



## To Our Shareholders

Takeo Fukui  
President and Chief Executive Officer

### The Year in Review

Fiscal 2006, which ended March 31, 2006, was the first year of Honda's new mid-term business plan, launched in April 2005. During the year, we strengthened our position in each business and region and enhanced local operations. Seeking to lead the world in "creating new value for the customer," we harnessed our resources in an effort to further pursue the creation of advanced technologies and products that represent the uniqueness of Honda.

#### Environment

Honda's operating environment in fiscal 2006 was characterized by growing concern about soaring crude oil prices in various world regions. The U.S. economy was strong, benefiting from rising personal consumption and improved employment numbers, and the European economy posted a moderate recovery. Economies in Asia continued to record strong growth, especially in China and India. In Japan, the economy recovered modestly, supported by increasing personal consumption and capital expenditures and a turnaround in exports.

In this operating environment, Honda strove to solidify its corporate foundation in order to meet the needs of customers and society more swiftly and accurately. With respect to R&D, we actively developed technologies aimed at enhancing safety and minimizing environmental impact, as well as advanced technologies designed to boost the attractiveness of our products. On the production side, we strengthened our manufacturing foundation and expanded capacity at our Asian production facilities and affiliates accounted for under the equity method. We also started construction of a new transmission plant in the United States and a production facility in Asia. Regarding sales, we aggressively launched products offering new levels of value and delivered offerings with global appeal. Also, we worked to consolidate our automobile sales channels in Japan, upgraded our product lineup and strengthened our sales system.

#### Motorcycle Business

In fiscal 2006, we continued supplying attractive products to the rapidly growing Asian motorcycle market. This enabled us to expand sales, especially in India and Indonesia. To address rising demand, we increased production capacity at our manufacturing subsidiaries and affiliates accounted for under the equity method in those countries.

We also reported higher sales in Brazil, where the market continues to grow. Sales in other regions were also favorable.

Amid ongoing expansion of our global operations, we sought to improve our production technologies and our ability to efficiently launch new models. At the same time, we advanced the skills of our technicians and strengthened our domestic production systems, with a view toward launching our advanced technologies globally.

We continued our aggressive pursuit of safety-enhancing and environmentally friendly technologies with highlights of the period including the launch in Asia of a small-size motorcycle equipped with Honda's original programmed fuel injection (PGM-FI)<sup>\*1</sup> technology. We also succeeded in developing the world's first mass-produced motorcycle with an airbag protection system. In these and other ways, we used multiple technologies, accumulated from our experience in automobiles, to make better and safer motorcycles.

Unit sales of Honda motorcycles, all-terrain vehicles (ATVs) and personal watercraft (PWC) in fiscal 2006 amounted to 10,271,000 units<sup>\*2</sup>, down 2.0% from the previous year.

In another highlight, cumulative motorcycle production reached 150 million units in fiscal 2006, 57 years since the launch of the *Dream Type D*<sup>\*3</sup> in 1949.

### Automobile Business

In the automobile segment, we undertook a full model change of the *Civic* in various regions around the world, launching models that meet specific local needs. These included dedicated models for the North American and European markets. Increasingly concerned about rising gasoline prices and environmental issues, more customers are demanding fuel-efficient products. As a result, the new *Civic* received overwhelming support.

Fiscal 2006 saw healthy sales of the *Civic* and other passenger cars in North America. Sales of light truck models in the region were also strong, mainly boosted by the launch of the *Ridgeline* in March 2005.

In Asia, where the market continues to grow, sales in China, India and other major markets increased, enabling us to broaden our business in the region. In response, we increased the production capacity of manufacturing subsidiaries and affiliates accounted for under the equity method.

In the domestic market, which remained challenging, we upgraded our product lineup and deployed information technology to strengthen our sales and service systems. Seeking to maximize customer satisfaction and enjoyment, in March 2006 we integrated our three sales channels—Primo, Clio and Vemo—into a single Honda channel, through which all Honda-brand automobiles can now be purchased.

Unit sales of automobiles rose 4.6%, to 3,391,000 units,

### Power Product Business

In the power product segment, we reported solid sales in North America of generators and engines supplied on an OEM<sup>\*4</sup> basis for use in pressure washers. In Europe, sales of engines supplied on an OEM basis for use in lawnmowers increased. Sales were also boosted by our supply to various regions of highly cost-competitive products made in Asia.

During the year, Honda began sales of the *iGX* engine<sup>\*5</sup>, boasting world-class environmental

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**\*1: Programmed fuel injection (PGM-FI)**

This original Honda system is designed to enhance fuel efficiency and lower emissions. It employs various sensors to monitor engine operating status and a computer to calculate the optimal amounts of fuel required. The system then delivers those amounts to the engine cylinders. Honda adapted its PGM-FI system, originally developed for automobiles, to motorcycles by reducing the number of parts to make it more compact and less expensive.

**\*2:** Of the unit sales of Honda-brand motorcycle products that are manufactured and sold by overseas affiliates accounted for under the equity method, those to which parts for manufacturing were not supplied from Honda or its subsidiaries are not included in unit sales. If those products, which amounted to approximately 2.6 million units, had been added, total unit sales would have increased 12% from last fiscal year.

**\*3: Dream Type D:** This was Honda's first originally-developed motorcycle, marking a notable departure from previous models, which had been based on bicycle frames.

**\*4: OEM** (Original equipment manufacturer)

OEM refers to a manufacturer of products and components supplied for sale under a third-party brand.

**\*5: iGX engine**

The world's first<sup>®</sup> engine to incorporate electronic engine speed control technology by using the STR GOVERNOR, an electronic governor<sup>®</sup> that requires no battery.

(i) According to a Honda survey

(ii) STR GOVERNOR (electronic governor)

This system allows the electronic control unit (ECU) to constantly monitor throttle opening and engine speed, electronically regulating the throttle opening to maintain a constant engine speed even under changing engine load conditions.

STR: Self-Tuning Regulator

GOVERNOR: A device that regulates engine speed, maintaining a constant engine speed, regardless of load fluctuations

performance, in major global markets. We also strove to expand sales of our compact, home-use cogeneration system.\*6

As a result, unit sales of power products rose 10.9% compared with the preceding term, to 5,876,000 units.

Due to the factors described above, consolidated net sales in fiscal 2006 reached ¥9,907.9 billion, up 14.5% from the previous year. Net income rose 22.8%, to ¥597.0 billion.\*7

## Future Initiatives

### *Fiscal 2007: Key Initiatives by Business Segment*

Looking at the global economy, the U.S. and Asian economies are expected to grow steadily, and Japan and Europe are also expected to maintain moderate economic recoveries.

However, due to a number of uncertainties including global political and economic factors, rising prices for oil and raw materials, and currency fluctuations, we expect that the global environment surrounding Honda will remain very challenging.

It is under these circumstances that Honda will strengthen its corporate structure quickly and flexibly to meet the requirements of our customers and society, as well as changes in the business environment. Also, in order to improve the competitiveness of its products, Honda will strive to enhance its R&D structure and its production and sales abilities. Further, Honda will continue striving to earn even more trust and understanding from society through its Companywide activities.

### **Motorcycle Business**

Although it is likely that the motorcycle business will continue to be affected by high gasoline prices, as well as interest rate hikes in some regions, we anticipate ongoing growth in regions where motorcycles are an important part of people's lives and an essential mode of transportation.

Through such moves as equipping scooters with AT\*8, Honda is meeting increasingly diverse customer needs with products that are competitively priced, with the goal of increasing sales. From an environmental perspective, we are equipping more models with PGM-FI and other features that provide superior environmental performance. To meet the expected increase in sales, we are raising production capacity at our affiliates accounted for under the equity method in India and China, as well as consolidated subsidiaries in the Philippines and Pakistan.

In other regions, against the backdrop of a robust economy, we expect the Brazilian market to continue expanding, and are working to strengthen our model lineup as well as expand sales of our mainstay models in this country. Besides Brazil, in mid-2006 we plan to begin production in Argentina to meet demand in this expanding market.

In North America, in mid-2006 we will launch new ATV models that are tailored to customer needs and introduce an entry-level motocross bike. Such efforts should enhance sales in this region.

From the standpoint of safety, from mid-2006 we will offer the first motorcycles equipped with airbags, and will remain aggressive in our efforts to develop other safety initiatives.

As a result of these activities, we plan to sell 10,840,000 units\*9 in fiscal 2007, deepening Honda's involvement in the motorcycle business, where the Company got its start.

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#### \*6: Compact, home-use cogeneration system

Honda has combined its original electromagnetic inverter technologies with the world's smallest<sup>(i)</sup> natural gas engine (GE160V) in an efficient layout to create a small, lightweight generation unit. Due to its compactness, the unit can be installed in the home and boasts an overall energy efficiency of 85%. It also emits approximately 30% less carbon dioxide than conventional natural gas-powered generators or hot-water heating units using natural gas.<sup>(ii)</sup>

i: A Honda development, the reciprocal gas engine

ii: Data from Honda test results. Data compares electric power from natural gas-powered generation with hot-water heating units that use natural gas.

\*7: Net income was boosted by a ¥138.0 billion gain on the return of the substitutional portion of the Employees' Pension Funds to the Japanese government, which was accounted for at the operating income stage.

\*8: AT is an acronym for "automatic transmission."

\*9: Of the unit sales forecasts for Honda-brand motorcycle products that are manufactured and sold by overseas affiliates accounted for under the equity method, those to which parts for manufacturing were not supplied from Honda or its subsidiaries are not included in unit sales. If those products, which amounted to approximately 3.36 million units, had been added, total unit sales of forecasts would have increased 10.3% from last fiscal year.

## Automobile Business

Taking into consideration such factors as high gasoline prices and higher interest rates, in calendar 2006, we expect overall United States demand for automobiles to total approximately 16.5 million units.

Honda will further enhance its model lineup that features superior environmental and safety performance. In addition to launching a new entry-premium SUV (sport utility vehicle), the *Acura RDX*, the Honda *CR-V* and the *Acura MDX* will undergo full model changes, and we will further expand our lineup of light truck models, which offer superb fuel economy and driving performance. In the passenger car segment, we will work to expand sales of the new *Civic*, which went on sale in 2005, and the *Fit*, for which sales launched from Canada in March 2006. In May 2006, we expanded local production by beginning operations at a new AT plant in the state of Georgia, in the United States.

We expect the Asian markets to continue delivering high levels of growth. To meet this burgeoning demand and increase sales, we will expand our sales and service networks within each country in this region. We will work to accelerate sales of the new *Civic*, which went on sale in China in April 2006. In addition to boosting production capacity at an affiliate accounted for under the equity method, we will also begin operations at a new powertrain plant in China in early 2007 as part of our efforts to increase local production. To meet as broad a range of market needs as possible, in 2006 we will launch a progression of Acura-brand vehicles, such as the *Acura RL* and the *Acura TL*. In addition to the *Accord* and the *City*, production of the *Civic* will begin in India, and this model will go on sale there in July 2006. We have accelerated our initially planned expansion to 100,000 units by three years, to 2007. In Vietnam, a new plant with an annual production capacity of 10,000 units will begin manufacturing and selling the *Civic* in mid-2006.

In other regions, we anticipate sales to continue growing in South America as these economies expand. To meet rising demand in Brazil, we will expand annual production capacity to 80,000 units in early 2007, rising to 100,000 units in 2008.

Despite an extremely competitive environment in Europe, the new *Civic*, five-door model (for the European market) has fared well since its launch at the beginning of 2006. We will add a three-door model within 2006, aiming to boost sales in this market as we augment our lineup. In anticipation of rapid expansion in the Ukrainian market, we have established a new subsidiary to strengthen our sales efforts there and round out our sales structure for the European region.

Japan remains an intensely difficult market, and in 2006 demand is expected to remain at the previous year's level. To better focus on enhancing the lifetime satisfaction of customers, we will bring our core Honda brand to the forefront, strengthening our sales and service system and making the Honda channel\*<sup>10</sup> easier for customers to access.

Through these activities, we are planning sales of 3,720,000 units in fiscal 2007. Our aim, while continuing to develop our business globally, is to create new value for our customers.

## Power Product Business

From the time we manufactured our first general-purpose engines in 1953, we have steadily enhanced our product portfolio. As a result, in May 2006 our cumulative global output of power products reached 70 million units. In fiscal 2007, we will focus on supplying cost-competitive general-purpose engines from Asia to other regions as we work to expand sales of generators and general-purpose engines in North America and Asia.

Taking into account growing worldwide awareness of environmental and energy-related issues, in the second half of 2006 we plan to extend sales of our compact, home-use cogeneration system from Japan to include the United States.

Through these efforts, we plan to sell 5,880,000 units in fiscal 2007. We will meet increasingly diverse customer needs by offering products with superior environmental and safety performance, which will also accelerate the expansion of Honda's power product business.

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\*10: Honda channel

In line with the integration of the Honda channel, the current Primo, Clio and Verno channel dealers will all be renamed "Honda Cars."

## Preparing for the Next Leap Forward

Honda believes that an even stronger spirit of innovation and creativity is essential to its goal of stepping up the pace of its effort to become number one in “creating new value” for customers throughout the world. Although the environment in which Honda operates is likely to grow increasingly challenging, to take our next leap forward Honda will accelerate its efforts to bolster “at the spot” activity, strengthening the core characteristics that make Honda unique and achieve further growth.



More specifically, I will discuss Honda’s medium- to long-term vision, which identifies three themes—“Establishing advanced manufacturing systems and capabilities,” “Strengthening the foundation for overseas growth” and “Strengthening our commitment to reduce Honda’s environmental footprint”.

### Establishing advanced manufacturing systems and capabilities

We will strengthen our production and R&D systems in Japan to support the development of our overseas business, and build innovative manufacturing systems that help create new value.

Addressing production in Japan, we are building a leading-edge automobile plant that will allow integrated production of everything from engines to entire automobiles. Our new plant in Japan will employ a high-quality and highly efficient production system featuring the most advanced technology, and strengthen our global production network by taking on the leader function for Honda facilities throughout the world.

So that each of our engineers will set their sights as high as possible, in April 2006 we reorganized our R&D operations in Japan. We are also building a new R&D center to enhance the development of next-generation vehicles and to upgrade our R&D structure, which serves as the starting point of manufacturing.

By improving our production and R&D systems in these ways, we will continue to provide products that exceed our customers’ expectations. As a result, we will hone further our ability to “create new value.”

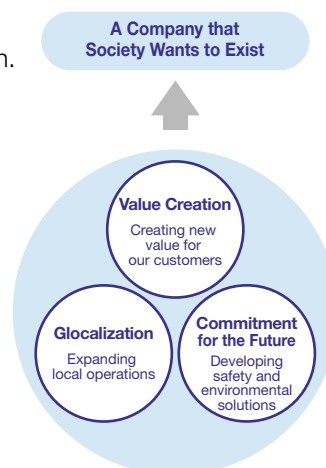
### Strengthening the foundation for overseas growth

We are constructing a new automobile plant in the United States and an automobile engine plant in Canada to strengthen our business in North America. We are also setting our sights on Asia and South America, which in recent years have experienced remarkable growth. To benefit from this growth, we are expanding our local production capacity in these regions.

These measures are designed to take Honda’s worldwide sales to more than 18 million motorcycles, more than 4.5 million automobiles and more than 7 million power products by 2010.

### Strengthening our commitment to reduce Honda’s environmental footprint

Honda regards environmental issues as one of the most important management issues, based on the direction of our “Commitment for the future”. To demonstrate this awareness, we are working



aggressively on reducing the burden that we place on the environment. Global warming is an environmental issue that we are addressing through concerted efforts at our facilities throughout the entire world, and we consider it important to accelerate these initiatives even further.

Based on this belief, we are working to develop manufacturing plants that generate as little CO<sub>2</sub> as possible and to become a manufacturer of products that emit minimal levels of CO<sub>2</sub>. To these ends, we have set voluntary CO<sub>2</sub> reduction goals. To achieve these goals from a product standpoint, we are aggressively pursuing a host of advanced environmental technologies, including a new dedicated hybrid vehicle, a new clean diesel engine with emissions as low as those of gasoline engines and a new fuel cell vehicle. From a manufacturing standpoint, we are

## Preparing for Honda's Next Leap Forward

<p><b>Establishing Advanced Manufacturing Systems and Capabilities</b></p> <p>By strengthening the areas of production and R&amp;D in Japan that support the future growth of overseas operations, Honda will establish advanced manufacturing systems and capabilities to create new value.</p> <p><b>Strengthening Japan Production</b></p> <ul style="list-style-type: none"> <li>■ Building a new automobile plant <ul style="list-style-type: none"> <li>● New automobile plant to be built in Yorii, Saitama</li> <li>· Production capacity: approximately 200,000 units/year (Production capacity in Japan once operational: approximately 1.5 million units/year)</li> <li>· Scheduled start of operations: 2010</li> <li>· Related investment: approximately ¥70 billion</li> <li>· Work force: approximately 2,200 associates</li> <li>● Renovation of Sayama plant as a leading-edge manufacturing facility (After new plant begins operations)</li> </ul> </li> <li>■ Strengthening AT production <ul style="list-style-type: none"> <li>● Strengthen AT manufacturing system at Hamamatsu Plant</li> </ul> </li> </ul> <p><b>Strengthening R&amp;D Capabilities</b></p> <ul style="list-style-type: none"> <li>■ Establishing new R&amp;D center <ul style="list-style-type: none"> <li>● New R&amp;D center to be built in Sakura, Tochigi</li> <li>· Scheduled start of operations: 2009</li> <li>· Related investment: approximately ¥17 billion</li> </ul> </li> </ul>	<p><b>Strengthening the Foundation for Overseas Growth</b></p> <p>Focusing on strengthening its business foundation in North America and on business expansion in such growth areas as Asia and South America</p> <p><b>Strengthening North American Operations</b></p> <ul style="list-style-type: none"> <li>■ Building a new automobile plant in the U.S.*<sup>11</sup> <ul style="list-style-type: none"> <li>● Construction planned near Greensburg, Indiana</li> <li>· Production capacity: approximately 200,000 units/year (Production capacity in North America once operational: approximately 1.6 million units/year)</li> <li>· Scheduled start of operations: 2008</li> <li>· Related investment: approximately US\$550 million</li> <li>· New employment: approximately 2,000 associates (once operating at full scale)</li> </ul> </li> <li>■ Building a new automobile engine plant in Canada <ul style="list-style-type: none"> <li>● Construction planned adjoining existing auto plant</li> <li>· Production capacity: approximately 200,000 units/year</li> <li>· Scheduled start of operations: 2008</li> <li>· Related investment: approximately US\$140 million</li> <li>· New employment: approximately 340 associates</li> </ul> </li> </ul> <p><b>Expanding Business in Growing Markets</b></p> <ul style="list-style-type: none"> <li>■ Motorcycle business in Asia <ul style="list-style-type: none"> <li>· India: Increase production capacity to 5.2 million units/year in 2007</li> <li>· Also planning to raise production capacity in the Philippines and Pakistan</li> <li>· Raise production capacity in Asia (excluding China) to 14 million units/year in 2007 (addition of 6 million units/year over three-year period)</li> </ul> </li> <li>■ Automobile business in Asia <ul style="list-style-type: none"> <li>· India: Production capacity of 100,000 units/year by the end of 2007</li> </ul> </li> <li>■ Automobile business in China <ul style="list-style-type: none"> <li>● Second plant at Guangzhou Honda to begin operations in second half of 2006</li> <li>· Production capacity: approximately 120,000 units/year (Production capacity in China once operational: approximately 530,000 units/year)</li> </ul> </li> <li>■ Automobile business in South America <ul style="list-style-type: none"> <li>· Brazil: Production capacity of 100,000 units/year by 2008</li> </ul> </li> </ul>	<p><b>Strengthening our Commitment to Reduce Environmental Footprint</b></p> <p>Continue pursuing more proactive efforts to reduce its environmental load with the main focus on CO<sub>2</sub> reduction</p> <p><b>Reduction of CO<sub>2</sub> Emissions—Setting Voluntary Goals (Compared to the level of 2000)</b></p> <ul style="list-style-type: none"> <li>■ Reduce worldwide CO<sub>2</sub> levels by 2010 <ul style="list-style-type: none"> <li>● Emission volume (per unit) when using products*<sup>12</sup> <ul style="list-style-type: none"> <li>· Motorcycles: 10% reduction</li> <li>· Automobiles: 10% reduction</li> <li>· Power products: 10% reduction</li> </ul> </li> <li>● Emission volume (per unit) when manufacturing products*<sup>13</sup> <ul style="list-style-type: none"> <li>· Motorcycles: 20% reduction</li> <li>· Automobiles: 10% reduction</li> <li>· Power products: 20% reduction</li> </ul> </li> </ul> </li> </ul> <p><b>Product Strategy</b></p> <ul style="list-style-type: none"> <li>■ New dedicated hybrid vehicle <ul style="list-style-type: none"> <li>· Additional improvements to fuel-efficient technologies and expected 2009 launch of vehicles with price significantly lower than the current <i>Civic Hybrid</i></li> <li>· Anticipated annual worldwide sales of 200,000 units/year (100,000 designated for North America)</li> </ul> </li> <li>■ New clean diesel engines <ul style="list-style-type: none"> <li>· Within three years, introduce new four-cylinder clean diesel engine that meets Tier2 BIN5*<sup>14</sup> U.S. exhaust emission standard</li> <li>· Also start developing a clean V6 diesel engine</li> </ul> </li> <li>■ Motorcycles <ul style="list-style-type: none"> <li>· By the end of 2010, install the majority of motorcycle models for sale worldwide with PGM-FI</li> <li>· Introduce new engine technologies, such as super-low friction engines and VCM system for motorcycles</li> </ul> </li> <li>■ New fuel cell vehicle <ul style="list-style-type: none"> <li>· Develop working prototype vehicle based on the FCX concept model in the second half of 2006, and launch within the next three years</li> </ul> </li> <li>■ Solar cell <ul style="list-style-type: none"> <li>· Begin sales in Japan of solar cell panels in the second half of 2006</li> <li>· Establish a production line at Kumamoto plant capable of 27.5 megawatts/year and begin mass production in 2007</li> </ul> </li> </ul>
<p>▼</p> <p><b>Honda's Expected Global Sales in 2010</b></p> <p><b>Motorcycles: more than 18 million    Automobiles: more than 4.5 million    Power products: more than 7 million</b></p>		

\*11: Reflects information distributed in the United States in a press release dated June 28, 2006

\*12: For motorcycles and automobiles, units are g/km; for power products, kg/hour

\*13: For motorcycles, automobiles and power products, units are kg/unit

\*14: Tier2 BIN5

This standard for exhaust emissions was established in the United States by the Environmental Protection Agency based on the U.S. Clean Air Act and went into effect in 2004. Regulation value of NOx for emission category BIN5: 0.07g/mile

installing cogeneration systems and accelerating efforts to reduce environmental load from each of our plants.

As a leading company that creates mobility products, reducing CO<sub>2</sub> emissions is a top concern for Honda. Accordingly, we are prioritizing our global environmental initiatives. By strengthening the foundation for overseas growth and creating the innovative manufacturing systems as I described earlier, we expect to succeed in our goal of providing products that exceed customers' expectations.

## Returning Profits to Shareholders

Honda strives to carry out its operations from a global perspective and to increase its corporate value. With respect to the redistribution of profits to our shareholders, which we consider to be one of the most important management issues, Honda's basic policy for dividends is to make distributions after taking into account our long-term consolidated earnings performance. Honda will also acquire its own shares at the optimal timing with the goal of improving efficiency of the Company's capital structure. The present goal is to maintain a shareholder return ratio (i.e. the ratio of the total of the dividend payment and the repurchase of Company shares to consolidated net income) of approximately 30%. Retained earnings will be allocated toward financing R&D activities that are essential for the future growth of Honda and capital expenditures and investment programs that will expand operations for the purpose of improving business results and strengthening Honda's financial condition.

The recent enactment of the new Company Law in Japan lifts restrictions on the number of dividend payments a company can make each year. With this in mind, Honda is considering a flexible shareholder return policy, such as quarterly dividend payments. We will continue striving to meet the expectations of all shareholders.

Based on these policies, Honda decided on a fiscal 2006 year-end cash dividend of ¥60 per share, bringing total cash dividends for the year to ¥100, when adding the ¥40 interim dividend. In fiscal 2007, we plan to pay interim and year-end dividends of ¥30 each, for total cash dividends for the year of ¥60 per share. To make Honda shares more accessible to investors, we will implement a two-for-one stock split on July 1, 2006. Had the stock split not been carried out, dividends would have been equal to ¥60 per share for both interim and year-end dividends, which would have been an increase of ¥20 per share for the interim dividend and, as a result, an increase of ¥20 per share for the year, to ¥120.

## In Closing

Honda's overriding quest is to become a company that society wants to exist around the world. To this end, we will further hone our ability to create advanced technologies and products to lead the global industry in terms of providing people with enjoyment and inspiration. We look forward to the continued understanding and support of shareholders and other investors as we embrace the challenges of the future.

June 23, 2006



Takeo Fukui  
President and Chief Executive Officer

### Dividends per Share

Years ended March 31

