

HONDA

Investors and Analyst Session for FY24 1st Quarter Financial Results Q&A

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

Speakers :

Eiji Fujimura Executive Officer, CFO

Masao Kawaguchi Operating Executive, Head of Accounting and Finance Supervisory Unit

Q: Analyst A

1. Results were quite strong. How do you evaluate the results and how was it compared to the internal forecast? Despite of good results, you have kept FY2024 forecast for the year unchanged. What is the background?
2. It seems that you are struggling in term of sales units. What is the latest status, including price competition, risk in term of sales volume? And what is the impact based on equity method profit?

A: Fujimura

1. About our evaluation on first quarter results, the group unit sales of automobiles was 900,000 units, up about 90,000 units from the previous year, of which approximately 130,000 units were sold in North America, where profits are maximized. This is 21% of the annual plan of 4.35 million units, which might look low, but we think it is online to achieve our annual plan.

As we mentioned in our financial results announcement on May, China implemented 6B pollution standard which resulting in discount competition, and increase in market share in the NEV market, so we expected that it will be a difficult market. In that sense, regarding unit sales, China was as we expected.

As for the semiconductor, because of supply shortage we struggled significantly last year - there were times we needed to change our production plan one or two weeks ahead of time. But this year, from April to June, we no longer experienced such a difficult situation. But we cannot become too optimistic regarding China. So, I will come back to China later.

As for motorcycle business, compare to last year, the Group unit sales increased by app. 220,000. However, on a consolidated basis, unit sales declined by app. 100,000 due mainly to the decline in India and Vietnam. In India, we have been installing new parts to comply with environmental regulations since April, and the semiconductors related to these parts have had a slight impact, resulting in a decrease of about 50,000 units compared to last year. However, we can see a plan to recover from the second quarter onward, and we expect to earn a solid volume in India. As for Vietnam, there are signs of a slowing of the economy. We are very concerned because Vietnam is our largest revenue source, but on the other

hand, motorcycle sales are growing in Thailand, Europe and the U.S., so we hope to somehow cover this in terms of revenue.

As for profitability, as you mentioned, the operating profit annual target is JPY1 trillion, and it is at about 40% progress at JPY390 billion. Regarding motorcycle, even with the struggle we have in Vietnam, we are able to report rather strong result with ROS of 19%. As for the automobile business, we have always been focusing on fixed cost reduction. We have been saying that we would release new models with enhanced profitability, and I believe that the three months have been a time when we were finally able to show that we could maximize the effect of increased volume by combining a considerable improvement in marginal profit per unit with an increase in the number of units sold. Of course, there were not many quality costs incurred in the first quarter, and they amounted to about 0.6% of sales.

In addition, there was also a difference in the original budgeted quota for expenses, and to be more precise, there was a delay in expenses compared to the budget, except for quality. The ROS of 5.8% for automobile business is not a realistic value to continue throughout the year, but as I explained earlier, I appreciate the fact that gross profit was pulled up properly by the number of vehicles.

To give you an idea, we had originally estimated operating profit of 300 billion yen for the first three months, but the figure is now 390 billion yen, an increase of about 90 billion yen, about half of the increase is due to the impact of exchange rates. The other half is due to delayed expenses, etc. Both volume and revenue are almost on target.

We considered various factors such as China and Vietnam, but we have decided that we are not at the stage of changing our initial target in the first three months of the fiscal year so that we can firmly maintain our original target of 1 trillion yen in real terms, other than exchange rate effects.

A: Fujimura

2. For China, we kept the sales plan of 1.4 million. On this point, as I mentioned earlier, we expected first quarter to be somewhat weaker. And from second quarter onwards, with our new model launch such as Accord and Breeze Inspire CRV, we will strive to maximize the sales volume. But we know we need to focus and put much effort. That is how we view the situation. In coastal cities, some of the cities, and in inland cities where we were not traditionally strong, we will also reinforce our sales capabilities. And in our Chinese headquarters with the partners, to achieve the target, efforts are being made. But a recent trend is such that, in July the combining the results, including our joint venture at the retail level, unit sales were about 80,000 to 90,000. Because we have partners, I'm not able to tell the change in sales we might make from 1.4 million sales plan. However, that the key point will be if the sales volume decline in China, we will allocate parts to other regions and cover the drop in volume by other means, such as to cover the revenue in real terms and

to somehow cover the volume on a global basis.

Following question on 1.

Honda tends to make small changes to forecasts on Q-by-Q basis, but not this time. I would like to get your comments on whether you have changed the way you present the forecast.

Following question on 2.

Is it correct to understand that the sales forecast of 4.35 million units has not changed, and that there is an opportunity, such as demand trends that allow some allocation of the decline in China to North America and other regions, as well as trends in commonization of semiconductors?

A: Fujimura

Following question on 1.

What we will do in the first quarter of next year depends on the situation, but what we set at the beginning of the fiscal year is both a forecast and our goal, so we would like to keep the real figure, excluding foreign exchange and other factors, as our operational goal. If we find it difficult to achieve the target in China, we will make up for it elsewhere.

Following question on 2.

I did not talk about North America, but even in North America, production is being carried out in a very difficult environment. Although the supply shortage of semiconductors is beginning to be resolved, we are in the process of raising production volume. Under such condition, last quarter the production could not meet the forecast. We are watching the situation carefully because suppliers are also struggling to ramp up production. In any case, we are determined to make efforts to keep the 435 figure as our global target, so we have left the figure unchanged.

Q: Analyst B

1. Looking at page 17 of the presentation, please explain what is happening regarding the impact of selling prices/costs in the factors for profit increase/decrease by business segment for motorcycles and automobiles, respectively. From earlier explanation, assume that prices and other factors were in line with expectations, but since there was a fairly large increase, I would like to know what is going on in this item. I would also like to know if this item is also in line with the plan.
2. View on the demand for motorcycles in the future. You have explained that you will aim to achieve the overall figure of 435 for automobile business even if the content of that figure changes. Would it be the same for motorcycle business?

A: Fujimura

1. Kawaguchi will explain the detail of price/cost impacts.

As for motorcycles, basically the same thing can be said, and we would like to keep the target firmly in place. India, as I mentioned earlier, experienced a semiconductor supply shortage, but we are now seeing a little bit of a prospect so that we can take firm action afterwards, so we will keep this target in place. As for Vietnam, we are a little more cautious. As we always say, Asia and Brazil are our strongest markets for motorcycles, accounting for the majority of our volume and revenue. These areas are naturally very volatile. We have quoted a ROS figure of 19%, but we naturally expect fluctuations, and we are always aiming for around 15%. We would like to maintain the volume target for the current fiscal year, and while profits in Vietnam will decline, we hope to somehow make up in other areas. We would like to do well in Thailand, Europe, and the U.S., where profit margins per unit are high, as well. We have not yet raised our flag in Vietnam, and we would like to do our best in Vietnam as well.

A: Kawaguchi

1. Regarding the impact of prices/costs, I would like to start with the company-wide total. In the first quarter, the company-wide price/cost impact was positive 65.9 billion yen compared to last year. This includes various cost increases, including material costs and infrastructure costs, as well as the net effect of our corporate efforts to respond to these costs by pricing our products according to their prices. Until last year, the impact of inflation and material price hikes was very large, and we naturally tried to absorb these factors by adjusting selling prices. In addition, the prices of materials, including precious metals, have stabilized, and we indicated at the beginning of this fiscal year that we expect to see the full-year effects of our price measures in the current fiscal year.

In the first quarter of this fiscal year, what we had planned at the beginning of this fiscal year has been realized in the 1Q. In the area of costs, compared to the first quarter of last year, inflation has been intermittent since then, and compared to the first quarter of this year, there are factors that have increased costs, including labor costs. In addition, our business partners have also experienced various cost increases, including utility costs, and we are discussing with each company individually and sharing the burden of these cost increases. We are discussing with each company individually and each company is bearing a proportion of the cost increase. On the other hand, material prices have continued to fall since last year, especially for PGM. Compared to last year, the first quarter was favorable in terms of lower precious metal costs. The cost increase and the decline in material prices have generally produced a net gain. In other words, the 65.9 billion yen companywide, if you look at it from a company-wide perspective, you can see the full effect of the product price increase that we have continued to implement since last year.

If we break this down into automobiles and motorcycles, the cost increase in the automobile business has been absorbed by the decline in precious metals, and the impact of price increases have positive impact. On the other hand, in the motorcycles business, the price increase works positive, and cost reductions are slightly more positive in the motorcycle business, due in part to the faster return of production volume. Within the ¥29.4 billion for motorcycles, the positive impact of selling prices and costs is also positive, net. We intend to make firm efforts to reduce costs for automobile business in line with production volume, while keeping a close eye on our suppliers.

Following question on 1.

Should we simply recognize that the first quarter is in-line and that we are not in a position to change the full year plan or even change it at this point? Or should we assume that there are a few more opportunities?

A: Kawaguchi

Following question on 1.

Inflation related cost such as labor fee had a slightly more effect on costs than we had estimated, while material prices have fallen slightly. As for precious metals, it is difficult to say what will happen in the future due to market conditions, but I think it is fair to say that the prices are online in terms of actual performance.

Q: Analyst C

1. Further explanation on the sustainability of fixed costs in the first quarter, especially in Japan. From previous explanation, I assume it is not sustainable. On the other hand, however, looking at the profit margin by geographic area, the margin in Japan was 8.9%, which is an unprecedentedly high margin, and I feel that it is too high. On the other hand, I would like to see another explanation or comment on the sustainability of the company, with the hope that the effects of the efforts that have been made over the past few years will continue in the future.
2. Update on the how to think of free cash flow. In first quarter, excluding financial service business, FCF is 290 billion yen. On the other hand, on the balance sheet, there is still a high level of inventory, albeit with some foreign exchange impact. If production were to return and volumes were to increase in the future, perhaps internal inventories would decrease, then FCF for the fiscal year would be at a large level. If you have any figures that could be considered as a guide, I would appreciate an explanation.

A: Fujimura

1. The Japanese business is shown in the segment "Japan" in per geographical segment page in the presentation. This segment includes a mixture of three types of business: business of made and sold products in Japan, business of shipping KDs from Japan, and business that conducts R&D and collects royalties from each region. It is very complicated segment. Rather than the benefits of fixed cost reductions in Japan, I think it is better to understand that the impact of royalties from the growth in overseas sales volume and the impact of foreign exchange rates are considerably larger here. We are reducing fixed costs in Europe, North America, Asia, etc., as well as in Japan, including the Sayama Factory, but I think it is important to understand that the increase in foreign exchange rates and royalties were rather large.
2. FCF was 290 billion yen. As was the case last year, we are hoping to generate FCF of 700 billion level. As I mentioned, we already generated 40% of our profit, and our investments and other activities are rather in the second half of the year, and some of the investments we have made recently have been made in the latter half of the year, so our plan for FCF for this fiscal year is to generate 600 to 700 billion yen. Compared to other companies, our inventory management is slightly higher in relation to sales, which I think is related to our global complementary structure. This is, conversely, an issue for our logistics operations, and we have stated that we would like to shift to ROIC management in the future. Although the exchange rate has also had an impact, I believe that inventories are a little high under such circumstances.

Following question on 1.

Is it right to assume that there is no discrepancy or hindrance in the current Japanese business?

Following question on 2.

Toward the end of the current fiscal year, although there might be an increase in investments, etc., as inventory levels decline, will it contribute to FCF increase?

A: Fujimura

Following question on 1.

Yes.

Following question on 2.

Since we are now in a situation where production is immediately followed by sales, especially in North America, the inventory level may remain the same as the current situation. Of course, the slightly increasing inventory will certainly lower the FCF, but overall, we are estimating a level of about 700 billion yen.

Q: Analyst D

1. Please go to the page 17 of the presentation, volume and model mix in profit analysis, which is divided into motorcycle and automobile business segment. Volume and model mix impact for automobile is about 130 billion yen. Although the number of automobile sales in North America, where the unit price per unit of revenue is high, increased by about 130,000 units, but even so, the figure is quite large. In addition, Mr. Fujimura mentioned earlier that the automobile business operating profit margin of 5.8% is not sustainable. However, I believe there will be another recovery in the automobile sales volume from now on. The marginal profit per unit is expected to be very high, and 5.8% is not such high level compared to competitors. Then, I would like to know why the profits will not go up any further – mechanism of even though profit structure is strengthened, the number of units will recover, but profits will not rise any further. What is needed to further improve the situation, what is the bottleneck?
2. Update on your perception of demand in the US. What is your view of the competitor's situation, the financing situation, and how you perceive this area?

A: Fujimura

1. As for the point of profits being high in relation to the number of units, the profitability of the models and the reduction of fixed costs have been very effective. Although not disclosing the marginal profit per unit in North America, the amount has increased considerably compared to when I was in the U.S. about three years ago. Some of the increase is due to exchange rate fluctuations, but I believe that the very high level of marginal profit from newly launched models such as Accord, CR-V, and Pilot have changed.

As you have said, 5.8% is not as high as other companies. In any case, as we are aiming to achieve a ROS of 7% or higher by 2025, this does not mean 7% or higher for automobile business. 7% with the help of motorcycle business, and 5% to 5.5% for automobile business. Therefore, I said that this 5.8 is not sustainable in terms of this fiscal year, but we would like to increase it steadily and firmly over the year.

As for how we can increase the production capacity, globally speaking, it is still 4.35 million units out of a total production capacity of 5.14 million units, so we must make up the number of units. We will continue to examine the unit sales price, and we will also continue to consider ways to reduce costs and provide support to suppliers. We will work hard to stabilize production. There is no magic in this area of production and sales, so we will achieve our goals by steadily working as a manufacturing company.

A: Kawaguchi

1. As Fujimura explained at the beginning of this presentation, there was an increase of about 125,000 units in North America, where models with very strong profitability, including the

effect of the Honda architecture that we have worked on as our important measure to improve the profitability of automobile business for some time, were all available. In terms of other causes, the volume was slightly weak in Asia, especially in India, which may have had a slight effect on raising the unit price of automobile business in terms of average. However, I would like you to understand that much of the increase is attributable to the increase in the number of units produced in North America.

A: Fujimura

1. As for the situation in the U.S., sales were solid, and demand was very high in the first quarter. We could make the most of the model cycle, such as Civic, HR-V, CR-V, Pilot, and Accord. Dealer inventory was 60,000 units at the end of March, the end of last fiscal year. At the end of June, while production has increased, inventory is 62,000 units, only 2,000 units higher than that of end of March. This means that the situation of production immediately followed by sales is continuing. We will work with suppliers to ramp up production. We are going to work with suppliers to ramp up production, and although there will be some difficulties, we are determined to complete production in the U.S.

In the current fiscal year, I feel that at least the recessionary fears and the uncertainties of the used car market, in particular the recession, have disappeared a little. Our goal is to maximize sales by taking advantage of our strong lineup of products and keep production plan.

As for financing, at one point we were selling with very low incentives, and the penetration rate fell below 50%, and the financing receivables themselves were decreasing considerably due to the low volume of American Honda cars. However, the decrease in financing receivables has already bottomed out since the penetration has finally recovered to over 60%. We are operating our finance business based on ROA, and therefore, the decrease in operating income area is not an inevitable part of our business. Since we are still at the stage of bottoming out, the amount of receivables is still less than last year, and profits are still declining, but the gross profit margin is in such a situation.

As for the decline in used car prices, the Manheim index is showing some signs of this, but in fact we are still in the stage of gains of about \$4,000 per car on average against the residual value of the contract, and we do not think that this will immediately turn into a loss. Even if it were to turn into a loss, we believe that this is a sign that the market is heading back toward normalization. If the residual value is a profit per unit, it means that the car will not be returned. Before COVID-19, about 60,000 cars came back and were sold at auction, resulting in a residual value loss. But now, only about 200 cars are coming back. Because of this level, the used car market will be negatively affected for a while, but we do not expect it to have an immediate impact on the market. As for bad debts, we are still back to the pre-COVID-19 stage a little bit. Of course, since the Trump administration, there has

been considerable support for households, and we have returned from a situation where bad debts were almost non-existent. We have set aside about 0.6% of the allowance at the end of the fiscal year, and while actual bad debts have increased, we believe that this is within the range of normalization, and if it is within the normal range, we will basically manage the leakage by setting the pricing as American Honda Finance. We do not feel very concerned about finance at this time.

Q: Analyst E

1. Announced a buyback, and now it has announced a stock split. I assume that these actions will be continued, but I would like to ask Mr. Fujimura what other measures and actions is under consideration. In addition, took a step on Yachiyo Industry. How do you plan to change the structure of the group companies?
2. In an earlier question, there was a statement that China has to be leveraged quite a bit, but what is the substance of that. Inevitably, the pricing of EVs is very tough, and I think it would be quite difficult to guarantee the business viability of EVs and China in this price range. What kind of leveraging measures you have in mind, in relation to EVs?

A: Fujimura

1. As for buy-backs, as we have announced at the beginning of this fiscal year, we will implement while considering future free cash flow and other factors. Currently net cash is 2.9 trillion yen, about 2.3 months of monthly sales. The capital adequacy ratio is about 46%, and I believe that capital policy must be carefully considered, taking into account investment funds for a major transition period in the future. We have been trying to do something about it. It is difficult to say what we will do from now on, but we will continue to pay a dividend with payout ratio of 30%, and we will buy back our own shares in a more timely manner, depending on the situation.

We have been considering a stock split for a long time, as many other companies have recently done. I am not sure if my figures are correct, but about 1,000 trillion yen of the 2,000 trillion yen in personal assets in Japan are bank deposits, etc., which is almost equal to the market capitalization of the TSE. While the government is aiming to expand the NISA program, we only have a relationship with about 8% of individual investors. We would like to increase the number of individual investors and encourage them to support Honda and become more interested in Honda's business through their shareholdings. We thought it would be appropriate to do stock split only when the stock price had risen to a certain level, and since it has risen this time, we decided to do it at this time. I am glad that we were able to do it just in time for the expansion of NISA next year. It is not enough just to split the stock, so we will continue to expand our IR activities for individual investors, and we will also engage in activities to attract young investors, especially since we want to be a young

company.

Regarding the reorganization of Yachiyo, the structure of the group companies will naturally take the form of determining which parts and technologies will become the core in the course of electrification. Naturally, we cannot tell you here what we will do in the future, which parts and technologies will become the core in the electrification process. as in the case of Yachiyo, Motherson has raised its hand to us, where we can still generate considerable benefits and increase corporate value if we work as a group. We would like to carry out this type of structural reform.

2. In terms of leverage in China, I think there are about three things. Short-term, we are planning to start up a new BEV plant with both joint ventures by 2024. If the current 1.4 million units are not enough, we will have to consider what the capacity or fixed cost should be. This is what we will do in the short- and medium-term. We will continue to focus on EVs and make them more attractive. As I have said for some time, we will launch our second and third EVs in 2024 and expand the number of models to 10 by 2027, but we need to consider whether this speed is sufficient. Since we are forming joint venture, we will discuss our thoughts and ideas with our joint venture partners and find out what we think should be done. However, the joint venture partners are probably aware of the same issues. We will discuss this with our partners and decide what we will do in the short, medium, and long term. I am sorry that I cannot give you an answer at this time, but I said that this is the way to leverage our efforts.

Q: Analyst F

About battery strategy. Not to give examples from other companies, but Toyota has announced the development of various batteries, and many companies have announced the procurement of cylindrical type. I understand that you have also started a battery development company business with GS Yuasa. What kind of batteries are you developing now, and what is the current situation with all-solid-state batteries? Also, overseas, there are various companies such as LG, but in Japan, who is going to produce the batteries? This is a bit broad, but I would like to know a little bit about the progress of the batteries, including the procurement of raw materials, etc.

A: Fujimura

I assume your question comes based on our Business Update on April 26. Because of the nature of battery, we believe it should be locally produced for local consumption. In our major markets, or those where electric vehicles are expected to make the fastest progress in the future, we are procuring batteries from CATL in China. We are facing some issues in terms of speed, and there are other issues as well, but that is the way it is.

In the U.S., the electric model that we have been jointly developing with GM will finally be released this fiscal year, and we are considering the portion that we can procure from GM in the form of vehicles and the portion that we can produce at the joint venture with LG in Ohio and use in our vehicles.

For Japan, since GS Yuasa is a company that develops batteries, we are considering both the production area and the development of manufacturing. We are already working with GS Yuasa to develop manufacturing methods and development, and to consider the entire flow, from the raw material stage to recycling, as a kind of resource circulation. In Japan, we are discussing what kind of production system we should have with GS Yuasa, Blue Energy, which has been working together with us, and Honda.

Following question

Understand the general direction. In terms of battery performance, are you aiming for something quite innovative, or are you going to consider all-solid-state batteries for innovative ones, and separate them into practicality and sustainability in terms of recycling, etc., by type of battery?

A: Fujimura

Following question

Currently, the mainstream is liquid LIBs, and there are different types of materials for their contents. We believe that it is a bit risky to stick to only one technological direction, and we are currently working with GM on semi-solid-state batteries. As for all-solid-state batteries, we have reached a certain point where we are ready to start the test production of all-solid-state batteries in the laboratory, and we are in the process of building a pilot production line. We are working toward commercialization toward the latter half of the 2020s. In this sense, we are proceeding in a way that we need to keep each of them under control to some extent.