Q&A for the Third Quarter of the Fiscal Year Ending March 31, 2022 Financial Results

✧ Message from the Minami, Director of the Board, and Managing Executive Officer, Corporate Strategy Division Executive, and Corporate Planning & Finance Division Executive

I would like to talk about the evaluation of the third quarter results of this fiscal year ending March 31, 2022, and the full-year outlook. The operating income for the third quarter was 51.3 billion yen, almost in line with the company's plan. On the other hand, as a result of supply chain issues, we could not produce products as many as we had expected, thus many customers' orders cannot be met in the midst of the strong demand. Though the cause comes from an external factor, we deeply regret for the inconvenience we are causing to our customers.

Last summer, the supply chain in Southeast Asia experienced a disruption in the supply of production parts due to the spread of COVID-19, but this impact had been normalized by the beginning of last fall. However, it took the whole third quarter to make up for the delay in production plan. In addition, the supply shortage of parts using semiconductors became apparent at the end of last year. Although it affected only one or two specific parts, it significantly restricts the production of almost all CV vehicles for advanced countries. The procurement amount will remain far below the required amount in the fourth quarter. Fortunately, production of vehicles sold in emerging countries are not impacted by the semiconductor shortage. Plus, demand is also strong in these countries. In the fourth quarter we plan to tackle the chip shortage by shifting production of vehicles for advanced countries to vehicles for emerging countries. It is very good news that the LCV production in Thailand is on track at a high level, which we believe will contribute to our fourth quarter earnings.

While the current exchange rate is favorable for our profitability, we have to expect further increases in material and logistics costs. In addition, the sales in Japan and North America, where the supply of product inventory is insufficient, is in a very serious situation. We cannot help but slow down order intake in these markets, and thus we need more time to figure out how this will affect our earnings. Distribution of goods are very active globally, and the strong demand for trucks remains unchanged. Although we are in a environment where we will be able to increase sales if we can produce vehicles, we have kept the operating income forecast of 170.0 billion yen unchanged, partly because it is unclear when the negative factors on production will be resolved.

✧ Full-Year Outlook

Q. Why is it that Isuzu did not change its sales figures for the full year even though the company revised the unit sales downwardly?

A. Although the total unit sales of CV and LCV vehicles are forecasted to decrease, we reflected the higher-than-expected revenues from aftersales services and parts in the full year outlook, hence the sales remain unchanged.

Q. By shifting the CV destination from Japan and North America to emerging countries, there shall only be a slight decline in the overall unit sales. Could you tell me about the deterioration in the sales and model mix due to this shift? Also, is it correct to understand that this deterioration only affects this fiscal year and will not continue onto the next fiscal year?

A. The sales and model mix worsened by 4.5 billion yen from the previous forecast. This trend is not just for this fiscal year; it will continue until the supply shortage of semiconductors is resolved.

Q. You have mentioned that the impact of decrease in sales and model mix is 4.5 billion yen. Considering the decrease in unit sales of CVs in Japan and LCVs in Thailand, the profitability of the emerging countries, to which Isuzu made a production shift, seems to be not so bad. Please tell me about the profitability in emerging countries.

A. The breakdown of the sales and model mix decrease is as follows: negative 15.0 billion yen in CV in Japan; positive 11.0 billion yen in CV in overseas markets; negative 2.0 billion yen in LCV; and positive 1.5 billion yen in other categories such as aftersales services. Overall, the markets of CBU (complete built-up) destinations are highly profitable, while the markets of knockdown-set destinations tend to be less profitable as the local procurement ratio increases. Of the destinations of which production has been shifted to, profitability of Australia and the Middle East is not bad.

Q. Regarding the full-year change analysis described on page 19 of the earnings report, cost reduction activity of 24.4 billion yen is expected, which is much higher than the previous forecast. The negative impact from fixed cost fluctuation has also been reduced from the previous forecast. Is it correct to assume that reduction in expenses will continue sustainably to the next fiscal year and onward, or is the cost reduction just the result of urgent measures to secure the full-year outlook of 170.0 billion yen in operating income in the face of the decrease in sales and model mix?

A. Among the change analysis factors, cost reduction activity amounts to 24.4 billion yen, and as usual, half of it comes from Japan and the other half from Thailand. We have been working on activities such as improvements in the production processes at our plants and promotion of local procurement of parts. Therefore, we are not increasing the cost reduction for the sake of meeting the profit target, but rather we recognize it as a result of steady efforts, and hence the cost reduction activity is sustainable. On the other hand, in the fixed cost fluctuation, reduction of 3.7 billion yen from the previous forecast includes a revised amount of 2.0 billion yen in promotion expenses for overseas markets. If and when the current situation changes, promotion expenses are expected to return to the normal level.

Q. Out of the steel, oil price etc. fluctuations of negative 45.0 billion yen, how much of it is impacted by logistics expenses?

A. Out of negative 45.0 billion yen in steel, oil price etc. fluctuations, logistics expenses amount to negative 10.0 billion yen. This includes the increase in port charges and transportation costs in inland areas in North America, but it is mainly due to the increase in ocean freight cost.

Q. In the fourth quarter, the operating income is expected to be 21.4 billion yen, a 30.0 billion yen decline from the third quarter. What is the reason for the large decline, which includes the impact from the production cutback?

A. In addition to the historical trend of cost generation disproportionately concentrated in the fourth quarter, the negative impact of steel, oil price etc. fluctuations are assumed to be concentrated in the fourth quarter for this fiscal year. Although the number of CV registrations in Japan tends to increase in the fourth quarter in normal times, the unit sales in Japan has been decreasing due to production constraints caused by the chip and parts supply shortage. As the sales and model mix will fall more than the decline in unit sales in Japan, the sales and model mix are assumed to increase by only 1.9 billion yen. Under normal circumstances, the sales and model mix would be around 10.0 billion yen, which is also one of the reasons for the decline in operating income in the fourth quarter.

Q. Is it correct to understand that the operating income forecast of 170.0 billion yen announced in November had some leeway in cost reduction and rationalization efforts?

A. That is correct. In the November forecast, Isuzu kept its operating income forecast at 170.0 billion yen unchanged, partly due to uncertainty over parts supply.

✧ Production and sales situation

Q. Isuzu mentioned that the outlook for the supply of semiconductors will remain uncertain, but I would like to know if there is any prospect that this supply shortage issue will be resolved.

A. The outlook for semiconductor supply remains uncertain for the CVs produced for advanced countries. At present, it is assumed that the prospect of chip supply recovery can be seen in the first quarter of the next fiscal year. However, it will take at least until the first half of the next fiscal year to normalize production, and subsequently the sales to return to normal in the second half of the next fiscal year or later. As to LCVs produced in Thailand, although supply constraints remain for some parts at the moment, the CBU production levels in January have recovered to the production capacity limit.

Q. How many vehicles were actually lost in production cutback due to the semiconductor shortages for this third quarter alone, and how many are expected to be for the entire fiscal year?

A. Following are the numbers of vehicle units affected by the semiconductor issue as well as by disrupted parts supplies from Southeast Asia: For this third quarter alone, 10,000 units of CVs for the Japanese market, 5,000 units of CVs for overseas markets, and 5,000 units of LCVs, totaling 20,000 units. For the full year, around 32,000 units of CVs for Japan, 8,000 units of CVs for the rest of the world thanks to less negative impact from the semiconductor issue, and 45,000 units of LCVs.

Q. The market share of your light-duty trucks in Japan for January 2022 was substantially lower than the level usually maintained (like 40% or above). How do you think these production restrictions will influence your business in the medium run?

A. As regards the light-duty trucks for Japan, we foresaw at the beginning of the third quarter that the disrupted parts supply from Southeast Asia would improve at a certain point, explaining the situation to our customers and persuading them to understand delay in delivery and wait. However, the rise of a new issue, i.e. semiconductor shortages, made us unable to determine the delivery timing. We expect that some customers will leave us for our rivals. We have sold our trucks with emphasis not only on their quality and performance, but together with connected services and uptime guarantee in a comprehensive manner. We expect to recover our sales by the middle of the next fiscal year with the inventory properly adjusted.

Q. What are the backorder levels of CVs and LCVs? Also explain when you expect to eliminate and normalize the backorders.

A. The backorders of CVs for Japan at the end of December 2021 were around 14,000 units for medium-and heavy-duty trucks and 14,000 units for light-duty trucks. The backorders of CVs for overseas markets were around 30,000 units, the same level as at the release of the current fiscal year's second quarter results. The backorders for emerging markets are falling while those for the North American market are rising, as the production for North America has been shifted to the one for emerging markets due to the semiconductor shortage issue. As regards when we will normalize the current levels of backorders, firstly, it will take us until the end of the next fiscal year's first quarter to settle the semiconductor shortage issue affecting CVs, with various countermeasures now ongoing, and until the end of the next fiscal year's first half to normalize our production level; the backorder elimination will follow them. The backorders of LCVs, as of the end of December 2021, also remained at the same level as the release of the current fiscal year's second quarter results, i.e. about 30,000 units for Thailand, 60,000 units for export markets, totaling 90,000 units. The production level of LCVs, though recovering more than expected, is forecasted to take some more time before normalization.

Q. You explained that the number of completely built-up (CBU) LCVs produced in Thailand in January 2022 amounted to 30,000 units. Explain your views on the LCV production cutback risk in the future.

A. Although supplies of semiconductors are yet to be secured for all vehicle components and systems where such chips are needed, most of them are showing signs of recovery. Though we cannot say for sure that no new issues will arise, the number of CBU LCVs produced in January 2022 was very high as a monthly production level, a status that is expected to contribute positively to the fourth quarter's earnings.

Q. Explain your views about the LCV demand in Thailand.

A. The total industry volume of LCVs in Thailand for CY2021 was lower than the previous year due to production constraints materially affecting LCV manufacturers. But the demand is very strong, a positive sign that the next term's industry volume will significantly exceed this term's, though depending on how the production constraints will improve.

✧ Changes in business environments/conditions from the mid-term business plan

Q. What is your expectation about sales volumes for the next fiscal year? Explain if any changes are expected in the numbers shown in your mid-term business plan.

A. The demand for CVs is very strong across the world, thanks partly to economic recovery measurers by countries. For instance, in Australia we confirm a strong demand due to tax incentive measures. In America we see a robust demand from the goods delivery sector, though having difficulty delivering trucks to our customers. We are now seeing a market recovery in Thailand and Indonesia too. Though the production constraints have remained as open issues, the sales volumes of CVs are expected to exceed the 300,000-unit level shown in our mid-term business plan. As regards LCVs, the demands in Thailand and export markets are strong, and our new LCV models have been highly evaluated and well accepted. The backorders have remained at a high level due to production constraints, and it is expected to take some more time for us to see the inventory return to its normal level even if the high LCV production level, which has been seen since January 2022, is maintained. The sales volumes in the mid-term business plan, though set at a fairly high level, are fully achievable.

Q. Is it more appropriate to think that there is a risk that the negative impact from fluctuations in raw material prices, logistics costs, etc. will prevent Isuzu from achieving your operating income target of 250.0 billion yen in the mid-term business plan’s final year? Or is the operating income target achievable, due to the strong demand and price increase? Explain your view on this point.

A. The fluctuations in prices of raw materials such as steel and logistics costs have a substantial impact on profitability, despite the strong vehicle demand. The scale of the negative impact on operating income from raw material price hikes is expected to be around 40.0 billion yen for the full year, though the influence from logistics costs is still unclear. This level of negative impact is difficult to absorb within a year, posing us a challenge of how to absorb it in the next fiscal year and the year after that. We shall raise prices of our products in the overseas markets over the next two years, starting from the next fiscal year. Of course, we shall also implement further cost-down measures. Though there are possibilities that the said impact could be offset by an increase in sales volumes, fundamentally we would like to absorb it somehow.

✧ About UD Trucks

Q. As regards synergies with UDT, nine months have passed since the acquisition of UDT. You may have encountered to possibilities of synergies what you did not expect before. Explain about potentiality of more synergies being created with UD Trucks.

A. UD Trucks’ overseas businesses have been considerably improving, with its aftersales business becoming profitable as the accumulated number of its vehicles sold to and used by customers has been on the increase. However, due to the Covid-19 pandemic, we see some delay in creating synergies from collaboration in local operations in such places as South Africa and Thailand, as well as in product lineup. Production collaboration has begun on a small scale in Japan, like part of the painting process for Isuzu trucks being done at UDT’s plant. But it will take us some more time to achieve big synergies, as we need to streamline mutual product lineup. As regards aftersales services, it is planned that dealers of Isuzu and UDT will mutually utilize each other's service capacity. Isuzu and UDT are currently identifying and adjusting differences between us in terms of ways of operations for services and supply parts. Other possible synergies will be proposed in the next fiscal year or the year after that. We would like to comment on this in a separate occasion.

Q. Do you expect that the results of the post-merger integration with UDT will be better than expected in the next fiscal year, so that the effects will offset the negative impact from the material price hikes on profitability?

A. We do not expect that it would be enough to make up for the negative impact from the rise in material price in the next fiscal year. As we have originally forecasted, to create big synergies, we need to further pursue complementarity Isuzu and UDT have in terms of mutual product lineup, which will take some more time.