that by 2040, 100% of vehicles would be EVs, and by around 2030, 40% would be EVs. Considering the production volume of automobiles, or the level of 5 million units, we were aiming for 2 million units as 40% of the total.

We honestly could not anticipate the changes in China at that time, so we may have to rethink the number of units on a global basis.

However, in light of the 40% as our intention, it is quite reasonable to say that 2 million units is not right while 4 million units have been produced so far. I would like to make a decision again at some point or maybe at a business update.

Originally, we had planned to increase the number of units in China to about 2 million, but now we are in this situation, so I think you are right to ask such questions, and we must do.

As for the Japan business, there were still some restrictions on semiconductors in Japan until about last year, and we are now in this situation.

The market is influenced by company D and company S. I do not believe that the market is flowing to us due to the influence of these other companies, but basically, I believe that our current vehicles are successful in attracting new customers, and we would like to continue to expand the market.

What will happen in the next fiscal year and the year after that is another matter, and this fiscal year, at least for now, we will concentrate on the new models and EVs. We would like to firmly turn around our business in Japan.