Taking advantage of the opportunities of the future

» Annual Report 2008

DEUTZ

DEUTZ Group: Key figures

€ million	Continuing operations 2007	Continuing operations 2008	Change in %
New orders	1,584.5	1,363.5	–13.9
Unit sales (units)	285,861	252,359	–11.7
Compact Engines	248,971	219,681	–11.8
DEUTZ Customised Solutions	36,890	32,678	–11.4
Revenue	1,524.2	1,495.0	–1.9
Compact Engines	1,186.0	1,143.2	–3.6
DEUTZ Customised Solutions	338.2	351.8	4.0
Thereof excluding Germany (%)	78.0	75.6	–
EBITDA	161.0	91.9	–42.9
EBITDA (before one-off items)	161.0	106.2	–34.0
EBIT	95.5	17.5	–81.7
EBIT (before one-off items)	95.5	31.8	–66.7
EBIT margin (%)	6.3	1.2	–
EBIT margin (before one-off items, %)	6.3	2.1	–
Net income/loss	59.4	–4.2	–
Basic earnings per share (€)	0.51	–0.04	–
Total assets	1,378.6	1,206.3	–12.5
Non-current assets	511.3	539.7	5.6
Equity	557.1	511.3	–8.2
Equity ratio (%)	40.4	42.4	–
Cash flow from operating activities before payment of compensation for vested company pension rights	41.1	90.1	–
Cash flow from operating activities	–38.7	89.7	–
Free cash flow	–111.5	–23.3	79.1
Net financial position [1]	89.7	–12.2	–
Working capital [2]	196.9	205.0	4.1
Working capital as percentage of revenue (31 Dec.)	12.9	13.7	–
Capital expenditure (excluding capitalisation of R&D)	143.5	69.9	–51.3
Depreciation and amortisation	65.5	74.4	13.6
Research and development	55.8	90.3	61.8
Employees (31 Dec.)	4,617	4,701	1.8

1) Net financial position: cash and cash equivalents less current and non-current interest-bearing financial liabilities
2) Working capital: inventories plus trade receivables minus trade payables

Highlights 2008

» February 2008

On 1 February 2008, Dr.-Ing. Helmut Leube took office as the new Chairman of the Management Board of DEUTZ AG. Before joining DEUTZ, the 55-year-old was Chief Operating Officer for Webasto AG and held a variety of management positions for BMW AG. The new Chairman of the Management Board announced that investments in research and development would be continued and activities in exhaust gas after-treatment technology would be increased.

» July 2008

In July 2008, DEUTZ started production of Xchange engines at the new Pendergrass location in Georgia, USA. The plant in Pendergrass is organisationally subordinate to Deutz Corporation in Atlanta, Georgia, USA and employs around 40 people.

» September 2008

The DEUTZ choir set off on an extended concert tour to China. For more than three weeks, 100 singers and three soloists toured the Middle Kingdom, and in addition to Changsha and Beijing, they also visited the seaport of Dalian in northeastern China where Deutz AG has maintained the joint venture DEUTZ (Dalian) Engine Co., Ltd. since 2007.

» Trade Shows 2008

DEUTZ was represented at key trade shows with its extensive product range.

Construction equipment shows included

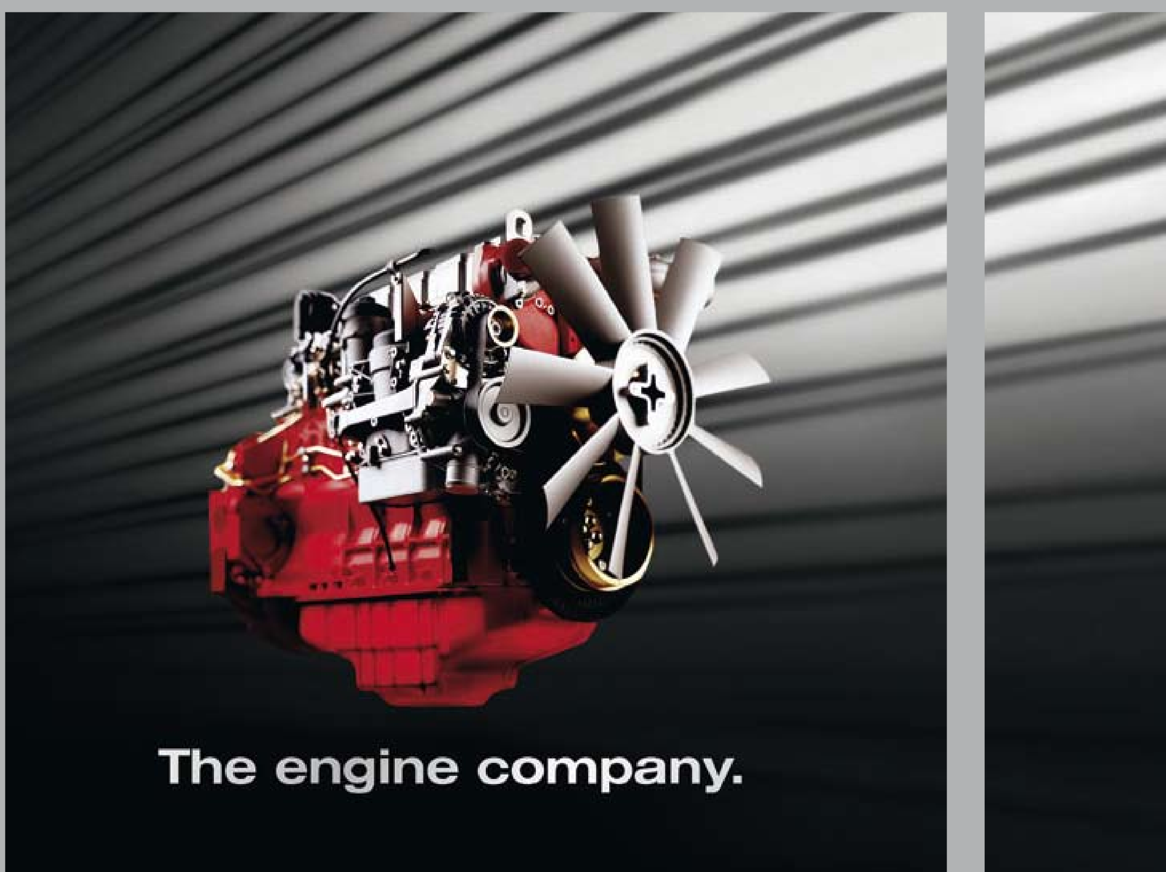
- CONEXPO (Las Vegas): 11 – 15 March 2008
- CTT (Moscow): 17 – 21 June 2008
- BAUMA China (Shanghai): 25 – 28 November 2008

Automotive shows

- COMTRANS (Moscow): 22 – 26 April 2008

Worldwide presence

Taking advantage of the opportunities of the future



» To recognise trends around the globe and take advantage of the opportunities of the future – this is the overarching goal of DEUTZ AG. «

Different megatrends influence the long-term development of our world. In this annual report, we will show you the opportunities that will arise for DEUTZ from the rising demand for food, increasing urbanisation, growing global trade and stronger environmental awareness in society – all based on different applications for our engines.

» We will continue to reinforce our technological base and our innovativeness even in times of crisis, because these are areas on which the future of DEUTZ depends. «

Management Board Members: **Dr.-Ing. Helmut Leube**
Chairman,
Market and Product Lines

Foreword

DEAR SHAREHOLDERS,
PARTNERS AND FRIENDS OF OUR COMPANY,

In 2008, we came through a year of extremes. The performance of our business could not have seen a greater contrast: up to the middle of 2008, everything pointed initially to another record year, the main performance indicators were on target and production was running at virtually full capacity. Although a slight downturn in new orders could be seen at the mid-point in the year, the underlying sentiment both here in our Company and in our customer companies remained one of optimism – no one expected a financial and economic crisis of the force and speed that we had to endure just a few weeks and months later.

As the crisis in the financial markets hit the real economy, there was a rapid deterioration in market environments during the second half of the year. This applied not only to DEUTZ's important customer industries, such as construction equipment and commercial vehicles, but also to many other sectors of the economy. Our customers were severely shaken by the sudden economic slump. The effects of their caution extended beyond an abrupt drop in new orders: it also made it difficult to plan future development and determine reliable forecasts; we had to adjust our forecasts twice during the course of the year. With all the market players initially hoping that calm would soon be restored after the economic turmoil, the downturn instead took yet another turn for the worse, the crisis in the financial markets reaching an interim climax with the collapse of major US investment banks and a number of German banks finding themselves in an alarmingly precarious financial position, and the overall situation ultimately turning into perhaps the worst global economic crisis for decades. As things stand at the moment, no one can predict with any certainty how long this recession will last or how deep it will turn out to be.

Gino Mario Biondi
Development, Procurement,
Logistics and Production

Helmut Meyer
Finance,
Human Resources and Service

Karl Huebser
Overall responsibility
for Asia

The deterioration in the overall economic climate, particularly in the second half of 2008, clearly left its mark on our main performance indicators: unit sales of engines in 2008 amounted to 252,000 engines compared with 286,000 in 2007, revenue at €1,495 million remained around 2 per cent down on 2007 and operating profit before one-off items fell from €95.5 million in 2007 to €31.8 million. Accordingly, the EBIT margin for 2008 was 2.1 per cent – significantly below the margin achieved in our record year in 2007 and falling short of our forecasts.

As early as the middle of 2008 we implemented initial action plans to counter the downturn in demand: from the summer onwards, the number of shifts operating in our plants was reduced and production adjusted in line with the change in demand. As a further acceleration in the deterioration of the economic environment took hold and it became clear that this corrective action was no longer having an adequate impact, towards the end of the year we put together a comprehensive package of measures for 2009 entitled "MOVE". This included a range of unavoidable radical measures affecting jobs. We chose not to extend the contracts of temporary employees and those on fixed-term contracts and have introduce short-time working from December 2008.

We must exploit the current tough economic climate to achieve even more improvements: we intend to make further reductions in costs, increase our efficiency, enhance productivity – so that we can lead DEUTZ out of the crisis to a position of greater strength with long-term improvements in profitability. We have scaled back some of our capital expenditure, in particular our investment in increased capacity, to reflect the changes in the current situation. Nevertheless, we remain firmly focussed on our long-term strategy of growth and internationalisation. We will continue to reinforce our technological base and our innovativeness even in times of crisis, because these are areas on which the future of DEUTZ depends.

One of our advantages in this tense situation is that the foundations of the Company are financially sound. DEUTZ enjoys a high equity ratio of around 42 per cent, its financing is hot secured over the long term with the US private placement and as at 31 December 2008 we were again able to report a significant balance of cash and cash equivalents of approximately € 208 million. On top of this, DEUTZ is very well-positioned with its engines business and is able to face up to the crisis with a degree of optimism. The DEUTZ name, a byword for outstanding technology and reliable quality, our close long-term customer relationships, our highly qualified and dedicated employees as well as our technological expertise and culture of innovation – these are all factors that have served DEUTZ well in the past and from which the Company will continue to benefit in the future.

The issue of the future is also addressed on the features pages of the annual report. In the section headed “Taking advantage of the opportunities of the future” we demonstrate why demand for our diesel engines will remain strong for some time in the future. Regardless of short-term economic fluctuations, we believe there are four global “megatrends” that will ensure growth in demand for fuel-efficient, high-performance, low-emission diesel engines. The efficiency improvements in agriculture necessary to ensure the supply of food for a contin-ually growing global population can only be achieved with appropriate machinery. Increas-ing population numbers are also one of the primary drivers behind the urbanisation mega-trend: more and more people are living in towns and cities, need living space, infrastructure and means of transport. A key function in globalisation and the associated growth in the flow of goods and transport is logistics: without trucks, railways and ships, this development would be inconceivable. And because everyone is consuming more, but resources are finite, the issue of the environment continues to loom ever larger.

DEUTZ will benefit from these megatrends in the future: with a broad product portfolio of diesel engines covering many different industries – from tractors and trucks to construction equipment, from train drive systems and gensets to mining drilling equipment – and a service network spanning the globe, DEUTZ is very well positioned. Not least, the require-ment for increasingly lower fuel consumption and emissions can only be satisfied by innovative engines and emissions technology combined into an integrated system, or by alternative drive designs, such as the hybrid. The achievement of all this requires considerable technological expertise in many different specialist areas, an in-depth knowledge of a wide variety of customer requirements and engines “in the soul”. As one of the world's leading independent engine manufacturers with a broad range of skills and expertise and a highly-regarded global brand, DEUTZ has extremely good long-term prospects.

Dear readers, the last few weeks and months have demonstrated that all market players are confronted by a very considerable challenge as a result of the current economic conditions and significant efforts will be required to overcome this extraordinary situation. Given that the extreme uncertainty in the markets is continuing, it is currently impossible to make a quantifiable and, above all, reliable forecast for 2009. What is certain is that we must adjust to the fact that the economic situation will cause a significant fall in unit sales and revenue with a corresponding impact on profitability. However, please be reassured: The Management Board's top priority is to lead your Company, DEUTZ, through these difficult times and to bring it back onto the path of profitable growth achieved over the last few years. There is no doubt that this will not be an easy task; above all, it will need a resolute, prudent and responsible approach. We are fully conscious of this and are certain that the long-term growth prospects for DEUTZ remain intact.

We would like to thank you, our shareholders, for your loyalty and for your constructive support for our Company – even in these difficult times.

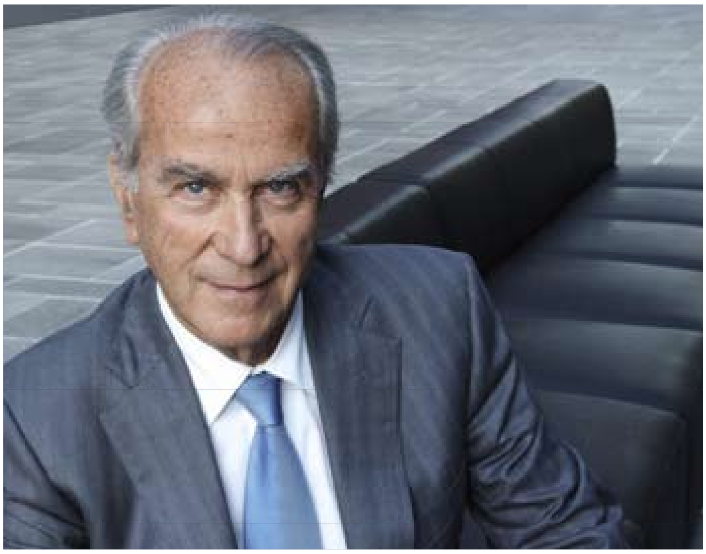
Yours sincerely

Dr.-Ing. Helmut Leube

Karl Huebser

Gino Mario Biondi

Helmut Meyer

Dr Giuseppe Vita
Chairman

Report of the Supervisory Board

Close cooperation between Management Board and Supervisory Board

In 2008 the Supervisory Board once again constantly monitored the governance of the Company and fulfilled its function as adviser to the Management Board on major decisions. In addition to strategic issues, the key areas of focus in the year under review were current business performance – especially taking into account the prevailing economic environment – and the reorganisation of Management Board responsibilities.

The Management Board ensured that it provided the Supervisory Board with comprehensive, regular and timely information at all times. The Management Board informed the Supervisory Board, both orally and in writing, about business performance, the risk position and risk management, all relevant aspects of strategic planning and any transactions requiring the consent of the Supervisory Board. Outside of the meetings, the Management Board regularly informed the members of the Supervisory Board in writing about important events. Furthermore, the chairman of the Management Board remained in constant contact with the Supervisory Board chairman and kept him comprehensively informed in a timely manner about all major transactions and decisions that needed to be made. The Supervisory Board adopted all resolutions required by law and the Company's Statutes based on the reports and draft resolutions submitted by the Management Board.

Six Supervisory Board meetings

Five scheduled meetings of the Supervisory Board took place in 2008. An additional constituent meeting of the Supervisory Board was held following the election of the shareholder representatives to the Supervisory Board by the Annual General Meeting on 21 May 2008. No member of the Supervisory Board was absent for more than half of the meetings.

The economic environment as a subject of deliberations

The key areas of the detailed discussions and deliberations between the Management Board and Supervisory Board were the strategic further development of the Compact Engines segment, the current status of the DEUTZ Dalian Engine Co., Ltd. (DDE) joint venture in

China and the strategic options in the field of exhaust-gas aftertreatment. In addition to consideration of current business performance taking into account risk reporting, detailed discussions were also held on the slowdown in the German economy caused by the global financial crisis, the impact on the DEUTZ Group and action that needed to be taken.

The Supervisory Board also focussed its attention on strategic planning, capital expenditure, a new HR development concept, the decision to call in the convertible bond issued in 2004, the settlement with the acquirer of DEUTZ Power Systems and the structure of Management Board remuneration.

Reorganisation of Management Board responsibilities

At its meeting held on 20 May 2008, the Supervisory Board held detailed discussions on the reorganisation of Management Board responsibilities. This reorganisation included the creation of product lines and the introduction of a matrix organisation as part of a plan to streamline the organisation of the DEUTZ Group as a whole. As a result, there were changes to the allocation of Management Board responsibilities, as follows: The chairman of the Management Board, Dr.-Ing. Helmut Leube, added responsibility for the product lines to his existing remit of sales, corporate strategy, quality management, internal audit, marketing and communications. Karl Huebser, who had been the Management Board member responsible for production and technology since 2001, transferred these responsibilities to Gino Mario Biondi and is now responsible for all of DEUTZ's operations in China. Gino Mario Biondi has taken charge of production and technology in addition to his existing remit of procurement and logistics. Helmut Meyer retained responsibility for finance and human resources. Responsibility for investor relations and service was also added to his remit. The reorganisation came into effect on 1 July 2008.

Corporate governance: Declaration of compliance with few exceptions

At its meeting on 17 December 2008 the Supervisory Board held an in-depth discussion of the German Corporate Governance Code as amended 6 June 2008 and, together with the Management Board, issued a declaration of compliance pursuant to section 161 of the German Stock Corporation Act (AktG). Since December 2008 the declaration of compliance for the year under review has been available in the 'Investors/Corporate Governance' section of the Company's website at www.deutz.com, where it can be downloaded. In 2008, the members of the Supervisory Board also discussed the efficiency of their own activities. Overall, their assessment was positive.

Efficient committee work

The Supervisory Board has set up four committees to enable it to perform its duties effectively; these committees use their expertise to prepare the various topics and resolutions for the full Supervisory Board. The composition of the Supervisory Board and its committees, as well as the further mandates held by its members, are shown separately on pages 151 to 152.

The Human Resources Committee advises on the content, conclusion and amendment of service contracts signed with the Management Board members appointed by the Supervisory Board and submits appropriate proposals to the full Supervisory Board. Its remit also covers all remuneration-related issues specified in service contracts. In addition, it includes all questions arising from the relationship between Management Board members and the Company. Furthermore, the Human Resources Committee prepares the appointment of members of the Management Board. The committee met six times in the year under review, the meetings focusing primarily on the reorganisation of Management Board responsibilities, Management Board remuneration issues and the introduction of a further long-term incentive plan (LTI No. II) during the year under review.

The work of the Audit Committee in the year under review focussed on the single-entity and consolidated financial statements for 2007 and the corresponding auditors' reports, the condensed consolidated financial statements for the six months to 30 June 2008 and their review by the auditors, the interim reports for the periods ended 31 March and 30 September 2008, the discussion of the audit engagement for the year ended 31 December 2008, and risk management. The Audit Committee met on four occasions in 2007. The auditors attended three meetings of this committee.

The Arbitration Committee set up pursuant to section 27 (3) of the German Codetermination Act (MitbestG) is responsible for the activities described in section 31 (3) of the Act. It did not need to be convened during the year under review.

The Nominations Committee consists of three Supervisory Board members elected by the Annual General Meeting and is tasked with proposing to the Supervisory Board suitable candidates for the positions of shareholder representative on the Supervisory Board so that the Supervisory Board can then propose to the Annual General Meeting that these candidates be elected. The Nominations Committee met on one occasion in 2008. At this meeting at the beginning of March 2008, the Committee selected six candidates and submitted their names to the full Supervisory Board so that it could recommend their election by the 2008 Annual General Meeting.

The entire Supervisory Board was informed of the outcome of all discussions in the committees.

Single-entity and consolidated financial statements audited in detail

The single-entity annual financial statements of DEUTZ AG prepared by the Management Board in accordance with the German Commercial Code (HGB), the consolidated annual financial statements prepared in accordance with International Financial Reporting Standards (IFRS) and the respective management reports (in each case for the year ended 31 December 2008) were audited by Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft, Düsseldorf, Germany, the auditors appointed by the Annual General Meeting on 21 May 2008. The auditors issued unqualified opinions. They also audited the report on relationships with subsidiaries (dependency report) prepared by the Management Board pursuant to section 312 of the German Stock Corporation Act (AktG).

The single-entity annual financial statements of DEUTZ AG, the consolidated annual financial statements, the respective management reports, the dependency report, the proposed appropriation of profits, and the auditors' reports were made available to all Supervisory Board members and were examined by the Supervisory Board. The auditors explained their audit findings in detail to the Audit Committee meeting held on 2 March 2009 and to the Supervisory Board meeting held on 12 March 2009 and answered any supplementary questions raised.

The Supervisory Board noted with approval the findings of the auditors' reports on DEUTZ AG and the DEUTZ Group. The conclusive findings of the Supervisory Board's own audit have not led to any reservations about either the single-entity annual financial statements or the consolidated annual financial statements, and the Supervisory Board has therefore approved them. The annual financial statements have thus been adopted. The Supervisory Board agreed with the proposal of the Management Board that the distributable profit be carried forward and retained in full in the next financial year.

No reservations about the dependency report

The auditors endorsed the dependency report submitted by the Management Board pursuant to section 312 of the German Stock Corporation Act (AktG) for the 2008 financial year and issued the following opinion:

“Having conducted our audit and assessment in accordance with the terms of our engagement, we hereby confirm that

1. the actual disclosures in the report are accurate
2. in the legal transactions mentioned in the report, payments made by the Company were not unreasonably high,

3. in the activities listed in the report, there is no reason that would give rise to a materially different assessment from that of the Management Board."

Having conducted its own audit of the dependency report, the Supervisory Board has no reservations. Furthermore, it agrees with the findings of the audit of the dependency report conducted by the auditors. The conclusive findings of the Supervisory Board's audit have not led to any reservations about the statements made by the Management Board at the end of the dependency report.

New elections to the Supervisory Board

New elections for the shareholder representatives on the Supervisory Board were held at the Annual General Meeting on 21 May 2008. Ing Massimo Bordi, Michael Haupt, Dr Helmut Lerchner and Dr Giuseppe Vita, all existing members of the Supervisory Board, were re-elected. Dr Francesco Carozza and Lars-Göran Moberg were elected as new Supervisory Board members, Professor Klaus-Otto Fruhner and Professor Marco Vitale having resigned. The Supervisory Board would like to thank Professor Fruhner and Professor Vitale for their commendable work.

The employee representatives on the Supervisory Board had already been elected by the DEUTZ AG workforce on 9 April 2008. Werner Scherer, Helmut Müller, Karl-Heinz Müller, Dr Witich Rossmann and Egbert Zieher were re-elected. Reinhold Götz was replaced by on the Supervisory Board by Susanne Scholtyssek. The Supervisory Board would like to express its gratitude to Reinhold Götz for his valuable contribution.

At its constituent meeting, the Supervisory Board elected Dr Giuseppe Vita as its chairman and Werner Scherer as deputy chairman.

The members of the Human Resources Committee, Audit Committee and Nominations Committee remained unchanged. On the Arbitration Committee, Karl-Heinz Müller was replaced by Egbert Zieher.

Conflicts of interest and consultancy agreements

The Supervisory Board members Ing Massimo Bordi and Dr Francesco Carozza are subject to a conflict of interest because of their functions in companies in the SAME DEUTZ-FAHR Group, which are also major customers of DEUTZ AG. The chairman of the Supervisory Board reviews each individual case to establish whether this conflict of interest restricts the opportunity for the involvement of Ing Massimo Bordi and/or Dr Francesco Carozza in the work of the Supervisory Board.

There is an agreement between DEUTZ AG and Lars-Göran Moberg, a member of the Supervisory Board, on the basis of which Lars-Göran Moberg advises DEUTZ AG on customer-specific issues. The Supervisory Board consented to this agreement. There is a disclosure on page 147 of the Notes to the consolidated financial statements regarding payments to Lars-Göran Moberg under this agreement.

The Supervisory Board would like to express its thanks and appreciation to all employees in Germany and abroad, to the elected employee representatives and to the Management Board for their valuable efforts and the considerable dedication they have shown in 2008.

Cologne, March 2009

The Supervisory Board

Dr Giuseppe Vita
Chairman

World population

Growth Consumption Food supplies

The world population is growing –

the challenge is to provide it with sufficient food.

3 billion*
1960

6.7 billion*
2009

9.2 billion*
2050

* World population growth (number of people)

»Constant world population growth, changes in eating habits and the conversion of land from agricultural to industrial use will demand that agriculture becomes hugely more efficient in future. Today, each farmer feeds some 140 people – in future, it will be many more. High-performance machinery is one of the keys to increased productivity. As a long-standing partner of agricultural machinery manufacturers, **DEUTZ** supplies a broad range of powerful yet economical engines of between 10 and 500kW – both for high-performance large tractors and harvesters and for fuel-efficient small tractors in the developing world.«

Strategy

OUR STRATEGY: FOCUS ON CORE COMPETENCIES, INCREASE CUSTOMER VALUE AND A SUSTAINABLE APPROACH TO CORPORATE MANAGEMENT OVER THE LONG TERM. CURRENT KEY ISSUES INCLUDE THE DEVELOPMENT OF INTEGRATED ENGINE AND EXHAUST-GAS CONCEPTS TO REDUCE CONSUMPTION AND EMISSIONS, THE EXPANSION OF SERVICE ACTIVITIES AND THE SEIZING OF MARKET OPPORTUNITIES IN GROWTH REGIONS. ORGANIZATIONAL STRUCTURES WITH CLEARLY DEFINED RESPONSIBILITIES INCREASE THE EFFICIENCY AND SPEED AT WHICH WE CAN ACHIEVE OUR DEMANDING OBJECTIVES.

Since the sale of DEUTZ Power Systems in 2007, DEUTZ has been focussing on its core competencies: the development, design, production, sales and service of compact diesel engines. As a non-captive engine manufacturer with comprehensive technological expertise, DEUTZ is benefiting primarily from the enhanced demands being placed on the refinement of engines as a result of increasingly stringent emissions legislation. In future, drive designs, engine and exhaust-gas technologies will be brought together in integrated overall systems that are significantly more complex than at present. The increasing overall value of these new engine designs translates into additional growth potential for DEUTZ.

Strategic objectives in DEUTZ include the consolidation of our market position as one of the world‘s top three suppliers of four-litre to eight-litre engines and the successful implementation of the product offensive for compact engines with a capacity of up to four litres. At the same time, we intend to further reinforce our leading international position in the market for air-cooled engines and expand on our position in the market segment covering engines with a capacity of more than eight litres. As far as medium-term and long-term strategic considerations in new engines business are concerned, we are focussing on the implementation of the next stage in emissions legislation with the successful launch of TIER 4 engines from 2011.

DEUTZ‘s objective in the service business is to increase revenue on an ongoing basis and accelerate profitable growth in this business. We also intend to continue driving forward with the internationalisation of the DEUTZ Group; our efforts in this regard are focussed on our activities in China. A new development in 2008 was the opening of a production facility for reconditioned exchange engines (“Xchange”) in the USA.

Given the changes in economic conditions and in expectation of a difficult trading environment over the coming year, we have initiated an action programme known as “MOVE” to secure profitability and the future of the business over the long term. In the current year, we are focussing primarily on an immediate reduction in costs. “MOVE” also includes structural measures to bring about a sustained improvement in profitability by means of more efficient processes.

Focus on successful launch of TIER 4 engines

Looking ahead to the forthcoming exhaust-gas emission stages due from 2011 onward, our primary focus over the next two years will be on the successful refinement of our engines to ensure that they meet the TIER 4 emission standards. The management of exhaust gases increasingly needs to be approached as part of the development of the actual engine itself: the required further reductions in nitrogen oxides and diesel particulates can no longer be achieved solely by optimising the combustion process within the engine. Exhaust-gas recirculation systems and – at the latest with the introduction of TIER 4 final from 2014 – exhaust-gas aftertreatment systems are required because, in future, engine manufacturers will be under a legal obligation to comply with the relevant emission standards. The focus of our research and development activities is therefore shifting to engine designs that include high-performance modules for the management of exhaust gases in addition to the internal combustion engine itself. Under the slogan "As much technology as necessary but not as much as possible", DEUTZ offers its customers exhaust-gas components and systems on a modular basis to provide the best possible solution for the widest variety of end applications. We are therefore continuing to systematically develop the successful DVERT concept (DEUTZ variable emissions reduction technology).

Consolidating our top three position for four-litre to eight-litre engines

Our strategic partnerships are an essential cornerstone of our efforts to build on our position as one of the leading engine manufacturers in the world. Overall, our partnerships with SAME DEUTZ-FAHR, Volvo and other major equipment manufacturers have been critical in enabling us to successfully achieve growth in the last few years in the Compact Engines segment and, in particular, in the four-litre to eight-litre engines business. As we see it, close, long-term partnerships with major equipment and vehicle manufacturers are a key to further sustained growth and one of the foundations for our innovative strength.

During 2008, we were able to continue to increase deliveries to the agricultural machinery manufacturer, SAME DEUTZ-FAHR. We can now look back on almost 15 years of successful, trusting cooperation with this long-established Italian company in the agricultural machinery sector. DEUTZ will continue to strengthen its customer relationship with the SAME DEUTZ-FAHR Group, one of the worldwide largest manufacturer of agricultural equipment, with the planned delivery by 2011 of an additional approx. 10,000 four-cylinder engines in the 2012 series. With the discontinuation of engine production at SAME DEUTZ-FAHR's principal plant in Italy, DEUTZ will become the exclusive engine supplier in important markets. This strategic partnership, together with the long-term growth trend in the agricultural machinery industry, is a key element in our strategy for long-term business growth.

Even though our partner, Volvo, and other companies in the construction equipment and commercial vehicles industries were hit in the second half of 2008 by the economic downturn, we are still benefiting in the long term from this strategic partnership for four-litre to eight-litre engines, which has been in place since 1998. The Volvo Group's further growth in international markets and our close collaboration in the development of engines with integrated exhaust-gas systems offer additional potential. In Volvo, we have at our side a strong partner highly regarded throughout the world. Its equipment and vehicles occupy leading market positions in their respective segments.

Product offensive for engines with capacities of less than four litres

As one of the leading global independent manufacturers of compact diesel engines, we also want to offer our customers engines with outputs of up to 75kW. The trend – primarily in Europe and North America – is increasingly toward compact equipment, particularly in the Mobile Machinery application segment. This equipment requires correspondingly small engines. To date, we have been able to provide outstanding coverage of this engine class with engines in the 2009 and 2011 series. The 2011 engine in particular - with unit sales to date of well over one million - is widely regarded as a very succesful construction equipment engine. Its successor engine, the 2010 series, is currently being developed as a TIER 4 engine and the launch is planned for 2011. We are already in discussion with a large number of existing and new customers, the aim of which is to open up additional market potential with this engine based on the next exhaust-gas emission stage from 2012. The new engine of less than four litres is not restricted solely to applications in the Mobile Machinery segment. By developing this engine as an "agripower variant", we intend to win new customers in the agricultural machinery sector.

DEUTZ Customised Solutions: profitable market niches

At our Ulm facilities, the DEUTZ Customised Solutions segment has become well established as a centre of competence for air-cooled engines. More than 28,000 engines in air-cooled series were sold in the year under review – demonstrating once again our long-standing expertise and leading global market position in this engine category. The objective in DEUTZ Customised Solutions is to carry out intensive marketing of air-cooled engines in markets segments where air cooling is particularly advantageous. A further development was the market launch of air-cooled diesel gensets (ADG) in 2007. These gensets, based on an air-cooled engine, are aimed at the consumer market and are now in demand around the world. Although unit sales in 2008 fell short of our expectations as a result of the global economic downturn, we are convinced that, as a provider of complete end products, we will be able to develop further potential in the market for decentralised gensets.

With its liquid-cooled engines in engine series with a capacity greater than eight litres, DEUTZ Customised Solutions is increasingly opening up potential in profitable market niches for marine, rail and special mobile applications; the latter includes, for example, aircraft-towing vehicles and mining equipment. This business normally operates on a project basis and involves small numbers of units. These units are exclusively customer-specific or application-specific powertrain solutions developed, tested and launched in close collaboration with the customer. This also includes preparation for the next emission stages on the basis of common-rail technology.

The Customised Solutions segment was able to achieve a further strengthening of its position in 2008 on the back of customer-related product developments. For example, in the Rail application segment, Customised Solutions entered into a framework agreement with Siemens for the supply of TCD 2015 series engines, which will include the delivery of engines for the new generation of railway multiple units over the next few years.

The reconditioned engines and parts business, known as “Xchange” business, is also managed within the DEUTZ Customised Solutions segment. The advantages for the customer of buying a reconditioned instead of a new engine are that a reconditioned engine can be available to the customer very quickly (normally within a few days) and no modifications to the end equipment are required (or the customer does not have to replace the equipment); reconditioned engines also include engines that are no longer in production. In 2008, we again achieved encouraging unit sales with a total of more than 4,400 exchange engines sold – this underlines our forecast that, in the event of the need for rapid deployment or repair, it is worthwhile for customers to use an exchange engine or exchange components with DEUTZ quality and warranty equivalent to that for new products.

Xchange business expanded: US plant commences production

In July 2008, we opened an exchange engine assembly plant in the USA at Pendergrass, Georgia, to support the expansion of the Xchange engine business. The engines produced at this plant are distributed in North America and parts of Latin America. This is the second DEUTZ plant dedicated to the exchange engine business, the first plant being in Übersee, Bavaria, Germany. The main factors behind the establishment of a plant in the USA are the proximity to our local customers together with logistics and cost benefits, because previously we had to ship the required engines from Germany.

The systematic expansion of service activities in the DEUTZ Group also continued in 2008. Despite the fall in consolidated revenue, revenue from the service business rose by around 4 per cent to €212 million in the year under review. We were able to expand and streamline our existing global dealer network with the addition of new DEUTZ dealers in hitherto underrepresented regions, such as the Gulf region and various parts of Russia. These business relationships provide us with better access to the engines in use locally and enable us to develop additional market potential – a win-win situation for both our customers and DEUTZ.

Targeted expansion of the service business

With the introduction of the new exhaust-gas emissions stages from 2011, there will be a further reduction in the permitted limits for nitrogen oxide (NOX) and soot particles. A diesel particulate filter system needs to be used to achieve the relevant standards for particulate emissions. This places special demands on service operations, although it also creates opportunities for potential earnings in the future. DEUTZ is benefiting from its experience in the retrofitting of diesel particulate filters. Our objective is, in future, to offer our customers an attractive replacement system for particulate filters and the corresponding reconditioning of filters, enabling us to develop further market potential. We have also undertaken further expansion of our business involving genuine DEUTZ engine oil. This oil is optimally prepared for use in DEUTZ engines and is used on engine development test rigs in DEUTZ. We were able to increase revenue from genuine DEUTZ engine oil by over 40 per cent year-on-year by focussing on the regional expansion of our sales activities, for example in Australia.

In 2007, we had already made a successful entry into the market for IT-based customer service solutions with DEUTZ Telematics, a telemetric system for monitoring the condition of an engine in customer equipment. The condition of the engine can be reliably evaluated in real time using key engine data, such as the oil and fuel level, which is transmitted to a central server. Many major equipment manufacturers now use this system to achieve optimum installation and function monitoring of DEUTZ engines. The use of DEUTZ Telematics has also enabled us to strengthen and intensify our relationship with customers.

DEUTZ Dalian in first full year of production

The establishment of the DEUTZ (Dalian) Engine Co. Ltd. joint venture in 2007 was an important step in the context of the DEUTZ Group‘s long-term internationalisation strategy. This development enabled us to expand our presence in the Chinese market significantly. We have been present in China since 2000 in the form of Weifang Weichai-Deutz Diesel Engine Co. Ltd., a joint venture with Weichai Holding Group Co. Ltd. for the production of engines for various applications.

DEUTZ Dalian manufactures and markets diesel engines for commercial vehicles and for use in industrial applications. Currently, its largest customer is FAW Jiefang, a subsidiary of the Chinese FAW Group (First Automobile Works Group), the largest supplier of commercial vehicles in China. FAW Jiefang is also our partner in the joint venture, owning 50 per cent of the company. In the future, we also plan to use the plant in Dalian to support international DEUTZ customers in China that already have their own local production facilities or that are planning to establish such facilities.

In 2008, DEUTZ Dalian recorded its first full year of production. The plant produced around 97,000 engines, of which around 7,000 were four-litre to eight-litre engines based on DEUTZ technology. Although these figures were below our original forecasts – over the past year, the Chinese economy has also been hit by the impact of the global financial markets crisis and economic downturn – this market will remain one of the most dynamic growth markets in the world. We are therefore continuing to pursue our objective of further expansion of our market share in China, specifically with DEUTZ engines from the joint venture‘s new plant.

Action programme to secure the future of the business

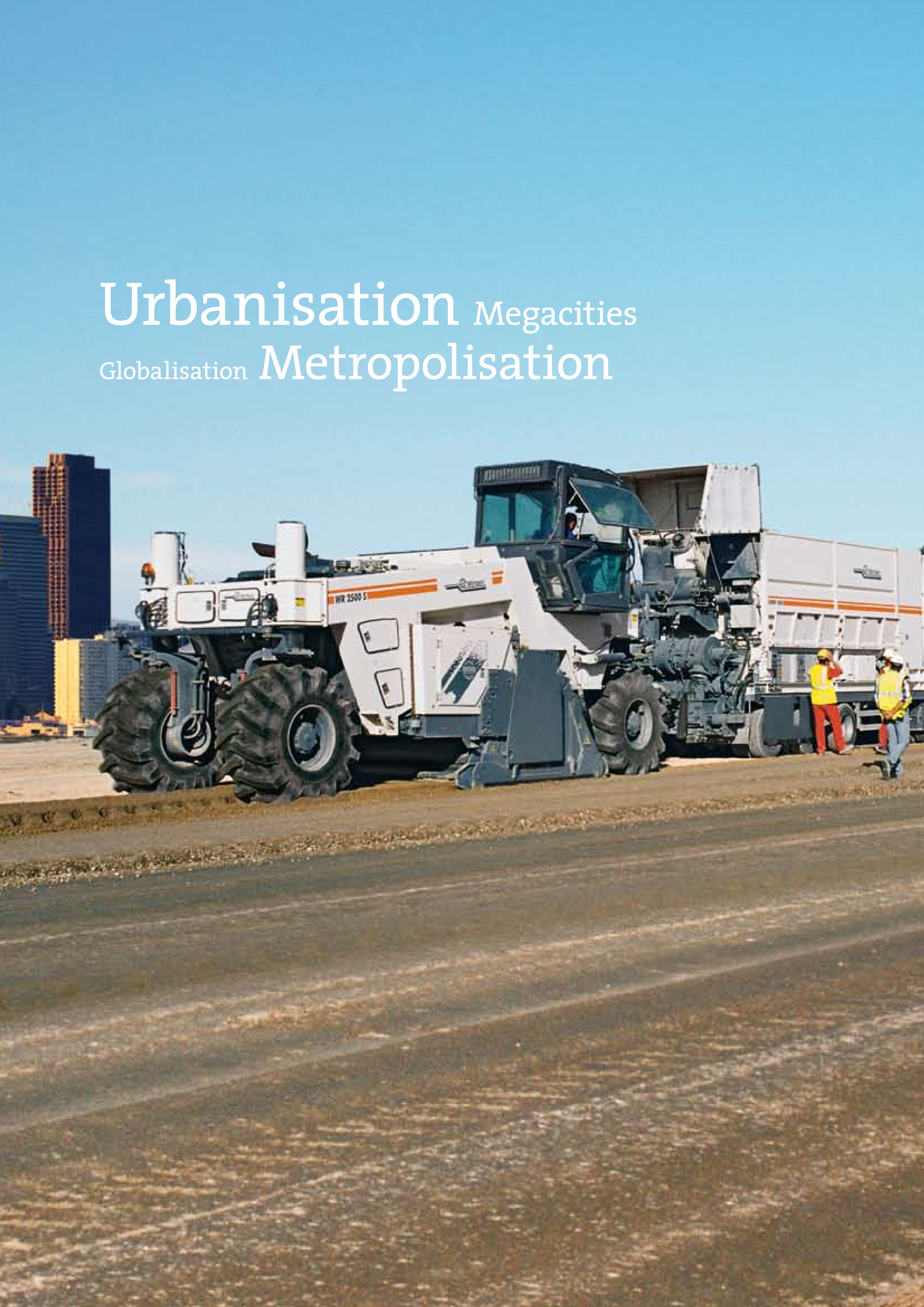
The changes in the global economy during the course of 2008 and the persistently tough market conditions mean that DEUTZ must equip itself with the necessary flexibility to cope with the commercially challenging conditions while at the same time maintaining a clear focus on our long-term growth and internationalisation strategy. In November 2008 we therefore initiated "MOVE", a programme to secure profitability and the future of the business.

We intend to become even more competitive in future with the instigation of action plans to enhance efficiency in all company processes. The introduction of a matrix organisation over the past year with clear responsibilities for individual product lines supports this objective, as do measures to secure important product processes over the next two years. We plan to ensure our new engines business becomes more profitable, particularly as regards compact engines; an appropriate pricing policy and the systematic streamlining of all processes and costs are essential elements for the successful realisation of this objective. Planned capital expenditure, particularly expenditure for the expansion of capacity, has been adjusted in line with current market conditions. This also includes projects in connection with our strategy of further internationalisation; these projects have been scaled back for the time being in view of the global recession. However, we will continue to invest in research and development, the basis for our future growth, first and foremost with an eye to the forthcoming exhaust-gas emission stages and the associated development expenditure on appropriate engine and exhaust-gas technology.

In the short term, we have to adjust to the continuation in the tough market conditions with a significant suppression of customer demand. In the current financial year, we will therefore be focussing primarily on effective measures to reduce costs, including the realignment of processes and organisation with lower unit sales.

Urbanisation Megacities

Globalisation Metropolisation



Urbanisation is increasing –

infrastructure expansion has top priority.

2* 1940	**17*** 2000	**22*** 2015

* Urbanisation, expressed in megacities (= cities of at least 8 million people)

»More and more people are living in cities; it is essential that the infrastructure and transport networks keep pace. Increasing prosperity also leads to individuals needing more space. There is a parallel growth in the need for all types of construction machinery. As one of the biggest independent engine manufacturers, **DEUTZ** develops and builds diesel engines for a great variety of applications – all our engines are powerful, economical and robust, able to operate in harsh conditions, as well as being quiet, compact and producing few emissions. International economic stimulus packages should help to stimulate demand in the short term. The trend for medium and long-term growth in construction machinery remains intact.«

DEUTZ shares

NERVOUS STOCK MARKETS, FALLING SHARE PRICES, INDICES AT RECORD LOWS: 2008 WAS A TURBULENT AND ABOVE ALL DISAPPOINTING YEAR, EVEN FOR DEUTZ. AFTER A POSITIVE PERFORMANCE IN THE FIRST SIX MONTHS, THE DEUTZ SHARE SIGNIFICANTLY DECLINED IN VALUE DURING THE SECOND HALF OF THE YEAR. ESPECIALLY IN THESE TROUBLED TIMES, WE REMAIN COMMITTED TO OUR POLICY OF CONSISTENT AND TRANSPARENT DIALOGUE WITH THE CAPITAL MARKET.

Global crisis in the financial markets results in stock market turmoil

During the course of 2008, the international financial and economic crisis spread with increasing severity. What started as a collapse in the US mortgage market in 2007, turned in 2008 into one of the biggest economic crises since the Second World War: on a global basis, bad speculation and investment resulted in financial instability or even collapse for major banks and investment firms, major corporations found themselves in financial difficulty, commodity prices fluctuated wildly, governments had to bail out troubled banks, various countries approved fiscal stimulus packages and the ominous signs of a forthcoming global recession were clear for all to see. The huge resulting level of uncertainty on the part of many investors and the pressure on the bulk of institutional investors to liquidate holdings led to massive turmoil on international stock markets over the year.

Sharp fall in indices

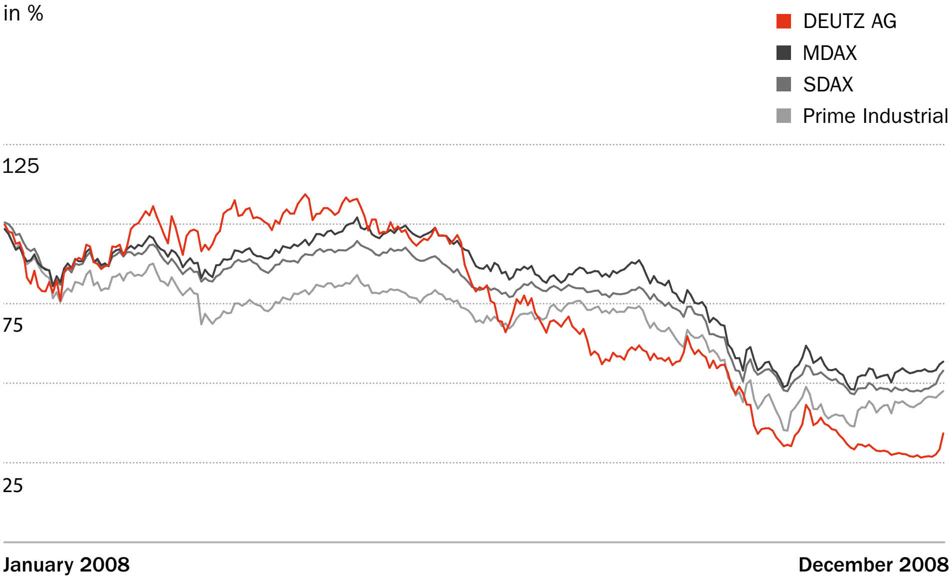
During the year under review, this turmoil also dragged down German securities prices in its wake. The MDAX stood at just 5,602 points on 31 December 2008, whereas it had been at 9,865 points on the last day of 2007. This equates to a drop of 43.2 per cent. The SDAX fared even worse over the same period: it fell from 5,192 points at 31 December 2007 to 2,801 points, a drop of 46.1 per cent. The Prime Industrial Index ended trading at the end of the year 52.5 per cent down at 1,868 points (31 December 2007: 3,930 points).

DEUTZ cannot escape the downward market trend

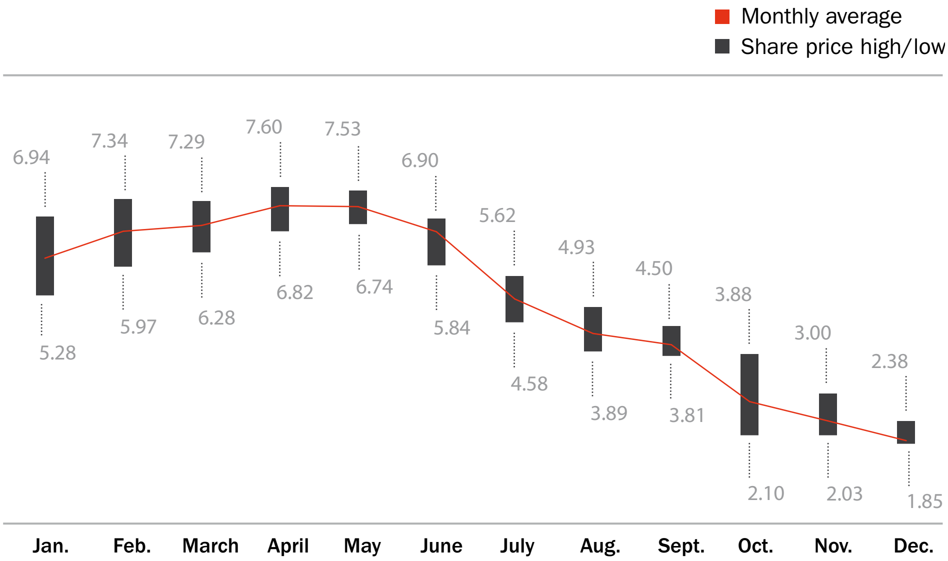
Up to the middle of 2008, the performance of DEUTZ shares had been encouraging. Between February and May, the share price had managed to outperform the two main benchmarks (MDAX and Prime Industrial Index) and in April 2008 achieved a high for the year of €7.60. However, the second half of the year saw the global crisis in the financial markets and the associated economic collapse have a significant impact on subsequent share price performance. Poor economic data in important customer industries, particularly in the last six months of the year, resulted in a sharp decline in the demand for DEUTZ products and a corresponding reduction in revenue and unit sales figures with a significant impact on profitability. As a consequence, we were forced on two occasions to make a downward adjustment to our forecasts for 2008, which had a corresponding impact on the share price.

General predictions of falling economic growth in almost all corners of the globe and the resulting reluctance to commit to investment in industrial equipment also took a toll on the DEUTZ share price. DEUTZ shares therefore ended 2008 at € 2.38, 65.8 per cent down on the closing price in 2007 (31 December 2007: € 6.95).

Price performance of DEUTZ share in 2008
in %



DEUTZ share price high and low for 2008
in €



Key figures for DEUTZ shares

	2008	2007
Number of shares (31 Dec.)	120,861,783	120,085,030
Number of shares (average)	120,793,508	117,315,867
Share price (31 Dec., €)	2.38	6.95
Share price high (€)	7.60	12.02
Share price low (€)	1.85	6.82
Market capitalisation (31 Dec., € million)	287.7	834.6
Basic earnings per share (€)	–0.07	1.56
continuing operations	–0.04	0.51
discontinued operations	–0.03	1.05
Diluted earnings per share (€)	–0.07	1.52
continuing operations	–0.04	0.50
discontinued operations	–0.03	1.02

Based on XETRA closing price

Earnings per share down

Earnings per share is calculated by dividing the net income for the year by the weighted average number of shares in issue. In the year under review, the latter figure was 120.8 shares, producing a basic earnings per share of €–0.04. In 2007, basic earnings per share amounted to €0.51, with a weighted average number of shares outstanding of 117.3 million.

Switch to SDAX

Despite the higher number of shares in issue, DEUTZ AG's market capitalisation fell by 65.5 per cent year on year owing to the decline in the Company's share price: at the end of 2007 market capitalisation had been €834.6 million, but this figure fell to just €287.7 million by the end of 2008. Based on the free float, DEUTZ shares were ranked 76 by Deutsche Börse in December 2008; however, with an average daily trading volume of 560,400 shares (2007: 703,800 shares), DEUTZ's ranking rose to 52.

Deutsche Börse reviews its indices four times a year based on market capitalisation and trading volume. On the relevant review date at the end of August, DEUTZ shares were ranked in position 48 in terms of order-book turnover and position 64 in terms of market capitalisation (only the free float is taken into account). Since DEUTZ AG's ranking was below 60, the company was switched from the MDAX to the SDAX on 22 September 2008 and since then DEUTZ shares have been listed in the latter.

DEUTZ shares are listed in the Official Market and Prime Standard segment of Deutsche Börse and are primarily traded on the floors of the Frankfurt/Main and Düsseldorf stock exchanges as well as in the Xetra IT-based trading system.

Key data on stock market listing

ISIN	DE0006305006
WKN	630500
Reuters	DEZG.F
Bloomberg	DEZ.GR
Market segment	Official Marktet/Prime Standard
Traded at	Xetra, Frankfurt/Main, Düsseldorf

Following the exercise of 776,753 bond and profit-sharing conversion rights, the number of DEUTZ shares increased from 120,085,030 (31 December 2007) to 120,861,783 (31 December 2008). DEUTZ had made use of the option to call the convertible bond on 8 March 2008 because the outstanding volume of convertible bonds at the end of 2007 represented less than 10 per cent of the original 19,792,998 convertible bonds issued. Until 3 March 2008, bondholders still had the option of converting each bond into one DEUTZ share. The 68,070 bonds that had not been exchanged were redeemed at a price of €3.40 per bond by way of a total cash payment to bondholders of €0.2 million.

Conversions increase number of shares

The DEUTZ shareholder structure remained almost unchanged year on year: SAME DEUTZ-FAHR Holding & Finance B.V. continues to be the principal shareholder in DEUTZ and increased its shareholding over 2008 by 2.6 percentage points to 45.1 per cent. The second-largest individual shareholder is AB Volvo Group: at the end of 2008, the Swedish company held 6.7 per cent of the total shares (31 December 2007: 6.8 per cent). The free float fell slightly during 2008 and at 31 December 2008 accounted for 48.2 percent of shares compared with 50.7 per cent at 31 December 2007.

Shareholder structure remains stable

Breakdown of shareholders as at 31 December 2008
in %

- **48.2** Free float
- **45.1** SAME DEUTZ-FAHR Holding & Finance B.V.
- **6.7** AB Volvo Group

DEUTZ attaches great importance to ongoing, detailed dialogue with the capital markets, primarily with institutional and private investors as well as analysts. As part of our regular investor relations activities, in 2008 we held an analysts' meeting in Frankfurt/Main to present our annual financial statements and also held detailed discussions with the capital markets regarding our business performance and strategic issues in conference calls accompanying the publication of each interim report. We also issued ad hoc announcements and press releases to ensure that our stakeholders and shareholders were informed promptly and comprehensively about any relevant issues. In addition, we organised roadshows in Frankfurt/Main, London and Zurich during 2008, in which the Management Board and the investor relations team participated. DEUTZ was also involved in investor conferences in Frankfurt/Main with presentations and one-on-one meetings. These conferences included the German Equity Forum in November 2008.

Active investor relations

Currently, the performance of DEUTZ AG is regularly and actively tracked and analysed by 16 brokerage houses ("coverage"): Bankhaus Lampe, Berenberg Bank, BHF-Bank, Cazenove, Crédit Agricole Cheuvreux, Credit Suisse Securities, Deutsche Bank, Dresdner Kleinwort, DZ Bank, Goldman Sachs, HSBC Trinkaus & Burkhardt, Oppenheim Research (Sal. Oppenheim), Solventis Wertpapierbank, UBS, Viscardi Securities and WestLB. A complete overview with current investment recommendations and target prices, together with further information regarding DEUTZ shares and forthcoming dates in the financial calendar, can be found on our website at www.deutz.com.

Globalisation Mobility
Accessibility Global trade

The world is getting smaller –

made possible by smooth-functioning logistics.

236 million TEU*
2000

530 million TEU*
2008

830 million TEU*
2015

* Growth in global trade in TEU (Twenty-foot Equivalent Unit = standard container)

»The global interdependence of national economies, new growth markets and production increasingly located in low-wage countries; these are the factors leading to a rapid expansion in the flow of goods and traffic and the movement of people. A key function is performed by logistics, on land as well as in the air and at sea. **DEUTZ** supplies high-performance, low-emission engines for trucks and aircraft tow tractors, and generator units for supplying aircraft with power on the ground. With its global presence and broad product range, DEUTZ is well-placed to benefit from these positive trends.«

Corporate Governance report

FOR DEUTZ, A RESPONSIBLE APPROACH TO MANAGEMENT THAT MEETS THE STANDARDS OF GOOD CORPORATE GOVERNANCE FORMS THE BASIS FOR ENHANCING SHAREHOLDER VALUE OVER THE LONG TERM. THIS IS ONE OF THE MAIN REASONS WHY WE ATTACH GREAT IMPORTANCE TO THE IMPLEMENTATION OF THE GERMAN CORPORATE GOVERNANCE CODE AND ENSURE QUALITY AND TRANSPARENCY IN ALL KEY DECISIONS AND PROCESSES IN OUR COMPANY.

Declaration of compliance with few exceptions

In 2008 the Management Board and the Supervisory Board once again carefully considered to what extent it was proper and consistent with the Company's objectives for DEUTZ to apply all the guidelines and recommendations of the German Corporate Governance Code (DCGK). As a result, DEUTZ AG complies with the recommendations of the Code, as amended on 6 June 2008, with the following exceptions:

1. The D&O insurance (directors' and officers' insurance providing protection in the event of liability for financial loss) taken out by DEUTZ AG for the members of the Management Board and Supervisory Board does not provide for any excess (item 3.8 (2) DCGK). This is a group insurance policy covering a number of employees in Germany and abroad. Outside Germany, an excess is the norm; in addition, it does not seem appropriate to differentiate between members of the Management Board and Supervisory Board and other employees.
2. There is no age limit at DEUTZ for members of either the Management Board or Supervisory Board (items 5.1.2 (2) sentence 3 and 5.4.1 sentence 2 DCGK). With this deviation from DCGK, DEUTZ retains the option of continuing to benefit from the long years of experience brought to the company by older members of the Management Board and Supervisory Board.

The current declaration of compliance in accordance with section 161 AktG, which the Management Board and Supervisory Board submitted on 17 December 2008, can be accessed in the 'Investors/Corporate Governance' section of the Company's website at www.deutz.com where you can also view and download the declarations of compliance from previous years.

Close cooperation between Management Board and Supervisory Board

With the long-term development of the company in mind, the Management Board and Supervisory Board maintain an open, ongoing dialogue on all strategic decisions in the company – a process which continued in the year under review. The primary aim of the close cooperation between the two bodies is to enhance the value of the company over the long term for the benefit of shareholders, employees and business partners. Accordingly, the Management Board provides the Supervisory Board with regular, comprehensive and timely reports on all relevant issues relating to planning, business performance, risk position and risk management.

No former members of the Management Board of DEUTZ AG are now members of the Supervisory Board. The Supervisory Board is elected for a period that runs until the Annual General Meeting in 2013.

Responsible risk management

A forward-looking, prudent and responsible approach to corporate risks forms a core aspect of good corporate governance and the basis for the risk management system at DEUTZ. The Management Board regularly notifies the Supervisory Board of any existing or anticipated risks. Details of the DEUTZ Group's risk management systems can be found in the risk report on pages 69 to 74.

Comprehensive transparency and active investor relations

The transparent presentation of developments and decisions in a company forms the core of any model system of corporate governance. Continuous, open dialogue with all the players involved ensures trust in the company and its value creation process. DEUTZ therefore attaches the greatest importance to ensuring that all relevant target groups are given the same information at the same time and in a timely manner.

We achieve this objective by using various media. DEUTZ AG reports four times a year in its interim reports and the annual report on the performance and development of its business and on significant changes and events. It maintains constant contact with investors and analysts through its regular investor relations activities. In addition to the annual analysts‘ meeting held when the Company‘s consolidated annual financial statements are published, conference calls for analysts and institutional investors take place with the publication of interim reports. The Annual General Meeting is usually held in the first five months of the year; shareholders who do not attend the AGM in person can instruct proxies to vote on their behalf.

Our website also offers comprehensive information on the Company: DEUTZ AG annual and interim reports, press releases and ad hoc announcements, analyst recommendations and investor relations presentations as well as key dates in the financial calendar can all be found at www.deutz.com. The Company‘s Statutes and the rules of procedure for the Supervisory Board can also be accessed online. Almost all the pages on our website are provided in both German and English to ensure that important company news and information is as accessible as possible, including to an international audience. Apart from the regularly published information, DEUTZ AG also provides details of circumstances that are not publicly known but that could have a significant impact on DEUTZ‘s share price were they to become known. The Company‘s reporting policy therefore complies with both legal requirements and the German Corporate Governance Code guidelines.

Management Board, Supervisory Board and Supervisory Board committees

At DEUTZ, responsibility for the executive function lies with the Management Board; the Supervisory Board monitors and advises the Management Board in its activities.

There was one change to Management Board personnel during 2008: on 1 February 2008, Dr.-Ing. Helmut Leube took up the post of chairman of the Management Board. Up to that date, Helmut Meyer, the member of the Management Board with responsibility for finance, human resources and service had been acting chairman.

In July 2008, the Management Board decided to create product lines and introduce a matrix organisation as part of a plan to streamline the organisation of the DEUTZ Group as a whole. At the same time, there were changes to the allocation of Management Board responsibilities, as follows: The chairman of the Management Board, Dr.-Ing. Helmut Leube, added responsibility for the product lines to his existing remit of sales, corporate strategy, quality management, internal audit, marketing and communications. Karl Huebser, who had been the Management Board member responsible for production and technology since 2001, transferred these responsibilities to Gino Mario Biondi and is now responsible for all of DEUTZ‘s operations in Asia. Gino Mario Biondi has taken charge of production and development in addition to his existing remit of procurement and logistics. Helmut Meyer retained responsibility for finance and human resources. Responsibility for investor relations and service was also added to his remit.

In accordance with the provisions of the MitbestG, the Supervisory Board of DEUTZ AG comprises twelve members, six members being the representatives of the shareholders and six members being the representatives of the employees.

Some of the work of the Supervisory Board is carried out by four committees created by the Supervisory Board: in accordance with sections 7 (1) (2) and (3) of the rules of procedure for the Supervisory Board, the Human Resources Committee, Audit Committee and Nominations Committee are allocated responsibility for specific areas of activity. These committees are supplemented by the Arbitration Committee, which is required by section 27 (3) of the German Codetermination Act. Each of these committees comprises representatives of both the shareholders and the employees. The one exception is the Nominations Committee, which consists solely of shareholder representatives. Further information on the functions and remit of each of the committees in the year under review can be found in the Report of the Supervisory Board from page 6 onward. The membership of the committees is shown on page 152.

Compliance organisation

As part of the systematic development of the compliance system, the Management Board has appointed a Compliance Officer with responsibility for coordinating all the development of compliance-based activities in coordination with Helmut Meyer, the member of the Management Board with responsibility for compliance.

In November and December 2008, the Management Board agreed on insider trading guidelines and a code of conduct based on proposals by the Compliance Officer. These guidelines and code of conduct were then announced within the DEUTZ Group.

Conflicts of interest and consultancy agreements

All members of the Supervisory Board are obliged to notify the Supervisory Board of any conflicts of interest, especially those arising from an advisory function or directorship at customers, suppliers, lenders or other business partners.

The members of the Management Board must also disclose any conflicts of interest to the Supervisory Board, which then reports these cases to the Annual General Meeting.

The Supervisory Board members Ing Massimo Bordi and Dr Francesco Carozza are subject to a conflict of interest because of their functions in companies in the SAME DEUTZ-FAHR Group, which is also a major customer of DEUTZ AG. The chairman of the Supervisory Board reviews each individual case to establish whether this conflict of interest restricts the opportunity for the involvement of Ing Massimo Bordi and/or Dr Francesco Carozza in the work of the Supervisory Board.

There is an agreement between DEUTZ AG and Lars-Göran Moberg, a member of the Supervisory Board, on the basis of which Lars-Göran Moberg advises DEUTZ AG on customer-specific issues. The Supervisory Board consented to this agreement. There is a disclosure on page 147 of the Notes to the consolidated financial statements regarding payments to Lars-Göran Moberg under this agreement.

Related-party disclosures are shown on page 142 of the Notes to the consolidated financial statements.

Remuneration report

Remuneration of the Management Board

Management Board remuneration in DEUTZ comprises fixed, variable and long-term-oriented components. The performance-related variable portion of the remuneration is linked to specific key performance indicators such as the DEUTZ Group's revenue, EBIT margin, ROCE as well as individual departmental targets. The long-term incentive plans (LTI no. I and LTI no. II) introduced in 2007 and 2008, which are open to the Management Board (LTI no. I and LTI no. II) and top level of senior management (LTI no. I), represent a long-term-oriented component of remuneration aimed at a sustained increase in shareholder value. The LTI plans involve the allocation of virtual stock options; before they receive stock options, those eligible must invest some of their own capital in DEUTZ shares. The stock options confer the right to receive a cash payment after a lock-up period of three to five years has elapsed, provided that DEUTZ's share price performance has met one of the two criteria stipulated in the LTI plan. Either DEUTZ's share price must be 30 per cent above the fixed reference price at the time the options are exercised (with the reference price being the weighted average price of DEUTZ shares in the three months before the options were issued), or DEUTZ's share price must have outperformed the Prime Industrial Index by 30 per cent. In the year under review, Dr.-Ing. Helmut Leube, Gino Mario Biondi and Helmut Meyer, all members of the Management Board, received a total of 345,000 virtual stock options under long-term incentive plan no. II. Further information on the remuneration paid to the Management Board can be found on page 146 of the Notes to the consolidated financial statements.

Remuneration of the Supervisory Board

The remuneration paid to the Supervisory Board is specified in paragraph 15 of the Company's Statutes. This stipulates that the members of the Supervisory Board of DEUTZ AG receive a fixed annual remuneration of €12,500. They also receive a fee of €1,000 for each Supervisory Board meeting attended and are reimbursed for their out-of-pocket expenses. Furthermore, each member of the Supervisory Board is paid a fixed amount of €2,000 for each percentage point by which the dividend exceeds 4 percentage points of the Company's paid-up share capital; this amount is payable proportionately for fractions of percentage points. The chairman of the Supervisory Board receives double these amounts, and his deputy one-and-a-half times.

The chairmanship and membership of Supervisory Board committees are remunerated separately in accordance with the German Corporate Governance Code. Each member of a committee also receives a fee of €1,000 for each committee meeting they attend. The chairman of a committee is entitled to twice this sum, his deputy to one-and-a-half times the amount. In addition, DEUTZ reimburses the members of the Supervisory Board for any VAT they incur in connection with the performance of their mandate. Further information on the remuneration paid to the Supervisory Board can be found on page 147 of the Notes to the consolidated financial statements.

Dealings subject to reporting requirements

Section 15 a of the German Securities Trading Act (WpHG) states that members of supervisory and management boards of public limited companies and persons authorised to take key operational decisions must disclose to the German Financial Supervisory Authority (BaFin) their own dealings in shares of the Company or in financial instruments of the Company based on such shares.

In 2008, two members of the Management Board disclosed the purchase or sale of shares under this provision. Up to the date on which the annual financial statements were formally adopted, no other members of the Management Board and no other persons subject to the disclosure requirement acquired shares. The table below gives a breakdown of the relevant dealings in shares:

Trade date	Person subject to reporting requirements	Function	Securities	ISIN	Stock exchange	Type of transaction	Quantity	Price per share	Business volume
18/02/2008	Gino M. Biondi	Member of the Management Board	DEUTZ-Share	DE0006305006	Düsseldorf	Purchase	6,000	€6.48	€38,880
19/02/2008	Helmut Meyer	Member of the Management Board	DEUTZ-Share	DE0006305006	Hamburg	Purchase	6,000	€6.98	€41,880
19/12/2008	Helmut Meyer	Member of the Management Board	DEUTZ-Share	DE0006305006	Hamburg	Sale	12,000	€1.88	€22,560
19/12/2008	Helmut Meyer	Member of the Management Board	DEUTZ-Share	DE0006305006	Hamburg	Purchase	12,000	€1.92	€23,040

These dealings were disclosed pursuant to section 15 a WpHG and published on DEUTZ's website.

Together with other members of the Carozza family, Dr Francesco Carozza, a member of the Supervisory Board, has an indirect investment in SAME DEUTZ-FAHR Holding & Finance B.V., which is the largest individual shareholder in DEUTZ AG with 45.1 per cent of the Company. Dr Francesco Carozza therefore indirectly holds 45.1 per cent of DEUTZ shares. As at 31 December 2008, there was no other ownership subject to reporting requirements pursuant to item 6.6 German Corporate Governance Code. This means that the total number of shares in DEUTZ AG held by all members of the Management Board and other members of the Supervisory Board as at the balance sheet date accounted for less than 1 per cent of the shares issued by the Company.

Where this Corporate Governance Report refers to the Notes to the consolidated financial statements for further details of remuneration, the information disclosed therein forms part of the Corporate Governance Report.

Environmental protection

Emission reduction **Sustainability** Alternative drives

Resources are limited –

Technologies for reducing energy consumption and emissions will shape the future.

Nitrogen oxide 9.2 g/kWh	**Nitrogen oxide 4.0 g/kWh**	**Nitrogen oxide 0.4 g/kWh**
Particulates 0.7 g/kWh	**Particulates 0.3 g/kWh**	**Particulates 0.025 g/kWh**
1999	2006	2014

Applies to engines for Mobile machinery of between 75 and 130 kw.

»In view of climate change and the constant increase in energy consumption, it is essential to reduce both consumption and emissions. Because fossil resources are limited, development will increasingly concentrate on regenerative energy sources such as renewable raw materials. By developing fuel-efficient, low-emission engines, both hybrid designs and engines which can run on renewable fuels, **DEUTZ** is not only making a significant contribution towards protecting the environment but is also profiting from the need to introduce new types of engines. Growth in this area has been given added impetus by new exhaust technologies which permit more sophisticated, integrated drive systems.«

Group management report

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GROUP STRUCTURE AND BUSINESS ACTIVITIES

DEUTZ is an independent manufacturer of compact diesel engines with power outputs of 10 kW to 500 kW for both on-road and non-road applications, i.e. for engine-powered commercial vehicles licensed for use on public roads and engine-powered equipment not licensed for use on public roads.

The DEUTZ Group‘s activities are divided into two segments: Compact Engines and DEUTZ Customised Solutions. In its two segments, DEUTZ focuses on value creation processes involving the development, design, production, sales and service of diesel engines cooled by water, oil or air.

DEUTZ AG

Compact Engines	DEUTZ Customised Solutions
• liquid-cooled engines: <4 litres and 4–8 litres	• air-cooled engines: <4 litres, 4–8 litres, >8 litres • liquid-cooled engines: >8 litres

The range of products offered by DEUTZ is based on the following application segments:

- Mobile Machinery:
  construction equipment, material handling equipment, ground support equipment, mining equipment
- Stationary Equipment:
  gensets, pumps, compressors
- Agricultural Machinery:
  tractors, agricultural equipment
- Automotive:
  commercial vehicles (trucks, buses), rail vehicles, special vehicles
- Miscellaneous:
  Includes marine equipment

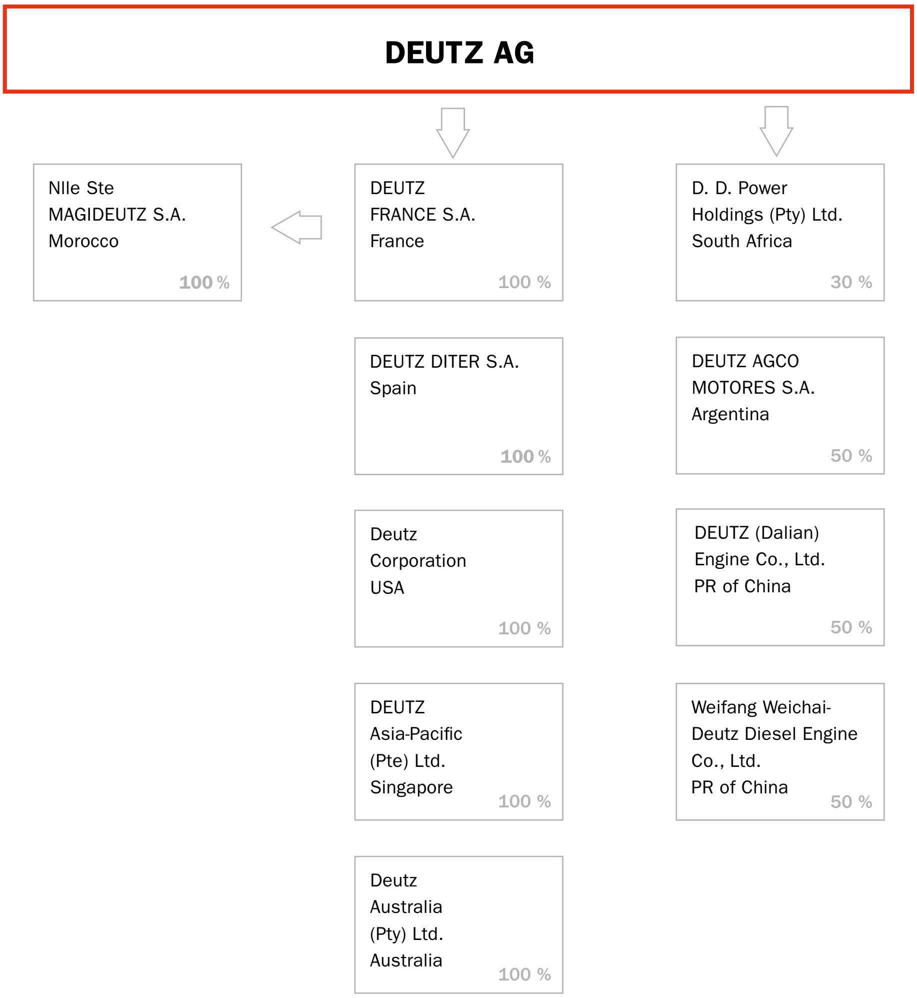
DEUTZ Group: Unit sales by application segment
units (2007 figures)

115,058	(141,670)	Mobile Machinery
68,569	(73,810)	Stationary Equipment
34,008	(34,636)	Agricultural Machinery
32,938	(33,593)	Automotive
1,786	(2,152)	Miscellaneous
252,359	(285,861)	**Total**

The DEUTZ product range is complemented by comprehensive service support operations. These operations are being expanded on an ongoing basis, very much driven by the requirements of customers. The service business comprises the supply of spare parts, together with repair, servicing and maintenance support for customers. The global service network consists of the Company‘s own subsidiaries and service centres, together with authorised agents. An important part of the service business is also the availability of reconditioned exchange parts and engines promoted under the name “DEUTZ Xchange” and managed within the DEUTZ Customised Solutions segment.

The Compact Engines segment comprises liquid-cooled engines with a capacity of less than four litres and engines with capacities of four to eight litres, whereas the DEUTZ Customised Solutions segment focuses on air-cooled engines and large liquid-cooled engines with capacities of more than eight litres.

DEUTZ AG is the executive and operating parent company in the DEUTZ Group, which also comprises various subsidiaries in Germany and abroad. These subsidiaries are a production facility in Spain and companies with sales and service functions. DEUTZ customers are supported by 9 distribution companies, 9 sales offices and over 800 sales and service partners in more than 130 countries around the world. DEUTZ also has two joint ventures in China – DEUTZ (Dalian) Engine Co., Ltd. and Weifang Weichai-Deutz Diesel Engine Co., Ltd. – and one in Argentina, DEUTZ AGCO MOTORES S.A.



Market and competitive environment

The market is divided into captive manufacturers, who produce equipment and vehicles as well as their own engines, and non-captive manufacturers, whose core competence is specifically the manufacture of equipment. According to a calculation carried out by DEUTZ in 2008, the global market for engines relevant to DEUTZ, i.e. the non-captive market, was around 2.1 million engines. DEUTZ has a market share of approximately 12 per cent in this market segment and enjoys a strong international position, supplying engines to a large number of customers in a variety of industries. In the last few years, DEUTZ has entered into strategic alliances to open up additional potential that was previously the preserve of the captive market. For example, DEUTZ has entered into alliances with the Volvo Group in Sweden for four-litre to eight-litre capacity engines to be used in commercial vehicles, construction machinery and gensets, and with the SAME DEUTZ-FAHR Group in Italy for agricultural machinery engines.

There are no other competitors in this market offering a product range that is identical to that of DEUTZ. However, in the various application segments, DEUTZ faces other companies whose range of services and applications is in part comparable with that offered by DEUTZ:

Application segment	Application	Main competitors
Mobile Machinery	Construction equipment Material handling equipment Ground support equipment	Kubota (J), Yanmar (J), Perkins (UK)
Stationary Equipment	Generators Pumps Compressors	Perkins (UK), Cummins (USA), Kubota (J)
Agricultural Machinery	Tractors Harvesters Forestry equipment	Perkins (UK), Yanmar (J), Kubota (J), Deere & Company (USA)
Automotive	Trucks Buses Railcars	Cummins (USA), Caterpillar (USA), Navistar (USA), Isuzu (J)

INTERNAL CONTROL SYSTEM

Responsible corporate management based on transparent performance indicators

The DEUTZ Group defines its budget targets and medium-term corporate targets using selected key performance indicators recorded within an internal control system. A range of these key performance indicators is monitored continuously to ensure profitable growth is achieved. The primary indicators are unit sales and revenue in conjunction with the EBIT margin; we also manage the capital tied up in the business using the working capital ratio (ratio of average working capital[1)] over four quarters to revenue for the last twelve months) and the capital expenditure volume. In conjunction with EBIT optimisation, this in turn ultimately determines the return on capital employed (ROCE; ratio of EBIT to average capital employed[2)]). In view of the current difficult business environment, DEUTZ has strengthened its focus on free cash flow as a key performance indicator (cash flow from operating activities and cash flow from investing activities less interest expense). This means that the Group‘s financial flexibility is subject to constant analysis in the form of a comparison between budget and actual so that appropriate action can be taken rapidly in the event of significant variances.

In order to enable us to act proactively and respond promptly, DEUTZ has defined fixed dates for the analysis and discussion of the performance indicators. The Management Board tracks changes in the performance indicators with the help of a fortnightly and monthly reporting system and is therefore able to respond quickly to any current developments. In combination with sound causal analysis, risks are minimised and additional potential exploited. Three times a year the Company produces a one-year forecast for all key performance indicators. In this way, DEUTZ ensures optimum transparency in our business performance, benefiting both the Company and its stakeholders.

1) Working capital: inventories and trade receivables less trade payables
2) Capital employed: total assets less cash and cash equivalents, trade payables and other current and non-current liabilities based on average values from two balance sheet dates

The growing deterioration in economic conditions during the course of 2008 had a significant impact on the main key performance indicators during the year under review:

		2008	2007
Revenue	€ million	1,495.0	1,524.2
Unit sales	units	252,359	285,861
EBIT margin before one-off items	in %	2.1	6.3
ROCE	in %	4.0	13.5
Free cash flow [1)]	€ million	–23.3	–111.5

1) Free cash flow: continuing operations before payment of compensation for vested company pension rights

Continuous optimisation of the control system

Regardless of economic volatility – such as the considerable deterioration in economic conditions during the third and fourth quarters of 2008 – the continuous optimisation of the management of the Group remains one of DEUTZ's important overarching objectives. The annual planning of all key performance indicators highlights any possible flexibility with regard to optimisation. This planning is based both on our internal estimates of future business and on benchmark figures relating to competitors. Strategic planning is carried out at DEUTZ from the bottom up. This means that the key variables are available at the relevant hierarchical levels for use in the operational management of the business. Both the specific unit sales and revenue targets and the customer and product-related targets (EBIT margins) are reviewed with the operating units each year on the basis of Group-wide objectives.

Detailed working capital targets are specified for the individual companies in the DEUTZ Group to ensure that capital tie-up is optimised. To translate these targets to the operating business, specific targets for inventories, trade receivables and trade payables are then set for individual managers.

The management of capital expenditure is a key element in the control of capital tie-up in DEUTZ because of the Group's long-term growth strategy. Clear budgets fix the level of capital expenditure; actual requirements are derived from the medium-term planning of unit sales and the corresponding requirements in terms of capacity and technologies. The levels of capital expenditure and individual projects are agreed and fixed in conjunction with the financial planning department in the context of annual budget meetings. An additional detailed review is carried out before projects are actually approved. To this end, DEUTZ uses standard investment appraisal methods (internal rate of return, amortisation period, net present value, income statement, cost comparisons). A project with an appropriate budget is only approved if there is a clear positive outcome from this investment appraisal.

There will be an even greater focus on free cash flow from the 2009 financial year, both at Group level and for the individual Group companies.

STRATEGIC OBJECTIVES

Since the sale of DEUTZ Power Systems in 2007, DEUTZ has been focussing on its core competencies: the development, design, production, sales and service of compact diesel engines. As a non-captive engine manufacturer with comprehensive technological expertise, DEUTZ is benefiting primarily from the enhanced demands being placed on the refinement of engines as a result of increasingly stringent emissions legislation. In future, drive designs, engine and exhaust-gas technologies will be brought together in integrated overall systems that are significantly more complex than at present. The increasing overall value of these new engine designs translates into additional growth potential for DEUTZ.

Strategic objectives in DEUTZ include the strengthening of our market position as one of the world's top three suppliers of four-litre to eight-litre engines and the successful implementation of the product offensive for compact engines with a capacity of up to four litres. At the same time, we intend to further reinforce our leading international position in the market for air-cooled engines and expand on our position in the market segment covering engines with a capacity of more than eight litres. As far as medium-term and long-term strategic considerations in new engines business are concerned, we are focussing on the implementation of the next stage in emissions legislation with the successful launch of TIER 4 engines from 2011.

DEUTZ's objective in the service business is, in addition to customer satisfaction, to increase revenue on an ongoing basis and accelerate profitable growth in this business.

We also intend to continue driving forward with the internationalisation of the DEUTZ Group; our efforts in this regard are focussed on our activities in China. Thanks to the joint venture, which commenced operations there in August 2007, DEUTZ has significantly better access to the Chinese domestic market and also has local, low-cost production facilities. We can also use the joint venture to support existing DEUTZ customers who have their own production facilities in the region. Our objective is to reach break-even point with the joint venture as soon as possible, even though this is a very challenging objective in view of market expectations for 2009.

Another new development in the process of internationalisation in 2008 was the opening of an assembly facility for reconditioned exchange engines ("Xchange") in the USA.

Given the changes in economic conditions and in expectation of a difficult trading environment over the coming year, we have initiated an action programme known as "MOVE" to secure profitability and the future of the business. The focus of this programme is, firstly, to secure the short-term profitability of the business, primarily by cutting the cost of materials and overheads, setting prices appropriately and adjusting capacity in line with the new unit sales forecasts. "MOVE" also includes structural measures to bring about a sustained improvement in profitability by means of more efficient processes and improved productivity and quality. The main priority over the coming years is to secure the launch of major new products at optimized target costs by way of investment in technologies of the future and focussed spending on research and development.

ECONOMIC ENVIRONMENT

Global economic growth weaker than expected [1)]

Optimism still prevailed during the first few months of 2008. Although there had already been a slight slowdown in the global economy as a result of the crisis in the financial markets, there still seemed to be little likelihood of a significant economic slump. Quite the opposite: experts were still forecasting further growth in the global economy of more than 3.0 per cent compared with 4.7 per cent in 2007. The tide turned in the middle of the year 2008: a heightening of the financial markets crisis increasingly hit the real economy around the globe, with slowing growth even affecting Asian countries hitherto accustomed to exceptional growth rates. By the end of the year, a global economic slump had taken hold. Even in Germany, where the economic position initially remained robust, growth eased off significantly. Although the global economy still recorded overall growth of 3.0 per cent in 2008, there was nevertheless a significant drop in gross domestic product in almost all regions during the third and fourth quarters.

1) Global economic data: Deutsche Bank Economic Research Bureau Frankfurt

In Germany and in the euro zone, which is particularly important for DEUTZ, gross domestic product grew in the year under review by 0.9 per cent and 0.7 per cent respectively (2007: 2.6 per cent in both cases). The US economy still grew by 1.3 per cent in 2008 (2007: 2.0 per cent), whereas Asia (excluding Japan) and China – increasingly important markets for DEUTZ – continued to record very high growth rates of 7.2 per cent and 9.0 per cent respectively (2007: 9.4 per cent and 11.9 per cent respectively).

Downturn in orders in the German engineering industry [1)]

The significant slowdown in growth in the global economy was also reflected in individual industries. At the beginning of 2008, all the indicators in the German engineering industry still pointed to growth: the sector started the year in confident mood with new orders in January and February up around 10 per cent on the same period in 2007, the industry therefore carrying on seamlessly from its boom year in 2007. From May onwards, there were clear signs of a slowdown with new orders in this month falling sharply for the first time (down 12 per cent); from the midpoint in the year, the downward trend, mainly in foreign demand, continued with a resulting sharp drop in exports. In Q4 2008, the engineering industry experienced a year-on-year fall in new orders of 29 per cent, a real collapse in demand and the worst quarterly results for 50 years. Summary for 2008: although German engineering companies recorded a fifth successive year of production growth (up more than 5 per cent on 2007), this figure is attributable solely to the growth achieved in the first six months of 2008.

Construction equipment: end of the boom [1)]

After six years of growth, 2008 saw the end of the boom for the German construction equipment industry. Although this sector was able to register a revenue increase of 7 per cent in 2008, new orders declined on average over the course of the year by one third compared with 2007. The trigger for the downturn in this industry, which is heavily dependent on exports, was primarily the recession in important European construction markets such as the United Kingdom, Spain and France and a decline in construction activity in the USA.

According to the EUROCONSTRUCT trade association, the European construction industry, viewed overall, recorded zero growth over the past year. The only stimulus for growth came from eastern Europe. Whereas the western European building industry at around 1 per cent was just below the figure achieved in 2007, the German construction industry was able to record slight growth of around 1 per cent owing to the positive trend in commercial and public sector construction. The US construction industry shrank by 4 per cent in 2008; the main reason was the disproportionally sharp contraction in the housing sector.

Noticeable downturn at year-end in the market for medium-heavy commercial vehicles [1)]

There was also a significant shift in trend over the course of the year in the European commercial vehicles industry: according to the European Automobile Manufacturers‘ Association (ACEA), there was a downturn in the total number of new commercial vehicles registered from May onwards. In November and December alone, registrations of medium-heavy vehicles in the 3.5 to 16 tonne category (excluding buses and coaches) fell by 28 per cent and 15 per cent respectively; over the whole of 2008, the total number of new registrations in this segment was around 431,000 vehicles, which equates to a 4 per cent decrease compared with 2007. The decrease was significantly less marked in western Europe than in the new member states of the European Union; there was only a moderate fall in new registrations in Germany (1 per cent down). Overall, western Europe accounted for around 83 per cent of new commercial vehicle registrations in the 3.5 to 16 tonne category (excluding buses and coaches) in 2008; Germany represented the largest individual market with around 105,900 vehicles.

1) Industry data: German Engineering Federation (VDMA), EUROCONSTRUCT/CESifo Group, ACEA

The European agricultural machinery market can now look back on four years of a sustained boom. In the year under review, production volume in this market – in which Germany, Italy and France account for the highest proportion of global production, even ahead of North America – rose by more than 15 per cent to € 28 billion. The performance of the agricultural machinery sector in Germany was even more encouraging with the production of tractors, combine harvesters and other agricultural machinery rising by 24 per cent to € 7.5 billion, the proportion of which accounted for by exports continued to run at a high level (around 75 per cent). Export demand was concentrated primarily in France, the United Kingdom, Russia and the USA; the export revenue of German agricultural machinery manufacturers again rose by 25 per cent. From November, there was an easing in the growth in demand in Germany; new orders in the final two months of 2008 came in below the very high order volumes experienced in the last two months of 2007. However, the significant orders on hand continue to provide an excellent starting position for 2009.

Agricultural machinery industry continues to expand [1)]

BUSINESS PERFORMANCE IN THE DEUTZ GROUP

	Continuing operations 2008	Continuing operations 2007	Change in %
€ million			
New orders	1,363.5	1,584.5	–13.9
Unit sales (units)	252,359	285,861	–11.7
Revenue	1,495.0	1,524.2	–1.9
Thereof excluding Germany (%)	75.6	78.0	–
EBIT (before one-off items)	31.8	95.5	–66.7
EBIT margin (before one-off items, %)	2.1	6.3	–
Net loss/income	–4.2	59.4	–
Total assets	1,206.3	1,378.6	–12.5
Fixed assets	539.7	511.3	5.6
Equity ratio (%)	42.4	40.4	–
Net financial position	–12.2	89.7	–
Working capital	205.0	196.9	4.1
Cash flow from operation activities	89.7	–38.7	–
Free cash flow	–23.3	–111.5	79.1
Capital expenditure (excluding capitalisation R&D)	69.9	143.5	–51.3
Research and development	90.3	55.8	61.8
Employees (31 Dec.)	4,701	4,617	1.8

The comments and figures for new orders, orders on hand, unit sales, revenue, operating profit (EBIT before one-off items) and EBIT after one-off items only relate to the continuing operations in Compact Engines and DEUTZ Customised Solutions. Comments on discontinued operations relate to delayed effects in connection with the sale of DEUTZ Power Systems in 2007.

Preliminary note: continuing and discontinued operations

1) Industry data: German Engineering Federation (VDMA), EUROCONSTRUCT/CESifo Group, ACEA

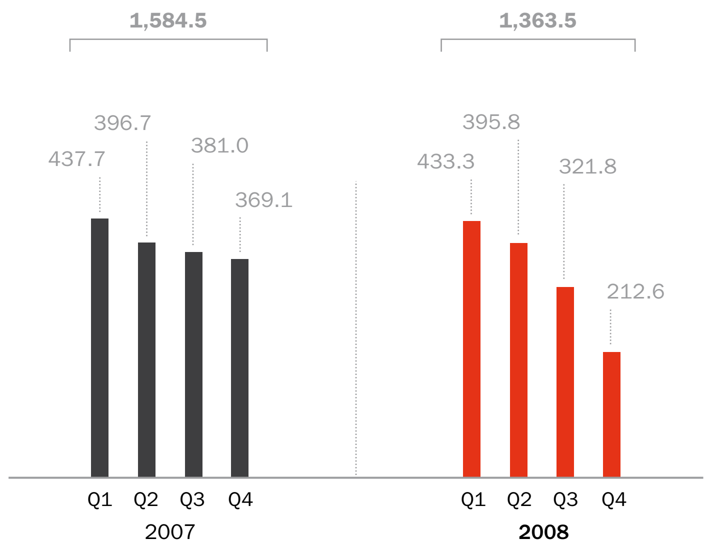
Economic slump impacts on business performance

Overall conditions both in the economy as a whole and in individual industries became increasingly gloomy during the course of 2008 and had a growing negative impact on DEUTZ business performance. Whereas key performance indicators, such as new orders, unit sales, revenue and EBIT were in line with, or exceeded, the 2007 figures up to the middle of the year, there was a significant collapse in demand in the second half of 2008; this affected the Compact Engines segment in particular.

DEUTZ Group: New orders
€ million

1) Includes DEUTZ Power Systems

DEUTZ Group: New orders by quarters
€ million

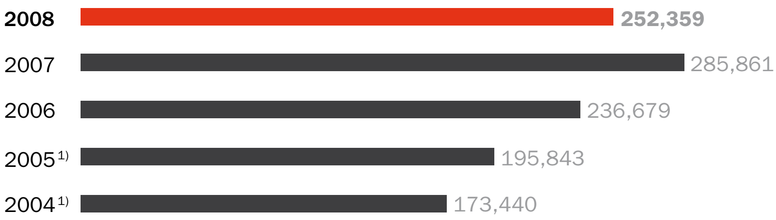


New orders hit by economic downturn

At the end of 2008, new orders in the DEUTZ Group amounted to € 1,363.5 million; this compares with a figure of € 1,584.5 million at the end of 2007. Demand therefore fell by 13.9 per cent. Despite the fact that new orders remained at the level of 2007 until the middle of 2008, the third and fourth quarters saw a double-digit decrease in line with the growing deterioration in economic conditions. The fall in new orders affected both segments. In Compact Engines, new orders worth € 1,032.5 million were received, 14.2 per cent down on the equivalent period in 2007 (2007: € 1,203.9 million). In DEUTZ Customised Solutions, new orders amounted to € 331.0 million compared with a figure of € 380.6 million in 2007. This equates to a decrease of 13.0 per cent, which is attributable both to the conversion by one agricultural machinery customer from air-cooled to water-cooled DEUTZ engines and also to the general economic situation.

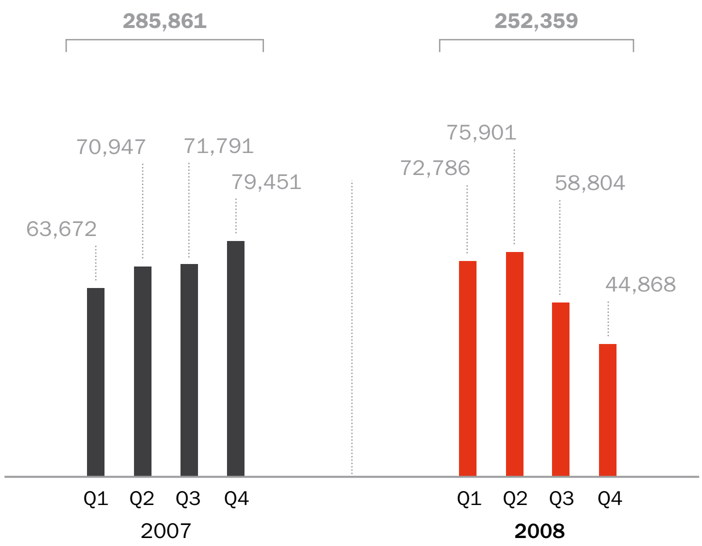
In line with the downturn in new orders in the second half of 2008, DEUTZ ended the year under review with orders on hand of € 179.5 million (31 December 2007: € 316.0 million).

DEUTZ Group: Unit sales
units



1) Includes DEUTZ Power Systems

DEUTZ Group: Unit sales by quarters
units



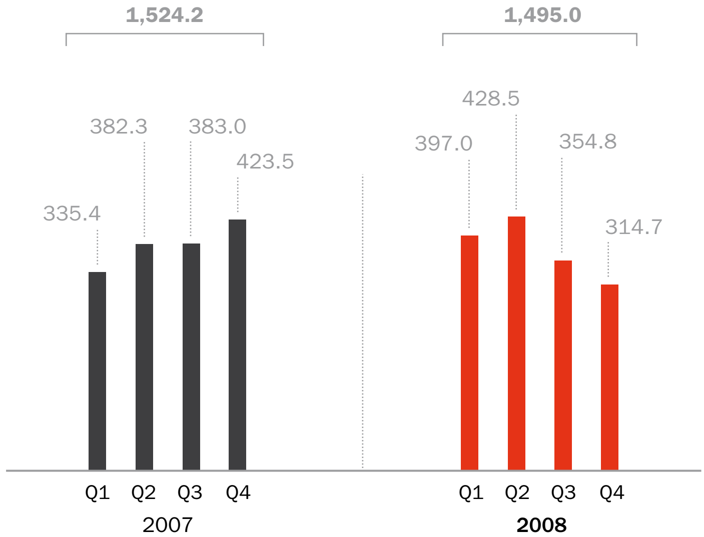
Unit sales down significantly at the end of the year

As a result of the downward trend in new orders, unit sales in the year under review amounted to 252,359 engines, 11.7 per cent down on 2007 which had been a record year with 285,861 engines sold. The decrease is primarily attributable to the downturn in unit sales in the fourth quarter; after the first nine months of 2008, the number of engines sold had still been at the level achieved in 2007. As regards the segments, both Compact Engines and DEUTZ Customised Solutions sold fewer engines than in 2007. Although unit sales of compact engines exceeded the level of unit sales in the corresponding period in 2007 until the end of the third quarter, the figure fell significantly in the fourth quarter and ended the year at 219,681 engines sold, which equates to a decrease of 11.8 per cent on 2007 (2007: 248,971 engines). DEUTZ Customised Solutions ended the year under review with unit sales of 32,678 engines (2007: 36,890 engines), a decline of 11.4 per cent. However, this decrease is attributable to the switch by one agricultural machinery customer from air-cooled to water-cooled DEUTZ engines (around 3,600 fewer engines than in 2007) and the discontinuation of the assembly of small air-cooled engines in Spain (around 2,900 fewer engines than in 2007).

DEUTZ Group: Revenue
€ million

1) Includes DEUTZ Power Systems

DEUTZ Group: Revenue by quarters
€ million



Positive revenue trend for DEUTZ Customised Solutions

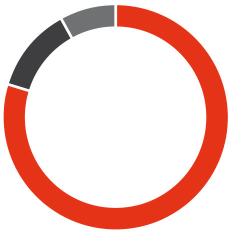
Consolidated revenue in 2008 amounted to €1,495.0 million and was therefore close to the 2007 revenue figure of €1,524.2 million (down 1.9 per cent). Up to the middle of the year, revenue had still been up by 15.0 per cent but in the second half of the year declined increasingly sharply. In the fourth quarter alone, revenue was down by a quarter on the equivalent period in 2007. The Compact Engines segment contributed €1,143.2 million to the total revenue for the DEUTZ Group, 3.6 percent less than in the corresponding period in 2007 (2007: €1,186.0 million). In contrast, an improvement in the product mix led to revenue in DEUTZ Customised Solutions of €351.8 million, which equates to a 4.0 per cent increase over 2007 (2007: €338.2 million).

Despite the drop in overall revenue in 2008, DEUTZ was able to continue the expansion of its groupwide service business: at €212.0 million, service business revenue was 4.2 per cent up on 2007 (2007: €203.5 million). However, given the global economic slowdown, the first signs of a downturn did begin to appear, primarily towards the end of the year: falling equipment utilisation rates and shorter operating periods at our end customers meant that some maintenance and repair work was being deferred.

DEUTZ Group: Revenue by application segment
€ million (2007 figures)

529.8	(581.3)	Mobile Machinery
266.2	(279.8)	Automotive
259.3	(258.8)	Stationary Equipment
212.0	(203.5)	Service
195.8	(163.7)	Agricultural Machinery
31.9	(37.1)	Miscellaneous
1,495.0	(1,524.2)	**Total**

DEUTZ Group: Revenue by region
€ million (2007 figures)



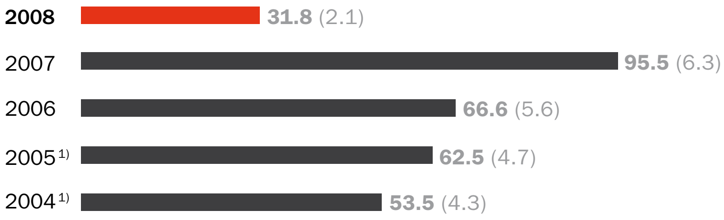
1,195.7	(1,193.2)	Europe/Middle East/Africa
180.7	(207.2)	Americas
118.6	(123.8)	Asia-Pacific
1,495.0	(1,524.2)	**Total**

Encouraging revenue performance in Germany

Considering 2008 as a whole, revenue held up well in Germany. However, the trend in the second half of the year was increasingly downward. In Germany, DEUTZ achieved revenue of €364.7 million, 8.7 per cent more than in 2007 (2007: €335.4 million). This increase was mainly attributable to the Agricultural Machinery application segment. Despite the deterioration in the general economic situation, there was excellent growth in the engines business for tractors and other agricultural equipment.

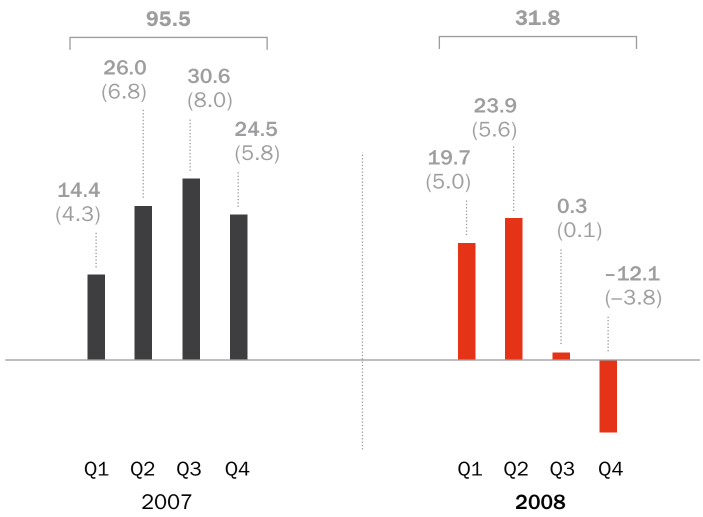
The fall in demand caused by the economic situation had significantly more impact on revenue outside Germany; revenue from non-German customers fell 4.9 per cent year-on-year from €1,188.8 million to €1,130.3 million. There was a corresponding change in the proportion of revenue accounted for by markets outside Germany: at the end of 2008, this figure was 75.6 per cent as against 78.0 per cent in 2007. Demand tailed off dramatically from the third quarter onwards. Revenue declined primarily in the Americas (North and South America), although this was also attributable to the less favourable exchange rate between the US dollar and the euro. As regards the individual regions, European countries other than Germany accounted for the largest proportion of revenue at €744.6 million (2007: €769.0 million), followed by the Americas with revenue of €180.7 million (2007: €207.2 million) and the Asia-Pacific region with revenue of €118.6 million (2007: €123.8 million). More than half the revenue generated in Asia came from Chinese customers.

DEUTZ Group: Operating profit/EBIT margin before one-off items
€ million (EBIT margin in %)



1) Includes DEUTZ Power Systems

DEUTZ Group: Operating profit/EBIT margin before one-off items by quarters
€ million (EBIT margin in %)



Significant fall in operating profit

In 2008, DEUTZ generated operating profit (EBIT) before one-off items of €31.8 million (2007: €95.5 million). This figure was adversely affected primarily by the dramatic decrease in volume in the second half of the year as a result of the economic downturn, the higher cost of materials as a result of price increases and changes in the product mis as well as start-up costs of €11.1 million (2007: €6.0 million) for the DEUTZ Dalian joint venture in China. In contrast, in 2007, residual one-off income from the sale of the Marine Service business amounting to €5.0 million and income in connection with the settlement of pension claims amounting to €9.0 million had a positive impact on operating profit. After one-off items, EBIT for 2008 came to €17.5 million (2007: €95.5 million). One-off expenses of €14.3 million relate to capacity adjustments in connection with the "MOVE" action programme (€10.5 million) and impairment losses on an engine series for small engines of up to 27kW. Most of the one-off effects were incurred in the Compact Engines segment. The Group operating profit margin fell accordingly from 6.3 per cent in 2007 to 2.1 per cent. After one-off items, the EBIT margin was 1.2 per cent (2007: 6.3 per cent).

The DEUTZ Customised Solutions segment made a significant contribution of €47.1 million to the operating profit (EBIT before one-off items) of the DEUTZ Group (2007: €44.7 million) and was up 5.4 per cent, whereas the Compact Engines segment reported an operating loss of €13.6 million (2007: operating profit of €45.3 million). The “Other” segment also recorded an operating loss of €1.7 million (2007: operating profit of €5.5 million), whilst in 2007 residual one-off income of €5.0 million had been reported from the sale of the Marine Service business.

The cost of materials as a proportion of total output in the DEUTZ Group again saw a slight year-on-year increase of 2.2 percentage points. The main reason for this was the increasing number of engine series that met the TIER 3 emission standards. This means our purchases of higher quality, complex components also increased and these series with the latest engine technology now account for a greater proportion of revenue. This trend primarily affects the Compact Engines segment. The rise in the price of commodities also forced up our cost of materials.

The €15.0 million rise in staff costs to €290.0 million in the year under review was largely attributable to one-off items for restructuring to enable us to adjust our capacity. In 2008, we recognised provisions of €10.2 million to cover this. This put the ratio of staff costs to total output at 19.1 per cent. Excluding the above one-off items, the ratio would have been 18.4 per cent.

The depreciation and amortisation expense in the year under review was €71.8 million (2007: €65.5 million). The increase compared with 2007 is attributable to the continuous rise in the capitalisation of development costs over the last few years. Operating profit in the year under review was also adversely affected by impairment losses amounting to a total of €2.6 million, which largely resulted from the decision to cease production of one of the series of engines with a capacity of less than four litres.

The €1.7 million reduction in other operating income to €65.0 million was mainly the result of two one-off items in 2007: the reversal of warranty provisions of €5.0 million in connection with the sale of the Marine Service business and the reversal of provisions for pension and other post-employment benefits of €9.0 million in connection with the surrender of vested company pension rights for which a compensation payment was made. The absence of these one-off income items in 2008 was only partially compensated for by income from foreign currency gains of €14.7 million, and these were in turn offset by foreign currency losses of €12.4 million recognized as other operating expenses.

The increase in other operating expenses to €159.1 million, a rise of €3.8 million, was largely attributable to foreign currency losses amounting to €12.4 million. On the other hand, DEUTZ was able to reduce its expenses for temporary employees and general services.

In the year under review, there was a further reduction in the profit on equity-accounted investments. This primarily resulted from losses in connection with the investment in the DEUTZ Dalian joint venture.

Net interest income increased by €4.8 million on 2007. The increase in interest expenses was more than compensated for by the increase in interest income resulting, in particular, from the fact that the significant funds from the sale of DEUTZ Power Systems were able to be invested over the whole twelve-month period of 2008.

Net income deteriorates

Taking into account the one-off items of €14.3 million, net income on continuing operations before tax amounted to €2.7 million compared with €76.1 million in 2007. Income taxes amounted to €6.9 million (2007: €16.7 million). The lower amount of income taxes on continuing activities were mainly attributable to lower income tax expenses due to the current earnings situation. The income tax expenses for the year under review primarily include deferred expenses from the lower revaluation of tax loss carryforwards reflecting the deterioration of the general economy. There was a net loss from continuing operations of €4.2 million compared with a net income of €59.4 million in 2007 and a further net loss on discontinued operations of €4.1 million (2007: net income of €123.9 million). In total, the net loss for the year amounted to €8.3 million (2007: net income of €183.3 million).

Basic earnings per share on continuing operations in 2008 was €–0.04 (2007: €+0.51).

DEUTZ Group segments

€ million	Continuing operations 2008	Continuing operations 2007	Change in %
New orders			
Compact Engines	1,032.5	1,203.9	–14.2
DEUTZ Customised Solutions	331.0	380.6	–13.0
Total	**1,363.5**	**1,584.5**	**–13.9**
Unit sales (units)			
Compact Engines	219,681	248,971	–11.8
DEUTZ Customised Solutions	32,678	36,890	–11.4
Total	**252,359**	**285,861**	**–11.7**
Revenue			
Compact Engines	1,143.2	1,186.0	–3.6
DEUTZ Customised Solutions	351.8	338.2	4.0
Total	**1,495,0**	**1,524.2**	**–1.9**
Operating profit (EBIT before one-off items)			
Compact Engines	–13.6	45.3	–
DEUTZ Customised Solutions	47.1	44.7	5.4
Other	–1.7	5.5	–
Total	**31.8**	**95.5**	**–66.7**

BUSINESS PERFORMANCE IN THE COMPACT ENGINES SEGMENT

Economic slump curbs demand

In 2008, the Compact Engines segment received new orders worth €1,032.5 million, 14.2 per cent down on 2007 (2007: €1,203.9 million). Demand, particularly demand for smaller engines (engines with a capacity of up to four litres), declined rapidly from the middle of the year onwards; new orders for four-litre to eight-litre engines also contracted towards the end of the year. Furthermore, the significant economic uncertainty also meant that customers were postponing and, in some cases, cancelling existing orders. On the positive side, there was growth in the demand for engines in the Agricultural Machinery application segment and for customer support services: both areas of the business experienced an increase in new orders compared with 2007.

Unit sales down significantly at the end of the year

Overall, the Compact Engines segment sold 219,681 engines in the year under review; in 2007, DEUTZ had sold 248,971 engines. The 11.8 per cent drop in unit sales resulted primarily from the significant decrease in unit sales of engines with a capacity of less than four litres which are mainly used in construction equipment and compressors. Unit sales of four-litre to eight-litre engines were only slightly down, although unit sales in the Agricultural Machinery application segment were up significantly on 2007. Despite the fact that unit sales in the Compact Engines segment over the first nine months of the year were slightly above unit sales over the comparable period in 2007, these unit sales fell by 50 per cent in the fourth quarter as a result of the slump in demand.

Compact Engines: Revenue by application segment
€ million (2007 figures)

454.8	(516.8)	Mobile Machinery
223.1	(237.6)	Automotive
186.0	(135.8)	Agricultural Machinery
170.6	(186.3)	Stationary Equipment
100.6	(92.5)	Service
8.1	(17.0)	Miscellaneous
1,143.2	(1,186.0)	**Total**

Double-digit revenue growth in Agricultural Machinery

Up to the end of September 2008, revenue still exceeded the figure achieved over the equivalent period in 2007; in the fourth quarter, segment revenue fell by a third, primarily in the Mobile Machinery application segment. Total revenue in the Compact Engines segment in 2008 was €1,143.2 million, 3.6 per cent below the revenue achieved in 2007 (2007: €1,186.0 million). Within the overall segment, performance in the individual application segments varied: Agricultural Machinery again managed to notch up a significant increase, achieving revenue of €186.0 million (2007: €135.8 million), an increase of 37.0 per cent on the year before. This is also attributable in part to a major customer in this segment switching from air-cooled to water-cooled DEUTZ engines. The service business also generated an encouraging increase, with revenue rising by 8.8 per cent to €100.6 million (2007: €92.5 million), primarily as a result of the growth in the spare parts business in Europe. In the other application segments, the trend in revenue was downward: revenue from engines in the Mobile Machinery application segment, the largest generator of revenue in the Compact Engines segment, fell to €454.8 million in the year under review (2007: €516.8 million), a decrease of 12.0 per cent. This application segment particularly felt the impact of the fall in demand for engines for construction and material handling equipment. Revenue also declined in the Stationary Equipment and Automotive application segments with decreases of 8.4 per cent to €170.6 million (2007: €186.3 million) and 6.1 per cent to €223.1 million (2007: €237.6 million) respectively. Whereas revenue for commercial vehicle engines remained slightly above the 2007 level until the end of September 2008, this business felt the impact in the fourth quarter of the significant slowdown in the European commercial vehicles industry. The drop in revenue in the Stationary Equipment application segment resulted, first and foremost, from the lower sales of engines for use in compressors – an end application closely linked to trends in the construction industry.

Operating profit adversely affected by various factors

There was a substantial decline in segment earnings (EBIT before one-off items) in the Compact Engines segment in the year under review: whereas EBIT had still been at around €21 million at the midpoint in the year, this had turned into an operating loss of €13.6 million by the end of the year (2007: operating profit of €45.3 million). The main reasons were the economic slump, the corresponding sharp drop in demand for compact engines – particularly in the second half of the year – and additional costs caused by increases in the price of materials. In addition, there were start-up losses in connection with the DEUTZ Dalian joint venture in China amounting to €11.1 million (2007: €6.0 million), which also adversely impacted on operating profit.

In the Compact Engines segment, one-off items amounting to minus €12.3 million were reported in connection with the "MOVE" action programme. EBIT after one-off items was minus €25.9 million.

DEUTZ Dalian joint venture in first full year of production

The DEUTZ (Dalian) Engine Co., Ltd. joint venture in China ended the year under review, its first full year of production, having manufactured a total of around 97,000 engines; of this total, approximately 7,000 engines were produced on the basis of DEUTZ technology. The total revenue generated amounted to more than €226 million. In addition to the supply of engines to our largest customer, FAW Jiefang Automotive Co., Ltd., which is also our partner in the joint venture of which it owns 50 per cent, we were also able to develop our supply relationship with other DEUTZ customers in China. In 2008, the joint venture employed just under 2,000 people at the Dalian facilities.

The joint venture is still in the start-up phase. In the year under review, we therefore recognised losses of €11.1 million (losses in 2007: €6.0 million). There was also an adverse impact from the slowing of growth in China as a result of the global economic slump and from increases in the cost of materials.

BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS SEGMENT

Growing signs of a downturn in new orders

There was a decrease in new orders in the DEUTZ Customised Solutions segment in the year under review, primarily in the new engines business. Total new orders amounted to €331.0 million (2007: €380.6 million), a year-on-year decrease of 13.0 per cent. A switch from air-cooled to water-cooled DEUTZ engines by one of the major customers in the Agricultural Machinery application segment was one reason for this, with new orders in this application segment falling by more than half. Demand for service support activities remained encouragingly buoyant, but the global economic downturn also resulted in an easing of demand in this area. The deterioration in market conditions also had an impact on the level of new orders in the new engines business towards the end of the year, particularly in the area of engines for construction equipment and mining equipment.

Decrease owing to the change in sales structure

In the year under review, DEUTZ Customised Solutions sold 32,678 engines, 11.4 per cent fewer than in 2007 (2007: 36,890 engines). The switch by one of the agricultural machinery customers from air-cooled to water-cooled DEUTZ engines and the cessation of assembly of small air-cooled engines in Spain resulted in 2008 in an overall fall in unit sales of engines in air-cooled series, which account for around 86 per cent of unit sales in the segment. Only large air-cooled engines with a capacity of more than eight litres managed to achieve a double-digit increase. We were also able to generate a year-on-year increase in the unit sales of large liquid-cooled engines that are used, for example, in rail and marine applications.

DEUTZ Customised Solutions: Revenue by application segment
€ million (2007 figures)

111.4	(111.0)	Service
88.7	(72.5)	Stationary Equipment
75.0	(64.5)	Mobile Machinery
43.1	(42.2)	Automotive
9.8	(27.9)	Agricultural Machinery
23.8	(20.1)	Miscellaneous
351.8	(338.2)	**Total**

Encouraging growth in revenue

Despite the decline in unit sales, revenue in the DEUTZ Customised Solutions segment climbed by 4.0 per cent in the year under review. In 2008, segment revenue amounted to €351.8 million compared with €338.2 million in 2007. The engines business in the Stationary Equipment application segment recorded double-digit revenue growth with revenue rising in the year under review to €88.7 million (2007: €72.5 million), an increase of 22.3 per cent. This growth is primarily attributable to an improved product mix. The Mobile Machinery (mainly mining equipment) and Automotive application segments were able to achieve further improvements in revenue: a 16.3 per cent increase to €75.0 million (2007: €64.5 million) and a 2.1 per cent increase to €43.1 million (2007: €42.2 million) respectively. The Automotive application segment in DEUTZ Customised Solutions includes both the supply of air-cooled engines to commercial vehicle customers in North Africa and Turkey as well as the special rail vehicles business. The “Other” application segment – comprising engines for marine applications for the most part – increased revenue by 18.4 per cent to €23.8 million (2007: €20.1 million). The only exception was revenue relating to air-cooled engines for the Agricultural Machinery application segment, which fell to €9.8 million (2007: €27.9 million), for the reasons already explained. As in 2007, the largest proportion of segment revenue was the €111.4 million (2007: €111.0 million) generated by DEUTZ Customised Solutions in its service business, up 0.4 per cent on 2007. In addition to spare parts, the service business also includes the business involving reconditioned exchange parts and engines, referred to as “Xchange” engines.

Segment operating profit continues to grow

The performance of the DEUTZ Customised Solutions segment was encouraging in terms of operating profit. In 2008, the segment generated operating profit (EBIT before one-off items) of €47.1 million, which equates to an increase of 5.4 per cent on 2007 (2007: €44.7 million). This increase is primarily attributable to the rise in revenue from an improved product mix and the significant proportion accounted for by the service business, but also to the absence of the start-up costs that had been incurred in 2007 in connection with the relocation of production from Cologne to Ulm.

In the DEUTZ Customised Solutions segment, one-off items amounting to minus €1.3 million were reported in connection with the “MOVE” action programme. EBIT after one-off items was €45.8 million.

NET ASSETS AND FINANCIAL POSITION

Financial management centrally organised

Responsibility for financial management in the DEUTZ Group is held by DEUTZ AG as the overall parent company in the Group. This responsibility primarily comprises management of the lines of credit required by the Company, cash pooling and any necessary foreign exchange hedging. Centralised cash pooling ensures optimum use of cash within the Group. Foreign currency surpluses in the Group are to a large extent naturally hedged by purchasing agreements. The risk arising in connection with any remaining or foreseeable currency surpluses or requirements are hedged by the head office finance department in accordance with internal guidelines.

To date, the current financial crisis has not had any direct impact on DEUTZ‘s net assets and financial position because DEUTZ AG does not currently have to make use of short-term lines of credit and the Company covered its long-term financing requirements with the placement of a bond in the USA in 2007 (US private placement). DEUTZ AG complied at all times with existing covenants – ancillary loan agreements specifying particular key performance indicators. The covenants are defined by key performance indicators based on the ratio of net debt to equity, net debt to EBITDA (before one-off items), and EBITDA (before one-off items) to net interest income/expense. Net debt includes all current and non-current interest-bearing financial liabilities (loans, bonds, notes, finance lease liabilities less any existing cash and cash equivalents). It also has unused short-term lines of credit. We only had to accept a very small number of margin increases relating to short-term lines of credit made available by the banks.

Long-term funding via US private placement

By issuing bonds for US$ 274 million as part of a private placement in the United States in 2007, DEUTZ obtained long-term, non-bank-based financing with maturities of five, seven and ten years. This means that we are not directly impacted by the current difficulties in the credit markets. Interest payments and the repayment of the principal in US dollars are hedged over the entire maturity of the bonds by cross-currency swaps in euros. In other words, DEUTZ is not faced with any interest rate or currency risks in connection with the US private placement.

Optimum receivables management by means of factoring

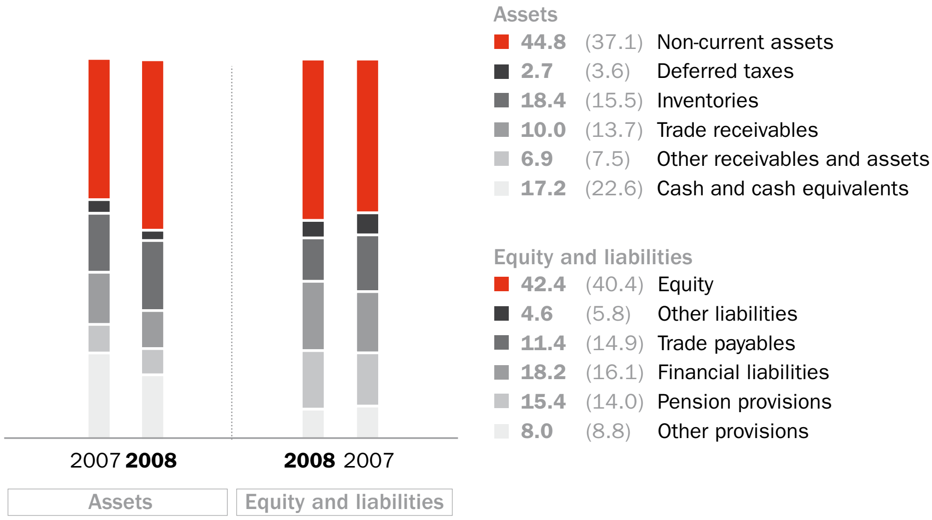
Over the last few years, factoring – the sale of receivables – has steadily become increasingly important. DEUTZ uses these opportunities to sell receivables in order to optimise our receivables management. As at 31 December 2008, the volume of receivables sold under factoring agreements was around €93 million (2007: approximately €95 million).

Convertible bond issued in 2004 called in

Of the original issue of 19,792,998 convertible bonds, 839,263 were still outstanding at the end of 2007. Since the outstanding volume represented less than 10 per cent of the original issue, DEUTZ made use of the provision in the terms of the bond to call the bond. The effective date for redeeming the bond was 7 March 2008, although up to 3 March 2008 bondholders still had the option to exchange one convertible bond for one DEUTZ share. The 68,070 bonds that had not been exchanged by that date were redeemed at a price of €3.40 per bond by way of a total cash payment to bondholders of €0.2 million.

The structure of the DEUTZ Group balance sheet as at 31 December 2008 was largely unchanged on that as at 31 December 2007 and was as follows:

DEUTZ Group: Balance sheet structure
in %



Decrease in total assets

As at 31 December 2008, the total assets of the DEUTZ Group amounted to €1,206.3 million, a decrease of €172.3 million on the total assets as at 31 December 2007. Although there was an increase in non-current assets, largely as a result of capital expenditure on property, plant and equipment (up €7.5 million) and the capitalisation of development costs (up €15.1 million) this increase was more than offset, in particular, by the decrease in trade receivables and in cash and cash equivalents.

As at 31 December 2008, working capital (total of inventories and trade receivables less trade payables) amounted to €205.0 million, an increase of €8.1 million on the working capital as at 31 December 2007 (€196.9 million). The reason for this increase was an increase in inventories amounting to €7.8 million, caused by a slower turnover of inventories as a result of the economic situation. Given the sharp fall in business volume in the second half of 2008, there was a corresponding reduction in trade receivables (decrease of €67.7 million) and trade payables (decrease of €68.0 million). The average working capital ratio (ratio of average working capital over four quarters to the revenue for twelve months) was 16.2 per cent, on average 2.9 percentage points above the corresponding ratio for 2007. The high quarterly inventory levels were a significant contributing factor in this regard. The working capital ratio on the balance sheet date was 13.7 per cent, an increase of 0.8 percentage points over the ratio on 31 December 2007.

Slight increase in working capital

The reduction in total assets resulted in an equity ratio of 42.4 per cent, two percentage-points higher than at 31 December 2007 (40.4 per cent). As at the balance sheet date, equity had decreased by €45.8 million to €511.3 million (31 December 2007: €557.1 million). In particular, the reasons for the decrease were the dividend distribution amounting to €48.0 million and the consolidated net loss of €8.3 million in the year under review.

Dividend distribution reduces equity

Current and non-current provisions for pensions and other post-employment benefits were reduced as planned by €7.7 million to €185.7 million (31 December 2007: €193.4 million).

Other current provisions were reduced year-on-year by €14.9 million to €48.8 million (31 December 2007: €63.7 million). The necessary recognition of a provision for capacity adjustment costs amounting to €10.2 million was more than offset, amongst other things, by the utilisation of warranty provisions arising from the sale of DEUTZ Power Systems in 2007.

The fall of €68.0 million in trade payables as at 31 December 2008 to €138.1 million (31 December 2007: €206.1 million) was attributable to the reduction in purchasing volume as a result of the growing downturn in new orders in the second half of 2008.

Reduction in provisions and liabilities

ROCE (ratio of EBIT before one-off items to the average capital employed, comprising the asset side of the balance sheet less cash and cash equivalents, less trade payables and less other liabilities) for 2008 was 4.0 per cent (2007: 13.5 per cent), the result of lower operating profit before one-off items and a higher average capital employed.

Return on capital employed (ROCE) deteriorates

As at 31 December 2008, the net financial position was minus €12.2 million. The equivalent figure as at 31 December 2007 was plus €89.7 million as a result of the significant inflow of funds from the proceeds of the disposal of DEUTZ Power Systems.

The “net financial position” key performance indicator is defined as the existing cash and cash equivalents less all current and non-current interest-bearing financial liabilities in the form of loans, bonds, notes and finance lease liabilities.

Lower net financial position

Downturn in business activity impacts on cash flow

Cash flow from operating activities was raised by € 128.4 million on the previous year to €89.7 million (2007: minus € 38.7 million). This increase results primarily from a € 73.4 million reduction in the level of working capital required and from the absence of the payment of compensation for vested company pension rights totalling € 79.8 million that had been made in the corresponding period in 2007.

Cash flow from investing activities fell to minus € 97.3 million largely owing to lower capital expenditure on financial assets (2007: minus € 144.1 million). In 2007, the Company had made payments amounting to around € 58 million for the 50 per cent stake in the DEUTZ Dalian joint venture in China.

Cash flow from investing activities for discontinued operations amounting to a total of minus € 26.8 million reflected the effects of the sale of the DEUTZ Power Systems segment in 2007 to the financial investor 3i, the effects of this sale comprising the settlement agreed with 3i and the various processing costs.

Cash flow from financing activities amounted to minus € 69.2 million (2007: € 161.9 million). It includes interest paid, the payment of € 48.0 million in dividends to shareholders and the repayment of bank debt amounting to € 6.0 million. The positive cash flow from financing activities in the previous year included the inflow of funds from the US bond placement.

Free cash flow from continuing operations in 2008 excluding the settlement of vested company pension rights amounted to minus € 23.3 million compared with minus € 111.5 million in 2007.

DEUTZ Group: Summary cash flow statement

€ million	2008	2007
EBIT	**17.5**	**95.5**
Cash flow from operating activities before payment of compensation for vested company pension rights (continuing operations)	**90.1**	**41.1**
Payment of compensation for vested company pension rights (continuing operations)	–0.4	–79.8
Cash flow from operating activitites (continuing operations)	**89.7**	**–38.7**
Cash flow from operating activitites (discontinued operations)	–	–9.1
Cash flow from operating activitites (total)	**89.7**	**–47.8**
Capital expenditure on intangible assets, property, plant and equipment and investments	–97.5	–159.0
Cash receipts from the sale of businesses and proceeds from the sale of non-current assets	0.2	14.9
Cash flow from investing activities (continuing operations)	**–97.3**	**–144.1**
Cash flow from investing activities (discontinued operations)	–26.8	296.4
Cash flow from investing activities (total)	**–124.1**	**152.3**
Free cash flow	**–23.3**	**–111.5**
Cash flow from financing activities	**–69.2**	**161.9**
Change in cash and cash equivalents	**–103.6**	**266.4**

CAPITAL EXPENDITURE

Volume of capital expenditure adjusted in line with the economic situation

Capital expenditure, including capitalised development costs, amounted to a total of €118.1 million in 2008 compared with €167.8 million in 2007. Approximately €58 million of the relatively high prior-year figure was spent on the 50 per cent stake in the DEUTZ Dalian joint venture in China.

Some of the capital expenditure planned for 2008, in particular expenditure on the expansion of capacity, was deferred as a result of the economic situation. We invested €61.6 million in property, plant and equipment (2007: €73.9 million) and €56.7 million in intangible assets (2007: €36.0 million). The capital expenditure on intangible assets included €48.2 million on capitalised development costs; the corresponding figure in 2007 was €24.3 million. The capitalised development costs were primarily in support of development to meet the future TIER 4 Interim and TIER 4 Final emission standards for industrial and agricultural machinery applications.

Capital expenditure without financial assets 2008 by usage
€ million (2007 figures)

57.2	(44.1)	New products/engine refinement/R&D
23.0	(37.7)	Expansion of capacity
16.0	(10.4)	Replacement procurement
6.2	(7.7)	Structural measures
15.9	(10.0)	Miscellaneous
118.3	(109.9)	**Total**

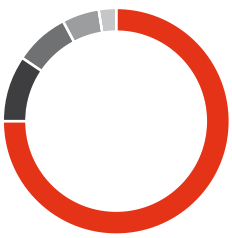
Capital expenditure in the Compact Engines segment

The bulk of DEUTZ's capital expenditure was dedicated to the Compact Engines segment. Total capital expenditure in this segment was €106.6 million (2007: €160.5 million), with almost half of the expenditure (€45.1 million) being accounted for by capitalised development costs in connection with the development and refinement of engines in line with existing and future exhaust-gas emission standards. Other capital expenditure was directed towards replacement procurement and targeted adjustments in capacity at production facilities in Cologne and Zafra (Spain) focussing on four-litre to eight-litre engines. A number of processing centres, lathes, grinding and milling machines for the production of crankcases, camshafts, crankshafts, conrods and cylinder heads were purchased.

Capital expenditure in the DEUTZ Customised Solutions segment

The DEUTZ Customised Solutions segment accounted for €11.5 million of this capital expenditure (2007: €7.3 million); this included the implementation of measures to comply with environmental covenants at the Ulm facilities – the engine testing facility was equipped with a diesel filter installation. Some of the capital expenditure was directed towards the development of the Xchange plant in the USA. Other expenditure was also directed towards necessary replacement procurement in mechanical fabrication.

Capital expenditure without financial assets 2008 by location
€ million (2007 figures)

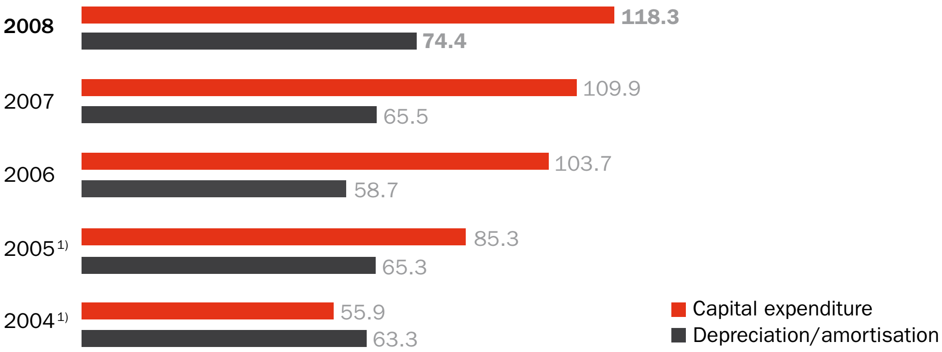


89.0	(60.9)	Cologne
11.0	(21.9)	Zafra/Spain
9.4	(7.3)	Ulm and Übersee/Germany
6.2	(18.0)	Suppliers
2.7	(1.8)	Other international locations
118.3	(109.9)	**Total**

Depreciation, amortisation expense and impairment losses above 2007 level

The depreciation/amortisation expense and impairment losses in the DEUTZ Group were higher in 2008 than in 2007, amounting to € 74.4 million (2007: € 65.5 million). € 24.2 million was accounted for by intangible assets (2007: € 17.9 million), whereas property, plant and equipment accounted for € 50.2 million (2007: € 47.6 million).

Capital expenditure and depreciation/ amortisation expense and impairment losses (excluding financial assets)
€ million



1) Includes DEUTZ Power Systems

OVERALL ASSESSMENT OF 2008

Performance affected by economic slump

The course of 2008 was characterised by a significant worldwide economic slowdown as a consequence of the global crisis in the financial markets. This trend, which led to a great deal of uncertainty on the part of our customers across all industries and regions, accelerated from the middle of the year onwards, impacting specifically on performance in the second half of the year. Whereas unit sales and revenue notched up double-digit growth rates up to the midpoint in the year and remained in line with budgets, a slowing of demand was already noticeable in new orders. In its half yearly report, DEUTZ adjusted its forecast for the whole year to reflect this trend. The subsequent slump in demand as a consequence of the massive deterioration in the economic situation led to a further adjustment of the forecast for 2008.

Adverse impact on operating profit from fall in unit sales and increase in cost of materials

The rapid and substantial drop in unit sales in the third quarter and above all in the fourth quarter of 2008 had a negative impact on operating profit and therefore also on the EBIT margin. Operating profit was also hit by the rise in the cost of materials: the cost of materials was adversely affected both by higher material prices and, more than anything else, by the higher proportion of unit sales accounted for by newly launched engine series containing components based on higher-cost technologies. The EBIT margin before one-off items of 2.1 per cent in 2008 was markedly below our target figure.

Action programme to secure profitability and the future of the business

Given the changes in economic conditions and in expectation of a difficult trading environment during the current financial year, we have initiated an action programme known as "MOVE" to secure profitability and the future of the business. In the current year, we are focussing primarily on an immediate reduction in costs. "MOVE" also includes structural measures to bring about a sustained improvement in profitability by means of more efficient processes.

ROCE fell to 4.0 per cent in the year under review, reflecting the change in net income. Working capital increased in the year under review to around €205 million, primarily as a result of the increase in inventories, itself the result of the slower turnover induced by the economic circumstances. The key balance sheet data as at 31 December 2008 shows that the financial structure of DEUTZ is sound: the Company enjoys an equity ratio of around 42 per cent and has a balance of cash and cash equivalents of around €208 million. Longer-term funding is secured primarily by way of a bond placed with US investors in 2007 (US private placement).

Sound balance sheet

At the time of preparation of the 2007 consolidated financial statements, the sale of DEUTZ Power Systems, including the price adjustment mechanisms stipulated in the sale and purchase agreement, had not yet been completed. In October 2008, financial investor 3i, to whom DEUTZ had sold its gas and diesel engines business for decentralised power generation in September 2007, announced that it was pursuing a retrospective reduction in the purchase price by initiating an arbitration action. In November 2008, DEUTZ reached an out-of-court agreement with 3i on all its claims in connection with the acquisition of DEUTZ Power Systems. Under this settlement, DEUTZ AG has undertaken to make a compensation payment to 3i in full and final settlement of all claims on the part of 3i in connection with the sale and purchase agreement. Taking into account the provisions recognised in connection with the disposal and other countervailing effects, the adjustments to the purchase price produced a net loss on discontinued operations of €4.1 million and cash flow from investing activities of discontinued operations of minus €26.8 million.

Out-of-court agreement with the financial investor 3i

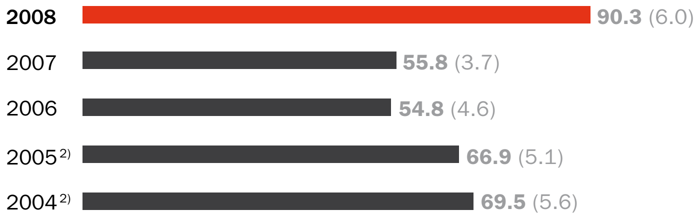
RESEARCH AND DEVELOPMENT

In 2008, research and development (R&D) expenditure amounted to €90.3 million (2007: €55.8 million). €78.7 million of this expenditure was attributable to the Compact Engines segment (2007: €47.3 million) and €11.6 million to the DEUTZ Customised Solutions segment (2007: €8.5 million). The increase in R&D expenditure in the year under review by more than 60 per cent was primarily attributable to development projects in connection with the next exhaust-gas emission stages. The R&D ratio – the ratio of R&D expenditure to consolidated revenue – rose accordingly in the year under review to 6.0 per cent (2007: 3.7 per cent). The number of employees in research and development also increased: as at 31 December 2008, DEUTZ had 431 R&D employees (31 December 2007: 388) at its Cologne facilities and at its Dursley site in the UK.

Research and development (R&D) activities stepped up

In the year under review, around 77 per cent (2007: 66 per cent) of all R&D expenditure was accounted for by new engine development and engine refinement, around 17 per cent (2007: 23 per cent) by customer applications and support for engine series production, and the remaining 6 per cent (2007: 11 per cent) by research and preliminary development.

Research and Development expenditure
€ million (R&D ratio in %)[1]



1) R&D ratio = R&D expenditure/group revenue
2) Includes DEUTZ Power Systems

Focus on development of TIER 4 engines

In 2011, exhaust-gas emission stage EU IIIB in Europe and TIER 4 Interim in the USA come into force for mobile machinery engines with an output of 130kW or more. These emissions standards include a nitrogen oxide (NOX) emission limit of 2.0 g/kWh and a diesel particulate emission limit of 0.025 g/kWh. As the US name, TIER 4 Interim, already indicates, this is an interim standard to be followed in 2014 by TIER 4 Final in the US and EU IV in Europe. This subsequent standard will impose a further reduction in the emission limit for nitrogen oxide to 0.4 g/kWh. This statutory requirement means that, by 2014, emissions of the exhaust-gas components nitrogen oxide and diesel particulates will have to be reduced by a total of 95 percent compared with the levels in 1999.

In the year under review, the focus of R&D activities in the Compact Engines and DEUTZ Customised Solutions segments was therefore on the development of appropriate engine series capable of meeting the limits imposed by the next exhaust-gas emissions standards. The key task has been to develop technologies for injection, supercharging, exhaust-gas recirculation and exhaust-gas aftertreatment. In addition to harmonising technical parameters in engines and carrying out design adjustments for the various customer applications, we have also carried out initial functional testing using prototypes. We are currently preparing further field trials that will be initiated during the course of this year.

In 2008, DEUTZ also laid down the foundations for the development of engines with outputs of less than 130kW to which the TIER 4 Interim emission standard applies from 2012. Taking into account the special requirements for this class of engine, our focus has been on the development of compact, less expensive systems. At the start of 2008, we started up production of engines with outputs between 37 and 75kW that meet the TIER 3 emission standard.

Exhaust-gas aftertreatment systems for customer-specific solutions

The required reduction in emissions of nitrogen oxides and soot particles from 2011 and 2014 can no longer be achieved from within the engine alone or via systems for recirculating exhaust gas. These reductions require the use of exhaust-gas aftertreatment systems. These engines use SCR (selective catalytic reduction) systems to reduce nitrogen oxide. We are able to make use of our experience in manufacturing such engines for on-road applications (commercial-vehicle engines) in the development of these engines for non-road applications. Special filter systems are required for the soot particles arising in the combustion of diesel fuel. In this regard, we have many years of experience, particularly from our retrofitting business. We have already developed an electronically controlled burner system for the regeneration of the filter element that is sometimes required and have carried out initial functional testing. Our objective is to offer customers exhaust-gas aftertreatment solutions optimally designed for their applications.

Further development of the hybrid drive

For DEUTZ, technological progress also means the development of innovative engine designs to achieve a sustained improvement in the impact of engines on the environment. These designs include the hybrid drive, which DEUTZ had already presented at the "bauma" construction equipment trade fair in 2007 as the world's first hybrid drive for construction equipment; the drive was installed in a wheel loader.

This drive is now being developed for production and hybrid-related R&D activity in 2008 was therefore focussed on the following elements. The prototype at "bauma" was equipped with a lithium-ion battery. DEUTZ is also simultaneously investigating the use of other battery technologies, for example bipolar lead-acid batteries, which are simple, robust and efficient, but comparatively inexpensive. The development of system software for the hybrid drive is being handled inhouse by DEUTZ. New functions and operating strategies to reduce fuel consumption and emissions, and at the same time enhance performance, have been developed in this regard and tested in the wheel loader. To optimise consumption, the wheel loader that was presented at "bauma" received new hydraulics optimised for the hybrid drive and a smaller engine (downsizing) with lower fuel consumption. At the same time, work began on the construction of a second wheel loader with the refined hybrid system. DEUTZ has also gained a second key customer from the construction equipment industry for use of the hybrid system.

In 2008, we also set up an "alternative drives" team comprising specialists in various areas such as electric motors, power electronics, storage technologies, software and system development, and system applications. With this team of experts, we have been able to refine components, for example an electric motor that is significantly more compact but with increased output.

Patent applications underline innovative strength

The number of patents held by DEUTZ rose again during the year under review, reflecting the very strong innovative culture in the Group. In 2008, patent applications were filed for a total of 37 inventions, of which 30 were in Germany and 7 elsewhere. At the end of 2008, the DEUTZ Group held a total of 343 patent applications, patents and utility models, of which 189 were in Germany and 154 elsewhere.

PROCUREMENT

The international procurement markets for unfinished parts and components were characterised in 2008 primarily by starkly opposing economic trends.

In the first half of 2008, procurement continued to be under some strain, as in 2007, as a consequence of the strong growth in the DEUTZ Group and the positive general economic situation. This resulted in supply bottlenecks for individual components, a sharp rise in the inflation surcharge imposed by suppliers for the steel scrap element in purchased cast-iron and forged parts, and general price increases on bought-in parts.

With the growing slowdown in the global economy during the second half of 2008, the situation in procurement markets eased off noticeably and any bottlenecks in the supply of parts disappeared. However, contractual obligations meant that there was some delay before DEUTZ was able to adjust the purchasing of parts in response to the rapid, sharp fall in unit sales. The situation also normalised in commodities markets, primarily in the fourth quarter, although the fall in commodity prices during 2007 has not yet had any impact on DEUTZ due to the calculation methodology for the inflation surcharge.

Collaboration with suppliers for forthcoming emission stages

In the year under review, we specifically set out the basis for collaboration with suppliers of exhaust-gas aftertreatment components and concluded negotiations about long-term agreements for the purchase of components in connection with the next stages in exhaust-gas emission standards. For these components, DEUTZ relies on the expertise of relevant global market leaders and on innovation-oriented collaboration with these companies. The “MOVE” action programme also included various measures in purchasing to help us identify potential savings jointly with our suppliers. Among other things, we held workshops with the suppliers who account for most of DEUTZ‘s purchasing volume and set up commercial and technical benchmarks.

Commodity prices at a record level

In 2008, prices of the main raw materials used by DEUTZ reached record levels. The market-price foundry scrap steel – the main material used by iron foundries and therefore DEUTZ‘s most important raw material – increased from € 260 per tonne at the start of 2007 to over € 470 per tonne by the middle of 2008. On average over the year, inflation surcharges for foundry scrap steel and scrap in forged products registered a year-on-year increase of more than 30 per cent and more than 50 per cent respectively. Only prices for the non-ferrous metals copper and aluminium saw a slight reduction on average compared with 2007.

Cost of materials: foundry products account for significant proportion

In 2008, foundry products, fuel injection equipment and measurement and control devices were the most significant items in the cost of materials. Foundry products accounted for around 40 per cent, fuel injection equipment for around 25 per cent and measurement and control devices together for around 10 per cent of the cost of materials. Other important material subcategories were generators and starters, turned parts, sheet metal parts, DIN and standard parts, together with forged parts.

PRODUCTION

Component production and engine assembly in the DEUTZ Group are based at the following sites:

Assembly and component production by location

	Germany Cologne region	Spain Zafra	Germany Ulm	China JV Dalian	Argentina JV Buenos Aires
Assembly	●		●	● [1]	● [1]
Component manufacturing					
Crankcases	●		●	●	
Cylinder heads	●	●		●	
Crankshafts	●		●		
Camshafts	●			●	
Conrods		●			

1) Joint ventures in China and Argentina are accounted for using equity method.

In line with the accelerating downturn in the economy during 2008, the figure of 251,057 engines produced by the DEUTZ Group in 2008 was 12.5 per cent down on the production volume in the record year enjoyed in 2007 (286,968 engines).

In the year under review, the assembly plants at Cologne-Porz and Cologne-Deutz produced a total of 218,601 engines (2007: 251,384 engines), a year-on-year decrease of 13.0 per cent. The cut in production from the middle of the year particularly affected engines with a capacity of less than four litres, which are used mainly in construction equipment and compressors. Production of four-litre to eight-litre engines was only scaled back in line with the reduced market volume in the fourth quarter of 2008. In the second full year of production for the TCD 2013 4V engine, the assembly lines rolled out 32,784 engines, exceeding the high production figures achieved in the previous year (2007: 31,544 engines). However, by the end of 2008, there was a significant reduction in call-off orders for this engine series following a downturn in demand in the global commercial vehicles market, primarily in the fourth quarter.

Downward market trend impacts on production in Cologne

With the onset of a drop in demand – initially specifically for engines with a capacity of less than four litres from the middle of 2008 – three-shift operation at the main assembly plant at Cologne-Porz was replaced by two-shift operation. In November 2008, the shift operation for four-litre to eight-litre engines was also switched to two shifts. As a result of these changes, the number of temporary and contract employees in production was reduced significantly. Following the unexpectedly sharp drop in orders in the fourth quarter, DEUTZ introduced short-time working at the start of December 2008 for parts of its production and assembly operations; this affected the Cologne plants.

Production capacity adjustments and short-time working necessary

In 2008, DEUTZ introduced further measures to enhance productivity as part of its continuous improvement process (CIP) and stepped up these activities during the course of the year as a result of the business trends over the year. We initiated continuous workshops on the subject of value flow optimisation with the aim of improving material flows and workflows along the production process. Other key areas for attention were the reduction of set-up times and the standardisation of individual workstations in production in order to minimise the time spent on locating parts and to shorten transit channels. All the action taken is based on the philosophy of “lean production”, i.e. lean production processes, a sharp focus on synchronisation with the customer and continuous maximisation of value creation.

Continuous improvement process ongoing

A total of 31,444 engines (2007: 31,308 engines) were produced at the Ulm plant in 2008, of which 27,751 units were air-cooled engines and 3,693 units were liquid-cooled engines in engine series with a capacity greater than eight litres. The year under review also saw the start of production for DEUTZ air-cooled diesel gensets (ADGs) – complete power generation units based on an air-cooled engine. ADGs are the first-ever products offered by DEUTZ to end-customers and in the year under review were already showing the first signs of success in the marketplace.

Ulm: centre of competence for air-cooled diesel engines

Since the relocation of the production of air-cooled engine series from Cologne in 2007, the Ulm plant has been the centre of competence for air-cooled diesel engines in the DEUTZ Group and in 2008 the plant managed to achieve further increases in productivity. Key areas that were streamlined included goods inward, picking & packing zones and the entire assembly process; the relevant organisational structures were also more closely aligned with processes.

In the year under review, production at the Ulm plant was hardly affected by the downturn in demand: the production programme is based on longer term project business and covers customer segments such as rail and marine applications, which to date have been less affected by the economic slowdown. This means that we did not have to adjust production at the Ulm plant during 2008.

Zafra: component supplier in DEUTZ's network of production facilities

Following the final cessation of production of small air-cooled engines in the 909 and 910 engine series at the start of 2008, the Spanish plant at Zafra is now exclusively a component supplier in the DEUTZ Group's network of production facilities. The plant concentrates primarily on the production of conrods, cylinder heads and gearwheels for the assembly plants in Cologne and Ulm.

In the year under review, Zafra successfully completed the ramp-up in production of cylinder heads and conrods compliant with the TIER 3 exhaust-gas standard for the 2011 engine series which is assembled in Cologne. It also produced the first cylinder head prototypes designed for the next TIER 4 emission stage.

As a consequence of the downturn in new orders and unit sales in the DEUTZ Group, component manufacture structures at Zafra were also adjusted in the second half of 2008 in line with the changes in the economic situation: among other things, shift operation was adjusted to reflect demand.

International joint ventures

The DEUTZ (Dalian) Engine Co., Ltd. joint venture in China, which commenced operations in August 2007, completed its first full year of production in the year under review. In 2008, the joint venture's production lines manufactured around 97,000 engines primarily for the Chinese commercial vehicles market, of which around 7,000 units were based on licensed DEUTZ technology. In Weifang – where DEUTZ has been operating the Weifang Weichai-Deutz Diesel Engine Co., Ltd. joint venture together with Weichai Power since 2000 – over 29,000 engines were produced in 2008 for various application segments, mainly for the Chinese market. In the year under review, the Argentinian joint venture, DEUTZ AGCO Motores S.A. (DAMSA), produced more than 3,400 engines for the local market, primarily for agricultural machinery applications.

Strict guidelines ensure consistently high level of quality

DEUTZ structures all its processes - from development through to the delivery of engines - in accordance with strict quality guidelines. These guidelines were also accompanied by quality offensives during 2008. Ultimately, a sustained high level of engine quality is one of the outstanding factors in our success.

An important yardstick in the measurement of engine quality is the satisfaction of our customers. Quality is measured objectively on the basis of the additional costs that are incurred in connection with internal rejects or warranty repairs despite all the care taken in production. These costs are recorded on the basis of internal rules, although they cannot be compared with competitors because there is no benchmark and they are therefore not published.

Steady downward trend in the number of workplace accidents

Since 2005, there has been a steady decline in the number of notifiable workplace accidents at DEUTZ. The key indicator, the rate of notifiable accidents per thousand employees[1)], once again improved by around 13 per cent on 2007: in 2008, there were 34 notifiable accidents per thousand employees compared with 39 in 2007. The trend in this indicator shows that our concepts and activities to reduce workplace accidents and downtime have been successful. The most important internal procedures include the formal acceptance of new installations, machinery and other resources, and the authorisation procedure for hazardous materials. They contribute to the fact that there are continuous improvements in important areas such as health and safety and environmental protection. Increasing automation in production and assembly also helps to reduce the risks for employees.

At DEUTZ, the rate of notifiable accidents per thousand employees, the figure used by the engineering employers' liability insurance association as the benchmark in the industry, has in the last few years been regularly below the industry average. Most recently it has been around 15 per cent below the rate calculated by accident insurers.

1) Known as TMQ (Tausend-Mann-Quote) in German

EMPLOYEES

DEUTZ Group: Employees

	31 Dec. 2008	31 Dec. 2007
Headcount		
DEUTZ Group	**4,701**	**4,617**
Thereof		
Germany	3,802	3,766
Outside Germany	899	851
Thereof		
Non-salaried employees	2,876	2,830
Salaried employees	1,637	1,613
Apprentices	188	174
Thereof		
Compact Engines [1]	3,792	3,698
DEUTZ Customised Solutions [1]	909	919

1) Including apprentices

Number of employees rises slightly

As at 31 December 2008, the DEUTZ Group employed 4,701 people worldwide (31 December 2007: 4,617). This equates to an increase of 84 employees or 1.8 per cent, accounted for exclusively by the Compact Engines segment. Of this total, 3,802 (31 December 2007: 3,766), i.e. the majority, were based in Germany, the largest site being Cologne with 2,897 employees (31 December 2007: 2,891), followed by Ulm with 556 employees (31 December 2007: 542). DEUTZ employed 899 people (31 December 2007: 851) outside Germany at the end of 2008, mostly in Spain and the USA. In the year under review, an average of 306 persons were employed under temporary employment agreements, representing a decrease of 60 on 2008.

As a result of the high level of orders in the first half of 2008, DEUTZ had increased the number of employees on flexible contracts by around 700 to a total of approximately 1,200 temporary and contract employees at the mid-year point. As a result of the significant drop in new orders and unit sales in the second half of the year, this figure had to be reduced to around 400 people by the end of 2008.

Following the unexpectedly sharp drop in orders in the fourth quarter, DEUTZ introduced short-time working at the start of December 2008 for parts of its production and assembly operations; this affected the Cologne plants. The Ulm plant was not affected by the short-time working measures in 2008. Measures were also taken at the facilities in Spain and the USA to adjust structures to the new market situation.

DEUTZ Group: Breakdown of employees by location

	31 Dec. 2008	31 Dec. 2007
Cologne	2,897	2,891
Ulm	556	542
Other German locations	349	333
Germany	**3,802**	**3,766**
Outside Germany	**899**	**851**
Total	**4,701**	**4,617**

As at 31 December 2008, the Compact Engines segment employed 3,792 people (31 December 2007: 3,698), while the DEUTZ Customised Solutions segment had 909 employees (31 December 2007: 919). The increase of 94 in the number of employees in the Compact Engines segment (up 2.5 per cent) was concentrated primarily on research and development in Cologne and also on the manufacture of components at Zafra in Spain. This reflected the step-up in our research and development activities, principally focussed on the refinement of our engines to comply with the next stages in exhaust-gas emission standards. The 1.1 per cent reduction (10 employees) in the DEUTZ Customised Solutions segment only affected production units.

DEUTZ Group: Staff costs

	2008	2007
€ million		
Wages	121.6	126.5
Salaries	111.0	102.7
Social security contributions	44.2	44.2
Cost of staff adjustments	10.5	0.1
Cost of post-employment benefits and other long-term employee benefits	2.7	1.5
DEUTZ Group	**290.0**	**275.0**

DEUTZ focuses on training

Even in tough economic conditions, DEUTZ invests in the vocational training of young persons – and therefore in the future. In 2008, we offered 62 school leavers training and apprenticeship places in technical, trade or commercial vocations, for example in industrial technology, electronics and business administration. Worldwide, DEUTZ employed a total of 188 trainees and apprentices, of which 133 were in Cologne. The trainee ratio, i.e. the ratio of trainees and apprentices to the Group‘s total workforce in Germany, again increased during the year under review and at 31 December 2008 stood at 4.9 per cent (31 December 2007: 4.6 per cent). All trainees and apprentices who successfully passed their examinations in 2008 were subsequently transferred by DEUTZ to specific departments for at least one year – in this way, we managed to retain 46 young, motivated employees in the Company.

We also assume the social responsibility of offering young persons with learning and social difficulties the opportunity to obtain skilled vocational training. In what is now a 16-year partnership with IN VIA, an association under the auspices of the German Caritas organisation, and the German Federal Employment Agency, we prepare these young people in our training workshop and production facilities for vocational training. There are 38 participants in the current year group; the placement rate is 95 per cent.

At the Ulm site, we were also able to continue our successful partnership with the Heidenheim University of Cooperative Education in the year under review. In Ulm, we offer school leavers with the German Abitur the opportunity to study for a bachelor of engineering degree on a sandwich course operated by DEUTZ in cooperation with this university. In the year under review, five school leavers took up this attractive and very efficient training option.

Prospects for graduate recruits

As a well-known technology company specialising in diesel engines, DEUTZ is an attractive employer for graduates of technical courses. In the past year, we have recruited almost 90 trainee engineers from various universities and provide professional development primarily via training on the job - for example as specialists in engine development, thermodynamics or electronics, or as sales and service engineers. Cologne has an advantage in that, within its catchment area, it has important, prestigious universities, such as RWTH Aachen University, Aachen University of Applied Sciences and various universities of applied sciences in Cologne that offer students the opportunity to study subjects relevant to our Company.

As part of our marketing to universities, we had stands attracting a large number of people at various recruitment events at RWTH Aachen University, Cologne University of Applied Sciences, RFH University of Applied Sciences Cologne, Darmstadt University of Applied Sciences, at the Association of German Engineers (VDI) recruitment conference in Graz, at the Education Fair in Ulm and at the 2008 careers fair at Ulm University of Applied Sciences.

In November 2008, DEUTZ held an open day for university students. 61 students visited our assembly plant and the technical centre at Cologne-Porz and listened to presentations by our managers, all of which provided the students with an initial introduction to DEUTZ. The event also provided a relaxed atmosphere in which the students could make initial contact with engineers and managers at the Company.

For four years in a row, we have now been offering a trainee programme to very well educated, highly motivated university graduates to give them a starting point on the professional ladder and interesting career prospects in the DEUTZ Group. In 2008, four such graduates received intensive management development training. The participants in the programme were supported by personal mentors and worked on various projects each lasting four months in different parts of the Company. One of the projects took place at a Company site outside Germany. This enabled the trainees to gain new professional and cultural experience and also to improve their language skills. With the regular presentation of their results to the Management Board, the management trainees learned to hold discussions and communicate with management. Since 2004, a total of 24 management trainees have been through this programme; more than three quarters of them are still employed in the DEUTZ Group.

Further development of strategic personnel activities

In the year under review, we reorganised strategic HR activities in the DEUTZ Group with the introduction of appropriate HR development processes and tools. For example, we developed a competency model aligned with our strategic corporate objectives. Training sessions were held in connection with this change and the content was discussed in detail. The “DEUTZ competency model” will in future form the basis for the assessment and promotion of appropriate employee development. An integral part of the concept is the staff appraisal interview at which the competencies of the employee are assessed and the next stages of development are evaluated and specified. In turn, this forms the basis for individual career planning from the employee perspective and, from the Company perspective, efficient succession planning – this is also required in order to enable us to overcome the future challenge of demographic change. The action taken in this regard is supported by conferences to identify potential future managers. These new personnel development tools on the basis of the DEUTZ competency model are to be introduced in other areas of the Group during the current 2009 financial year.

Internal and external seminars for the development of professional and social skills are open to all employees subject to agreement with the relevant line managers. In addition to various external seminars, there have also been DEUTZ-specific training sessions to support the development of teamwork and management skills. We will continue to expand on these activities with a separate professional development programme.

ENVIRONMENT

Focus on energy management and reducing emissions

In 2003, DEUTZ voluntarily introduced an environmental management system. In September 2008, an independent auditor from the certification organisation DNV (Det Norske Veritas) again confirmed that the system complied with DIN EN ISO 14001, the internationally recognised standard. We use this environmental management system to ensure that environmentally relevant processes in the Company are monitored, analysed and evaluated on an ongoing basis and that systematic improvements are carried out, if required. In addition to reviewing appropriate processes, the audit also covered the current environmental programme in DEUTZ AG which focuses on "energy management" and "reducing emissions". Under this programme, we set ourselves voluntary targets for reducing the environmental impact that may result from DEUTZ's business activities. The renewed certification by DNV confirms and strengthens our efforts to implement a variety of measures aimed at a lasting contribution to the protection of the environment.

DEUTZ identified at an early stage that there is an overlap between commercial and ecological objectives: it is called "saving". As a result, almost half of all our engine test rigs in research and development are equipped with state-of-the-art generator brakes; the conversion of further test rigs is planned. In this technology, the mechanical energy generated by the diesel engines is converted into electrical energy and fed into its own grid. We have already been able to measure the first signs of success: in relation to total global electricity consumption by the DEUTZ Group, we were able to reclaim 14 per cent more electricity in 2008 than in 2007, despite considerable expansion in research and development activities.

A further measure that had a positive impact on energy consumption in the Company was the automating and conditioning of around 30 test rigs. The associated cut in the duration of engine tests led directly to a reduction in emissions during test runs. Simultaneously, we also managed to save approximately 100,000 litres of diesel fuel.

Further improvement in environmental efficiency

Environmental efficiency – i.e. the evaluation of environmentally relevant factors such as emissions using appropriate key performance indicators – showed a further improvement compared with 2007. The key performance indicators are determined by carrying out a systematic internal collection of data and are representative of the worldwide production of engines in the DEUTZ Group. For example, we managed to reduce emissions of benzene during the development and production process by 11 per cent compared with 2007.

Participation in Carbon Disclosure Project

DEUTZ has undertaken to make a comprehensive disclosure of its greenhouse gas emissions[1] and from 2008 has been taking part in the Carbon Disclosure Project (CDP). In future, DEUTZ will determine the total CO_2 emissions that it generates throughout the world and describe the action it has taken to reduce these emissions. The Carbon Disclosure Project is the world's largest collaboration between institutional investors to investigate the economic impact of climate change. The objective is to promote dialogue with companies on this subject. The Carbon Disclosure Project is based on a questionnaire sent to over 3,000 listed companies throughout the world and the results are assembled into a report. 2008 was the sixth time that the survey had been carried out. The survey is international; in Germany, over 50 per cent of the 200 largest German companies (measured on the basis of market capitalisation) took part in 2008.

In 2008, DEUTZ achieved a further reduction in carbon dioxide emissions of 4 per cent, principally as a result of fuel savings in engine testing. Apart from the reduction of CO_2 emissions as part of the production process, the CO_2 emissions from our own products play a critical role for us as a manufacturer of diesel engines. Our core competency lies in the development and production of low-emission engines with optimum fuel consumption that comply with the strict limits imposed by emission legislation in Europe and the USA. We are

1) Carbon dioxide emissions

also carrying out intensive research and development work in the areas of exhaust-gas aftertreatment and environmentally friendly drive units. More information can be found in the "Research and development" section on page 55 to 57.

At DEUTZ, safety management is a contributing factor in ensuring that all plant and equipment of particular significance to the environment is regularly assessed by internal and external specialists to guarantee continuous, problem-free operation. As an example, in the year under review, some of the production engine testing facilities at the Cologne-Porz plant were modernised at a total cost of € 1.2 million in order to improve processes and reduce the danger from substances that are potentially harmful to water supplies.

Safety management ensures problem-free operation in production

RESULTS OF OPERATIONS FOR DEUTZ AG

DEUTZ AG: Income statement

	2008	2007
€ million		
Revenue	1,417.0	1,443.1
Profit from ordinary activities	**7.0**	**52.3**
Net extraordinary result	–17.8	119.5
Income taxes	4.2	–18.0
Other taxes	–0.8	–0.6
Net loss/income	**–7.4**	**153.2**
Profit/loss carried forward	34.2	7.7
Addition to the legal reserve	–	–4.1
Addition to the other retained earnings	–	–74.6
Accumulated income	**26.8**	**82.2**

The annual financial statements of DEUTZ AG are prepared in accordance with the requirements of the German Commercial Code (HGB) and the German Stock Corporation Act (AktG). In 2008, DEUTZ AG generated sales revenue of € 1,417.0 million (2007: € 1,443.1 million).

The profit from ordinary activities was € 7.0 million (2007: € 52.3 million). Including an extraordinary item of minus € 17.8 million (2007: € 119.5 million) specifically as a result of additional provisions for expenses in connection with restructuring, this produced a net loss for the year of € 7.4 million (2007: net income of € 153.2 million).

The Annual General Meeting of DEUTZ AG held on 21 May 2008 decided to pay a dividend of € 0.20 per dividend-bearing share to shareholders from its accumulated income for the 2007 financial year and to pay a special dividend of € 0.20 per dividend-bearing share to shareholders from the gain on the disposal of DEUTZ Power Systems. € 4.00 per profit-sharing right with a par value of DM 50 (€ 25.56) was paid to the holders of profit-sharing rights. This equated to a total amount of € 48.0 million distributed in the year under review. Taking into account the profit of € 34.2 million carried forward from 2007, the accumulated income before appropriation of profits amounted to € 26.8 million. For the 2008 financial year, the Management Board will propose to the Annual General Meeting that the accumulated income of DEUTZ AG calculated in accordance with the principles of the German Commercial Code (HGB) be carried forward to the new financial year.

DEPENDENCY REPORT

The Management Board of DEUTZ AG has submitted a report for the year ended to the Supervisory Board as required under section 312 of the German Stock Corporation Act (AktG). This report covers the relationships between the companies in the DEUTZ Group and the SAME DEUTZ-FAHR Group. The Management Board issued the following concluding statement:

"For all the legal transactions and activities stated, our company received an appropriate consideration for each legal transaction in accordance with the circumstances known to us at the time the transactions were conducted or the activities carried out and was not disadvantaged as a result of measures that were taken."

DISCLOSURES PURSUANT TO SECTION 315 (4) HGB

Composition of the issued capital

The issued capital (share capital) of DEUTZ AG amounted to €308,978,241.98 at the end of 2008 (2007: €306,992,504.46) and was divided into 120,861,783 (2007: 120,085,030) no-par-value bearer shares.

Direct or indirect investments representing more than 10 per cent of voting rights

At the end of 2008, SAME DEUTZ-FAHR Holding & Finance B.V., Amsterdam, Netherlands, held a direct investment in DEUTZ AG representing 45.1 per cent of voting rights. Via SAME DEUTZ-FAHR Holding & Finance B.V., the following companies and persons held an indirect investment in DEUTZ AG equivalent to the same percentage:

- SAME DEUTZ-FAHR Group S.p.A., Treviglio, Italy
- Intractor B.V., Amsterdam, Netherlands
- Belfort S.A., Luxembourg, Luxembourg
- Messrs Vittorio, Aldo and Dr Francesco Carozza and Ms Luisella Carozza-Cassani.

Legal provisions and Statute provisions regarding the appointment and removal of members of the Management Board and regarding changes to the Statutes

According to articles 7 (1) and 7 (2) of the Statutes of DEUTZ AG:
"(1) The Management Board shall comprise at least two members.
(2) The Supervisory Board shall determine the number of members of the Management Board and the allocation of responsibilities. It may draw up and issue rules of procedure."

As far as the appointment and removal of members of the Management Board are concerned, sections 84, 85 German Stock Corporation Act (AktG) and section 31 German Codetermination Act (MitbestG) also apply.

According to article 14 of the Statutes of DEUTZ AG:
"The Supervisory Board may change the wording but not the spirit of the Statutes."

Sections 179, 133 AktG also apply in the case of changes to the Statutes.

Authority of the Management Board, in particular with regard to share issue or buyback

The authority of the Management Board is derived from the legal provisions and from the rules of procedure laid down by the Supervisory Board.

Pursuant to article 4 (5) of the Statutes of DEUTZ AG, the Management Board is authorised, with the consent of the Supervisory Board, in the period up to 21 June 2011 to increase the issued capital through the issue of new no-par-value shares against cash or non-cash contributions on one or more occasions up to a total amount of €120,000,000. Capital increases against non-cash contributions may not exceed a total of €80,000,000.

In accordance with the resolution approved by the Annual General Meeting on 21 May 2008, the Management Board is authorised pursuant to section 71 (1) no. 8 of the German Stock Corporation Act (AktG), on or before 20 November 2009, to purchase treasury shares up to a total of 10 per cent of the existing share capital at the time the resolution was adopted. The shares purchased on the basis of this authorisation, together with other treasury shares or shares attributable to the Company pursuant to sections 71 d and 71 e AktG must at no time account for more than 10 per cent of the Company's existing share capital. The authorisation must not be used for the purpose of trading in treasury shares. Measures taken by the Management Board on the basis of this Annual General Meeting resolution must be approved by the Supervisory Board.

Further disclosures

There are no restrictions affecting voting rights or the transfer of shares.

No bearers of shares have any special rights conferring authority to control the Company.

Numerous employees have direct shareholdings in DEUTZ AG. There are no restrictions affecting the direct exercise of rights of control in connection with these shares.

In July 2007, by means of a private placement with US institutional investors, DEUTZ AG issued notes (bonds) with a total value of approximately US$ 274 million. The notes had various terms of issue and maturities of five, seven and ten years. Under the terms of issue for these notes, holders can demand premature redemption if there is a change of control in the Company and, within a specified period after this change of control, any rating for the notes or other financial liability of the Company or of the controlling person with a residual maturity of at least five years

a) is withdrawn, or
b) is downgraded from investment grade to non-investment grade, or
c) if the notes or the financial liabilities have a non-investment grade rating at the time of the change of control, is not upgraded to investment grade.

A change of control is deemed to have taken place if, at an Annual General Meeting, a third party (or third parties acting jointly) elect(s) new shareholder representatives to all the shareholder positions on the Supervisory Board of DEUTZ AG or, at two successive Annual General Meetings of DEUTZ AG, a third party (or third parties acting jointly) control(s) more than 50 per cent of the votes represented at the meeting or acquire(s) more than 50 per cent of the issued capital in DEUTZ AG. However, this does not apply to control in the sense described if this control is acquired by AB Volvo or by companies controlled by AB Volvo or by the (indirect) shareholders of SAME DEUTZ-FAHR Holding & Finance B.V., providing these shareholders are members of the Carozza family, or by companies controlled by these shareholders. If DEUTZ AG needed to repay a considerable proportion of the notes in the event of a change of control, it would need to raise the necessary funds some other way in the short term.

The bilateral credit facilities agreed by DEUTZ AG are mostly subject to a change-of-control clause. Under this clause, the banks would be permitted in the event of a change of control and in the event of a resulting deterioration in the risk situation to tighten their lending terms or, if it proved impossible to reach an agreement on new terms, to terminate the loan agreement.

DEUTZ AG has no indemnification agreements with members of the Management Board or employees that would come into force in the event of a takeover bid.

Explanatory statement by the Management Board in connection with sections 289 (4) and 315 (4) HGB

The disclosures contained in the management report and group management report pursuant to sections 289 (4) and 315 (4) HGB relate to arrangements that may be significant in the success of any public takeover bid for DEUTZ AG. It is the opinion of the Management Board that these arrangements are normal for publicly traded companies comparable with DEUTZ AG. Insofar as the terms of the private placement regarding a change of control link the premature repayment of the notes, among other things, to the withdrawal, downgrading or failure to achieve an upgrading in the rating of financial liabilities, the Management Board hereby draws attention to the fact that DEUTZ AG currently does not hold any financial liabilities that are rated.

REMUNERATION REPORT

Remuneration of the Management Board

Total Management Board remuneration for 2008 in DEUTZ AG and the Group was €3.8 million. The remuneration paid to the individual members of the Management Board comprises fixed, variable and long-term performance-related components. The variable component of the remuneration is also performance-related and depends on Group performance indicators such as revenue, EBIT margin and ROCE as well as on personal targets specifically for the individual‘s area of responsibility.

The long-term incentive plan no. I and the long-term incentive plan no. II were introduced in 2007 and 2008 respectively as long-term remuneration components in which the Management Board (LTI no. I and LTI no. II) and top level of senior management (LTI no. I) could participate. Under both plans, virtual stock options are issued to senior executives to reward them for their sustained contribution to the Company‘s success. Before they receive stock options, those eligible must invest some of their own capital in DEUTZ shares. The stock options include the right to receive a cash payment at the end of a lock-up period of three to five years, providing the performance of DEUTZ shares meets the criteria specified in the plan. Under these criteria, the price of DEUTZ shares on the exercise date either must be 30 per cent above the defined reference price – the weighted average price of DEUTZ shares in the three months prior to the option grant date – or must have outperformed the Prime Industrial index by 30 per cent. Further information on remuneration can be found on page 146 of this annual report.

Remuneration of the Supervisory Board

The remuneration of the Supervisory Board is fixed by section 15 of the Statutes of the company. This stipulates that the members of the Supervisory Board of DEUTZ AG receive a fixed annual remuneration of €12,500. They also receive a fee of €1,000 for each Supervisory Board meeting they attend and are reimbursed for their out-of-pocket expenses. Furthermore, each member of the Supervisory Board is paid a fixed amount of €2,000 for each percentage point by which the dividend exceeds 4 percentage points of the Company‘s paid-up share capital; this amount is payable proportionately for fractions of percentage points. The chairman of the Supervisory Board receives double these amounts, and his deputy one-and-a-half times.

The chairmanship and membership of Supervisory Board committees are remunerated separately in accordance with the German Corporate Governance Code. DEUTZ also pays each member of a committee a fee of €1,000 for each committee meeting they attend. The chairman of a committee is entitled to twice this sum, his deputy to one-and-a-half times the amount. In addition, DEUTZ reimburses the members of the Supervisory Board for any VAT they incur in connection with the performance of their mandate.

Further information on the remuneration paid to the Supervisory Board can be found on page 147 of the Notes to the consolidated financial statements.

EVENTS AFTER THE BALANCE SHEET DATE

No events occurred after the balance sheet date that had a material impact on the financial position or financial performance of the DEUTZ Group.

RISK REPORT

Risk management system

Conditions in the global economy and in individual markets are in a constant state of rapid change. Companies must act fast and respond even faster if they want to hold their own in the marketplace over the long term. Against the background of increasingly complex corporate structures and growing internationalisation, systematic risk management therefore forms an important basis for long-term business success.

DEUTZ operates in a variety of industries and regions worldwide and manages its business through a number of organisational units: the operating segments of the Group's parent company, subsidiaries, sales offices and authorised dealers. This organisational structure presents the Company with a large number of opportunities, but also gives rise to business-specific risks.

DEUTZ's objective is to generate profits on a sustained basis and to increase these profits significantly over the medium and long terms in order to develop the Company and secure its future. It is therefore critically important to identify and assess business risks at an early stage and take corrective action where required. Since 1998, DEUTZ has therefore had an appropriate risk management system, as required by the German Control and Transparency of Companies Act (KonTraG).

The benefits of such a system can hardly be overestimated: it raises the awareness of employees to possible or existing risks and strengthens their sense of responsibility. It also supports them in identifying, analysing and communicating risks in good time and in initiating effective corrective action.

The basic principles, monitoring standards, responsibilities, functions and procedures in the risk management system have been defined by the Management Board of DEUTZ AG and set out in a manual that is continually updated. A systematic reporting structure in conjunction with the Risk Management Committee ensures that all major risks are documented and communicated, and that appropriate corrective action is taken and documented at an early stage.

Risk inventories normally take place four times a year - and this was also the case in 2008. These risk inventories are carried out in all functions and areas of the Company and in the main subsidiaries to identify whether new risks have arisen in respect of short-term and medium-term planning. At the same time, a review is carried out to establish whether and how agreed action has successfully minimised risks that have already been identified and whether there is still a need for further action. The Risk Management Committee assesses the risks and makes proposals to the Management Board, which then decides on appropriate measures to prevent or minimise the risk. To enable the Company to respond promptly at all times to any possible risks arising, risk officers and their employees are under an obligation to make ad hoc reports independently of the regular reporting requirements as soon as any new material risks arise or if there is an increase in the threat from known risks.

The Group internal audit department and the independent auditors carry out an audit of DEUTZ AG's system for the early identification of risks pursuant to section 91 (2) AktG each year to assess whether the system is functioning efficiently. The findings of the audits carried out in 2008 confirmed that the system for the early identification of risks was functioning efficiently. As in prior years, suggestions for improvements proposed by the internal audit department, the independent auditors or the Risk Management Committee were speedily implemented by DEUTZ.

Sales risks

To take account of the impact of the global recession on its sales markets, DEUTZ has revised downwards its unit sales forecast for 2009 and subsequent years. Currently, it is impossible to predict how the economic situation will develop in the markets relevant to DEUTZ and further negative developments cannot therefore be ruled out. In order to be prepared for such developments, additional scenarios have been developed and action plans “MOVE” put in place.

In the medium term and long term, DEUTZ counters regional and application-related sales risks with development activities and alliances aligned with its product strategy.

The close alliances with key customers such as Volvo and SAME DEUTZ-FAHR are of considerable importance in enabling us to achieve our sales targets, in particular in the Automotive and Agricultural Machinery application segments. DEUTZ is substantially strengthening its market position in Asia, from both regional and application perspectives, with DEUTZ (Dalian) Engine Co., Ltd., a joint venture between DEUTZ AG and FAW Jiefang Automotive Co., Ltd. On the basis of this joint venture, which commenced operations in August 2007, DEUTZ has significantly better access to the Chinese domestic market and low-cost production options in the price-sensitive Asian market. We can also use the joint venture to support existing DEUTZ customers who have their own production facilities in the region. One critical factor in the success of this strategy will be the level of demand for products using DEUTZ technology in the Chinese and the wider Asian market.

DEUTZ also hedges future sales risks with innovative product developments. These developments are focussed on the reduction of emissions and the efficient use of energy. Together with the construction equipment manufacturer ATLAS WEYHAUSEN, for example, DEUTZ presented the first fully functioning wheel loader with a hybrid drive at the “bauma” trade fair in 2007. During the course of 2008, DEUTZ was able to recruit a second key customer as a project partner for further use of the hybrid system. When used in suitable applications, the hybrid drive developed by DEUTZ can also increase performance, reduce the cost of exhaust-gas aftertreatment and achieve fuel savings of up to 20 per cent. The DEUTZ hybrid drive is scheduled to be ready for production in 2012.

DEUTZ is well diversified and well positioned for the future in terms of the geographical and industrial distribution of its customers. However, critical factors influencing the performance of DEUTZ in its markets are of course how the markets develop and how individual customers perform, and DEUTZ itself has no influence over these factors.

Procurement risks

Procurement risks resulting from bottlenecks in the market and unforeseen price increases cannot be fully ruled out. These potential risks arise specifically in connection with the procurement of parts, components and services from third parties.

DEUTZ counters these risks by carrying out intensive supplier management based on procurement tools and key performance indicators, and by monitoring the market, which is becoming increasingly globally oriented. This is supported by the implementation of local purchasing offices in China and India, which use the infrastructure of DEUTZ subsidiaries abroad. These local offices allow the Group to ensure a high level of quality and supplier performance and, at the same time, to benefit from the low wage costs in these two huge growth markets.

Besides these global activities, there are three cornerstones to the DEUTZ procurement strategy for strategic and production-critical components: first, long-term supplier relationships and supply agreements; secondly, increased dual sourcing; and, thirdly, where appropriate, allocation of production to subcontractors. These proven approaches together minimise the procurement risks and secure the required capacity to the greatest possible extent.

Given the significant global recessionary trends, the possibility of a financial squeeze also affecting DEUTZ suppliers cannot be ruled out. On an ongoing basis, DEUTZ therefore analyses which suppliers could be exposed to financial difficulties and liquidity problems.

At the same time, DEUTZ works on backup solutions to minimise the risk from supplier default. These solutions may involve a switch to in-house production or a shift to other suppliers.

Production risks

As a consequence of the financial crisis and the associated economic downturn, the production and assembly capacity that had been expanded in 2007 and at the start of 2008 was significantly higher than the unit sales requirements in the second half of 2008. The number of shifts was reduced as early as July 2008, marking the start of an ongoing adjustment of capacity. Short-time working was also introduced in some parts of the business in December 2008. Until further notice, short-time working will be continued in the current year in under-utilised units. A review is being carried out monthly to take into consideration any change in the level of new orders.

Production programme meetings are held at least once a month and capacity planning meetings each month to ensure that DEUTZ's capacity is adjusted in line with sales.

Technological risks

In 2011, exhaust-gas emission stage EU IIIB in Europe and TIER 4 Interim in the USA come into force for mobile machinery engines with an output of 130kW or more. In 2014, these intermediate stages will be superseded by the TIER 4 Final and EU IV exhaust-gas emission stages. The timely development and refinement of engines that meet these emissions standards is an extremely challenging target and is therefore subject to a corresponding level of uncertainty.

Quality risks

Quality assurance in all plants and areas of the company is based on a centralised quality system which systematically analyses sources of errors and defects, optimises production processes and minimises the risk in series production start-ups. At the same time, central quality management also ensures there is a substantial reduction in warranty risks. In addition, DEUTZ AG has defined uniform standards for the selection of suppliers and, in close cooperation with the suppliers, continuously improves the quality of supplied parts. The Company also implements additional quality initiatives to handle the significant technical complexity of engines and satisfy the steadily increasing quality requirements of DEUTZ customers.

The basic principles of the DEUTZ quality management system are set out in a quality management manual. The manual is broken down into three parts. The first part, "Quality policy", describes the overall quality principles and definitions. The second part provides information on the most important quality processes. The third part explains the continuous improvement process and provides employees with information on numerous methods and systems for controlling and improving product and process quality. The manual is also available in an interactive online version on DEUTZ's intranet.

Financial risks

As a corporate group operating at a global level, DEUTZ is exposed to various financial risks that may have a significant impact on the financial position and financial performance of the Company. The objective of the overarching risk management system is to eliminate these potentially negative effects or at least to minimise them. Against the backdrop of the global financial crisis, it is especially important that financial risks are properly managed.

DEUTZ AG therefore hedges financial risks in a number of different ways. The basis of the risk management system is annual financial planning and regular analysis of variances during the course of the year. A weekly rolling forecast is produced showing the cash inflows and outflows for the subsequent four weeks. Responsibility for financial management in the Group is held by DEUTZ AG as the overall parent company in the Group. Head office cash pooling ensures optimum use of cash in the Group. The central finance department is also responsible for managing the investment of available cash and the arrangement of lines of credit or other financing to cover financing requirements in accordance with internal financing guidelines.

DEUTZ AG has sufficient existing credit facilities with leading banks, although the use of these facilities is currently minimal. With the issue of notes with a total value of US$ 274 million under the US private placement in 2007, DEUTZ was able to open up broadly based financing from institutional investors in the US independently of the banks. The coupon is fixed for the entire maturity of the individual tranches (between five and ten years). Where interest payments and the repayment of the principal are due in US dollars, these payments are hedged over the entire term to maturity. With the placement of the bond, DEUTZ has undertaken to comply with certain covenants. These covenants are defined by key performance indicators based on the ratio of net debt to equity, net debt to EBITDA (before one-off items), and EBITDA (before one-off items) to net interest income/expense. In the event of failure to comply with the defined key performance indicators, the creditors (providing they have a majority) have the right to terminate the bond before the maturity date or to demand an adjustment to the terms of the contract, which would currently involve an increase in the interest payable. These key performance indicators are subject to constant monitoring and must be reported by DEUTZ on a quarterly basis. To date, DEUTZ has met the targets for the key performance indicators at all times. Given that it is difficult to predict economic trends henceforward, our short-term and medium-term forecasts are subject to corresponding uncertainty. The aim of the “MOVE” action programme is to be able to react flexibly to changing economic circumstances in 2009 so as to achieve a small operating profit and thus to ensure continuing compliance with the covenants associated with the US private placement. In the event of a sustained and worsening crisis for the Company in terms of sales and revenue, there would be a risk of infringing these covenants with the negative consequences for DEUTZ described above.

DEUTZ protects itself against the risk from bad debts by constant IT-supported monitoring and regular analysis of receivables and their breakdown. The Company takes out credit insurance to cover a large proportion of its receivables unless payment is made in advance or by letter of credit.

Exchange-rate risks are monitored at DEUTZ under a centralised currency management system and reduced by the use of hedging transactions. DEUTZ AG‘s net currency exposure is normally hedged by forwards equivalent to 50 to 70 per cent of open items, or 100 per cent in the case of project-based firm commitments. DEUTZ is also taking specific action to increase the volume of purchasing in US dollars; this enables the Company to counteract exchange-rate risks from sales invoiced in US dollars by way of natural hedging.

Organisational risks

Organisational risks are risks that arise from inadequate or non-harmonised organisational structures, processes, communication and information flows, procedures and guidelines. At DEUTZ, special central units provide support to the individual operating units so that such risks are avoided. The organisational combination into head office functions and services of responsibilities covering all locations and segments guarantees the application of standardised processes throughout the Group. This is also supported by appropriate groupwide guidelines.

All operating levels, including subsidiaries outside Germany, are integrated into a detailed planning, control and reporting system. The core elements of the system are: revolving short-term and medium-term plans, monthly budget/actual analyses, quarterly forecasts and regular review/planning meetings. This early-warning system ensures that management is in a position to instigate any necessary corrective action promptly.

IT risks

In the first half of 2008, information and communications technology and the range of applications was adjusted in line with requirements arising from the sharp increase in the production programme. Specifically, the necessary expansion of capacity was initiated with logistics service providers and at DEUTZ‘s own sites with the introduction of new warehouse management systems. As far as possible, DEUTZ used proven standard systems already available in the market. In addition, DEUTZ implemented IT activities to ensure the Company could meet enhanced compliance requirements (including those in accordance with the EU anti-terrorism regulation).

Risks that could be caused by out-of-date systems are avoided by ensuring that DEUTZ's highly integrated hardware and software systems are kept up-to-date from both technical and system perspectives. This work is carried out with the involvement of prestigious international service providers. Risks arising from deficiencies in transparency are further reduced by the integration of DEUTZ AG subsidiaries into existing DEUTZ processes and systems.

Strategic business processes are handled using the proven SAP ERP 6.0 software. The infrastructure continues to be operated by the service provider on the basis of the principles in the current version of the de facto ITIL (IT Infrastructure Library) standard. DEUTZ is continuing its strategy of consolidating its information and communication technology systems; in future, this strategy will focus on the exploitation of existing potential available from the SAP system.

Risks that may arise over the course of time as a result of the loss of employee skills are avoided by means of continuous, intensive skills and professional development activities for IT personnel in order to ensure that employees can meet the continuously increasing demands of DEUTZ AG's business. These activities are a key area of focus in the IT department.

Human resources risks

In a technology-oriented international company like DEUTZ, highly skilled employees are the basis for a successful business.

There are risks in this regard in connection with not being able to recruit additional personnel quickly enough to meet the requirements of growth in DEUTZ, and specifically, not being able to appoint suitably qualified managers and specialist employees to relevant posts promptly. DEUTZ counters these human resources risks by systematically analysing the skills and qualifications of its managers and using this analysis to draw up appropriate measures targeting the development of individual managerial and technical capabilities. By combining this targeted personnel development with long-term succession planning, DEUTZ is also well positioned from a human resources perspective to meet the challenges of demographic change.

In addition, DEUTZ AG offers its employees professional development opportunities both in Germany and abroad and demanding responsibilities in the various areas of the business. This allows DEUTZ AG to continuously align the capabilities of its employees with the growing requirements of the market; it also ensures a higher degree of employee retention, with the result that valuable expertise remains in the Company.

Pension risks

DEUTZ recognises significant provisions to cover its pension obligations. The amount of these pension obligations is subject to risks arising in connection with the change in life expectancy, the future amount of pension adjustments and the movement in interest rates on capital markets.

Legal risks

Existing and imminent legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and covered by an appropriate amount added to ongoing risk provisioning. On this basis, the management of the Group can take appropriate action promptly and, where appropriate, recognise any necessary accounting provisions.

Groupwide standards such as the "General terms and conditions of business", sample contracts for various uses and implementation provisions in the form of organisational guidelines reduce the level of new legal risks at DEUTZ. The Legal Affairs Department and, if necessary, external lawyers are also regularly consulted for projects and the finalisation of contracts that fall outside the scope of the standards developed for day-to-day business.

The claim by the Greek tax authorities against a Greek subsidiary of DEUTZ AG for supplementary tax payments and penalties amounting to a total of €35 million is pending. There are also two legal actions brought by private persons against the American subsidiary of DEUTZ AG alleging damage to health caused by asbestos. A further US asbestos lawsuit was dismissed in the year under review.

An American customer is also claiming for damages in excess of US$ 40 million. The action is without substance in the opinion of the Company because the engines were used in a manner contrary to instructions and liability for consequential loss is contractually excluded. A provision has been recognised in the consolidated financial statements to cover the risk in connection with the litigation.

Planning risks

The preparation of the consolidated financial statements in accordance with IFRS requires estimates and assumptions to be made that have an impact, in particular, on the recognition, measurement and reporting of assets and liabilities. The estimates and assumptions are based on projections, which by their nature are subject to a degree of uncertainty. Against the background of the crisis in the financial markets, it is difficult to predict how the economic situation will develop and forecasts are subject to a greater level of uncertainty. The possibility of routine adjustments to the estimates and assumptions and any associated negative impact on the financial position and financial performance of DEUTZ can therefore not be excluded at present.

Risks in accounting for deferred taxes

Under IFRS, deferred tax assets are recognised in respect of loss carryforwards that it will be possible to offset against future profits, thus reducing the tax liability. Against the background of the crisis in the financial markets, it is difficult to predict how the economic situation will develop and long-term profit forecasts are subject to corresponding uncertainty. Currently, it is therefore not possible to rule out future changes and risks that could have a negative impact on whether these loss carryforwards could in fact be used and therefore also on the recoverability of the deferred tax assets recognised by the DEUTZ Group in its financial statements

Future tax risks

The external tax audit started in April 2007 covering the tax assessment periods 2002 to 2005 is still in progress. We have not yet received the tax auditor‘s report. An appropriate provision for tax risks has been recognised. As things stand, the Company is also not expecting any material risks.

An external audit of employee income tax was started in 2008 covering the tax assessment periods 2004 to 2007. We have not yet received the external auditor‘s report. Possible risks are covered by a provision.

OUTLOOK

The economy in 2009: global recession [1)]

Global economic growth still managed to reach 3.0 per cent in 2008 but the figure in 2009 will be substantially lower. Economic experts are currently expecting the global economy to contract by 0.8 per cent. The western industrialised nations will be hit particularly hard by the drop in economic output: negative growth of between –2.7 per cent and –3.5 per cent (Germany) is being forecast for Germany, the euro zone and the USA. If this forecast were actually to materialise in Germany, leading institutes and experts claim it will be the worst recession since the Federal Republic was established in 1949. There will also be a noticeable slowdown in economic growth in emerging markets: gross domestic product in Asia (excluding Japan) and China is expected to grow at 4.6 per cent and 7.0 per cent respectively, significantly lower rates than in 2008.

1) Global economic data: Deutsche Bank Economic Research, Bureau Frankfurt

Because of the anticipated deterioration in the global economy, a number of countries have announced or passed economic stimulus packages, including Germany, the USA and China. It is difficult to assess at this point in time how effective these packages will be in countering a global recession in 2009.

Drop in production in the engineering industry expected [1)]

The crisis in the financial markets and the significant and sustained level of corporate uncertainty will continue to have a notable adverse impact on the real economy in 2009. Following a 29 per cent year-on-year drop in new orders in the fourth quarter of 2008 and a further significant decline of 42 per cent in January, the German Engineering Federation (VDMA) is forecasting a decline in German production of 7 per cent on average in 2009 as a result of reduced spending or a complete freeze on capital investment amongst companies in Germany and abroad. However, the extent of this reduction will vary from sector to sector.

Prospects worse for the construction equipment sector [1)]

In line with overall economic trends, a substantial fall in revenue is forecast for the German construction equipment and building materials industry in 2009. The construction equipment segment is expected to be hardest hit, with a percentage drop in double figures, in view of the fact that new orders have been particularly weak of late in this segment and dealers are known to still be holding high levels of stock. The construction equipment trade association does not expect to see any recovery before the second half of 2010.

The European construction industry as a whole is expected to be faced with a drop in construction volume of 4.5 per cent in 2009. According to experts at the EUROCONSTRUCT trade association, this drop in construction activity in Europe – together with the weak year in 2008 – represents the worst slump in the industry for decades. This trend affects both housing and commercial construction, although public sector construction could benefit from government capital investment programmes. Following a period of stagnation in 2010, a slight recovery in demand is only expected to materialise in the year after that. The only positive stimulus will come from eastern Europe. The general health of the construction industry in the US is not expected to improve materially in 2009 either.

Substantial drop in demand for commercial vehicles [1)]

A further fall in production and sales is expected for the European commercial vehicles industry. Whereas the Association of International Motor Vehicle Manufacturers (VDIK) is expecting a downturn in new registrations of 10 per cent, various commercial vehicle manufacturers are forecasting a slump in unit sales of up to 40 per cent and had already initiated significant capacity reductions in 2008. Overall, the trade associations for the commercial vehicles sector are currently remaining reticent about meaningful forecasts for the current year. The downturn in new registrations of commercial vehicles in Europe which began in the middle of 2008 (with new registrations in January 2009 down 36 per cent) can only lead to the conclusion that the industry is in for a very lean year.

1) Industry data: German Engineering Federation (VDMA), EUROCONSTRUCT/CESifo Group, ACEA, VDIK

Agricultural machinery: optimism for the first half of 2009[1)]

Given the high level of orders on hand, the outlook for the European agricultural machinery industry is still positive, at least for the first half of 2009. However, the capital expenditure requirement in agriculture has fallen as a result of the high level of investment over the last few years. The forecasts for western Europe for the whole of 2009 are assuming an average reduction in revenue of 5 per cent; the production volume of German agricultural machinery manufacturers will decrease accordingly from €7.5 billion in 2008 to €7.0 billion in the current year. In contrast, a contraction in market volume is expected in the countries of central and eastern Europe as a result of a squeeze on financing. However, the longer term trend in demand in the agricultural machinery industry remains intact and is supported by the sustained pressure for an increase in the production of non-meat agricultural products, which in turn leads to a higher degree of mechanisation in the management of arable land around the world.

Statutory regulations: exhaust-gas emission standards

Development and sales of diesel engines are strongly influenced by statutory provisions on emissions. These provisions lay down significant requirements to be met by producers. From 1 January 2008, the EU Stage IIIA emission standard for non-road applications in the 37 to 75 kW engine class came into force in the member states of the European Union (EU). Similarly, from the same date, the US EPA TIER 3 standard came into force in the US for engines of 37 to 75kw and TIER 4 Interim for engines of 19 to 56kW. From January 2011, further emission standards, depending on individual engine output class, will gradually come into force in the EU and in the US in the period up to 2014/2015.

For on-road applications, the Euro V emission standard will come into force from 1 October 2009 in the EU.

Commodities, US dollar, collective pay agreements

Changes in the prices of steel scrap, copper and aluminium have a significant impact on DEUTZ‘s cost of materials. For 2009, we are assuming that, as a result of the general recession, prices will be significantly lower than the high levels recorded in 2008. However, there will be a delay before DEUTZ benefits from these lower prices because of the system used for determining the inflation surcharge.

DEUTZ hedges sales transactions denominated in US dollar by entering into forwards and utilising natural hedging whereby components are purchased in US dollars. Overall, this means that approximately 70 per cent of the US dollar surplus at DEUTZ is hedged.

Collectively agreed pay rises in 2009 have already been determined under the current binding collective pay agreement that runs until 30 April 2010. In addition to one-off payments, collectively agreed pay is being increased in two stages by a total of 4.2 per cent.

New orders, unit sales, revenue

Given the continuing, severe economic uncertainty, we are unable to make any reliable forecasts for 2009 at present. Against the background of the global recession and the forecasts by trade associations relating to DEUTZ sales markets, we must assume that new orders, unit sales and revenue will be significantly below the levels achieved in 2008. We are therefore basing our plans on various sales scenarios, so that we can respond flexibly, in terms of both structure and costs, to different trends during the course of the year. It is our current assumption that the negative trend in the fourth quarter of 2008 will continue in the first half of 2009.

The Compact Engines segment will be materially affected by the sustained weakness in its principal customer industries, first and foremost the construction equipment and commercial vehicle industries. Because its business is based on longer term projects and a high proportion of service business, the DEUTZ Customised Solutions segment will not be as badly affected by the global recession. However, we are also expecting to see a marked downturn in this segment compared with 2008.

1) Industry data: German Engineering Federation (VDMA)

Operating profit (EBIT)

The forecast fall in new orders, unit sales and revenue will have a corresponding impact on operating profit. The aim of the “MOVE” action programme is to be able to react flexibly to changing economic circumstances in 2009 so as to achieve a small operating profit. The measures set out in the “MOVE” action programme, including the announcement of short-time working, the reduction in the cost of materials and overheads and the adjustment of employee numbers in line with changing sales forecasts should bring about a positive contribution to operating profit in the current financial year. The achievement of our target for operating profit in 2009 hinges on the successful implementation of the “MOVE” action programme.

Working capital ratio, equity ratio

Our objective is to sustain a working capital ratio of less than 15 per cent and to stabilise the equity ratio at around 40 per cent.

Capital expenditure, free cash flow

In 2009, DEUTZ is planning to maintain capital expenditure excluding research and development expenditure at least at the level of 2008, although capital expenditure will be aligned with market trends. More than 75 per cent of the invested funds will be dedicated to the Compact Engines segment. Our objective is to generate a stable free cash flow.

Research and development expenditure

Research and development expenditure, i.e. investment in future projects such as expenditure related to forthcoming exhaust-gas emission standards from 2011 and new technologies such as exhaust-gas aftertreatment, is to be maintained at the significant 2008 level.

Employees

In the context of our ongoing capacity adjustment, short-time working will be continued in under-utilised production and assembly units over the course of the current year until further notice. A review is being carried out monthly to take into consideration any change in the level of new orders. In addition, short-time working was extended to all areas of the Company at the beginning of 2009 with the exception of Research and Development.

Given the expected substantial fall in new orders and unit sales, we will continue to adjust personnel structures in line with the changing situation. There will be a further reduction in the number of employees compared with 2008 as a result of these restructuring measures.

Outlook for 2010

Various economic forecasts point to a recovery in the global economy in 2010. Following a recession phase in 2009, the main western industrialised nations are expected to benefit once again from slight economic growth. This recovery ought to be reflected in our new orders and correspondingly in unit sales and revenue. We expect the measures to improve profitability introduced as part of the “MOVE” action programme to continue to bear fruit in 2010. With an eye to the forthcoming exhaust-gas emission standards from 2011, research and development expenditure will remain at a high level.

This management report includes certain statements about future events and developments, together with disclosures and estimates provided by the Company. Such forward-looking statements include known and unknown risks, uncertainties and other factors that may mean that the actual performances, developments and results in the Company or those in sectors important to the Company are significantly different (especially from a negative point of view) from those expressly or implicitly assumed in these statements. The Management Board cannot therefore make any warranty with regard to the statements made in this management report. The Company gives no undertaking that it will update forward-looking statements to bring them into line with future developments.

Consolidated financial statements

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	Note	2008	2007
€ million			
Revenue	1	**1,495.0**	**1,524.2**
Change in inventories and other own work capitalised	2	25.4	30.1
Other operating income	3	65.0	66.7
Cost of materials	4	–1,039.7	–1,029.7
Staff costs	5	–290.0	–275.0
Depreciation and amortisation	6	–71.8	–65.5
Impairment loss	6	–2.6	–
Other operating expenses	7	–159.1	–155.3
Net result from equity-accounted investments	8	–6.3	–1.7
Other investment income	8	1.6	1.5
Reversal of impairment losses on non-current financial assets	8	–	0.2
EBIT		**17.5**	**95.5**
thereof one-off items		**–14.3**	**–**
thereof operating profit (EBIT before one-off items)		**31.8**	**95.5**
Interest expenses, net		–13.3	–18.1
thereof finance costs	9	–35.7	–29.6
Other taxes	10	–1.5	–1.3
Net income before taxes on continuing operations		**2.7**	**76.1**
Income taxes	10	–6.9	–16.7
Net income on continuing operations		**–4.2**	**59.4**
Net income on discontinued operations	11	**–4.1**	**123.9**
Net income		**–8.3**	**183.3**
thereof minority interest		–	–
thereof attributable to the shareholders of the parent enterprise		–8.3	183.3
Earnings per share	12		
Basic earnings per share (€)		**–0.07**	**1.56**
thereof from continuing operations		–0.04	0.51
thereof from discontinued operations		–0.03	1.05
Diluted earnings per share (€)		**–0.07**	**1.52**
thereof from continuing operations		–0.04	0.50
thereof from discontinued operations		–0.03	1.02

BALANCE SHEET FOR THE DEUTZ GROUP

Assets

€ million	Note	31 Dec. 2008	31 Dec. 2007
Property, plant and equipment	13	342.1	334.6
Intangible assets	14	125.7	110.6
Equity-accounted investments	15	55.1	57.6
Other financial assets	16	16.8	8.5
Non-current assets (before deferred tax assets)		539.7	511.3
Deferred tax assets	17	33.1	49.4
Non-current assets		**572.8**	**560.7**
Inventories	18	222.0	214.2
Trade receivables	20	121.1	188.8
Other receivables and assets	20	82.0	102.9
Cash and cash equivalents	21	207.5	311.1
Current assets		**632.6**	**817.0**
Non-current assets held for sale	19	0.9	0.9
Total assets		**1,206.3**	**1,378.6**

Equity and liabilities

Issued capital		309.0	307.0
Additional paid-in capital		28.8	28.1
Other reserves		2.5	–5.3
Retained earnings		79.1	79.1
Accumulated income		91.9	148.2
Equity attributable to the shareholders of the parent enterprise		511.3	557.1
Equity	22	**511.3**	**557.1**
Provisions for pensions and other post-retirement benefits	23	169.3	176.7
Deferred tax provisions	17	0.1	–
Other provisions	24	45.7	46.5
Financial liabilities	25	214.1	216.0
Other liabilities	25	1.7	10.0
Non-current liabilities		**430.9**	**449.2**
Provisions for pensions and other post-retirement benefits	23	16.4	16.7
Provision for current income taxes	17	2.1	11.3
Other provisions	24	48.8	63.7
Financial liabilities	25	5.6	5.4
Trade payables	25	138.1	206.1
Other liabilities	25	53.1	69.1
Current liabilities		**264.1**	**372.3**
Total equity and liabilities		**1,206.3**	**1,378.6**

STATEMENT OF CHANGES IN EQUITY FOR THE DEUTZ GROUP

	Issued capital	Additional paid-in capital	Retained earnings	Fair value reserve [1), 2)]	Currency translation reserve [1)]	Accumulated income	Total Group interest	Minority interest	Total
€ million									
Balance at 1 Jan. 2007	**292.3**	**24.1**	**0.4**	**1.0**	**–2.8**	**43.5**	**358.5**	**–**	**358.5**
Increase from exercise of conversion rights on convertible bonds/on profit-sharing rights	14.7	4.0					18.7		18.7
Accumulated other comprehensive income/loss (thereof reversals recognised in net income)				3.1 [3)] (–2.1)	–6.6 [5)]		–3.5 (–2.1)		–3.5 (–2.1)
Net income						183.3	183.3	–	183.3
Total of net income and accumulated other comprehensive income/loss in reporting period				3.1	–6.6	183.3	179.8	–	179.8
Appropriations to retained earnings			78.7			–78.7	–		–
Balance at 31 Dec. 2007	**307.0**	**28.1**	**79.1**	**4.1**	**–9.4**	**148.2 [4)]**	**557.1**	**–**	**557.1**
Balance at 1 Jan. 2008	**307.0**	**28.1**	**79.1**	**4.1**	**–9.4**	**148.2 [4)]**	**557.1**	**–**	**557.1**
Dividend payments to shareholders						–48.0	–48.0		–48.0
Increase from exercise of conversion rights on convertible bonds/on profit-sharing rights	2.0	0.7					2.7		2.7
Accumulated other comprehensive income/loss (thereof reversals recognised in net income)				5.4 [3)] (–1.0)	2.4		7.8 (–1.0)		7.8 (–1.0)
Net income						–8.3	–8.3	–	–8.3
Total of net income and accumulated other comprehensive income/loss in reporting period				5.4	2.4	–8.3	–0.5	–	–0.5
Balance at 31 Dec. 2008	**309.0**	**28.8**	**79.1**	**9.5**	**–7.0**	**91.9**	**511.3**	**–**	**511.3**

1) On the face of the balance sheet these items are aggregated under "Other reserves".
2) Reserves from the measurement of cash flow hedges and reserves from the measurement of available-for-sale financial assets
3) See note 26 on page 130 ff.
4) There is a rounding difference of €0.1 million in the reconciliation of the accumulated income at 1 January 2007 to that shown at 31 December 2007.
5) This includes income of €0.7 million that was recognised in income and offset against the sales proceeds on disposal of the DEUTZ Power Systems segment.

CASH FLOW STATEMENT FOR THE DEUTZ GROUP

€ million	Note	2008	2007
EBIT		**17.5**	**95.5**
Interest income		13.2	4.8
Other taxes paid		–1.5	–1.3
Income taxes paid		–1.8	–19.4
Depreciation and amortisation		74.4	66.8
Gains/losses on the sale of non-current assets		0.6	0.1
Net result from equity-accounted investments		7.3	2.6
Other non-cash income and expenses		–10.1	–24.5
Change in working capital		–0.2	–73.6
Change in inventories		–7.2	–49.5
Change in trade receivables		67.8	–51.3
Change in trade payables		–60.8	27.2
Change in other receivables and other current assets		–7.5	–15.3
Change in provisions and other liabilities (excluding financial liabilities)		–1.8	5.4
Cash flow from operating activities before payment of compensation for vested company pension rights (continuing operations)		**90.1**	**41.1**
Payment of compensation for vested company pension rights (continuing operations)		–0.4	–79.8
Cash flow from operating activities (continuing operations)		**89.7**	**–38.7**
Cash flow from operating activities (discontinued operations)	11	–	–9.1
Cash flow from operating activities (total)		**89.7**	**–47.8**
Capital expenditure on intangible assets, property, plant and equipment		–97.5	–100.8
Capital expenditure on investments		–	–58.2
Cash receipts from the sale of businesses		–	14.2
Proceeds from the sale of non-current assets		0.2	0.7
Cash flow from investing activities (continuing operations)		**–97.3**	**–144.1**
Cash flow from investing activities (discontinued operations)	11	–26.8	296.4
Cash flow from investing activities (total)		**–124.1**	**152.3**
Dividend payments to shareholders		–48.0	–
Interest expenses		–16.1	–8.5
Cash receipts from borrowings		0.9	249.8
Repayments of loans		–6.0	–79.4
Cash flow from financing activities[1]		**–69.2**	161.9
Cash flow from operating activities		89.7	**–47.8**
Cash flow from investing activities		–124.1	152.3
Cash flow from financing activities		–69.2	161.9
Change in cash and cash equivalents		**–103.6**	**266.4**
Cash and cash equivalents at 1 January		**311.1**	**49.4**
Change in cash and cash equivalents		–103.6	266.4
Change in cash and cash equivalents related to exchange rates		–	–4.7
Cash and cash equivalents at 31 December		**207.5**	**311.1**

1) 2007 includes cash flow from financing activities for discontinued operations

CONSOLIDATED FINANCIAL STATEMENTS

SEGMENT REPORTING FOR THE DEUTZ GROUP

Breakdown by business segment	Compact Engines		DEUTZ Customised Solutions		Other		Total for segments: continuing operations	
	2008	2007	2008	2007	2008	2007	2008	2007
€ million								
External revenue	1,143.2	1,183.8	351.8	336.9	–	–	1,495.0	1,520.7
Intersegment revenue	–	2.2	–	1.3	–	–	–	3.5
Total revenue	**1,143.2**	**1,186.0**	**351.8**	**338.2**	**–**	**–**	**1,495.0**	**1,524.2**
Total depreciation, amortisation and impairment	**73.9**	**59.5**	**0.4**	**5.9**	**0.1**	**0.1**	**74.4**	**65.5**
thereof depreciation and amortisation	71.3	59.5	0.4	5.9	0.1	0.1	71.8	65.5
thereof impairment loss	2.6	–	–	–	–	–	2.6	–
thereof reversal of impairment losses	–	–	–	–	–	–	–	–
Segment earnings before one-off items [1]	**-13.6**	**45.3**	**47.1**	**44.7**	**-1.7**	**5.5**	**31.8**	**95.5**
One-off items	**-12.3**	**–**	**-1.3**	**–**	**-0.7**	**–**	**-14.3**	**–**
Less net result from equity-accounted investments	**6.3**	**1.7**	**–**	**–**	**–**	**–**	**6.3**	**1.7**
Less result from investments and from the disposal of financial assets	**-0.9**	**-1.3**	**–**	**–**	**–**	**–**	**-0.9**	**-1.1**
Net income	–	–	–	–	–	–	–	
Segment earnings	**-20.5**	**45.7**	**45.8**	**44.7**	**-2.4**	**5.7**	**22.9**	**96.1**
Segment assets	**701.4**	**752.0**	**186.5**	**171.5**	**1.0**	**21.2 [2]**	**888.9**	**944.7**
Segment liabilities	**389.5**	**469.4**	**42.9**	**40.9**	**36.2**	**54.8 [2]**	**468.6**	**565.1**
Segment capital expenditures	**106.8**	**160.5**	**11.5**	**7.3**	**–**	**–**	**118.3**	**167.8**
Material non-cash expenses (excluding depreciation)	**27.0**	**15.6**	**3.6**	**1.5**	**1.8**	**1.1**	**32.4**	**18.2**
Carrying amounts of equity-accounted investments	**55.1**	**57.6**	**–**	**–**	**–**	**–**	**55.1**	**57.6**

1) Before one-off items including net result from equity-accounted investments and profits/losses from the sale of investments
2) All assets and liabilities in the DEUTZ Power Systems segment were disposed of with the sale of the DPS Group.
Any remaining assets and liabilities associated with the disposal process are reported under Other in 2007.

Breakdown by region	Revenue from external customers		Segment assets		Capital expenditure	
	2008	2007	2008	2007	2008	2007
€ million						
Europe	1,109.3	1,104.4	805.0	865.4	115.8	108.4
Middle East	34.5	43.8	–	–	–	–
Africa	51.9	45.0	10.6	8.1	–	–
Americas	180.7	207.2	56.5	56.1	2.0	1.6
Asia-Pacific	118.6	123.8	16.8	15.1	0.5	57.8
DEUTZ Group	**1,495.0**	**1,524.2**	**888.9**	**944.7**	**118.3**	**167.8**

Discontinued operations: DEUTZ Power Systems		Total for segments: continuing and discontinued operations		Reconciliation/ consolidation		DEUTZ Group	
2008	2007	2008	2007	2008	2007	2008	2007
–	206.9	1,495.0	1,727.6	–	–	1,495.0	1,727.6
–	0.2	–	3.7	–	–	–	3.7
–	**207.1**	**1,495.0**	**1,731.3**	**–**	**–**	**1,495.0**	**1,731.3**
–	**4.3**	**74.4**	**69.8**	**–**	**–**	**74.4**	**69.8**
–	4.3	71.8	69.8	–	–	71.8	69.8
–	–	2.6	–	–	–	2.6	–
–	–	–	–	–	–	–	–
–	**9.4**	**31.8**	**104.9**	**–**	**–**	**31.8** 1)	**104.9** 1)
–	**147.1**	**-14.3**	**147.1**	**–**	**–**	**-14.3**	**147.1**
–	**-1.3**	**6.3**	**0.4**	**-6.3**	**-0.4**	**–**	**–**
–	**–**	**-0.9**	**-1.1**	**0.9**	**1.1**	**–**	**–**
–	**155.2**	**22.9**	**251.3**	**-5.4**	**0.7**	**17.5**	**252.0**
–	**–**	**–**	**–**	**-25.8**	**-68.7**	**-8.3**	**183.3**
–	**–**	**888.9**	**944.7**	**317.4**	**433.9**	**1,206.3**	**1,378.6**
–	**–**	**468.6**	**565.1**	**737.7**	**813.5**	**1,206.3**	**1,378.6**
–	**6.5**	**–**	**174.3**	**–**	**–**	**–**	**174.3**
–	**12.7**	**32.4**	**30.9**	**–**	**–**	**32.4**	**30.9**
–	**–**	**55.1**	**57.6**	**–**	**–**	**55.1**	**57.6**

Notes to the Consolidated Financial Statements

BASIS OF PRESENTATION

Parent company

The parent company of the DEUTZ Group is DEUTZ AG. Its registered office is located at Ottostrasse 1, 51149 Cologne, Germany, and the company is entered under no. HRB 281 in the commercial register at the local court of Cologne. These consolidated financial statements were approved for publication by resolution of the Management Board on 19 February 2009 and received the consent of the Supervisory Board on 12 March 2009.

The DEUTZ AG shares were listed in the MDAX of Deutsche Börse from 18 September 2006 to 22 September 2008 and have been listed in the SDAX of Deutsche Börse since 22 September 2008. Deutz AG shares are publicly traded on the stock exchanges in Frankfurt and Düsseldorf and on the XETRA electronic trading platform.

DEUTZ is an independent manufacturer of compact diesel engines. The Group's activities are divided into two operating segments – Compact Engines and DEUTZ Customised Solutions – and the Other segment. In its two operating segments, DEUTZ focuses on value creation processes involving the development, design, production and sales of liquid-cooled and air-cooled engines. The business is broken down into the main application segments of Mobile Machinery, Automotive, Agricultural Machinery and Stationary Equipment. Comprehensive after-sales service rounds off the product range offered.

Basis of preparation of the financial statements

The DEUTZ Group's consolidated financial statements, prepared for the group parent company DEUTZ AG, comply with uniform accounting policies. The consolidated financial statements are generally prepared using the cost method, with the exception of derivative financial instruments and financial assets held for sale, which are measured at fair value. The consolidated financial statements are prepared in euros. Unless otherwise specified, all figures are rounded up or down to the nearest € million.

The consolidated financial statements of DEUTZ AG are prepared in accordance with the International Financial Reporting Standards (IFRSs) as adopted by the EU. The standards comprise the IFRSs and International Accounting Standards (IASs) promulgated by the International Accounting Standards Board (IASB), together with the interpretations of both the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC).

The consolidated financial statements are consistent with the statutory obligations applicable to publicly traded parent companies subject to disclosure requirements as set forth in section 315a (1) of the German Commercial Code (HGB) in conjunction with Article 4 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, as amended (IAS Regulation).

Application of the International Financial Reporting Standards (IFRSs)

1) Amendments to accounting policies

The accounting policies applied generally correspond to the policies applied in the previous year with the following exceptions:

In the year under review, the Group applied the new and revised standards (IFRSs) and interpretations (IFRICs) specified below. Initial application of the revised standards and interpretations did not have any effect on the consolidated financial statements. However, the revisions did lead to certain changes in accounting policies.

Amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures" The amendments permit reclassifications of some financial instruments in limited circumstances. Since the DEUTZ Group does not undertake any reclassifications, these amendments had no effect on the consolidated financial statements.

IFRIC 11 "IFRS 2: Group and Treasury Share Transactions" The Group has applied IFRIC 11 to the extent relevant to the consolidated financial statements. This interpretation clarifies that share-based payment arrangements under which an employee is granted rights to equity instruments of an entity and should be accounted for as equity-settled share-based payment transactions, regardless of whether the entity acquires those equity instruments from another party or the employee's rights to the equity instruments are granted by the entity itself or its shareholders. No equity instruments falling under the scope of this interpretation have been issued by the DEUTZ Group.

IFRIC 14 "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" IFRIC 14 provides general guidance on how to assess the limit on the amount of the surplus that can be recognised as a defined benefit asset under IAS 19 "Employee Benefits". Initial application of this interpretation had no effect on the consolidated financial statements since none of the DEUTZ Group's defined benefit plans show a surplus of plan assets over the amount of the defined benefit obligation.

2) Published but not yet mandatory standards, interpretations and amendments

The International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) have published the following standards and interpretations that have already become part of EU law via the commitology procedure but were not yet required to be applied in 2008. The Group has not opted for early application of these standards and interpretations.

Amendments to IFRS 1 "First-time Adoption of International Financial Reporting Standards" and IAS 27 "Consolidated and Separate Financial Statements" The amendments to IFRS 1 and IAS 27 were published in May 2008 and apply to annual periods beginning on or after 1 January 2009. The amendments concern the measurement of the cost of an investment on first-time adoption of IFRSs and the presentation of dividends from investments in the separate financial statements. They also remove the definition of the cost method from IAS 27. Thus in the future, dividends from jointly controlled entities, associates and subsidiaries must be presented as income in the separate financial statements of the investor, even if the dividend payment resulted from earnings prior to the acquisition date. The investments accounted for must therefore be tested for impairment in accordance with IAS 36. Since the amendments relate to recognition and measurement in the separate financial statements, initial application of the revised standards will not affect the consolidated financial statements.

Amendments to IFRS 2 "Share-based Payment" The amendments to IFRS 2 were published in January 2008 and apply to annual periods beginning on or after 1 January 2009. The revised IFRS 2 restricts the definition of vesting conditions to include only service conditions and performance conditions. It also specifies that all cancellations of equity instruments granted under share-based payment plans, whether by the entity or by other parties such as employees, should receive the same accounting treatment. The amendments are to be applied retrospectively. We do not expect any occurrences that would fall under the scope of the revised standard. Therefore, initial application of the revised standard is not expected to have any significant effects on the consolidated financial statements.

IFRS 8 "Operating Segments" IFRS 8 was published in November 2006 and applies to annual periods beginning on or after 1 January 2009. IFRS 8 provides for the mandatory application of the "management approach" in segment reporting. In accordance with IFRS 8, the classification of segments and the presentation of disclosures should be based on the breakdown used internally by an entity's chief operating decision maker for the purposes of allocating resources to operating segments and evaluating segment performance. The new standard will affect the way in which financial data on operating segments is published, though not the recognition and measurement of assets and liabilities in the consolidated financial statements.

Revised IAS 1 "Presentation of Financial Statements" A revised IAS 1 was issued in September 2007 and applies to annual periods beginning on or after 1 January 2009. The revised version of IAS 1 includes significant changes in the manner in which financial data is presented in the financial statements. In particular, a statement of comprehensive income has been introduced, which includes profit or loss for the period along with unrealised gains and losses that were previously recognised in equity. The statement of comprehensive income replaces the income statement in its previous form. Moreover, when an entity applies an accounting policy retrospectively or makes a retrospective restatement, the entity must present a balance sheet as at the beginning of the earliest comparative period rather than only as at the current reporting date and the reporting date for the previous year. The new standard will affect the way in which financial data of the DEUTZ Group is published, though not the recognition and measurement of assets and liabilities in the consolidated financial statements.

Revised IAS 23 "Borrowing Costs" A revised IAS 23 was issued in March 2007 and applies to annual periods beginning on or after 1 January 2009. The Group will apply the revised standard prospectively in accordance with the transitional provisions. Accordingly, borrowing costs relating to qualifying assets will be capitalised from 1 January 2009. This does not affect borrowing costs incurred previously, which were expensed in the period in which they were incurred. The effects on the consolidated financial statements are currently being determined.

Amendments to IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements" The amendments to IAS 32 and IAS 1 were published in February 2008 and apply to annual periods beginning on or after 1 January 2009. They concern the classification of share capital with termination rights as equity or as a liability. Under the previous regulations, entities were forced in some circumstances to report share capital as a financial liability due to shareholder termination rights granted by law. In future, share capital should be classified as equity provided certain conditions are met. The revised standard will not lead to changes in either the presentation or measurement of share capital in the consolidated financial statements.

Annual Improvements to IFRSs: 2006-2008 Annual Improvement Project In May 2008, a set of amendments to several existing standards was published. The amendments apply to annual periods beginning on or after 1 January 2009. In addition to changes of an editorial nature, the amendments relate to changes in the presentation, recognition and measurement of various items. Since only some of these changes affect the DEUTZ Group, no significant impact on the consolidated financial statements is expected.

The International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) have issued the following standards and interpretations, the application of which was not yet mandatory in financial year 2008. These standards and interpretations have not yet been adopted by the EU and are not applied by the Group.

Revised IFRS 1 "First-time Adoption of International Financial Reporting Standards" The revised version of IFRS 1 was published in November 2008 and applies to annual periods beginning on or after 1 July 2009. Since the revision of IFRS 1 did not affect its contents, initial application of the revised standard will not affect the consolidated financial statements.

Amendments to IFRS 3 "Business Combinations" A revised IFRS 3 was published in January 2008 and applies to annual periods beginning on or after 1 July 2009. The most significant changes involve introduction of an explicit option to measure any non-controlling interests (formerly referred to as "minority interests") either at the non-controlling interest's proportionate share of the net identifiable assets of the entity acquired (purchased goodwill method) or at fair value. When measuring non-controlling interest's at fair value, all goodwill attributable to the acquired entity must be recognised, including the portion attributable to the non-controlling interest's (full goodwill method). Other changes involve the requirement in the case of a business combination achieved in stages for an acquirer to remeasure its pre-existing equity interest in an acquired entity and recognise any resulting gain or loss in profit or loss, the requirement for contingent consideration to be measured at the acquisition date and the requirement to recognise transaction costs in profit or loss. The amendments are to be applied prospectively. The amendments do not affect assets and liabilities arising from business combinations prior to first-time adoption of the new standard. Since from a current perspective, no business combinations are expected to occur in the Group during the financial year of initial application, application of the standard is not expected to affect the consolidated financial statements.

Amendments to IAS 27 "Consolidated and Separate Financial Statements" The revised IAS 27 was published in January 2008. The amendments apply to annual periods beginning on or after 1 July 2009. They resulted from a joint IASB/FASB project to revise the accounting provisions applicable to business combinations and relate primarily to the accounting treatment of non-controlling interests (minority interests), to which entities will be required to attribute their share of group losses in future, and transactions leading to a loss of control of a subsidy, any gain or loss from which must be recognised in profit or loss. However, any gains or losses from a sale of shares that does not result in a loss of control are recognised directly in equity. The transitional provisions, which generally require retrospective application of amendments, call for prospective application of the aforementioned provisions. For this reason, assets and liabilities arising from such transactions prior to first-time adoption of the new standard are not affected. Since the DEUTZ Group does not anticipate any of the transactions specified to occur or any new losses amongst non-controlling interests, initial application of the standard is not expected to affect the consolidated financial statements.

Amendment to IAS 39 "Financial Instruments: Recognition and Measurement" The amendment to IAS 39 was published in July 2008 and applies to annual periods beginning on or after 1 July 2009. The amendment clarifies which sub-risks can be hedged with which instruments in hedge accounting and provides guidance on the designation of purchased options as hedging instruments and of inflation as a hedged risk. Since the DEUTZ Group does not currently hedge inflation risk or use options as hedging instruments, these changes are not expected to impact the consolidated financial statements on initial application.

IFRIC 12 "Service Concession Agreements" IFRIC 12 was published in November 2006 and applies to annual periods beginning on or after 1 January 2008. The interpretation provides guidance on the accounting treatment of obligations undertaken and rights received under service concession arrangements in the financial statements of the service concession operators. First-time application of this interpretation is not expected to have any material impact on the consolidated financial statements. As the companies included in the consolidated financial statements are not service concession operators within the meaning of IFRIC 12, this interpretation will not affect the DEUTZ Group. Application of IFRIC 12 was already mandatory in financial year 2008, though it has not yet been adopted by the EU.

IFRIC 13 "Customer Loyalty Programmes" IFRIC 13 was published in June 2007 and applies to annual periods beginning on or after 1 July 2008. The interpretation requires loyalty award credits granted to customers to be accounted for as a separate component of the sale transaction. Some of the proceeds of the initial sale – measured by reference to their fair value – is allocated to the award credits as a deferred liability. The deferred portion of the proceeds is recognised as revenue in the period in which the award credits are redeemed or expire. Initial application of this interpretation will have no impact on the consolidated financial statements as the DEUTZ Group does not operate any such customer loyalty programmes.

IFRIC 15 “Agreements for the Construction of Real Estate” IFRIC 15 was published in July 2008 and applies to annual periods beginning on or after 1 January 2009. The interpretation provides guidance on how to determine whether an agreement for the construction or sale of real estate is within the scope of IAS 11 or IAS 18, with a focus on purchase agreements concluded before construction is completed or before the start of construction. Such agreements must be accounted for either under IAS 11 (with revenue recognition depending on the stage of completion) or IAS 18 (with revenue recognition at completion upon or after delivery). The interpretation clarifies when IAS 11 or IAS 18 is to be applied and when revenue from the construction of real estate should be recognised. Since this interpretation applies to the real estate industry, no impact on the DEUTZ Group is anticipated.

IFRIC 16 “Hedges of a Net Investment in a Foreign Operation” IFRIC 16 was published in July 2008 and applies to annual periods beginning on or after 1 October 2008. The interpretation provides clarification of three main issues: First, how to designate risk arising from foreign currency exposure and the maximum amount that may be designated as a hedged risk. Second, which entity within a group can hold a hedging instrument in a hedge of a net investment in a foreign operation and third, how to handle a disposal of an investment in a foreign operation in terms of accounting treatment. The DEUTZ Group does not currently hedge any net investments in foreign operations. Therefore, initial application of IFRIC 16 is not expected to affect the consolidated financial statements.

IFRIC 17 “Distributions of Non-cash Assets to Owners” IFRIC 17 was published in November 2008 and applies to annual periods beginning on or after 1 July 2009. The interpretation standardises practice in the accounting treatment of distributions of non-cash assets to owners. It clarifies that dividends payable should be measured at the fair value of the net assets to be distributed and that the difference between the dividend paid and the carrying amount of the net assets distributed should be recognised in profit or loss. Since no distributions of non-cash assets to owners are expected to occur in the Group during the financial year of initial application, initial application of the standard is not likely to affect the consolidated financial statements.

IFRIC 18 “Transfers of Assets from Customers” IFRIC 18 was published in January 2009 and applies to annual periods beginning on or after 1 July 2009. The interpretation includes guidance clarifying recognition and measurement of assets as well as issues regarding revenue recognition in connection with the transfer of assets from customers. Since such transfers currently are not relevant for the business activities of DEUTZ, initial application of the interpretation is not likely to affect the consolidated financial statements.

Significant estimates and assumptions

The preparation of the consolidated financial statements in accordance with IFRS requires estimates and assumptions to be made that have an impact on the recognition, measurement and reporting of assets and liabilities, the disclosure of contingent liabilities at the balance sheet date and the reporting of income and expenses. Estimates and assumptions giving rise to a material risk in the form of adjustments to the carrying amounts of assets or liabilities over the next financial year are explained in the following. In particular, forecasts of future cash flows are subject to additional uncertainties in view of the financial market crisis. Adjustments to estimates are recognised in income when better knowledge becomes available.

Impairment of non-financial assets The Group ascertains whether there are any indications of impairment of non-financial assets as at each balance sheet date. For the purpose of assessing value in use, the management estimates future cash flows expected to be generated from the asset or the cash-generating unit and selects an appropriate discount rate for calculating the present value of the cash flows.

Impairment losses of €2.6 million (2007: €0.0 million) were recognised for non-financial assets as at 31 December 2008. For more information, please see Note 6 on page 106.

Deferred tax assets The DEUTZ Group is obliged to pay income taxes in various countries. It is therefore necessary to make estimates on the basis of which tax provisions and deferred taxes can be recognised. Estimates must also be made in order to determine whether the Group needs to recognise deferred tax assets. When determining the amount of deferred tax assets, the management must make judgments – which may involve material uncertainties – regarding the expected timing and amount of future taxable income as well as future tax planning strategies. DEUTZ mainly recognises deferred tax assets on losses carried forward. Deferred tax assets are recognised on all unused tax losses carried forward to the extent that it is probable that future taxable profit will be available against which the losses carried forward can actually be set off.

As at 31 December 2008, the carrying amount of deferred tax assets recognised on tax losses carried forward amounted to €37.9 million (2007: €43.5 million). Please see Note 17 on page 117 f. for more information.

Expenses for **defined benefit plans** are determined on the basis of actuarial calculations. The actuarial valuation is prepared on the basis of assumptions on discount rates, expected returns on plan assets, future wage and salary increases, staff turnover, mortality and future pension increases. Due to the long-term focus of defined benefit plans, such estimates are subject to material uncertainty.

Because of changes in economic and market conditions, the costs and liabilities actually incurred may differ significantly from the estimates made on the basis of actuarial assumptions. The rate of pension and salary increases, the longevity of those entitled to pension benefits and the discount rate used can have a material impact on the amount of the defined benefit obligation and, consequently, on future pension costs. A change of 0.5 percentage points in the discount rate used is estimated to cause the majority of pension benefit obligations to be adjusted by between 4 per cent and 5 per cent. A change of 0.5 percentage points in the projected rate of pension increase would cause the majority of pension benefit obligations to rise by 4.4 per cent.

Provisions for pensions and other post-retirement benefits amounted to €185.7 million as at 31 December 2008 (2007: €193.4 million). Additional information is provided in Note 23 on page 123 ff..

Development expenditure is capitalised in accordance with the accounting policies described. Initial capitalisation of the expenditure is based on management's judgment that technical and economic feasibility has been established; this is generally the case when a product development project has reached certain milestones in the existing project management model. For the purpose of calculating the amounts to be capitalised, the management makes assumptions on the amount of future cash flows expected to be generated from assets, the applicable discount rate and the period in which the assets are expected to generate cash flows. The carrying amount of capitalised development expenditure was €96.8 million at 31 December 2008 (2007: €77.1 million).

Pending or potential legal disputes DEUTZ AG and some of its subsidiaries are involved in a number of legal disputes and arbitration proceedings. These relate to risks concerning quality defect liability, tax law, competition law and antitrust law. Provisions have been recognised to cover the risks arising from this litigation. At present, it is not possible to predict the outcome of these pending cases with any degree of certainty beyond the provisions already recognised. We do not expect them to have a significantly adverse impact on the DEUTZ Group's financial position or financial performance. The overall position of the legal risks facing the DEUTZ Group is explained in more detail in Note 28 on page 141.

BASIS OF CONSOLIDATION

All subsidiaries, joint ventures and associates have been included in the consolidated financial statements. Subsidiaries are all enterprises (including special-purpose entities) over which DEUTZ AG exerts direct or indirect control. The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity is controlled. Subsidiaries are fully consolidated from the point at which the Group obtains control. Consolidation ends as soon as the parent effectively loses control. The consolidated financial statements include DEUTZ AG as well as 3 (2007: 3) German enterprises and 7 (2007: 8) foreign enterprises in which DEUTZ AG holds the majority of voting rights, either directly or indirectly or – as in the case of special-purpose entity Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf – is exposed to a majority of the opportunities and risks.

With respect to the foreign enterprises, DEUTZ DITER COMPONENTES S.A., Zafra, was merged into DEUTZ DITER S.A., Zafra (both in Spain).

Joint ventures are enterprises over which joint control is exercised together with other entities. Associates are enterprises over which DEUTZ AG exerts a significant influence that are not subsidiaries or joint ventures. Associates and joint ventures are both accounted for in the consolidated financial statements using the equity method.

In 2008, 2 (2007: 2) joint ventures and 1 (2007: 1) foreign enterprise were consolidated in accordance with the provisions governing associates.

Page 150 of the annex to the notes to the consolidated financial statements lists the companies consolidated as part of the DEUTZ Group as at 31 December 2008. Full disclosure of shareholdings is published in the electronic German Federal Gazette.

PRINCIPLES OF CONSOLIDATION

The separate financial statements of the consolidated companies (including the financial statements of associates and joint ventures) have been consistently prepared and audited or reviewed in accordance with the regulations on consolidation based on uniform accounting policies. The consolidated financial statements comprise the financial statements of DEUTZ AG and its subsidiaries as at 31 December of each year.

Equity is consolidated by offsetting the carrying amount of investments against the DEUTZ Group's share of the consolidated subsidiaries' proportionate remeasured equity at the time they are acquired or consolidated for the first time, taking into account any utilisation of the exemption option pursuant to IFRS 1 relating to opening balance sheets at 1 January 2004.

Business combinations are accounted for using the purchase method. The cost of a business combination is the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree, plus any costs directly attributable to the business combination. Assets, liabilities and contingent liabilities identifiable as part of a business combination are measured at their fair value at the date of exchange for the purposes of first-time consolidation, irrespective of the extent of any minority interests.

Any positive differences are capitalised as goodwill; any negative goodwill is recognised in income.

Minority interest is that portion of the profit or loss and net assets that is not attributable to the Group. The DEUTZ Group currently has no minority interests.

All income, expenses, assets and liabilities and intercompany profits and losses arising between consolidated enterprises are eliminated, unless they are insignificant.

JOINT VENTURES AND ASSOCIATES

Interests in joint ventures and associates are accounted for using the equity method. Under this method, the Group recognises its interests in an associate or a joint venture in the balance sheet at cost plus any changes in the Group's share of the enterprise's net assets occurring after acquisition. The goodwill relating to the associate/joint venture is included in the carrying amount of the investment and is not amortised. The income statement contains the Group's share in the profits of the associate/joint venture. Any changes reported directly in equity of the associate/joint venture are recognised by the Group in the amount of its interest and, where applicable, presented in the statement of changes in equity. The financial statements of the associate/joint venture are – with one exception – prepared as at the same reporting date as the parent's financial statements. The Group adapts its uniform accounting policies where necessary.

CURRENCY TRANSLATION

The items in the financial statements of each Group enterprise are measured in the currency that corresponds to the currency of the primary economic environment in which the enterprise operates (functional currency).

Balance sheet items – with the exception of equity – are translated into the DEUTZ Group's functional currency (the euro) at closing rates. Income and expense items – including the net profit or loss – are translated at the average rates for the year. Equity – with the exception of the net profit or loss – is translated at the prevailing historical closing rates.

Translation differences arising from the translation of equity at historical rates and the translation of the net profit or loss at average rates for the year are reported under accumulated other comprehensive income/loss.

Foreign-currency transactions are translated into the functional currency at the exchange rates prevailing at the time of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of foreign-currency monetary assets and liabilities at closing rates are reported on the face of the income statement unless they are recognised in equity as qualified cash flow hedges.

The significant exchange rates used for currency translation purposes are shown in the following table:

		Average exchange rates		Closing rates at 31 Dec.	
		2008	2007	2008	2007
USA	1 USD	0.68	0.72	0.71	0.68
UK	1 GBP	1.25	1.45	1.03	1.36
Singapore	1 SGD	0.48	0.48	0.49	0.47
China	1 CNY	0.10	0.10	0.10	0.09
Australia	1 AUD	0.57	0.61	0.49	0.60

ACCOUNTING POLICIES

The significant accounting policies used to prepare these consolidated financial statements are described below:

Revenue recognition

Revenue generated by the sale of engines and the provision of services comprises the fair value received less VAT, discounts and price reductions.

Revenue and other income are recognised as follows:

Revenue from the sale of engines Revenue from the sale of engines is recognised once a DEUTZ Group enterprise has delivered to a customer and the risk and rewards has passed to the customer. Estimates of costs to be incurred subsequently are covered by provisions and deducted from revenue.

Revenue generated by services Revenue generated by services is recognised at the time the service is provided.

Interest income, user fees, dividends and other income Interest income is recognised pro rata temporis using the effective interest method. Revenue from user fees is deferred and recognised pro rata temporis in accordance with the commercial content of the relevant agreements.

Dividend income is recognised at the time the right to receive the payment arises. Other income is recognised according to contractual agreements on the transfer of risks and rewards.

Property, plant and equipment

Property, plant and equipment is recognised at cost and, if depreciable, less any straight-line depreciation and any accumulated impairment losses. The cost of property, plant and equipment includes the purchase price and any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The costs of conversion of self-constructed property, plant and equipment includes the directly attributable costs, allocated indirect material and indirect labour and production or service-related administrative expenses.

Subsequent costs are included in the carrying amounts of these items of property, plant and equipment at the time the cost is incurred if the recognition criteria are met. Service and maintenance costs are recognised immediately in income. Borrowing costs are not capitalised.

The depreciation period is based on the expected useful life of the asset. Land is not depreciated.

Straight-line depreciation is based on the following useful lives in the main investment categories:

	Useful life in years
Buildings and grounds	15 to 33
Technical equipment and machines	10 to 15
Other equipment, furniture and fixtures	3 to 10

The residual carrying amounts, useful lives and depreciation methods applied are reviewed at the end of each financial year and adjusted if needed.

An item of property, plant and equipment is derecognised upon disposal or when an economic benefit can no longer be expected from the continued use or sale of the asset. Gains and losses resulting from the derecognition of an asset represent the difference between the net sales proceeds and the carrying amount of the asset and are recognised in the income statement in the period in which the asset is derecognised.

Intangible assets

Intangible assets are measured at cost at the acquisition date. Expenditure on internally generated intangible assets is recognised as an expense in the period in which it is incurred, with the exception of development expenditure that qualifies for capitalisation. The cost of an internally generated intangible asset comprises all directly attributable costs. The cost also includes an appropriate proportion of overhead expenditure. In subsequent periods, intangible assets are recognised at cost less straight-line depreciation and any accumulated impairment losses. The useful lives of acquired and internally generated intangible assets are limited. Amortization and impairment losses are reported correspondingly in the income statement.

The following principles are applied:

Concessions, trademarks and similar rights Concessions, trademarks and similar rights are measured at amortised cost. Amortisation is undertaken on a straight-line basis over an estimated useful life of 3 to 10 years.

Internally generated intangible assets Development expenditure is capitalised if it can be clearly allocated to a newly developed product or process that is technically feasible and is intended for the enterprise's own use or marketing activities. It is generally amortised on a straight-line basis over the expected production cycle of 3 to 8 years.

Gains and losses resulting from the derecognition of intangible assets represent the difference between the net sales proceeds and the carrying amount of the asset and are recognised in profit or loss in the period in which the asset is derecognised.

Impairment of non-financial assets

The DEUTZ Group reviews, at each balance sheet date, whether there is any indication that an asset may be impaired. Intangible assets not yet available for use are tested for impairment at least once annually.

An impairment loss is recognised if the carrying amount of the asset exceeds its recoverable amount. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. If an individual asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs. When impairment tests are conducted, assets are aggregated at the lowest-possible level at which the assets generate largely independent cash flows (cash generating units).

The value in use of an asset is calculated by estimating the present value of future cash flows using a discount rate that reflects the current market assessment of the time value of money and the risks specific to the asset or the cash-generating unit. If an impairment loss recognised for an asset in prior periods no longer exists, the impairment loss is reversed.

Government grants

Government grants relating to purchases of non-current assets are deducted from the cost of the respective asset. The amount of depreciation and amortisation is based on the cost of purchase after deduction of such grants.

Income taxes

Deferred taxes are recognised using the balance sheet liability method for all temporary differences between the carrying amount of an asset or liability in the balance sheet and its tax base as at the reporting date.

Deferred tax assets are recognised to the extent that sufficient future taxable profits are likely to be generated over the planning period against which deductible temporary differences and unused tax losses can be offset.

Deferred taxes arising from temporary differences associated with investments in subsidiaries, joint ventures and associates are recognised except to the extent that the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred taxes referring to items that are recognised directly in equity are not recognised in profit or loss, but are likewise taken directly to equity.

Deferred tax assets and liabilities are netted if the DEUTZ Group is entitled to have the current tax assets offset against tax liabilities and if the deferred taxes relate to income taxes levied by the same tax authority.

Deferred taxes are recognised at the rates anticipated on recognition of the asset or liability. The anticipated tax rate is the rate that has already been enacted or announced at the balance sheet date, provided announcement of the tax rate has the substantive effect of actual enactment.

Current tax expense for the current and prior periods is measured at the amount expected to be paid to (recovered from) the tax authorities using the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

Inventories

Inventories are recognised at the lower of cost or net realisable value. Net realisable value is the estimated selling price in the normal course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

The cost of raw materials and consumables as well as bought-in and spare parts is calculated using the weighted average cost formula.

Work in progress and finished goods are recognised at the cost of conversion, which includes directly attributable costs as well as a proportion of indirect labour and indirect materials.

Additional adjustments are made to cover risks resulting from inventories' period of storage and impaired usability as well as contract-related losses.

Borrowing costs are not capitalised.

Non-current assets and disposal groups held for sale

Non-current assets are classified as held for sale and recognised at the lower of their carrying amount and their fair value less costs to sell if their carrying amount essentially derives from their sale rather than from their continued use.

Financial assets

The following financial assets as defined in IAS 39 relate to the DEUTZ Group and are classified accordingly:

- Financial assets at fair value through profit or loss
- Loans and receivables
- Available-for-sale financial assets

Upon initial recognition, financial assets are measured at fair value through profit or loss. In the case of financial assets other than those recognised at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the asset are added to the fair value.

Financial assets are classified into one of the above categories for the purpose of measurement upon initial recognition. Reclassification is undertaken when necessary and permissible.

All regular way purchases and sale of financial assets – with the exception of held-for-trading financial assets – are recognised at the settlement date, i.e. the date that the asset is delivered to or from DEUTZ. Held-for-sale financial assets are recognised at the trade date, i.e. the date that the Group commits itself to purchase or sell the asset. A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Financial assets at fair value through profit or loss In the DEUTZ Group, the group of financial assets at fair value through profit or loss includes financial assets held for trading. The DEUTZ Group has not yet made use of the option to designate financial assets as financial assets at fair value through profit or loss upon initial recognition.

A financial asset is classified as held for trading if it is acquired for the purpose of selling it in the near term. Derivatives, including embedded derivatives that are separated from the host contract, are also classified as held for trading with the exception of derivatives that have been designated as hedging instruments and are determined to be effective hedges. Gains or losses on financial assets held for trading are recognised in profit or loss. The Group determines whether an embedded derivative is required to be separated from the host contract and accounted for as a derivate at the time it first becomes a party to a contract. Reassessment occurs only if there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract.

Loans and receivables Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not traded in an active market. This category comprises trade receivables and other receivables and assets. They arise when the DEUTZ Group provides money, goods or services directly to a customer or other debtor. They are classified as current assets, except for those that do not fall due until twelve months after the balance sheet date, in which case they are reported as non-current assets. After initial recognition, the loans and receivables are measured at amortised cost using the effective interest rate method, less any impairment losses. A gain or loss is recognised in profit or loss when the loan or receivable is derecognised or impaired, and through the amortisation process.

Available-for-sale financial assets Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified in one of the other categories for financial assets of IAS 39. After initial measurement, available-for-sale financial assets are measured at fair value. Assets whose fair value cannot be determined either using generally accepted measurement methods (e.g. discounted cash flow) or from their market prices are recognised at amortised cost. Unrealised gains or losses are recognised as accumulated other comprehensive income/loss. When any such financial asset is derecognised or impaired, the cumulative gain or loss previously recognised in accumulated other comprehensive income/loss is recognised in profit or loss.

Impairment of financial assets

Financial assets, with the exception of financial assets measured at fair value through profit or loss, are assessed at the end of each reporting period for objective evidence of impairment. Such evidence may consist of observable data such as significant financial difficulty of the obligor, the probability that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market for the financial asset, significant changes in the technological, market, economic or legal environment in which the issuer operates or a prolonged decline in the fair value of the financial asset below amortised cost.

Financial assets carried at amortised cost If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate, i.e. the effective interest rate computed at initial recognition. The impairment loss is recognised in profit or loss.

If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. The new carrying amount of the financial asset may, however, not exceed what the amortised cost would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal is recognised in profit or loss.

In the case of trade receivables, if there is objective evidence that not all amounts due will be paid pursuant to the original invoice conditions (such as insufficient creditworthiness on the part of the obligor, disagreement on the existence or amount of the receivable, inability to enforce the receivable for legal reasons, etc.), an impairment loss is recognised through use of an allowance account. The receivable is derecognised when it is classified as uncollectible.

Impairment of other receivables and assets is recognised by the direct write-down of carrying amounts.

Available-for-sale financial assets When an available-for-sale financial asset is impaired, the difference between the acquisition cost and the current fair value, less any impairment losses on that financial asset previously recognised in profit or loss, is reclassified from accumulated other comprehensive income/loss to profit or loss. Reversals of impairment losses of equity instruments classified as available for sale are not recognised through profit or loss. Impairment losses on unquoted equity instruments classified as available for sale and accounted for at cost may not be reversed. Reversals of impairment losses for debt instruments classified as available for sale are reversed through profit or loss if the increase in the fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and credit balances held with banks.

Financial liabilities

The following financial liabilities as defined in IAS 39 relate to the DEUTZ Group:

- Financial liabilities at fair value through profit or loss
- Other financial liabilities

Financial liabilities at fair value through profit or loss In the DEUTZ Group, the group of financial liabilities at fair value through profit or loss includes financial liabilities held for trading. The DEUTZ Group has not yet made use of the option to designate financial liabilities as financial liabilities at fair value through profit or loss upon initial recognition.

A financial liability is classified as held for trading if it is acquired for the purpose of selling it in the near term. Derivatives, including embedded derivatives that are separated from the host contract, are also classified as held for trading with the exception of derivatives that have been designated as hedging instruments and are determined to be effective hedges. If the fair value of such a derivative is negative, it is recognised as a financial liability. Gain or losses on financial liabilities held for trading are recognised in profit or loss.

Other financial liabilities of the DEUTZ Group are comprised mainly of:

- Financial liabilities (bonds (US private placement), liabilities to banks)
- Trade payables and other liabilities

Other financial liabilities are classified as current unless the DEUTZ Group does not have to repay the financial liability until at least twelve months after the balance sheet date.

Other financial liabilities are initially recognised at their fair value, including transaction costs. In subsequent periods they are measured at amortised cost using the effective interest method.

Derivative financial instruments and hedging relationships

DEUTZ only uses derivative financial instruments (interest-rate and currency derivatives) for hedging purposes as part of its operating activities.

At DEUTZ, derivative financial instruments are used regularly only for the purpose of reducing the foreign currency risk in planned transactions involving foreign currencies and to reduce interest rate risk. Forwards and interest-rate swaps are the primary instruments used.

These instruments are initially recognised at their fair value on the day they are concluded and are subsequently measured at the fair value prevailing at the time. The fair value of derivatives corresponds to the present value of estimated future cash flows. The fair value of currency forwards is based on the forward exchange rate at the balance sheet date.

Changes in the fair value of financial instruments not used as hedging instruments under hedge accounting guidelines (non-hedging derivatives) are recognised immediately in profit or loss.

Cash flow hedges Forecast transactions (cash flows) in foreign currency are hedged using cash flow hedges. The effective portion of the changes in the market value of derivatives designated as cash flow hedges is recognised as accumulated other comprehensive income/loss. The ineffective portion of the changes in market value is reported on the face of the income statement under other expenses (exchange differences).

The changes in market value reported in the reserve for cash flow hedges are recognised in the income statement in the period in which the hedged item is recognised in income.

The market values of derivatives designated as cash flow hedges are stated in Note 26 on page 130 ff.. Changes in the cash flow hedge reserve are reported under accumulated other comprehensive income/loss (fair value reserve).

Provisions for pensions and other post-retirement benefits

The occupational pension scheme offered by the DEUTZ Group takes account of the relevant legislation in various countries and the benefits that each company provides for its staff. The resultant obligations relate to both existing pensions and entitlements to future pensions.

Occupational pensions take the form of **defined-benefit pension plans**, which are funded by the recognition of pension provisions. Since pension plans in Germany were closed to new members in 1996, employees in Germany can no longer acquire any further employer-funded pension entitlements. Currently, therefore, accrued interest cost is simply added to existing pension provisions. There is one funded pension plan in the UK (branch of DEUTZ AG), and the US subsidiary has pension liabilities.

The liabilities recognised in the balance sheet reflect the present value of the defined benefit obligation less the fair value of plan assets, adjusted for cumulative unrecognised actuarial gains and losses and past service cost. The amount of the obligation under the defined benefit plans is calculated separately for each plan using the projected unit credit method. This method takes into account pensions and accrued benefits known at the balance sheet date as well as anticipated future wage and salary and pension increases.

The interest rate used to discount the present value of the defined benefit obligation, taking into account future wage and salary increases, is based on an index of high-quality fixed income investments at the plans' valuation dates. The term of the interest rate matches the maturity of the pension obligation. Actuarial gains and losses are recognised as income or expense if the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceed the greater of 10 per cent of the present value of the defined benefit obligation and 10 per cent of the fair value of plan assets. These limits are calculated and applied separately for each defined benefit plan. The gains and losses are recognised over the expected average remaining working lives of the employees participating in the relevant plan.

Past service cost is recognised immediately if the benefits have vested; otherwise it is recognised as an expense on a straight-line basis over the average remaining vesting period.

The interest component of pension expenses is included in finance costs.

DEUTZ also has **defined-contribution pension plans** (e.g. direct insurance). The mandatory contributions are immediately recognised as staff costs. In this case, the recognition of provisions is not required because the DEUTZ Group has no obligation apart from the obligation to pay premiums.

Other provisions

Other provisions are recognised if there are legal or constructive obligations towards third parties that arise from past events and are likely to result in an outflow of resources. Furthermore, it must be possible to estimate the obligation reliably.

If a number of identical obligations exist, the probability of an outflow of resources based on this group of obligations as a whole is calculated.

Provisions are recognised at their settlement amount calculated at the balance sheet date and take account of projected cost increases. Non-current provisions are discounted.

Contingent liabilities

Contingent liabilities are potential obligations that arise from past events and whose existence will only be confirmed by the occurrence of one or more uncertain future events, which, however, are beyond the control of the DEUTZ Group. Furthermore, present obligations may constitute contingent liabilities if it is not probable that an outflow of resources will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made.

Discontinued operations pursuant to IFRS 5

IFRS 5 stipulates that a component of an entity that has been disposed of and represents a major line of business or geographical area of operations must be reported separately. All income and expenses up to the point of deconsolidation, any gains on disposal and any adjustments to amounts presented in discontinued operations in the previous year must be reported separately on the income statement under discontinued operations.

1. REVENUE

The tables below give a breakdown of revenue by business segment and geographical segment (sales regions):

Segments

€ million	2008	2007
Engines	1,042.6	1,093.5
Service	100.6	92.5
Compact Engines	**1,143.2**	**1,186.0**
Engines	240.4	227.2
Service	111.4	111.0
DEUTZ Customised Solutions	**351.8**	**338.2**
Total	**1,495.0**	**1,524.2**

Sales regions

€ million	2008	2007
Europe/Middle East/Africa	**1,195.7**	**1,193.2**
thereof Germany	364.7	335.4
thereof rest of Europe	744.6	769.0
thereof Middle East	34.5	43.8
thereof Africa	51.9	45.0
Americas	**180.7**	**207.2**
Asia-Pacific	**118.6**	**123.8**
Total	**1,495.0**	**1,524.2**

2. CHANGE IN INVENTORIES AND OTHER OWN WORK CAPITALISED

Change in inventories

The change in inventories of finished goods and work in progress amounted to €5.5 million (2007: €16.4 million) in financial year 2008.

Other own work capitalised

Other own work capitalised amounted to €19.9 million (2007: €13.7 million). This primarily related to expenditure for new engine development and the further development of existing engines to comply with current and future exhaust emissions standards, particularly the upcoming interim TIER 4 and final TIER 4 standards.

3. OTHER OPERATING INCOME

€ million	2008	2007
Income from recharged costs and services	44.1	37.8
Exchange rate gains	13.5	3.2
Income from the measurement of currency forwards	1.2	3.0
Rentals and leases	1.0	4.1
Income from the settlement of pension claims	–	9.0
Income from the reversal of warranty provisions following disposal of Marine Service business	–	5.0
Income from the disposal of non-current assets and deconsolidations	–	0.1
Sundry other income	5.2	4.5
Total	**65.0**	**66.7**

The decrease in other operating income from one-off items realised in 2007 is mainly offset by the increase of foreign exchange gains. These one-off items realised in 2007 were mainly due to the reversal of pension provisions related to the settlement of pension claims and the reversal of provisions on expiry of warranty periods in connection with the sale of the Marine Service business.

4. COST OF MATERIALS

€ million	2008	2007
Cost of raw materials and consumables, bought-in parts and goods procured	971.1	984.7
Cost of services procured	58.2	42.8
Impairment of raw materials, bought-in parts and goods procured	10.4	2.2
Total	**1,039.7**	**1,029.7**

The increase of the impairment losses for raw materials, bought-in parts and goods procured result from higher valuation allowances, among other things due to recognised inventory differences and expenses for scrapping assets as well as from the discontinuation of a series in the low power range (< 4 litres).

5. STAFF COSTS

The average number of employees during the year is specified in the section entitled "Disclosures under German accounting standards".

€ million	2008	2007
Wages	121.6	126.5
Salaries	111.0	102.7
Social security contributions	44.2	44.2
Cost of staff adjustments	10.5	0.1
Cost of post-employment benefits and other long-term employee benefits	2.7	1.5
Total	**290.0**	**275.0**

The expenses for making staff adjustments almost entirely result from the recognition of a provision for necessary adjustments in the number of employees.

6. DEPRECIATION, AMORTISATION AND IMPAIRMENT

This item gives details of depreciation and amortisation, which represent the scheduled allocation of the cost of an asset over its useful life, and impairment, which is determined by testing for impairment as described in IAS 36.

€ million	2008	2007
Property, plant and equipment	49.5	47.6
Intangible assets	22.3	17.9
Total	**71.8**	**65.5**

In financial year 2008, impairment losses totalling €2.6 million (2007: €0.0 million) were recognised on property, plant and equipment and intangible assets, mainly due to discontinuation of a series in the low power range (< 4 litres).

7. OTHER OPERATING EXPENSES

€ million	2008	2007
Expenses for general services	52.5	55.7
Special selling expenses	24.7	25.2
Cost of rentals and leases	12.2	13.2
Cost of fees, contributions and consultancy services	12.1	12.3
Temporary staff	10.6	14.3
Office, postal, telecommunications, advertising and other administrative expenses	10.6	10.3
Expenses in connection with the measurement of currency forwards	6.3	2.3
Exchange rate losses	6.1	4.5
Costs of disposal of non-current assets	0.6	0.4
Sundry other expenses	23.4	17.1
Total	**159.1**	**155.3**

8. NET RESULTS FROM ON EQUITY-ACCOUNTED FINANCIAL ASSETS, OTHER INVESTMENT INCOME AND REVERSAL OF IMPAIRMENT LOSSES ON NON-CURRENT FINANCIAL ASSETS

	2008	2007
€ million		
Net result from equity-accounted investments		
Income from equity-accounted investments	1.7	1.8
Expenses from equity-accounted investments	–8.0	–3.5
Total	**–6.3**	**–1.7**
Other investment income	**1.6**	**1.5**
Reversal of impairment losses on non-current financial assets	**–**	**0.2**
Total	**–4.7**	**–**

Income and expenses from equity-accounted financial assets mainly include profits transferred and losses assumed on a proportional basis. In the year under review, the increase of the losses assumed results from start-up losses in the first full financial year of the Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd.

9. INTEREST EXPENSE, NET

	2008	2007
€ million		
Interest received on credit balances held with banks	11.1	3.7
Other interest income	11.3	7.8
Interest income	**22.4**	**11.5**
Interest paid on liabilities to banks	–2.6	–3.8
Interest paid on bonds, convertible bonds and profit-sharing rights	–11.3	–6.1
Interest cost of pension provisions and similar obligations	–10.8	–12.1
Other interest expense	–11.0	–7.6
Interest expenses (finance costs)	**–35.7**	**–29.6**
Net interest expense	**–13.3**	**–18.1**

In the year under review, interest income of €12.8 million (2007: €6.5 million) and interest expense of €13.9 million (2007: €9.9 million) were attributable to financial instruments measured at amortised cost or at fair value with changes in fair value recognised in equity.

10. TAXES

Other taxes Other taxes essentially comprise real-property taxes.

Income taxes The following table gives a breakdown of income taxes:

	2008		
	Continuing operations	Discontinued operations	Total
€ million			
Current tax expense thereof not related to the reporting period	−1.8 −1.8	−9.6 −9.6	−11.4 −11.4
Deferred taxes	8.7	5.1	13.8
thereof due to temporary differences	3.1	5.1	8.2
thereof from losses carried forward	5.6	–	5.6
Total tax expense	**6.9**	**−4.5**	**2.4**

	2007		
€ million			
Current tax expense thereof not related to the reporting period	12.7 –	30.8 –	43.5 –
Deferred taxes	4.0	−0.3	3.7
thereof due to temporary differences	−4.6	−0.3	−4.9
thereof from losses carried forward	8.6	–	8.6
Total tax expense	**16.7**	**30.5**	**47.2**

Deferred tax expense included expenses for an impairment of deferred tax assets on tax loss carryforwards in the amount of €5.6 million (2007: €8.6 million), given that it is no longer probable that sufficient taxable profit will be available against which the deferred tax assets can be offset in full.

Any dividends paid out by DEUTZ AG to its shareholders do not result in potential income tax consequences for DEUTZ AG.

The tax reconciliation table shows the reconciliation from anticipated income taxes to effective taxes as shown on the face of the income statement. Effective income taxes include actual and deferred taxes. The applicable tax rate is 31 per cent (2007: 39 per cent) and comprises corporation tax at 15 per cent (2007: 25 per cent), the solidarity surcharge of 5.5 per cent charged on the corporation tax and the trade tax based on an average rate of approx. 15 per cent (2007: 13 per cent). The tax rates applicable from financial year 2008 as a result of the business tax reforms that took effect on 1 January 2008 were already taken into account in the calculation of deferred taxes in the 2007 reporting year.

€ million	2008	2007
Net income before income taxes	**–5.9**	**230.5**
Anticipated tax	–1.9	89.9
Difference in local basis of assessment	1.4	–9.5
Tax rates outside Germany	–0.7	–2.2
Change in adjustment of deferred tax assets on losses carried forward, change in deferred tax assets capitalised for losses carried forward/temporary differences	12.7	–38.0
Change in tax rates	–0.1	10.0
Effect of non-deductible expenses	0.2	0.1
Net result from equity-accounted subsidiaries, joint ventures and associates	2.3	
Effect of tax-exempt income	–3.2	–0.5
Effects from other periods		
Tax refunds for previous years	–2.6	–
Purchase price adjustment (disposal of DPS KG)	–5.4	–
Other	–0.3	–2.6
Effective tax expense	**2.4**	**47.2**
Effective tax rate (%)	–40.7	20.5

The subsequent recognition of/changes in adjustments and the non-recognition of deferred tax assets on losses carried forward essentially relate to:

- the change in deferred tax assets following the utilisation of losses carried forward in the reporting period;
- the capitalisation of deferred taxes on losses carried forward that can be utilised in subsequent years; and
- unrecognised deferred tax assets on losses of consolidated enterprises in the reporting period.

11. DISCONTINUED OPERATIONS

At the time of preparation of the 2007 consolidated financial statements, the sale of DEUTZ Power Systems, including the price adjustment mechanisms stipulated in the sale and purchase agreement, had not yet been completed. In financial year 2008, DEUTZ AG reached an out-of-court settlement with financial investor 3i regarding any and all claims on the part of the buyer company arising from the acquisition of DEUTZ Power Systems in September 2007. As part of the settlement, DEUTZ AG agreed to make a compensation payment to the buyer company. This payment settles all claims on the part of 3i arising from the purchase agreements.

There was relatively little overlap between the Compact Engines business and the medium-sized and large engines business of DEUTZ Power Systems because of their differing business processes, customer profiles and market conditions. For this reason, the DEUTZ Power Systems segment – including its associates and subsidiaries – was sold to financial investor 3i.

DEUTZ Power Systems was reported as a discontinued operation in accordance with IFRS 5 in financial year 2007. In the reporting year, discontinued operations included the adjustments resulting from the settlement agreed with 3i and other costs for winding up the process. As a result of the compensation payment and other winding-up costs, the net loss attributable to discontinued operations amounted to €4.1 million. This figure takes into account the provisions recognised in connection with the sale, including provisions for income taxes and other offsetting factors.

The following table gives a breakdown of the net income from discontinued operations:

	2008	2007
€ million		
Revenue	**–**	**207.1**
Change in inventories and other own work capitalised	–	31.1
Cost of materials	–	–140.2
Staff costs	–	–49.1
Other income and expenses	–	–39.5
EBIT from discontinued operations	**–**	**9.4**
Net interest expense/other taxes	–	–2.1
Current net income from discontinued operations	**–**	**7.3**
Income taxes	–	–1.7
Current net income after income taxes from discontinued operations	**–**	**5.6**
Profit/loss on adjustments/disposal gains before income taxes	–8.6	147.1
Income taxes	4.5	–28.8
Profit/loss on adjustments/disposal gains after income taxes on discontinued operations	**–4.1**	**118.3**
Net income from discontinued operations	**–4.1**	**123.9**

Due to the adjustments and winding-up costs, the cash outflow from investing activities (discontinued operations) amounted to €26.8 million. This figure includes the unavailable deposits of amounts recognised in connection with the sale and other offsetting factors.

12. EARNINGS PER SHARE

Earnings per share is calculated in accordance with IAS 33. The DEUTZ Group computes basic earnings per share by dividing the net income attributable to its shares by the weighted average number of shares outstanding.

To calculate diluted earnings per share, dilutive effects such as profit-sharing rights and convertible bonds are factored in. In doing so, it is assumed that the profit-sharing rights and convertible bonds will be converted into shares. Net income is accordingly increased by the amount of the interest expenses that are not incurred in such case. The resultant tax charge is recognised.

	2008	2007
€ million/Shares in thousands		
Net income	–8.3	183.3
Weighted average number of shares outstanding	120,794	117,316
Basic earnings per share (€)	**–0.07**	**1.56**
thereof from continuing operations	–0.04	0.51
thereof from discontinued operations	–0.03	1.05
Dilutive effect		
Increase in net income resulting from derecognition of interest cost on dilutive convertible profit-sharing rights and convertible bonds	–	0.9
Current and deferred taxes	–	–0.3
Adjusted net income for the period	–8.3	183.9
Weighted average number of shares outstanding (diluted)	120,872	120,936
Diluted earnings per share (€)	**–0.07**	**1.52**
thereof from continuing operations	–0.04	0.50
thereof from discontinued operations	–0.03	1.02

13. PROPERTY, PLANT AND EQUIPMENT

Gross figures
Acquisition and production cost

€ million	Land, land rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Construction in progress	Total
Balance at 1 Jan. 2008	**187.7**	**428.9**	**166.7**	**18.5**	**801.8**
Exchange differences	–	−0.1	−0.1	–	−0.2
Additions	1.0	23.1	14.3	23.2	61.6
Capital investment grants	–	−2.1	−0.8	–	−2.9
Disposals	−0.3	−4.4	−5.9	–	−10.6
Reclassifications	7.5	25.2	1.0	−34.2	−0.5
Balance at 31 Dec. 2008	**195.9**	**470.6**	**175.2**	**7.5**	**849.2**

Gross figures
Depreciation and impairment

€ million	Land, land rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Construction in progress	Total
Balance at 1 Jan. 2008	**53.1**	**294.0**	**120.1**	**–**	**467.2**
Exchange differences	–	−0.1	−0.1	–	−0.2
Depreciation	4.7	31.0	13.8	–	49.5
Impairment	0.2	–	0.5	–	0.7
Disposals	–	−4.3	−5.8	–	−10.1
Balance at 31 Dec. 2008	**58.0**	**320.6**	**128.5**	**–**	**507.1**
Net carrying amount at 31 Dec. 2008	**137.9**	**150.0**	**46.7**	**7.5**	**342.1**

Gross figures
Acquisition and production cost

€ million	Land, land rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Construction in progress	Total
Balance at 1 Jan. 2007	**245.5**	**472.7**	**197.0**	**14.1**	**929.3**
Exchange differences	–0.2	–0.1	–0.2	–	–0.5
Additions	3.9	34.1	20.4	21.6	80.0
Capital investment grants	–0.2	–3.5	–1.3	–	–5.0
Disposals	–	–6.5	–15.1	–	–21.6
Change in basis of consolidation	–5.9	–1.7	–0.5	–	–8.1
Disposals of non-current assets held for sale and disposal groups (sale of DEUTZ Power Systems)	–55.5	–79.1	–34.6	–2.9	–172.1
Reclassifications	0.1	13.0	1.0	–14.3	–0.2
Balance at 31 Dec. 2007	**187.7**	**428.9**	**166.7**	**18.5**	**801.8**

Gross figures
Depreciation and impairment

€ million	Land, land rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Construction in progress	Total
Balance at 1 Jan. 2007	**67.6**	**333.2**	**153.9**	**–**	**554.7**
Exchange differences	–0.1	–0.2	–0.2	–	–0.5
Additions	7.0	33.2	13.0	–	53.2
Disposals	–	–6.4	–15.1	–	–21.5
Change in basis of consolidation	–4.7	–1.7	–0.5	–	–6.9
Disposals of non-current assets held for sale and disposal groups (sale of DEUTZ Power Systems)	–16.7	–64.1	–31.0	–	–111.8
Balance at 31 Dec. 2007	**53.1**	**294.0**	**120.1**	**–**	**467.2**
Net carrying amount at 31 Dec. 2007	**134.6**	**134.9**	**46.6**	**18.5**	**334.6**

Other than replacements, the additions to property, plant and equipment mainly comprised capital expenditure for expanding capacity in Cologne and Zafra in the Compact Engines segment and capital expenditure for environmentally friendly projects in Ulm in the DEUTZ Customised Solutions segment.

Government grants received by a Spanish subsidiary were deducted from the cost of purchasing the property, plant and equipment. In 2008, government grants of €2.0 million (2007: €3.5 million) were received. Total government grants recognised at 31 December 2008 amounted to €7.3 million (2007: €6.5 million). In 2008, €1.2 million (2007: €1.5 million) was recognised in income (as a reduction in depreciation).

Purchase commitments relating to property, plant and equipment are shown on page 141.

14. INTANGIBLE ASSETS

Gross figures
Acquisition and production cost

€ million	Concessions, trademarks and similar rights	Internally generated intangible assets	Total
Balance at 1 Jan. 2008	**115.2**	**100.8**	**216.0**
Additions	8.5	48.2	56.7
Capital investment grants	–0.8	–16.9	–17.7
Disposals	–23.5	–0.2	–23.7
Reclassifications	0.5	–	0.5
Balance at 31 Dec. 2008	**99.9**	**131.9**	**231.8**

Gross figures
Depreciation and impairment

€ million	Concessions, trademarks and similar rights	Internally generated intangible assets	Total
Balance at 1 Jan. 2008	**81.7**	**23.7**	**105.4**
Amortisation	12.0	10.3	22.3
Impairment	0.8	1.1	1.9
Disposals	–23.5	–	–23.5
Balance at 31 Dec. 2008	**71.0**	**35.1**	**106.1**
Net carrying amount at 31 Dec. 2008	**28.9**	**96.8**	**125.7**

Gross figures
Acquisition and production cost

€ million	Concessions, trademarks and similar rights	Internally generated intangible assets	Total
Balance at 1 Jan. 2007	**110.3**	**82.3**	**192.6**
Exchange differences	–0.1	–	–0.1
Additions	11.8	24.3	36.1
Capital investment grants	–1.6	–5.8	–7.4
Disposals of non-current assets held for sale and disposal groups (sale of DEUTZ Power Systems)	–5.4	–	–5.4
Reclassifications	0.2	–	0.2
Balance at 31 Dec. 2007	**115.2**	**100.8**	**216.0**

Gross figures
Depreciation and impairment

€ million	Concessions, trademarks and similar rights	Internally generated intangible assets	Total
Balance at 1 Jan. 2007	**76.1**	**16.2**	**92.3**
Additions	10.5	7.5	18.0
Disposals of non-current assets held for sale and disposal groups (sale of DEUTZ Power Systems)	–4.9	–	–4.9
Reclassifications	–	–	–
Balance at 31 Dec. 2007	**81.7**	**23.7**	**105.4**
Net carrying amount at 31 Dec. 2007	**33.5**	**77.1**	**110.6**

The additions to intangible assets essentially relate to the capitalisation of the expenditure on new engine development and the further development of existing engines to comply with current and future exhaust emissions standards, particularly the upcoming interim TIER 4 and final TIER 4 standards.

The income statement includes research and development expenditure of € 42.1 million for financial year 2008 (2007: € 40.6 million).

15. EQUITY-ACCOUNTED INVESTMENTS

The shares held by the DEUTZ Group in associates and joint ventures, none of which are listed companies, are as follows:

€ million	2008	2007
1 January	**57.6**	**12.8**
Additions	–	57.8
Disposals	–	–8.1
Share of profit/loss on equity-accounted investments	–6.3	–1.7
Other changes arising from measurement using the equity method	3.8	–3.2
31 December	**55.1**	**57.6**

One associate has a different financial year (ending on 30 November). No preparation of financial statements as at 31 December is undertaken due to lack of materiality.

The following table summarises the financial data of equity-accounted investments:

€ million	2008	2007
Total assets	17.0	15.1
Total liabilities	8.8	7.4
Revenue	27.1	24.2
Net income (after taxes)	5.1	3.8

DEUTZ AG has an interest of 50 per cent in DEUTZ (Dalian) Engine Co., Ltd., Dalian, China, and in DEUTZ AGCO MOTORES S.A., Haedo, Argentina. These are jointly controlled entities that manufacture engines for DEUTZ's internationally operating customers on site. The interests are accounted for using the equity method.

The Group's share in the assets, liabilities, revenues and net income after taxes of the jointly controlled entities was as follows as at 31 December 2008 and 31 December 2007:

€ million	2008	2007
Current assets	85.6	58.4
Non-current assets	65.2	63.3
Total assets	**150.7**	**121.6**
Current liabilities	73.3	44.5
Non-current liabilities	24.4	21.7
Total liabilities	**97.7**	**66.2**
Revenue	125.2	49.4
Net income (after taxes)	–7.7	–2.9

16. OTHER FINANCIAL ASSETS (NON-CURRENT)

€ million	31 Dec. 2008	31 Dec. 2007
Investments[1]	5.8	5.8
Non-current securities[2]	1.2	1.4
Loans[3]	1.3	1.3
Derivatives[4]	8.5	–
Total	**16.8**	**8.5**

1) Available-for-sale financial assets measured at amortised cost because fair values cannot be determined
2) Available-for-sale financial assets measured at fair value
3) Primary financial instruments measured at amortised cost
4) Derivatives measured at fair value

Non-current securities

This item includes €1.2 million (2007: €1.4 million) in securities in the form of shares and bonds. The securities are used as a form of investment for the pension obligations of a foreign subsidiary (Deutz Corporation).

17. DEFERRED TAXES, CURRENT TAX ASSETS AND LIABILITIES

At the balance sheet date, DEUTZ AG had unutilised tax losses carried forward of € 971.7 million for corporation tax (2007: € 948.3 million) and € 1,117.7 million for trade tax (2007: € 1,103.8 million). Additional tax loss carry forwards were also available to international companies in the Group.

The following table gives a breakdown of the deferred taxes and the current tax assets and liabilities reported on the face of the balance sheet:

	31 Dec. 2008	31 Dec. 2007
€ million		
Non-current		
Deferred tax assets	33.1	49.4
Deferred tax provisions	0.1	–
Current		
Current tax assets	1.4	0.7
Provision for income taxes	2.1	11.3
Income tax liabilities	0.3	0.2

The decline of the balance of deferred taxes by € 16.4 million to € 33.0 million results, apart from the utilization of the provisions from the disposal of DEUTZ Power Systems, primarily from the higher amount of capitalized development expenditure as well as the impairment of loss carryforwards due to the weaker economy. An amount of € 2.6 million of the change was recognised in accumulated other comprehensive income/loss and the remaining amount (€ 13.8 million) was recognised in profit or loss. No current taxes are incurred for items recognised in accumulated other comprehensive income/loss.

The provisions for income taxes of € 2.1 million primarily comprise the tax expense for corporation tax and trade tax on the disposal of DEUTZ Power Systems. The external tax audit for the years 2002 to 2005 begun in April 2007 has continued in the current financial year and is not yet completed.

The following table gives a breakdown of deferred tax assets and liabilities:

	31 Dec. 2008		31 Dec. 2007	
	Assets	Liabilities	Assets	Liabilities
€ million				
Intangible assets	–	31.6	–	25.2
Property, plant and equipment	9.3	0.4	10.9	–
Equity-accounted investments, financial assets	7.4	10.2	–	–
Inventories	1.0	0.9	0.9	1.7
Receivables and other assets	0.2	2.4	0.5	6.4
Liabilities	22.6	2.3	27.1	2.4
Losses carried forward	37.9	–	43.5	–
Tax credits	–	–	–	–
Consolidation	1.6	–	2.2	–
Other	0.8	–	–	–
Impairment losses	–	–	–	–
Deferred taxes (gross)	**80.8**	**47.8**	**85.1**	**35.7**
Netting	47.7	47.7	35.7	35.7
Deferred taxes (net)	**33.1**	**0.1**	**49.4**	**–**

The change in deferred taxes on temporary differences recognised in accumulated other comprehensive income/loss amounted to €0.3 million for financial assets (2007: €1.3 million) and €2.3 million for liabilities (2007: €0.0 million).

No deferred tax liabilities were recognised for taxes on profits not transferred from subsidiaries, associates and joint ventures as at 31 December 2007 and 31 December 2008 since the timing of the reversal of the temporary difference can be controlled or is largely not subject to tax and no material tax effects are expected in the foreseeable future.

Temporary differences for which no deferred tax liabilities were recognised are of minor significance.

In addition to the tax loss carry forwards on which deferred taxes have been recognised, there are loss carry forwards in the following amounts and with the following expiry periods for which deferred taxes have not been recognised because the losses cannot be utilised:

Loss carry forwards on which deferred taxes have not been recognised

	2008	2007
€ million		
Corporation tax	864.2	817.9
Trade tax	999.1	973.4
Tax credits/loss carry forwards outside Germany	15.2	16.5

Thereof: expiry periods for German and international losses carried forward

	Corporation tax		Trade tax	
	2008	2007	2008	2007
€ million				
Less than 5 years	9.7	6.6	–	–
5 to 9 years	1.8	9.9	–	–
Indefinite	867.9	817.9	999.1	973.4

The loss carryforwards as at 31 December 2007 were mainly updated in the current year due to findings from tax audits.

18. INVENTORIES

	31 Dec. 2008	31 Dec. 2007
€ million		
Raw materials and consumables, bought-in parts and spare parts	127.2	125.0
Work in progress	35.6	39.2
Finished goods	59.2	50.0
Total	**222.0**	**214.2**

The increase in inventories of €7.8 million resulted chiefly from reduced inventory turnover in the second half of 2008 due to the slower economy.

The carrying amount of inventories at 31 December 2008, written down to net realisable value, was €36.1 million (2007: €42.4 million).

The following table shows the changes of the allowance account for inventories:

€ million	2008	2007
January 1	**18.5**	**58.9**
Changes	0.1	–40.4
December 31	**18.6**	**18.5**

19. NON-CURRENT ASSETS HELD FOR SALE

The non-current assets held for resale at 31 December 2008 and 31 December 2007 relate to land and buildings owned by special-purpose entity Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf, at Cologne-Deutz (€0.9 million). It is intended to sell the assets within 12 months of the balance sheet date. The land and buildings of the Deutz-Mülheim special-purpose entity are assigned to the Compact Engines segment.

20. RECEIVABLES AND OTHER ASSETS (EXCLUDING TAXES)

€ million	31 Dec. 2008	31 Dec. 2007
Trade receivables	126.7	194.1
Less adjustments	–5.6	–5.3
Trade receivables (net)	**121.1**	**188.8**
Other receivables and assets		
Receivables from investments	12.0	6.7
thereof trade receivables	11.6	5.1
thereof other receivables	0.4	1.6
Advances paid on property, plant and equipment and inventories	8.2	14.0
Derivative financial instruments[1)]	0.7	7.2
Sundry other receivables[2)]	49.0	60.4
Receivables arising from other taxes	6.4	9.4
Prepaid expenses	4.3	4.5
Total	**80.6**	**102.2**

1) The derivative financial instruments essentially consist of foreign-currency derivatives embedded in purchase contracts.
2) Sundry other receivables include unavailable deposits of €19.5 million from the disposal of DEUTZ Power Systems.

As at 31 December 2008, the volume of receivables sold under factoring agreements was around €93 million (2007: €95 million).

Trade receivables at par value amounting to €4.9 million (2007: €8.0 million) were impaired at 31 December 2008. The allowance account changed as follows:

€ million	2008	2007
Balance at 1 January	**5.3**	**12.8**
Change in basis of consolidation	–	–7.1
Additions	3.1	1.6
Utilisation	–1.3	–1.6
Reversals	–1.5	–0.4
Balance at 31 December	**5.6**	**5.3**

Impairment of other receivables and assets is recognised by the direct write-down of carrying amounts. In the reporting period, total write-downs of €21.2 million (2007: €20.9 million) were applied to receivables due from investments.

21. CASH AND CASH EQUIVALENTS

The cash and cash equivalents presented in the balance sheet comprise cash on hand and credit balances held with banks.

22. EQUITY

€ million	31 Dec. 2008	31 Dec. 2007
Issued capital	309.0	307.0
Additional paid-in capital	28.8	28.1
Other reserves	2.5	–5.3
Retained earnings	79.1	79.1
Accumulated income	91.9	148.2
Equity attributable to the shareholders of the parent enterprise	**511.3**	**557.1**
Total	**511.3**	**557.1**

Issued capital

At the end of 2008, the issued capital (share capital) of DEUTZ AG amounted to €308,978,241.98 (2007: €306,992,504.46), divided into 120,861,783 no-par-value bearer shares (2007: 120,085,030).

In 2008, 771,193 (2007: 5,758,434) convertible bonds and 556 (2007: 18) profit-sharing rights were converted into a total of 776,753 (2007: 5,758,614) no-par-value shares in DEUTZ AG.

Since less than 10 per cent of the original 19,792,998 convertible bonds was outstanding at the end of 2007, DEUTZ took advantage of the opportunity to call in the bond. The effective date for redeeming the bond was 8 March 2008, and bondholders had the opportunity to exchange 1 convertible bond for 1 DEUTZ share up to 3 March 2008. The 68,070 bonds not converted by such date were redeemed via cash payment to the bearers in the amount of €3.40 per bond, or €0.2 million in total. Now there are no more convertible bonds outstanding.

In accordance with Article 7 (1) of the terms and conditions governing its profit-sharing rights, DEUTZ gave due notice of cancellation of the convertible profit-sharing rights it had previously issued with effect from midnight on the day immediately following the Annual General Meeting at which the adopted annual financial statements for the period ended 31 December 2007 were presented. The remaining 638 convertible profit-sharing rights were redeemed at par value due to the cancellation.

Authorised capital

The Annual General Meeting held on 22 June 2006 approved a resolution to create new authorised capital. The Management Board is authorised, with the consent of the Supervisory Board, to increase the issued capital on or before 21 June 2011 through the issue of new no-par-value shares against cash or non-cash contributions on one or more occasions up to a total amount of €120,000,000. Capital increases against non-cash contributions may not exceed a total of €80,000,000.

If the capital is increased against cash contributions, the shareholders must be granted pre-emptive rights. The new shares may be transferred to a bank specified by the Management Board subject to an undertaking by the bank to offer the shares to shareholders (indirect pre-emptive right). The Management Board is authorised, with the consent of the Supervisory Board, to exclude the pre-emptive rights of shareholders in the following cases:

- for fractional amounts;
- in so far as is necessary to grant holders of bonds with conversion rights, option rights or conversion obligations issued by DEUTZ AG subscription rights to new shares to the extent that would be required if they were to exercise their conversion or option rights or fulfil their conversion obligations;
- if the issue price of the new shares is not significantly below the market price and the shares issued under the exclusion of pre-emptive rights pursuant to section 186 (3) sentence 4 of the German Stock Corporation Act (AktG) in total do not exceed 10 per cent of the issued capital, either at the effective date or at the time the authorisation is exercised. The aforementioned 10 per cent threshold includes shares that are acquired on the basis of an authorisation granted by the Annual General Meeting and sold during the period of this authorisation pursuant to section 71 (1) number 8 sentence 5 of the AktG in conjunction with section 186 (3) sentence 4 of the AktG. This restriction also includes shares that have been, or are to be, issued in order to service bonds with conversion rights, option rights or conversion obligations in so far as the bonds were issued during the term of the authorisation under the exclusion of pre-emptive rights in accordance with section 186 (3) sentence 4 of the AktG.

Conditional capital

Convertible bonds The Annual General Meeting voted on 27 May 2004, to increase the Company's conditional share capital by up to €34,000,000. The conditional capital will only be increased to the extent that

a) the holders or creditors of conversion rights or warrants attached to the convertible bonds or bonds with warrants issued by DEUTZ AG, or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding, on or before 26 May 2009, exercise their conversion rights or option rights or

b) the holders or creditors of the convertible bonds issued on or before 26 May 2009 by DEUTZ AG, or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding, who are obliged to exercise their conversion rights, fulfil their conversion obligations.

The new shares entitle their holders to a share of the Company's profits from the beginning of the financial year in which they are created through the exercise of conversion rights or option rights, or through fulfilment of conversion obligations.

The Management Board is also authorised, with the consent of the Supervisory Board, to exclude pre-emptive rights in so far as the capital increase is made against non-cash contributions in the context of the acquisition of an enterprise, parts of an enterprise or investments in an enterprise. Conditional capital amounted to €174 thousand as at 31 December 2008.

Additional paid-in capital

The additional paid-in capital contains premiums and contributions from shareholders as well as the equity component of compound financial instruments, such as non-interest-bearing profit-sharing rights and low-interest-bearing convertible bonds. The value of the right to exercise profit-sharing rights and convertible bonds was recognised in equity at fair value less pro rata transaction costs, taking account of deferred taxes, at the date of issue.

Other reserves

Currency translation Translation differences arising from the translation of equity at historical rates and the translation of the net income or loss at average rates for the year are reported under accumulated other comprehensive income/loss. In 2008, a gain of €2.4 million (2007: loss of €6.6 million) was reported. The cumulative loss from exchange differences recognised in other reserves amounted to €7.0 million at the end of 2008 (2007: €9.4 million).

Fair value reserve Changes in the fair value of financial instruments available for sale are recognised in the fair value reserve. The fair value reserve of accumulated other comprehensive income/loss also includes the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge.

Retained earnings

Retained earnings contain the statutory reserve of DEUTZ AG of €4.5 million plus other retained earnings of €74.6 million.

Accumulated income

Accumulated income reflects income earned in the past by the enterprises included in the consolidated financial statements, provided such income has not been paid out as dividends.

The Annual General Meeting of DEUTZ AG resolved on 21 May 2008 to pay shareholders a dividend of €0.20 for each share entitled to dividends from the accumulated income for financial year 2007 and a special dividend of €0.20 for each share entitled to dividends from the gain on the disposal of DEUTZ Power Systems. The holders of profit-sharing rights were paid €4.00 per profit-sharing right with a par value of DEM 50 (€25.56). This equates to a total dividend payout of €48 million in the year under review. No dividends were resolved or distributed during financial year 2007. The Management Board will propose to the Annual General Meeting that the accumulated income of DEUTZ AG for the financial year 2008 as reported under German commercial law be carried forward to new account.

23. PROVISIONS FOR PENSIONS AND OTHER POST-RETIREMENT BENEFITS

DEUTZ AG maintains both defined-contribution plans and defined-benefit plans for its employees.

Defined-contribution plans

Employees in Germany receive statutory social insurance benefits for which contributions are paid as part of income. Additional direct insurance and pension scheme entitlements that are financed by employees also exist at DEUTZ. These plans are treated as defined-contribution plans because the Company has no obligation beyond the payment of contributions to public and private insurers. Ongoing contribution payments are reported as an expense for the period concerned.

The employer's contribution to the German statutory pension insurance scheme in 2008 came to € 17.9 million (2007: € 17.3 million). In addition, a further € 2.6 million (2007: € 1.9 million) was passed on to pension insurers under employees' direct retirement insurance agreements as contributions from their salary.

Defined-benefit plans

Defined benefit obligation for pensions and other post-retirement benefits

	31 Dec. 2008	31 Dec. 2007
€ million		
Unfunded	187.3	195.5
Funded	10.7	17.1
Total	**198.0**	**212.6**

No employer-funded pension entitlements have been granted to new employees joining the DEUTZ Group in Germany since 1995 (closed pension plans). There is a funded pension plan in the UK (branch of DEUTZ AG) that is wholly or partly covered by plan assets. Pension liabilities of the US subsidiary are also reported.

The following tables present a summary of the composition of expenses for retirement benefits recognised in the income statement and the composition of amounts recognised for the plans in the consolidated balance sheet.

Total expenses for pensions and other post-retirement benefits

	2008	2007
€ million		
Service cost	0.3	0.3
Interest cost	10.8	12.1
Anticipated return on plan assets	–0.7	–0.8
Total	**10.4**	**11.6**

Interest cost and the expected return on plan assets are reported under interest expense, net. In the year under review, the actual loss on plan assets amounted to € 1.8 million (2007: actual gain of € 0.6 million). All other expenditure is shown under staff costs in the consolidated income statement.

Reconciliation of provisions for pensions and other post-retirement benefits

€ million	31 Dec. 2008	31 Dec. 2007
Defined benefit obligation for pensions and other post-retirement benefits	198.0	212.6
External plan assets measured at fair value	–10.7	–13.7
Actuarial gain (+)/loss (–)	–1.6	–5.5
Pension provisions reported on the face of the balance sheet	**185.7**	**193.4**

Development of the present value of defined benefit obligations (DBO)

€ million	2008	2007
DBO at 1 January	**212.6**	**337.6**
Change in basis of consolidation	–	–6.2
Service cost	0.3	0.3
Employee contributions	0.5	0.4
Interest	10.8	12.1
Gain (–)/loss (+)	–5.8	–28.8
Exchange differences	–3.7	–1.6
Pensions paid	–16.3	–21.4
Compensation for vested company pension rights	–0.4	–79.8
DBO at 31 December	**198.0**	**212.6**

Actuarial gains reported in 2007 were mainly a result of the one-off settlement of vested company pension rights.

Development of the fair value of plan assets

€ million	2008	2007
Fair value of plan assets at 1 January	**13.7**	**14.3**
Anticipated return on plan assets	0.7	0.8
Gains (+)/losses (–) on plan assets	–2.6	–0.1
Exchange differences	–3.5	–1.2
Employer contributions	2.6	0.1
Employee contributions	0.2	0.3
Pensions paid from plan assets	–0.4	–0.5
Fair value of plan assets at 31 December	**10.7**	**13.7**

Composition of plan assets

in %	31 Dec. 2008	31 Dec. 2007
Equities	46	59
Debt securities	53	40
Other assets	1	1

The external plan assets relate solely to the UK branch of DEUTZ AG and contain neither securities issued by Group enterprises nor assets used by the DEUTZ Group.

The anticipated total return on plan assets is calculated on the basis of current market expectations for the period over which the obligation is settled. Due to the downturn on the capital markets, the anticipated return on plan assets has changed significantly, resulting in a loss on plan assets in 2008.

Pension obligations are measured on the basis of actuarial opinions using the following actuarial assumptions:

Actuarial assumptions

	2008	2007
in %		
Discount rate		
Germany	5.62	5.41
USA	6.00	6.75
UK	6.70	5.70
Foreign countries (weighted)	6.59	5.79
Anticipated return on plan assets		
Germany	–	–
USA	–	–
UK	5.75	5.75
Foreign countries (weighted)	5.75	5.75
Rate of pension increase		
Rate of pension increase – pensions of the Essener Verband pension association	2.00	1.50
Rate of pension increase – other pensions	2.00	2.00
USA	3.00	3.00
UK	2.80	3.25
Foreign countries (weighted)	2.83	3.23
Rate of salary increase		
Germany	–	–
USA	4.00	4.00
UK	2.75	2.75
Foreign countries (weighted)	2.96	2.85

Funding status and experience adjustments

	2008	2007	2006	2005
€ million				
Defined benefit obligations for pensions and other post-retirement benefits	198.0	212.6	337.6	355.6
External plan assets measured at fair value	–10.7	–13.7	–14.3	–13.0
Plan funding (surplus)/deficit	187.3	198.9	323.3	342.6
Gains (+)/losses (–) based on historical experience				
on obligations	3.0	1.1	6.4	–0.1
on plan assets	–2.6	–0.1	0.3	1.3

The Group anticipates contributions to defined-benefit plans amounting to €16.8 million in financial year 2009.

24. OTHER PROVISIONS

The following table gives a breakdown of other provisions:

	31 Dec. 2008			31 Dec. 2007		
	Total	With a residual term of up to 1 year	With a residual term of more than 1 year	Total	With a residual term of up to 1 year	With a residual term of more than 1 year
€ million						
Warranties	27.8	18.5	9.3	22.4	10.2	12.2
Imminent losses on pending transactions	10.2	3.4	6.8	11.8	4.6	7.2
Obligations to employees	31.8	6.2	25.6	28.7	5.8	22.9
Staff adjustments	10.2	10.2	–	–	–	–
Other	14.5	10.5	4.0	47.3	43.1	4.2
Total	**94.5**	**48.8**	**45.7**	**110.2**	**63.7**	**46.5**

Other provisions are recognised at their settlement value, calculated at the balance sheet date, and take account of projected cost increases. Non-current provisions are discounted at a rate of 5.5 per cent.

Other provisions cover all identifiable risks and other contingent liabilities. The main items covered are the cost of warranties and potential risks, discounts and price reductions, contractual risks, onerous contracts and provisions for obligations to employees, such as pre-retirement part-time working, early retirement and collective pay agreements. Provisions amounting to €10.2 million were recognised at year end in connection with the necessity of making staff adjustments. The provisions for 2007 also covered commitments relating to the disposal of the DEUTZ Power Systems segment.

The following table shows the changes to other provisions in 2008:

	Warranties	**Imminent losses on pending transactions**	**Obligations to employees**	**Staff adjustments**	**Other**	**Total**
€ million						
1 Jan. 2008	**22.4**	**11.8**	**28.7**	**–**	**47.3**	**110.2**
Additions	5.7	0.8	10.0	10.2	5.7	32.4
Exchange differences	–	–	–	–	0.1	0.1
Utilization	–0.1	–0.7	–6.8	–	–34.8	–42.4
Reversals	–0.6	–1.7	–0.1	–	–3.8	–6.2
Accrued interest/effect of changes in interest rates	0.4	–	–	–	–	0.4
31 Dec. 2008	**27.8**	**10.2**	**31.8**	**10.2**	**14.5**	**94.5**

25. FINANCIAL LIABILITIES, TRADE PAYABLES AND OTHER LIABILITIES

Summary

	31 Dec. 2008				31 Dec. 2007			
	Total	With a residual term of up to 1 year	With a residual term of 1–5 years	With a residual term of more than 5 years	Total	With a residual teram of up to 1 year	With a residual term of 1–5 years	With a residu-al term of more than 5 years
€ million								
Financial liabilities								
Profit-sharing rights	–	–	–	–	–[1]	–[1]	–	–
Convertible bonds	–	–	–	–	2.7	2.7	–	–
Bond (USPP)	196.2	–	39.8	156.4	190.1	–	39.3	150.8
Liabilities to banks	23.4	5.5	16.9	1.0	28.5	5.2	18.9	4.4
Liabilities under finance leases	0.1	0.1	–	–	0.1	0.1	–	–
Total	**219.7**	**5.6**	**56.7**	**157.4**	**221.4**	**8.0**	**58.2**	**155.2**
Trade payables	**138.1**	**138.1**	**–**	**–**	**206.1**	**206.1**	**–**	**–**
Other liabilities	**54.8**	**53.1**	**1.7**	**–**	**79.1**	**69.1**	**10.0**	**–**
Total	**412.6**	**196.8**	**58.4**	**157.4**	**506.6**	**283.2**	**68.2**	**155.2**

1) € 30 thousand

Profit-sharing rights

In accordance with Article 7 (1) of the terms and conditions governing its profit-sharing rights, DEUTZ gave due notice of cancellation of the convertible profit-sharing rights it had previously issued with effect from midnight on the day immediately following the Annual General Meeting at which the adopted annual financial statements for the period ended 31 December 2007 were presented.

Convertible bonds

Since less than 10 per cent of the original 19,792,998 convertible bonds was outstanding at the end of 2007, DEUTZ took advantage of the opportunity to call in the bond. The effective date for redeeming the bond was 8 March 2008, and bondholders had the opportunity to exchange 1 convertible bond for 1 DEUTZ share up to 3 March. The 68,070 bonds not converted by such date were redeemed via cash payment to the bearers in the amount of € 3.40 per bond, or € 0.2 million in total.

Bonds (US private placement)

In the financial year 2007, DEUTZ AG issued bonds worth USD 274 million (€ 203 million) as part of a private placement in the United States and recognised them in accordance with IAS 39. The placement was completed on 16 July 2007. The bonds – which carry maturities of 5, 7 and 10 years – were purchased by US institutional investors. Around 20 per cent of the total volume was taken up directly in euros (€ 43.0 million), with the remainder in US dollars (USD 216.1 million) hedged in euros. The bonds carry maturities of 4, 6 and 9 years and have coupons of between 5.22 to 5.27 per cent. The coupon for the USD tranche ranges from 5.89% to 6.12%.

Liabilities to banks

The following table shows the effective interest rates paid on existing liabilities to banks:

	2008	2007
in %		
Short-term interest rate	6.21	5.59
Long-term interest rate (up to five years)	6.22	5.64
Long-term interest rate (more than five years)	6.13	5.86

As at 31 December 2008, cash collateral of €1.2 million (2007: €0.0 million) was provided for bank loans.

The fair value of financial liabilities is explained in Note 26 on page 130 ff..

The carrying amounts of current and non-current **financial liabilities** are denominated in the following currencies:

	31 Dec. 2008	31 Dec. 2007
€ million		
EUR	66.5	74.3
USD	153.2	147.1
Total	**219.7**	**221.4**

Trade payables and other liabilities

	31 Dec. 2008	31 Dec. 2007
€ million		
Trade payables	**138.1**	**206.1**
Other liabilities		
Derivatives	1.2	8.7
Liabilities to investments	4.3	4.9
Liabilities arising from other taxes	1.0	1.4
Personnel-related liabilities	8.7	13.8
Sales and marketing liabilities	20.5	25.5
Advances received	1.4	2.2
Other liabilities and deferred income	17.7	22.6
Total	**54.8**	**79.1**

The decline in trade payables by €68.0 million to €138.1 million is attributable to a declining purchasing volume due to the increasingly weak order situation in the second half of 2008.

NOTES TO THE CASH FLOW STATEMENT

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and credit balances with banks.

Cash flow from operating activities includes dividend income of €1.0 million for fiscal 2008 (2007: €0.8 million).

NOTES ON SEGMENT REPORTING

Notes on segment reporting
The DEUTZ Group reports segment information in accordance with IAS 14, with the primary segment reporting format being business segments and the secondary format geographical segments.

Business segments
Based on the Group's internal financial reporting and organisational structure, its products and services and the structure of risks and returns, the **primary segment reporting format** is based on business segments, broken down into the following reportable segments:

Continuing operations
Compact Engines This segment comprises new business and the servicing of air-, water- and oil-cooled diesel engines with capacities of less than 4 and 4–8 litres.

DEUTZ Customised Solutions This segment focuses on air-cooled engines as well as large liquid-cooled engines with capacities of more than 8 litres. It also includes customer-specific solutions (gensets) and service.

Other This segment contains Group and consolidation activities that do not belong in any other segment.

Discontinued operations
DEUTZ Power Systems This segment included project-related systems business, the servicing of gas engines and diesel engines with an output of between 180 kW and 4,000 kW and systems used to convert fossil and non-fossil fuels. DEUTZ Power Systems was sold by DEUTZ AG with effect from 30 September 2007 and was consequently reclassified as a discontinued operation in accordance with IFRS 5. Segment profit or loss therefore includes the disposal gains and the results of the purchase price adjustments in the reporting year.

Reconciliation of segment data to Group figures
The reconciliation contains the effects of consolidation as well as the amounts arising from the differences in the definition of the content of individual segment items compared with the corresponding Group items. Transfers between segments are reported at fair value.

Geographical segments
The **secondary reporting format** is based on geographical segments and on the DEUTZ Group's internal regional sales structure (Europe/Middle East/Africa, Americas, Asia-Pacific). Revenue is shown in accordance with the location of customers; assets and capital expenditure are shown in accordance with the location of the consolidated enterprises.

Segment data are calculated as follows: External revenue shows the revenue received by the segments from external customers. Revenue generated between segments is shown as intersegment sales.

Depreciation and amortisation relate to property, plant and equipment and intangible assets.

The segment result before one-off items is the segment result as defined under IFRS plus profit/loss from equity-accounted investments, other investment income and gains or losses on the disposal of financial assets.

IFRS 14 defines segment result as segment revenue less segment expenses. Gains or losses on the disposal of financial assets, the share of profit/loss from equity-accounted investments, other investment income, interest and similar income, interest expense and similar charges, and taxes are not included.

Segment assets include operating assets and comprise intangible assets, property, plant and equipment, inventories, non-interest-bearing receivables and other assets.

Segment liabilities comprise financial obligations arising from operating activities. They include provisions – especially pension provisions – and non-interest-bearing liabilities (excluding tax liabilities).

Segment capital expenditure consists of purchases of intangible assets and property, plant and equipment.

Non-cash expenses include additions to other provisions.

OTHER INFORMATION

26. FINANCIAL RISK MANAGEMENT AND ADDITIONAL INFORMATION ON CAPITAL MANAGEMENT

Basic principles

Owing to its global business operations, the DEUTZ Group is exposed to various financial risks that can arise from adverse movements and trends in the international interest rate, foreign exchange, sales and procurement markets. The overarching risk management strategy used is designed to mitigate potentially negative effects on the DEUTZ Group's financial position.

The basis for managing financial risk and identifying any risk at an early stage is the Company's annual financial planning, together with regular analyses of variances during the course of the year. Rolling forecasts of liquidity inflows and outflows for the next four weeks are prepared on a weekly basis. The responsibility for the Group's financial management remains with DEUTZ AG as the controlling Group company.

The Treasury department identifies, measures and hedges financial risk in close collaboration with the Group's operating segments. The Management Board specifies written principles for the Group's overarching risk management strategy as well as guidelines for certain areas, such as how to manage currency risk, interest rate risk and credit risk, and how to use derivative and non-derivative financial instruments.

The Finance Committee, which meets at least every 8 weeks, also provides an additional forum at which operational issues relating to risk management and other financially relevant decisions are discussed. The Finance Committee consists of the responsible member of the Management Board plus representatives of the central Treasury department and the Controlling department. The objective of risk management is to reduce profit and cash flow fluctuations caused by volatility in interest rate and foreign exchange markets. Derivative financial instruments are only used for hedging purposes, i.e. only in conjunction with corresponding hedged items from the Group's ordinary business activities or financial transactions that have a countervailing risk profile to that of the hedging transaction. The nature and scope of the hedged items are specified in a binding financial directive.

DEUTZ works exclusively with leading banks to ensure the availability of loan financing. The Group has sufficient credit lines, which it currently only uses in a small scope for short-term funding needs, however. The Group also has a secure source of long-term debt capital independent of banks following a US private placement in 2007 in the amount of USD 274 million with maturity tranches of 5, 7 and 10 years. The Group's USD liabilities relating to interest and capital repayment are hedged in euros using cross-currency swaps, eliminating any USD-related exchange-rate risk for DEUTZ.

The central Treasury department manages the lines of credit in accordance with the Group's financing principles. Subsidiaries are funded primarily by means of Group loans. In some cases, DEUTZ AG's lines of credit are made available to subsidiaries and secured by guarantees.

Liquidity risk

Prudent liquidity management includes, among other things, holding a sufficient reserve of cash and cash equivalents, ensuring the possibility of obtaining funding by maintaining an adequate level of bank credit and ensuring the ability to issue short- and long-term capital market instruments. Because the business environment in which the DEUTZ Group operates is constantly changing, the Treasury department aims to maintain the necessary degree of funding flexibility at all times by ensuring that it has sufficient unused credit lines at its disposal. Moreover, the cash proceeds from the US private placement in 2007 are based on initial terms of 5 to 10 years, meaning that DEUTZ AG is not directly affected by the current difficult credit climate.

The following liquidity analysis provides an overview of the contractually agreed, undiscounted, gross payments of interest and capital in connection with financial liabilities at the balance sheet date on the basis of the exchange rates at the respective balance sheet dates:

	31 Dec. 2008			
	2009 cash outflow	2010–2013 cash outflow	>2013 cash outflow	Total
€ million				
Primary financial instruments	**–200.0**	**–104.8**	**–182.8**	**–487.6**
Derivative financial instruments	**–2.0**	**1.9**	**–4.6**	**–4.7**
Currency derivatives				
thereof gross settlement: cash outflows	–22.5	–	–	–22.5
thereof gross settlement: cash inflows	20.4	–	–	20.4
Interest rate derivatives Presentation of net cash flows	0.6	1.9	–4.6	–2.1
Commodity derivatives Presentation of net cash flows	–0.5	–	–	–0.5

	31 Dec. 2007			
	2008 cash outflow	2009–2012 cash outflow	>2012 cash outflow	Total
€ million				
Primary financial instruments	**–295.8**	**–106.6**	**–199.7**	**–602.1**
Derivative financial instruments	**–1.5**	**–0.2**	**–11.1**	**–12.8**
Currency derivatives				
thereof gross settlement: cash outflows	–15.1	–	–	–15.1
thereof gross settlement: cash inflows	14.3	–	–	14.3
Interest rate derivatives Presentation of net cash flows	0.3	–0.1	–11.1	–10.9
Commodity derivatives Presentation of net cash flows	–1.0	–0.1	–	–1.1

Credit risk

There are no significant concentrations of potential credit risk in the DEUTZ Group. The risk from bad debts is limited by constant monitoring and regular analysis of receivables and their breakdown. Receivables are, to a large extent, covered by credit insurance. Further measures, such as guarantees and creditworthiness checks, are used to protect against credit risk. The Group has also put in place procedures and guidelines to ensure that products and services are only sold to customers who have a satisfactory payment record. Appropriate write-downs are applied to allow for the credit risk attaching to financial assets. In the case of trade receivables as well as other financial assets such as cash and cash equivalents, financial assets held for sale and derivative financial instruments, the maximum credit risk exposure is limited to the carrying amount of the instrument in question. Credit risks in connection with derivative financial instruments are limited through a careful selection of counterparties.

The following table provides an overview of impaired financial assets and of the age structure of financial assets that are past due but not impaired. The table does not include: cash and cash equivalents of €207.5 million (2007: €311.1 million), available-for-sale financial assets of €7.0 million (2007: €7.2 million) and derivative financial instruments of €9.2 million (2007: €7.2 million).

	31 Dec. 2008							
			thereof impaired at the balance sheet date		**thereof past due at the balance sheet date but not impaired**			
	Carrying amount	thereof neither past due nor impaired at the balance sheet date	Gross amount before impairment	Impairment	up to 90 days	91 to 180 days	181 to 360 days	more than 360 days
€ thousand								
Non-current financial assets	**1,315**	**1,260**	**837**	**–795**	**–**	**–**	**–**	**13**
Current financial assets	**179,137**	**150,933**	**23,260**	**–22,990**	**23,646**	**2,722**	**1,471**	**95**
Trade receivables	121,163	93,036	4,927	–4,734	23,646	2,722	1,471	95
Other receivables and assets	57,974	57,897	18,333	–18,256	–	–	–	–
	31 Dec. 2007							
Non-current financial assets	**1,307**	**1,255**	**848**	**–795**	**–**	**–**	**–**	**–**
Current financial assets	**264,594**	**228,610**	**28,633**	**–22,904**	**27,349**	**1,857**	**411**	**639**
Trade receivables	188,776	155,892	7,956	–5,327	27,349	1,857	411	639
Other receivables and assets	75,818	72,718	20,677	–17,577	–	–	–	–

With respect to those trade receivables and other receivables and assets that were neither past due nor impaired at the balance sheet date, there are no indications that the customers will not meet their payment obligations. Trade receivables relate primarily to DEUTZ AG and are insured with EULER HERMES Kreditversicherungs-AG. DEUTZ AG has an obligation to the trade credit insurance association (WKV) or, where applicable, the German government's export credit guarantee scheme (APG) to meet defaults on the receivables unless they are secured against letters of credit or similar instruments confirmed by a bank. DEUTZ does not produce any standardised credit rating for its customers itself, but sets the maximum customer exposure in accordance with the level of cover provided by the credit insurance agency. In addition, guarantees amounting to €1.9 million (2007: €0.8 million) have been issued for foreign trade receivables. New terms were negotiated for €10.0 million (2007: €1.6 million) of overdue trade receivables. At the time of preparation of the annual financial statements, all receivables concerned had been paid within the renegotiated deadlines.

Currency risk

The DEUTZ Group is internationally active and is therefore exposed to currency risk arising from fluctuating exchange rates, mainly with respect to the US dollar. Exchange-rate risks are monitored under a centralised currency management system and reduced by the use of hedging transactions. The Group's Finance Department uses hedging instruments, particularly futures contracts, to hedge currency risks arising from the net position on forecast cash flows in foreign currencies. Normally, between 50 per cent and 70 per cent of the net positions budgeted for the following year are hedged, as are 100 per cent of project-based firm commitments.

As part of what is known as "natural hedging", DEUTZ also takes specific action to increase the volume of purchasing in US dollars, which enables the Company to counteract exchange-rate risks from sales invoiced in US dollars. Risks arising from the translation of financial statements of subsidiaries drawn up in currencies other than the euro are not hedged.

Currency sensitivity analysis

The Group is mainly exposed to exchange rate risks from the currencies of the USA (USD), Australia (AUD) and the United Kingdom (GBP).

The table below illustrates the sensitivity – from a Group perspective – to a 10 per cent rise or fall in the euro against each of the above currencies. The sensitivity analysis only takes into account outstanding monetary positions denominated in foreign currency. Translation of those amounts is adjusted as at year end, in line with a 10 per cent change in the respective exchange rates. On the one hand, the items mainly refer to forward currency contracts which are part of an effective cash flow hedge to hedge fluctuations of incoming or outgoing foreign currency payments due to exchange rate changes. Exchange rate fluctuations of the currencies underlying these transactions affect the hedging reserve under accumulated other comprehensive income/loss and the fair value of these hedges. On the other hand, the items refer to forward currency contracts, commodities and embedded derivatives which are not part of a hedging relationship. Exchange rate fluctuations of currencies underlying these financial instruments affect the gains/losses from adjustments of their carrying amount to their fair value. In addition, the sensitivity analysis includes outstanding primary financial instruments (trade receivables and payables) denominated in a foreign currency. Exchange rate fluctuations of currencies underlying these items affect the gains/losses from their measurement at the balance sheet date.

The following table shows the impact on net income and on equity of a rise in the euro of 10 per cent against the respective currency. A 10 per cent fall in the euro relative to the respective currency would have an approximately equal but opposite impact on net income and equity.

Cash payments and receipts are shown as net amounts under "notional amounts".

	2008			
	Notional amounts	Effect on net income	Notional amounts	Effect on equity
Currency				
USD	47.11	–3.74	39.01	3.91
AUD	3.43	–0.31	–	–
GBP	0.06	–0.37	–6.01	–0.63
	2007			
USD	64.18	0.49	23.82	2.17
AUD	2.23	0.53	4.18	0.37
GBP	9.88	–1.76	10.21	–0.93

Interest rate risk and sensitivity analysis

The sensitivity analyses shown below are based on interest rate risk exposures of derivative and non-derivative instruments at the balance sheet date. Non-derivative instruments mainly comprise floating rate deposits as well as floating rate loans. As a result of the high liquidity at the end of 2008, an interest rate increase leads to an improvement in earnings. The US private placement is not subject to any interest rate risks within the meaning of IFRS 7 due to the fact that it represents a fixed-income financial instrument measured at amortised cost. Interest rate changes of the cross-currency swap, which was designated as a hedging instrument within the context of a cash flow hedge to hedge cash flow fluctuations resulting from interest rate changes, have the following effects on the hedging reserve in accumulated other comprehensive income/loss.

If interest rates had been 100 basis points higher and all other variables had remained constant

- net income for the financial year ended 31 December 2008 would have risen by €1.81 million (2007: increase of €2.2 million); and
- Group equity would have risen by €7.2 million (2007: increase of €10.6 million).

A cut in interest rates of 100 basis points would have had an equal but opposite effect on net income and equity.

Commodity price risk and raw materials sensitivity analysis

The DEUTZ Group is exposed to risk arising from changes in prices for metal raw materials, particularly steel and aluminium. DEUTZ hedges part of its commodities risk by way of an aluminium swap agreement. A 10 per cent change in the price of aluminium (expressed in USD, assuming a constant USD/EUR exchange rate), would have an impact of €540 thousand on the derivative transaction (2007: €590 thousand).

Capital management

The DEUTZ Group manages its capital with the primary goal of supporting business operations and ensuring the continued existence of the Company as a going concern over the long term. A healthy financial structure is necessary to assure the required flexibility in the provision of financial resources. At present, no credit rating has been set for DEUTZ. However, the current balance sheet figures and those aimed for in the future should meet the requirements for an investment grade rating. Capital management therefore extends to both equity and debt.

DEUTZ is not subject to capital requirements under its statutes. However, by issuing a private placement in the US it agreed to maintain its ratio of equity to net financial debt below a certain level.

This external requirement has been integrated into capital management. The net financial position (cash and cash equivalents less interest-bearing financial liabilities) was positive for the most part during the reporting period. The required ratio was thus not only adhered to but well exceeded. As of the balance sheet date, the net financial position was €–12.2 million (2007: €89.7 million). In addition to the net financial position, free cash flow (defined as cash flow from operating activities and investing activities less payments of interest) is an essential part of active capital management and used as a measure to show changes in the liquidity situation. In fiscal year 2008, the free cash flow was €–23.3 million (2007: €–111.5 million).

The equity/assets ratio is another indicator used by the Group to monitor its capital. This indicator reflects the ratio of total assets to Group equity as reported in the consolidated balance sheet. As at 31 December 2008, the equity/assets ratio had risen 2 percentage points over the previous year to 42.4 per cent (2007: 40.4 percent), which corresponds with internal targets.

Financial instruments

The following table shows the carrying amounts of the individual financial assets and liabilities for each separate category of financial instrument, reconciled to the corresponding balance sheet item.

	Measured at amortised cost		Measured at fair value		Assets not falling under the scope of IAS 39	
	Loans and receivables	Financial assets available for sale	Financial assets available for sale	Financial assets held for trading	Carrying amount	Carrying amount in the balance sheet
31 Dec. 2008						
€ million						
Assets						
Non-current financial assets	**1.3**	**5.8**	**1.2**	**8.5**	**–**	**16.8**
Current financial assets	**386.6**	**–**	**–**	**0.7**	**23.3**	**410.6**
Trade receivables	121.1	–	–	–	–	121.1
Other receivables and assets	58.0	–	–	0.7	23.3	82.0
Cash and cash equivalents	207.5	–	–	–	–	207.5
31 Dec. 2007						
Non-current financial assets	**1.3**	**5.8**	**1.4**	**–**	**–**	**8.5**
Current financial assets	**575.7**	**–**	**–**	**7.2**	**19.9**	**602.8**
Trade receivables	188.8	–	–	–	–	188.8
Other receivables and assets	75.8	–	–	7.2	19.9	102.9
Cash and cash equivalents	311.1	–	–	–	–	311.1

	31 Dec. 2008			
	Measured at amortised cost	**Measured at fair value**	**Liabilities not falling under the scope of IAS 39**	
	Financial liabilities	Held-for-trading financial liabilities	Carrying amount	Carrying amount in the balance sheet
€ million				
Equity and liabilities				
Non-current financial liabilities	**215.7**	**–**	**0.1**	**215.8**
Financial liabilities	214.0		0.1	214.1
Other liabilities	1.7	–	–	1.7
Current financial liabilities	**189.1**	**2.3**	**5.4**	**196.8**
Financial liabilities	5.6	–	–	5.6
Trade payables	138.1	–	–	138.1
Other liabilities	45.4	2.3	5.4	53.1

	31 Dec. 2007			
Non-current financial liabilities	**218.0**	**7.9**	**0.1**	**226.0**
Financial liabilities	215.9	–	0.1	216.0
Other liabilities	2.1	7.9	–	10.0
Current financial liabilities	**273.0**	**0.8**	**6.8**	**280.6**
Financial liabilities	5.4	–	–	5.4
Trade payables	206.1	–	–	206.1
Other liabilities	61.5	0.8	6.8	69.1

The next table shows the carrying amounts and fair values of all financial instruments included in the consolidated financial statements that fall under the scope of IFRS 7 “Financial Instruments: Disclosures”.

	31 Dec. 2008		31 Dec. 2007	
	Carrying amount	Fair value	Carrying amount	Fair value
€ million				
Non-current financial assets	**16.8**	**11.0**	**8.5**	**2.7**
Other loans	1.3	1.3	1.3	1.3
Available-for-sale financial assets measured at amortised cost	5.8	–	5.8	–
Available-for-sale financial assets measured at fair value	1.2	1.2	1.4	1.4
Derivative financial instruments	8.5	8.5	–	–
Current financial assets	**387.3**	**387.3**	**582.9**	**582.9**
Trade receivables	121.1	121.1	188.8	188.8
Derivative financial instruments	0.7	0.7	7.2	7.2
Other receivables and assets	58.0	58.0	75.8	75.8
Cash and cash equivalents	207.5	207.5	311.1	311.1
Non-current financial liabilities	**215.7**	**240.6**	**225.9**	**232.2**
Liabilities to banks	17.8	17.8	23.1	23.1
US private placement, bonds and profit-sharing rights	196.2	221.1	192.8	199.1
Derivative financial instruments	–	–	7.9	7.9
Other liabilities	1.7	1.7	2.1	2.1
Current financial liabilities	**191.4**	**191.4**	**273.8**	**273.8**
Financial liabilities	5.6	5.6	5.4	5.4
Trade payables	138.1	138.1	206.1	206.1
Derivative financial instruments	2.3	2.3	0.8	0.8
Other liabilities	45.4	45.4	61.5	61.5

In the case of cash and cash equivalents, trade payables and receivables and other current financial assets (due in less than one year), the carrying amounts are virtually the same as the fair values due to the short residual terms.

The fair value of financial assets held for sale is calculated on the basis of quoted prices published on an active market. No disclosure of fair value is made for unquoted financial assets held for sale with a carrying amount of € 5.8 million (2007: € 5.8 million), given that these involve investments for which no fair value can be determined and are therefore measured at amortised cost.

The fair value of derivative financial instruments (forward exchange contracts and cross-currency swaps) is calculated over the remaining term of the instrument on the basis of current foreign exchange rates, market interest rates and interest rate curves. The data is based on bank valuations.

The fair value of non-current financial assets and liabilities is computed by discounting expected future cash flows using prevailing market interest rates. The swap curve was used to ascertain the fair value of euro-denominated loans. The US Treasury curve was used for measurement of the loans denominated in US dollars. The relevant spread was added in each case. Bank valuations were used, where available.

Net income/loss from financial instruments

The recognised net income/loss is broken down by measurement category pursuant to IAS 39 as follows:

	2008			
	Loans and receivables	Held-for-trading financial assets	Financial liabilities measured at amortised cost	Held-for-trading financial liabilities
€ million				
Net gains/losses	5.0	–5.1	0.5	–0.2
	2007			
Net gains/losses	–2.1	0.7	1.2	–0.8

The net income/loss for each measurement category primarily comprises gains and losses recognised in income resulting from the measurement at fair value, currency translation as well as impairment or reversals of impairment.

Unrealised losses from financial assets held for sale were recognised in accumulated other comprehensive income/loss in the amount of €0.3 million in the reporting year (2007: gain of €0.4 million). Realised gains of €0.0 million (2007: €0.9 million) were reclassified from equity to the income statement in the reporting year.

Hedging relationships

Cash flow hedges As at 31 December 2008 and 31 December 2007, foreign exchange contracts in US dollars and Pound sterling (2007: also Australian dollar) were classified as hedging instruments for the purpose of hedging the risk arising from expected future transactions in foreign currencies.

Cross-currency swaps were also classified as hedging instruments as at 31 December 2008 and 31 December 2007. These instruments are intended to hedge the currency risk and interest rate risk arising from expected future payments of interest and capital from the US private placement, which has fixed maturity tranches of 5, 7 and 10 years.

Unrealised gains from cash flow hedges were recognised in accumulated other comprehensive income/loss in the amount of €9.3 million in 2008 (2007: €5.0 million), taking into account deferred tax assets in the amount of €2.9 million (2007: 1.5 million). The changes in value represent the effective portion of the hedge. In 2008, gains of €1.0 million (2007: €1.2 million) that had been recognised in accumulated other comprehensive income/loss were reclassified to other operating income on the face of the income statement, before taking deferred taxes into account. In 2008, there was no hedging ineffectiveness requiring reclassification from the reserve for cash flow hedges to income. With respect to hedges of future transactions of the operating business, revocation of the cash flow hedge designation and reclassification of the gains and losses recognised in accumulated other comprehensive income/loss to the income statement is expected to occur within the next 12 months. For hedges of interest and capital repayments from the US private placement, this is expected to occur at the maturity dates of the individual tranches (in 4, 6 and 9 years).

Derivative financial instruments

The following derivative financial instruments were reported at the balance sheet date:

	Nominal amounts 2008	Nominal amounts 2007	Fair values 2008	Fair values 2007
€ million				
Currency forwards				
not used as hedges	8.7	18.8	–	0.6
used as cash flow hedges	45.0	38.2	–1.2	1.4
Cross-currency swaps				
used as cash flow hedges	160.2	160.2	8.5	–7.9
Commodities				
not used as hedges	15.4	7.0	–1.1	–0.8
Embedded derivatives	–	–	0.7	5.2

The embedded derivatives relate to purchasing contracts denominated in foreign currency.

27. CONTINGENT LIABILITIES AND OTHER FINANCIAL OBLIGATIONS

Contingent liabilities

The following contingent liabilities existed in the DEUTZ Group at the balance sheet date:

	31 Dec. 2008	31 Dec. 2007
€ million		
Liabilities on endorsed bills of exchange	2.6	2.5
Liabilities on guarantees	1.8	10.0
Warranty liabilities	2.0	11.3
Total	**6.4**	**23.8**

Contingent liabilities at 31 December 2008 amounted to €6.4 million, a decrease of €17.4 million on the figure reported as at 31 December 2007. The decline was mainly due to the fact that the guarantees issued by DEUTZ AG to DEUTZ Power Systems are no longer in force.

Other financial obligations

The following table shows the notional amounts and due dates of other financial obligations under operating leases:

	31 Dec. 2008	31 Dec. 2007
€ million		
due in less than 1 year	7.2	8.4
due in 1 to 5 years	22.3	23.9
due in more than 5 years	0.1	2.6
Total	**29.6**	**34.9**

The above obligations relate to leases on real estate and movable assets.

Commitments to purchase property, plant and equipment and intangible assets amounted to €32.6 million at 31 December 2008 (2007: €39.8 million), and commitments to purchase inventories amounted to €30.5 million (2007: €45.5 million).

Obligations under leases were partly offset by receivables of €0.4 million (2007: €0.3 million) from subleases.

28. LEGAL DISPUTES

DEUTZ AG and some of its subsidiaries are involved in a number of legal disputes, claims for damages and arbitration proceedings that have an impact on the Group's financial position.

The claim by the Greek tax authorities against a Greek subsidiary of DEUTZ AG for supplementary tax payments and penalties totalling about €35 million is still pending, as are the actions brought by private persons against more than 100 companies, including one American subsidiary of DEUTZ AG, for alleged damage to health caused by asbestos. In addition, a US customer is claiming damages of more than USD 40 million. This action is without substance in the opinion of the Company because the engines were used in a manner contrary to instructions and liability for consequential loss is contractually excluded. A provision has been recognised to cover the risk in connection with the litigation.

Financial provision has been made to cover litigation risks facing the respective Group companies if the event in question occurred before the balance sheet date and the companies' legal representatives estimate the probability of an outflow of resources to be more than 50 per cent. In the case of legal disputes where no financial provision has been made, it is estimated that the probability of an outflow of resources with economic benefit is less than 10 per cent.

We do not expect the above risks to have a significantly adverse impact on the DEUTZ Group's financial position or financial performance beyond the financial provision already made.

29. RELATED-PARTY DISCLOSURES

In addition to its consolidated subsidiaries, the DEUTZ Group maintains relationships with related parties.

These include the business relationships between the DEUTZ Group and entities in which it holds significant investments, as well as the following DEUTZ AG shareholders (including their subsidiaries) that are in a position to exert a significant influence over the DEUTZ Group. These are:

- SAME DEUTZ-FAHR Holding & Finance BV, Amsterdam, Netherlands (group); and
- AB Volvo Power (publ) Gothenburg, Sweden (group).

Related parties also include the Supervisory Board, the Management Board and other members of the management team.

The following table shows the volume of material goods and services either provided for or received from entities in which the DEUTZ Group (continuing operations) holds investments:

	Goods and services provided		Goods and services received		Receivables at 31 Dec.		Liabilities at 31 Dec.	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**
€ million								
Associates	–	–	–	–	0.3	–	–	–
Joint ventures	5.7	4.3	–	–	11.6	3.6	–	–
Other investments	2.5	3.2	3.7	3.8	0.1	3.1	4.3	4.9
Total	**8.2**	**7.5**	**3.7**	**3.8**	**12.0**	**6.7**	**4.3**	**4.9**

A total of €21.2 million (2007: €20.5 million) of the receivables due from investments had been written down at 31 December 2008; this resulted in an expense of €0.7 million in 2008 (2007: €0.3 million).

The following table gives a breakdown of the significant relationships between the DEUTZ Group and its shareholders, including their subsidiaries:

	SAME DEUTZ-FAHR Group		Volvo Group	
	2008	**2007**	**2008**	**2007**
€ million				
Engines and spare parts supplied	79.3	44.5	396.0	408.4
Services	4.6	4.2	38.6	17.0
Receivables at 31 December[1]	20.5	8.3	15.9	35.9

1) including factoring

All transactions were concluded at arm's-length market rates.

The following benefits were provided to the Supervisory Board, the Management Board and other members of the management team as related parties of the DEUTZ Group:

	Supervisory Board		Management Board		Other members of management	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**
€ million						
Short-term remuneration	0.4	0.4	3.8	3.4	2.4	2.0

The DEUTZ Group did not maintain any other significant business relationships with related parties.

30. EVENTS AFTER THE BALANCE SHEET DATE

No material events occurred after the balance sheet date.

31. REMUNERATION PROGRAMMES

The Company launched Long-term Incentive Plan No. I in 2007 and Long-term Incentive Plan No. II in 2008. Under these long-term remuneration plans, virtual stock options are issued to reward management for its sustained contribution to the Company's success.

General description of the incentive plan of DEUTZ AG

Under the DEUTZ AG's incentive plan, virtual options are issued on shares in DEUTZ AG. The Company decides who is eligible to participate in the plan at its discretion. However, only members of the DEUTZ Group's senior management and members of the Supervisory Board of DEUTZ AG may be considered for inclusion.

The options were granted on 1 July 2007 (Long-term Incentive Plan No. I) and 1 February 2008 (Long-term Incentive Plan No. II) without payment. It is at the discretion of the Company to decide how many options are granted.

At the balance sheet date, 380,000 options had been granted under Long-term Incentive Plan No. I and 345,000 under Long-term Incentive Plan No. II. A total of 405,000 options were granted to members of the Management Board and Supervisory Board of DEUTZ AG.

All of the aforementioned options remained outstanding at the end of the 2007 and 2008 financial years.

Information on the exercise of options

One requirement for exercising options is that the option holders themselves invest in the Company at a ratio of 1 share per 10 options.

There is a 3-year vesting period from the date on which options are granted, i.e. options under Long-term Incentive Plan I may not be exercised before 1 July 2010 and options under Long-term Incentive Plan II may not be exercised before 1 February 2011 at the earliest. Options must be exercised within a period of 4 years from the end of the vesting period, and only within 10 days from the date of publication of quarterly financial statements. However, certain tranches launched in 2009 and 2010 have vesting periods of either 4 or 5 years. The exercise periods for these options are postponed accordingly.

The Company is entitled to change the start of an exercise window and may also accelerate the exercise and vesting periods of the options. A request to exercise options must be submitted to the Company in writing.

The reference price for all options issued on 1 July 2007 is €10.68. The reference price for a total of 40,000 options issued at a later date is €8.51. The reference price for all options issued on 1 February 2008 is €6.92.

The options may only be exercised if

- the price of DEUTZ AG shares has risen by at least 30 per cent relative to the reference price; dividend distributions by DEUTZ AG have been taken into consideration, i.e. for the purposes of calculating the performance target, the total gross dividend distribution up to the exercise date must be added to the share price; or
- in the period starting from the grant date of the option and ending on the date of exercise, DEUTZ AG shares outperform the Prime Industrial Performance Index — or any future index that replaces the Prime Industrial Performance Index — by at least 30 per cent.

When an option is exercised, the beneficiary receives a cash payment in the amount of the difference between the DEUTZ AG share price on the exercise date and the reference price at the time the option was granted. In no case does the beneficiary receive shares in the Company.

Long-term Incentive Plan No. I:
No options had been exercised at 31 December 2007 or 31 December 2008, and 25,000 had expired based on employees leaving the Company. Therefore, a total of 355,000 options were outstanding at 31 December 2008 (2007: 380,000).

Long-term Incentive Plan No. II:
No options had been exercised at 31 December 2008, thus a total of 345,000 options remain outstanding.

Notes on the fair value of options

Because virtual options are cash-based instruments rather than equity-based instruments, the Company is obliged to recognise a provision, the amount of which is derived from the fair value of the virtual options at the grant date and which is apportioned over the vesting period pro rata temporis.

An option pricing model using the Black-Scholes formula was used to ascertain the fair value. The model takes into consideration the aforementioned exercise prices, the term and the value of the underlying asset (DEUTZ AG shares).

Long-term Incentive Plan No. I:
The risk-free interest rate (4.25 per cent) used in the calculation is based on German federal government bonds with terms of 4 to 10 years issued in mid-2007. The assumed volatility (50.88 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. Fluctuation was assumed to be 0 per cent.

The calculation on the grant date was based on the DEUTZ AG share price (€ 9.68) on 2 July 2007 (the first trading day after the options were granted). It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provision was calculated on the basis of the vesting period.

In accordance with the requirement for the fair value of options to be recalculated on each balance sheet date, a calculation was carried out on the basis of the DEUTZ AG share price of € 2.38 on 30 December 2008, the last trading day of the financial year (28 December 2007: € 6.95) As a result, a provision of € 76,576 was recognised at the end of 2008 (2007: € 95,541).

Long-term Incentive Plan No. II:
The risk-free interest rate (4.00 per cent) used in the calculation is based on German federal government bonds with terms of 4 to 10 years issued at the start of 2008. The assumed volatility (59.28 per cent) is based on the average value for call options on DEUTZ AG shares available on the market on 1 February 2008. Fluctuation was assumed to be 0 per cent.

The calculation on the grant date was based on the DEUTZ AG share price (€6.92) on 1 February 2008. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provision was calculated on the basis of the vesting period.

In accordance with the requirement for the fair value of options to be recalculated as at each balance sheet date, a calculation was carried out on the basis of the DEUTZ AG share price of €2.38 on 30 December 2008, the last trading day of the financial year. As a result, a provision of €51,053 was recognised at the end of financial year 2008.

DISCLOSURES UNDER GERMAN ACCOUNTING STANDARDS

32. AVERAGE NUMBER OF EMPLOYEES DURING THE YEAR (PURSUANT TO SECTION 314 (1) NO. 4 OF THE HGB)

	2008	2007
Non-salaried employees	3,056	3,005
Salaried employees	1,640	1,586
Apprentices	166	161
Continuing operations	**4,862**	**4,752**
Discontinued operations[1)]	–	685
Total	**4,862**	**5,437**

1) until September 30, 2007

33. CORPORATE GOVERNANCE

In December 2008, the Management Board and the Supervisory Board of DEUTZ AG issued a declaration of compliance with the recommendations of the German Corporate Governance Code government commission as amended on 14 June 2007 and 6 June 2008 pursuant to section 161 of the AktG and made this declaration permanently available to shareholders on the Company's website (www.deutz.com).

34. AUDITORS' FEES

The following fees were recognised as an expense in financial year 2008 and 2007:

	2008	2007
€ thousand		
Auditing	279	305
Other advisory and attestation services	525	119
Other services	6	–
Total	**810**	**424**

35. TOTAL REMUNERATION PAID TO THE MANAGEMENT BOARD, FORMER MEMBERS OF THE MANAGEMENT BOARD AND THE SUPERVISORY BOARD (MANAGEMENT BOARD AND SUPERVISORY BOARD REMUNERATION)

Management Board

The following table shows the breakdown of total remuneration for members of the Management Board:

		Fixed remu-neration	Variable remu-neration	Other[1]	Total	No. of virtual share options granted	Fair value at grant date
€ thousand							
Dr.-Ing. Helmut Leube	2008	619	550	168	1,337	225,000	760
(since February 1, 2008)	2007	–	–	–	–	–	–
Gino Mario Biondi	2008	450	65	155	670	60,000	178
(since September 1, 2007)	2007	150	60	50	260	–	–
Karl Huebser	2008	450	270	229	949	–	–
	2007	450	300	433	1,183	–	–
Helmut Meyer	2008	450	202	154	806	60,000	178
	2007	418	305	152	875	60,000	204
Gordon Riske	2008	–	–	–	–	–	–
(until September 30, 2007)	2007	408	548	125	1,081	–	–
Total	**2008**	**1,969**	**1,087**	**706**	**3,762**	**345,000**	**1,116**
Total	**2007**	**1,426**	**1,213**	**760**	**3,399**	**60,000**	**204**

1) including payment of life insurance premiums

Remuneration paid to former members of the Management Board or their surviving dependants amounted to €1.482 thousand (2007: €1,438 thousand) at DEUTZ AG and in the Group; a provision of €12,799 thousand (2007: €13,437 thousand) has been recognised to cover pension obligations to these persons.

Supervisory Board

The following table shows the breakdown of total remuneration for members of the Supervisory Board:

	Fixed remuneration	Meeting attendance fee	Total
in €			
Dr Giuseppe Vita Chairman	25,000	30,000	55,000
Werner Scherer Deputy Chairman	18,750	24,000	42,750
Ing Massimo Bordi	12,500	7,000	19,500
Dr Francesco Carozza (since May 21, 2008)	7,684	3,000	10,684
Professor Klaus-Otto Fruhner (until May 21, 2008)	4,816	3,000	7,816
Reinhold Götz (until May 21, 2008)	4,816	3,000	7,816
Michael Haupt	12,500	21,000	33,500
Dr Helmut Lerchner	12,500	5,000	17,500
Lars-Göran Moberg[1)] (since May 21, 2008)	7,864	3,000	10,684
Helmut Müller	12,500	6,000	18,500
Karl-Heinz Müller	12,500	10,000	22,500
Dr Witich Roßmann	12,500	6,000	18,500
Susanne Scholtyssek (since May 21, 2008)	7,684	3,000	10,684
Professor Dr Marco Vitale (until May 21, 2008)	4,816	1,000	5,816
Egbert Zieher	12,500	6,000	18,500
Total	**168,750**	**131,000**	**299,750**

1) including remuneration of €50 thousand for consulting services

Advances and loans to members of the Board of Management and the Supervisory Board

As at 31 December 2008, there were no outstanding advances or loans to any members of the Management Board or the Supervisory Board, nor had any guarantees or other warranties been issued in favour of any such persons.

36. DISCLOSURES UNDER THE GERMAN SECURITIES TRADING ACT (WPHG)

The German Securities Trading Act (WpHG) obliges investors whose share of voting rights in listed companies reaches certain thresholds to notify the company accordingly. DEUTZ AG has been notified of the following shareholdings:

AB Volvo (publ), SE-40508 Gothenburg, Sweden, notified pursuant to sections 21 (1) and 24 of the WpHG that its shareholding in DEUTZ AG fell below the 10 per cent threshold on 23 October 2003 and now amounts to 7.09 per cent of the voting rights.

SAME DEUTZ-FAHR Group S.p.A., V. le Cassani 14, 24047 Treviglio (BG), Italy, notified pursuant to sections 21 (1) and 24 of the WpHG that the shareholding of SAME DEUTZ-FAHR Holding & Finance BV, Herengracht 548, 1017 CG Amsterdam, Netherlands, in DEUTZ AG exceeded the 25 per cent threshold on 2 July 2004 and now amounts to 29.90 per cent of the voting rights. These voting rights are attributable to SAME DEUTZ-FAHR Group S.p.A. pursuant to section 22 (1) number 1 of the WpHG.

In a letter dated 6 June 2006, INTAL INTERNATIONAL S.A., Luxembourg, notified the following pursuant to section 21 et seq. of the WpHG:

"The share of voting rights held by SAME DEUTZ-FAHR Holding & Finance B.V., Rokin 55, 1012 KK Amsterdam, Netherlands, in DEUTZ AG exceeded the threshold of 25 per cent on 2 July 2004; on 2 July 2004, this share amounted to 29.90 per cent and is now 38.88 per cent. Pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) of the WpHG, the voting rights are fully attributable to SAME DEUTZ-FAHR Group S.p.A., V. le Cassani 14, 24047 Treviglio (BG), Italy. As a result, the share of voting rights held by SAME DEUTZ-FAHR Group S.p.A. in DEUTZ AG on 2 July 2004 also exceeded the threshold of 25 per cent; on 2 July 2004, this share amounted to 29.90 per cent and is now 38.88 per cent.

We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you, pursuant to sections 21 et seq. of the WpHG, in our own name and in the name of, and on the behalf of, the company and individuals specified under (i) and (ii) below that the share of voting rights held in DEUTZ AG by

(i) Intractor B.V., Rokin 55, 1012 KK Amsterdam, Netherlands;
(ii) Messrs Vittorio Carozza, Dr Francesco Carozza und Aldo Carozza and Ms Carozza-Cassani, V. le Cassani 14, 24047 Treviglio (BG), Italy; and
(iii) INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, exceeded the threshold of 25 per cent on 2 July 2004, with the share on 2 July 2004 amounting to 29.90 per cent and now standing at 38.88 per cent. These voting rights are fully attributable to the companies and natural persons specified under (i) to (iii) above pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) of the WpHG."

In a letter dated 15 November 2006, INTAL INTERNATIONAL S.A., Luxembourg, notified the following pursuant to section 21 et seq. of the WpHG:

"We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you, pursuant to sections 21 et seq. of the WpHG, that the share of the voting rights held by INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, in DEUTZ AG on 8 November 2006 exceeded the thresholds of 5 per cent, 10 per cent and 25 per cent and now amounts to 0 per cent."

In a letter dated 15 November 2006, Belfort S.A., Luxembourg, notified the following pursuant to sections 21 et seq. of the WpHG:

“We, Belfort S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you, pursuant to sections 21 et seq. of the WpHG, that the share of the voting rights held by Belfort S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, in DEUTZ AG on 8 November 2006 exceeded the thresholds of 5 per cent, 10 per cent and 25 per cent and is now 40.32 per cent. These voting rights are attributable to us pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) of the WpHG.”

In the fiscal year 2008, DEUTZ AG did not receive any new notifications.

37. SUPERVISORY BOARD AND BOARD OF MANAGEMENT

Information on the members of the Supervisory Board and the Management Board, including non-executive directorships held at other companies, is given in a separate list on page 151 and 152.

Cologne, 19 February 2009

DEUTZ Aktiengesellschaft
The Management Board

Dr.-Ing. Helmut Leube

Karl Huebser

Gino Mario Biondi

Helmut Meyer

As at 31 December 2008

Ref. no.	Name and registered office of the company	Holding (%)	Equity (€ thousand)	Net income/ loss (€ thousand)
1	DEUTZ AG	–	441,722	–7,392
Consolidated subsidiaries				
Germany				
2	Unterstützungsgesellschaft mbH der DEUTZ Aktiengesellschaft, Cologne	100.0	26	–
3	Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf	19.6	–3,171	–139
4	DEUTZ Beteiligung GmbH, Cologne	100.0	25	4
Outside Germany				
Europe/ Africa				
5	DEUTZ DITER S.A., Zafra/Spain	100.0	13,844	–1,542
6	DEUTZ FRANCE S.A., Gennevilliers/France	100.0	12,732	1,242
7	DEUTZ UK Ltd., Cannock/UK	100.0	12,784	12,150
8	Nlle Ste MAGIDEUTZ S.A., Casablanca/Morocco	100.0	1,863	521
Americas				
9	Deutz Corporation, Atlanta/USA	100.0	23,982	–2,545
Asia-Pacific				
10	DEUTZ Asia-Pacific (Pte) Ltd., Singapore/Singapore	100.0	4,625	1,568
11	Deutz Australia (Pty) Ltd., Braeside/Australia	100.0	4,346	287
Associates				
Outside Germany				
12	D. D. Power Holdings (Pty) Ltd., Elandsfontein/South Africa	30.0	8,225	5,079
13	DEUTZ AGCO MOTORES S.A., Haedo/Argentina [1)]	50.0	5,536	487
14	DEUTZ (Dalian) Engine Co., Ltd., Dalian/China [1)]	50.0	100,513	–15,902

1) Joint venture measured in accordance with IAS 31.38

SUPERVISORY BOARD

Dr Giuseppe Vita
Chairman
Chairman of the Supervisory Board of Axel Springer AG, Berlin
a) Axel Springer AG, Berlin, Chairman
HUGO BOSS AG, Metzingen, Chairman
(until 30 June 2008)
Vattenfall Europe AG, Berlin,
(until 19 June 2008)
b) Allianz S.p.A., Milan/Italy, Chairman
Gruppo Banca Leonardo, Milan/Italy, Chairman
Barilla S.p.A., Parma/Italy
Humanitas S.p.A., Milan/Italy

Werner Scherer [1)]
Deputy Chairman
Chairman of the Group Works Council Cologne and of the Joint Works Council of DEUTZ AG, Cologne

Ing Massimo Bordi
CEO of SAME DEUTZ-FAHR Group S.p.A., Treviglio/Italy
a) SAME DEUTZ-FAHR ITALIA S.p.A., Treviglio/Italy
SAME DEUTZ-FAHR Group S.p.A., Treviglio/Italy

Dr Francesco Carozza
(since 21 May 2008)
Vice President of SAME DEUTZ-FAHR ITALIA S.p.A., Treviglio/Italy
a) SAME DEUTZ-FAHR DEUTZSCHLAND GmbH, Lauingen, Chairman
b) SAME DEUTZ-FAHR INDIA Private Ltd., Ranipet/India, Chairman
SAME DEUTZ-FAHR Trading (Dalian) Co. Ltd., Dalian/China
SAME DEUTZ-FAHR Group S.p.A., Treviglio/Italy
SAME DEUTZ-FAHR Agricultural Machinery (Dalian) Co. Ltd., Dalian/China, Deputy Chairman
I.T. International Transmissions S.A., Stabio/Switzerland, Chairman

Professor Klaus-Otto Fruhner
(until 21 May 2008)
CEO of K.O.F.-Projektberatung GmbH, Cologne

Reinhold Götz [1)]
(until 21 May 2008)
2. Deputy Chief Executive of IG Metall Administrative Office Mannheim, Mannheim
a) MVV-Energie AG, Mannheim
MWM GmbH, Mannheim
b) Stadt Mannheim Beteiligungsgesellschaft mbH, Mannheim
Sparkasse Rhein-Neckar-Nord, Mannheim

Michael Haupt
Former member of the Group Board of SKF AB, Gothenburg/Sweden

Dr Helmut Lerchner
Management consultant, Aichtal-Rudolfshöhe
a) ElringKlinger AG, Dettingen/Erms, Chairman

Lars-Göran Moberg
(since 21 May 2008)
Management consultant and Supervisory Board member, Stockholm/Sweden
b) Haldex AB, Stockholm/Sweden, Chairman
Volvo Construction Equipment NV, Beesd/Netherlands
Volvo Aero AB, Trollhättan/Sweden

Helmut Müller [1)]
Chairman of the Senior Staff Committee of DEUTZ AG, Cologne

Karl-Heinz Müller [1)]
Deputy Chairman of the Joint Works Council of DEUTZ AG, Cologne

Dr Witich Roßmann [1)]
1. Chief Executive of IG Metall Cologne, Cologne
a) Ford Werke GmbH, Cologne
Ford Holding Deutschland GmbH, Cologne

Susanne Scholtyssek [1)]
(since 21 May 2008)
Head of Personnel Development at IG Metall Frankfurt/Main

1) Employee representative on the Supervisory Board
a) Membership on statutory German supervisory boards within the meaning of section 125 of the AktG
b) Membership on comparable German or international supervisory bodies pursuant to section 125 of the AktG

Professor Dr Marco Vitale
(until 21 May 2008)
President of Vitale-Novello & Co SRL, Milan/Italy
b) SAME DEUTZ-FAHR ITALIA S.p.A., Treviglio/Italy, Chairman
BANCA POPOLARE DI MILANO, Milan/Italy,
C. BORGOMEO & CO. SRL, Rome/Italy
CONNECT SUD SRL, Palermo/Italy
VINCENZO ZUCCHI S.p.A., Milan/Italy

Egbert Zieher [1)]
Chairman of the Ulm Works Council of DEUTZ AG, Ulm

SUPERVISORY BOARD COMMITTEES

Human Resources Committee
Dr Giuseppe Vita, Chairman
Werner Scherer, Deputy Chairman
Michael Haupt

Audit Committee
Michael Haupt, Chairman
Werner Scherer, Deputy Chairman
Karl-Heinz Müller
Dr Giuseppe Vita

Arbitration Committee
(Section 27 (3) of the German Codetermination Act (MitbestG))
Dr Giuseppe Vita, Chairman
Michael Haupt
Karl-Heinz Müller (until 21 May 2008)
Werner Scherer
Egbert Zieher (since 21 May 2008)

Nominations Committee
Dr Giuseppe Vita, Chairman
Michael Haupt
Ing Massimo Bordi

MANAGEMENT BOARD

Dr.-Ing. Helmut Leube (55), Herrsching a.A.
(since 1 February 2008)
Chairman
Market and Product Lines
a) KUKA AG, Augsburg
b) Deutz Corporation, Atlanta/USA, Chairman (since 1 August 2008)
DEUTZ (Dalian) Engine Co., Ltd., Dalian/China, Deputy Chairman (since July 2008)

Gino M. Biondi (49), Brombach
Development, Procurement, Logistics and Production
b) DEUTZ (Dalian) Engine Co., Ltd., Dalian/China
DEUTZ DITER S.A., Zafra/Spain, Chairman (since 8 October 2008)

Karl Huebser (63), Rottach-Egern
Overall responsibility for Asia
b) DEUTZ DITER S.A., Zafra/Spain, Chairman (until 8 October 2008)
DEUTZ (Dalian) Engine Co., Ltd., Dalian/China
Weifang Weichai Deutz Diesel Engine Co., Ltd., Weifang/China, Chairman

Helmut Meyer (59), Düsseldorf
Finance, Human Resources and Service
b) Deutz Corporation, Atlanta/USA, Chairman (Chairman until 1 August 2008)
DEUTZ Asia-Pacific (Pte) Ltd., Singapore/Singapore, Chairman
DEUTZ (Dalian) Engine Co., Ltd., Dalian/China
DEUTZ UK Ltd., Cannock/UK

1) Employee representative on the Supervisory Board
a) Membership on statutory German supervisory boards within the meaning of section 125 of the AktG
b) Membership on comparable German or international supervisory bodies pursuant to section 125 of the AktG

Annual financial statements in accordance with the german commercial code (HGB)

BALANCE SHEET OF DEUTZ AG

Assets

€ million	31 Dec. 2008	31 Dec. 2007
Expenses for the expansion of operations	**10.4**	**20.8**
Intangible assets	24.9	29.6
Property, plant and equipment	279.4	280.1
Investments	181.9	181.9
Fixed assets	**486.2**	**491.6**
Inventories	155.1	149.3
Receivables and other assets	223.3	271.6
Cash and cash equivalents	200.2	298.1
Current assets	**578.6**	**719.0**
Prepaid expenses	3.7	3.7
Total assets	**1,078.9**	**1,235.1**

Equity and liabilities

€ million	31 Dec. 2008	31 Dec. 2007
Issued capital	309.0	307.0
Additional paid-in capital	26.8	26.2
Retained earnings		
Legal reserve	4.5	4.5
Other retained earnings	74.6	74.6
Accumulated income	26.8	82.2
Equity	**441.7**	**494.5**
Provisions	278.6	320.9
Other liabilities	358.6	419.7
Total equity and liabilities	**1,078.9**	**1,235.1**

INCOME STATEMENT OF DEUTZ AG

€ million	2008	2007
Revenue	1,417.0	1,443.1
Change in inventories	–0.1	13.1
Other own work capitalised	0.7	0.4
Total output	**1,417.6**	**1,456.6**
Other operating income	87.2	78.9
Cost of materials	–1,063.8	–1,043.2
Staff costs	–239.0	–237.0
Depreciation and amortisation	–61.8	–63.5
Other operating expenses	–139.5	–138.6
Net investment income	14.4	13.4
Net interest expense	–8.1	–14.3
Profit from ordinary activities	**7.0**	**52.3**
Net extraordinary result	–17.8	119.5
Income taxes	4.2	–18.0
Other taxes	–0.8	–0.6
Net loss/income	**–7.4**	**153.2**
Profit carried forward	34.2	7.7
Additions to legal reserve	–	–4.1
Additions to other retained earnings	–	–74.6
Accumulated income	**26.8**	**82.2**

Miscellaneous

RESPONSIBILITY STATEMENT

“To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group management report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.”

Cologne, 19 February 2009

DEUTZ Aktiengesellschaft
The Management Board

Dr.-Ing. Helmut Leube

Karl Huebser

Gino Mario Biondi

Helmut Meyer

AUDIT OPINION

We have audited the consolidated financial statements – comprising the income statement, the balance sheet, the statement of changes in equity, the cash flow statement, the segment reporting and the notes to the consolidated financial statements – and the Group management report prepared by DEUTZ Aktiengesellschaft, Cologne, Germany, for the financial year from 1 January to 31 December 2008. The preparation of the consolidated financial statements and the Group management report, in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, and the additional requirements of German commercial law pursuant to section 315a (1) of the German Commercial Code (HGB), are the responsibility of the Parent Company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the Group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with section 317 HGB and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW – German Institute of Auditors). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements, in accordance with the applicable financial reporting framework and in the Group management report, are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the internal control system relating to the accounting system and the evidence supporting the disclosures in the consolidated financial statements and the Group management report are examined, primarily, on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the management, as well as evaluating the overall presentation of the consolidated financial statements and the Group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements of DEUTZ Aktiengesellschaft comply with IFRS, as adopted by the European Union, and the additional requirements of German commercial law pursuant to section 315a (1) HGB, and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The Group management report is consistent with the consolidated financial statements and, as a whole, provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Düsseldorf, 11 March 2009

Deloitte & Touche GmbH
Wirtschaftsprüfungsgesellschaft

Signed: Crampton
Wirtschaftsprüfer
(German Public Auditor)

Signed: Lammers
Wirtschaftsprüferin
(German Public Auditor)

Glossary

Emissions legislation Sets limits for certain exhaust-gas constituents in engine-powered vehicles and equipment. Also specifies test procedures, implementation schedules and, if applicable, transitional periods

Exhaust gas aftertreatment By purifying combustion exhaust gases, ensures compliance with legally required emissions limits for gaseous pollutants such as nitrogen oxides (NOx) and soot particles. In vehicles, exhaust gas aftertreatment is performed by catalytic converters and soot particulate filters.

Exhaust gas recirculation (EGR) Process for reducing nitrogen oxides (NOx) in combustion exhaust gases. Combustion exhaust gas is fed beck into the engine's combustion chamber for combustion. The proportion of exhaust gas in the fuel-air mixture results in a comparatively low combustion temperature in the combustion chamber, which in turn reduces the NOx in the exhaust gas.

Captive market, captive segment Market segment in which the equipment and commercial vehicle manufacturers meet the demand for engines by producing them in-house. For this reason, the captive market is generally inaccessible to independent engine manufacturers.

Cash pooling Centralised cash management instrument for the purpose of smoothing intra-group liquidity differentials between entities within the group. Cash pooling manages the liquidity shortages and surpluses of all entities throughout the group with the goal of optimising the interest expense and income of the group.

Common Rail Injection system for diesel engines in which all cylinders are supplied with fuel at a constant pressure via a common high-pressure fuel line. Advantages of common rail injection are the better mixture formation in the cylinders, lower consumption and reduced emissions.

Compliance Describes the totality of measures of a company to comply not only with laws, ordinances and directives but also contractual obligations and voluntary commitments. Compliance is a key element of corporate governance.

Corporate governance Responsible management and supervision of companies directed to long-term creation of value and enhancing shareholder value.

Covenants Additional undertakings in a loan agreement that must be adhered to by a borrower over the term of a loan agreement. They govern financial or other obligations and contain clauses with regard to legal consequences in the form of sanctions

Coverage Describes the regular reporting concerning the company by a bank analyst. This includes the observation, analysis and evaluation of the company with the objective of calculating the fair price of a share and accordingly of deriving price potentials or risks leading to an investment recommendation.

Cross-currency swap An agreement between two parties to exchange various specified interest payments in different currencies over a period stipulated in the agreement.

D&O Insurance Stands for "directors' and officers' insurance"; a liability insurance policy that a company takes out to indemnify its directors and senior managers against claims for damages.

DAX The Deutscher Aktienindex (DAX) reflects the share price performance of the 30 largest German companies with the highest turnover on the Frankfurt Stock Exchange. It is the leading share index for the German stock market.

DEUTZ Common Rail Common rail injection system, in which the fuel line is supplied with fuel via two high-pressure pump elements.

DIN EN ISO 14001 Deutsches Institut für Normung, European Norm, International Organization for Standardisation – 14001; an international, European and German industrial standard for environmental management.

DNV certification Det Norske Veritas (DNV) is an independent foundation that was set up to safeguard life, property and the environment. Its DNV Certification division certifies management systems, conducts audits and assessments and provides services in the fields of environmental protection, business excellence and corporate social responsibility.

Downsizing Describes a process making it possible for engines with smaller cubic capacity to have the same engine performance as engines with higher cubic capacity. The advantage is lower fuel consumption and lower CO_2 emissions with no change in performance.

Dual Sourcing A procurement strategy in which a component is purchased from two different suppliers to minimise the business risk.

DVERT® (DEUTZ Variable Emission Reductions Technology) A combination of systems, components and procedures that are used as modules to create technically optimised and, at the same time, cost-effective solutions for reducing exhaust and noise emissions.

US EPA TIER 1, 2, 3, 4 US emissions standards for non-road applications. Set limits for pollutants such as nitrogen oxides, hydrocarbons and soot particulates in exhaust gas.

EU Stage I, II, III A, III B, IV Exhaust standard laid down by the European Union for non-road applications. Sets limits for pollutants such as nitrogen oxides, hydrocarbons and soot particulates in exhaust gas.

Euro 1, 2, 3, 4, 5 Emissions standard laid down by the European Union for motor vehicles. Sets limits for pollutants such as nitrogen oxides, hydrocarbons and soot particulates in exhaust gas.

Factoring A financing instrument used by a company to safeguard its short-term liquidity and transfer the default risk of receivables through the sale of trade receivables to a factor (factor = a financial institution or special financing institution).

Forward Individually designed forward transaction which is not traded on a stock exchange.

Hedging Safeguarding of interest rate risks, currency risks, price risks or similar risks through derivative financial instruments that limit the risks of the hedged items.

Hybrid drive A drive combining two different types of propulsion units and energy storage systems (generally an internal combustion engine and an electric motor).

Investment-grade bonds Bonds of high credit quality (i.e. with good credit ratings).

Investor relations Management responsibility with the strategic objective of achieving a perception of the company in the public and in particular in the financial market which is as realistic as possible. Efficient investor relations should also pursue the objective of optimising capital costs. The activities are primarily focused on bringing the expectations of the capital market into harmony with the actual and probable developments of the company. This goal is achieved by continuous dialog concerning the company‘s long-term prospects and timely, reliable information concerning current business performance.

Deferred taxes Differences between the rules for computing taxable profits and IAS result in differences with respect to the tax burden. These differences are recognised in the balance sheet as deferred assets or liabilities.

Long-term incentive (LTI) plan An incentive system or form of remuneration offered to the Management Board and selected senior managers; its purpose is to enable these executives to benefit from the company‘s long-term success, thereby encouraging them to stay with the company.

MDAX An index selected by Deutsche Börse AG comprising 50 medium-sized companies (mid-caps) which come immediately below DAX shares in terms of market capitalization and liquidity. The MDAX only contains the shares of companies from traditional sectors.

Megatrends Changes in the economy and in society which can be expected to persist for an extended period of time and can take place globally but also in geographically limited areas.

Non-captive market, non-captive segment Market segment in which the equipment and commercial vehicle manufacturers meet the demand for engines through external production. For this reason, a non-captive market is accessible to independent engine manufacturers.

Non-road applications Engine-powered applications that are not licensed for use on public roads such as mobile machinery.

Net Present Value (NPV) Capital value or present value of an investment. It is the sum of the discounted future cash receipts and cash payments less the investment outlays. In investment decisions, net present value is used to assess the advantageousness of investments.

On-road applications Engine-powered applications that are licensed for use on public roads such as commercial vehicles and buses.

Option A contract that confers the right on the holder and the obligation on the writer to buy or sell the underlying instrument (a security or a product) up until the expiration date of the contract at the previously determined strike price.

Prime Standard The standard set by Deutsche Börse AG for companies looking to raise capital from international investors. These companies have to meet stringent international disclosure requirements. Admission to the Prime Standard is a prerequisite for inclusion in the DAX, MDAX, TecDAX and SDAX indices.

Credit rating Credit ratings are used to assess a company‘s creditworthiness. They gauge to what extent the company will be able to repay the principal and interest on its outstanding liabilities at the agreed date.

Soot and particulate filters Devices for reducing the particulates contained in the exhaust gases of diesel engines. There are two types of filter, which work in very different ways: wall-flow filters (surface-type filters), in which the exhaust gas penetrates a porous wall; and flow filters (deep-bed filters), in which the exhaust gas flows through the filter itself.

Selective Catalytic Reduction (SCR) Catalytic reduction of nitrogen oxides in the exhaust gas of combustion engines whereby the reducing agent urea is injected into the exhaust gas. In the hot exhaust gas, the urea disintegrates to form ammonia, which converts the nitrogen oxide into harmless molecular nitrogen.

Stakeholders Groups having specific interests with regard to a company and formulate such interests in the form of claims; however, stakeholders may also be groups that are influenced by the company‘s activities. Such groups include, for example, employees, shareholders, banks, customers, suppliers, the government, trade unions and associations.

SDAX An index selected by Deutsche Börse AG comprising 50 small-sized companies (small-caps) which come immediately below MDAX shares in terms of market capitalization and liquidity. The SDAX only contains the shares of companies from traditional sectors.

Free float Proportion of shares of a stock corporation not directly held by one shareholder. As defined by Deutsche Börse AG, share packages of less than 5% are included in free float.

Supplementary production The production of a specific quantity of a specific component is allocated externally due to utilisation of the company‘s own production capacity. Supplementary production makes it possible to adjust the production volume of the component flexibly depending on need and without expanding the company‘s own production capacity.

US Private Placement A private placement involves the private, non-public sale of bonds (in the USA).

Convertible bond A bond that can be exchanged for the company‘s shares within a specific period of time under certain conditions and at a fixed exchange ratio.

Xetra This stands for “Exchange Electronic Trading” and is the name given to the electronic dealing system run by Deutsche Börse AG (also known as screen-based trading).

DEUTZ Group: Multi-year overview

€ million	2004	2005	Continuing operations 2006	Continuing operations 2007	Continuing operations 2008
New orders	1,265.1	1,350.5	1,296.9	1,584.5	1,363.5
Unit sales (units)	173,440	195,843	236,679	285,861	252,359
Compact Engines	172,684	195,082	199,202	248,971	219,681
DEUTZ Customised Solutions	–	–	37,477	36,890	32,678
DEUTZ Power Systems	756	761	–	–	–
Revenue	1,242.3	1,322.8	1,183.6	1,524.2	1,495.0
Compact Engines	909.9	999.7	868.3	1,186.0	1,143.2
DEUTZ Customised Solutions	–	–	315.3	338.2	351.8
DEUTZ Power Systems	332.4	323.1	–	–	–
Thereof excluding Germany (%)	74.5	73.0	74.6	78.0	75.6
EBITDA	81.8	180.0	125.3	161.0	91.9
EBITDA (before one-off items)	113.9	121.5	125.3	161.0	106.2
EBIT	18.5	114.7	66.6	95,5	17.5
EBIT (before one-off items)	53.5	62.5	66.6	95.5	31.8
EBIT margin (%)	1.5	8.7	5.6	6.3	1.2
EBIT margin (before one-off items, %)	4.3	4.7	5.6	6.3	2.1
Net income	–18.7	71.4	61.5	183.3	–8.3
continuing operations	–	–	38.5	59.4	–4.2
discontinued operations	–	–	23.0	123.9	–4.1
Earnings per share, basic (€)	–0.21	0.77	0,57	1,56	–0,07
continuing operations	–	–	0,36	0,51	–0,04
discontinued operations	–	–	0,21	1,05	–0,03
Total assets	1,029.1	1,063.8	1,162.9	1,378.6	1,206.3
Non-current assets	462.5	479.2	499.1	511.3	539.7
Equity	158.7	247.0	358.5	557.1	511.3
Equity ratio (%)	15.4	23.2	30.8	40.4	42.4
Cash flow from operating activities before payment of compensation for vested company pension rights	111.9	143.4	84.4	41.1	90.1
Cash flow from operating activities	111.9	143.4	84.4	–38.7	89.7
Free Cash flow	47.0	134.0	–14.8	–111.5	–23.3
Net financial position[1]	–232.4	–89.7	–34.0	89.7	–12.2
Working capital[2]	314.1	238.1	133.1	196.9	205.0
Working capital as percentage of revenue (31 Dec.)	25.3	18.0	11.2	12.9	13.7
Capital expenditure (excluding capitalisation of R&D)	43.0	67.6	81.9	143.5	69.9
Depreciation and amortisation	63.3	65.3	58.7	65.5	74.4
Research and development	69.5	66.9	54.8	55.8	90.3
Employees (31 Dec.)	5,472	5,058	4,331	4,617	4,701

1) Net financial position: Cash and cash equivalents less current and non-current interest-bearing financial liabilities
2) Working capital: Inventories plus trade receivables less trade payables

	2004	2005	Continuing operations 2006	Continuing operations 2007	Continuing operations 2008
Revenue by region (€ million)	**1,242.3**	**1,322.8**	**1,183.6**	**1,524.2**	**1,495.0**
Europe/Middle East/Africa	945.5	989.6	896.3	1,193.2	1,195.7
Americas	160.3	193.2	210.2	207.2	180.7
Asia-Pacific	136.5	140.0	77.1	123.8	118.6
Revenue by application segment (€ million)	**1,242.3**	**1,322.8**	**1,183,6**	**1,524.2**	**1,495.0**
Mobile Machinery	310.5	374.1	440.9	581.3	529.8
Automotive	63.1	68.6	119.4	279.8	266.2
Stationary Equipment	329.0	350.8	260.4	258.8	259.3
Service	343.9	315.5	179.7	203.5	212.0
Agricultural Machinery	124.3	145.8	146.8	163.7	195.8
Miscellaneous	71.5	68.0	36.4	37.1	31.9
Key figures DEUTZ shares					
Number of shares (31 Dec.)	91,149,075	95,003,621	114,326,416	120,085,030	120,861,783
Number of shares (average)	91,149,075	92,584,625	107,161,106	117,315,867	120,793,508
Share price (31 Dec., (€)	2.93	4.14	10.05	6.95	2.38
Share price high (€)	4.70	4.68	10.40	12.02	7.60
Share price low (€)	2.41	2.86	4.00	6.82	1.85
Market capitalisation (31 Dec., € million)	267.1	393.3	1,148.9	834.6	287.7
Basic earnings per share (€)	–0.21	0.77	0.57	1.56	–0.07
continuing operations	–	–	0.36	0.51	–0.04
discontinued operations	–	–	0.21	1.05	–0.03
Diluted earnings per share (€)	–	0.62	0.52	1.52	–0.07
continuing operations	–	–	0.33	0.50	–0.04
discontinued operations	–	–	0.19	1.02	–0.03

Financial calendar 2009

Date	Event	Location
19 March	Annual Results press conference Publication Annual Report 2008	Cologne
20 March	Analysts‘ meeting	Frankfurt/Main
30 April	Annual General Meeting 2008	Cologne
7 May	Publication Report 1st Quarter 2009 Conference call with analysts and investors	
12 August	Public Report 1st Half 2009 Conference call with analysts and investors	
5 November	Publication Report 1st to 3rd Quarter 2009 Conference call with analysts and investors	

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