SECTOR COMMENT
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Automotive – Japan

Proposed Honda-Nissan integration credit positive if executed successfully

On 23 December, Honda Motor Co., Ltd. (A3 stable) and Nissan Motor Co., Ltd. (Baa3 negative) said they have signed a memorandum of understanding (MOU) to start discussions and considerations toward a business integration between the two companies through the establishment of a joint holding company. The integration has the potential to be credit positive for both companies if executed successfully. However, we believe Nissan will benefit the most from a credit perspective, while Honda faces more risk due to its stronger credit profile.

Overall, we believe a larger scale through an integration will result in stronger credit quality, particularly for Nissan, which currently has significantly weaker credit metrics than Honda. The business integration will create the world's third-largest automaker by volume. In fiscal 2023 that ended on 31 March 2024, on a group basis including China (A1 negative) volumes, Honda sold 4.1 million units, while Nissan sold 3.4 million units. A combined 7.5 million units would put the integrated company behind the world's largest and second-largest automakers, Toyota Motor Corporation (A1 positive) and Volkswagen Aktiengesellschaft (A3 negative), which sold 11.1 million units in fiscal 2023 and 9.2 million units in 2023, respectively, on a group basis. The potential addition of Mitsubishi Motors Corporation, which will make a decision on whether to join Nissan and Honda by the end of January 2025, would increase the combined volume to around 8.5 million units.

Honda and Nissan have significant overlap in their sales regions and the business integration is unlikely to significantly enhance their geographic diversification by sales for automobiles. However, in terms of profit and cash flow, Honda's highly profitable motorcycle business will continue to support the combined company. Heavy exposure of Honda's motorcycle business to emerging markets, such as ASEAN and India (Baa3 stable), will help with cash flow diversification outside of automobiles and developed markets. The new entity would also retain its top share globally in motorcycles through Honda, which sold around 19 million units in fiscal 2023.

An integration would allow the automakers to share research and development (R&D) costs, supply chain costs and manufacturing plant investment. This will particularly help in the introduction of new electrified powertrain models, such as hybrids, plug-in hybrids and battery electric vehicles. Honda and Nissan expect potential synergies for consolidated operating profit to exceed ¥1 trillion, but further details were not disclosed. Notably, these synergies could help the two automakers pool resources for new model design and manufacturing of vehicles in China, the world's largest automotive market by sales, where both have been struggling to adapt to consumer preferences for new energy vehicles. However, turning around two sizable China operations will entail significant execution risk.

The integration could help mitigate the potential effects of increases in tariffs on imports to the US (Aaa negative) under the new Trump presidency starting in January 2025. Honda and Nissan may also face tariffs from Mexico (Baa2 negative) and Canada (Aaa stable). Sharing manufacturing facilities in the US could help increase local production in the US faster. Though we do not see a large amount of excess capacity in the US at present, the introduction of shared models and powertrains under different brands may help both companies versus initiatives on a standalone basis.

The integration would be more credit positive for Nissan than for Honda. Honda is the stronger credit, reflecting a better track record of stable profit and cash flow, management strategy, and diversification outside of automobiles into motorcycles. Motorcycle margins are significantly higher than those for automobiles. In addition, growth in the motorcycles sector is less correlated to the mature automotive markets that Nissan is dependent on and instead more exposed to fast-growing emerging markets, such as those in ASEAN and India. Motorcycles also face much less threat from electrification.

Honda also announced at the same time of the MOU announcement plans to buy back its own shares in 2025. The company will repurchase up to ¥1.1 trillion, or 24%, of its outstanding shares next year, which is credit negative because it favors shareholders over creditors. The extent of credit negative effects depends on the funding mix for the buyback, which the company has not disclosed. Honda held ¥4.3 trillion of cash, excluding its captive finance business, as of September 2024, so we believe it can absorb the buyback within its current liquidity. Use of leverage for the buyback will also be credit negative, but we do not know of the capital structure of the integrated company at this stage.

The companies plan to complete the integration through the listing of a new holding company in 2026. After final contract completion in June 2025, and pending the approval by shareholders in April 2026, both companies plan to delist by the end of July to August 2026 and relist on the Tokyo Stock Exchange in August 2026 as a merged entity. Furthermore, there is a ¥100 billion penalty if either party decides to end the business integration. Initial details of the holding company ownership structure indicate that Honda shareholders and management may exert more influence on the integrated group due to its larger scale, including market capitalization.

Execution risk is high, especially for Honda. Honda's fiscal 2023 industrial operating margin,[1] excluding its captive finance business, of 6.4% is primarily supported by its highly profitable motorcycle business, which generates operating margin in the high-teens. Honda's operating margin for the automotive business alone was just 4.1% in fiscal 2023, lower than those of similarly rated global auto peers. Honda's automotive business does not have much buffer to absorb Nissan's automotive business operating margin, which was loss-making as of H1 fiscal 2024. Increased costs related to the merger could also weaken Honda's credit profile.

Details regarding cash flow, debt and credit support between entities in the new structure were not disclosed at the time of the announcement. The credit risks will lie in the seniority of existing debt under the new structure, potential structural subordination, and change of control under existing debt. We expect more creditor details will be disclosed during the upcoming due diligence phase to be completed before the final contract completion planned for June 2025.

There were no details relating to the Nissan-Renault-Mitsubishi Motors alliance in the statement. We therefore assume that there will be no change in Renault S.A.'s (Ba1 positive) 36% ownership in Nissan, which includes both Renault and its French trust shareholdings.

There are some parallels to the merger of Fiat Chrysler Automobiles N.V. and Peugeot S.A., which were rated at Ba1 positive and Baa3 stable, respectively, at the time of the binding agreement announced in December 2019. Both companies then merged in January 2021 as Stellantis N.V. (Baa1 negative), which was rated Baa3 stable at the time of the merger.

Endnotes

1 Including autos, power products and motorcycles

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