

Investor Information  
20 March 2003

- Check against delivery -

## **Statement by Stefan Krause Member of the Board of Management of BMW AG, Finance BMW Group Financial Analysts' Meeting 20 March 2003**

Ladies and Gentlemen,

Following our usual practice, I would like to explain the 2002 Group Financial statements to you. I will then discuss some topical issues in more detail.

Allow me to start with the 2002 business year.

### **Successful business development in 2002.**

In 2002 the BMW Group continued to develop successfully. Against a background of a difficult economic climate, we have delivered more than 1 million cars to customers for the first time and achieved Group revenues exceeding euro 42 billion, thus once again setting new records.

With a profit from ordinary activities of euro 3.3 billion and a net profit exceeding euro 2 billion for the first time, the BMW Group achieved the best ever result in the history of the Company even in a phase of substantial investment in our product and market offensive.

The Group's cash flow reached a new record of euro 4.4 billion.

Firstly, a few comments on the earnings of the BMW Group.

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As Dr. Panke has just explained, the BMW Group is in the middle of the biggest ever product and market offensive in its history.

The expenditure incurred in preparation of this comprehensive growth and expansion strategy is substantial, and, as I will be explaining in greater detail, shapes the structure of the Group financial statements.

**Previous year's record levels surpassed.**

The fact that we have succeeded in this period in surpassing the previous year's record levels clearly demonstrates the strength of the BMW Group's core business.

**Revenues increased in all segments and regions.**

Concerning the key figures: BMW Group revenues increased in the year under report by 9.9 per cent to euro 42.3 billion. Revenues increased in all segments and regions.

The regional breakdown of these figures clearly reveals the international strength of the BMW Group: in Europe, revenues increased by 6.7 per cent, in America by 11.1 per cent, and in Africa, Asia and Oceania by no less than 24.1 per cent. Particularly in the Asian markets, we achieved an over proportional growth in revenues.

Despite the on-going product and market offensive and the structural costs involved, the gross margin improved

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by 0.1 percentage points to 25.4 per cent as the cost of sales rose under-proportionally.

Sales and administrative costs also showed an under-proportional development at 5.5 per cent, with a share in revenues of 11.6 per cent. In the prior year, due to expenditure on the market launch of the new BMW 7 Series and the MINI, they amounted to a share in revenues of 12.1 per cent.

**Research and Development costs with clear increase.**

Research and Development costs to be shown under IAS in the Income Statement amounted to euro 2.0 billion in 2002.

Let me explain this with the help of a chart.

The euro 2 billion are made up of R&D expenditures of euro 2.3 billion less additions to capitalised development costs according to IAS and plus amortisations on the cost of development already recognised as assets in the past. The capitalisation ratio was 36.8 per cent in the 2002 year of business. In the previous year, the ratio was 35.3 per cent.

Reflecting the large number of new products in development and testing, research and development costs increased significantly by 20.9 per cent.

The proportion of Research and Development costs to revenues, the R&D ratio, increased from 4.3 per cent to

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revenues, the R&D ratio, increased from 4.3 per cent to 4.8 per cent.

Net other operating expenses changed by euro 378 million from the prior year. The figure reported last year, however, included a one-off gain of euro 75 million from the sale of land not required for operational purposes. In addition, reflecting the growth of the leasing business, higher provisions were set up in 2002 for residual value risks in the financial services business.

**Profit before financial result up by 0.7%.**

The profit before financial result – our operating result – rose by 0.7 per cent compared to the previous year. After adjustment for the one-off gain from the sale of land not required for operational purposes, the profit before financial result even increased by 3.0 per cent. The EBIT margin measured as a function of revenues is 8.0 per cent.

The financial result improved by 28.9 per cent compared to the prior year due to a reduction in the negative impact of the fair values of derivative financial instruments.

Overall, the profit from ordinary activities increased by 1.7 per cent. And adjusted for the one-off gain in the previous year which I already mentioned, the profit from ordinary activities increased by 4.1 per cent.

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**Return on sales significantly above industry average.**

As a result of the premium positioning of the BMW Group and the quality of Group business, the return on sales in 2002 is significantly above the average figure in the automotive industry. The pre-tax return on sales on Group level was 7.8 per cent compared to an adjusted value of 8.2 per cent in the previous year.

Income taxes are down compared to the previous year by 7.2 per cent. The reduction is mainly attributable to a change in legislation in the USA ("Job Creation and Worker Assistance Act of 2002"). The effective tax rate is 38.7 per cent following 42.4 per cent in the previous year.

**Net profit up by 8.3%.**

As a result, the BMW Group achieved a net profit of euro 2,020 million, 8.3 per cent above the previous year's figure of euro 1,866 million. Thus, for the first time in history, the BMW Group shows overall Group earnings after tax of more than euro 2 billion.

Ladies and Gentlemen,

**Profit from ordinary activities in the Automobiles segment up by 6.1% on an adjusted basis.**

let me now move briefly on to the results of the individual business segments: In the Automobiles segment the profit from ordinary activities increased by 3.3 per cent against the previous year to the new record figure of euro 2.88 billion. Adjusted for the one-off gain in the previous year already mentioned, we achieved an increase by 6.1 per cent despite significant additional

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increase by 6.1 per cent despite significant additional expenditure.

**Motorcycles with tenth record result in a row.**

In a difficult market, the Motorcycles segment improved its profit from ordinary activities by 1.7 per cent to euro 60 million, that is the tenth record result in a row.

**Financial Services with significant profit increase.**

Reflecting the increase in business volume and the continuing reduction in the financing costs, the profit of the Financial Services segment increased by 8.2 per cent to euro 422 million.

The net result of Reconciliations – including companies, income and expenses not specifically attributable to the business segments, and consolidations between the business segments – is euro 69 million lower than the prior year. This is attributable to the higher level of eliminations of inter-group profits as a result of the higher level of leasing in 2002.

The development of gross margins also demonstrates that the BMW Group's core business remains strong and profitable.

**Gross margin above the long-term average.**

At 25.4 per cent in the year under report, the gross margin was above the BMW Group's historical average of 23.4 per cent – which, until the year 2000, was influenced by Rover. The gross margin was above

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average even though structural costs – that is especially the costs of preparing for the start of new products at our plants – increased once again due to the market launches of new products in 2002 and 2003, such as the Rolls-Royce, the BMW Z4, the new 5 Series, the X3 and the 6 Series.

**Cash flow covers capital expenditure in the industrial operations.**

Ladies and Gentlemen,  
Even in this period of our intense product and market offensive, the cash flow covers the capital expenditure of the industrial operations. The coverage ratio was 108 per cent.

**Investments up to euro 9.7 billion.**

Investing activities in our plants and products as well as in leased-out products in the Financial Services business amounted to euro 9.7 billion, up by euro 3.6 billion compared to the prior year.

In the year under report, capital expenditure on intangible assets and on property, plant and equipment totalled euro 4.0 billion (including development costs of euro 858 million recognised as assets according to IAS 38), that is 15 per cent more than in 2001. Our capital expenditure ratio thus increased to 9.6 per cent (previous year 9.1 per cent).

As a result of this significant capital expenditure – and after adjustment for the effects of exchange rate and changes in the composition of the group – cash and

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changes in the composition of the group – cash and cash equivalents decreased by euro 104 million to euro 2.3 billion.

For the first time this year, the cash flow statement has been expanded to show the cash flows of the industrial and financial operations, to provide you with a better understanding of the separate effects.

Looking at the difference of the cash inflow from operating activities and cash outflow from investing activities, it becomes clear that in the industrial operations, cash inflows outweigh cash outflows. However, due to the strong growth in the leasing business, the cash outflow from investing activities outweighs the cash inflows in the financial operations. Thus the cash inflow from financing activities served in 2002 to primarily cover the refinancing of our Financial Services business. This is in line with the corporate policy we have pursued over many years.

**Net financial assets within industrial operations increased to euro 1.7 billion.**

Compared with the prior year, net financial assets (cash and cash equivalents less financial liabilities) within industrial operations have increased by euro 164 million. This means that in the Automobiles segment alone, we have – after deduction of financial liabilities – euro 1.7 billion liquidity at our disposal.

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Let's look now at the structure of assets and liabilities. The balance sheet total rose by 8.3% to euro 55.5 billion. Without currency impact, the balance sheet total would have increased to over euro 58 billion.

In addition to the currency development, the fair value measurement of the derivatives had a significant impact on the balance sheet. This can be seen from the increase in current assets and the decrease in liabilities.

**Equity ratio increased from 21% to 25%.**

Equity has increased by 29 per cent to euro 13.9 billion due to the successful development of business and the fair value measurement of derivatives. The equity ratio amounts to 25 per cent compared to 21 per cent in the previous year. This is a value of substance.

Ladies and Gentlemen,  
I would like to discuss the changes in the accumulated other equity as this is where the fair value measurement, in particular of derivatives, is recognised. Let me explain this in more detail.

**Fluctuations of market values of hedging contracts shape accumulated other equity.**

The BMW Group uses derivative financial instruments for long-term hedging of the operating currency risk. Fluctuations in the market values of these derivatives, which may be quite significant depending on currency developments, are recognised directly in accumulated other equity in accordance with IAS.

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At the end of the year 2001 our hedged rates were worse than the corresponding spot rates. Accordingly, the negative market values were shown as other liabilities. This is the main reason why we had negative accumulated other equity of euro 1.245 billion at the end of 2001.

Due to the weakness in particular of the US Dollar in 2002, the fair value measurement of the derivatives at year-end resulted in significantly positive market values. As a result, other receivables were recorded in accordance with IAS 39 rather than other liabilities. The overall improvement amounted to euro 2.86 billion.

After setting off deferred taxes of euro 1.13 billion against this figure, the overall change in equity attributable to derivatives is euro 1.727 billion. Together with the other factors mentioned, accumulated other equity has increased over the previous year by euro 1.413 billion.

To conclude the review of 2002, let us consider the development of the key figures and ratios. As you can see from the tables, the BMW Group continues to report strong figures for earnings and liquidity as well as for the structure of assets and liabilities.

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I have already mentioned the pleasing development of the gross margin as well as the strength of the equity ratio. Other figures, for example the return on sales, have slightly declined compared to 2001. This is attributable, however, to specific expenditure for developing, testing and preparing for the production and marketing of our new models.

**Expenditure for the product and market offensive financed out of the on-going business.**

Substantial expenditure was incurred in preparation of the product and market offensive, reflected again by the increase in the capital expenditure ratio to 9.6 per cent as well as the increase in the R&D ratio to 4.8 per cent, and the growing level of structural costs. These expenditures were financed from the BMW Group's current business due to the strength of the core operations. The market introduction of the respective products will generate the earnings on this upfront expenditure.

Ladies and Gentlemen,

I now wish to comment on some current issues which clearly reveal the quality of the business year under report.

The product and market offensive Dr. Panke has described in detail shapes the earnings and liquidity of the BMW Group as well as the structure of the assets and liabilities.

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**Product and market  
offensive requires  
upfront expenditure.**

In the year 2000 the Board of Management decided to expand the BMW Group's brand portfolio by adding the new MINI and Rolls-Royce brands as well as enlarging the model range with the BMW 6 Series, the X3 and the 1 Series. This leads to

- research and development costs
- depreciation and structural costs and
- launch and marketing expenditure

which considerably exceed the expenditure required for the existing product portfolio.

Let me explain that with a chart.

Figuratively speaking, these costs move in waves, having an impact on the Income Statement at different points in time.

First of all, new models require research and development. Accordingly, the research and development costs have increased from euro 1.7 billion in 2000 to euro 1.9 billion in 2001 to euro 2.3 billion in 2002. These increased costs reflect the development of the additional models which the BMW Group has introduced since 2001 and will continue to introduce into the market in 2003/2004.

In a second step, as of the start of production, depreciation on capital expenditure for the restructuring

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and expansion of our production network starts. In order to actually achieve the increase in production from 880,000 units in 2000 to some 1.4 million units in 2008 planned as a result of the product and market offensive, we have increased capital expenditure from euro 2.1 billion in 2000 to euro 3.2 billion in 2002. In addition, approximately 12-15 months prior to the actual start of series production, additional items of expenditure referred to as structural costs are also incurred. These are costs for preparing the start of series production, the cost of IT and training. These items are recorded in the Income Statement within costs of sales.

Around the start of series production, there are then the launch and marketing costs. These are the costs of dealer training, marketing, as well as of preparing the sales and distribution network for the new products.

The BMW Group has succeeded in accommodating all this additional expenditure because of its continued high level of profitability in the core business. Indeed, the increase in Group earnings in 2002 is all the more remarkable considering the expenditure incurred.

**Decisions on new products based on net present value calculation.**

I also wish to mention once again in this context that the decision as to whether a specific model should be developed to series production level and launched on the market is based on the net present value of the cash flows involved in the project. Each model in our product

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range must prove that, taking all cost items and earnings into consideration throughout its entire product lifecycle, it generates a positive net present value and thus earns the demanding capital costs appropriate for a premium manufacturer.

This also applies to the MINI brand launched in 2001.

**MINI: profitable in the first lifecycle.**

Let me make it quite clear again at this point that on a per unit basis we earn money with every MINI sold. MINI is thus making a significant contribution to the coverage of the Group's overhead costs.

We are proud of this achievement, since experience in the automotive industry shows that it is not easy to achieve a positive contribution right from the start when introducing a new brand into the market.

Despite very substantial expenditure incurred in establishing the MINI brand, in particular in the years 2000 and 2001, it is our objective to make the MINI project achieve a positive net present value for the BMW Group in its first lifecycle.

We are already well on the road towards achieving this objective. The development of MINI sales figures, the large share of Cooper and Cooper S models, the premium price positioning, as well as the very high level

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of optional equipment for this segment are all making a significant contribution to the achievement of our goal.

Now let me make a few remarks on our financial services business:

**Financial Services  
with strong growth of  
new business.**

We continued to substantially grow our new business in 2002.

We have also further strengthened both our operational and accounting risk management.

The business is very profitable, the profit from ordinary activities increased in 2002 by 8.2 per cent to euro 422 million.

The business volume in the Financial Services Segment amounted to euro 26.5 billion in 2002, exceeding the prior year's figure by 4.7 per cent.

18.3 per cent more financing contracts were signed by customers and 11.0 per cent more dealer financing contracts were signed. In total, 36.1 per cent of all new vehicles sold by the BMW Group worldwide were financed by Financial Services, slightly more than in the prior year (35.0 per cent).

**Three-level risk  
management concept  
to manage  
accounting risks.**

The BMW Group uses a three-level risk management concept to manage accounting risks in the Financial Services Segment. Allow me to explain this concept by taking leasing as a core business area of Financial Services:

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The Financial Services Segment writes off leased vehicles on a straight-line basis over the contract period to their anticipated residual value.

In a second step, the Financial Services Segment records so-called market risk or residual value provisions. These cover the risk that the vehicle does not achieve the anticipated residual value in the market at the end of lease period. These provisions are adjusted to the current market situation on a quarterly basis. In the balance sheet, the provisions are deducted directly from the line "Leased Products" and are not shown on the liabilities side.

The third step is the elimination of so-called inter-group profits at a Group level, carried out in Reconciliations. The underlying principle is that a vehicle sold to a dealer and then sold on to the Financial Services Segment because the customer decided to lease, and not to buy, is treated as never having left the BMW Group. Profits made in the Automobiles Segment when selling the vehicle to the dealer are therefore reversed in Reconciliations as consolidations. These profits are then released again on a straight line basis in Reconciliations over the term of the lease. In the balance sheet the eliminations of inter-group profits is shown as a deduction from the item "Leased Products".

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In your handouts you will also find an example of the impact of inter-group profit eliminations.

The operative risk management procedure includes:

- BMW Group residual value forecast tools based on our better knowledge of the BMW Group's product portfolio
- The reduction of vehicle sales through auctions and the promotion of the remarketing activities through our dealer network
- The development of used car warranties and
- The provision of competitive financing programmes.

These operative measures have led to clear improvements in the development of used car prices. The residual values achieved by the BMW 3 and 5 Series in the market are in some cases far higher than those of our major competitors. The 61 per cent residual value achieved by the predecessor of the current 7 Series (there were no new 7 Series returned as lease cars in 2002) was still far higher than the estimates by some market research institutes.

Now let me refer briefly to the influence of currencies on the Income Statement as well as the Balance Sheet.

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**Consistent hedging  
strategy of BMW  
Group.**

The BMW Group has, for some years, pursued a consistent strategy in hedging against currency risks: We start out by minimising our currency exposure through "natural hedging". This means that we have established plants in the markets in which we sell our products, with the motto of "production follows market". This year, for example, we will be building approximately 150,000 vehicles at our plant in Spartanburg. And we are also pursuing the same policy with the MINI, which is built in most significant market.

The export of cars from these overseas plants creates a balancing flow of goods and money to the exports out of Germany. This effectively leads to a netting of foreign currency inflows and outflows.

The remaining currency exposure is minimised by currency hedges: In periods of significant over-valuation of the most important foreign currencies, the BMW Group enters into a series of successively long-term currency hedges to minimise or even to eliminate the risk of negative effects on business results.

The impact of currency developments due to the comprehensive hedging measures is only visible in the Balance Sheet through the market valuation of hedging transactions.

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The changes in equity that I explained earlier clearly show that our hedging approach is currently correct and appropriate.

Since the BMW Group believes that the equilibrium rate versus the US Dollar is far above parity, we have entered into very substantial currency hedging transactions in recent years when the US Dollar was strong. We therefore expect virtually no earnings impact from currency fluctuations in 2003, since the exposure of the BMW Group has been almost completely covered for 2003. We have already entered into significant currency hedging transactions for 2004 and 2005, which will significantly reduce the volatility of results.

Given the long-term focus of our hedging policy, the average hedge rate in 2002 was still slightly weaker than the spot rate. In 2003 and 2004 we will have a transaction rate better than the current spot rate.

Ladies and Gentlemen,

**BMW Group not exposed to any major risks as to pension commitments.**

Corporate pension commitments have recently attracted increasing interest with some companies, above all in the USA, being required to make – in some cases quite significant – contributions into their fund-based pension system due to the developments on the capital markets.

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The BMW Group's pension commitments relate mainly to Germany and Great Britain.

In Germany we are maintaining our existing system of covering pension obligations by appropriate pension provisions. We have established adequate provisions to cover the anticipated pension claims and entitlements of our employees. The 5.8 per cent discount rate used to discount these claims is on a conservative, low level.

By tradition, corporate post-employment benefit plans are more significant in Great Britain due to the low level of support and assistance provided by the state. These plans are based on pension funds. Our obligations relate primarily to claims and entitlements of former Rover Group employees. In conjunction with the Rover disengagement, pension obligations and fund assets relating to employees transferred to MG Rover and Land Rover were transferred to these companies in 2002.

Considering the lower risk position, we converted the large majority of fund assets in the year 2000 from stocks into fixed-interest securities.

This is why the downturn in the stock market in the last two years did not affect the BMW Group as much as other companies. The pension fund shortfall as of 31 December 2002 in the UK was euro 617 million.

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However, the actuarial losses outside the IAS 19 corridor of 10% of the defined benefit obligations amount to only euro 84 million.

The BMW Group's total actuarial losses in excess of the 10 per cent corridor amounted euro 119 million. In 2003 these losses will lead to additional expenditure of euro 9 million. Of this, expenditure of euro 6 million will be recorded in Great Britain.

To conclude, the BMW Group has also followed a policy of risk minimisation with the pension commitments and is not exposed to any major risks.

Ladies and Gentlemen,

**Further extending the leading position in the premium segments of the Automobile industry.**

The BMW Group is on its way to a new dimension. In 2002, we have made substantial expenditure on our product and market offensive, and we will continue to do so in the current year. These investments are laying the foundation for the future success of the BMW Group. This will enable us to further extend the leading position of the BMW Group in the premium segments of the Automobile industry.

Ladies and Gentlemen, thank you very much for your attention.