Results of Operations, Financial Position and Net Assets

The Volkswagen Group's sales revenue recorded further growth in fiscal year 2016. Despite further charges resulting from legal risks, especially in connection with the diesel issue, and restructuring measures, operating profit was up significantly on the previous year.

The Volkswagen Group's segment reporting in compliance with IFRS 8 comprises the four reportable segments Passenger Cars, Commercial Vehicles, Power Engineering and Financial Services, in line with the Group's internal management and reporting.

At Volkswagen, segment profit or loss is measured on the basis of the operating result.

The reconciliation column contains activities and other operations that do not by definition constitute segments. These include the unallocated Group financing activities. Consolidation adjustments between the segments (including the holding company functions) are also contained in the reconciliation. Purchase price allocation for Porsche Holding Salzburg and Porsche, as well as for Scania and MAN, reflects their accounting treatment in the segments.

The Automotive Division comprises the Passenger Cars, Commercial Vehicles and Power Engineering segments, as well as the figures from the reconciliation. The Passenger Cars segment and the reconciliation are combined to form the Passenger Cars Business Area. Effective January 1, 2016, the previously combined Commercial Vehicles/Power Engineering Business Area is presented as two separate business areas in accordance with the segment reporting: the Commercial Vehicles Business Area and the Power Engineering Business Area. The Financial Services Division corresponds to the Financial Services segment.

Activities in the Passenger Cars segment cover the development of vehicles and engines, the production and sale of passenger cars, and the genuine parts business. This segment combines the Volkswagen Group's individual passenger car brands on a consolidated basis. It also includes the Ducati brand's motorcycle business.

The Commercial Vehicles segment primarily comprises the development, production and sale of light commercial vehicles, trucks and buses from the Volkswagen Commercial Vehicles, Scania and MAN brands, the corresponding genuine parts business and related services.

The Power Engineering segment combines the large-bore diesel engines, turbomachinery, special gear units, propulsion components and testing systems businesses.

KEY FIGURES FOR 2016 BY SEGMENT

€ million	Passenger Cars	Commercial Vehicles	Power Engineering	Financial Services	Total segments	Reconciliation	Volkswagen Group
Sales revenue	177,815	32,080	3,593	31,251	244,739	−27,472	217,267
Segment profit or loss (operating result)	5,235	718	−217	2,435	8,171	−1,068	7,103
as a percentage of sales revenue	2.9	2.2	−6.0	7.8			3.3
Capex, including capitalized development costs	15,891	2,433	194	357	18,875	27	18,902

The activities of the Financial Services segment comprise dealer and customer financing, leasing, banking and insurance activities, fleet management and mobility offerings.

SALE OF LEASEPLAN

The final approvals for the sale of LeasePlan to an international consortium of investors were issued by the competent authorities in January 2016. Legal transfer of the LeasePlan shares to the consortium was completed on March 21, 2016. In the reporting period, the transaction had a positive effect of €2.2 billion on investing activities attributable to operating activities and net liquidity and, taking into account the disposal of the equity-accounted investment, resulted in income in €0.2 billion for the Volkswagen Group, which is reported in the financial result.

SPECIAL ITEMS IN THE FISCAL YEAR

Special items consist of certain items in the financial statements whose separate disclosure the Board of Management believes can enable a better assessment of our economic performance.

Special items relating to the diesel issue amounted to €–6.4 (–16.2) billion in fiscal year 2016, mainly due to higher expenses attributable to the recognition of provisions for legal risks.

Additional provisions had to be recognized for the replacement of potentially faulty airbags manufactured and supplied by Takata, which had been imposed by the competent authorities on all affected automobile manufacturers. The special items recognized in the operating result relating to these measures amount to €–0.3 (–0.3) billion in the reporting period.

In addition, special items for restructuring measures weighed on both the passenger cars business, in an amount of €–0.2 (–0.2) billion, and the trucks business, in an amount of €–0.1 (–0.2) billion in South America; in the Power Engineering Business Area, operating profit was impacted in an amount of €–0.2 billion. The measures are aimed at sustainably enhancing competitiveness and safeguarding future viability.

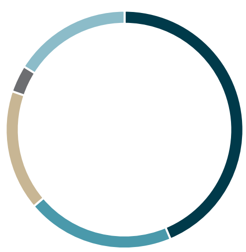
Provisions for legal risks relating to the commercial vehicles antitrust proceedings launched by the European Commission resulted in special items of €–0.4 billion in the Commercial Vehicles Business Area in the reporting period.

INCOME STATEMENT BY DIVISION

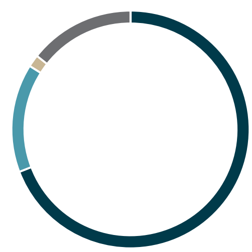
	VOLKSWAGEN GROUP		AUTOMOTIVE[1]		FINANCIAL SERVICES	
€ million	**2016**	2015	**2016**	2015	**2016**	2015
Sales revenue	**217,267**	**213,292**	**186,016**	**183,936**	**31,251**	**29,357**
Cost of sales	−176,270	−179,382	−150,860	−155,553	−25,410	−23,829
Gross profit	**40,997**	**33,911**	**35,156**	**28,382**	**5,841**	**5,528**
Distribution expenses	−22,700	−23,515	−21,453	−22,281	−1,248	−1,234
Administrative expenses	−7,336	−7,197	−5,730	−5,646	−1,606	−1,552
Net other operating result	−3,858	−7,267	−3,306	−6,761	−552	−506
Operating result	**7,103**	**−4,069**	**4,668**	**−6,305**	**2,435**	**2,236**
Operating return on sales (%)	**3.3**	**−1.9**	**2.5**	**−3.4**	**7.8**	**7.6**
Share of profits and losses of equity-accounted investments	3,497	4,387	3,433	4,366	64	21
Finance costs and Other financial result	−3,308	−1,620	−3,217	−1,695	−91	75
Financial result	**189**	**2,767**	**216**	**2,671**	**−27**	**97**
Earnings before tax	**7,292**	**−1,301**	**4,884**	**−3,634**	**2,408**	**2,333**
Income tax expense	−1,912	−59	−1,149	527	−763	−586
Earnings after tax	**5,379**	**−1,361**	**3,735**	**−3,107**	**1,645**	**1,747**
Noncontrolling interests	10	10	−81	−10	91	19
Earnings attributable to Volkswagen AG hybrid capital investors	225	212	225	212	–	–
Earnings attributable to Volkswagen AG shareholders	**5,144**	**−1,582**	**3,591**	**−3,310**	**1,553**	**1,728**

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

SHARE OF SALES REVENUE BY MARKET 2016
in percent



SHARE OF SALES REVENUE BY DIVISION/BUSINESS AREA 2016
in percent



Overall, negative special items recognized in the operating result amounted to €– 7.5 (–16.9) billion in fiscal year 2016.

RESULTS OF OPERATIONS

Results of operations of the Group

The Volkswagen Group generated sales revenue of €217.3 billion in fiscal year 2016, thus surpassing the prior-year figure by €4.0 billion. Improvements in the mix and the good business development in the Financial Services Division were offset by negative exchange rate effects and a slight decline in vehicle unit sales, excluding the Chinese joint ventures. At 79.9 (80.2)%, a large majority of sales revenue was recorded outside Germany.

At €41.0 (33.9) billion, gross profit was up year-on-year. Adjusted for the special items recognized here in both periods, gross profit was on a level with the previous year, at €42.5 (42.4) billion. The gross margin amounted to 18.9 (15.9)%; excluding special items it was 19.6 (19.9)%.

At €14.6 (12.8) billion, the Volkswagen Group's operating profit before special items was up year-on-year, while the operating return on sales before special items increased to 6.7 (6.0)%. In addition to optimized product costs, improvements in the mix had a positive effect, while exchange rate effects, the decline in unit sales (excluding the Chinese joint ventures) and higher depreciation and amortization charges had a negative impact. Negative special items of €7.5 (16.9) billion, particularly for legal risks, weighed on operating profit; of this total, €6.9 (16.7) billion was attributable to the Passenger Cars Business Area, €0.5 (0.2) billion to the Commercial Vehicles Business Area and €0.2 billion to the Power Engineering Business Area.

At €7.1 (–4.1) billion, the Volkswagen Group's operating profit was up significantly on the previous year. The operating return on sales rose to 3.3 (–1.9)%.

At €0.2 billion, the financial result was €2.6 billion lower than in 2015. In the previous year, the income from the sale of the Suzuki shares had a clearly positive effect. The decline was also the result of a year-on-year decrease in income from the equity-accounted Chinese joint ventures, higher finance costs due to interest-related and remeasurement effects as well as higher expenses from derivative financial instruments. The income from the sale of the LeasePlan shares had a positive effect.

At €7.3 billion, the Volkswagen Group's profit before tax was €8.6 billion higher than in the previous year. The return on sales before tax improved from –0.6% to 3.4%. The income tax expense amounted to €1.9 (0.1) billion, resulting in a tax rate of 26.2% in the reporting period. Compared with the previous year, profit after tax grew by €6.7 billion to €5.4 billion.

Results of operations in the Automotive Division

The Automotive Division's sales revenue in the reporting period was up slightly compared with the previous year, at €186.0 (183.9) billion. Improvements in the mix had a positive effect, while negative exchange rate effects and the slight decline in vehicle unit sales (excluding the Chinese joint ventures) had an opposing impact. 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 by deliveries of vehicles and vehicle parts.

Cost of sales declined year-on-year. A significant decline in special items from the diesel issue, optimized product costs, exchange rate effects and lower research and development expenditures recognized in profit or loss more than offset the rise in depreciation and amortization charges and negative special items from the replacement of procured airbags. The ratio of cost of sales to sales revenue declined year-on-year. As a result, gross profit in the Automotive Division exceeded the 2015 figure, at €35.2 (28.4) billion.

Distribution expenses declined in fiscal year 2016 due to lower special items from the diesel issue as well as positive exchange rate effects. The ratio of distribution expenses to sales revenue also decreased. Administrative expenses rose year-on-year, although the ratio of administrative expenses to sales revenue was unchanged. A year-on-year decline in special items resulting from legal risks in connection with the diesel issue and lower negative exchange rate effects were positive factors, while the main negative factor was negative special items from legal risks in the Commercial Vehicles Business Area; as a result, the other operating result, at €−3.3 billion, improved by €3.5 billion compared with the previous year.

At €4.7 billion, the Automotive Division's operating profit in fiscal year 2016 was €11.0 billion higher than in the previous year. The operating return on sales rose to 2.5 (−3.4)%. Negative special items contained in this figure amounted to a total of €7.5 (16.9) billion. Excluding the special items, the Automotive Division's operating profit rose to €12.2 (10.6) billion. The operating return on sales before special items was 6.6 (5.8)%. Optimized product costs and favorable mix developments were able to more than offset negative exchange rate effects, declining vehicle unit sales if our Chinese joint ventures are excluded, as well as higher depreciation and amortization charges. Since the profit recorded by our Chinese joint ventures is accounted for in the financial result using the equity method, their business growth is primarily reflected in the Group's operating result only by deliveries of vehicles and vehicle parts, and license income.

The financial result declined by €2.5 billion to €0.2 billion; this figure contains lower investment income from the Chinese joint ventures, higher finance costs due to interest-related and remeasurement effects as well as increased expenses from derivative financial instruments. The income from the sale of the LeasePlan shares was a positive factor in the reporting period; in the prior-year period, the sale of the Suzuki shares had a clearly positive effect.

RESULTS OF OPERATIONS IN THE PASSENGER CARS BUSINESS AREA

€ million	2016	2015
Sales revenue	150,343	149,716
Gross profit	29,660	23,023
Operating result	4,167	−7,013
Operating return on sales (%)	2.8	−4.7

Sales revenue in the Passenger Cars Business Area in 2016 was on a level with the previous year, at €150.3 (149.7) billion. At €29.7 billion, gross profit exceeded the prior-year figure by 28.8%. At €4.2 billion, operating profit improved by €11.2 billion. The special items contained in this figure from the diesel issue, from the replacement of procured airbags and from restructuring measures in South America amounted to €6.9 (16.7) billion. Optimized product costs and favorable mix developments were able to more than offset negative exchange rate effects and declining vehicle unit sales, as well as higher depreciation and amortization charges. The operating return on sales was 2.8 (−4.7)%.

RESULTS OF OPERATIONS IN THE COMMERCIAL VEHICLES BUSINESS AREA

€ million	2016	2015
Sales revenue	32,080	30,445
Gross profit	4,899	4,589
Operating result	718	586
Operating return on sales (%)	2.2	1.9

Sales revenue in the Commercial Vehicles Business Area was €32.1 billion in 2016 and hence €1.6 billion higher than in 2015. At €4.9 (4.6) billion, gross profit improved compared with the previous year. At €0.7 billion, the Commercial Vehicles Business Area's operating profit was up €0.1 billion year-on-year; the operating return on sales rose to 2.2 (1.9)%. Higher unit vehicle sales and the expansion of the service business were positive factors, while special items from restructuring measures to sustainably enhance competitiveness and provisions for legal risks relating to the commercial vehicles antitrust proceedings launched by the European Commission weighed on operating profit.

RESULTS OF OPERATIONS IN THE POWER ENGINEERING BUSINESS AREA

€ million	2016	2015
Sales revenue	3,593	3,775
Gross profit	597	770
Operating result	−217	123
Operating return on sales (%)	−6.0	3.2

The Power Engineering Business Area recorded sales revenue of €3.6 billion in fiscal year 2016, a decline of 4.8% year-on-year due to volume-related factors. Gross profit was €0.6 (0.8) billion. Operating profit declined by €0.3 billion to €–0.2 billion due to volume- and margin-related factors, as well as to the special items from restructuring measures to safeguard future viability; the operating return on sales decreased from 3.2% to −6.0%.

Results of operations in the Financial Services Division

The Financial Services Division generated sales revenue of €31.3 billion in 2016; the year-on-year increase of 6.5% was attributable primarily to the higher business volume. Exchange rate effects had a negative impact.

Despite sustained pressure on margins, a negative exchange rate trend and higher depreciation and amortization charges, the higher volumes increased gross profit to €5.8 (5.5) billion.

Distribution expenses in the reporting period were on a level with the previous year. Administrative expenses rose slightly. The ratios of both figures to sales revenue declined. The net other operating result amounted to €–0.6 (–0.5) billion.

Operating profit at the Financial Services Division increased by 8.9% year-on-year to €2.4 billion, with the division again making a significant contribution to consolidated profit. The operating return on sales rose to 7.8 (7.6)%. The return on equity before tax was 10.8 (12.2)%.

PRINCIPLES AND GOALS OF FINANCIAL MANAGEMENT

Financial management at the Volkswagen Group covers liquidity management, currency, interest rate and commodity risk management, 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 MAN and Porsche Holding Salzburg subgroups are integrated into the main financial management functions, while Scania is integrated to a limited extent. Additionally, these subgroups have their own financial management structures.

The goal of liquidity 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. To do this, the – positive or negative – balances accumulating on the cash pooling accounts are swept daily into a target account at Group Treasury and thus pooled. Currency, interest rate and commodity risk management is designed to hedge the prices on which investment, production and sales plans are based using derivative financial instruments. Credit and country risk management aims to use diversification to avoid exposing the Volkswagen Group to the risk of loss or default. To achieve this, internal limits are defined on the basis of various credit risks for the volume of business per counterparty when entering into financial transactions. These primarily focus 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 Executive Committee for Liquidity and Foreign Currency.

For additional information on the principles and goals of financial management, please refer to page 199 and to the notes to the 2016 consolidated financial statements on pages 291 to 299.

FINANCIAL POSITION

Financial position of the Group

The Volkswagen Group generated gross cash flow of €26.0 billion in fiscal year 2016, up 59.7% on the prior-year figure. Funds tied up in working capital increased by €14.0 billion to €16.6 billion. The new special items recognized in the reporting period had a negative impact on gross cash flow and a positive effect on the change in working capital. Cash flows from operating activities declined by €4.2 billion to €9.4 billion.

At €16.8 billion, the Volkswagen Group's investing activities attributable to operating activities in 2016 were up 8.2% on the previous year. Within this item, investments in property, plant and equipment, investment property and intangible assets, excluding capitalized development costs (capex) of €13.2 (13.2) billion were on a level with the previous year, while capitalized development costs increased to €5.8 (5.0) billion. The "acquisition and disposal of equity investments" item comprises primarily the cash inflow from