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Annual Session 2017 – Part 2

The Volkswagen Passenger Cars brand began fiscal year 2017 with a strong first quarter.

- In the first three months of the year, we achieved sales revenue of €19 billion.
- Our operating result amounted to almost €900 million.

These figures are a clear indication that we're on the right track.

Certainly you would all like to have comparable figures for the same quarter of last year. But these figures can only be compared to a limited extent, especially with regard to unit sales and sales revenue.

We have a new reporting structure. I will briefly explain this in the following.

In the structure up until now, the Volkswagen brand was naturally responsible for its own core business activities: In other words, for the development, production and sale of vehicles from the Volkswagen brand. Of course, this will remain so in the future.
In addition, however, a substantial share of unit sales came from the sale of vehicles from other Group brands. Sales revenue from multi-brand importers with Audi, Seat and Skoda vehicles in countries such as the UK, France and India have been depicted in the Volkswagen brand until now.

The activities of some Group service companies were also presented with the brand. This was the case with Volkswagen Group Logistics, for instance.
These activities are only partly related to the performance of our own brand.
For this reason, we have separated the relevant companies from the Volkswagen Passenger Cars brand. The corresponding revenues are already consolidated on the Group level since 1st January 2017.
The individual presentation of the Volkswagen brand in the future will focus on the core business.

What does the structural realignment mean for the key financial indicators of the Volkswagen Passenger Cars brand?
In 2016 we reported revenue of €106 billion. Some €32 billion of that amount came from the aforementioned activities not related to the brand.
Applying the new reporting structure, our sales revenue would have amounted to €74 billion for fiscal year 2016.

Realignment would have resulted in a contraction of the figures for the operating result, too. Therefore, instead of the €1.9 billion reported, the operating result would have been around €1.6 billion.
At 2.1%, the operating return on sales would have been 0.3 percentage points above the figure reported.
As from fiscal year 2017, the figures we report will be based on this new structure.

By ceding the companies, we are surrendering a substantial part of our earnings to the Group. The ceded units posted half a billion euros in 2016.

In other places, however, we will be streamlining the allocation of costs within the Group. All things being equal, the Volkswagen brand will bear only those costs for which it is directly accountable.

In total, this adjustment would have impacted the brand's result with approx. €300 million in 2016.

The structural adjustment depicted …

- improves transparency,
- enables better comparability of the financial indicators with our competitors, and
- supports management focus on the brand's core activities.

Let's take a look now at how business developed in the first quarter.

As mentioned earlier: We are off to a strong fiscal year 2017. With slightly improved sales as a basis, we were able to increase our sales revenue by approx. €2 billion.

There were two crucial reasons for this:

- First, there were strong recoveries in several markets. We could therefore stabilise our sales in Western Europe and significantly increase in Russia. In North America and South America, we could also post a stronger result compared to the admittedly weak prior-year figures.
- In terms of models, the full market availability of the Tiguan was particularly favorable. The new model was very well received and resulted in significant positive contributions to both sales and earnings.

At this juncture, I would like to once again point out that the sales of our joint ventures in China are not included in our unit sales figures, sales revenue or operating result. That business is consolidated at equity.

We achieved an operating result of approx. €870 million.

The weak prior-year quarter was still significantly impacted by the diesel issue.
On the other hand, we recorded growth in terms of both volume and price/mix effects. Reduced use of sales support also had a positive effect.

An earnings increase of some €600 million was achieved in this block. Exchange rate effects contributed a positive €160 million. The Russian ruble in particular added tailwind.

Product costs fell by around €130 million compared with Q1 2016. Further progress was also made in terms of fixed costs.

Consistent cost discipline helped us maintain low fixed costs close to those in the prior year for the first quarter of 2017, ...

- despite the planned SUV offensive, and
- despite the preliminary work for our electric architecture and our digital ecosystem.

Initial measures from the “Zukunftspakt” also started to bear fruit in fixed costs.

The structural realignment meant that our operating result fell by around €70 million in the first quarter.
The operating result of approx. €870 million corresponds to an operating return on sales of 4.6%.

We have three key levers in sight for increasing earnings by 2020. First, our product offensive will help us gain market share in the margin-intensive SUV segment. Dr. Diess will expand on this in detail.

The rollout of the Modular Transverse Toolkit (MQB) will help us further optimize our cost basis. With its combination of product substance and cost basis, the MQB represents a clear competitive advantage.

The second lever here is the “Zukunftspakt” signed in November last year. Its targets include a significant increase in productivity by 25%, a sharp reduction in factory costs, disciplined investments and a considerable reduction in bureaucracy by 2020.
Third, we are expecting the turnaround in key regions such as North and South America, and Russia to provide a considerable boost to both sales revenue and operating result.

We can report that we have already seen the first positive effects in these regions.
As Mr. Diess presented, in the USA, South America and in Russia, we returned to the growth path at the start of the year.
Indeed, much of the improvement in our year-on-year result is down to these regional performances.

And we are expecting the positive developments to continue throughout the year.

In the USA, we will be rolling out the Atlas and the Tiguan – two new vehicles in the high-growth SUV segment. This will serve to enhance our market presence while making much better utilization of our capacities in the region.

In South America, we commenced wholesale restructuring in 2014 in order to tailor capacities to the market situation. In this context, we have been forced to significantly reduce our workforce in Brazil since 2012. At the end of the year, we will be launching a additional product offensive based on our Modular Transverse Toolkit (MQB).

In Russia, the foundation has been laid for a marked period of recovery. We have reduced our fixed costs and increased productivity, and it now appears that the Russian ruble has recovered again from its low points of last year.
An added factor is that our locally manufactured Tiguan has met with a very positive response in Russia as well.
These effects led to an operating profit in Russia for the first quarter.

Our clear objective is to break even in all regions by 2020 at the latest.
Let us now come to the outlook for the brand in 2017.
The first quarter should not serve as a benchmark for the entire year.
At present, we anticipate that we will be able to increase revenue by around 10% for the year as a whole.

This outlook refers to the adjusted revenue-status in 2016.
We expect an operating return on sales at the upper end of the communicated bandwidth of 2.5 to 3.5 percent.

This means that we are on course to achieve our mid- to long-term margin targets of at least 4% by 2020 and 6% by 2025.
By 2020. we expect positive contributions from our product offensive, the “Zukunftspakt” and from the regions.

That said, substantial financial burdens are looming on the horizon.

- On the one hand side costs from implementing the increasingly strict worldwide CO_2 guidelines and from future emissions legislation will impact us significantly.
- In addition, transformation of the industry toward e-mobility and digitization will require us to make considerable advance outlays.

These effects will be overcompensated for by the “Zukunftspakt”.

We will consistently examine the earnings targets with a critical eye and raise them the moment we consider that what we have achieved is sustainable going forward.

Until such time, we will concentrate on implementing the “Zukunftspakt” and Transform 2025+ strategy.