Results of Operations

The Volkswagen Group recorded sales revenue of €235.8 billion in fiscal year 2018, thus exceeding the prior-year figure by €6.3 billion. Improvements in volumes and in the mix, and the healthy business performance in the Financial Services Division were offset by negative exchange rate effects. The effects of applying the new International Financial Reporting Standards resulted in an overall increase in sales revenue. The Volkswagen Group generated 81.4 (80.7)% of its sales revenue abroad.

Gross profit was up on 2017 at €46.3 (43.5) billion. Adjusted for special items recorded under this item in both periods, gross profit amounted to €46.6 (45.8) billion. The gross margin rose to 19.7 (19.0)%; excluding special items it was 19.8 (19.9)%.

At €17.1 (17.0) billion, the Volkswagen Group’s operating profit before special items was on a level with the previous year. The operating return on sales before special items amounted to 7.3 (7.4)%.

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Positive factors included primarily volume improvements, although higher depreciation and amortization charges due to the large volume of capital expenditure, increased research and development costs, and fair value measurement gains and losses on certain derivatives, which have had to be reported here since the beginning of the year, had a negative impact. Special items in connection with the diesel issue weighed on operating profit, reducing this item by €–3.2 (–3.2) billion. The Volkswagen Group’s operating profit was €13.9 (13.8) billion and the operating return on sales stood at 5.9 (6.0)%.

The financial result increased by €1.9 billion to €1.7 billion. Foreign currency measurement, lower interest expenses and lower expenses from the measurement on the reporting date of derivative financial instruments, which are used to hedge financing transactions, had a positive impact. The effect of the remeasurement of put options and compensation rights in connection with the control and profit and loss transfer agreement with MAN SE was negative. The share of profits of equity-accounted investments decreased year-on-year, while there was a rise in the profits generated by the Chinese joint ventures. In the prior-year period, the remeasurement of the interest in HERE following the acquisition of shares by additional investors had a positive impact.

The Volkswagen Group’s profit before taxes increased to €15.6 billion in the reporting period; this was 14.4% higher than in the previous year. The return on sales before tax improved to 6.6 (6.0)%.

Income taxes resulted in an expense of €3.5 (2.2) billion, which in turn led to a tax rate of 22.3 (16.2)% in fiscal year 2018. In the previous year, the tax reform in the USA passed at the end of 2017 had a non-recurring positive non-cash measurement effect. Profit after tax was €12.2 billion, an improvement of €0.7 billion compared with 2017.

Results of operations in the Automotive Division

Sales revenue in the Automotive Division rose by €5.2 billion to €201.1 billion in the reporting period. Improvements in volumes and in the mix had a positive impact, while the effect of exchange rates was negative. In the second half of the year, the changeover to WLTP (Worldwide Harmonized Light-Duty Vehicles Test Procedure) weighed on performance. As our Chinese joint ventures are accounted for using the equity method, the Group’s performance in the Chinese passenger car market is mainly reflected in consolidated sales revenue only through deliveries of vehicles and vehicle parts.
Cost of sales was up, mainly as a result of expansion and due to higher depreciation and amortization charges and research and development costs recognized in profit or loss. Special items recognized here in the reporting period were down on the previous year. Expressed as a percentage of sales revenue, cost of sales before special items was up slightly. Total research and development costs as a percentage of the Automotive Division’s sales revenue (research and development ratio or R&D ratio) amounted to 6.8 (6.7)% in fiscal year 2018. In addition to new models, our activities focused above all on the electrification of our vehicle portfolio, a more efficient range of engines, digitalization and new technologies.

Distribution expenses and their ratio to sales revenue were down on the previous year. This was attributable to reclassifications of expenses to sales revenue as a consequence of the new IFRS 15, the sale of the PGA Group in June 2017, as well as exchange rate effects. Administrative expenses and their ratio to sales revenue increased compared with 2017. The main factors contributing to the €2.3 billion decline in other operating income to €–2.5 billion in fiscal year 2018 included an increase in special items recognized in connection with the diesel issue, negative exchange rate effects, and the fair value measurement of gains and losses on certain derivatives to which hedge accounting is not applied, and which have had to be reported here since the beginning of the year.

The operating profit of the Automotive Division was at the prior-year level at €11.1 (11.1) billion. Special items in connection with the diesel issue weighed on profit, reducing this item by €–3.2 (–3.2) billion. Moreover, an increase in depreciation and amortization charges, higher research and development costs recognized in profit or loss, and the fair value measurement of gains and losses on certain derivatives, which have had to be reported in operating profit since the beginning of the year, had a negative impact, while the effect of volume improvements was positive. The operating return on sales amounted to 5.7 (5.9)%.

The Passenger Cars Business Area recorded sales revenue of €160.8 billion in the reporting period, €3.5 billion more than in the previous year; this increase was driven mainly by volume and mix improvements, while exchange rates had a negative effect. At €9.2 (9.3) billion, operating profit was in line with the previous year. Special items in connection with the diesel issue weighed on profit, reducing this item by €–3.2 (–3.2) billion. Moreover, an increase in depreciation and amortization charges, higher research and development costs recognized in profit or loss, and the fair value measurement of gains and losses on certain derivatives, which have had to be reported in operating profit since the beginning of the year, had a negative impact, while the effect of volume improvements was positive. The operating return on sales amounted to 5.7 (5.9)%.

The Commercial Vehicles Business Area reported sales revenue of €36.7 (35.2) billion in fiscal year 2018. At €2.0 billion, its operating profit was €0.1 billion higher than in the previous year; the operating return on sales was unchanged at 5.4 (5.4)%. The year-on-year increase was mostly driven by higher volumes, positive mix and exchange rate effects, while cost increases had a negative impact.
RESULTS OF OPERATIONS IN THE POWER ENGINEERING BUSINESS AREA

<table>
<thead>
<tr>
<th>€ million</th>
<th>2018</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>3,608</td>
<td>3,283</td>
</tr>
<tr>
<td>Operating result</td>
<td>–64</td>
<td>–55</td>
</tr>
<tr>
<td>Operating return on sales (%)</td>
<td>–1.8</td>
<td>–1.7</td>
</tr>
</tbody>
</table>

Sales revenue in the Power Engineering Business Area increased by 9.9% year-on-year to €3.6 billion in 2018. The operating loss amounted to €–0.1 (–0.1) billion. Volume improvements were offset by a deterioration in the mix. The operating return on sales stood at –1.8 (–1.7)%.

Results of operations in the Financial Services Division

The Financial Services Division generated sales revenue of €34.8 billion in the reporting period; the 3.1% rise compared with the previous year was mainly due to higher business volume.

Cost of sales rose slightly slower than sales revenue, increasing by €0.7 billion to €28.2 billion. Distribution expenses and their ratio to sales revenue were both higher. Administrative expenses rose slightly, while their ratio to sales revenue was virtually unchanged year-on-year. The growth in volumes and higher IT costs were the main factors in the overall increase in expenses compared with the previous year.

The Financial Services Division’s operating profit improved by 4.5% compared with the previous year, increasing to €2.8 billion and thus contributing significantly to consolidated net profit. The operating return on sales amounted to 8.0 (7.9)%. At 9.9 (9.8)%, the return on equity before tax was on a level with the previous year.

Principles and goals of financial management

Financial management in the Volkswagen Group covers liquidity management, the management of currency, interest rate and commodity risks, as well as credit and country risk management. It is performed centrally for all Group companies by Group Treasury, based on internal directives and risk parameters. The main areas of the MAN and Porsche Holding Salzburg subgroups are integrated into the financial management of the Group while Scania is included to a limited extent. Additionally, these subgroups have their own financial management structures.

The goal of financial management is to ensure that the Volkswagen Group remains solvent at all times and at the same time to generate an adequate return from the investment of surplus funds. We use cash pooling to optimize the use of existing liquidity between the significant companies in Europe. In this system, the balances, either positive or negative, accumulating in the cash pooling accounts are swept daily into a target account at Group Treasury and thus pooled. The aim of currency, interest rate and commodity risk management is to hedge the prices on which investment, production and sales plans are based using derivative financial instruments and commodity forwards, and to mitigate interest rate risks incurred in financing transactions. Credit and country risk management uses diversification to limit the Volkswagen Group’s exposure to counterparty risk. To achieve this, counterparty risk management imposes internal limits on the volume of business per counterparty when financial transactions are entered into. Various credit rating criteria are used in this process. These focus primarily on the capital resources of potential counterparties, as well as the ratings awarded by independent agencies. The relevant risk limits and the authorized financial instruments, hedging methods and hedging horizons are approved by the Group Board of Management Committee for Risk Management. For additional information on the principles and goals of financial management, please refer to page 185 and to the notes to the 2018 consolidated financial statements on pages 289 to 310.

FINANCIAL POSITION

Financial position of the Group

The Volkswagen Group’s gross cash flow was €35.6 billion in fiscal year 2018, an increase of 9.1% compared with the prior-year figure. Administrative fines imposed after regulatory offense proceedings, which were recognized as special items in connection with the diesel issue in the reporting period, led to cash outflows. The rise in working capital led to tied-up funds in the amount of €–28.3 (–33.8) billion. The €5.5 billion change reflects the significant decrease in cash outflows attributable to the diesel issue in the reporting period, set against a WLTP-related increase in inventories. As a result, cash flows from operating activities were up by €8.5 billion to €7.3 billion.

The Volkswagen Group’s investing activities attributable to operating activities stood at €19.4 billion, 6.4% more than in the previous year.

Cash inflows from financing activities amounted to €24.6 (17.6) billion. The figure mainly comprises the issuance and redemption of bonds and other financial liabilities. Financing activities also include the dividends paid to the shareholders of Volkswagen AG, the acquisition of MAN shares tendered following the ruling in the award pro-