Financial Review

Business Segments and Scope of Consolidation

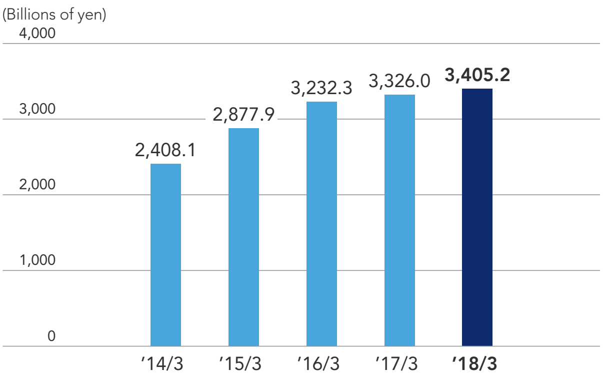
The SUBARU Group ("the Group") consists of three business segments: the core Automotive Business Unit, which accounts for approximately 95% of consolidated net sales; the Aerospace Company; and Other Businesses, consisting of businesses that do not belong to either of the other two segments. In the fiscal year ended March 31, 2018 (April 1, 2017 to March 31, 2018; the "fiscal year under review"), SUBARU CORPORATION ("the Company"), 75 subsidiaries, and 8 equity-method affiliated companies were included in the scope of consolidation.

Overview of Business Performance

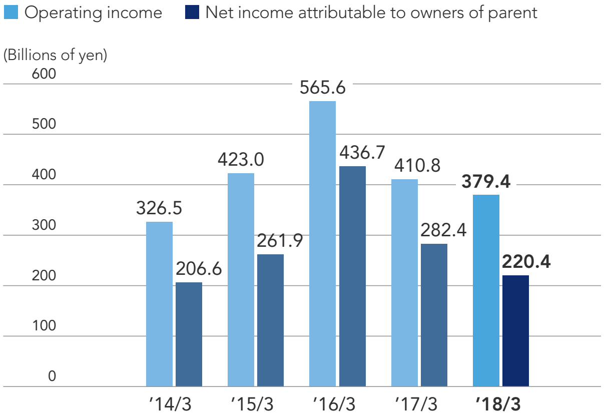
As the employment and income environment improved supported by various policies, the Japanese economy continued on a gradual recovery path in the fiscal year under review., Although the economic development in China and other Asian emerging markets, the impact from political uncertainties, and trends in the financial and capital markets were of note, the global economy, especially the United States, steadily recovered. Given this backdrop, the exchange rate was mostly stable, with the yen against the U.S. dollar getting slightly stronger in the fourth quarter.

The North American market, our key market, continued to drive global sales, and we had steady results over the fiscal year under review, including the achievement of record-high automobile unit sales. Consolidated net sales increased by 79.2 billion yen (2.4%) from the previous fiscal year to a record 3,405.2 billion yen, owing to net sales pushed up by the favorable foreign exchange rates and higher automobile unit sales. Consolidated operating income decreased by 31.4 billion yen (7.6%) year on year to 379.4 billion yen, due to the increase in selling expenses associated with rising interest rates in the U.S., the effect of raw materials market, and higher R&D expenses, despite the positive effect from the foreign exchange rates. Net income attributable to owners of parent decreased by 62.0 billion yen (22.0%) year on year to 220.4 billion yen partly owing to airbag related extraordinary loss of 81.3 billion yen.

Net Sales

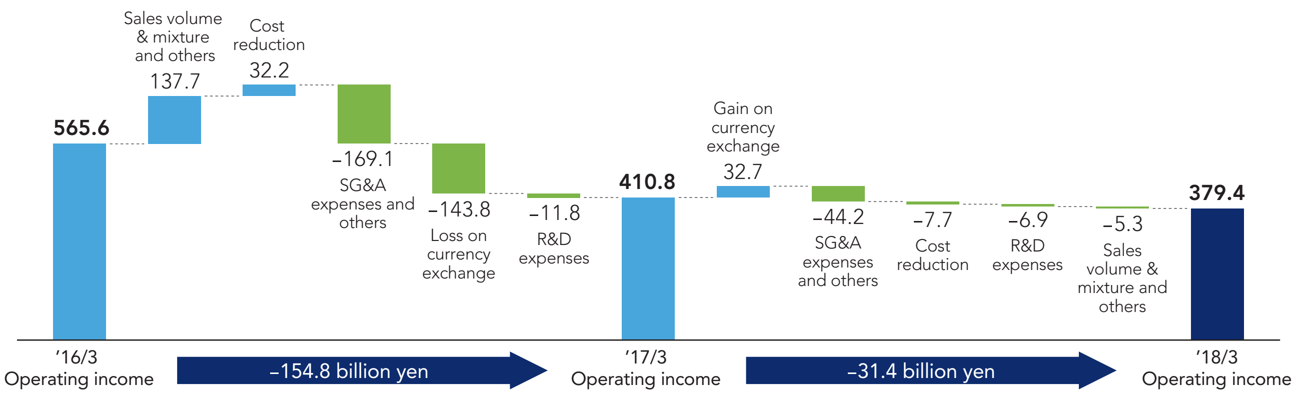


Operating Income／Net Income Attributable to Owners of Parent



Analysis of Increase and Decrease in Operating Income Changes (Consolidated)

(Billions of yen)



Segment Information

Automotive Business Unit

Net sales from the Automotive Business Unit were 3,234.9 billion yen, up by 82.9 billion yen (2.6%), and segment income was 361.5 billion yen, down by 36.2 billion yen (9.1%), compared with the previous fiscal year. Consolidated global unit sales reached a record high for the sixth consecutive year, increasing by 2,000 vehicles (0.2%) year on year to 1,067,000 units.

<Domestic Market>

Total automobile demand in Japan, in the fiscal year under review, increased 2.3% year on year to 5,197,000 units due to factors including continued steady sales of passenger cars and increased minicar sales compared with the previous fiscal year.

The Group's unit sales in Japan increased by 5,000 units (2.8%) year on year to 163,000 units. Although minicar unit sales reached no further than 31,000 units, down by 2,000 units (5.1%) from the previous fiscal year, passenger car sales remained strong, led mainly by the all-new SUBARU XV, resulting in a sales increase of 6,000 units (4.9%) to 133,000 units.

<Overseas Market>

The total automobile demand in the United States, which is our key market, was 17,308,000 units, a 1.0% decrease year on year, shifting further from passenger vehicles to light trucks, including SUVs.

The Group's overseas unit sales marked a slight decrease of 2,000 units (0.2%) to 903,000 units. While the unit sales in the U.S. stayed strong, reaching a record-high for the ninth consecutive fiscal year, the unit sales in China decreased owing to fierce competition. By region, sales volume increased by 7,000 units (1.0%) year on year to 728,000 units in North America, increased by 2,000 units (3.7%) to 48,000 units in Europe and Russia, increased by 7,000 units (13.4%) to 56,000 units in Australia, decreased by 17,000 units (38.9%) to 27,000 units in China, and decreased by less than 1,000 units (0.8%) to 45,000 units in other regions.

Aerospace Company

Net sales from the Aerospace Company were 142.2 billion yen, up by 3.4 billion yen (2.5%), and segment income was 12.3 billion yen, up by 3.2 billion yen (34.7%), compared with the previous fiscal year. Sales of products for the Japan Ministry of Defense saw an increase from the previous fiscal year, mainly due to current development under a contract for the new UH-X multi-purpose helicopter. Sales of products for the commercial sector also grew year on year with the increase in production of the Boeing 787, covering the decline in production of the Boeing 777.

Other Businesses

Net sales from Other Businesses were 28.2 billion yen, down by 7.1 billion yen (20.1%), and segment income was 5.1 billion yen, up by 1.6 billion yen (44.2%), compared with the previous fiscal year.

Net Sales by Segment (Billions of yen)

	'14/3	'15/3	'16/3	'17/3	'18/3
Automotive	2,246.6	2,699.0	3,039.4	3,152.0	**3,234.9**
Aerospace	124.4	142.8	152.8	138.8	**142.2**
Industrial products	29.8	29.0	—	—	**—**
Other	7.3	7.1	40.0	35.3	**28.2**
Total	2,408.1	2,877.9	3,232.3	3,326.0	**3,405.2**

Operating Income by Segment (Billions of yen)

	'14/3	'15/3	'16/3	'17/3	'18/3
Automotive	309.0	400.9	543.6	397.7	**361.5**
Aerospace	14.1	18.9	18.2	9.1	**12.3**
Industrial products	0.6	0.8	—	—	**—**
Other	2.1	1.9	3.0	3.5	**5.1**
Corporate and elimination	0.6	0.6	0.8	0.5	**0.7**
Total	326.5	423.0	565.6	410.8	**379.4**

*Following the decision in November 2016 to terminate the Industrial Products business, the said business has been included in the Other Businesses segment since FYE March 2017. Figures for FYE March 2016 in the tables above have been restated to comply with the new segment classification.

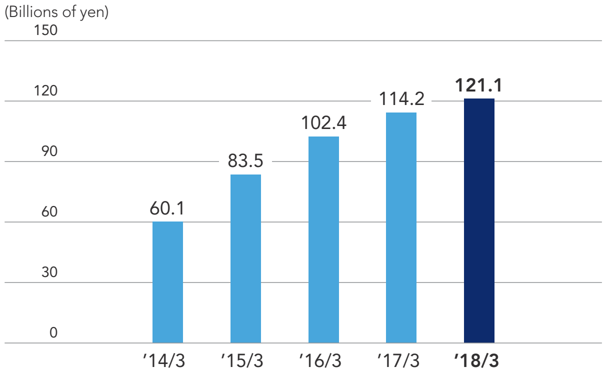
R&D Expenses

In the fiscal year under review, R&D expenses increased by 6.9 billion yen (6.0%) compared with the previous fiscal year to 121.1 billion yen. Of that amount, 117.6 billion yen was related to the Automotive Business Unit. In FYE March 2019, the Group plans to reduce R&D spending by 1.1 billion yen (1.0%) year on year to 120.0 billion yen.

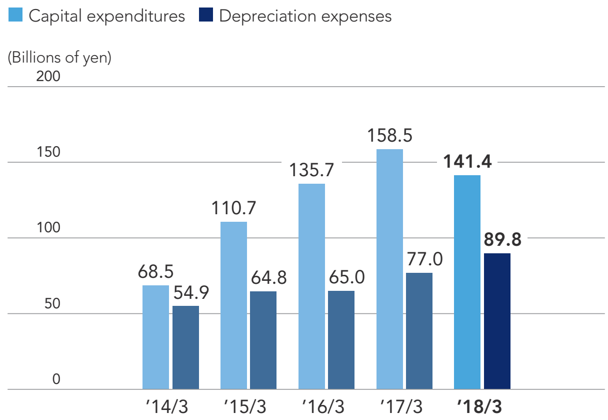
Capital Expenditures and Depreciation

In the fiscal year under review, the Group made capital expenditures of 141.4 billion yen, a decrease of 17.1 billion yen (10.8%) compared with the previous fiscal year. Among the total capital expenditures, 133.4 billion yen has been spent in relation to the Automotive Business Unit. The Company made investments of 63.0 billion yen in the automotive business, primarily for augmenting production capacity accompanying the increase in unit sales and for developing and expanding production facilities for new products, R&D facilities, and sales networks. Subaru of Indiana Automotive, Inc. (SIA), our production base in the U.S., made investments of 39.5 billion yen, mainly for new products and production facilities to boost production capacity. Subaru of America, Inc. (SOA), a sales subsidiary in the U.S., also spent 9.0 billion yen mainly for the relocation of its head office. Depreciation expenses in the fiscal year under review increased by 12.8 billion yen (16.6%) year on year to 89.8 billion yen. Capital expenditures in FYE March 2019 are projected to decrease by 11.4 billion yen (8.1%) year on year to 130.0 billion yen, and depreciation expenses to increase by 3.2 billion yen (3.6%) to 93.0 billion yen.

R&D Expenses



Capital Expenditures／Depreciation Expenses

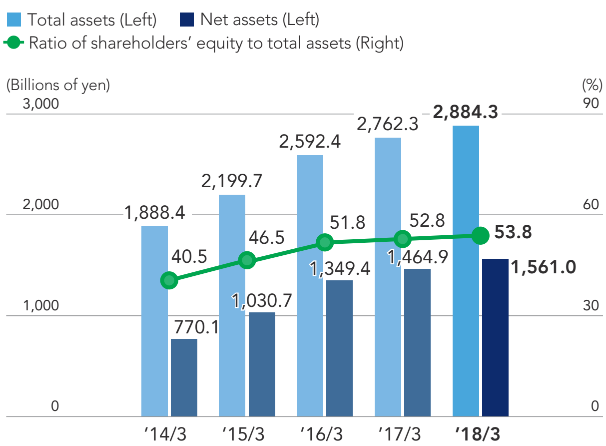


Liquidity and Source of Funds

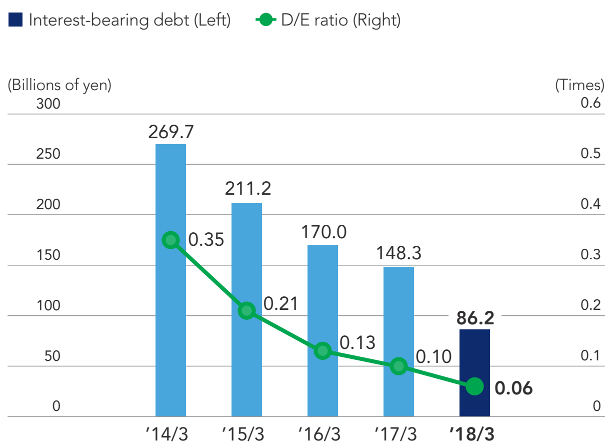
Financial Position

Total assets as of March 31, 2018 were 2,884.3 billion yen, an increase of 122.0 billion yen compared with the previous fiscal year-end. Property, plant and equipment, funds in hand (the sum of cash and deposits and short-term investment securities), and deferred tax assets increased by 45.8 billion yen, 28.6 billion yen, and 26.5 billion yen, respectively. Total liabilities amounted to 1,323.3 billion yen, up by 25.9 billion yen from the previous fiscal year-end. While the total of short-term loans payable and both current and noncurrent long-term loans payable decreased by 62.1 billion yen, provision for loss related to airbags and accrued expenses increased by 64.7 billion yen and 34.6 billion yen, respectively. The fiscal

Total Assets／Net Assets／
Ratio of Shareholders' Equity to Total Assets



Interest-Bearing Debt／D/E Ratio

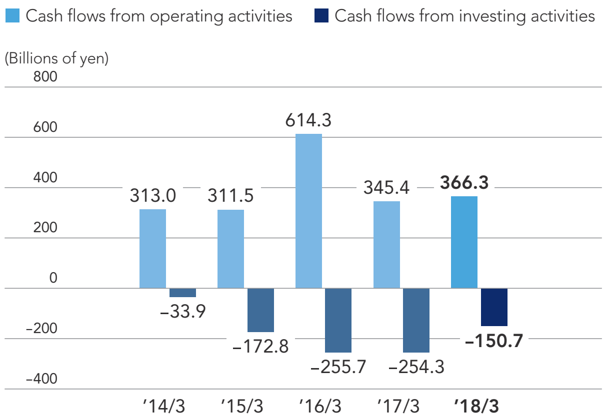


year-end balance of interest-bearing debt decreased by 62.1 billion yen from the previous fiscal year-end to 86.2 billion yen. The debt/equity ratio (interest-bearing debt over shareholders' equity) was 0.06, remaining at a safe level. Net assets stood at 1,561.0 billion yen, an increase of 96.1 billion yen compared with the previous fiscal year-end, mainly due to an increase in retained earnings of 110.3 billion yen. The shareholders' equity ratio resulted in 53.8%.

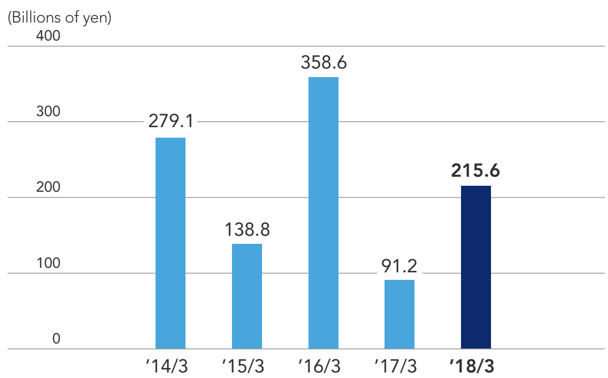
Cash Flows

In the fiscal year under review, net cash provided by operating activities was 366.3 billion yen. Major cash in-flow items were income before income taxes of 297.3 billion yen, and provision for loss related to airbags of 64.7 billion yen. Net cash used in investing activities was 150.7 billion yen. Major cash out-flow items included purchase of non-current assets (net of proceeds from sales) of 146.5 billion yen. As a result, free cash flow for the fiscal year under review was 215.6 billion yen. Net cash used in financing activities totaled 170.9 billion yen. Major cash out-flow items were cash dividends paid of 110.3 billion yen, repayments of long-term loans payable (net of proceeds) of 40.9 billion yen, and net decrease in short-term loans payable of 18.4 billion yen. As a result of the above cash flows, including the effect of translation adjustments, cash and cash equivalents at the end of the fiscal year under review amounted to 765.6 billion yen.

Cash Flows from Operating Activities and Investing Activities



Free Cash Flow



Basic Policy on Profit Distribution and Dividends

The Company regards shareholder interests as an important management priority and applies a performance-linked approach to shareholder returns by considering the business performance of each fiscal year, investment plans, and the business environment, while maintaining a basic policy of paying continuous dividends. The Company determines dividend payments for each fiscal year based on a consolidated dividend payout ratio range of 30–50%, taking a variety of conditions into consideration. In light of these considerations, the Company paid an annual dividend of 144 yen per share for the fiscal year under review, the same as the previous fiscal year. Internal reserves are allocated to investments for future growth, such as strengthening production and sales systems as well as research and development activities for the purpose of offering appealing products, while bolstering the financial position.

In July 2018, the Company announced its future capital policy in the new mid-term management vision "STEP," the details of which are explained on pages 13–14. For FYE March 2019, the Company plans to pay a dividend of 144 yen per share (interim and year-end dividends of 72 yen each), the same as for the fiscal year under review.

Business Performance in FYE March 2019

The Company forecasts the consolidated automobile sales volume in FYE March 2019 will continue to increase, mainly in the North America market, to 1,100,000 units. Consolidated net sales are forecasted to mark 3,250.0 billion yen, due to the negative effect of foreign exchange rate fluctuations and changes in accounting policies. In terms of income, despite the expected increase in automobile unit sales, the Company forecasts consolidated operating income of 300.0 billion yen, consolidated ordinary income of 305.0 billion yen, and net income attributable to owners of parent of 220.0 billion yen, due to the increase in selling expenses from higher interest rates in the U.S., and higher raw material costs. The exchange rate assumptions used for the full-year forecast of consolidated business performance are 105 yen/1 U.S. dollar (actual rate of 111 yen in FYE 2018) and 130 yen/1 euro (actual rate of 130 yen in FYE 2018).

Business Risks

Operational and other risks that could significantly influence the decisions of investors and impact the Company's financial status are set out below.

Based on information available to the Group as of the end of the consolidated fiscal year under review, the enumerated risks include forward-looking statements, but do not encompass every possible risk posed to the Group. As such, there are other risk factors which could influence investors and their decisions.

(1) Economic Trends

Economic trends in countries and regions that comprise important markets for the Group could potentially impact the Group's business performance. In Japan and North America, key markets for the Group, economic recession, decreasing demand or increasing price competition could undermine the sales and profitability of the Group's products and services.

(2) Currency Exchange Rate Fluctuations

The Group's ratio of overseas net sales stood at 80.4%. The Group's consolidated financial statements, which are presented in Japanese yen, are affected by translation of overseas net sales, operating income and assets from local currencies, particularly U.S. dollars, into yen. Accordingly, in the event that discrepancies arise between projected exchange rates in full-year forecasts and actual rates at the time of account settlement, the Group's business performance and financial position may be adversely affected when the yen appreciates or positively affected when the yen depreciates.

The Company uses forward exchange rate contracts and other circumstance-appropriate risk hedges to minimize the Group's sensitivity to such currency exchange risks. However, the effect of severe fluctuations in currency exchange rates at the end of the fiscal year could result in a loss on valuation of derivatives and have a major impact on non-operating expenses.

(3) Dependence on Certain Businesses

The Group is mainly comprised of the Automobiles and Aerospace business segments. However, the Automobiles business segment accounts for the overwhelming majority of the Group's business operations. Accordingly, in the event that automobile-related demand, market conditions, price competition with other automakers, or other factors exceed projected levels, the entire Group's overall business performance and financial position could be significantly affected.

(4) Changes in Market Appraisal

The Group develops, manufactures and releases new products based on appropriate timing and pricing in line with product planning that reflects market demand and customer needs. Such actions are the most important factors in maintaining stable increases in Group business performance. In the event that market appraisals of new model vehicles and other new products do not meet sales plan expectations or that the obsolescence rate of current products exceeds forecasts, the Group's business performance and financial position could be significantly affected.

(5) Dependence on Specific Suppliers, Raw Materials, and Components

The Group procures raw materials, components and other items from numerous suppliers. However, there are cases in which the Group relies on certain items and/or a limited number of suppliers. Due to tightening supply and demand or other factors, the inability to procure supplies in a manner that ensures stable costs, delivery dates and quality could seriously impact the Group's business performance and financial position.

(6) Protection of intellectual property

The Group is strongly committed to protecting its intellectual property in areas, such as technologies and expertise, that ensure product differentiation. However, in cases where a third party makes unauthorized use of the Group's intellectual property to manufacture similar products and in cases where a dispute relating to intellectual property arises and a decision disadvantageous to the Company is made, the Group's business results and financial condition may be significantly affected.

(7) Product Defects

The Group places the highest priority on the safety of the products it develops, manufactures and sells. However, completely avoiding defects and recalls, etc. regarding all products and services is impossible. The substantial cost, damage to our brand image, etc. associated with a major recall could significantly affect the Group's business performance and financial position.

(8) Retirement Benefits and Retirement Benefit Obligations

The Group's employee retirement benefit costs and obligations are calculated based on the following assumptions: retirement benefit obligation discount rates and the expected long-term rate of return on pension assets, both of which are established based on mathematical calculations. However, in the event that actual performance differs from the assumptions, the Group's business performance and financial position could be affected over the long term.

(9) Environmental and Other Legal Regulations

The Group is subject to various domestic and overseas legal regulations in relation to automobile fuel efficiency, exhaust emissions, energy conservation, noise, recycling, the level of pollutants emitted from manufacturing facilities, and the safety of automobiles and other products. The Group's business performance and financial position could be affected by cost increases due to future tightening of such regulations.

(10) Impact of Natural Disasters, War, Terror, Strikes and Other Events

The occurrence of natural disasters such as major earthquakes, typhoons, etc., and diseases, wars, terrorist attacks or other events, could impede the Group's business activities as well as delay or suspend raw material/component purchases, production, product sales/transport, and the provision of services. The Group's business performance and financial position could be affected in the event that such delays or suspensions are prolonged.

(11) International Business Activities

Though the Group focuses on the U.S., it does business in countries around the world. Business activities in overseas markets entail the following types of risk. If any of these risks materializes, the Group's business performance and financial position could be adversely affected.

- Unfavorable political or economic factors
- Difficulties arising from changes in laws or regulations
- Revisions to taxes, duties, or other taxation systems
- Difficulties in hiring and retaining personnel

(12) Impact of Information Security

The Group uses various kinds of information technology, networks, and systems in product development, production, sales, and other business activities. Although safety measures have been implemented with respect to information technology, networks, and systems, interruption of important work or services, data corruption or loss, leaks of confidential information, or other problems could occur due to cyberattacks, hacking, computer virus attacks, or the like. This could damage the brand image or adversely affect the Group's business performance and financial position.

(13) Compliance and Reputation

The Group considers rigorous compliance one of the most important management priorities and strives to avoid or minimize compliance risks through compliance with all laws, ordinances, and internal regulations required in corporate activities and the execution of fair and equitable corporate activities in conformity with social norms. Nevertheless, the occurrence of a material legal violation could have a significant impact on the Group and adversely affect the Group's business performance and financial position due to loss of customer confidence and trust, or damage to the Group's reputation in society.