6 May, 2016

To the members of the Volkswagen ("VW") Executive and Supervisory Boards,

TCI is one of the largest shareholders in the VW/Porsche Group with an economic exposure to more than 2% of the company. We manage over $10bn in assets and have been a shareholder for over four years, during which time the shares and management have been constant disappointments. We believe there is potential for massive profit and cashflow expansion at VW. However, over the past five years the company has been held back by underperforming and overpaid management. With a new management team in place we want to express formally what we expect from the company and how management should be paid going forward.

In 2011, VW made an operating profit of €11.3bn; it sold 6m vehicles (ex-China) and had 502,000 employees. In 2016, at the mid-point of management's guidance, profits will still be €11.3bn. That is six years of flat profits. Moreover, in that time, the company bought Porsche, which has added over €3bn of EBIT, meaning profits ex-Porsche have declined from €11.3bn to €8bn. The core business has gone significantly backwards. Performance has been poor. Shockingly, in that six-year period, the nine members of the Board of Management will have been paid around €400m. That is corporate excess on an epic scale. Management has been rewarded for failure.

The signs of mismanagement are numerous. The company's wage bill has ballooned during a period of stagnant growth. Since 2011, VW's volumes ex-China have risen 6%, yet the number of employees is 33% higher. Alarmingly, the company's wage bill has increased 50%, from €24bn to €36bn. High-cost workers based in Germany have increased 40%. Clearly employee and management compensation are constantly prioritised over shareholder profits to an extreme degree.

Indeed, in 2015, a year when volumes ex-China *fell*, the number of employees increased by 4% and personnel expenses rose by €2.4bn. In a year of down volumes, this cost increase is staggering. 2015 was also a year in which, despite VW reporting a loss, the 12 members of the Board of Management were paid €63m, while the owners of the company (i.e. the owners of 500 million shares) were paid €68m in dividends. That is a disgrace. Clearly the company has a major corporate governance problem.

It is also worth noting that in Scania's last year of independence the eight people on the executive board were paid a combined €7m between them. In 2015, with Scania now part of VW, Mr. Renschler, VW's new head of Trucks, made over €15m *himself*, for just 11 months' work.

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We believe that excessive top management compensation, unlinked to transparent metrics and paid in cash with no vesting or deferral, has encouraged aggressive management behavior, contributing to the diesel emission scandal.

This extravagance must end. The management remuneration system needs to change. It is currently not fit for purpose. It is completely opaque to external investors. While there is a performance-related part of the bonus scheme, the parameters on which it is based are not clear. One thing we do know is that the floor in operating profit below which no bonus is paid is set at only €5bn. This is farcical for a company that generates over €200bn in revenues and owns the hugely profitable Porsche, Audi and Scania brands, which generate €10bn of EBIT between them. Bonuses are therefore effectively guaranteed irrespective of VW Brand performance.

There is also a non-performance-related part of the bonus that is paid at the discretion of the Supervisory Board for "extraordinary individual performance." This takes into account, for example, "the successful implementation of special projects." However, it seems these payments are not "extraordinary" at all. They are paid every year and investors can only speculate why the payments are made.

The fact that huge management bonuses have been approved by the labour-dominated Supervisory Board suggests the old executive management team knew they would be paid a lot of money simply for protecting jobs and increasing wages. We are concerned this improper arrangement is continuing today. That is no way to run one of the biggest companies in the world and it is no longer acceptable to minority shareholders. It also brings into serious question the judgement of the controlling Porsche and Piech families as to why they are happy to see management enrich themselves whilst the value of their shareholding collapses.

A new remuneration system should be implemented immediately. The criteria for bonuses should be transparent and measurable. There should be clear targets made known to investors. The targets should be a stretch. Management currently has almost no exposure to the VW share price, so bonuses should be paid in stock and deferred over three years. There needs to be alignment between management and shareholders and so compensation must be tied to the share price. Poor performance should mean zero bonuses.

The inefficiencies that have accumulated at VW mean there is a massive opportunity to increase profits and cashflow. Labour productivity at the company is half that at Toyota and around 40% lower than at Renault and Peugeot. VW has realised no positive scale benefits. In fact, it has managed to generate negative scale benefits, a woeful achievement in an industry where there should be huge economies of scale in purchasing and R&D. Immediate change is necessary. Clear financial targets must be set to

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introduce accountability and to enable investors to evaluate corporate and management performance. What should these targets be?

Both Renault and Peugeot are predicted to make group margins of approximately 6% in 2016. Considering its scale and premium pricing the VW Brand should make margin of at least 6%. Indeed, 6% has been the VW Brand's target for several years but it has never been achieved. It should still be the target, to be met within 2-3 years. At this level of profitability, VW Group would make an operating profit of €19bn, net income of €15bn and eps of €30. A dividend of €9 per share could be paid based on the publically stated management target of a 30% payout ratio. Until these targets are achieved we do not support management bonuses. If these goals are sustainably achieved we would be very happy for management to be paid large bonuses because shareholders should see a doubling of the share price. We have no problem with generous incentives for meeting stretch targets, in fact we encourage them.

The Group's current priorities are clear. They are stated in the Value Added Statement in the Annual Report. In 2014, a normal year for VW, only 4% of funds generated were paid to shareholders. 65% were paid to employees, 7% to the state and 7% to creditors. The rest of the funds were retained. Priorities need to change. Shareholders have been abused for too long.

In the past five years (a period of stagnant financial performance and management indulgence) the number of preference shares has increased over 20% and the dividend has been significantly below the peer group. Shareholders have suffered huge losses. They will not be patient forever. VW needs access to capital markets to survive. The financial services division has huge annual funding requirements. The combination of underperformance and continuing contempt for shareholders could threaten the company's existence.

The inexorable rise in labour costs is bad for the health of VW. In the long term, higher profits will be good for employees. More cashflow increases financial stability and job security and enables investment and R&D that strengthen the long-term survival of the group. It will provide protection in the next downturn. The cost of paying for the massive diesel emission provisions of an estimated €16bn makes it even more imperative that management is properly held to account by shareholders.

Therefore, we urge the introduction of a new management remuneration system. It should be submitted to a shareholder vote every year for formal approval. This will demonstrate a respect for investors and instil necessary alignment of shareholders and management. During a recent management roadshow in London, which we attended, the hostility of major institutional investors towards the company was palpable. They view the stock as uninvestable. It is time for management to prove them wrong.

In summary, a more flexible, efficient, profitable and cash-generative VW will be good for employees as well as shareholders. If stock compensation is promoted more widely in the company there will be no tension between the two.

Shareholders expect to see full details of the company's business plan and management compensation system set out for them to review at the investor day that is due to take place this summer.

One final point: please do not spend time picking over the numbers in this letter. Waste no time trying to justify the past five years. Make no excuses. Instead, set clear goals for the future and implement a compensation system which is transparent and does not pay for failure. Align the whole company to making VW the most efficient and profitable auto company in the world. It has the brands to achieve it, now it needs the leadership.

Yours sincerely,

Sir Chris Hohn

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TCI Fund Management

Productivity Analysis (ex China JVs)

	2011	2015	Change
Deliveries ex-China	6,004,726	6,381,885	+6%*
Revenue	€159bn	€213bn	+30%
Assets	€254bn	€382bn	+50%
Employees	454,000	604,000	+33%
• in Germany	196,000	276,000	+41%
• Abroad	258,000	329,000	+28%
Personnel Expenses	€23.9bn	€36.3bn	+52%
Capex (includes capitalised R&D)	€9.6bn	€17.8bn	+85%
Capex as % revenue	6.8%	9.6%	
Number of preference shares	170m	206m	+21%
Personnel expense ratio	15%	17%	
Operating profit (ex charges)	€11.3bn	€12.8bn	+14%
EBIT Margin	7%	6%	
Gross margin	17.6%	15.9%	

Note: Porsche was consolidated for the first time in 2012. In 2015, Porsche sold 225,000 vehicles and generated €3.4bn of operating profit.

*3% growth ex-Porsche acquisition

Key conclusions:
Deliveries +6%
Personnel expenses +52%

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