

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the quarterly period ended December 31, 2019**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number 001-36111**

**AMERICAN HONDA FINANCE CORPORATION**

(Exact name of registrant as specified in its charter)

**California**

(State or other jurisdiction of incorporation or organization)

**20800 Madrona Avenue, Torrance, California**

(Address of principal executive offices)

**95-3472715**

(IRS Employer Identification No.)

**90503**

(Zip Code)

**(310) 972-2555**

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol(s)	Name of exchange on which registered
1.300% Medium-Term Notes, Series A Due March 21, 2022	N/A	New York Stock Exchange
2.625% Medium-Term Notes, Series A Due October 14, 2022	N/A	New York Stock Exchange
1.375% Medium-Term Notes, Series A Due November 10, 2022	N/A	New York Stock Exchange
0.550% Medium-Term Notes, Series A Due March 17, 2023	N/A	New York Stock Exchange
0.750% Medium-Term Notes, Series A Due January 17, 2024	N/A	New York Stock Exchange
0.350% Medium-Term Notes, Series A Due August 26, 2022	N/A	New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer   
Non-accelerated filer   
Emerging growth company

Accelerated filer   
Smaller reporting company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
 Yes  No

As of January 31, 2020, the number of outstanding shares of common stock of the registrant was 13,660,000 all of which shares were held by American Honda Motor Co., Inc. None of the shares are publicly traded.

#### **REDUCED DISCLOSURE FORMAT**

American Honda Finance Corporation, a wholly-owned subsidiary of American Honda Motor Co., Inc., which in turn is a wholly-owned subsidiary of Honda Motor Co., Ltd., meets the requirements set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this Form 10-Q with the reduced disclosure format.

**AMERICAN HONDA FINANCE CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q**  
For the quarter ended December 31, 2019

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## Cautionary Statement Regarding Forward-Looking Statements

Certain statements included herein constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 that involve a number of risks and uncertainties. Certain such forward-looking statements can be identified by the use of forward-looking terminology such as “believes,” “expects,” “may,” “will,” “should,” “seeks,” “scheduled,” or “anticipates” or similar expressions or the negative thereof or other variations thereof or comparable terminology, or by discussions of strategy, plans, or intentions. In addition, all information included herein with respect to projected or future results of operations, cash flows, financial condition, financial performance, or other financial or statistical matters constitute forward-looking statements. Such forward-looking statements are necessarily dependent on assumptions, data, or methods that may be incorrect or imprecise and that may be incapable of being realized. The following factors, among others, could cause actual results and other matters to differ materially from those in such forward-looking statements:

- declines in the financial condition or performance of Honda Motor Co., Ltd. or the sales of Honda or Acura products;
- changes in economic and general business conditions, both domestically and internationally, including changes in international trade policy;
- fluctuations in interest rates and currency exchange rates;
- the failure of our customers, dealers or counterparties to meet the terms of any contracts with us, or otherwise fail to perform as agreed;
- our inability to recover the estimated residual value of leased vehicles at the end of their lease terms;
- changes or disruption in our funding sources or access to the capital markets;
- changes in our, or Honda Motor Co., Ltd.’s, credit ratings;
- increases in competition from other financial institutions seeking to increase their share of financing of Honda and Acura products;
- changes in laws and regulations, including the result of financial services legislation, and related costs;
- changes in accounting standards;
- a failure or interruption in our operations; and
- a security breach or cyber attack.

Additional information regarding these and other risks and uncertainties to which our business is subject is contained in our Annual Report on Form 10-K for the fiscal year ended March 31, 2019 filed with the Securities and Exchange Commission on June 21, 2019. Readers of this Quarterly Report should review the information contained in that report, and in any subsequent reports that we file with the Securities and Exchange Commission as such risks and uncertainties may be amended, supplemented or superseded from time to time. We do not intend, and undertake no obligation to, update any forward-looking information to reflect actual results or future events or circumstances, except as required by applicable law.

**PART I – FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**AMERICAN HONDA FINANCE CORPORATION  
AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS (UNAUDITED)  
(U.S. dollars in millions, except share amounts)**

	<b>December 31, 2019</b>	<b>March 31, 2019</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 837	\$ 795
Finance receivables, net	40,495	40,424
Investment in operating leases, net	34,436	32,606
Due from Parent and affiliated companies	125	162
Income taxes receivable	336	228
Other assets	1,302	1,369
Derivative instruments	399	380
<b>Total assets</b>	<b>\$ 77,930</b>	<b>\$ 75,964</b>
<b>Liabilities and Equity</b>		
<b>Debt</b>	<b>\$ 50,640</b>	<b>\$ 49,754</b>
Due to Parent and affiliated companies	104	106
Income taxes payable	285	152
Deferred income taxes	6,681	6,399
Other liabilities	1,765	1,717
Derivative instruments	441	568
<b>Total liabilities</b>	<b>59,916</b>	<b>58,696</b>
Commitments and contingencies (Note 8)		
Shareholder's equity:		
Common stock, \$100 par value. Authorized 15,000,000 shares; issued and outstanding 13,660,000 shares as of December 31, 2019 and March 31, 2019	1,366	1,366
Retained earnings	15,691	15,088
Accumulated other comprehensive loss	(89)	(118)
<b>Total shareholder's equity</b>	<b>16,968</b>	<b>16,336</b>
Noncontrolling interest in subsidiary	1,046	932
<b>Total equity</b>	<b>18,014</b>	<b>17,268</b>
<b>Total liabilities and equity</b>	<b>\$ 77,930</b>	<b>\$ 75,964</b>

The following table presents the assets and liabilities of consolidated variable interest entities. These assets and liabilities are included in the consolidated balance sheets presented above. Refer to Note 9 for additional information.

	<b>December 31, 2019</b>	<b>March 31, 2019</b>
Finance receivables, net	\$ 9,436	\$ 9,073
Investment in operating leases, net	558	—
Other assets	616	600
<b>Total assets</b>	<b>\$ 10,610</b>	<b>\$ 9,673</b>
Secured debt	\$ 9,608	\$ 8,790
Other liabilities	10	8
<b>Total liabilities</b>	<b>\$ 9,618</b>	<b>\$ 8,798</b>

See accompanying Notes to Consolidated Financial Statements.

**AMERICAN HONDA FINANCE CORPORATION  
AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**  
(U.S. dollars in millions)

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
<b>Revenues:</b>				
Retail	\$ 438	\$ 415	\$ 1,314	\$ 1,192
Dealer	52	59	174	169
Operating leases	1,952	1,826	5,782	5,391
Total revenues	2,442	2,300	7,270	6,752
Leased vehicle expenses	1,463	1,352	4,264	3,994
Interest expense	307	303	947	870
Net revenues	672	645	2,059	1,888
Other income, net	24	19	67	51
Total net revenues	696	664	2,126	1,939
<b>Expenses:</b>				
General and administrative expenses	124	109	369	338
Provision for credit losses	65	75	171	181
Early termination loss on operating leases	37	22	97	78
(Gain)/Loss on derivative instruments	(76)	106	129	416
(Gain)/Loss on foreign currency revaluation of debt	145	(63)	(1)	(337)
Total expenses	295	249	765	676
Income before income taxes	401	415	1,361	1,263
Income tax expense	106	67	379	320
Net income	295	348	982	943
Less: Net income attributable to noncontrolling interest	27	22	87	74
Net income attributable to American Honda Finance Corporation	<u>\$ 268</u>	<u>\$ 326</u>	<u>\$ 895</u>	<u>\$ 869</u>

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)**  
(U.S. dollars in millions)

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
Net income	\$ 295	\$ 348	\$ 982	\$ 943
<b>Other comprehensive income:</b>				
Foreign currency translation adjustment	41	(103)	56	(103)
Comprehensive income	336	245	1,038	840
Less: Comprehensive income/(loss) attributable to noncontrolling interest	47	(27)	114	25
Comprehensive income attributable to American Honda Finance Corporation	<u>\$ 289</u>	<u>\$ 272</u>	<u>\$ 924</u>	<u>\$ 815</u>

See accompanying Notes to Consolidated Financial Statements.

**AMERICAN HONDA FINANCE CORPORATION  
AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (UNAUDITED)**  
(U.S. dollars in millions)

	<b>Total</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive income/(loss)</b>	<b>Common stock</b>	<b>Noncontrolling interest</b>
<b>Balance at March 31, 2018</b>	\$ 16,596	\$ 14,449	\$ (85)	\$ 1,366	\$ 866
Net income	943	869	—	—	74
Other comprehensive loss	(103)	—	(54)	—	(49)
Dividends declared	(235)	(235)	—	—	—
<b>Balance at December 31, 2018</b>	<u>\$ 17,201</u>	<u>\$ 15,083</u>	<u>\$ (139)</u>	<u>\$ 1,366</u>	<u>\$ 891</u>
<b>Balance at March 31, 2019</b>	\$ 17,268	\$ 15,088	\$ (118)	\$ 1,366	\$ 932
Net income	982	895	—	—	87
Other comprehensive income	56	—	29	—	27
Dividends declared	(292)	(292)	—	—	—
<b>Balance at December 31, 2019</b>	<u>\$ 18,014</u>	<u>\$ 15,691</u>	<u>\$ (89)</u>	<u>\$ 1,366</u>	<u>\$ 1,046</u>

See accompanying Notes to Consolidated Financial Statements.

**AMERICAN HONDA FINANCE CORPORATION  
AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(U.S. dollars in millions)

	<b>Nine months ended December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 982	\$ 943
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Debt and derivative instrument valuation adjustments	60	81
Provision for credit losses	171	181
Early termination loss on operating leases	97	78
Depreciation on leased vehicles	4,275	4,112
Accretion of unearned subsidy income	(1,255)	(1,210)
Amortization of deferred dealer participation and other deferred costs	272	252
Gain on disposition of leased vehicles	(113)	(118)
Deferred income taxes	273	214
<b>Changes in operating assets and liabilities:</b>		
Income taxes receivable/payable	25	35
Other assets	60	(31)
Accrued interest/discounts on debt	37	51
Other liabilities	(31)	61
Due to/from Parent and affiliated companies	35	16
Net cash provided by operating activities	<u>4,888</u>	<u>4,665</u>
<b>Cash flows from investing activities:</b>		
Finance receivables acquired	(13,678)	(14,368)
Principal collected on finance receivables	13,024	12,007
Net change in wholesale loans	556	150
Purchase of operating lease vehicles	(14,020)	(11,966)
Disposal of operating lease vehicles	8,184	6,991
Cash received for unearned subsidy income	913	1,490
Other investing activities, net	(4)	(4)
Net cash used in investing activities	<u>(5,025)</u>	<u>(5,700)</u>

Statement continues on the next page.

**AMERICAN HONDA FINANCE CORPORATION  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(U.S. dollars in millions)

	Nine months ended December 31,	
	2019	2018
Cash flows from financing activities:		
Proceeds from issuance of commercial paper	\$ 24,449	\$ 23,289
Paydown of commercial paper	(24,361)	(22,254)
Proceeds from issuance of short-term debt	300	1,100
Paydown of short-term debt	(1,100)	(300)
Proceeds from issuance of related party debt	2,337	2,984
Paydown of related party debt	(2,526)	(3,293)
Proceeds from issuance of medium term notes and other debt	5,911	5,365
Paydown of medium term notes and other debt	(5,303)	(5,492)
Proceeds from issuance of secured debt	4,692	3,514
Paydown of secured debt	(3,916)	(3,493)
Dividends paid	(292)	(235)
Net cash provided by financing activities	191	1,185
Effect of exchange rate changes on cash and cash equivalents	2	(8)
Net increase in cash and cash equivalents	56	142
Cash and cash equivalents and restricted cash at beginning of period	1,383	1,226
Cash and cash equivalents and restricted cash at end of period	<u>\$ 1,439</u>	<u>\$ 1,368</u>
Supplemental disclosures of cash flow information:		
Interest paid	\$ 689	\$ 594
Income taxes paid	\$ 61	\$ 39

The following table provides a reconciliation of cash and cash equivalents and restricted cash from the Consolidated Balance Sheets to the Consolidated Statements of Cash Flows.

	December 31,	
	2019	2018
Cash and cash equivalents	\$ 837	\$ 811
Restricted cash included in other assets <sup>(1)</sup>	602	557
Total	<u>\$ 1,439</u>	<u>\$ 1,368</u>

(1) Restricted cash balances relate primarily to securitization arrangements (Note 9).

See accompanying Notes to Consolidated Financial Statements.

## **(1) Summary of Business and Significant Accounting Policies**

### ***Organizational Structure***

American Honda Finance Corporation (AHFC) is a wholly-owned subsidiary of American Honda Motor Co., Inc. (AHM or the Parent). Honda Canada Finance Inc. (HCFI) is a majority-owned subsidiary of AHFC. Noncontrolling interest in HCFI is held by Honda Canada Inc. (HCI), an affiliate of AHFC. AHM is a wholly-owned subsidiary and HCI is an indirect wholly-owned subsidiary of Honda Motor Co., Ltd. (HMC). AHM and HCI are the sole authorized distributors of Honda and Acura products, including motor vehicles, parts and accessories in the United States and Canada.

Unless otherwise indicated by the context, all references to the “Company”, “we”, “us”, and “our” in this report include AHFC and its consolidated subsidiaries, and references to “AHFC” refer solely to American Honda Finance Corporation (excluding AHFC’s subsidiaries).

### ***Basis of Presentation***

The unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim information, and instructions to the Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. In the opinion of management, these unaudited interim financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair statement of the results of operations, cash flows, and financial condition for the interim periods presented. Results for interim periods should not be considered indicative of results for the full year or for any other interim period. These unaudited interim financial statements should be read in conjunction with the Company’s audited consolidated financial statements, significant accounting policies, and the other notes to the consolidated financial statements for the fiscal year ended March 31, 2019 included in the Company’s Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission (SEC) on June 21, 2019. All significant intercompany balances and transactions have been eliminated upon consolidation.

Certain reclassifications have been made to prior period financial statements and notes to conform to the current period presentation.

### ***Recently Adopted Accounting Standards***

Effective April 1, 2019, the Company adopted Accounting Standard Update (ASU) 2016-02, *Leases (Topic 842)*, and the related amendments using the modified retrospective approach. Prior period comparative information has not been restated and will continue to be reported under previous accounting policies. The Company also elected the package of practical expedients which allows the Company to not reassess prior conclusions about lease identification, classification, and initial direct costs. The adoption of the new lease standard did not have a cumulative-effect adjustment to the opening balance of retained earnings.

Upon adoption, the Company recognized right-of-use assets of \$56 million, lease liabilities of \$62 million, and a reduction in other liabilities of \$6 million for accrued rent and unamortized tenant improvement allowances for existing operating leases as a lessee. The new lease standard is not expected to have a significant impact on the Company’s net income on an ongoing basis.

Lessor accounting remains largely unchanged except for limited amendments impacting the Company’s income statement classification of the following: (i) the Company has elected to record the general allowance for uncollectible operating lease receivables through a reduction to revenue rather than a provision for credit loss, (ii) lessor costs, such as property taxes, paid directly to third parties and reimbursed by lessee which were presented net are now recognized gross as revenue and expense, and (iii) the amortization of initial direct costs which was previously recognized as a reduction of lease revenue is now presented as an expense. The Company has elected to exclude from lease revenue and expenses, sales taxes and other similar taxes collected from lessees on behalf of governmental agencies, which is consistent with previous accounting policies.

Effective April 1, 2019, the Company adopted ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, which better aligns an entity’s risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The adoption of this standard did not impact the Company’s consolidated financial statements since there were no designated hedge accounting relationships.

**AMERICAN HONDA FINANCE CORPORATION**  
***Recently Issued Accounting Standards***

In June 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments replace the incurred loss impairment methodology in current GAAP with a methodology that reflects lifetime expected credit losses. The Company is finalizing accounting policy elections and refining its models and methodologies used to estimate the allowance for credit losses to meet the requirements of the new standard. The Company will adopt the new standard and the related amendments effective April 1, 2020, with a cumulative-effect adjustment to opening retained earnings, net of tax, in the period of adoption. The Company's allowance for credit losses is expected to increase upon adoption of this standard. The magnitude of the increase will depend on the composition and seasoning of the loan portfolio, existing and forecasted economic conditions, and other management judgments at the date of adoption. Based on the portfolio balances and forecasted economic conditions as of December 31, 2019, the total allowance for credit losses is expected to increase by approximately 60%, primarily for retail loans.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments modify the disclosure requirements on fair value measurements in Topic 820, based on FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements*. Certain disclosure requirements were removed, modified and added in Topic 820. This standard is not expected to have an impact on the consolidated financial statements. The Company will adopt the new guidance effective April 1, 2020.

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. The amendments simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. The Company is currently assessing the impact of this standard on the consolidated financial statements. The Company plans to adopt the new guidance effective April 1, 2021.

## (2) Finance Receivables

Finance receivables consisted of the following:

	December 31, 2019		
	Retail	Dealer	Total
	(U.S. dollars in millions)		
Finance receivables	\$ 35,924	\$ 5,169	\$ 41,093
Allowance for credit losses	(199)	—	(199)
Deferred dealer participation and other deferred costs	451	—	451
Unearned subsidy income	(850)	—	(850)
Finance receivables, net	<u>\$ 35,326</u>	<u>\$ 5,169</u>	<u>\$ 40,495</u>
	March 31, 2019		
	(U.S. dollars in millions)		
Finance receivables	\$ 35,457	\$ 5,835	\$ 41,292
Allowance for credit losses	(193)	(8)	(201)
Deferred dealer participation and other deferred costs	431	—	431
Unearned subsidy income	(1,098)	—	(1,098)
Finance receivables, net	<u>\$ 34,597</u>	<u>\$ 5,827</u>	<u>\$ 40,424</u>

Finance receivables include retail loans with a net carrying amount of \$9.4 billion and \$9.1 billion as of December 31, 2019 and March 31, 2019, respectively, which have been transferred to bankruptcy-remote special purpose entities (SPEs) and are considered to be legally isolated but do not qualify for sale accounting treatment. These retail loans are restricted as collateral for the payment of the related secured debt obligations. Refer to Note 9 for additional information.

### *Credit Quality of Finance Receivables*

Credit losses are an expected cost of extending credit. The majority of our credit risk is with consumer financing and to a lesser extent with dealer financing. Credit risk on consumer finance receivables can be affected by general economic conditions. Adverse changes such as a rise in unemployment can increase the likelihood of defaults. Declines in used vehicle prices can reduce the amount of recoveries on repossessed collateral. Credit risk on dealer loans is affected primarily by the financial strength of the dealers within the portfolio, the value of collateral securing the financings, and economic and market factors that could affect the creditworthiness of dealers. Exposure to credit risk is managed through regular monitoring and adjusting of underwriting standards, pricing of contracts for expected losses, focusing collection efforts to minimize losses, and ongoing reviews of the financial condition of dealers.

### *Allowance for Credit Losses*

The allowance for credit losses is management's estimate of probable losses incurred on finance receivables, which requires significant judgment and assumptions that are inherently uncertain. The allowance is based on management's evaluation of many factors, including the Company's historical credit loss experience, the value of the underlying collateral, delinquency trends, and economic conditions.

Consumer finance receivables in the retail loan segment are collectively evaluated for impairment. Delinquencies and losses are monitored on an ongoing basis and the Company's historical experience provides the primary basis for estimating the allowance. Management utilizes various methodologies when estimating the allowance for credit losses, including models which incorporate vintage loss and delinquency migration analysis. These models take into consideration attributes of the portfolio including loan-to-value ratios, internal and external credit scores, collateral types, and loan terms. Market and economic factors such as used vehicle prices, unemployment, and consumer debt service burdens are also incorporated into these models.

Dealer loans are individually evaluated for impairment when specifically identified as impaired. Dealer loans are considered impaired when it is probable that the Company will be unable to collect the amounts due according to the terms of the applicable contract. The Company's determination of whether dealer loans are impaired is based on evaluations of the dealership's payment history, financial condition, ability to perform under the terms of the loan agreements, and collateral values as applicable. Dealer loans that have not been specifically identified as impaired are collectively evaluated for impairment.

There were no modifications to the terms of dealer loan contracts that constituted troubled debt restructurings during the nine months ended December 31, 2019 and 2018.

The Company generally does not grant concessions on consumer finance receivables that are considered troubled debt restructurings other than modifications of retail loans in reorganization proceedings pursuant to the U.S. Bankruptcy Code. Retail loans modified under bankruptcy protection were not material to the Company's consolidated financial statements during the nine months ended December 31, 2019 and 2018. The Company does allow payment deferrals on consumer finance receivables. However, these payment deferrals are not treated as troubled debt restructurings since the deferrals are deemed insignificant and interest continues to accrue during the deferral period.

The following is a summary of the activity in the allowance for credit losses of finance receivables:

	<b>Three and nine months ended December 31, 2019</b>		
	<b>Retail</b>	<b>Dealer</b>	<b>Total</b>
	<b>(U.S. dollars in millions)</b>		
Beginning balance, October 1, 2019	\$ 197	\$ —	\$ 197
Provision	65	—	65
Charge-offs	(86)	—	(86)
Recoveries	23	—	23
Effect of translation adjustment	—	—	—
Ending balance, December 31, 2019	<u>\$ 199</u>	<u>\$ —</u>	<u>\$ 199</u>
Beginning balance, April 1, 2019	\$ 193	\$ 8	\$ 201
Provision	162	9	171
Charge-offs	(230)	(17)	(247)
Recoveries	74	—	74
Effect of translation adjustment	—	—	—
Ending balance, December 31, 2019	<u>\$ 199</u>	<u>\$ —</u>	<u>\$ 199</u>
Allowance for credit losses – ending balance:			
Individually evaluated for impairment	\$ —	\$ —	\$ —
Collectively evaluated for impairment	199	—	199
Finance receivables – ending balance:			
Individually evaluated for impairment	\$ —	\$ 4	\$ 4
Collectively evaluated for impairment	35,525	5,165	40,690

	<b>Three and nine months ended December 31, 2018</b>		
	<b>Retail</b>	<b>Dealer</b>	<b>Total</b>
	<b>(U.S. dollars in millions)</b>		
Beginning balance, October 1, 2018	\$ 191	\$ —	\$ 191
Provision	56	8	64
Charge-offs	(80)	—	(80)
Recoveries	21	—	21
Effect of translation adjustment	—	—	—
Ending balance, December 31, 2018	<u>\$ 188</u>	<u>\$ 8</u>	<u>\$ 196</u>
Beginning balance, April 1, 2018	\$ 179	\$ —	\$ 179
Provision	143	7	150
Charge-offs	(200)	—	(200)
Recoveries	66	1	67
Effect of translation adjustment	—	—	—
Ending balance, December 31, 2018	<u>\$ 188</u>	<u>\$ 8</u>	<u>\$ 196</u>
Allowance for credit losses – ending balance:			
Individually evaluated for impairment	\$ —	\$ 8	\$ 8
Collectively evaluated for impairment	188	—	188
Finance receivables – ending balance:			
Individually evaluated for impairment	\$ —	\$ 178	\$ 178
Collectively evaluated for impairment	34,252	5,273	39,525

## Delinquencies

The following is an aging analysis of past due finance receivables:

	<u>30 – 59 days past due</u>	<u>60 – 89 days past due</u>	<u>90 days or greater past due</u>	<u>Total past due</u>	<u>Current or less than 30 days past due</u>	<u>Total finance receivables</u>
(U.S. dollars in millions)						
<b>December 31, 2019</b>						
Retail loans:						
New auto	\$ 284	\$ 71	\$ 19	\$ 374	\$ 28,635	\$ 29,009
Used and certified auto	106	27	6	139	5,100	5,239
Motorcycle and other	16	6	4	26	1,251	1,277
Total retail	<u>406</u>	<u>104</u>	<u>29</u>	<u>539</u>	<u>34,986</u>	<u>35,525</u>
Dealer loans:						
Wholesale flooring	1	—	—	1	4,128	4,129
Commercial loans	—	—	—	—	1,040	1,040
Total dealer loans	<u>1</u>	<u>—</u>	<u>—</u>	<u>1</u>	<u>5,168</u>	<u>5,169</u>
Total finance receivables	<u>\$ 407</u>	<u>\$ 104</u>	<u>\$ 29</u>	<u>\$ 540</u>	<u>\$ 40,154</u>	<u>\$ 40,694</u>

## March 31, 2019

Retail loans:						
New auto	\$ 214	\$ 41	\$ 10	\$ 265	\$ 28,521	\$ 28,786
Used and certified auto	70	14	4	88	4,712	4,800
Motorcycle and other	12	3	2	17	1,187	1,204
Total retail	<u>296</u>	<u>58</u>	<u>16</u>	<u>370</u>	<u>34,420</u>	<u>34,790</u>
Dealer loans:						
Wholesale flooring	1	—	17	18	4,668	4,686
Commercial loans	51	—	17	68	1,081	1,149
Total dealer loans	<u>52</u>	<u>—</u>	<u>34</u>	<u>86</u>	<u>5,749</u>	<u>5,835</u>
Total finance receivables	<u>\$ 348</u>	<u>\$ 58</u>	<u>\$ 50</u>	<u>\$ 456</u>	<u>\$ 40,169</u>	<u>\$ 40,625</u>

## Credit Quality Indicators

### Retail Loan Segment

The Company utilizes proprietary credit scoring systems to evaluate the credit risk of applicants for retail loans. These systems assign internal credit scores based on various factors, including the applicant's credit bureau information and contract terms. The internal credit score provides the primary basis for credit decisions when acquiring retail loan contracts. Internal credit scores are determined only at the time of origination and are not reassessed during the life of the contract.

Subsequent to origination, collection experience provides an indication of the credit quality of consumer finance receivables. The likelihood of accounts charging off is significantly higher once an account becomes 60 days delinquent. Accounts that are current or less than 60 days past due are considered to be performing. Accounts that are 60 days or more past due are considered to be nonperforming. The table below presents the Company's portfolio of retail loans by this credit quality indicator:

	Retail new auto loans	Retail used and certified auto loans	Retail motorcycle and other loans	Total consumer finance receivables
(U.S. dollars in millions)				
<b>December 31, 2019</b>				
Performing	\$ 28,919	\$ 5,206	\$ 1,267	\$ 35,392
Nonperforming	90	33	10	133
Total	<u>\$ 29,009</u>	<u>\$ 5,239</u>	<u>\$ 1,277</u>	<u>\$ 35,525</u>
<b>March 31, 2019</b>				
Performing	\$ 28,735	\$ 4,782	\$ 1,199	\$ 34,716
Nonperforming	51	18	5	74
Total	<u>\$ 28,786</u>	<u>\$ 4,800</u>	<u>\$ 1,204</u>	<u>\$ 34,790</u>

#### *Dealer Loan Portfolio Segment*

The Company utilizes an internal risk rating system to evaluate dealer credit risk. Dealerships are assigned an internal risk rating based on an assessment of their financial condition and other factors. Factors including liquidity, financial strength, management effectiveness, and operating efficiency, are evaluated when assessing their financial condition. Financing limits and interest rates are based upon these risk ratings. Monitoring activities including financial reviews and inventory inspections are performed more frequently for dealerships with weaker risk ratings. The financial conditions of dealerships are reviewed and their risk ratings are updated at least annually.

The Company's outstanding portfolio of dealer loans has been divided into two groups in the table below. Group A includes the loans of dealerships with the strongest internal risk rating. Group B includes the loans of all remaining dealers.

	December 31, 2019			March 31, 2019		
	Wholesale flooring	Commercial loans	Total	Wholesale flooring	Commercial loans	Total
(U.S. dollars in millions)						
Group A	\$ 2,631	\$ 784	\$ 3,415	\$ 3,121	\$ 823	\$ 3,944
Group B	1,498	256	1,754	1,565	326	1,891
Total	<u>\$ 4,129</u>	<u>\$ 1,040</u>	<u>\$ 5,169</u>	<u>\$ 4,686</u>	<u>\$ 1,149</u>	<u>\$ 5,835</u>

### (3) Investment in Operating Leases

Investment in operating leases consisted of the following:

	December 31, 2019	March 31, 2019
	(U.S. dollars in millions)	
Operating lease vehicles	\$ 44,113	\$ 42,427
Accumulated depreciation	(8,206)	(8,262)
Deferred dealer participation and initial direct costs	133	119
Unearned subsidy income	(1,484)	(1,563)
Estimated early termination losses	(120)	(115)
Investment in operating leases, net	<u>\$ 34,436</u>	<u>\$ 32,606</u>

Operating lease revenue consisted of the following:

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
	(U.S. dollars in millions)			
Lease payments	\$ 1,697	\$ 1,607	\$ 5,003	\$ 4,760
Subsidy income and dealer rate participation, net <sup>(1)</sup>	241	219	732	631
Reimbursed lessor costs <sup>(2)</sup>	14	—	47	—
Total operating lease revenue, net	<u>\$ 1,952</u>	<u>\$ 1,826</u>	<u>\$ 5,782</u>	<u>\$ 5,391</u>

(1) Includes amortization of initial direct costs during the three and nine months ended December 31, 2018.

(2) Reimbursed lessor costs were presented net during the three and nine months ended December 31, 2018.

Leased vehicle expenses consisted of the following:

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
	(U.S. dollars in millions)			
Depreciation expense	\$ 1,448	\$ 1,376	\$ 4,275	\$ 4,112
Initial direct costs and other lessor costs <sup>(1)</sup>	32	—	102	—
Gain on disposition of leased vehicles <sup>(2)</sup>	(17)	(24)	(113)	(118)
Total leased vehicle expenses, net	<u>\$ 1,463</u>	<u>\$ 1,352</u>	<u>\$ 4,264</u>	<u>\$ 3,994</u>

(1) Amortization of initial direct costs was presented as a reduction to lease revenue and reimbursed lessor costs were presented net during the three and nine months ended December 31, 2018.

(2) Included in the gain on disposition of leased vehicles are end of term charges of \$12 million for both the three months ended December 31, 2019 and 2018, and \$58 million and \$52 million for the nine months ended December 31, 2019 and 2018, respectively.

Investment in operating leases includes lease assets with a net carrying amount of \$558 million as of December 31, 2019, which have been transferred to SPEs and are considered to be legally isolated but do not qualify for sale accounting treatment. These investments in operating leases are restricted as collateral for the payment of the related secured debt obligations. Refer to Note 9 for additional information.

Contractual operating lease payments due as of December 31, 2019 are summarized below. Based on the Company's experience, it is expected that a portion of the Company's operating leases will terminate prior to the scheduled lease term. The summary below should not be regarded as a forecast of future cash collections.

<b>Twelve month periods ending December 31,</b>	<b>(U.S. dollars in millions)</b>
2020	\$ 5,935
2021	4,143
2022	1,684
2023	292
2024	65
Total	<u>\$ 12,119</u>

The Company recognized early termination losses due to lessee defaults of \$37 million and \$22 million during the three months ended December 31, 2019 and 2018, respectively, and \$97 million and \$78 million, during the nine months ended December 31, 2019 and 2018, respectively. Actual net losses realized totaled \$37 million and \$26 million for the three months ended December 31, 2019 and 2018, respectively, and \$93 million and \$62 million for the nine months ended December 31, 2019 and 2018, respectively.

The general allowance for uncollectible operating lease receivables was recorded through a reduction to revenue of \$9 million and \$22 million during the three and nine months ended December 31, 2019, respectively. The general allowance for uncollectible operating lease receivables was recorded through a provision for credit losses of \$11 million and \$31 million during the three and nine months ended December 31, 2018, respectively.

No impairment losses due to declines in estimated residual values were recognized during the three and nine months ended December 31, 2019 and 2018.

#### (4) Debt

The Company issues debt in various currencies with both floating and fixed interest rates. Outstanding debt net of discounts and fees, weighted average contractual interest rates and range of contractual interest rates were as follows:

	December 31, 2019	March 31, 2019	Weighted average contractual interest rate		Contractual interest rate ranges	
			December 31, 2019	March 31, 2019	December 31, 2019	March 31, 2019
(U.S. dollars in millions)						
Unsecured debt:						
Commercial paper	\$ 5,865	\$ 5,755	1.84%	2.60%	1.70 - 2.07%	1.79 - 2.71%
Related party debt	577	749	1.99%	2.18%	1.97 - 2.06%	2.02 - 2.31%
Bank loans	4,394	4,962	2.62%	3.16%	2.28 - 2.85%	2.35 - 3.50%
Private MTN program	999	999	3.84%	3.84%	3.80 - 3.88%	3.80 - 3.88%
Public MTN program	25,634	24,117	2.20%	2.35%	0.35 - 3.63%	0.35 - 3.63%
Euro MTN programme	28	868	2.23%	1.89%	2.23 - 2.23%	1.88 - 2.23%
Other debt	3,535	3,514	2.55%	2.50%	1.82 - 3.44%	1.63 - 3.44%
Total unsecured debt	41,032	40,964				
Secured debt	9,608	8,790	2.39%	2.42%	1.21 - 3.30%	1.16 - 3.30%
Total debt	<u>\$ 50,640</u>	<u>\$ 49,754</u>				

As of December 31, 2019, the outstanding principal balance of long-term debt with floating interest rates totaled \$12.4 billion, long-term debt with fixed interest rates totaled \$31.0 billion, and short-term debt totaled \$7.4 billion. As of March 31, 2019, the outstanding principal balance of long-term debt with floating interest rates totaled \$12.5 billion, long-term debt with fixed interest rates totaled \$29.2 billion, and short-term debt totaled \$8.1 billion.

##### **Commercial Paper**

As of December 31, 2019 and March 31, 2019, the Company had commercial paper programs that provide the Company with available funds of up to \$8.5 billion, at prevailing market interest rates for terms up to one year. The commercial paper programs are supported by the Keep Well Agreements with HMC described in Note 6.

Outstanding commercial paper averaged \$5.6 billion and \$5.5 billion during the nine months ended December 31, 2019 and 2018, respectively. The maximum balance outstanding at any month-end during both the nine months ended December 31, 2019 and 2018 was \$6.2 billion.

##### **Related Party Debt**

HCFI issues fixed rate short-term notes to HCI to help fund HCFI's general corporate operations. HCFI incurred interest expense on these notes totaling \$3 million and \$4 million for the three months ended December 31, 2019 and 2018, respectively, and \$11 million and \$12 million for the nine months ended December 31, 2019 and 2018, respectively.

##### **Bank Loans**

Outstanding bank loans at December 31, 2019 were either short-term or long-term, with floating interest rates, and denominated in U.S. dollars or Canadian dollars. Outstanding bank loans have prepayment options. No outstanding bank loans as of December 31, 2019 were supported by the Keep Well Agreements with HMC described in Note 6. Outstanding bank loans contain certain covenants, including limitations on liens, mergers, consolidations and asset sales.

##### **Medium Term Note (MTN) Programs**

###### *Private MTN Program*

AHFC no longer issues MTNs under its Rule 144A Private MTN Program. Notes outstanding under the Private MTN Program as of December 31, 2019 were long-term, with fixed interest rates, and denominated in U.S. dollars. Notes under this program were issued pursuant to the terms of an issuing and paying agency agreement which contains certain covenants, including negative pledge provisions.

### *Public MTN Program*

In August 2019, AHFC renewed its Public MTN program by filing a registration statement with the SEC under which it may issue from time to time up to \$30 billion aggregate principal amount of Public MTNs pursuant to the Public MTN program. The aggregate principal amount of MTNs offered under this program may be increased from time to time. Notes outstanding under the Public MTN program as of December 31, 2019 were either long-term or short-term, with either fixed or floating interest rates, and denominated in U.S. dollars, Euro or Sterling. Notes under this program are issued pursuant to an indenture which contains certain covenants, including negative pledge provisions and limitations on mergers, consolidations and asset sales.

### *Euro MTN Programme*

The Euro MTN Programme was retired in August 2014. AHFC has one note outstanding under this program as of December 31, 2019. The note has a maturity date of February 21, 2023, a fixed interest rate and is not listed on the Luxembourg Stock Exchange. The note was issued pursuant to the terms of an agency agreement which contains certain covenants, including negative pledge provisions.

The MTN programs are supported by the Keep Well Agreement with HMC described in Note 6.

### ***Other Debt***

The outstanding balances as of December 31, 2019 consisted of private placement debt issued by HCFI which are long-term, with either fixed or floating interest rates, and denominated in Canadian dollars. Private placement debt is supported by the Keep Well Agreement with HMC described in Note 6. The notes are issued pursuant to the terms of an indenture which contains certain covenants, including negative pledge provisions.

### ***Secured Debt***

The Company issues notes through financing transactions that are secured by assets held by issuing SPEs. Notes outstanding as of December 31, 2019 were long-term and short-term with either fixed or floating interest rates, and denominated in U.S. dollars or Canadian dollars. Repayment of the notes is dependent on the performance of the underlying retail loans and operating leases. Refer to Note 9 for additional information on the Company's secured financing transactions.

### ***Credit Agreements***

#### *Syndicated Bank Credit Facilities*

AHFC maintains a \$7.0 billion syndicated bank credit facility that includes a \$3.5 billion credit agreement, which expires on February 28, 2020, a \$2.1 billion credit agreement, which expires on March 3, 2021, and a \$1.4 billion credit agreement, which expires on March 3, 2023. As of December 31, 2019, no amounts were drawn upon under the AHFC credit agreements. AHFC intends to renew or replace these credit agreements prior to or on their respective expiration dates.

HCFI maintains a \$1.2 billion syndicated bank credit facility which provides that HCFI may borrow up to \$616 million on a one-year revolving basis and up to \$616 million on a five-year revolving basis. The one-year tranche of the credit agreement expires on March 25, 2020 and the five-year tranche of the credit agreement expires on March 25, 2024. As of December 31, 2019, no amounts were drawn upon under the HCFI credit agreement. HCFI intends to renew or replace the credit agreement prior to or on the expiration date of each respective tranche.

The credit agreements contain customary covenants, including limitations on liens, mergers, consolidations and asset sales and affiliate transactions. Loans, if any, under the credit agreements will be supported by the Keep Well Agreement described in Note 6.

#### *Other Credit Agreements*

AHFC maintains other committed lines of credit that allow the Company access to an additional \$1.0 billion in unsecured funding with two banks. The credit agreements contain customary covenants, including limitations on liens, mergers, consolidations and asset sales. As of December 31, 2019, no amounts were drawn upon under these agreements. These agreements expire in September 2020. The Company intends to renew or replace these credit agreements prior to or on their respective expiration dates.

## (5) Derivative Instruments

The notional balances and fair values of the Company's derivatives are presented below. The derivative instruments are presented on a gross basis in the Company's consolidated balance sheets. Refer to Note 13 regarding the valuation of derivative instruments.

	December 31, 2019			March 31, 2019		
	Notional balances	Assets	Liabilities	Notional balances	Assets	Liabilities
(U.S. dollars in millions)						
Interest rate swaps	\$ 59,380	\$ 303	\$ 343	\$ 58,132	\$ 308	\$ 307
Cross currency swaps	4,001	96	98	5,002	72	261
Gross derivative assets/liabilities		399	441		380	568
Counterparty netting adjustment and collateral		(324)	(318)		(313)	(318)
Net derivative assets/liabilities		\$ 75	\$ 123		\$ 67	\$ 250

The income statement impact of derivative instruments is presented below. There were no derivative instruments designated as part of a hedge accounting relationship during the periods presented.

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
(U.S. dollars in millions)				
Interest rate swaps	\$ (17)	\$ (25)	\$ (62)	\$ (5)
Cross currency swaps	93	(81)	(67)	(411)
Total gain/(loss) on derivative instruments	\$ 76	\$ (106)	\$ (129)	\$ (416)

The fair value of derivative instruments is subject to the fluctuations in market interest rates and foreign currency exchange rates. Since the Company has elected not to apply hedge accounting, the volatility in the changes in fair value of these derivative instruments is recognized in earnings. All settlements of derivative instruments are presented within cash flows from operating activities in the consolidated statements of cash flows.

These derivative instruments also contain an element of credit risk in the event the counterparties are unable to meet the terms of the agreements. However, the Company minimizes the risk exposure by limiting the counterparties to major financial institutions that meet established credit guidelines. In the event of default, all counterparties are subject to legally enforceable master netting agreements. In Canada, HCFI is a party to credit support agreements that require posting of cash collateral to mitigate counterparty credit risk on derivative positions.

## (6) Transactions Involving Related Parties

The following tables summarize the income statement and balance sheet impact of transactions with the Parent and affiliated companies:

Income Statement	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
(U.S. dollars in millions)				
<b>Revenue:</b>				
Subsidy income	\$ 404	\$ 414	\$ 1,249	\$ 1,204
<b>Interest expense:</b>				
Related party debt	3	4	11	12
<b>Other income, net:</b>				
VSC administration fees	27	28	82	82
Support Service Fee	(9)	(9)	(27)	(26)
<b>General and administrative expenses:</b>				
Support Compensation Agreement fees	17	6	51	17
Benefit plan expenses	2	3	7	8
Shared services	17	13	52	50

Balance Sheet	December 31,	March 31,
	2019	2019
(U.S. dollars in millions)		
<b>Assets:</b>		
Finance receivables, net:		
Unearned subsidy income	\$ (842)	\$ (1,091)
Investment in operating leases, net:		
Unearned subsidy income	(1,481)	(1,559)
Due from Parent and affiliated companies	125	162
<b>Liabilities:</b>		
Debt:		
Related party debt	\$ 577	\$ 749
Due to Parent and affiliated companies	104	106
Accrued interest expense:		
Related party debt	2	3
Other liabilities:		
VSC unearned administrative fees	372	387
Accrued benefit expenses	67	65

### Support Agreements

HMC and AHFC are parties to a Keep Well Agreement, effective as of September 9, 2005. This Keep Well Agreement provides that HMC will (1) maintain (directly or indirectly) at least 80% ownership in AHFC's voting stock and not pledge (directly or indirectly), or in any way encumber or otherwise dispose of, any such stock of AHFC that it is required to hold (or permit any of HMC's subsidiaries to do so), (2) cause AHFC to have a positive consolidated tangible net worth with tangible net worth defined as (a) stockholder's equity less (b) any intangible assets, determined on a consolidated basis in accordance with GAAP, and (3) ensure that AHFC has sufficient liquidity to meet its payment obligations for debt HMC has confirmed in writing is covered by this Keep Well Agreement, in accordance with its terms, or where necessary make available to AHFC, or HMC shall procure for AHFC, sufficient funds to enable AHFC to meet such obligations in accordance with such terms. This Keep Well Agreement is not a guarantee by HMC.

HMC and HCFI are parties to a Keep Well Agreement effective as of September 26, 2005. This Keep Well Agreement provides that HMC will (1) maintain (directly or indirectly) at least 80% ownership in HCFI's voting stock and not pledge (directly or indirectly), or in any way encumber or otherwise dispose of, any such stock of HCFI that it is required to hold (or permit any of HMC's subsidiaries to do so), (2) cause HCFI to have a positive consolidated tangible net worth with tangible net worth defined as (a) stockholder's equity less (b) any intangible assets, determined on a consolidated basis in accordance with generally accepted accounting principles in Canada, and (3) ensure that HCFI has sufficient liquidity to meet its payment obligations for debt HMC has confirmed in writing is covered by this Keep Well Agreement, in accordance with its terms, or where necessary make available to HCFI, or HMC shall procure for HCFI, sufficient funds to enable HCFI to meet such obligations in accordance with such terms. This Keep Well Agreement is not a guarantee by HMC.

Debt programs supported by the Keep Well Agreements consist of the Company's commercial paper programs, Private MTN Program, Public MTN Program, Euro MTN Programme, HCFI's private placement debt and loans, if any, under AHFC's syndicated bank credit facilities. In connection with the above agreements, AHFC and HCFI have entered into separate Support Compensation Agreements, where each has agreed to pay HMC a quarterly fee based on the amount of outstanding debt that benefit from the Keep Well Agreements. Support Compensation Agreement fees are recognized in general and administrative expenses.

### ***Incentive Financing Programs***

The Company receives subsidy payments from AHM and HCI, which supplement the revenues on financing products offered under incentive programs. Subsidy payments received on retail loans and leases are deferred and recognized as revenue over the term of the related contracts. The unearned balance is recognized as reductions to the carrying value of finance receivables and investment in operating leases. Subsidy payments on dealer loans are received as earned.

### ***Related Party Debt***

HCFI issues short-term notes to HCI to fund HCFI's general corporate operations. Interest rates are based on prevailing rates of debt with comparable terms. Refer to Note 4 for additional information.

### ***Vehicle Service Contract (VSC) Administration***

AHFC performs administrative services for VSCs issued by certain subsidiaries of AHM. AHFC's performance obligations for the services are satisfied over the term of the underlying contracts and revenue is recognized proportionate to the anticipated amount of services to be performed. Contract terms range between 2 and 9 years with the majority of contracts having original terms between 4 and 8 years. The majority of the administrative service revenue is recognized during the latter years of the underlying contracts as this is the period in which the majority of VSC claims are processed. AHFC receives fees for performing the administrative services when the contracts are acquired.

Unearned VSC administration fees represents AHFC's contract liabilities and are included in other liabilities (Note 11). VSC administration income is recognized in other income, net (Note 12). HCFI receives fees for marketing VSCs issued by HCI. These fees are also recognized in other income, net.

AHFC pays fees to AHM for services provided in support of AHFC's performance of VSC administrative services. The support fees are recognized as an expense within other income, net (Note 12).

### ***Shared Services***

The Company shares certain common expenditures with AHM, HCI, and other related parties including information technology services and facilities. The allocated costs for shared services are included in general and administrative expenses.

### ***Benefit Plans***

The Company participates in various employee benefit plans that are sponsored by AHM and HCI. The allocated benefit plan expenses are included in general and administrative expenses.

### ***Income taxes***

The Company's U.S. income taxes are recognized on a modified separate return basis pursuant to an intercompany income tax allocation agreement with AHM. Income tax related items are not included in the tables above. Refer to Note 7 for additional information.

## ***Other***

AHM periodically sponsors programs that allow lessees to terminate their lease contracts prior to the contractual maturity date. AHM compensates the Company for rental payments that were waived under these programs. During both the three months ended December 31, 2019 and 2018, the Company recognized \$3 million, and during the nine months ended December 31, 2019, and 2018, the Company recognized \$9 million and \$12 million, respectively, under these programs which were reflected as proceeds on the disposition of the returned lease vehicles.

The majority of the amounts due from the Parent and affiliated companies at December 31, 2019 and March 31, 2019 related to incentive financing program subsidies. The majority of the amounts due to the Parent and affiliated companies at December 31, 2019 and March 31, 2019 related to wholesale flooring payable to the Parent. These receivable and payable accounts are non-interest-bearing and short-term in nature and are expected to be settled in the normal course of business.

In August 2019, AHFC declared and paid a cash dividend of \$292 million to its parent, AHM.

## **(7) Income Taxes**

The Company's effective tax rate was 26.4% and 16.1%, for the three months ended December 31, 2019 and 2018, respectively, and 27.8% and 25.3% for the nine months ended December 31, 2019 and 2018, respectively. The increase in the effective tax rate for the three and nine months ended December 31, 2019 was primarily due to non-recurring adjustments recorded in fiscal year 2019 related to the U.S. tax reform, including the Transition Tax, as well as a reduction in tax credits in fiscal year 2020 compared to fiscal year 2019.

The Company does not provide for income taxes on its share of the undistributed earnings of HCFI which are intended to be indefinitely reinvested outside the United States. At December 31, 2019, \$1.0 billion of accumulated undistributed earnings of HCFI are intended to be so reinvested. If the undistributed earnings as of December 31, 2019 were to be distributed, the tax liability associated with these earnings would be \$62 million.

During the quarter ended December 31, 2019, the Company reduced previously unrecognized tax benefits as a result of a change in tax accounting method filed with the Internal Revenue Service. This reduction had no material net impact on the Company's total tax expense for the period. The Company does not expect any material changes in the amounts of unrecognized tax benefits during the remainder of the fiscal year ending March 31, 2020.

As of December 31, 2019, the Company has open tax years either currently subject to examination or eligible for potential future examination by U.S. federal and state tax jurisdictions for returns filed for the taxable years ended March 31, 2008 through 2018. The Company's Canadian subsidiary, HCFI, has open tax years either currently subject to examination or eligible for potential future examination for returns filed for the taxable years ended March 31, 2013 through 2019 federally, and returns filed for the taxable years ended March 31, 2009 through 2019 provincially. The Company believes an appropriate provision has been made for all outstanding issues for all open years.

## (8) Commitments and Contingencies

### *Operating Leases*

The Company leases certain premises and equipment through operating leases. AHFC leases its premises and equipment from third parties and HCFI leases its premises from HCI. Many of the Company's leases contain renewal options, and generally have no residual value guarantees or material covenants. When it is reasonably certain that the Company will exercise the option to renew a lease, the Company will include the renewal option in the evaluation of the lease term. The Company has elected not to recognize right-of-use assets or lease liabilities for leases with a lease term of less than one year. As most of the Company's leases do not provide an implicit rate, the incremental borrowing rate is used in determining the present value of lease payments. The right-of-use assets in operating lease arrangements are reported in other assets on the Company's consolidated balance sheets.

Operating lease liabilities are reported in other liabilities on the Company's consolidated balance sheets. At December 31, 2019, maturities of operating lease liabilities were as follows:

<b>Twelve month periods ending December 31,</b>	<b>(U.S. dollars in millions)</b>
2020	\$ 10
2021	10
2022	9
2023	8
2024	7
Thereafter	20
Total undiscounted future lease obligations	64
Less: imputed interest	(7)
Operating lease liabilities	<u>\$ 57</u>

Rent expense under operating leases was \$3 million for the three months ended December 31, 2019 and \$8 million for the nine months ended December 31, 2019. Rent expense is included within general and administrative expenses.

As of December 31, 2019, the weighted average remaining lease term for operating leases was 7.2 years and the weighted average remaining discount rate for operating leases was 3.04%.

### *Revolving Lines of Credit to Dealerships*

The Company extends commercial revolving lines of credit to dealerships to support their business activities including facilities refurbishment and general working capital requirements. The amounts borrowed are generally secured by the assets of the borrowing entity. The unused balance of commercial revolving lines of credit was \$381 million as of December 31, 2019. The Company also has commitments to finance the construction of auto dealership facilities. The remaining unfunded balance for these construction loans was \$20 million as of December 31, 2019.

### *Legal Proceedings and Regulatory Matters*

The Company establishes accruals for legal claims when payments associated with the claims become probable and the costs can be reasonably estimated. When able, the Company will determine estimates of reasonably possible loss or range of loss, whether in excess of any related accrued liability or where there is no accrued liability. Given the inherent uncertainty associated with legal matters, the actual costs of resolving legal claims and associated costs of defense may be substantially higher or lower than the amounts for which accruals have been established.

The Company is involved, in the ordinary course of business, in various legal proceedings including claims of individual customers and purported class action lawsuits. Certain of these actions are similar to suits filed against other financial institutions and captive finance companies. Most of these proceedings concern customer allegations of wrongful repossession or defamation of credit. The Company is also subject to governmental reviews and inquiries from time to time. The Company has received two Civil Investigative Demands from the U.S. Department of Justice (DOJ) relating to financing of motor vehicles by servicemembers under the Servicemembers Civil Relief Act. The Company is cooperating with the DOJ and is responding to their information requests. Based on available information and established accruals, management does not believe it is reasonably possible that the results of these proceedings, in the aggregate, will have a material adverse effect on the Company's consolidated financial statements.

## (9) Securitizations and Variable Interest Entities (VIE)

The Company utilizes SPEs for its asset-backed securitizations and these SPEs are considered VIEs, which are required to be consolidated by their primary beneficiary. The Company is considered to be the primary beneficiary of these SPEs due to (i) the power to direct the activities of the SPEs that most significantly impact the SPEs' economic performance through the Company's role as servicer, and (ii) the obligation to absorb losses or the right to receive residual returns that could potentially be significant to the SPEs through the subordinated certificates and residual interest retained. The debt securities issued by the SPEs to third-party investors along with the assets of the SPEs are included in the Company's consolidated financial statements.

During the nine months ended December 31, 2019 and 2018, the Company issued notes through asset-backed securitizations, which were accounted for as secured financing transactions totaling \$4.7 billion and \$3.5 billion, respectively. The notes were secured by assets with an initial balance of \$5.2 billion and \$4.3 billion, respectively.

The table below presents the carrying amounts of assets and liabilities of consolidated SPEs as they are reported in the Company's consolidated balance sheets. All amounts exclude intercompany balances, which have been eliminated upon consolidation. Investors in notes issued by a SPE only have recourse to the assets of such SPE and do not have recourse to the assets of AHFC, HCFI, or its other subsidiaries or to other SPEs. The assets of SPEs are the only source of funds for repayment on the notes.

	December 31, 2019				
	Assets			Liabilities	
	(U.S. dollars in millions)				
	Securitized assets	Restricted cash <sup>(1)</sup>	Other	Secured debt	Other
Retail loan securitizations	\$ 9,436	\$ 601	\$ 14	\$ 9,153	\$ 8
Operating lease securitizations	558	1	—	455	2
Total	<u>\$ 9,994</u>	<u>\$ 602</u>	<u>\$ 14</u>	<u>\$ 9,608</u>	<u>\$ 10</u>
	March 31, 2019				
	Assets			Liabilities	
	(U.S. dollars in millions)				
	Securitized assets	Restricted cash <sup>(1)</sup>	Other	Secured debt	Other
Retail loan securitizations	\$ 9,073	\$ 588	\$ 12	\$ 8,790	\$ 8
Operating lease securitizations	—	—	—	—	—
Total	<u>\$ 9,073</u>	<u>\$ 588</u>	<u>\$ 12</u>	<u>\$ 8,790</u>	<u>\$ 8</u>

(1) Included with other assets in the Company's consolidated balance sheets (Note 10).

In their role as servicers, AHFC and HCFI collect payments on the underlying securitized assets on behalf of the SPEs. Cash collected during a calendar month is required to be remitted to the SPEs in the following month. AHFC and HCFI are not restricted from using the cash collected for their general purposes prior to the remittance to the SPEs. As of December 31, 2019 and March 31, 2019, AHFC and HCFI had combined cash collections of \$493 million and \$496 million, respectively, which were required to be remitted to the SPEs.

**(10) Other Assets**

Other assets consisted of the following:

	December 31, 2019	March 31, 2019
(U.S. dollars in millions)		
Interest receivable and other assets	\$ 110	\$ 106
Vehicles held for disposition	195	252
Other receivables	138	175
Deferred expense	110	115
Software, net of accumulated amortization of \$162 and \$154 as of December 31, 2019 and March 31, 2019, respectively	24	29
Property and equipment, net of accumulated depreciation of \$22 and \$21 as of December 31, 2019 and March 31, 2019, respectively	5	6
Restricted cash	602	588
Operating lease assets	50	—
Like-kind exchange assets	49	73
Other miscellaneous assets	19	25
Total	<u>\$ 1,302</u>	<u>\$ 1,369</u>

Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the related assets, which range from 3 to 5 years. General and administrative expenses include depreciation and amortization expense of \$2 million and \$3 million for the three months ended December 31, 2019 and 2018, and \$8 million and \$9 million for the nine months ended December 31, 2019 and 2018, respectively.

**(11) Other Liabilities**

Other liabilities consisted of the following:

	December 31, 2019	March 31, 2019
(U.S. dollars in millions)		
Dealer payables	\$ 159	\$ 241
Accrued interest expense	190	150
Accounts payable and accrued expenses	401	399
Lease security deposits	91	85
VSC unearned administrative fees (Note 6)	372	387
Unearned income, operating leases	368	352
Operating lease liabilities	57	—
Uncertain tax positions	109	89
Other liabilities	18	14
Total	<u>\$ 1,765</u>	<u>\$ 1,717</u>

**(12) Other Income, net**

Other income consisted of the following:

	<b>Three months ended December 31,</b>		<b>Nine months ended December 31,</b>	
	<b>2019</b>	<b>2018</b>	<b>2019</b>	<b>2018</b>
	<b>(U.S. dollars in millions)</b>			
VSC administration (Note 6)	\$ 27	\$ 28	\$ 82	\$ 82
Other, net	(3)	(9)	(15)	(31)
Total	<u>\$ 24</u>	<u>\$ 19</u>	<u>\$ 67</u>	<u>\$ 51</u>

**(13) Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are those other than quoted prices included within Level 1 that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Nonperformance risk is also required to be reflected in the fair value measurement, including an entity's own credit standing when measuring the fair value of a liability.

### Recurring Fair Value Measurements

The following tables summarize the fair value hierarchy of assets and liabilities measured at fair value on a recurring basis:

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
(U.S. dollars in millions)				
<b>Assets:</b>				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 303	\$ —	\$ 303
Cross currency swaps	—	96	—	96
Total assets	<u>\$ —</u>	<u>\$ 399</u>	<u>\$ —</u>	<u>\$ 399</u>
<b>Liabilities:</b>				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 343	\$ —	\$ 343
Cross currency swaps	—	98	—	98
Total liabilities	<u>\$ —</u>	<u>\$ 441</u>	<u>\$ —</u>	<u>\$ 441</u>
(U.S. dollars in millions)				
<b>Assets:</b>				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 308	\$ —	\$ 308
Cross currency swaps	—	72	—	72
Total assets	<u>\$ —</u>	<u>\$ 380</u>	<u>\$ —</u>	<u>\$ 380</u>
<b>Liabilities:</b>				
Derivative instruments:				
Interest rate swaps	\$ —	\$ 307	\$ —	\$ 307
Cross currency swaps	—	261	—	261
Total liabilities	<u>\$ —</u>	<u>\$ 568</u>	<u>\$ —</u>	<u>\$ 568</u>

The valuation techniques used in measuring assets and liabilities at fair value on a recurring basis are described below:

#### Derivative Instruments

The Company's derivatives are transacted in over-the-counter markets and quoted market prices are not readily available. The Company uses third-party developed valuation models to value derivative instruments. These models estimate fair values using discounted cash flow modeling techniques, which utilize the contractual terms of the derivative instruments and market-based inputs, including interest rates and foreign exchange rates. Discount rates incorporate counterparty and HMC specific credit default spreads to reflect nonperformance risk.

The Company's derivative instruments are classified as Level 2 since all significant inputs are observable and do not require management judgment. There were no transfers between fair value hierarchy levels during the nine months ended December 31, 2019 and 2018. Refer to Note 5 for additional information on derivative instruments.

### ***Nonrecurring Fair Value Measurements***

The following tables summarize nonrecurring fair value measurements recognized for assets still held at the end of the reporting periods presented:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>	<u>Lower-of-cost or fair value adjustment</u>
	(U.S. dollars in millions)				
<b><u>December 31, 2019</u></b>					
Vehicles held for disposition	\$ —	\$ —	\$ 138	\$ 138	\$ 32
<b><u>December 31, 2018</u></b>					
Vehicles held for disposition	\$ —	\$ —	\$ 156	\$ 156	\$ 32

The following describes the methodologies and assumptions used in nonrecurring fair value measurements, which relate to the application of lower of cost or fair value accounting on long-lived assets.

#### ***Vehicles Held for Disposition***

Vehicles held for disposition consist of returned and repossessed vehicles. They are valued at the lower of their carrying value or estimated fair value, less estimated disposition costs. The fair value is based on current average selling prices of like vehicles at wholesale used vehicle auctions.

#### ***Fair Value of Financial Instruments***

The following tables summarize the carrying values and fair values of the Company's financial instruments except for those measured at fair value on a recurring basis. Certain financial instruments and all nonfinancial assets and liabilities are excluded from fair value disclosure requirements including the Company's investment in operating leases.

**December 31, 2019**

	Carrying value	Fair value			Total
		Level 1	Level 2	Level 3	
(U.S. dollars in millions)					
<b>Assets:</b>					
Cash and cash equivalents	\$ 837	\$ 837	\$ —	\$ —	\$ 837
Dealer loans, net	5,169	—	—	4,960	4,960
Retail loans, net	35,326	—	—	35,801	35,801
Restricted cash	602	602	—	—	602
<b>Liabilities:</b>					
Commercial paper	\$ 5,865	\$ —	\$ 5,865	\$ —	\$ 5,865
Related party debt	577	—	577	—	577
Bank loans	4,394	—	4,428	—	4,428
Medium term note programs	26,661	—	27,025	—	27,025
Other debt	3,535	—	3,578	—	3,578
Secured debt	9,608	—	9,659	—	9,659

**March 31, 2019**

	Carrying value	Fair value			Total
		Level 1	Level 2	Level 3	
(U.S. dollars in millions)					
<b>Assets:</b>					
Cash and cash equivalents	\$ 795	\$ 795	\$ —	\$ —	\$ 795
Dealer loans, net	5,827	—	—	5,611	5,611
Retail loans, net	34,569	—	—	34,857	34,857
Restricted cash	588	588	—	—	588
<b>Liabilities:</b>					
Commercial paper	\$ 5,755	\$ —	\$ 5,755	\$ —	\$ 5,755
Related party debt	749	—	749	—	749
Bank loans	4,962	—	5,000	—	5,000
Medium term note programs	25,984	—	26,130	—	26,130
Other debt	3,514	—	3,535	—	3,535
Secured debt	8,790	—	8,799	—	8,799

Fair value information presented in the tables above is based on information available at December 31, 2019 and March 31, 2019. Although the Company is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been updated since those dates, and therefore, the current estimates of fair value at dates subsequent to those dates may differ significantly from the amounts presented herein.

#### **(14) Segment Information**

The Company's reportable segments are based on the two geographic regions where operating results are measured and evaluated by management: the United States and Canada.

Segment performance is evaluated using an internal measurement basis, which differs from the Company's consolidated results prepared in accordance with GAAP. Segment performance is evaluated on a pre-tax basis before the effect of valuation adjustments on derivative instruments and revaluations of foreign currency denominated debt. Since the Company does not elect to apply hedge accounting, the impact to earnings resulting from these valuation adjustments as reported under GAAP is not representative of segment performance as evaluated by management. Realized gains and losses on derivative instruments, net of realized gains and losses on foreign currency denominated debt, are included in the measure of net revenues when evaluating segment performance.

No adjustments are made to segment performance to allocate any revenues or expenses. Financing products offered throughout the United States and Canada are substantially similar. Segment revenues from the various financing products are reported on the same basis as GAAP consolidated results.

Financial information for the three and nine months ended December 31, 2019 and 2018 is summarized in the following tables:

	United States	Canada	Valuation adjustments and reclassifications	Consolidated Total
(U.S. dollars in millions)				
<b>Three months ended December 31, 2019</b>				
Revenues:				
Retail	\$ 386	\$ 52	\$ —	\$ 438
Dealer	46	6	—	52
Operating leases	1,609	343	—	1,952
Total revenues	2,041	401	—	2,442
Leased vehicle expenses	1,199	264	—	1,463
Interest expenses	262	45	—	307
Realized (gains)/losses on derivatives and foreign currency denominated debt	33	—	(33)	—
Net revenues	547	92	33	672
Other income	21	3	—	24
Total net revenues	568	95	33	696
Expenses:				
General and administrative expenses	110	14	—	124
Provision for credit losses	63	2	—	65
Early termination loss on operating leases	37	—	—	37
(Gain)/Loss on derivative instruments	—	—	(76)	(76)
(Gain)/Loss on foreign currency revaluation of debt	—	—	145	145
Income before income taxes	\$ 358	\$ 79	\$ (36)	\$ 401
<b>Nine months ended December 31, 2019</b>				
Revenues:				
Retail	\$ 1,158	\$ 156	\$ —	\$ 1,314
Dealer	156	18	—	174
Operating leases	4,769	1,013	—	5,782
Total revenues	6,083	1,187	—	7,270
Leased vehicle expenses	3,493	771	—	4,264
Interest expenses	812	135	—	947
Realized (gains)/losses on derivatives and foreign currency denominated debt	71	(3)	(68)	—
Net revenues	1,707	284	68	2,059
Other income	58	9	—	67
Total net revenues	1,765	293	68	2,126
Expenses:				
General and administrative expenses	325	44	—	369
Provision for credit losses	167	4	—	171
Early termination loss on operating leases	96	1	—	97
(Gain)/Loss on derivative instruments	—	—	129	129
(Gain)/Loss on foreign currency revaluation of debt	—	—	(1)	(1)
Income before income taxes	\$ 1,177	\$ 244	\$ (60)	\$ 1,361
<b>December 31, 2019</b>				
Finance receivables, net	\$ 35,980	\$ 4,515	\$ —	\$ 40,495
Investment in operating leases, net	28,914	5,522	—	34,436
Total assets	67,762	10,168	—	77,930

	United States	Canada	Valuation adjustments and reclassifications	Consolidated Total
	(U.S. dollars in millions)			
<b>Three months ended December 31, 2018</b>				
Revenues:				
Retail	\$ 363	\$ 52	\$ —	\$ 415
Dealer	54	5	—	59
Operating leases	1,507	319	—	1,826
Total revenues	1,924	376	—	2,300
Leased vehicle expenses	1,104	248	—	1,352
Interest expense	258	45	—	303
Realized (gains)/losses on derivatives and foreign currency denominated debt	9	(5)	(4)	—
Net revenues	553	88	4	645
Other income	18	1	—	19
Total net revenues	571	89	4	664
Expenses:				
General and administrative expenses	97	12	—	109
Provision for credit losses	74	1	—	75
Early termination loss on operating leases	21	1	—	22
(Gain)/Loss on derivative instruments	—	—	106	106
(Gain)/Loss on foreign currency revaluation of debt	—	—	(63)	(63)
Income before income taxes	\$ 379	\$ 75	\$ (39)	\$ 415
<b>Nine months ended December 31, 2018</b>				
Revenues:				
Retail	\$ 1,035	\$ 157	\$ —	\$ 1,192
Dealer	154	15	—	169
Operating leases	4,460	931	—	5,391
Total revenues	5,649	1,103	—	6,752
Leased vehicle expenses	3,272	722	—	3,994
Interest expense	742	128	—	870
Realized (gains)/losses on derivatives and foreign currency denominated debt	9	(12)	3	—
Net revenues	1,626	265	(3)	1,888
Other income	45	6	—	51
Total net revenues	1,671	271	(3)	1,939
Expenses:				
General and administrative expenses	299	39	—	338
Provision for credit losses	176	5	—	181
Early termination loss on operating leases	75	3	—	78
(Gain)/Loss on derivative instruments	—	—	416	416
(Gain)/Loss on foreign currency revaluation of debt	—	—	(337)	(337)
Income before income taxes	\$ 1,121	\$ 224	\$ (82)	\$ 1,263
<b>December 31, 2018</b>				
Finance receivables, net	\$ 35,201	\$ 4,303	\$ —	\$ 39,504
Investment in operating leases, net	27,189	5,004	—	32,193
Total assets	64,900	9,469	—	74,369

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview

Our primary focus, in collaboration with AHM and HCI, is to provide support for the sale of Honda and Acura products and maintain customer and dealer satisfaction and loyalty. To deliver this support effectively, we seek to maintain competitive cost of funds, efficient operations, and effective risk and compliance management. The primary factors influencing our results of operations, cash flows, and financial condition include the volume of Honda and Acura sales and the portion of those sales that we finance, our cost of funds, competition from other financial institutions, consumer credit defaults, and used motor vehicle prices.

A substantial portion of our consumer financing business is acquired through incentive financing programs sponsored by AHM and HCI. The volume of these incentive financing programs and the allocation of those programs between retail loans and leases may vary from fiscal period to fiscal period depending upon the respective marketing strategies of AHM and HCI. AHM and HCI's marketing strategies are based in part on their business planning and control, in which we do not participate. Therefore, we cannot predict the level of incentive financing programs AHM and HCI may sponsor in the future. Our consumer financing acquisition volumes are substantially dependent on the extent to which incentive financing programs are offered. Increases in incentive financing programs generally increase our financing penetration rates, which typically results in increased financing acquisition volumes for us. The amount of subsidy payments we receive from AHM and HCI is dependent on the terms of the incentive financing programs and the interest rate environment. Subsidy payments are received upon acquisition and recognized in revenue throughout the life of the loan or lease; therefore, a significant change in the level of incentive financing programs in a fiscal period typically only has a limited impact on our results of operations for that period. The amount of subsidy income we recognize in a fiscal period is dependent on the cumulative level of subsidized contracts outstanding that were acquired through incentive financing programs.

We seek to maintain high quality consumer and dealer account portfolios, which we support with strong underwriting standards, risk-based pricing, and effective collection practices. Our cost of funds is facilitated by the diversity of our funding sources, and effective interest rate and foreign currency exchange risk management. We manage expenses to support our profitability, including adjusting staffing needs based upon our business volumes and centralizing certain functions. Additionally, we use risk and compliance management practices to optimize credit and residual value risk levels and maintain compliance with our pricing, underwriting and servicing policies at the United States, Canadian, state and provincial levels.

In our business operations, we incur costs related to funding, credit loss, residual value loss, and general and administrative expenses, among other expenses.

We analyze our operations in two business segments defined by geography: the United States and Canada. We measure the performance of our United States and Canada segments on a pre-tax basis before the effect of valuation adjustments on derivative instruments and revaluations of foreign currency denominated debt. For additional information regarding our segments, see Note 14—Segment Information of *Notes to Consolidated Financial Statements*. The following tables and the related discussion are presented based on our geographically segmented consolidated financial statements.

References in this report to our "fiscal year 2020" and "fiscal year 2019" refer to our fiscal year ending March 31, 2020 and our fiscal year ended March 31, 2019, respectively.

## Results of Operations

The following table presents our income before income taxes:

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
(U.S. dollars in millions)				
Income before income taxes:				
United States segment	\$ 321	\$ 352	\$ 1,113	\$ 1,051
Canada segment	80	63	248	212
Total income before income taxes	\$ 401	\$ 415	\$ 1,361	\$ 1,263

### Comparison of the Three Months Ended December 31, 2019 and 2018

Our consolidated income before income taxes was \$401 million during the third quarter of fiscal year 2020 compared to \$415 million during the same period in fiscal year 2019. This decrease of \$14 million, or 3%, was due to the following differences:

	Three months ended December 31,		Difference	% Change
	2019	2018		
(U.S. dollars in millions)				
Net revenues:				
Retail	\$ 438	\$ 415	\$ 23	6 %
Dealer	52	59	(7)	(12)%
Operating lease, net of leased vehicle expenses	489	474	15	3 %
Interest expense	(307)	(303)	(4)	1 %
Other	24	19	5	26 %
Total net revenues	696	664	32	5 %
Expenses:				
General and administrative expenses	124	109	15	14 %
(Gain)/Loss on derivative instruments	(76)	106	(182)	n/m
(Gain)/Loss on foreign currency revaluation of debt	145	(63)	208	n/m
Other	102	97	5	5 %
Total expenses	295	249	46	18 %
Total income before income taxes	\$ 401	\$ 415	\$ (14)	(3)%

n/m = not meaningful

**Comparison of the Nine Months Ended December 31, 2019 and 2018**

Our consolidated income before income taxes was \$1,361 million during the first nine months of fiscal year 2020 compared to \$1,263 million during the same period in fiscal year 2019. This increase of \$98 million, or 8%, was due to the following differences:

	<b>Nine months ended December 31,</b>		<b>Difference</b>	<b>% Change</b>
	<b>2019</b>	<b>2018</b>		
<b>(U.S. dollars in millions)</b>				
<b>Net revenues:</b>				
Retail	\$ 1,314	\$ 1,192	\$ 122	10%
Dealer	174	169	5	3%
Operating lease, net of leased vehicle expenses	1,518	1,397	121	9%
Interest expense	(947)	(870)	(77)	9%
Other	67	51	16	31%
Total net revenues	<u>2,126</u>	<u>1,939</u>	<u>187</u>	<u>10%</u>
<b>Expenses:</b>				
General and administrative expenses	369	338	31	9%
(Gain)/Loss on derivative instruments	129	416	(287)	n/m
(Gain)/Loss on foreign currency revaluation of debt	(1)	(337)	336	n/m
Other	268	259	9	3%
Total expenses	<u>765</u>	<u>676</u>	<u>89</u>	<u>13%</u>
Total income before income taxes	<u>\$ 1,361</u>	<u>\$ 1,263</u>	<u>\$ 98</u>	<u>8%</u>

n/m = not meaningful

**Segment Results—Comparison of the Three Months Ended December 31, 2019 and 2018**

Results of operations for the United States segment and the Canada segment are summarized below:

	United States Segment		Canada Segment		Consolidated	
	Three months ended December 31,		Three months ended December 31,		Three months ended December 31,	
	2019	2018	2019	2018	2019	2018
	(U.S. dollars in millions)					
Revenues:						
Retail	\$ 386	\$ 363	\$ 52	\$ 52	\$ 438	\$ 415
Dealer	46	54	6	5	52	59
Operating leases	1,609	1,507	343	319	1,952	1,826
Total revenues	2,041	1,924	401	376	2,442	2,300
Leased vehicle expenses	1,199	1,104	264	248	1,463	1,352
Interest expense	262	258	45	45	307	303
Net revenues	580	562	92	83	672	645
Other income	21	18	3	1	24	19
Total net revenues	601	580	95	84	696	664
Expenses:						
General and administrative expenses	110	97	14	12	124	109
Provision for credit losses	63	74	2	1	65	75
Early termination loss on operating leases	37	21	—	1	37	22
(Gain)/Loss on derivative instruments	(75)	99	(1)	7	(76)	106
(Gain)/Loss on foreign currency revaluation of debt	145	(63)	—	—	145	(63)
Income before income taxes	\$ 321	\$ 352	\$ 80	\$ 63	\$ 401	\$ 415

**Revenues**

Revenue from retail loans in the United States segment increased by \$23 million, or 6%, during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. The increase in revenue was attributable to higher average outstanding balances and higher yields. Revenue from retail loans in the Canada segment were flat during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019.

Operating lease revenue increased by \$102 million, or 7%, in the United States segment and by \$24 million, or 8%, in the Canada segment during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. The increase in the United States segment was attributable to higher average outstanding operating leases. The increase in the Canada segment was attributable to an increase in average outstanding operating leases and higher revenue on more recently acquired operating leases.

Revenue from dealer loans decreased by \$8 million, or 15%, in the United States segment during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. The decrease in revenue in the United States segment was attributable to lower yields and lower average outstanding balances. Revenue from dealers loans increased by \$1 million, or 20%, in the Canada segment during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. The increase in revenue in the Canada segment was due to higher average outstanding balances.

Consolidated subsidy income from AHM and HCI sponsored incentive programs decreased by \$10 million, or 2%, to \$404 million during the third quarter of fiscal year 2020 compared to \$414 million during the same period in fiscal year 2019 primarily due to the decrease in average subsidy payments received.

#### *Leased vehicle expenses*

Leased vehicle expenses increased by \$95 million, or 9%, in the United States segment and by \$16 million, or 6%, in the Canada segment during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. The increase is attributable to the increase in depreciation on operating leases due to higher average outstanding operating lease assets and the change in presentation of lessor costs resulting from lessor accounting changes that were adopted on April 1, 2019. For additional information regarding leases, see Note 1—Summary of Business and Significant Accounting Policies of *Notes to Consolidated Financial Statements (Unaudited)*.

#### *Interest expense*

Interest expense in the United States segment increased by \$4 million, or 2%, during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019 primarily due to higher average outstanding debt. Interest expense in the Canada segment were flat during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. See “—*Liquidity and Capital Resources*” below for more information.

#### *Provision for credit losses*

The provision for credit losses in the United States segment decreased by \$11 million, or 15%, during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. The decrease in the provision for credit losses is attributable to the change to the income statement presentation for uncollectible operating lease receivables resulting from lessor accounting changes that were adopted on April 1, 2019. For additional information regarding leases, see Note 1—Summary of Business and Significant Accounting Policies of *Notes to Consolidated Financial Statements (Unaudited)*. The provision for credit losses in the Canada segment increased by \$1 million during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. See “—*Financial Condition—Credit Risk*” below for more information.

#### *Early termination loss on operating leases*

Early termination losses on operating leases in the United States segment increased by \$16 million, or 76%, during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019 due to higher loss severities. Early termination losses on operating leases in the Canada segment decreased by \$1 million during the third quarter of fiscal year 2020 compared to the same period in fiscal year 2019. See “—*Financial Condition—Credit Risk*” below for more information.

#### *Gain/loss on derivative instruments*

In the United States segment, we recognized a gain on derivative instruments of \$75 million during the third quarter of fiscal year 2020 compared to a loss of \$99 million during the same period in fiscal year 2019. The gain in the third quarter of fiscal year 2020 was attributable to a gain on cross currency swaps of \$94 million and gain on pay fixed interest rates of \$52 million, partially offset by loss on pay float interest rate swaps of \$71 million. The gains on cross currency swaps during the third quarter of fiscal year 2020 was primarily attributable to the U.S. dollar weakening against the Euro and Sterling during the period. The gains on pay fixed interest rate swaps and losses on pay float interest rate swaps during the third quarter of fiscal year 2020 were primarily due to the increase in applicable swap rates during the period. In the Canada segment, we recognized a gain on derivative instruments of \$1 million during the third quarter of fiscal year 2020 compared to a loss of \$7 million during the same period in fiscal year 2019. The gain in the third quarter of fiscal year 2020 was due to a rise in applicable swap rates during the period. See “—*Derivatives*” below for more information.

#### *Gain/loss on foreign currency revaluation of debt*

In the United States segment, we recognized a loss on the revaluation of foreign currency denominated debt of \$145 million during the third quarter of fiscal year 2020 compared to a gain of \$63 million during the same period in fiscal year 2019. The loss during the third quarter of fiscal year 2020 was primarily due to the U.S. dollar weakening against the Euro and Sterling during the period.

### Income tax expense

The consolidated effective tax rate was 26.4% for the third quarter of fiscal year 2020 and 16.1% for the same period in fiscal year 2019. The increase in the effective tax rate for the three months ended December 31, 2019 was primarily due to non-recurring adjustments recorded in fiscal year 2019 related to the U.S. tax reform, including the Transition Tax, as well as a reduction in tax credits in fiscal year 2020 compared to fiscal year 2019. For additional information regarding income taxes, see Note 7—Income Taxes of *Notes to Consolidated Financial Statements (Unaudited)*.

### Segment Results—Comparison of the Nine Months Ended December 31, 2019 and 2018

Results of operations for the United States segment and the Canada segment are summarized below:

	United States Segment		Canada Segment		Consolidated	
	Nine months ended December 31,		Nine months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018	2019	2018
	(U.S. dollars in millions)					
Revenues:						
Retail	\$ 1,158	\$ 1,035	\$ 156	\$ 157	\$ 1,314	\$ 1,192
Dealer	156	154	18	15	174	169
Operating leases	4,769	4,460	1,013	931	5,782	5,391
Total revenues	6,083	5,649	1,187	1,103	7,270	6,752
Leased vehicle expenses	3,493	3,272	771	722	4,264	3,994
Interest expense	812	742	135	128	947	870
Net revenues	1,778	1,635	281	253	2,059	1,888
Other income	58	45	9	6	67	51
Total net revenues	1,836	1,680	290	259	2,126	1,939
Expenses:						
General and administrative expenses	325	299	44	39	369	338
Provision for credit losses	167	176	4	5	171	181
Early termination loss on operating leases	96	75	1	3	97	78
(Gain)/Loss on derivative instruments	136	416	(7)	—	129	416
(Gain)/Loss on foreign currency revaluation of debt	(1)	(337)	—	—	(1)	(337)
Income before income taxes	\$ 1,113	\$ 1,051	\$ 248	\$ 212	\$ 1,361	\$ 1,263

### Revenues

Revenue from retail loans in the United States segment increased by \$123 million, or 12%, during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. The increase in revenue was attributable to higher average outstanding balances and higher yields. Revenue from retail loans in the Canada segment, which includes the remaining balance of direct financing leases, decreased by \$1 million, or 1%, during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. The decrease in revenue was attributable to the \$3 million decline in direct financing leases due to runoff, offset by a \$2 million increase in retail loans due to higher yields.

Operating lease revenue increased by \$309 million, or 7%, in the United States segment and by \$82 million, or 9%, in the Canada segment during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. The increases in the United States and Canada segments were attributable to an increase in average outstanding operating leases and higher revenue on more recently acquired operating leases.

Revenue from dealer loans increased by \$2 million, or 1%, in the United States segment and by \$3 million, or 20%, in the Canada segment during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. The increases were due to higher yields and higher average outstanding balances.

Consolidated subsidy income from AHM and HCI sponsored incentive programs increased by \$45 million, or 4%, to \$1,249 million during the first nine months of fiscal year 2020 compared to \$1,204 million during the same period in fiscal year 2019 primarily due to the increase in average subsidy payments received.

#### *Leased vehicle expenses*

Leased vehicle expenses increased by \$221 million, or 7%, in the United States segment and by \$49 million, or 7%, in the Canada segment during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. The increase is attributable to the increase in depreciation on operating leases due to higher average outstanding operating lease assets and the change in presentation of lessor costs resulting from lessor accounting changes that were adopted on April 1, 2019. For additional information regarding leases, see Note 1—Summary of Business and Significant Accounting Policies of *Notes to Consolidated Financial Statements (Unaudited)*.

#### *Interest expense*

Interest expense in the United States segment increased by \$70 million, or 9%, during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019 primarily due to higher average interest rates and an increase in average outstanding debt. Interest expense in the Canada segment increased by \$7 million, or 5%, during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019 due to higher average interest rates. See “—*Liquidity and Capital Resources*” below for more information.

#### *Provision for credit losses*

The provision for credit losses in the United States segment decreased by \$9 million, or 5%, during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. The decrease in the provision for credit losses is due to the change to the income statement presentation for uncollectible operating lease receivables resulting from lessor accounting changes that were adopted on April 1, 2019. For additional information regarding leases, see Note 1—Summary of Business and Significant Accounting Policies of *Notes to Consolidated Financial Statements (Unaudited)*. The decrease in the provision for credit losses is partially offset by the increase in the provision for retail loans of \$19 million and the provision for dealer loans of \$2 million. The provision for credit losses in the Canada segment decreased by \$1 million, or 20%, during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. See “—*Financial Condition—Credit Risk*” below for more information.

#### *Early termination loss on operating leases*

Early termination losses on operating leases in the United States segment increased by \$21 million, or 28%, during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019 due to higher loss severities. Early termination losses on operating leases in the Canada segment decreased by \$2 million during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019 due to a smaller increase in estimated early termination losses. See “—*Financial Condition—Credit Risk*” below for more information.

#### *Gain/loss on derivative instruments*

In the United States segment, we recognized a loss on derivative instruments of \$136 million during the first nine months of fiscal year 2020 compared to a loss of \$416 million during the same period in fiscal year 2019. The loss in the first nine months of fiscal year 2020 was attributable to a loss on pay fixed interest rates of \$196 million and loss on cross currency swaps of \$66 million, partially offset by gains on pay float interest rate swaps of \$126 million. The losses on pay fixed interest rate swaps and gains on pay float interest rate swaps during the first nine months of fiscal year 2020 were primarily due to the decrease in applicable swap rates during the period. The loss on cross currency swaps during the first nine months of fiscal year 2020 was primarily attributable to the effect of unwinding the discount on swap valuations during the period. In the Canada segment, we recognized a gain on derivative instruments of \$7 million during the first nine months of fiscal year 2020 compared to a loss of less than \$1 million during the same period in fiscal year 2019. The gain in the first nine months of fiscal year 2020 was due to a rise in applicable swap rates during the period. See “—*Derivatives*” below for more information.

#### *Gain/loss on foreign currency revaluation of debt*

In the United States segment, we recognized a gain on the revaluation of foreign currency denominated debt of \$1 million during the first nine months of fiscal year 2020 compared to a gain of \$337 million during the same period in fiscal year 2019. The strength of the U.S. dollar against the Euro and Sterling was relatively flat as of December 31, 2019 compared to the beginning of the period March 31, 2019.

#### *Income tax expense*

The consolidated effective tax rate was 27.8% for the first nine months of fiscal year 2020 and 25.3% for the same period in fiscal year 2019. The increase in the effective tax rate for the nine months ended December 31, 2019 was primarily due to non-recurring adjustments recorded in fiscal year 2019 related to the U.S. tax reform, including the Transition Tax, as well as a reduction in tax credits in fiscal year 2020 compared to fiscal year 2019, offset by an adjustment to state taxes. For additional information regarding income taxes, see Note 7—Income Taxes of *Notes to Consolidated Financial Statements (Unaudited)*.

## Financial Condition

### Consumer Financing

#### Consumer Financing Acquisition Volumes

The following table summarizes the number of retail loans and leases we acquired and the number of such loans and leases acquired through incentive financing programs sponsored by AHM and HCI:

	Three months ended December 31,				Nine months ended December 31,			
	2019		2018		2019		2018	
	Acquired	Sponsored <sup>(2)</sup>	Acquired	Sponsored <sup>(2)</sup>	Acquired	Sponsored <sup>(2)</sup>	Acquired	Sponsored <sup>(2)</sup>
	(Units <sup>(1)</sup> in thousands)							
<b>United States Segment</b>								
Retail loans:								
New auto	109	63	109	70	332	191	362	237
Used auto	28	3	26	4	97	13	92	18
Motorcycle and other	16	—	17	1	56	1	55	4
Total retail loans	<u>153</u>	<u>66</u>	<u>152</u>	<u>75</u>	<u>485</u>	<u>205</u>	<u>509</u>	<u>259</u>
Leases	<u>133</u>	<u>105</u>	<u>105</u>	<u>91</u>	<u>430</u>	<u>345</u>	<u>356</u>	<u>315</u>
<b>Canada Segment</b>								
Retail loans:								
New auto	14	13	15	14	49	45	52	51
Used auto	2	—	1	—	4	—	3	1
Motorcycle and other	1	1	1	1	6	6	6	5
Total retail loans	<u>17</u>	<u>14</u>	<u>17</u>	<u>15</u>	<u>59</u>	<u>51</u>	<u>61</u>	<u>57</u>
Leases	<u>22</u>	<u>20</u>	<u>21</u>	<u>21</u>	<u>74</u>	<u>70</u>	<u>74</u>	<u>74</u>
<b>Consolidated</b>								
Retail loans:								
New auto	123	76	124	84	381	236	414	288
Used auto	30	3	27	4	101	13	95	19
Motorcycle and other	17	1	18	2	62	7	61	9
Total retail loans	<u>170</u>	<u>80</u>	<u>169</u>	<u>90</u>	<u>544</u>	<u>256</u>	<u>570</u>	<u>316</u>
Leases	<u>155</u>	<u>125</u>	<u>126</u>	<u>112</u>	<u>504</u>	<u>415</u>	<u>430</u>	<u>389</u>

- (1) A unit represents one retail loan or lease contract, as noted, that was originated in the United States and acquired by AHFC or its subsidiaries, or that was originated in Canada and acquired by HCFI, in each case during the period shown.
- (2) Represents the number of retail loans and leases acquired through incentive financing programs sponsored by AHM and/or HCI and only those contracts with subsidy payments. Excludes contracts where contractual rates met or exceeded AHFC's yield requirements and subsidy payments were not required.

### Consumer Financing Penetration Rates

The following table summarizes the percentage of AHM and/or HCI sales of new automobiles and motorcycles that were financed with either retail loans or leases that we acquired:

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
<b><u>United States Segment</u></b>				
New auto	60%	54%	62%	58%
Motorcycle	34%	36%	33%	36%
<b><u>Canada Segment</u></b>				
New auto	91%	88%	84%	82%
Motorcycle	31%	31%	30%	31%
<b><u>Consolidated</u></b>				
New auto	63%	57%	64%	60%
Motorcycle	33%	36%	33%	35%

## Consumer Financing Asset Balances

The following table summarizes our outstanding retail loan and lease asset balances and units:

	December 31, 2019	March 31, 2019	December 31, 2019	March 31, 2019
	(U.S. dollars in millions)		(Units <sup>(1)</sup> in thousands)	
<b>United States Segment</b>				
Retail loans:				
New auto	\$ 25,288	\$ 25,201	1,537	1,569
Used auto	4,986	4,522	350	318
Motorcycle and other	1,168	1,104	196	193
Total retail loans	<u>\$ 31,442</u>	<u>\$ 30,827</u>	<u>2,083</u>	<u>2,080</u>
Investment in operating leases	<u>\$ 28,914</u>	<u>\$ 27,493</u>	<u>1,319</u>	<u>1,300</u>
Securitized retail loans <sup>(2)</sup>	\$ 8,590	\$ 7,896	662	665
<b>Canada Segment</b>				
Retail loans:				
New auto	\$ 3,593	\$ 3,458	262	263
Used auto	197	226	25	29
Motorcycle and other	94	86	21	21
Total retail loans	<u>\$ 3,884</u>	<u>\$ 3,770</u>	<u>308</u>	<u>313</u>
Investment in operating leases	<u>\$ 5,522</u>	<u>\$ 5,113</u>	<u>298</u>	<u>289</u>
Securitized retail loans <sup>(2)</sup>	\$ 846	\$ 1,177	70	92
Securitized investments in operating leases <sup>(2)</sup>	\$ 558	\$ —	25	—
<b>Consolidated</b>				
Retail loans:				
New auto	\$ 28,881	\$ 28,659	1,799	1,832
Used auto	5,183	4,748	375	347
Motorcycle and other	1,262	1,190	217	214
Total retail loans	<u>\$ 35,326</u>	<u>\$ 34,597</u>	<u>2,391</u>	<u>2,393</u>
Investment in operating leases	<u>\$ 34,436</u>	<u>\$ 32,606</u>	<u>1,617</u>	<u>1,589</u>
Securitized retail loans <sup>(2)</sup>	\$ 9,436	\$ 9,073	732	757
Securitized investments in operating leases <sup>(2)</sup>	\$ 558	\$ —	25	—

(1) A unit represents one retail loan or lease contract, as noted, that was outstanding as of the date shown.

(2) Securitized retail loans and investments in operating leases represent the portion of total managed assets that have been sold in securitization transactions but continue to be recognized on our balance sheet. The outstanding securitized units as of March 31, 2019 disclosed in our March 31, 2019 Annual Report on Form 10-K was incorrect due to a clerical error and the corrected units are presented above.

In the United States segment, retail loan acquisition volumes decreased by 5% during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019 primarily due to the decline in sponsored new auto loan acquisition volumes. Lease acquisition volumes increased by 21% during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019 due to the increase in both sponsored and non-sponsored program volumes.

In the Canada segment, retail loan acquisition volumes decreased by 3% during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019 primarily due to the decline in sponsored new auto loan acquisition volumes. Lease acquisition volumes were flat during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019.

## Dealer Financing

### Wholesale Flooring Financing Penetration Rates

The following table summarizes the number of dealerships with wholesale flooring financing agreements as a percentage of total Honda and Acura dealerships in the United States and/or Canada, as applicable:

	December 31, 2019	March 31, 2019
<b>United States Segment</b>		
Automobile	30%	30%
Motorcycle	98%	97%
Other	16%	20%
<b>Canada Segment</b>		
Automobile	36%	35%
Motorcycle	95%	95%
Other	93%	95%
<b>Consolidated</b>		
Automobile	31%	31%
Motorcycle	97%	97%
Other	19%	22%

### Wholesale Flooring Financing Percentage of Sales

The following table summarizes the percentage of AHM unit sales in the United States and/or HCI unit sales in Canada, as applicable, that we financed through wholesale flooring loans with dealerships:

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
<b>United States Segment</b>				
Automobile	28%	27%	27%	28%
Motorcycle	98%	98%	98%	98%
Other	7%	6%	8%	8%
<b>Canada Segment</b>				
Automobile	32%	32%	32%	32%
Motorcycle	97%	94%	93%	92%
Other	97%	97%	96%	97%
<b>Consolidated</b>				
Automobile	29%	28%	28%	28%
Motorcycle	98%	97%	97%	97%
Other	10%	8%	12%	12%

## Dealer Financing Asset Balances

The following table summarizes our outstanding dealer financing asset balances and units:

	December 31, 2019	March 31, 2019	December 31, 2019	March 31, 2019
	(U.S. dollars in millions)		(Units <sup>(1)</sup> in thousands)	
<b>United States Segment</b>				
Wholesale flooring loans:				
Automobile	\$ 2,840	\$ 3,308	103	121
Motorcycle	672	750	83	101
Other	49	59	41	63
Total wholesale flooring loans	<u>\$ 3,561</u>	<u>\$ 4,117</u>	<u>227</u>	<u>285</u>
Commercial loans	\$ 977	\$ 1,084		
<b>Canada Segment</b>				
Wholesale flooring loans:				
Automobile	\$ 474	\$ 441	17	17
Motorcycle	67	95	8	13
Other	27	25	23	28
Total wholesale flooring loans	<u>\$ 568</u>	<u>\$ 561</u>	<u>48</u>	<u>58</u>
Commercial loans	\$ 63	\$ 65		
<b>Consolidated</b>				
Wholesale flooring loans:				
Automobile	\$ 3,314	\$ 3,749	120	138
Motorcycle	739	845	91	114
Other	76	84	64	91
Total wholesale flooring loans	<u>\$ 4,129</u>	<u>\$ 4,678</u>	<u>275</u>	<u>343</u>
Commercial loans	\$ 1,040	\$ 1,149		

- (1) A unit represents one automobile, motorcycle, power equipment, or marine engine, as applicable, financed through a wholesale flooring loan that was outstanding as of the date shown.

### Credit Risk

Credit losses are an expected cost of extending credit. The majority of our credit risk is in consumer financing and to a lesser extent in dealer financing. Credit risk of our portfolio of consumer finance receivables can be affected by general economic conditions. Adverse changes, such as a rise in unemployment, can increase the likelihood of defaults. Declines in used vehicle prices can reduce the amount of recoveries on repossessed collateral. We manage our exposure to credit risk in retail loans by monitoring and adjusting our underwriting standards, which affect the level of credit risk that we assume, pricing contracts for expected losses, focusing collection efforts to minimize losses, and ongoing reviews of the financial condition of dealers.

We are also exposed to credit risk on our portfolio of operating lease assets. We expect a portion of our operating leases to terminate prior to their scheduled maturities when lessees default on their contractual obligations. Losses are generally realized upon the disposition of the repossessed operating lease vehicles. The factors affecting credit risk on our operating lease assets and our management of the risk are similar to that of our consumer finance receivables.

Credit risk on dealer loans is affected primarily by the financial strength of the dealers within the portfolio, the value of collateral securing the financings, and economic and market factors that could affect the creditworthiness of dealers. We manage our exposure to credit risk in dealer financing by performing comprehensive reviews of dealers prior to establishing financing arrangements and monitoring the payment performance and creditworthiness of these dealers on an ongoing basis. In the event of default by a dealer, we seek all available legal remedies pursuant to related dealer agreements, guarantees, security interests on collateral, or liens on dealership assets. Additionally, we have agreements with AHM and HCI that provide for their repurchase of new, unused, undamaged and unregistered vehicles or equipment that have been repossessed from dealers who defaulted under the terms of their respective wholesale flooring agreements.

An allowance for credit losses is maintained for management's estimate of probable losses incurred on finance receivables. We also maintain an estimate for early termination losses on operating lease assets due to lessee defaults and an allowance for credit losses for estimated probable losses incurred on past due operating lease rental payments.

Additional information regarding credit losses is provided in the discussion of "*—Critical Accounting Policies—Credit Losses*" below.

The following table presents information with respect to our allowance for credit losses and credit loss experience of our finance receivables and losses related to lessee defaults on our operating leases:

As of or for the three months ended December 31,		As of or for the nine months ended December 31,	
2019	2018	2019	2018

(U.S. dollars in millions)

### United States Segment

Finance receivables:				
Allowance for credit losses at beginning of period	\$ 190	\$ 184	\$ 194	\$ 173
Provision for credit losses	63	64	167	146
Charge-offs, net of recoveries	(61)	(58)	(169)	(129)
Allowance for credit losses at end of period	<u>\$ 192</u>	<u>\$ 190</u>	<u>\$ 192</u>	<u>\$ 190</u>
Allowance as a percentage of ending receivable balance <sup>(1)</sup>			0.53%	0.53%
Charge-offs as a percentage of average receivable balance <sup>(1), (4)</sup>	0.68%	0.65%	0.62%	0.49%
Delinquencies (60 or more days past due):				
Delinquent amount <sup>(2)</sup>			\$ 127	\$ 133
As a percentage of ending receivable balance <sup>(1), (2)</sup>			0.35%	0.37%
Operating leases:				
Early termination loss on operating leases	\$ 37	\$ 21	\$ 96	\$ 75
Revenue reduction / provision for uncollectible operating lease receivables <sup>(3)</sup>	9	10	22	30

### Canada Segment

Finance receivables:				
Allowance for credit losses at beginning of period	\$ 7	\$ 7	7	6
Provision for credit losses	2	—	4	4
Charge-offs, net of recoveries	(2)	(1)	(4)	(4)
Effect of translation adjustment	—	—	—	—
Allowance for credit losses at end of period	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 7</u>	<u>\$ 6</u>
Allowance as a percentage of ending receivable balance <sup>(1)</sup>			0.14%	0.14%
Charge-offs as a percentage of average receivable balance <sup>(1), (4)</sup>	0.13%	0.11%	0.10%	0.11%
Delinquencies (60 or more days past due):				
Delinquent amount <sup>(2)</sup>			5	7
As a percentage of ending receivable balance <sup>(1), (2)</sup>			0.10%	0.15%
Operating leases:				
Early termination loss on operating leases	\$ —	\$ 1	\$ 1	\$ 3
Revenue reduction / provision for uncollectible operating lease receivables <sup>(3)</sup>	—	1	—	1

### Consolidated

Finance receivables:				
Allowance for credit losses at beginning of period	\$ 197	\$ 191	\$ 201	\$ 179
Provision for credit losses	65	64	171	150
Charge-offs, net of recoveries	(63)	(59)	(173)	(133)
Effect of translation adjustment	—	—	—	—
Allowance for credit losses at end of period	<u>\$ 199</u>	<u>\$ 196</u>	<u>\$ 199</u>	<u>\$ 196</u>
Allowance as a percentage of ending receivable balance <sup>(1)</sup>			0.49%	0.49%
Charge-offs as a percentage of average receivable balance <sup>(1), (4)</sup>	0.61%	0.59%	0.56%	0.45%
Delinquencies (60 or more days past due):				
Delinquent amount <sup>(2)</sup>			132	140
As a percentage of ending receivable balance <sup>(1), (2)</sup>			0.32%	0.35%
Operating leases:				
Early termination loss on operating leases	\$ 37	\$ 22	\$ 97	\$ 78
Revenue reduction / provision for uncollectible operating lease receivables <sup>(3)</sup>	9	11	22	31

- (1) Ending and average receivable balances exclude the allowance for credit losses, unearned subvention income related to our incentive financing programs and deferred origination costs. Average receivable balances are calculated based on the average of each month's ending receivables balance for each respective period.

- (2) For the purposes of determining whether a contract is delinquent, payment is generally considered to have been made, in the case of (i) dealer loans, upon receipt of 100% of the payment when due and (ii) consumer finance receivables, upon receipt of 90% of the sum of the current monthly payment plus any overdue monthly payments. Delinquent amounts presented are the aggregated principal balances of delinquent finance receivables.
- (3) Provisions for uncollectible operating lease receivables were included in total provision for credit losses in our consolidated statements of income during fiscal year 2019.
- (4) Percentages for the three and nine months ended December 31, 2019 and 2018 have been annualized.

In the United States segment, the provision for credit losses on our finance receivables was \$167 million during the first nine months of fiscal year 2020 compared to \$146 million during the same period in fiscal year 2019. The increase in the provision for credit losses is attributable to the increase in the provision for retail loans of \$19 million and the provision for impaired dealer loans of \$2 million. Net charge-offs of retail loans during the first nine months of fiscal year 2020 increased compared to the same period in fiscal year 2019, which continues the trend of increasing charge-offs that we have been experiencing since fiscal year 2016. The increasing trend in charge-offs was primarily due to the increase in the volume of retail loans with higher loan-to-value ratios and, as a result, higher loss severities. The increasing trend in charge-offs was also the result of higher charge-off frequencies due to the increase in the volume of retail loans in our lower credit grade tiers and used auto loans. As a result of lessor accounting changes that were adopted on April 1, 2019, the uncollectible operating lease receivables were recognized as a reduction to lease revenue rather than recording the losses through the provision for credit losses. See Note 1—Summary of Business and Significant Accounting Policies of *Notes to Consolidated Financial Statements (Unaudited)* for additional information. We recognized early termination losses on operating lease assets of \$96 million during the first nine months of fiscal year 2020 compared to \$75 million during the same period in fiscal year 2019. Early termination losses increased due to higher loss severities.

In the Canada segment, the provision for credit losses on our finance receivables were flat during the first nine months of fiscal year 2020 compared to the same period in fiscal year 2019. Early termination losses on operating lease assets was \$1 million during the first nine months of fiscal year 2020 compared to \$3 million during the same period in fiscal year 2019. Early termination losses decreased due to a smaller increase in estimated early termination losses.

### ***Lease Residual Value Risk***

Contractual residual values of lease vehicles are determined at lease inception based on expectations of future used vehicle values, taking into consideration external industry data and our own historical experience. Lease customers have the option at the end of the lease term to return the vehicle to the dealer or to buy the vehicle at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance). Returned lease vehicles can be purchased by the grounding dealer at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance) or for a market based price. Returned lease vehicles that are not purchased by the grounding dealers are sold through online and physical auctions. We are exposed to risk of loss on the disposition of returned lease vehicles when the proceeds from the sale of the vehicles are less than the contractual residual values.

We assess our estimates for end of lease term market values of leased vehicles, at minimum, on a quarterly basis. The primary factors affecting the estimates are the percentage of leased vehicles that we expect to be returned by the lessee at the end of lease term and expected loss severities. Factors considered in this evaluation include, among other factors, economic conditions, historical trends, and market information on new and used vehicles. Our leasing volumes and those across the automotive industry have increased significantly in recent years. As a result, the supply of off-lease vehicles will continue to increase over the next several years, which could negatively impact used vehicle prices. For operating leases, adjustments to estimated residual values are made on a straight-line basis over the remaining term of the lease and recognized as depreciation expense. Additional information regarding lease residual values is provided in the discussion of “—*Critical Accounting Policies—Determination of Lease Residual Values*” below.

We also review our investment in operating leases for impairment whenever events or changes in circumstances indicate that the carrying values may not be recoverable. If impairment conditions are met, impairment losses are measured by the amount the carrying values exceed their fair values. We did not recognize impairment losses due to declines in estimated residual values during the first nine months of fiscal year 2020 or the same period in fiscal year 2019.

The following table summarizes our number of lease terminations and the method of disposition:

	Three months ended December 31,		Nine months ended December 31,	
	2019	2018	2019	2018
(Units <sup>(1)</sup> in thousands)				
<b><u>United States Segment</u></b>				
Termination units:				
Sales at outstanding contractual balances <sup>(2)</sup>	79	68	275	231
Sales through auctions and dealer direct programs <sup>(3)</sup>	33	25	127	114
Total termination units	<u>112</u>	<u>93</u>	<u>402</u>	<u>345</u>
<b><u>Canada Segment</u></b>				
Termination units:				
Sales at outstanding contractual balances <sup>(2)</sup>	18	15	63	49
Sales through auctions and dealer direct programs <sup>(3)</sup>	1	2	5	5
Total termination units	<u>19</u>	<u>17</u>	<u>68</u>	<u>54</u>
<b><u>Consolidated</u></b>				
Termination units:				
Sales at outstanding contractual balances <sup>(2)</sup>	97	83	338	280
Sales through auctions and dealer direct programs <sup>(3)</sup>	34	27	132	119
Total termination units	<u>131</u>	<u>110</u>	<u>470</u>	<u>399</u>

- (1) A unit represents one terminated lease by their method of disposition during the period shown. Unit counts do not include leases that were terminated due to lessee defaults.
- (2) Includes vehicles purchased by lessees or dealers for the contractual residual value at lease maturity or the outstanding contractual balance if purchased prior to lease maturity.
- (3) Includes vehicles sold through online auctions and market based pricing options under our dealer direct programs or through physical auctions.

## Liquidity and Capital Resources

Our liquidity strategy is to fund current and future obligations through our cash flows from operations and our diversified funding programs in a cost and risk effective manner. Our cash flows are generally impacted by cash requirements related to the volume of finance receivable and operating lease acquisitions and various operating and funding costs incurred, which are largely funded through payments received on our assets and our funding sources outlined below. As noted, the levels of incentive financing sponsored by AHM and HCI can impact our financial results and liquidity from period to period. Increases or decreases in incentive financing programs typically increase or decrease our financing penetration rates, respectively, which result in increased or decreased acquisition volumes and increased or decreased liquidity needs, respectively. At acquisition, we receive the subsidy payments, which reduce the cost of consumer loan and lease contracts acquired, and we recognize such payments as revenue over the term of the loan or lease.

In an effort to minimize liquidity risk and interest rate risk and the resulting negative effects on our margins, results of operations and cash flows, our funding strategy incorporates investor diversification and the utilization of multiple funding sources including commercial paper, medium term notes, bank loans and asset-backed securities. We incorporate a funding strategy that takes into consideration factors such as the interest rate environment, domestic and foreign capital market conditions, maturity profiles, and economic conditions. We believe that our funding sources, combined with cash provided by operating and investing activities, will provide sufficient liquidity for us to meet our debt service and working capital requirements over the next twelve months.

The summary of outstanding debt presented in the tables and discussion below in this section “—*Liquidity and Capital Resources*” as of December 31, 2019 and March 31, 2019 includes foreign currency denominated debt, which was translated into U.S. dollars using the relevant exchange rates as of December 31, 2019 and March 31, 2019, as applicable. Additionally, the amounts in this section that are presented in “C\$” (Canadian dollar) were converted into U.S. dollars solely for the reader’s convenience based on the exchange rate on December 31, 2019 of 1.2990 per U.S. dollar. These translations should not be construed as representations that the converted amounts actually represent such U.S. dollar amounts or that they could be converted into U.S. dollars at the rates indicated.

### Summary of Outstanding Debt

The table below presents a summary of our outstanding debt by various funding sources:

			Weighted average contractual interest rate	
	December 31, 2019	March 31, 2019	December 31, 2019	March 31, 2019
(U.S. dollars in millions)				
<b>United States Segment</b>				
Unsecured debt:				
Commercial paper	\$ 4,970	\$ 5,029	1.83%	2.67%
Bank loans	3,297	3,896	2.63%	3.30%
Private MTN program	999	999	3.84%	3.84%
Public MTN program	25,634	24,117	2.20%	2.35%
Euro MTN programme	28	868	2.23%	1.89%
Total unsecured debt	34,928	34,909		
Secured debt	8,353	7,671	2.38%	2.41%
Total debt	\$ 43,281	\$ 42,580		
<b>Canada Segment</b>				
Unsecured debt:				
Commercial paper	\$ 895	\$ 726	1.85%	2.06%
Related party debt	577	749	1.99%	2.18%
Bank loans	1,097	1,066	2.56%	2.62%
Other debt	3,535	3,514	2.55%	2.50%
Total unsecured debt	6,104	6,055		
Secured debt	1,255	1,119	2.51%	2.49%
Total debt	\$ 7,359	\$ 7,174		
<b>Consolidated</b>				
Unsecured debt:				
Commercial paper	\$ 5,865	\$ 5,755	1.84%	2.60%
Related party debt	577	749	1.99%	2.18%
Bank loans	4,394	4,962	2.62%	3.16%
Private MTN program	999	999	3.84%	3.84%
Public MTN program	25,634	24,117	2.20%	2.35%
Euro MTN programme	28	868	2.23%	1.89%
Other debt	3,535	3,514	2.55%	2.50%
Total unsecured debt	41,032	40,964		
Secured debt	9,608	8,790	2.39%	2.42%
Total debt	\$ 50,640	\$ 49,754		

### *Commercial Paper*

As of December 31, 2019, we had commercial paper programs in the United States of \$7.0 billion and in Canada of C\$2.0 billion (\$1.5 billion). Interest rates on the commercial paper are fixed at the time of issuance. During the nine months ended December 31, 2019, consolidated commercial paper month-end outstanding principal balances ranged from \$4.2 billion to \$6.2 billion.

### *Related Party Debt*

HCFI issues fixed rate notes to HCI to help fund HCFI's general corporate operations. Interest rates are based on prevailing rates of debt with comparable terms. Generally, the term of these notes is less than 120 days.

### *Bank Loans*

During the nine months ended December 31, 2019, AHFC entered into one floating rate term loan agreement for \$200 million. HCFI did not enter into any term loan agreements. As of December 31, 2019, we had bank loans denominated in U.S. dollars and Canadian dollars with floating interest rates, in principal amounts ranging from \$38 million to \$600 million. As of December 31, 2019, the remaining maturities of all bank loans outstanding ranged from 14 days to approximately 4.9 years. The weighted average remaining maturity on all bank loans was 1.6 years as of December 31, 2019.

Our bank loans contain customary restrictive covenants, including limitations on liens, mergers, consolidations and asset sales, and a financial covenant that requires us to maintain positive consolidated tangible net worth. In addition to other customary events of default, the bank loans include cross-default provisions and provisions for default if HMC does not maintain ownership, whether directly or indirectly, of at least 80% of the outstanding capital stock of AHFC or HCFI, as applicable. All of these covenants and events of default are subject to important limitations and exceptions under the agreements governing the bank loans. As of December 31, 2019, management believes that AHFC and HCFI were in compliance with all covenants contained in our bank loans.

### *Medium Term Note (MTN) Programs*

#### *Private MTN Program*

AHFC no longer issues MTNs under its Rule 144A Private MTN Program. As of December 31, 2019, the remaining maturities of Private MTNs outstanding did not exceed 2.0 years. Private MTNs were issued pursuant to the terms of an issuing and paying agency agreement, which requires AHFC to comply with certain covenants, including negative pledge provisions, and includes customary events of defaults. As of December 31, 2019, management believes that AHFC was in compliance with all covenants contained in the Private MTNs.

#### *Public MTN Program*

AHFC is a well-known seasoned issuer under SEC rules and issues Public MTNs pursuant to a registration statement on Form S-3 filed with the SEC. In August 2019, AHFC renewed its Public MTN program by filing a registration statement with the SEC under which it may issue from time to time up to \$30.0 billion aggregate principal amount of Public MTNs, which includes the issuance of foreign currency denominated notes into international markets. The aggregate principal amount of MTNs offered under this program may be increased from time to time.

The Public MTNs may have original maturities of 9 months or more from the date of issue, may be interest bearing with either fixed or floating interest rates, or may be discounted notes. During the nine months ended December 31, 2019, AHFC issued \$2.3 billion aggregate principal amount of U.S. dollar denominated floating rate MTNs and \$3.4 billion aggregate principal amount of U.S. dollar denominated fixed rate notes, with original maturities between 12 months and 5.0 years. The weighted average remaining maturities of all Public MTNs was 2.2 years as of December 31, 2019.

The Public MTNs are issued pursuant to an indenture, which requires AHFC to comply with certain covenants, including negative pledge provisions and restrictions on AHFC's ability to merge, consolidate or transfer substantially all of its assets or the assets of its subsidiaries, and includes customary events of default. As of December 31, 2019, management believes that AHFC was in compliance with all covenants under the indenture.

### *Euro MTN Programme*

The Euro MTN Programme was retired in August 2014. AHFC has one note outstanding under this program. The note has a maturity date of February 21, 2023, a fixed interest rate and is not listed on the Luxembourg Stock Exchange. The note was issued pursuant to the terms of an agency agreement which requires AHFC to comply with certain covenants, including negative pledge provisions, and includes customary events of default. As of December 31, 2019, management believes that AHFC was in compliance with all covenants contained in the Euro MTNs.

The table below presents a summary of outstanding debt issued under our MTN Programs by currency:

	<b>December 31, 2019</b>	<b>March 31, 2019</b>
	<b>(U.S. dollars in millions)</b>	
U.S. dollar	\$ 22,710	\$ 21,210
Euro	3,131	3,969
Sterling	792	778
Japanese yen	28	27
Total	<u>\$ 26,661</u>	<u>\$ 25,984</u>

### *Other Debt*

HCFI issues privately placed Canadian dollar denominated notes, with either fixed or floating interest rates. During the nine months ended December 31, 2019, HCFI entered into one private placement transaction for C\$500 million (\$385 million). As of December 31, 2019, the remaining maturities of all of HCFI's Canadian notes outstanding ranged from 108 days to approximately 5.4 years. The weighted average remaining maturities of these notes was 2.8 years as of December 31, 2019.

The notes are issued pursuant to the terms of an indenture, which requires HCFI to comply with certain covenants, including negative pledge provisions, and includes customary events of default. As of December 31, 2019, management believes that HCFI was in compliance with all covenants contained in the privately placed notes.

### *Secured Debt*

#### *Asset-Backed Securities*

We enter into securitization transactions for funding purposes. Our securitization transactions involve transferring pools of retail loans and operating leases to bankruptcy-remote special purpose entities (SPEs). The SPEs are established to accommodate securitization structures, which have the limited purpose of acquiring assets, issuing asset-backed securities, and making payments on the securities. Assets transferred to SPEs are considered legally isolated from us and the claims of our creditors. We continue to service the retail loans and operating leases transferred to the SPEs. Investors in notes issued by a SPE only have recourse to the assets of such SPE and do not have recourse to the assets of AHFC, HCFI, or our other subsidiaries or to other SPEs. The assets of SPEs are the only source of funds for repayment on the notes

Our securitizations are structured to provide credit enhancements to investors in the notes issued by the SPEs. Credit enhancements can include the following:

- *Subordinated certificates*— securities issued by SPEs that are retained by us and subordinated in priority of payment to the notes.
- *Overcollateralization*— securitized asset balances that exceed the balance of securities issued by SPEs.
- *Excess interest*— excess interest collections to be used to cover losses on defaulted loans.
- *Reserve funds*— restricted cash accounts held by SPEs to cover shortfalls in payments of interest and principal required to be paid on the notes.
- *Yield supplement accounts*— restricted cash accounts held by SPEs to supplement interest payments on notes.

The risk retention regulations in Regulation RR of the Securities Exchange Act of 1934, as amended (Exchange Act), require the sponsor to retain an economic interest in the credit risk of the securitized assets, either directly or through one or more majority-owned affiliates. Standard risk retention options allow the sponsor to retain either an eligible vertical interest, an eligible horizontal residual interest, or a combination of both. AHFC has satisfied this obligation by retaining an eligible vertical interest of an amount equal to at least 5% of the principal amount of each class of note and certificate issued for the securitization transaction that was subject to this rule but may choose to use other structures in the future.

We are required to consolidate the SPEs in our financial statements, which results in the securitizations being accounted for as on-balance sheet secured financings. The securitized assets remain on our consolidated balance sheet along with the notes issued by the SPEs.

During the nine months ended December 31, 2019, we issued notes through asset-backed securitizations totaling \$4.7 billion, which were secured by assets with an initial balance of \$5.2 billion.

## ***Credit Agreements***

### *Syndicated Bank Credit Facilities*

AHFC maintains a \$3.5 billion 364-day credit agreement, which expires on February 28, 2020, a \$2.1 billion credit agreement, which expires on March 3, 2021, and a \$1.4 billion credit agreement, which expires on March 3, 2023. As of December 31, 2019, no amounts were drawn upon under the AHFC credit agreements. AHFC intends to renew or replace these credit agreements prior to or on their respective expiration dates.

HCFI maintains a C\$1.6 billion (\$1.2 billion) credit agreement which provides that HCFI may borrow up to C\$800 million (\$616 million) on a one-year revolving basis and up to C\$800 million (\$616 million) on a five-year revolving basis. The one-year tranche of the credit agreement expires on March 25, 2020 and the five-year tranche of the credit agreement expires on March 25, 2024. As of December 31, 2019, no amounts were drawn upon under the HCFI credit agreement. HCFI intends to renew or replace the credit agreement prior to or on the expiration date of each respective tranche.

The credit agreements contain customary conditions to borrowing and customary restrictive covenants, including limitations on liens and limitations on mergers, consolidations and asset sales, and limitations on affiliate transactions. The credit agreements also require AHFC and HCFI to maintain a positive consolidated tangible net worth as defined in their respective credit agreements. The credit agreements, in addition to other customary events of default, include cross-default provisions and provisions for default if HMC does not maintain ownership, whether directly or indirectly, of at least 80% of the outstanding capital stock of AHFC or HCFI, as applicable. In addition, the AHFC and HCFI credit agreements contain provisions for default if HMC's obligations under the HMC-AHFC Keep Well Agreement or the HMC-HCFI Keep Well Agreement, as applicable, become invalid, voidable, or unenforceable. All of these conditions, covenants and events of default are subject to important limitations and exceptions under the agreements governing the credit agreements. As of December 31, 2019, management believes that AHFC and HCFI were in compliance with all covenants contained in the respective credit agreements.

### *Other Credit Agreements*

AHFC maintains other committed lines of credit that allow the Company access to an additional \$1.0 billion in unsecured funding with two banks. The credit agreements contain customary covenants, including limitations on liens, mergers, consolidations and asset sales and a requirement for AHFC to maintain a positive consolidated tangible net worth. As of December 31, 2019, no amounts were drawn upon under these agreements. These agreements expire in September 2020. The Company intends to renew or replace these credit agreements prior to or on their respective expiration dates.

## ***Keep Well Agreements***

HMC has entered into separate Keep Well Agreements with AHFC and HCFI. Pursuant to the Keep Well Agreements, HMC has agreed to, among other things:

- own and hold, at all times, directly or indirectly, at least 80% of each of AHFC's and HCFI's issued and outstanding shares of voting stock and not pledge, directly or indirectly, encumber, or otherwise dispose of any such shares or permit any of HMC's subsidiaries to do so, except to HMC or wholly-owned subsidiaries of HMC;

- cause each of AHFC and HCFI to, on the last day of each of AHFC's and HCFI's respective fiscal years, have a positive consolidated tangible net worth (with "tangible net worth" meaning (a) shareholders' equity less (b) any intangible assets, as determined in accordance with GAAP with respect to AHFC and generally accepted accounting principles in Canada with respect to HCFI); and
- ensure that, at all times, each of AHFC and HCFI has sufficient liquidity and funds to meet their payment obligations under any Debt (with "Debt" defined as AHFC's or HCFI's debt, as applicable, for borrowed money that HMC has confirmed in writing is covered by the respective Keep Well Agreement) in accordance with the terms of such Debt, or where necessary, HMC will make available to AHFC or HCFI, as applicable, or HMC will procure for AHFC or HCFI, as applicable, sufficient funds to enable AHFC or HCFI, as applicable, to pay its Debt in accordance with its terms. AHFC or HCFI Debt does not include the notes issued by SPEs in connection with AHFC's or HCFI's secured financing transactions, any related party debt or any indebtedness outstanding as of December 31, 2019 under AHFC's and HCFI's bank loan agreements.

As consideration for HMC's obligations under the Keep Well Agreements, we have agreed to pay HMC a quarterly fee based on the amount of outstanding Debt pursuant to Support Compensation Agreements, dated April 1, 2019. We incurred expenses of \$17 million and \$6 million during the three months ended December 31, 2019 and 2018, respectively, and \$51 million and \$17 million during the nine months ended December 31, 2019 and 2018, respectively, pursuant to these Support Compensation Agreements.

### ***Indebtedness of Consolidated Subsidiaries***

As of December 31, 2019, AHFC and its consolidated subsidiaries had \$59.9 billion of outstanding indebtedness and other liabilities, including current liabilities, of which \$17.2 billion consisted of indebtedness and liabilities of our consolidated subsidiaries. None of AHFC's consolidated subsidiaries had any outstanding preferred equity.

### **Derivatives**

We utilize derivative instruments to mitigate exposures to fluctuations in interest rates and foreign currency exchange rates. The types of derivative instruments include interest rate swaps, basis swaps, and cross currency swaps. Interest rate and basis swap agreements are used to mitigate the effects of interest rate fluctuations of our floating rate debt relative to our fixed rate finance receivables and operating lease assets. Cross currency swap agreements are used to manage currency and interest rate risk exposure on foreign currency denominated debt. The derivative instruments contain an element of credit risk in the event the counterparties are unable to meet the terms of the agreements.

All derivative financial instruments are recorded on our consolidated balance sheet as assets or liabilities, and carried at fair value. Changes in the fair value of derivatives are recognized in our consolidated statements of income in the period of the change. Since we do not elect to apply hedge accounting, the impact to earnings resulting from these valuation adjustments as reported under GAAP is not representative of our results of operations as evaluated by management. Realized gains and losses on derivative instruments, net of realized gains and losses on foreign currency denominated debt, are included in the measure of net revenues when we evaluate segment performance. Refer to Note 14—Segment Information of *Notes to Consolidated Financial Statements (Unaudited)* for additional information about segment information and Note 5—Derivative Instruments of *Notes to Consolidated Financial Statements (Unaudited)* for additional information on derivative instruments.

### **Off-Balance Sheet Arrangements**

We are not a party to off-balance sheet arrangements.

## Contractual Obligations

The following table summarizes our contractual obligations, excluding lending commitments to dealers and derivative obligations, for the periods indicated:

	Payments due for the twelve month periods ending December 31,						
	Total	2020	2021	2022	2023	2024	Thereafter
	(U.S. dollars in millions)						
Unsecured debt obligations <sup>(1)</sup>	\$ 41,109	\$ 16,001	\$ 9,112	\$ 7,591	\$ 3,347	\$ 3,673	\$ 1,385
Secured debt obligations <sup>(1)</sup>	9,622	4,896	2,916	1,499	311	—	—
Interest payments on debt <sup>(2)</sup>	2,234	914	585	338	206	100	91
Operating lease obligations	64	10	10	9	8	7	20
Total	<u>\$ 53,029</u>	<u>\$ 21,821</u>	<u>\$ 12,623</u>	<u>\$ 9,437</u>	<u>\$ 3,872</u>	<u>\$ 3,780</u>	<u>\$ 1,496</u>

- (1) Debt obligations reflect the remaining principal obligations of our outstanding debt and do not reflect unamortized debt discounts and fees. Repayment schedule of secured debt reflects payment performance assumptions on underlying receivables. Foreign currency denominated debt principal is based on exchange rates as of December 31, 2019.
- (2) Interest payments on floating rate and foreign currency denominated debt based on the applicable floating rates and/or exchange rates as of December 31, 2019.

The obligations in the above table do not include certain lending commitments to dealers since the amount and timing of future payments is uncertain. Refer to Note 8—Commitments and Contingencies of *Notes to Consolidated Financial Statements (Unaudited)* for additional information on these commitments.

Our contractual obligations on derivative instruments are also excluded from the table above because our future cash obligations under these contracts are inherently uncertain. We recognize all derivative instruments on our consolidated balance sheet at fair value. The amounts recognized as fair value do not represent the amounts that will be ultimately paid or received upon settlement under these contracts. Refer to Note 5—Derivative Instruments of *Notes to Consolidated Financial Statements (Unaudited)* for additional information on derivative instruments.

## New Accounting Standards

Refer to Note 1—Summary of Business and Significant Accounting Policies of *Notes to Consolidated Financial Statements (Unaudited)*.

## Critical Accounting Policies

Critical accounting policies are those accounting policies that require the application of our most difficult, subjective, or complex judgments, often requiring us to make estimates about the effects of matters that are inherently uncertain and may change in subsequent periods, or for which the use of different estimates that could have reasonably been used in the current period would have had a material impact on the presentation of our financial condition, cash flows, and results of operations. The impact and any associated risks related to these estimates on our financial condition, cash flows, and results of operations are discussed throughout “*Management’s Discussion and Analysis of Financial Condition and Results of Operation*” where such estimates affect reported and expected financial results. Different assumptions or changes in economic circumstances could result in additional changes to the determination of the allowance for credit losses and the determination of lease residual values.

## Credit Losses

We maintain an allowance for credit losses for management’s estimate of probable losses incurred on our finance receivables. We also maintain an estimate for early termination losses on operating lease assets due to lessee defaults and an allowance for credit losses on past due operating lease rental payments. These estimates are evaluated by management, at minimum, on a quarterly basis.

Consumer finance receivables are collectively evaluated for impairment. Delinquencies and losses are monitored on an ongoing basis and this historical experience provides the primary basis for estimating the allowance. Management utilizes various methodologies when estimating the allowance for credit losses including models which incorporate vintage loss and delinquency migration analysis. These models take into consideration attributes of the portfolio, including loan-to-value ratios, internal and external credit scores, collateral types, and loan terms. Market and economic factors such as used vehicle prices, unemployment, and consumer debt service burdens are also incorporated into these models. Estimated losses on operating leases expected to terminate early due to lessee defaults are also determined collectively, consistent with the methodologies used for consumer finance receivables.

Dealer loans are individually evaluated for impairment when specifically identified as impaired. Dealer loans are considered impaired when it is probable that we will be unable to collect all amounts due according to the terms of the loan. Our determination of whether dealer loans are impaired is based on evaluations of dealership payment history, financial condition, their ability to perform under the terms of the loans, and collateral values as applicable. Dealer loans that have not been specifically identified as impaired are collectively evaluated for impairment.

Refer to Note 2—Finance Receivables of *Notes to Consolidated Financial Statements (Unaudited)* for additional information regarding charge-offs or write-downs of contractual balances of retail and dealer loans and operating leases.

Our allowance for credit losses and early termination losses on operating leases requires significant judgment about inherently uncertain factors. The estimates are based on management's evaluation of many factors, including our historical credit loss experience, the value of the underlying collateral, delinquency trends, and economic conditions. The estimates are based on information available as of each reporting date. Actual losses may differ from the original estimates due to actual results varying from those assumed in our estimates. Refer to Note 3—Investment in Operating Leases of *Notes to Consolidated Financial Statements (Unaudited)* for additional information.

#### *Sensitivity Analysis*

If we had experienced a 10% increase in net charge-offs of finance receivables during the twelve-month period ended December 31, 2019, our provision for credit losses would have increased by approximately \$43 million during the period. Similarly, if we had experienced a 10% increase in realized losses on the disposition of repossessed operating lease vehicles during the twelve-month period ended December 31, 2019, we would have recognized an additional \$24 million in early termination losses in our consolidated statement of income during the period.

#### ***Determination of Lease Residual Values***

Contractual residual values of lease vehicles are determined at lease inception based on expectations of future used vehicle values, taking into consideration external industry data and our own historical experience. Lease customers have the option at the end of the lease term to return the vehicle to the dealer or to buy the vehicle at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance). Returned lease vehicles can be purchased by the grounding dealer at the contractual residual value (or if purchased prior to lease maturity, for the outstanding contractual balance) or a market based price. Returned lease vehicles that are not purchased by the grounding dealer are sold through online and physical auctions. We are exposed to risk of loss on the disposition of returned lease vehicles when the proceeds from the sale of the vehicles are less than the contractual residual values at the end of lease term. We assess our estimates for end of term market values of the leased vehicles, at minimum, on a quarterly basis. The primary factors affecting the estimates are the percentage of leased vehicles that we expect to be returned by the lessee at the end of lease term and expected loss severities. Factors considered in this evaluation include, among other factors, economic conditions, historical trends and market information on new and used vehicles. Our leasing volumes and those across the automotive industry have increased significantly in recent years. As a result, the supply of off-lease vehicles will continue to increase over the next several years which could negatively impact used vehicle prices.

For operating leases, adjustments to estimated residual values are made on a straight-line basis over the remaining term of each lease and recognized as depreciation expense.

### *Sensitivity Analysis*

If future estimated auction values for all outstanding operating leases as of December 31, 2019 were to decrease by \$100 per unit from our current estimates, the total impact would be an increase of approximately \$75 million in depreciation expense, which would be recognized over the remaining lease terms. If future return rates for all operating leases were to increase by one percentage point from our current estimates, the total impact would be an increase of approximately \$15 million in depreciation expense, which would be recognized over the remaining lease terms. This sensitivity analysis may be asymmetric and is specific to the conditions in effect as of December 31, 2019. Additionally, any declines in auction values are likely to have a negative effect on return rates which could affect the severity of the impact on our results of operations.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We have omitted this section pursuant to General Instruction H(2) of Form 10-Q.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

Our Principal Executive Officer and Principal Financial Officer have performed an evaluation of our disclosure controls and procedures, as that term is defined in Rule 13a-15(e) of the Exchange Act, as of December 31, 2019, and each has concluded that such disclosure controls and procedures are effective, at the reasonable assurance level, to ensure that information required to be disclosed in our periodic reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, and such information is accumulated and communicated to management, including our Principal Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

#### **Changes in Internal Control over Financial Reporting**

There were no changes in the internal control over financial reporting during the quarter ended December 31, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

For information on our legal proceedings, see Note 8—Commitments and Contingencies—Legal Proceedings and Regulatory Matters of *Notes to Consolidated Financial Statements (Unaudited)*, which is incorporated by reference herein.

### Item 1A. Risk Factors

There are no material changes to the risk factors set forth under “*Item 1A. Risk Factors*” in our Annual Report on Form 10-K for the fiscal year ended March 31, 2019, which was filed with the SEC on June 21, 2019.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We have omitted this section pursuant to General Instruction H(2) of Form 10-Q.

### Item 3. Defaults Upon Senior Securities

We have omitted this section pursuant to General Instruction H(2) of Form 10-Q.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

## Item 6. Exhibits

Exhibit Number	Description
3.1 <sup>(1)</sup>	<a href="#">Articles of Incorporation of American Honda Finance Corporation, dated February 6, 1980, and Certificates of Amendment to the Articles of Incorporation, dated March 29, 1984, November 13, 1988, December 4, 1989, July 2, 1991, April 3, 1997, November 30, 1999, and December 17, 2003.</a>
3.2 <sup>(1)</sup>	<a href="#">Amended and Restated Bylaws of American Honda Finance Corporation, dated April 27, 2010.</a>
4.1 <sup>(1)</sup>	<a href="#">Form of Specimen Common Stock of American Honda Finance Corporation.</a>
4.2	American Honda Finance Corporation agrees to furnish to the Securities and Exchange Commission upon request a copy of each instrument with respect to issues of long-term debt of American Honda Finance Corporation and its subsidiaries, the authorized principal amount of which does not exceed 10% of the consolidated assets of the American Honda Finance Corporation and its subsidiaries.
4.3 <sup>(2)</sup>	<a href="#">Amended and Restated Issuing and Paying Agency Agreement between American Honda Finance Corporation and The Bank of New York Mellon, dated as of August 27, 2012.</a>
4.4	<a href="#">Trust Indenture between Honda Canada Finance Inc., as issuer, and BNY Trust Company of Canada (as successor to CIBC Mellon Trust Company), as trustee, dated as of September 26, 2005(3), as supplemented by supplemental indentures from time to time, and the Form of Debenture(4).</a>
4.5 <sup>(5)</sup>	<a href="#">Indenture, dated September 5, 2013, between American Honda Finance Corporation and Deutsche Bank Trust Company Americas, as trustee.</a>
4.6 <sup>(6)</sup>	<a href="#">First Supplemental Indenture, dated February 8, 2018, between American Honda Finance Corporation and Deutsche Bank Trust Company Americas, as trustee.</a>
4.7	<a href="#">Form of Fixed Rate Medium-Term Note, Series A(7) and Form of Floating Rate Medium-Term Note, Series A(8).</a>
31.1 <sup>(9)</sup>	<a href="#">Certification of Principal Executive Officer</a>
31.2 <sup>(9)</sup>	<a href="#">Certification of Principal Financial Officer</a>
32.1 <sup>(10)</sup>	<a href="#">Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350</a>
32.2 <sup>(10)</sup>	<a href="#">Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350</a>
101.INS <sup>(9)</sup>	XBRL Instance Document
101.SCH <sup>(9)</sup>	XBRL Taxonomy Extension Schema Document
101.CAL <sup>(9)</sup>	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB <sup>(9)</sup>	XBRL Taxonomy Extension Label Linkbase Document
101.PRE <sup>(9)</sup>	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF <sup>(9)</sup>	XBRL Taxonomy Extension Definition Linkbase Document

1. Incorporated herein by reference to the same numbered Exhibit filed with our registration statement on Form 10, dated June 28, 2013.
2. Incorporated herein by reference to the same numbered Exhibit filed with our registration statement on Form 10, amendment No. 1, dated August 7, 2013.
3. Incorporated herein by reference to Exhibit number 4.5 filed with our registration statement on Form 10, amendment No. 1, dated August 7, 2013.
4. Incorporated herein by reference to the same numbered Exhibit filed with our quarterly report on Form 10-Q, dated February 12, 2015.
5. Incorporated herein by reference to Exhibit number 4.1 filed with our registration statement on Form S-3, dated September 5, 2013.
6. Incorporated herein by reference to Exhibit number 4.6 filed with our quarterly report on Form 10-Q, dated February 8, 2018.
7. Incorporated herein by reference to Exhibit number 4.1 filed with our current report on Form 8-K, dated August 8, 2019.
8. Incorporated herein by reference to Exhibit number 4.2 filed with our current report on Form 8-K, dated August 8, 2019.
9. Filed herewith.
10. Furnished herewith.

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: February 10, 2020

**AMERICAN HONDA FINANCE CORPORATION**

By: /s/ Paul C. Honda

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Paul C. Honda

Vice President and Assistant Secretary  
(Principal Accounting Officer)