Enhancing the SUBARU brand: “From a company making things, to a company making people smile.”

Yasuyuki Yoshinaga
Representative Director of the Board, President and CEO
1. The Transformation to SUBARU CORPORATION

Although SUBARU’s consolidated automobile unit sales were in the 500,000 to 700,000 range until a few years ago, thanks to the loyal support of customers around the world, they passed the one million milestone for the first time in the FYE March 2017, reaching 1.065 million units. Although this is a highly gratifying achievement, SUBARU’s global market share in the automotive industry is a mere 1%. Even if we wanted to compete using the same management strategies as the major automakers, we would be no match for them due to business scale. I believe that the only path to survival for SUBARU is to practice selection and concentration of limited management resources, create added value that customers find appealing, and exhaustively pursue differentiation. We express these strategic imperatives using the phrase “Enhancing the SUBARU brand.”

In “Prominence 2020,” the mid-term management vision announced in 2014, we articulated the objective of doing everything possible to promote differentiation and enhance the SUBARU brand. The recent unification of the company name and its brand name is one such initiative and a declaration of our resolve to showcase SUBARU as a brand that truly stands out and shines. To achieve this, all employees of the SUBARU Group will constantly consider what constitutes value to our customers as they provide products and services. When customers are satisfied, we know it from their smiling faces. All Group employees will work in unison to transform SUBARU from a company making things, to a company making people smile.

2. The Pursuit of “Enjoyment and Peace of Mind”

What is SUBARU? In the pursuit of differentiation from competitors, we asked ourselves this question while reconsidering and discussing everything pertaining to SUBARU. The answer we finally arrived at is that SUBARU has its roots as an aircraft manufacturer. The most important thing in aircraft development is safety. The safety performance and technology standards required to guard against possible aviation accidents are extremely high, and safety is a given. This way of thinking has been handed down and imbues automobile development at SUBARU. We realized that the carrying on of the spirit and technologies of the aircraft business and the consistent pursuit of superior safety, superb driving performance, and functional packaging at all times is encoded in SUBARU’s DNA. Also, thinking that SUBARU can establish a prominent presence in the minds of customers when they are able to experience SUBARU’s quintessential “Enjoyment and Peace of Mind,” we defined “Enjoyment and Peace of Mind” as the core value SUBARU aspires to deliver to customers. We believe that peace of mind can exist only when there is trust in the SUBARU brand, not just safety, which is a functional attribute. Also, by enjoyment we mean not only the enjoyment of driving, but also the enjoyment of traveling by car and the enjoyment of a car lifestyle.

Today, SUBARU receives top-class ratings in safety evaluations performed by third-party organizations around the world. In the U.S., all SUBARU models equipped with EyeSight technology received the Top Safety Pick award in the 2016 safety ratings of the Insurance Institute for Highway Safety (IIHS), a nonprofit insurance industry organization.

Although in the past many people chose SUBARU cars because of our unique horizontally opposed engine and symmetrical AWD technologies, in recent years SUBARU has come to be strongly associated with safety, especially in the U.S. I think that for many customers, safety is a factor in SUBARU’s popularity.

To further increase our world-class safety performance, last year we adopted the SUBARU Global Platform. By completely revamping the vehicle platform, which is the basic frame of an automobile, we have realized significant evolutions in overall performance—including safety performance—that would not have been achievable through the simple extension of existing technologies.

We plan to introduce a plug-in hybrid vehicle (PHEV) in 2018 and an electric vehicle (EV) in 2021. Although the power source may change from an engine to an electric motor, we will continue to provide cars that are distinctively SUBARU through the pursuit of “Enjoyment and Peace of Mind.”
3. Changes in the Business Environment

SUBARU has grown rapidly during the past few years. Consolidated sales volume has increased from some 600,000 vehicles to more than 1,000,000, and consolidated net sales have risen from 1.5 trillion yen to more than 3 trillion yen. Income has increased as well. We have been able to achieve extraordinarily high operating margins thanks to a confluence of positive factors: namely, substantial growth in sales volume, mainly in the U.S. market, alleviation of the fixed cost burden, extraordinarily low sales incentives against a backdrop of supply shortages, low depreciation and amortization expenses and R&D expenses, and the benefits of a weak yen. However, changes in the market environment and the increase in company size have led to tremendous changes in the business arena. To deal with a prolonged supply shortage, we substantially increased production capacity at SIA, our production base in the U.S., from 218,000 to 394,000 units under standard operations, and the burden of depreciation and other fixed costs is increasing. Also, we will make appropriate R&D expenditures to cope with new technologies that I discuss in detail below.

Although the automotive industry was previously an industry that saw little change from technological innovation, it has now entered a period of transformation. I consider the question of how to respond to a wave of technological innovations that has suddenly rolled over the industry, such as electrification, automated driving, connected car technology, and car sharing, to be a matter of urgent importance. Since our management resources are limited, unlike the major automakers, we cannot deal with all of these innovations simultaneously. We intend to address them in the following order of priority while taking advantage of alliances with other companies.
1) Electrification
Since environmental regulations in various countries will be further tightened, we will move forward with automobile electrification as our highest priority. In the U.S., a key market, the scope of the Zero Emission Vehicle (ZEV) Regulations will be expanded to include medium-size automakers, including SUBARU, in 2018. We plan to launch a plug-in hybrid electric vehicle (PHEV) to coincide with this regulatory change, and are developing the PHEV with technical assistance obtained under an alliance. We also plan to launch an electric vehicle (EV) in 2021. In this new era of electrification, we will develop an EV that provides the distinctive “Enjoyment and Peace of Mind” that people expect from SUBARU.

2) Automated driving (See page 32)
SUBARU’s approach to automated driving is to provide advanced driver assist technology that reduces the burden of driving, not driverless vehicles. We will press ahead with further evolution of EyeSight, our highly popular driver assist system, with the aim of achieving the ultimate in safety: the complete elimination of automobile accidents.

3) Connected car technology
To accelerate our initiatives in the field of connected car technology and meet customer needs, which will only continue to grow, we established the position of Chief Information Officer (CIO) and the IT Strategy Division in April 2017 and will accelerate planning and development.

4) Car Sharing
In light of factors such as SUBARU’s sales volume, company size, and the preferences of our customers, we consider this a social innovation that will have little impact on our business. Accordingly, we will prioritize the initiatives described in 1) to 3) above.

**Consolidated Unit Sales** (Thousand units)

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<th>Year</th>
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<tr>
<td>'21/3 (Forecast)</td>
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</table>

**Production Capacity Expansion Plan** (Thousand units)

*Production capacity under standard operations*
Message from the CEO

4. Sales Trends in the U.S.

Although the U.S. auto sales market is said to have peaked, so long as total demand of about 17 million units does not markedly deteriorate, I think that SUBARU’s current strong sales can be maintained into the future. We launched the all-new Impreza at the end of 2016 following a full model change. We plan to launch an all-new Crosstrek (called the SUBARU XV outside North America) in the summer of 2017, introduce the Ascent, a 3-row SUV for North America, in 2018, and implement full model changes of existing models. The Ascent, a vehicle that will complement the current model lineup, is being developed at the strong request of our U.S. dealers. By continuously introducing products that appeal to customers in this way, we will maintain sales momentum.

Automakers are taking measures in response to a slowdown in the U.S. market, such as increasing incentives, and sales competition has intensified. SUBARU forecasts, for accounting purposes, incentives of U.S. $1,850 per vehicle, up $400 year on year, for FYE March 2018. The reasons for the projected increase are strengthening of a portion of the sales financing program, a higher rate of program use, and cost increases accompanying a policy interest rate increase in the U.S. Although an increase in incentives puts downward pressure on profits, we will carefully watch the industry trend in order to maintain relative competitiveness.

We believe that opportunity awaits in the sunbelt (the southern U.S.). A breakdown of SUBARU’s 3.5% total share of the U.S. market in calendar year 2016 indicates that our share was 5.0% in the snowbelt and 1.8% in the sunbelt. For this reason, we see room for sales growth in the southern part of the country. To achieve growth, we will not increase the number of dealers, but rather increase unit sales per dealer through service improvement and model lineup expansion (introduction of the Ascent).
5. Sales Trends Outside the U.S.

Although we planned for sales growth in China and Russia in "Prominence 2020," the mid-term management vision, we are currently facing difficulties in these markets.

In China, oversupply in the market continues, and sales competition is intensifying. Since SUBARU doesn’t have a local production base, we’re not forced to sell cars to keep a plant operating. We intend to distance ourselves from price competition and carefully maintain our sales network by engaging in meticulous sales activities targeting customers who appreciate SUBARU’s added value.

Russia is a market where people have a natural affinity for SUBARU’s product characteristics, and we expect sales growth there in the future. However, since the current economic environment is unfavorable, including a weak ruble, we intend to wait for a recovery.

In Southeast Asia, in addition to knockdown production (local assembly) of the SUBARU XV and Forrester in Malaysia, we plan to start knockdown production in Thailand beginning in 2019.

Although this look at individual markets shows that our sales plan for China and Russia is behind schedule, we have not changed the FY 2020 consolidated unit sales forecast of upward of 1.2 million units announced in "Prominence 2020," the mid-term management vision. Although, of course, it is important to achieve our sales and profit and loss plans, we will carefully adhere to our current business model and intensively focus on enhancing the SUBARU brand, placing the highest priority on paving the way to future success.
6. Strengthening Corporate Governance

Effective April 1, 2017, SUBARU established the Corporate Administration Division to strengthen the business management system and business supervision function and established the positions of Chief Quality Officer (CQO), Chief Technology Officer (CTO), and Chief Information Officer (CIO). The CQO position was established for the purpose of promptly resolving quality-related issues and further increasing product quality and customer-service quality. The purpose of the CTO position is to respond to new technologies in the automotive industry, which is now in a period of transformation, and the purpose of the CIO position is to accelerate business process innovation and improvement as well as digital-related planning and development in the automotive business utilizing IT.

Following approval at the Ordinary General Meeting of Shareholders of June 23, 2017, the Company changed the Board of Directors structure and revised the compensation structure for directors. The purpose of the change in the Board structure was to strengthen the oversight function and increase the speed of business execution by separating corporate management and business execution. Following a review of executive remuneration, we introduced a share-based compensation plan with transfer restrictions. The purpose of the revision of the compensation structure for directors was to provide an incentive to eligible directors to achieve sustained improvement in corporate value and to promote sharing of value between eligible directors and the shareholders.

7. Strengthening of CSR Initiatives

At SUBARU, we believe that actively working toward and contributing to the sustainability of society in the pursuit of sustained growth is our corporate social responsibility (CSR). To more clearly express the aspirations of the SUBARU Group and our efforts to contribute to the environment and communities, on April 1, 2017, we established the CSR & Environment Department and revised the SUBARU Environmental Policies. In the Environmental Policies, we define the business fields of SUBARU, a company whose core businesses are automobiles and aerospace, as “The earth, the sky and nature.” We consider protecting the environment of the Earth a matter of the utmost importance for ensuring a sustainable future for society and SUBARU and strive to protect the environment in all business activities. As president, I intend to further promote SUBARU’s CSR activities and work to protect the global environment and contribute to local communities.