“I am committed to steadily improving Toyota’s corporate value by continuing to pursue farsighted innovations and building a solid management platform.”
In fiscal 2007, ended March 31, 2007, Toyota posted new records for net revenues and all income categories for the second year in a row. At the same time, we increased dividends paid to our shareholders for the eighth consecutive year. I am particularly pleased that we were able to increase revenues and earnings despite tougher-than-usual business conditions in the automotive industry.

I am confident that the global automotive industry has growth potential. Centered on emerging markets, automotive markets worldwide are likely to continue to expand in the medium-to-long term. However, competition is intensifying. We have entered an era in which companies that do not have the flexibility to respond precisely to a multitude of changes will not survive. By maintaining a sense of crisis in that respect, I will adopt a management approach that balances aggressiveness and prudence.

In the two years since I became Toyota’s president, I have reasserted the importance of building a solid foundation for sustainable growth. Given that the source of our growth is innovation, we will invest efficiently in research and development to continue building vehicles that meet customer needs. In securing our foundation, we intend to steadily tackle three key areas: quality, cost competitiveness, and personnel training.

Toyota’s tradition and strength stem from carrying out these clear steps in an honest, steadfast, and uncompromising manner. Avoiding complacency over recent successes, I am committed to steadily improving Toyota’s corporate value by continuing to pursue farsighted innovations and building a solid management platform. As we pursue that goal, I ask our shareholders for their continued support.

July 2007

Katsuaki Watanabe, President
Market Overview

Looking back over the past year, what were the main industry and market trends?

Q

A Competition is becoming more intense, especially in the areas of environmental technologies and cost competitiveness.

Worldwide, the deep-seated demand for automobiles remained unchanged. However, differences among regional automotive markets emerged throughout the year. Markets in the United States and Europe remained solid, and the Chinese market continued to see strong growth. On the other hand, Asian markets slumped, especially in Indonesia and Taiwan. And, Japan’s market shrank year on year, mainly in the registered vehicle category.

Meanwhile, demand is shifting toward fuel-efficient vehicles and compact vehicles due to global oil price hikes and increasing concern over environmental issues. That trend will likely continue as gasoline prices remain high and countries strengthen environmental regulations. Due in part to those factors, I expect that competition in the global automotive industry will become even more fierce, especially in the areas of environmental technologies and cost competitiveness.

Performance Evaluation

Given those market trends, what is your evaluation of Toyota’s business results?

Q

A Despite tough business conditions, we increased revenues and earnings.

I think we deserve credit for achieving our best-ever performance while investing for the future. We were able to grow earnings in fiscal 2007 due to increased global vehicle sales and cost reduction efforts. This growth came despite more challenging business conditions, such as material price hikes and tougher sales competition as well as higher fixed costs, such as capital investment and research and development expenses. In addition, I think we have established a balanced earnings structure in each region.

Management Issues

What issues does Toyota need to overcome in order to achieve sustainable growth?

Q

A For sustainable growth, we need to turn issues and risks into opportunities.

In the past 20 years, car ownership around the world has increased by 100 million vehicles every five years. By 2010, ownership is projected to exceed one billion vehicles. Led by Brazil, Russia, India, and China, emerging markets have fueled that growth. In regions that already have widespread...
motorization, such as Europe and North America, we expect demand for cars that offer new technologies and concepts to continue to grow steadily.

However, there is a long list of issues that we must address in order to benefit from those growing markets—environmental and safety measures, responses to energy diversification, the maintenance of uniform quality worldwide, the development of low-cost technologies, cost reductions to offset hikes in material costs, among others. But, if we change our way of thinking, overcoming such issues and risks will lead to major business opportunities. With that in mind, I want to clear these obstacles one at a time and advance Toyota’s growth.

Management Philosophy and Targets

Q Would you explain your basic management approach and Toyota’s management targets?

A With an operating income margin target of 10% in the medium-to-long term, we will improve quality across many different facets of our operations.

Since my appointment as president, I have consistently impressed upon everyone at Toyota that without quality improvement there cannot be growth. I believe that rather than vehicle sales and other volume-related results we should take pride in quality—or the extent to which the vehicles we build meet the needs of our customers. Therefore, I would like to improve many different aspects of Toyota’s operations to become number one globally in terms of products, manufacturing speed, manufacturing cost, and sales services. Through those efforts, I want to build a rock-solid foundation for further dramatic improvements.

I firmly believe that by strengthening our overall quality in this way we will achieve high levels of profitability. Our medium-to-long-term profitability target is to reach and maintain a consolidated operating income margin of 10%. It is important to maintain such high levels of profitability so that growth in net revenues translates directly into growth in earnings.

Strategies for Building Our Foundation

Q Specifically, what measures is Toyota taking to secure its foundation?

A We will further improve Toyota’s quality levels.

In an effort to build a solid foundation for sustainable growth, we are focusing on three areas: quality, cost competitiveness, and personnel training. Of those, quality has been my number one priority over the past year. And, the Toyota Group, including suppliers and dealers, has made concerted efforts to improve quality, Toyota’s lifeblood.

As part of our Customer First initiative, we are reinforcing our systems for building in quality that reflects the customer’s perspective. Literally
going back to the drawing board, we are painstakingly improving “design quality” by analyzing the causes of problems from the design stage, which is the source of quality. We are also honing our ability to analyze quality on production lines by introducing in-line measurement. And, we are reasserting our basic conviction that assembly processes build in quality by introducing a team-leader system for training production personnel. Moreover, in an effort to improve quality through production and development, we are collaborating closely with suppliers. Through this range of initiatives, we are steadily producing results. Having said that, quality improvement never ends. Therefore, to avoid complacency, we will use those initiatives as a starting point for further quality improvement efforts.

Q: Would you explain the progress of Toyota’s cost reduction initiatives?

A: Our cost reduction efforts are counteracting higher material costs and growing earnings.

In fiscal 2007, while absorbing an increase in material costs, Toyota achieved cost reductions of roughly ¥100 billion. Cost reductions will become more important than ever as a way of strengthening cost competitiveness, prevailing against market competition, and securing high earnings given such anticipated trends as continuing increases in material prices, a shift in demand toward compact cars, and the further introduction of new technologies as part of environmental and safety measures.

One example of our cost reduction efforts is the Value Innovation initiative, which began in 2005. Through this initiative, we look to reduce costs in the development and design stages by taking a systems-based approach. Using Value Innovation, we have prepared plans for models all the way through to 2010, and we will incorporate the benefits of the initiative in new models released during the coming fiscal year.

Q: What steps is Toyota taking in personnel training?

A: True to our basic belief that manufacturing is about developing people, we are concentrating on personnel training.

At Toyota, we believe that a combination of people and technology lies at the heart of a company’s competitiveness. Therefore, we are moving forward with personnel training based on the philosophy that developing human resources is a key part of manufacturing. These efforts extend beyond simply having employees acquire knowledge and skills that development, production, or sales divisions need. Globally, we are implementing programs to enable all employees to embrace Toyota’s culture and values and understand the Toyota Way.

An important factor in training employees is the establishment of systems that encourage coworkers to share goals and work as a team. Bearing that in mind, this year we introduced a team-leader system in divisions to
make it easier for senior employees to develop the skills of their junior colleagues through on-the-job training. I believe that asking for advice and being asked for advice will naturally create relationships conducive to good workplace communication and increase employees’ learning speed.

**Growth Strategies**

**Q** From a medium-to-long-term viewpoint, what is Toyota’s growth strategy?

**A** We will pursue long-term technological innovation to propel growth for the future.

Technological innovation will be central to our growth plans. I believe that technological capabilities—not only in product development but also in production engineering—will be the most important factor for future success. Advanced technology development, particularly in the fields of the environment, energy, and safety, is Toyota’s responsibility as an automaker and a precondition for survival amid ever-increasing competition. By rigorously developing such technologies ahead of our competition, I want to take on the challenge of realizing dream cars that make the air cleaner as customers drive them and cars that avoid accidents and injury.

As for development initiatives in environmental technologies, Toyota recently identified hybrids as a core technology that will contribute to the solution of environmental issues. We are currently moving forward with the development of next-generation systems. Since launching the Prius in 1997 as the world’s first mass-produced hybrid vehicle, we have diversified our lineup of hybrid models. As a result, cumulative worldwide sales of hybrid models passed the one-million-vehicle milestone in May 2007. Hybrid vehicles help curb emissions of CO₂ compared to vehicles powered only by gasoline engines. I believe we have made a significant contribution to the reduction of CO₂, said to be a cause of global warming. We are also accelerating our efforts to develop practical plug-in hybrids.

To cater to energy diversification among regions, we follow a strategy of providing the right vehicle for the right place at the right time by developing environmentally friendly technologies or deploying eco-cars that reflect the infrastructure and customer needs of each region. For example, last year we concluded an agreement with Isuzu Motors Limited for the joint development of diesel engines that place even less burden on the environment. Also, in Brazil, where bioethanol is a widely used fuel, we recently launched a flexible-fuel Corolla that runs on pure bioethanol.

**Q** Would you explain Toyota’s sales plans and the market strategies that will support them?

**A** We plan to increase sales globally by aggressively rolling out appealing new products.

In the medium term, we are targeting Group vehicle sales* of about 9.8 million units in 2008. In 2006, Group vehicle sales totaled 8.81 million units,
and we project sales of 9.34 million vehicles in 2007 (as of the announcement on December 22, 2006). We aim to steadily grow sales worldwide by continuing to bring new products to market that meet the needs of customers.

Our strategy is to continuously launch products that will stimulate market demand. For example, having unveiled a hybrid version of the Lexus LS in Japan in May 2007, we are releasing it in regions around the world in stages. Similarly, we launched the new Corolla—a core global model—in Japan during fiscal 2007, and we are now introducing it in markets worldwide. Further, the strategic Auris model is already selling in Japan and in countries throughout Europe. In addition, full-fledged production and sales of the new Tundra have begun in the North American market. And, Toyota will have more new-model launches in Japan during the second half of 2007 than it did in the entire previous year.

The ability to draw on a full product lineup to achieve balanced sales in regions worldwide is one of Toyota’s strengths. Another of our major competitive advantages is that we cater to regional characteristics by carefully adjusting strategies across all operational stages, from product development to production and sales. We want to meet the needs of even more customers by building vehicles that reflect the requirements of each region.

* Worldwide retail vehicle sales of Toyota, Daihatsu Motor Co., Ltd., and Hino Motors, Ltd., which are calculated on a different basis than consolidated vehicle sales

Vehicle supply capabilities are as fundamental to maintaining stable growth as technological and marketing capabilities. At Toyota, we are continuously increasing overseas production capacity to cater to growing demand in regions around the world. In 2006, new plants came on line in Texas, in the United States, and Guangzhou, in China, and we ramped up production capacity at plants in France and Thailand. In 2007, production started up at new plants in Thailand and in Tianjin, China, while production of the Camry began at Fuji Heavy Industries’ North American plant. Through that series of projects, in roughly two and a half years, from January 2005 to the end of March 2007, our overseas production capacity rose by more than 1.1 million vehicles. We have slated the end of 2007 for the start-up of a new plant in Russia, 2008 for the completion of a second plant in Canada, and around 2010 for the completion of a new plant in Mississippi, in the United States. We will continue to increase production capacity in a globally balanced way while reflecting our basic philosophy of “building vehicles where demand is found” by making overseas manufacturing companies more self-reliant and growing hand-in-hand with local economies.
Performance Outlook

What is the outlook for Toyota’s business results in the current fiscal year?

We expect to record further gains in revenues and earnings as sales volumes increase globally.

In the current fiscal year, ending March 31, 2008, we anticipate year-on-year increases of 366,000 units in consolidated vehicle sales, to 8.89 million units; 4.4% in net revenues, to ¥25.00 trillion; 0.5% in operating income, to ¥2.25 trillion; and 0.4% in net income, to ¥1.65 trillion. (Please see Message from the Executive Vice President Responsible for Accounting on page 16 for information on performance outlook assumptions.)

We expect an increase in vehicle sales in regions across the world, including in Asia, which saw vehicle sales decline in fiscal 2007. Given currency exchange rate fluctuations and material cost trends, business conditions by no means warrant optimism. However, while investing for future growth, we aim to achieve higher revenues and earnings again in the current fiscal year.

Policies for Returns to Shareholders and Capital Efficiency

What are Toyota’s basic policies with respect to returning profits to shareholders and capital efficiency?

While targeting a consolidated dividend payout ratio of 30%, we will continue investing to expand operations.

Regarding returns to shareholders, in the past several years we have steadily increased cash dividends each year in line with our improving performance. Toyota’s consolidated dividend payout ratio target is 30% in the medium-to-long term. In fiscal 2007, we paid a significantly higher annual dividend of ¥120.00 per share, up ¥30.00 per share from the previous fiscal year. As a result, the consolidated payout ratio reached 23.4%.

In addition, the Company flexibly acquires shares of its own stock to improve capital efficiency. During the Ordinary General Shareholders’ Meeting in June 2007, the Company received authorization to acquire up to 30 million shares of its own stock, for a maximum aggregate purchase price of ¥250 billion.

The automotive industry is a growth industry, and expanding the operations of vehicle manufacturers requires a large amount of funding. Therefore, we intend to step up investment to further increase earnings and corporate value while consistently returning profits to shareholders. Specifically, we will invest in advanced development that will further improve product appeal and establish next-generation technologies. We will also enlarge and augment our production and sales systems for the further expansion of Toyota’s global operations.

I would like to ask our shareholders for their continued trust, support, and understanding.