

RESULTS OF OPERATIONS IN THE POWER ENGINEERING BUSINESS AREA

€ million	2018	2017
Sales revenue	3,608	3,283
Operating result	-64	-55
Operating return on sales (%)	-1.8	-1.7

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 invest-

ment 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-

CASH FLOW STATEMENT BY DIVISION

€ million	VOLKSWAGEN GROUP		AUTOMOTIVE ¹		FINANCIAL SERVICES	
	2018	2017 ²	2018	2017 ²	2018	2017 ²
Cash and cash equivalents at beginning of period	18,038	18,833	13,428	14,125	4,609	4,709
Earnings before tax	15,643	13,673	12,861	11,171	2,782	2,502
Income taxes paid	-3,804	-3,664	-3,786	-3,514	-19	-149
Depreciation and amortization expense ³	22,561	22,165	15,581	14,948	6,980	7,218
Change in pension provisions	524	468	503	452	21	15
Share of the result of equity-accounted investments	244	274	303	159	-58	115
Other noncash income/expense and reclassifications ⁴	445	-265	502	202	-56	-467
Gross cash flow	35,613	32,651	25,964	23,418	9,650	9,233
Change in working capital	-28,341	-33,836	-7,433	-11,732	-20,908	-22,104
Change in inventories	-5,372	-4,198	-5,337	-3,784	-34	-414
Change in receivables	-6,400	-1,660	-1,800	-937	-4,600	-724
Change in liabilities	3,645	5,302	2,793	4,168	853	1,134
Change in other provisions	-1,286	-9,910	-1,306	-10,079	20	169
Change in lease assets (excluding depreciation)	-11,647	-11,478	-1,590	-1,115	-10,056	-10,363
Change in financial services receivables	-7,282	-11,891	-191	15	-7,090	-11,906
Cash flows from operating activities	7,272	-1,185	18,531	11,686	-11,258	-12,871
Cash flows from investing activities attributable to operating activities	-19,386	-18,218	-18,837	-17,636	-549	-583
of which: investments in property, plant and equipment, investment property and intangible assets, excluding capitalized development costs	-13,729	-13,052	-13,218	-12,631	-510	-421
capitalized development costs	-5,234	-5,260	-5,234	-5,260	-	-
acquisition and disposal of equity investments	-705	-317	-594	-124	-111	-193
Net cash flow⁵	-12,113	-19,404	-306	-5,950	-11,807	-13,454
Change in investments in securities, loans and time deposits	-2,204	1,710	6,129	2,333	-8,332	-622
Cash flows from investing activities	-21,590	-16,508	-12,708	-15,303	-8,882	-1,205
Cash flows from financing activities	24,566	17,625	4,274	3,562	20,292	14,063
of which: capital transactions with noncontrolling interests	-28	-	-28	-	-	-
Capital contributions/capital redemptions	1,491	3,473	1,418	2,400	73	1,073
MAN noncontrolling interest shareholders: compensation payments and acquisition of shares tendered	-2,117	-118	-2,117	-118	-	-
Effect of exchange rate changes on cash and cash equivalents	-173	-727	-171	-641	-2	-86
Change of loss allowance within cash and cash equivalents	-1	-	-1	-	0	-
Net change in cash and cash equivalents	10,075	-796	9,925	-696	150	-99
Cash and cash equivalents at Dec. 31⁶	28,113	18,038	23,354	13,428	4,759	4,609
Securities, loans and time deposits	28,036	26,291	8,697	15,201	19,339	11,090
Gross liquidity	56,148	44,329	32,051	28,630	24,098	15,699
Total third-party borrowings	-190,883	-163,472	-12,683	-6,251	-178,200	-157,221
Net liquidity⁷	-134,735	-119,143	19,368	22,378	-154,103	-141,522

1 Including allocation of consolidation adjustments between the Automotive and Financial Services divisions.

2 Adjusted

3 Net of impairment reversals.

4 These relate mainly to the fair value measurement of financial instruments and the reclassification of gains/losses on disposal of noncurrent assets and equity investments to investing activities.

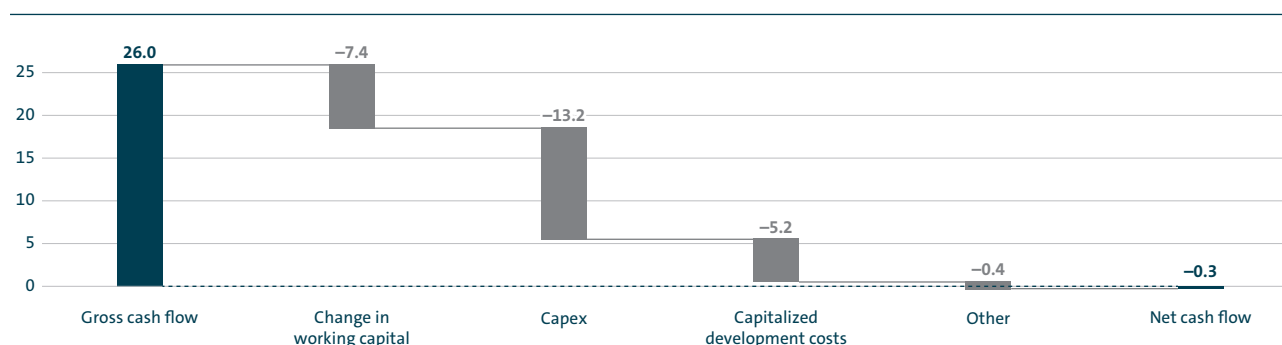
5 Net cash flow: cash flows from operating activities net of cash flows from investing activities attributable to operating activities (investing activities excluding change in investments in securities, loans and time deposits).

6 Cash and cash equivalents comprise cash at banks, checks, cash-in-hand and call deposits.

7 The total of cash, cash equivalents, securities, loans to affiliates and joint ventures and time deposits net of third-party borrowings (noncurrent and current financial liabilities).

AUTOMOTIVE DIVISION NET CASH FLOW 2018

€ billion



ceedings, the successful placement of dual-tranche hybrid notes in June 2018, and the redemption of the hybrid notes terminated in the third quarter of 2018.

At the end of the reporting period, the Volkswagen Group's cash and cash equivalents as reported in the cash flow statement amounted to €28.1 (18.0) billion and were thus significantly up on the prior-year reporting date.

On December 31, 2018, the Volkswagen Group's net liquidity was €-134.7 billion, compared with €-119.1 billion at the end of 2017.

Financial position of the Automotive Division

The Automotive Division's gross cash flow amounted to €26.0 billion in fiscal year 2018, €2.5 billion more than a year earlier. The increase was mainly due to healthy earnings growth. Special items recognized in the reporting period, most of which have already led to cash outflows, and a year-on-year decline in dividends from the Chinese joint ventures had a negative impact. The change in working capital of €-7.4 (-11.7) billion was €4.3 billion lower than in the previous year; it mainly 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 rose by €6.8 billion to €18.5 billion.

Investing activities attributable to operating activities increased by €1.2 billion to €18.8 billion. Investments in property, plant and equipment, investment property and intangible assets, excluding capitalized development costs (capex), were 4.6% higher, at €13.2 billion. The ratio of capex to sales revenue was 6.6 (6.5)%. We invested mainly in our

production facilities and in models that we launched in the reporting period or are planning to launch next year. These are primarily the Touareg, T-Cross, Audi e-tron, Audi Q3, Audi A6, Porsche 911 and Porsche Taycan model series, and the Bentley Continental family. Other investment priorities included the ecological focus of our model range, product electrification and digitalization, and our modular toolkits. Capitalized development costs of €5.2 (5.3) billion were in line with 2017 levels. Within the "Acquisition and disposal of equity investments" item, the sale of a part of the shares in There Holding was offset mainly by the investment in the newly established joint venture with Anhui Jianghuai Automobile (JAC) and the acquisition of additional shares in Quantum Scape. The prior-year figure had included the acquisition of the shares in Navistar and the disposal of part of the PGA Group.

Due mainly to markedly lower cash outflows attributable to the diesel issue, net cash flow in the Automotive Division improved by €5.6 billion to €-0.3 (-6.0) billion compared with the previous year.

Cash inflows from financing activities amounted to €4.3 (3.6) billion in fiscal year 2018. In May 2018, a dividend totaling €2.0 billion was distributed to the shareholders of Volkswagen AG, €1.0 billion more than in the previous year. The successful placement of dual-tranche hybrid notes with an aggregate principal amount of €2.75 billion via Volkswagen International Finance N.V. in June 2018 resulted in a cash inflow. The notes consist of a €1.25 billion note that carries a coupon of 3.375% and has a first call date after six years, and a €1.5 billion note that carries a coupon of 4.625% and has a first call date after ten years. Both tranches are

perpetual and, net of transaction costs and other factors, increase equity. €2.75 billion of the hybrid notes were classified as a capital contribution, which increased net liquidity. The redemption of the hybrid notes terminated in the third quarter of 2018 caused a cash outflow of €1.25 billion in the reporting period. Financing activities also include the issuance and redemption of bonds and other financial liabilities, as well as the MAN shares tendered as a result of the award proceedings and shares in AUDI AG acquired in the fiscal year.

The Automotive Division's net liquidity was €19.4 billion on December 31, 2018, €3.0 billion lower than at the end of fiscal year 2017. The Automotive Division's net liquidity stood at 8.2 (9.7)% of consolidated sales revenue in fiscal year 2018.

FINANCIAL POSITION IN THE PASSENGER CARS BUSINESS AREA

€ million	2018	2017
Gross cash flow	21,808	19,410
Change in working capital	-5,938	-10,122
Cash flows from operating activities	15,870	9,289
Cash flows from investing activities attributable to operating activities	-16,194	-15,337
Net cash flow	-325	-6,048

In fiscal year 2018, the Passenger Cars Business Area's gross cash flow improved by €2.4 billion to €21.8 billion. The increase was mainly due to healthy earnings growth; cash outflows associated with special items recognized in the reporting period had an offsetting effect. At €-5.9 (-10.1) billion, the negative impact on the change in working capital was less than in the year before, especially because of significantly lower cash outflows attributable to the diesel issue; this was set against a WLTP-related increase in inventories. Consequently, cash flows from operating activities went up by €6.6 billion to €15.9 billion. Investing activities attributable to operating activities of €16.2 (15.3) billion were up on 2017 levels. Capex grew, while capitalized development costs declined. In the reporting period, the sale of some of the shares in There Holding was offset by the investment in the joint venture with Anhui Jianghuai Automobile (JAC) and the acquisition of additional shares in Quantum Scape. In the prior-year period, the sale of part of the PGA Group had a positive effect on this item. Net cash flow increased to €-0.3 (-6.0) billion.

FINANCIAL POSITION IN THE COMMERCIAL VEHICLES BUSINESS AREA

€ million	2018	2017
Gross cash flow	3,847	3,739
Change in working capital	-1,234	-1,320
Cash flows from operating activities	2,613	2,419
Cash flows from investing activities attributable to operating activities	-2,480	-2,122
Net cash flow	132	297

The Commercial Vehicles Business Area's gross cash flow was €3.8 (3.7) billion in fiscal year 2018; the slight increase over the previous year was due to higher earnings. The change of funds tied up in working capital decreased by €0.1 billion to €-1.2 billion. As a result, cash flows from operating activities were up on the 2017 figure, increasing to €2.6 (2.4) billion. Investing activities attributable to operating activities stood at €2.5 (2.1) billion. This figure comprises increased capex and higher capitalized development costs mainly for the T7 and Caddy models. The prior-year figure included the acquisition of the shares in Navistar. Net cash flow amounted to €0.1 billion, €0.2 billion lower than a year earlier.

FINANCIAL POSITION IN THE POWER ENGINEERING BUSINESS AREA

€ million	2018	2017
Gross cash flow	309	268
Change in working capital	-260	-290
Cash flows from operating activities	49	-22
Cash flows from investing activities attributable to operating activities	-162	-177
Net cash flow	-113	-199

The Power Engineering Business Area generated a gross cash flow of €0.3 (0.3) billion in the reporting period. Funds tied up in working capital amounted to €-0.3 (-0.3) billion. Cash flows from operating activities were slightly higher than in the previous year. Investing activities attributable to operating activities stood at €0.2 (0.2) billion. Net cash flow improved by €0.1 billion to €-0.1 billion.