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Highlights of Major Japanese Automakers' Financial Results for Fiscal Year Ended March 2017

The following is 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 2017 (FY2016) and earnings forecasts for FY2017 of Japanese automakers.

1. Industry Trend

Japan's 8 automakers (excluding HINO MOTORS, LTD. ("HINO"), a consolidated subsidiary of TOYOTA MOTOR CORPORATION ("TOYOTA")) achieved a 3.2% year-on-year growth of their worldwide new car sales in FY2016 to reach 26,780 thousand units. In the medium-to-long-term forecast for worldwide new car sales, moderate growth will be expected. However, the current conditions show the slowdown in economies of resource-rich countries such as Middle and Near East countries and uncertainties in the U.S. market, which sustained high demands. According to NISSAN MOTOR CO., LTD. ("NISSAN")'s financial reporting for FY2016, growth rate of demand for worldwide new cars was 5.3% in FY2016 and that in FY2017 is expected to be 2.4%. By market, these growth rates are 2.8% and 0.4% in Japan, minus 0.7% and 0.1% in U.S., 5.8% and 1.5% in Europe (including Russia), and 13.2% and 7.1% in China (on a calendar year basis for China only).

Results of domestic sales of new cars in FY2016 show a year-on-year increase of 7.5% in registered car sales, in contrast with a year-on-year decrease of 5.1% in light vehicle sales due to impacts of fuel economy tests manipulation, etc. For FY2017, while light vehicle sales growth will take an upward turn in reaction to the previous year's, registered car sales growth will likely be sluggish due to stricter standards for applying eco-friendly cars tax break. The new car sales in U.S. were on an upward path with the support of replacement demand over recent years and reached a high level of 174.9 units in FY2016. However, a year-on-year decline is beginning to appear in a certain month after the course of the replacement cycle. In European market where the growth rate turned positive in FY2013, demand remains firm in Western Europe, but factors of uncertainties including political issues such as British exit from the European Union are making the situation unpredictable. In China, a tax relief measure for compact passenger cars started in October 2015 pushed up demand to bring high sales growth in FY2016, but the growth will be slower due to the tax relief measure moderation in FY2017. In Southeast Asia where market share held by Japanese cars reaches 80%, after prolonged weakness in demands in its major markets of Thailand and Indonesia, there were signs of a turnaround in FY2016 such as a year-on-year sales increase of 2% being positive for the first time in three years. In Thailand, the replacement prohibition period that had been set in line with the government incentives for purchasing in 2011 ended and currently sales are regaining momentum.

FY2016 domestic production of the 8 passenger car companies increased for both domestic sales and export, up 2.5% year-on-year. Overseas production hit a record high in 2016, up 5.9% year-on-year, increasing the overseas production ratio to 68.0%. Some Japanese automakers showed reshoring movements including the use of their domestic production capacities for the increased overseas production during the period of weaker yen from the end of 2012 to the end of 2015. However, the major direction of local production for local consumption and shifting to overseas production is not changed. Therefore, overseas production is steadily expanding.

2. Financial Results

Out of the 8 companies described above, 6 companies increased the worldwide new car sales, but a burden placed by the bout of yen appreciation in the first half of the fiscal year placed a burden resulted in decreases in 6 companies' earnings and reductions in 6 companies' operating incomes. Total net sales of the 8 companies decreased 3.47% year-on-year, and total operating income decreased 16.8% year-on-year to 4,532 billion yen. The operating income margin fell from 7.9% of FY2014 to 6.8%.

The operating income increase/decrease analysis (of data from the three companies of TOYOTA, HONDA MOTOR CO., LTD. ("HONDA") and NISSAN) shows that primary factors for the increase of operating income were “volume/ model mix” for 511.1 billion yen and “cost reduction” including cost improvement, fluctuations in raw materials prices, fluctuations in fixed cost, etc. for 897.4 billion yen, while “fluctuations in currency exchange rates” as a primary factor for the decrease amounted to 1,505.1 billion yen. Though the export profitability has improved due to yen depreciation since the November 2016, for the full year “fluctuations in currency exchange rates” weighed on the income growth. Excluding “fluctuations in currency exchange rates,” the top 3 companies posted an increase of 931.8 billion yen. In the U.S. market, demands have been shifting from sedan cars to sport utility vehicles (SUVs) on the back of low gasoline prices and low interest rates. Automakers incur heavy expenses of sedan sales incentives in fierce competition, which are putting downward pressure on incomes.

On the financial front, all companies increased net assets through profit accumulation as of the end of FY2016 though some companies saw a drop in foreign currency translation adjustments resulting from stronger yen and performed buyback of their own shares. The top 3 companies’ net cash amount (difference between ready liquidity and interest-bearing debts; based on liquid assets for TOYOTA) for the Automotive segment excluding sales finance increased to around 10.9 trillion yen (around 4.5 trillion yen as of the end of FY2007). Individually, Mazda Motor Corporation (“Mazda”) turned around to the net cash position of 35.4 billion yen at the end of FY2016. On the other hand, intensifying competition for developments of environment technology and autonomous drive technology is raising automakers’ R&D expenses and capital investments. FY2016 capital investments decreased 5.3% (the 8 companies’ total) year-on-year due to the impact of the drop in foreign currency translation adjustments resulting from stronger yen. For FY2017, capital investments are planned to increase by 6.9%. Investment burdens may be a factor of putting downward pressure on business performance in a short term, but many automakers have a policy to continue their capital investment for future growth including developments of environment technology and autonomous drive technology.

3. Highlights for Rating

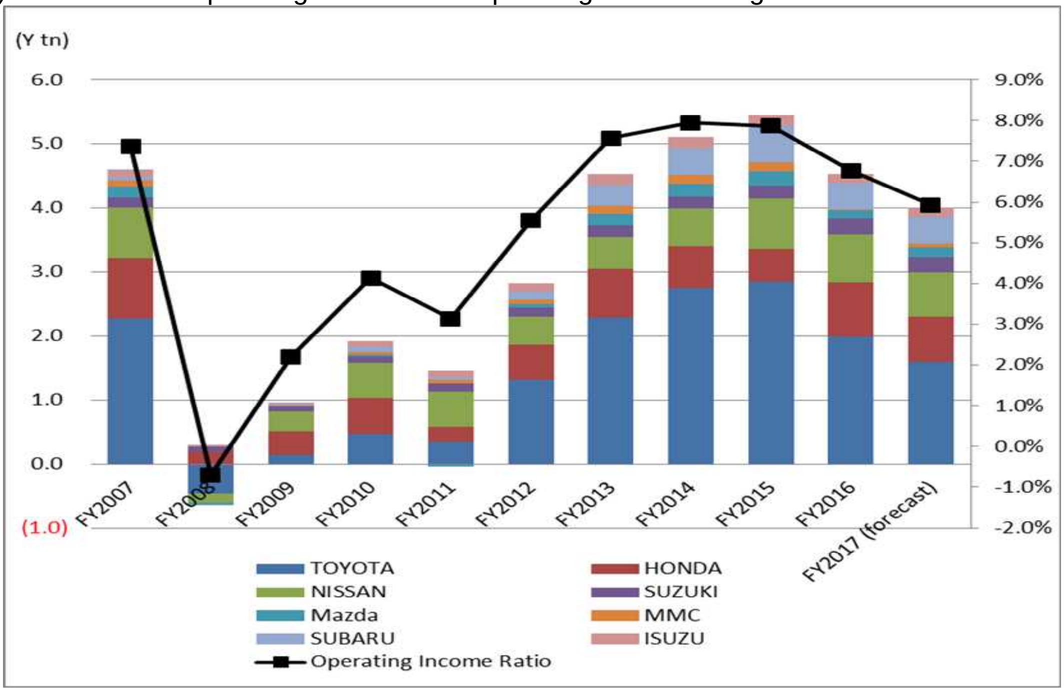
While the units of worldwide new car sales in FY2017 of the 8 companies are forecast to increase 1.9% year-on-year and sales volume increase 1.2% (increase in the 7 companies’ earnings), operating income decrease 11.5% year-on-year. Only the 3 companies expect earnings growth. The operating income increase/decrease analysis (of data from the 3 companies) forecasts that primary factors for an increase of operating income will be “cost reduction” for 270 billion yen, while “fluctuations in currency exchange rates” as a primary factor for a decrease for 265 billion yen and “volume/model mix” for 185.7 billion yen. Even if a negative impact of “fluctuations in currency exchange rates” is excluded, the decrease in income will amount to 322.2 billion yen. Since a rise in prices of raw materials such as steel products eliminates a part of effects of cost reduction activities with parts suppliers, the increase due to “cost reduction” is planned to be significantly less than 897.4 billion yen for FY2016. With the assumed exchange rates by the companies ranging from 105 to 110 yen, negative impacts of “fluctuations in currency exchange rates” on business performance will be significantly reduced compared to FY2016. The reason why “volume/ model mix” is cited as a factor for the decrease of operating income is that some automakers assume severe earnings environments in U.S. and other countries. On the other hand, some manufacturers expect operating leverage effects from increased sales of SUVs in U.S. Currently, the U.S. market is in an unpredictable situation because there are more uncertainties due to the new government’s trade protectionist policies as well as a lull in replacement demand and a buildup of sales incentives for sedan cars. The basic policies of the recent U.S. tax reform did not incorporate border adjustments for corporate taxation. However, concerns will remain about trade protectionist policies including a review of North American Free Trade Agreement (NAFTA). Any increase in a tariff through NAFTA review may have a bigger impact on automakers that handle large volumes of exports from Mexico to U.S. Then they will face issues about local production expansion and increasing tax cost absorption. Also, FY2016 financial reports show an increase in residual value costs due to weakness in used cars prices for the sales finance business in the U.S. market. The trend must still be watched.

In 2016, there were large-scale alliances (including started consideration) between TOYOTA and SUZUKI, following NISSAN and MMC. Japanese automakers precede other countries’ in many of these technologies, but there are few companies being able to develop these technologies in all directions single-handedly. There are increasing cases where the establishment of global cooperative relations is promoted for worldwide standardization of their own technologies by major automakers as well as middle-sized automakers. Recently, companies tend to forge partial alliances in relevant fields instead of cooperation by holding capital. It is important that they efficiently develop required technologies and make attractive cars through measures including partial alliance. JCR will pay attention to how they can maintain and strengthen their financial structure in the face of intensified competition for development.

Many Japanese automakers are promoting common use of platforms/ parts with an aim to raise product capability/development efficiency and to reduce costs. TOYOTA has been promoting the initiative "Toyota New Global Architecture" ("TNGA"). TOYOTA's new Prius launched in December 2015 is its TNGA's first model, and half of its global sales will be the TNGA model in around 2020. TOYOTA has a policy of focusing on improvement of gross margin per unit of car sales by TNGA and other initiatives. NISSAN has been promoting common use of platforms/ parts since it introduced its next-generation vehicle engineering concept, Common Module Family ("CMF") in FY2013 and will make 70% of vehicles into the CMF model in the Renault-Nissan alliance by 2020. JCR will pay attention to how these measures can improve the Japanese automakers' operating income margin through their strengthened brand power and cost competitiveness.

Mikiya Kubota, Akio Kamimura

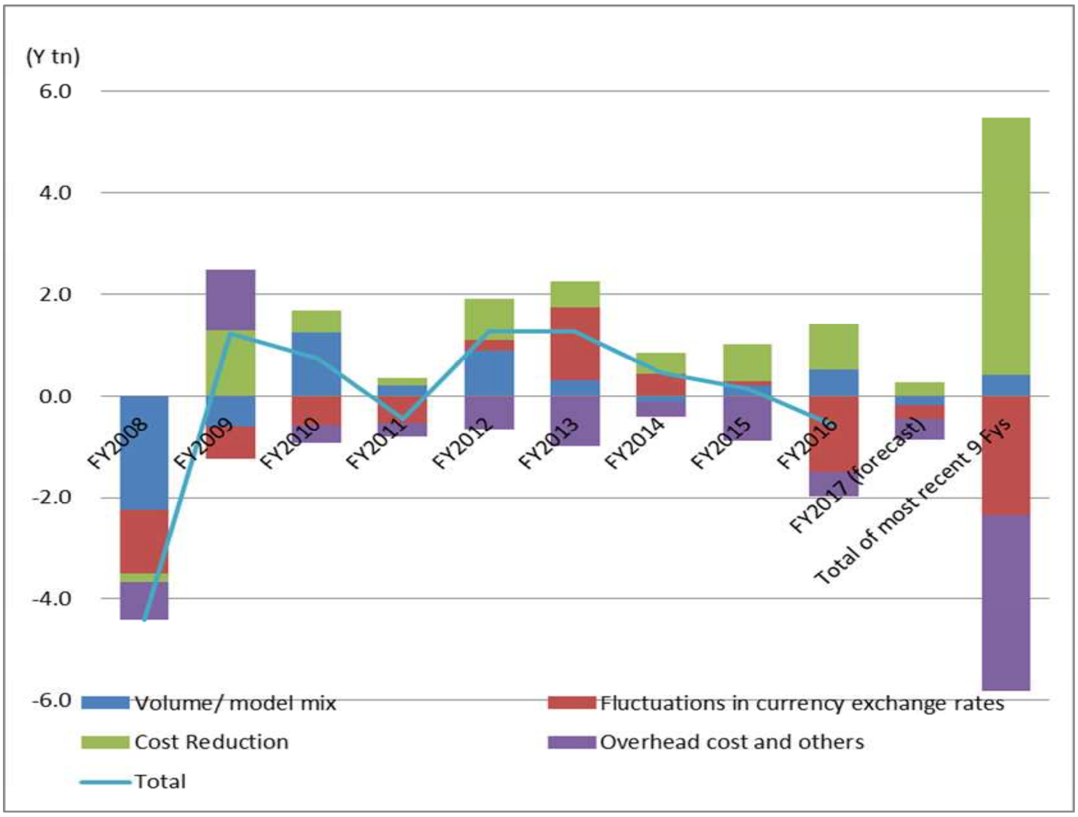
(Chart 1) Consolidated Operating Income and Operating Income Margin of 8 Listed Automakers



(Source: Prepared by JCR based on financial materials of above companies)

Note: (excluding HINO MOTORS, LTD. ("HINO"), a consolidated subsidiary of TOYOTA MOTOR CORPORATION ("TOYOTA"))

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



(Source: Prepared by JCR based on financial materials of top 3 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: Positive

Issuer: TOYOTA MOTOR CORPORATION

CP: J-1+

Issuer: Mazda Motor Corporation

Long-term Issuer Rating: A- Outlook: Stable

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