

# To Our Shareholders



## Review of Financial Performance and Operations

During fiscal 2001, ended March 31, 2001, economic conditions surrounding Honda remained challenging. The U.S. economy, while strong during the first half of the year, began to decelerate in the second half. Further, although principal European economies fared well and Asian economies displayed signs of recovery, the Japanese economy remained at a standstill under lackluster consumer spending and weak private-sector capital investment. Conditions in foreign exchanges generally remained severe, marked by the appreciation of the yen against the U.S. dollar and European currencies in the fiscal year, despite the tendency for the weaker yen during the second half.

Under such circumstances, Honda set a high record in unit sales for its automobile business operations. A new high was reached in net sales, thanks primarily to favorable automobile sales in North America and Japan. However, profits declined due mainly to decreased automobile sales in Europe, resulting in a lower capacity utilization rate at our auto plant in the United Kingdom, together with the higher yen against the European currencies and the weakened euro against the sterling pound.

Consolidated net sales and other operating revenue amounted to ¥6,463.8 billion (\$52,170 million), an increase of 6.0% from the previous fiscal year, due primarily to favorable



automobile sales in North America and Japan as well as motorcycle sales in North America, all of which offset the negative currency translation effects caused by the appreciation of the yen. We estimate that had the exchange rate of the yen remained unchanged from the previous fiscal year, revenue for the year under review would have increased approximately 8.0%.

Consolidated operating income for the year totaled ¥406.9 billion (\$3,285 million), a decrease of 4.5% compared to the previous fiscal year. Despite increases in unit sales for motorcycles and automobiles, as well as changes in model mix and Honda's ongoing cost-reduction efforts, the negative impact of the appreciation of the yen together with increased research and development expenses as well as selling, general and administrative expenses were the major factors for this decline in operating income.

Consolidated income before income taxes for the year totaled ¥384.9 billion (\$3,107 million), a decline of 7.5% compared to the previous fiscal year.

Consolidated net income for the year totaled ¥232.2 billion (\$1,874 million), a decrease of 11.5% from the previous fiscal year. Net income per common share for the year amounted to ¥238.34 (\$1.92).

With respect to Honda's sales for the fiscal year by geographical category, motorcycle unit sales in Japan

declined 7.5%, to 407,000 units, due primarily to lower sales of business motorcycles and scooters. Automobile unit sales increased 9.9%, to 776,000 units, due mainly to strong sales of the Odyssey minivan, redesigned in December 1999, and the introduction of the redesigned Civic in September 2000, followed by the new Stream minivan in October 2000. Unit sales of power products showed a 10.4% decline to 164,000 units, resulting from weaker sales of electric generators and outboard marine engines.

In North America, unit sales of motorcycles showed strong growth, totaling 519,000 units, a 31.7% increase from the previous fiscal year. This increase was attributable mainly to favorable sales of new, large-sized models. Unit sales of automobiles increased 3.9%, to 1,346,000 units, thanks to favorable sales of such light truck models as the Odyssey minivan and the newly introduced Acura MDX sport utility vehicle (SUV). Unit sales of power products declined 12.5%, to 1,412,000 units, due mainly to intensified competition in the OEM segment of general-purpose engines as well as higher inventories of electric generators in the market.

In Europe, motorcycle unit sales declined 12.3%, to 341,000 units, reflecting weaker sales in such major markets as Germany and France. Unit sales of automobiles totaled 191,000

units, down 23.3%, due to lower sales of the Accord and the Civic series as well as other changes in business conditions, such as pricing issues in the United Kingdom. Unit sales of power products declined 4.2%, to 1,269,000 units, due mainly to a decline in sales of lawnmowers. Under such circumstances, an operating loss was recorded in our European business in the geographical segment for the second consecutive year.

In other regions, which include Asia/Oceania, Latin America, the Middle East and Africa, Honda enjoyed stable unit sales growth for all of its business categories—motorcycles, automobiles and power products. Unit sales of motorcycles increased 19.9%, to 3,851,000 units, automobiles totaled 267,000 units, up 19.7%, and power products increased 11.1%, to 1,039,000 units.

Our motorcycle business in Asia continued to grow. An economic recovery in ASEAN countries, notably in Indonesia, resulted in an increase in unit sales. Sales in India exceeded one million units—the first time for one of Honda's overseas markets. Automobile sales in China exceeded 40,000 units, contributing to an increase in overall unit sales in this region.

#### **Progress to Mid-Term Goal**

In May 2000, we set a global sales target for the fiscal year ending March 31, 2004 of selling 7 million motorcycles,

3 million automobiles and 6 million power products—a grand total of 16 million Honda products. The fiscal year ended March 31, 2001 was the first year toward this goal. Motorcycle unit sales were 5.11 million units, automobile sales totaled 2.58 million units and power product sales were 3.88 million units. In total, we sold more than 11.5 million Honda products—an increase of 5.6% over the previous fiscal year.

For the fiscal year ending March 31, 2002, we have set sales targets of 5.68 million motorcycles, 2.71 million automobiles and 4.62 million power products—a total of 13 million units. If we can achieve this goal, it would be an increase of 12.3%. We intend to achieve this increase primarily through introducing new products with the newest, most advanced technologies.

Our strategy will continue to be based on a “market-in” approach. For Honda, this means understanding the rapidly changing needs of the local marketplace, then developing and producing products efficiently so that we can offer our customers a higher level of value. Achieving this requires that we continue to strengthen our ability to develop, build and sell products in local markets.

Currently, we have 118 plants in 31 countries, where we produce motorcycles, automobiles and power products or related components. This year, we began producing motorcycles at a new plant in India. In the United Kingdom, we will open our

second automobile plant. In the United States, our new automobile and engine plant will begin operations in Alabama.

In China, it is estimated that there are more than 10 million units of new motorcycles sold each year. In this market, we plan to set up a new motorcycle joint venture company by combining the current Tianjin Honda with a prominent local manufacturer—to form a new local company named Sundiro Honda Motorcycle Co., Ltd.

But the key is not just building factories. Rather, it is building a global network of factories that work together to meet the needs of our customers.

Over the past few years, we have been strengthening our production network through the launch of our New Manufacturing System. We have completed implementing this system for the assembly of automobiles at the Saitama Factory and Suzuka Factory in Japan, the East Liberty Plant in the United States, the Alliston Plant in Canada and the Swindon Plant in the United Kingdom.

We believe that with the New Manufacturing System, we have been able to improve the quality of our products, shorten the lead time required for production, increase our flexibility to build models on different production lines and reduce the level of investment required for new model introduction.

As a result, our capacity utilization ratio has increased a great deal. At the same time, the “Green Factory”



initiative incorporated in the New Manufacturing System has enabled us to reduce energy consumption and eliminate industrial waste almost completely.

Based on this success, we have now begun to implement the New Manufacturing System for our motorcycle and power product operations, which we expect to complete on a global basis by calendar 2003. We believe that we will achieve the same level of efficiency and flexibility with our motorcycle and power product operations as we have with the New Manufacturing System for automobile production.

Regarding our goal to achieve 16 million units in sales by fiscal 2004, we are well aware that one of our major challenges is the revitalization of our European operations. For the fiscal year ended March 31, 2001, we experienced significant losses in Europe related to our weak automobile sales.



The capacity utilization rate at our U.K. plant was less than half of its production capacity. Moreover, the rapid depreciation in the value of the euro against the yen negatively impacted our earnings.

However, we believe we can make a major improvement in profitability during the fiscal year ending March 31, 2002. For this fiscal year, we plan to increase our automobile sales in Europe, centered on the all-new Civic series. The 5-door model Civic is already on sale in the United Kingdom and sales are now being expanded to the continent. Furthermore, we will introduce the 3-door model this fall.

We are also committed to broadening our lineup to include the Stream—a strong-selling compact minivan in Japan—and the all-new CR-V SUV, which will be launched during this fiscal year. A new small car model

and a diesel version of the Civic will also be launched later this fiscal year.

In Europe, the need for small cars and diesel cars, which emit less CO<sub>2</sub>, is expanding because of the heightened concern for global warming and other environmental issues. In response to such circumstances, we will be introducing a highly competitive small car and diesel powered cars. A unique, next-generation small engine, which has two spark plugs per cylinder, has been created for the new small car. Through the computer-controlled ignition timing of the plugs, the fuel efficiency of this new gasoline engine is one of the highest levels in the world. This engine also reduces emission levels.

We will also begin producing, at our U.K. plant from November 2001, the new diesel version of the Civic, which will be equipped with a 1.7-liter diesel engine newly developed by Isuzu Motors Limited and built at its plant in Poland.

This is a unique engine for Honda, one that is not currently on the market. It comes to us as part of the mutual engine supply agreement with General Motors Corporation signed in late 1999. The new diesel engine will have an output of 100PS, but will also offer high fuel efficiency and cleaner emissions. We believe this engine is very competitive and will increase Civic series sales in Europe.

Further, with support from Isuzu we are developing a new Honda

two-liter-class diesel engine. This light, aluminum, diesel engine is targeted for the next-generation Euro Accord and capitalizes on our advanced gasoline engine technology. We believe it will be the most competitive diesel engine in the world, with top level performance and environmental friendliness.

On the manufacturing side, we intend to increase the capacity utilization ratio in the United Kingdom—including the new, second plant that will begin production in summer 2001. To achieve this, we will expand sales of the new Civic series on the continent of Europe. We will increase production volume by starting exports of the all-new U.K.-built Civic 3-door to both Japan and North America and the all-new CR-V to North America.

Our efforts are not limited to our automobile business. We also intend to strengthen our motorcycle and power products businesses in Europe. We plan to introduce a number of completely new, large-class motorcycles as well as full changeover models. In addition, we will expand the lineup of mid-sized motorcycle models based on local production and introduce some new scooter models.

We will expand introduction of the New Manufacturing System for motorcycles, which began in Japan, to our plants in Italy and Spain. Our motorcycle production in Europe should become more efficient and flexible without any significant new investment.

By adopting these measures, the local production ratio of our motorcycles in Europe will increase from the current 50% to approximately 60% of unit sales for the fiscal year ending March 31, 2004. Accordingly, we will be more resistant to currency rate fluctuations. Finally, we will also begin importing less expensive small motorcycles to Europe from emerging markets.

With regard to our power product business, as in our motorcycle business, we are now promoting the expansion of local production. We plan to further strengthen this in Europe by expanding the production of general-purpose engines in Italy. In France, we will begin the production of new push lawnmowers as well as grass trimmers. This will increase the local production ratio from the current 30% to approximately 40% of unit sales. Thus, as with our motorcycle business, our power product operations will be less vulnerable to currency fluctuations.

We will also strive to improve production efficiency, both in Italy and Spain. At the same time, we will establish a more efficient logistics system through various efforts, including greater concentration of inventory centers.

By adopting these strategies and such efforts as restructuring our European sales and distribution organizations, we plan for our European operations to return to profitability by the fiscal year ending March 31, 2003.

### Business Challenges

Among the biggest challenges now facing the auto industry are environmental concerns and the need for new technologies for safety.

In the 1970s, Honda created a new engine technology, CVCC—which met the most stringent emission regulation, the U.S. Clean Air Act of 1970. At the time, most people believed it was impossible to achieve such a level within a short period, but Honda did it. Since that time, we have remained a leader in the field of low-emission engines by setting our own high standards.

At Honda, we are not driven simply by compliance with regulations. We have always sought to achieve new standards faster than the requirements. Honda was the first automaker to achieve most of the low-emission, ultra-low-emission, and super-ultra-low-emission requirements set by the California Air Resources Board (CARB)

in the United States. Most recently, the new Civic GX natural gas model—introduced in December 2000—became the first vehicle to meet the advanced technology PZEV (Partial Credit Zero Emission Vehicle) standard set by CARB. The Honda Insight gasoline-electric hybrid car, introduced in 1999, has been the most fuel-efficient car in the United States, with an average fuel consumption of 64 miles per gallon, for two consecutive years, according to standards set by the U.S. Environmental Protection Agency (EPA).

In October 2000, the EPA awarded the Honda Insight with its “Climate Protection Award.” It was the first time that an auto company received this award, which recognizes individuals, organizations, and companies that demonstrate a commitment to greenhouse gas reduction, pollution prevention and recycling through technical innovation and stewardship.





We have already announced plans to expand our hybrid car technology. By March 2002, we will begin sales of a hybrid version of the Honda Civic in Japan and the United States.

In Japan, over 70% in terms of the number of our models have achieved a 50% lower emission level based on Japan's low emission regulations. By March 2003, every model we sell in Japan will meet this level.

In the United States, more than 85% of Honda vehicles sold in calendar 2000 were low-emission vehicles or cleaner—more than 980,000 units out of 1.15 million vehicles.

Working toward future power sources and the development of fuel cell vehicles, we have begun to work with the California Fuel Cell Partnership in the United States. By participating in this partnership, we are exploring the potential of fuel cell technologies and their infrastructure requirements. We have even begun test driving one of our fuel cell prototypes on public roads. In February 2001, we began test driving the vehicle with our own fuel cell stack. We plan to introduce a fuel cell vehicle to the market by 2003.

Turning to safety, in Japan in 2000 we established the world's first indoor, car-to-car crash test facility. This test facility provides the ability to conduct "real world" tests that help us improve our own safety standards, especially collision standards. Also, through this

facility we can strengthen our study of how to improve pedestrian safety.

Further, to create a total safety standard for the future we created the Honda Intelligent Driver Support System (HIDS)—currently being tested on public roads in Japan.

Honda's focus has always been on meeting the needs of our customers.

By improving the safety and environmental performance of our products—even as we make them fun and more enjoyable to operate we aim to create new values to earn the trust of our customers.

With the future in mind, but with gratitude for the past, I extend my thanks to our shareholders for your continued interest and support.

June 28, 2001

**Hiroyuki Yoshino**  
President  
and Chief Executive Officer