Management's Discussion and Analysis of Results of Operations and Financial Position

OVERVIEW

In May 2002, the FHI Group announced its new medium-term plan, Fuji Dynamic Revolution-1 (FDR-1), covering the five-year period from fiscal 2003 (ended March 31, 2003) to fiscal 2007, and subsequent business activities have been carried out in accordance with this plan. FDR-1 states the medium-term vision of being a "global player with premium brands," reflecting the aim of establishing its position as a company with brands that are recognized by customers around the world as reliable and offering exceptional value. To accomplish this, the FHI Group has pursued a wide range of activities, including production, sales, R&D, and after-sales service, with a particular focus on the automobile business.

In fiscal 2003, the first year of the new five-year plan, the FHI Group introduced an internal company system, with the automobile business as its core, as part of the structural reform of its management mechanisms. Simultaneously, the FHI Group took steady strides toward improving management efficiency, beginning with the restructuring of unprofitable operations. On the other hand, the macro-economic environment, particularly the domestic economy, remained harsh with little prospect for a recovery in business conditions. Under these circumstances, the automobile division registered lower domestic sales in anticipation of the upcoming full model changed sales of the flagship Legacy, while minicar sales also declined. Overseas, however, the North American subsidiary made substantial sales contributions, and every other major region turned in healthy revenues. Consequently, consolidated net sales rose ¥9.8 billion, or 0.7%, to ¥1,372. 3 billion. Overseas sales accounted for 56.3% of consolidated net sales, up from 53.7% in the previous fiscal year.

Operating income fell ¥20.9 billion, or 23.7%, to ¥67.5 billion. The decline was primarily attributable to deterioration in the sales mix for automobiles, costs associated with development investments, and higher SG&A, which more than offset the benefits of gain on currency exchange and reduction in costs. Net income, however, climbed ¥3.2 billion, or 10.6%, to ¥33.4 billion. This rise was attributable mainly to lower valuation losses on investment securities, the disappearance of a loss on liquidation of affiliated companies incurred in the previous fiscal year, and a significantly lower tax burden as a result of a reversal of the prior year's accrued income taxes. The breakdown in sales by business segment was as follows: automobile 89.4% (versus 89.3% in the previous fiscal year), industrial products 3.0% (2.9%), aerospace 4.6% (4.8%), and other 3.0% (3.0%). This breakdown was largely unchanged from the previous fiscal year. The breakdown in operating income by segment was as follows: automobile 100.9% (96.7%), industrial products -1.3% (-0.3%), aerospace 5.0% (8.4%), and other -4.7% (-4.8%). Lower earnings in the industrial products and aerospace segments caused the reliance on earnings in the automobile segment to rise slightly.

The FHI Group increased its share in the U.S. joint venture with Isuzu Motors Limited, Subaru Isuzu Automotive, Inc., from 51% to 100% on January 1, 2003, making it a wholly owned subsidiary, and SIA was assigned to produce certain Isuzu cars on an OEM basis. Due to the use of a class stock system at SIA, FHI had previously consolidated only the Subaru Division of SIA and the Isuzu Division was excluded from the consolidated financial statements. However, as a result of the acquisition of Isuzu's share of SIA, FHI consolidated SIA as a whole, including the Consignment Division (formerly the Isuzu Division).

REVIEW OF OPERATIONS BY DIVISION

Net Sales

Consolidated net sales in fiscal 2003 rose 0.7%, to ¥1,372.3 billion, setting a record for the second straight year. Information for each segment is presented below.

Automobile division

Domestic passenger car sales (unit basis) declined 5 thousand units, or 4.6%, to 103 thousand units. Although the full model changed Forester, which was launched in February 2002, and the Impreza, which underwent a big change in November 2002, were enthusiastically received by the market, our flagship Legacy model faced severe market competition and reluctance by consumers to buy it in anticipation of the upcoming new Legacy models.

In minicars, sales declined 14 thousand units or 8.8 %, to 143 thousand units. Although the Samber struggled during the first half term, in the second half, its sales volume grew 9.6%, compared with the same half of the previous year, prompted by a big change in September 2002. Meanwhile, the effect of new passenger minicar models introduced by competing manufacturers was greater than expected, and sales of the Pleo dipped significantly.

Net Sales