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Highlights of Major Japanese Automakers' Financial Results for Fiscal Year Ended March 2019

The following are Japan Credit Rating Agency, Ltd. (JCR)'s perception of the current status and highlights for rating concerning the financial results for the fiscal year ended March 2019 (FY2018) and earnings forecasts for FY2019 of major Japanese automakers*.

Note: Out of the major Japanese automakers, JCR assigns credit ratings to NISSAN MOTOR CO., LTD. (security code: 7201), ISUZU MOTORS LIMITED (security code: 7202), TOYOTA MOTOR CORPORATION (security code: 7203) and Mazda Motor Corporation (security code: 7261).

1. Industry Trend

Worldwide new car demand is expected to gradually expand over a medium and long term, led by markets in emerging countries. The new car sales, however, have peaked out in the 2 world's biggest U.S. and Chinese markets. In the face of political issues such as U.S.-China trade friction and Brexit (U.K.'s withdrawal from the EU), the slowdown of new car sales may accelerate in FY2019. According to NISSAN MOTOR CO., LTD. ("NISSAN")'s financial report for FY2018, growth rate of demand for worldwide new cars was -1.5% in FY2018 and that in FY2019 is expected to be +0.8%. By market, these growth rates are +1.2% and +1.0% in Japan, -0.8% and -2.7% in the U.S., +0.3% and +0.1% in Europe, and -2.7% and +3.1% in China (on a calendar year basis for China only). It is expected that the Japanese market will gradually shrink over a medium and long term against the backdrop of decreasing birthrate and aging population, and there are concerns about impact from the consumption tax hike scheduled for October this year in the short run. Demand in the U.S. market has been gradually shrinking since it peaked out after the course of the replacement cycle following the financial crisis represented by Lehman Brothers' collapse. The European market has been gradually expanding since 2013, but the sales resulted in only a slight increase in 2018 over 2017 due partly to the decreased sales in England and other countries and a shortage of supply since September 2018 as a result of delays in the authentication procedure for new standards of measuring exhaust emissions, Worldwide harmonized Light vehicles Test Procedure (WLTP). Sales in China in 2018 declined for the first time in 28 years from a year earlier due to factors including the ending of vehicle acquisition tax reduction (as of the end of 2017) and U.S.-China trade friction. The Chinese government hammered out in January 2019 a policy to subsidize new car replacement. JCR considers it is necessary to carefully examine the effects of the policy and the impact of U.S.-China trade friction.

With full-scale developments of next generation technologies represented by CASE (Connected, Autonomous, Shared, and Electric), automotive industry is facing a major change. In the field of vehicle electrification, alliances for sharing of developed technologies and standardization of such technologies are increasing in addition to sharing of development costs of new technologies in order to respond to these changes in the business environment. In the field of autonomous driving, alliances across industry boundaries such as those with IT companies are increasing in order to respond to data analysis technology (analysis of road conditions, map information, etc.) as well as automotive control technology (accelerator, brake, etc.).

2. Financial Results

The worldwide unit new car sales of the 8 listed automakers (excluding HINO MOTORS, LTD. ("HINO"), a consolidated subsidiary of TOYOTA MOTOR CORPORATION ("TOYOTA")) for FY2018 increased 0.4% over FY2017 to 27,716 thousand units. The total operating income of the 8 companies for FY2018 decreased 11.5% year-on-year to 4,403.6 billion yen. The operating income margin has been weakening since it peaked out at 7.9% for FY2015, and decreased to 6.0% for FY2018. The operating income increase/ decrease analysis (top 3 companies) shows that primary factors for the increase of operating income were "volume and model mix," of 245.3 billion yen and "cost reduction" (including cost improvement, fluctuations in raw materials prices, increase/ decrease in fixed cost) of 187.1 billion yen, while primary factors for the decrease were "fluctuations in currency exchange rates" of 275.7 billion yen and "overhead cost." Even excluding the minus effects from the "fluctuations in currency exchange rates," their operating income decreased 20.4 billion yen. For the "cost reduction," rise of prices of raw materials such as steel products offset the effects from cost reduction in part. For the "volume and model mix," slowdown of new car sales in the U.S. and Chinese markets and increased incentives placed a burden. For the "fluctuations in currency exchange rates," depreciated currencies of emerging countries had a significant impact.

Many Japanese automakers depend on the U.S. market for their income. In the U.S. market, demand shifted from sedan cars, in which Japanese automakers have strength, to SUVs, pickup trucks, etc. Their incentives are increasing centering on sedan. Due to the lowered profitability as a result of the increased fixed costs (personnel, development and production cost for meeting standards for environment and safety), operating income margin in the North America segment of the top 3 companies declined from 7.0% for FY2010 to 2.0% for FY2018. In the face of this declining trend, TOYOTA increased the operating income of its North America segment (excluding special factors) through strengthening production capacity of light truck, introduction of new cars, control of incentives, etc. from 132.1 billion yen for FY2017 to 144.1 billion yen for FY2018, ending the declining trend of profitability.

As of the end of FY2018, the top 3 companies' total net cash amount (difference between ready liquidity and interest-bearing debts; based on liquid assets for TOYOTA) for the Automotive segment excluding sales finance amounted to approximately 11.4 trillion yen, which was the same level as a year ago. The increase of the net cash has been continuing from the end of FY2018 where the amount was approximately 1.7 trillion yen. Intensifying competition in technological development for vehicle electrification, autonomous driving, etc. is raising automakers' R&D expenses and capital investments. The capital expenditures of the 8 companies in total for FY2018 increased 9.0% over FY2017, exceeding the amount for FY2017 before the financial crisis represented by Lehman Brothers' collapse.

3. Highlights for Rating

For FY2019, the worldwide unit new car sales of the 8 companies in total is expected to remain roughly unchanged, up only 0.1% year-on-year, and the operating income is expected to increase 2.3% year-on-year. Five companies out of the 8 companies expect their operating income to increase, but there remains uncertainty, because there is a possibility that effects from U.S.-China trade friction may intensify. In the operating income increase/ decrease analysis (top 3 companies), primary factors for the increase is "cost reduction" of 212 billion yen and that for the decrease is "fluctuations in currency exchange rates" of 260 billion yen. In terms of the fluctuations in currency exchange rates, many companies assume an exchange rate of JPY 110 to USD 1 (about JPY 111 for FY2018), and many also assume a negative impact from currencies other than US currency. Many companies also incorporated a certain amount of effects from rise of raw materials prices into their forecasts for FY2019, although the amount is not large as compared with FY2018, and the "cost reduction" remains at a low level.

Japanese automakers are facing an urgent issue of improvement of North America segment's profitability. It is important to increase their brand power and control incentives through introducing new cars which can meet needs of customers, fostering and supporting dealers, and so on. TOYOTA is strengthening its production capacity for light truck in response to the increasing needs and Mazda Motor Corporation ("Mazda") is focusing its attention on reforms of sales network in the U.S. NISSAN plans to focus on enhancement of product appeal, improvement of brand value, retail sales to individual customers in the market of North America, shifting from the unit sales-focused policy.

Sales in the Chinese market have been declining year-on-year since summer of 2018, but the major Japanese automakers' sales have been relatively solid on the strength of their product appeal. TOYOTA increased its income of China business (operating income of consolidated subsidiaries and equity in earnings of affiliated companies in China), which was disclosed for the first time by the financial results for FY2018, from 218.2 billion yen for FY2017 to 255.5 billion yen for FY2018. JCR is paying attention to their efforts to expand sales in the face of unpredictable business environment.

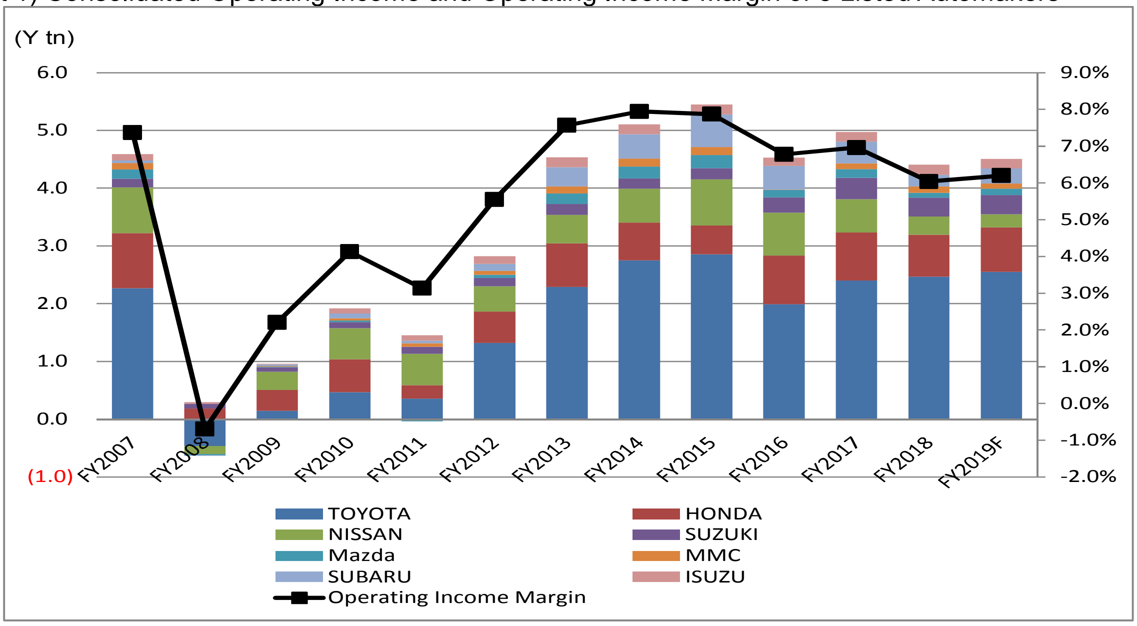
Political issues such as protectionist policies and Brexit are factors of uncertainty for business outlook over a medium term. In addition to the effects from the overheating U.S-China trade friction, the U.S. government's plans for raising its tariffs on Japanese automobiles and automotive parts and restrictions on the export volume from Japan, if realized, may have a significant amount of money impact. The higher tariffs will become a significant management issue in terms of their countermeasures such as to what extent they will pass the increasing taxation cost on to the selling price and how they will absorb the remaining cost through self-help effort. Concerning Brexit, there are concerns about disorder in the process of exit, disruption of distribution of goods, impact on domestic economy of England as well as the risk of increasing taxation cost for Japanese automakers which have production bases in England.

Delays in handling of vehicle electrification including electric vehicles (EVs) may decrease an automaker's competitive strength in the situation where every country is strengthening environmental regulations and then may lead to an occurrence of penalty, if it cannot meet the regulations. Under EU's CO2 emission regulations for vehicles, penalties are imposed depending on average CO2 emission per kilometer. There are currently cases where this penalty became a factor for income decrease.

Capital expenditures of the 8 companies in total for FY2019 are projected to increase 6.6% year on year, showing that many companies plan to continue their aggressive investments for the future including those for CASE. JCR is paying attention to how they can keep and strengthen their financial structure in the face of intensifying competition for development.

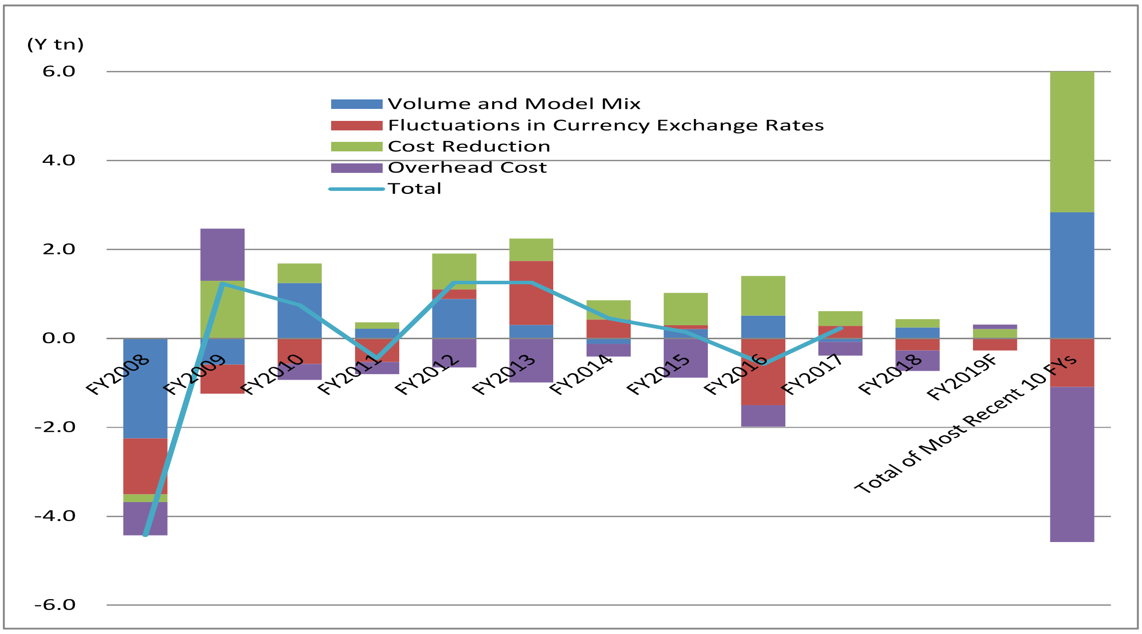
Mikiya Kubota, Akio Kamimura

(Chart 1) Consolidated Operating Income and Operating Income Margin of 8 Listed Automakers



(Source: Prepared by JCR based on financial materials of above companies)
Note: HINO, a consolidated subsidiary of TOYOTA, is excluded from 9 listed companies.

(Chart 2) Factors for Change of Operating Income of Top 3 Companies



(Source: Prepared by JCR based on financial materials of above companies)
Note: Top 3 companies are TOYOTA, HONDA and NISSAN.

<Reference>

Issuer: NISSAN MOTOR CO., LTD.

Long-term Issuer Rating: AA-　　Outlook: Stable

Issuer: ISUZU MOTORS LIMITED

Long-term Issuer Rating: A+　　Outlook: Stable

Issuer: TOYOTA MOTOR CORPORATION

CP:　　J-1+

Issuer: Mazda Motor Corporation

Long-term Issuer Rating: A-　　Outlook: Stable

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