

Financial Results Briefing for Q2 FYE Mar. 2024

Q: I understand that your operating profit forecasts as of 1Q were 30 billion yen for 1Q, 60 billion yen for 1H, and 100 billion yen for 2H, and you have revised the full-year forecast upward. Given the effect of the weak yen, it appears that 1H results have been weak. What was the factor for that? According to your forecasts for 2H, PT unit sales volume will be flat from 1H, and Toyota production volume will increase. Are these volume forecasts conservative? How about fixed costs forecasts? Are they also conservative?

A: 1H results were largely as expected except for some one-off quality-related expenses. Profit is expected to be stronger in 2H than 1H as the effect of rationalization and collections from higher resource prices tend to occur in 2H. As Toyota will announce their earnings results tomorrow, we do not yet know what its production volume projections will look like. However, given the situation in China and other circumstances, we have factored in a risk of about 10% for 4Q. Our fixed costs forecasts are conservative to some extent.

Q: There have been disclosures from other companies about share repurchases in conjunction with the dissolution of cross-shareholdings. What is the situation at your company?

A: It is as reported at the medium/long-term business strategy briefing 2023, and there has been no change since then.

Q: As there is a significant difference between 1H results and 2H forecasts, I would like you to indicate your idea of true profit levels. Is it correct to understand that the change of -23 billion yen in fixed costs, etc. shown in the analysis of operating profit has been included only to reflect the risk that matches the increase in profit due to exchange rates, rather than to reflect specific items, such as impairment losses or quality-related expenses?

A: It is not correct to say that we have not reflected any specific item. We have reflected a certain degree of risk.

SQ: But for these one-off expenses, I expect that operating profit would be about 140 billion yen for 2H and 70 billion yen on a quarterly basis. If we extrapolate these figures over the full year, operating profit would be about 280 billion yen. What is your estimate of true profit level given the current production volume and exchange rates?

SA: In 2Q, the operating profit margin was roughly 5%, and we think that this is about our true profit level, although the 2Q profit was inflated somewhat due to the effect of exchange rates.

Q: Regarding the changes in profit in North America from positive in 1Q to negative in 2Q with a full-year forecast for a positive profit, please tell us about your current evaluation of the situation and the likelihood that profit will improve in 2H.

A: The loss in North America was mainly due to rises in raw material prices and personnel expenses and instability in the production system. As we will continue efforts to improve the situation and the production volume of electrification products is expected to increase in 2H, we intend to achieve a return to profitability, and the forecast reflects our intention.

SQ: It appears that revenue in 2H will be lower than 1H. Do you think that there is a risk of failing to achieve the target?

SA: The lower revenue in 2H reflects the effect of currency translation. We do not expect that the business volume will decrease in 2H. We also expect that the direct impact of the UAW strike will be small. On the other hand, we are closely monitoring any impact and risks arising from the ripple effect of the compromise reached through the strike.

Q: What are the main factors behind the upward revision of Chinese OEM's revenue? In addition, is it correct to understand that such revenue will decrease in the medium term as the use of ICE decreases?

A: We have revised the full-year forecast upward by 59.7 billion yen. This is based on several factors, including the increase in exports from China, the increase in the sales of models that are equipped with our products, and an increase in production volume at our joint venture partner. Needless to say, we do not expect that AT sales will increase significantly in the long term.

Q: At the medium/long-term business strategy briefing, you announced an operating profit target of over 300 billion yen for FY2025. How do you plan to achieve an increase of 90 billion yen from 210 billion yen for the current fiscal year.

A: Our basic approach has not been changed from the explanation provided at the medium/long-term business strategy briefing. We will implement a resource shift to growing domains while promoting business portfolio restructuring, profitability improvement in existing products, and balance sheet reformation.

SQ: Does the increase of 23 billion yen in fixed costs include that?

SA: It includes both investment in growing domains and one-off risks.

Q: Please tell us about the situation of profit by product in 1H.

A: As for the Body segment, we expect that the profit margin will rise going forward as products in growing domains, such as PSDs and car space entry systems, will increase and we are also considering the outsourcing of certain existing products. As for the Chassis and Vehicle Safety System segment, profit levels are not yet high partly due to product quality and cost issues for cooperative regenerative brakes. We will work to improve the situation toward 2025 and 2030. As for the Powertrain segment, costs have been on a rising trend due to the shift from six-speed to eight-speed, and further to electrification. However, the profit situation is expected to improve going forward as the production volume of HEVs, eAxle, and e-Four vehicles increases.

Q : Electrification unit sales are increasing, and I understand that they are growing at a higher rate than the rate of growth of Toyota's HEV production volume. What is the reason for this?

A: Regarding HEVs, we share production with Toyota, and the rate of growth may be higher or lower depending on the models for which we are responsible. Therefore, we cannot draw a sweeping conclusion. On the other hand, the production volume of e-Four vehicles is increasing. As two electrification units are installed in one e-Four vehicle, it is contributing to the increase in electrification unit sales.

SQ: In the powertrain business, depreciation is relatively large compared to investment. Will investment and development expenses in the powertrain business as a whole increase going forwards as you continue to invest in electrification?

SA: We will continue investment to the extent necessary subject to a certain ceiling. Therefore, we will control such investment within the limit of depreciation of approximately 260 billion yen for the entire business portfolio.

Q: Regarding the 500 billion yen announced at the medium/long-term business strategy briefing, please tell us about your current plan for the additional return to shareholders.

A: Our plan for additional return to shareholders has not been changed since the medium/long-term business strategy briefing. There are various ways to implement shareholder returns, and dividends is one of them. We currently use payout ratio, but we plan to change this. More specifically, we are considering the use of total shareholder return ratio, DOE, etc., and plan to ensure stable dividends based on these metrics.

SQ: When will the additional return to shareholders be implemented?

SA: It depends on the progress of the reform for the creation of funds to be used as a source of such returns.

SQ: Is it correct to understand that the cost for the reform is included in the increase of 23 billion yen in fixed costs, and it is the cost for the reconstruction of the business portfolio, including the sale of entrusted businesses?

SA: The key question is how to use impaired assets effectively, and we will reduce business assets, cross-shareholdings, and global inventory as explained at the medium/long-term business strategy briefing.

Q: What is the situation of inquiries about Xin1 at the Mobility Show? Are there needs in China? Has there been any change in the internal and outsourced production needs of OEMs?

A: We believe that the Mobility Show visitors understood the progress in development by looking at the exhibition of our actual activities. As for the status of market acceptance, the BEV strategy of each market and each customer has not been clearly defined. Therefore, internal and outsourced production needs vary with each customer. We listen to customers' concerns using existing relationships with customers to make progress toward commercialization.

Q: You told us that you will focus full-year research and development spending of 210 billion yen on growing domains identified in your medium-term plan. Do you plan to raise the level of research and development spending from the current level of 5% to revenue? Please tell us about your approach.

A: Development spending will be allocated to growing domains subject to a certain ceiling. As we cannot allocate unlimited resources to them, we will secure the necessary development resources through reskilling as well as strategic responses in collaboration with our partners by defining the division of roles.

Q: What is the status of progress toward the reskilling of 3,000 employees?

A: Reskilling started in 2022, and we plan to achieve the reskilling of 3,000 employees throughout the Group on a cumulative basis in around four years. We are promoting the development and skill conversion of engineers through exchanges with OEMs. We are also increasing human resources with strong software skills, such as in digital transformation and AI.

Q: The business in Asia appears to be healthy. What is your outlook?

A: We have achieved growth focusing mainly on Japanese customers in Thailand and Indonesia. On the other hand, we understand that the market is gradually changing as the presence of Chinese and South Korean companies is notably increasing. As changes that occurred in China in the past could also occur in other parts of Asia, we are working to be ready to take early electrification actions while monitoring the developments among OEMs. As India will also be a future growing domain, we will promote responses mainly focusing on Suzuki.

Q: You have told us that PSDs are increasing in the Chinese market. How will they contribute to profit?

A: As the profit margin of PSDs is relatively high, they will contribute to profit to a certain degree.

Q: What is the current status of inventory? What is the future direction?

A: Excluding the effect of currency translation, we have achieved a reduction of approximately 40 billion yen. As explained at the medium/long-term business strategy briefing, our inventory reduction target is around 100 billion yen. North America is ahead in normalization following the end of the COVID-19 pandemic, dock strikes, and logistics disruptions, and inventory is decreasing steadily as a result.

Q: What is the progress status of eAxle, such as responses to sales promotion of second-generation and third generation eAxle?

A: We provide products that meet customer needs, rather than selling high-efficiency, small-size products at low prices. As customer needs for BEVs are increasingly diverse, we propose products that meet the needs of each customer.

Q: Toyota is shifting to in-house development and internal production, and competitors are promoting sales to other Japanese OEMs. What are your responses in competing with them?

A: It is conceivable that we will manufacture certain products that are also manufactured internally by OEMs as long as their standards and other requirements meet ours. As for Toyota, as we currently share the manufacturing of AT and HEVs, we may plan to share also the manufacturing of eAxle with Toyota.