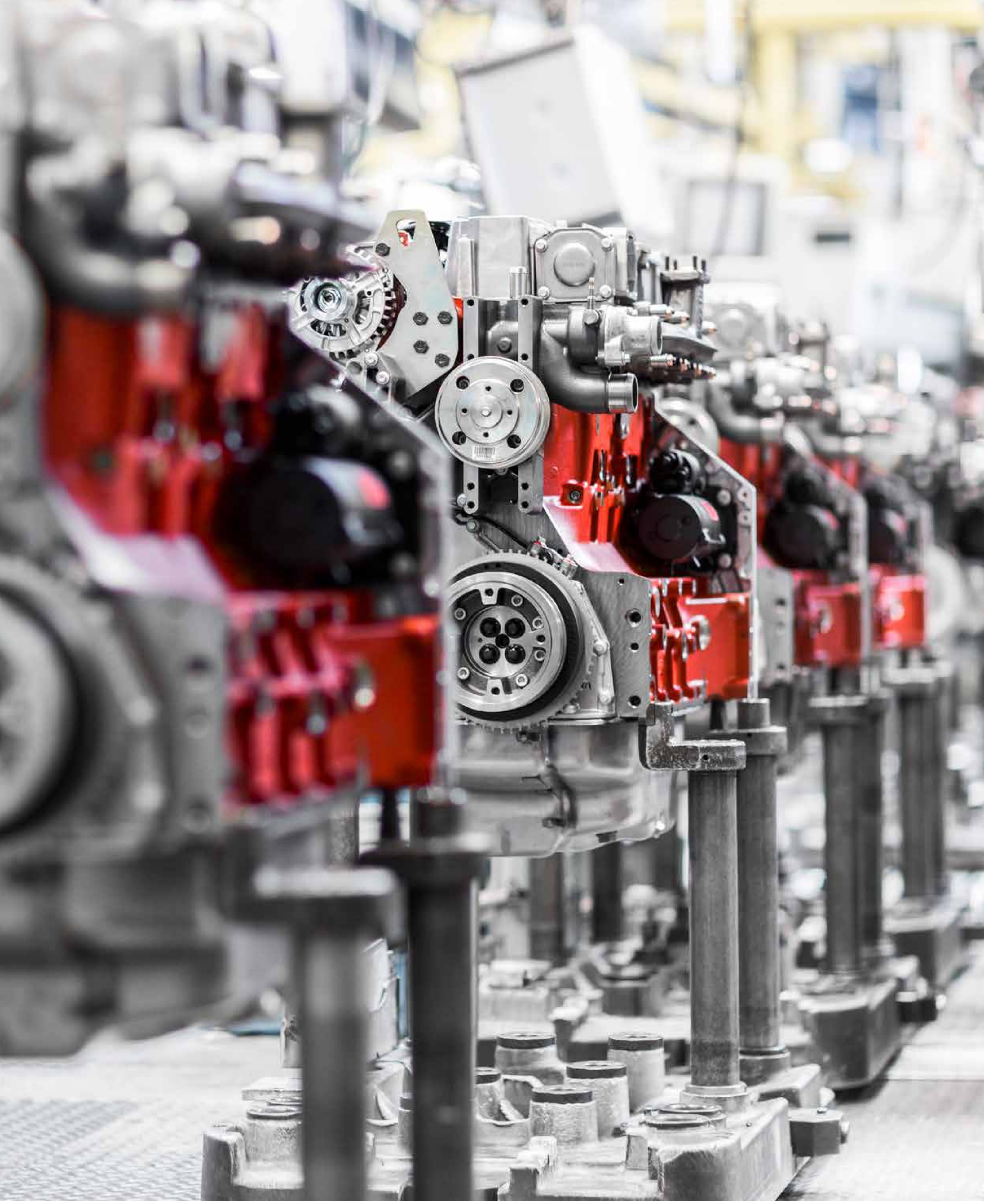


ANNUAL REPORT 2016

The engine company. DEUTZ

DEUTZ GROUP: KEY FIGURES

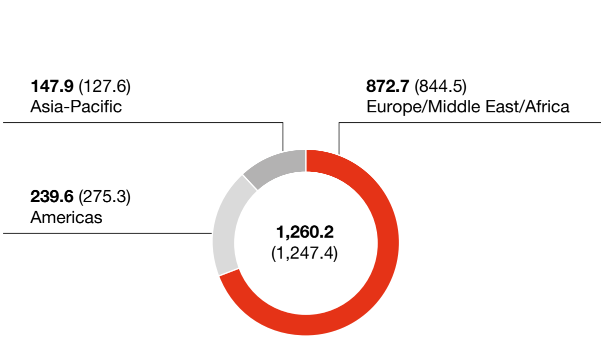
€ million

	2016	2015	Change (%)
New orders	1,261.4	1,225.9	2.9
Unit sales (units)	132,539	137,781	–3.8
Revenue	1,260.2	1,247.4	1.0
EBITDA	114.2	112.2	1.8
EBIT	23.4	4.9	–
EBIT margin (%)	1.9	0.4	–
Net income	16.0	3.5	–
Earnings per share (€)	0.14	0.04	–
Dividend per share (€)	0.07	0.07	–
Total assets	1,059.7	1,088.1	–2.6
Non-current assets	483.7	520.5	–7.1
Equity	491.1	495.6	–0.9
Equity ratio (%)	46.3	45.5	–
Cash flow from operating activities	63.8	103.3	–38.2
Free cash flow [1]	4.7	35.0	–86.6
Net financial position [2]	31.6	39.0	–19.0
Working capital [3]	204.3	183.6	11.3
Working capital ratio (31 Dec, %) [4]	16.2	14.7	–
Capital expenditure (excl. capitalisation of R&D, after deducting grants)	52.9	56.2	–5.9
Depreciation and amortisation	90.8	107.3	–15.4
Research and development expenditure (after deducting grants)	50.4	40.8	23.5
thereof capitalised	9.1	13.0	–30.0
Employees (31 Dec)	3,665	3,730	–1.7

[1] Free cash flow: cash flow from operating and investing activities less net interest expense.
[2] Net financial position: cash and cash equivalents less current and non-current interest-bearing financial debt.
[3] Working capital: inventories plus trade receivables minus trade payables.
[4] Working capital ratio (percentage as at balance sheet date): working capital as at the balance sheet date divided by revenue for the previous twelve months.

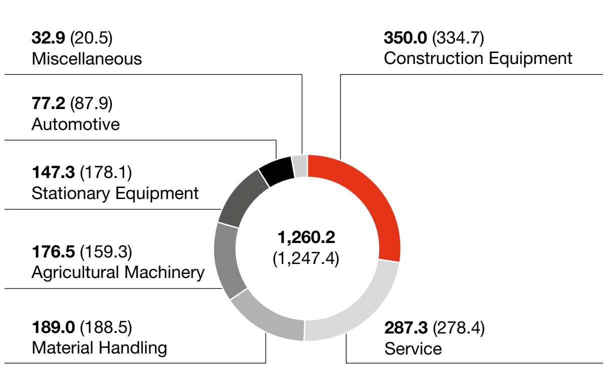
DEUTZ Group: Revenue by region

€ million (2015 figures)



DEUTZ Group: Revenue by application segment

€ million (2015 figures)



DEUTZ AG

DEUTZ AG is an independent manufacturer of diesel and gas engines with a power output of 25 to 520 kW and is headquartered in Cologne, Germany. For more than 150 years, the name DEUTZ has been synonymous with cutting-edge technology and high-quality products. We currently employ 3,665 people and have a presence in over 130 countries.

DEUTZ AROUND THE WORLD

Key

- ● Production/assembly/components plant
- ▲ Sales company
- ■ Sales office

In addition: over 800 independent DEUTZ sales and service partners in more than 130 countries

Americas

Argentina
●▲ Buenos Aires

Brazil
▲ São Paulo

USA
▲ Atlanta
● Pendergrass

Europe

Germany
● Herschbach
●■ Cologne
● Übersee
●■ Ulm

France
▲ Gennevilliers/ Paris

UK
■ Cannock

Russia
▲■ Moscow

Spain
▲ Madrid
● Zafra

Africa

Algeria
■ Algiers

Morocco
▲● Casablanca

South Africa
▲ Johannesburg

Asia

China
●▲ Dalian
▲■ Beijing
■ Shanghai

India
▲ Pune

Singapore
▲ Singapore

UAE
■ Abu Dhabi

Australia

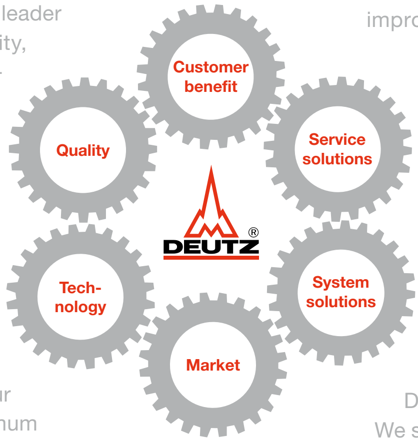
▲ Melbourne

OUR VISION

"To offer the most successful engine systems in the world" – this is our vision.

In 1864, DEUTZ became the world's first engine manufacturer and we intend to remain a market leader when it comes to customer benefit, quality, technology and all aspects of engine systems and service solutions. As a leading independent supplier in the premium segment, our objective is to be the force behind innovative, market-driven technologies and to provide our customers not just with engines but with complete system solutions and a comprehensive range of services.

We want the DEUTZ name to remain synonymous with quality and we want our products and services to generate maximum customer satisfaction and to offer the best possible cost-benefit ratio.



OUR MISSION

DEUTZ has been a byword for pioneering spirit, passion and innovation since its foundation in 1864.

We invented the internal combustion engine and have improved it every day since then.

We are leading the way in developing environmentally friendly and efficient drive technologies. Our customer-specific solutions offer long-lasting high quality and reliable performance at an affordable total cost of ownership.

Working closely with our partners, we are developing the technologies today that will meet the challenges of tomorrow.

DEUTZ – the engine company.
We set standards and shape the future.

DEUTZ SEGMENTS

DEUTZ Compact Engines

- Liquid-cooled engines of up to 8 litres cubic capacity for on-road and off-road applications
- Large number of modular approaches to design
- Chinese joint venture DEUTZ Dalian

DEUTZ Customised Solutions

- Air-cooled engines for on-road, off-road and marine applications
- Liquid-cooled engines of over 8 litres for on-road, off-road and marine applications
- Reconditioned (Xchange) engines for all DEUTZ engine series

DEUTZ Compact Engines

€ million

	2016	2015	Change (%)
New orders	1,011.6	958.4	5.6
Unit sales (units)	123,179	125,214	–1.6
Revenue	1,000.8	967.2	3.5
EBIT before exceptional items	–6.1	–31.9	80.9

DEUTZ Customised Solutions

€ million

	2016	2015	Change (%)
New orders	249.8	267.5	–6.6
Unit sales (units)	9,360	12,567	–25.5
Revenue	259.4	280.2	–7.4
EBIT before exceptional items	32.7	31.3	4.5

CONTENTS

FOREWORD

Dear shareholders,
friends and partners of our Company

DEUTZ operates in a market in which one topic is very much at the forefront of discussion: the future of the internal combustion engine and, in particular, that of the diesel engine. This prompted us to shine the spotlight on the environmental sustainability of our products in our latest annual report. We firmly believe that, going forward, the diesel engine will continue to justify its place in the application segments that we serve – which are mainly off-road applications – from a technological, financial and environmental perspective. At the same time, we will tackle the challenges resulting from alternative drive systems and seize the opportunities for our Company that this presents.

In 2016, the economy was again characterised by a variety of global risks and uncertainties. Prices for oil, commodities and agricultural goods were at a very low level, although they did rise over the course of the year. In this business environment, we were able to buck the market trend and generate a small amount of growth. New orders were up by 2.9 per cent year on year and reached €1,261.4 million. We sold 132,539 engines and our revenue increased by 1.0 per cent to €1,260.2 million, which was in line with our forecast that revenue would stagnate or, at best, rise slightly.

It was particularly encouraging that our measures to boost efficiency are having an effect. Despite only a slightly larger volume of business, EBIT improved significantly, from €4.9 million to €23.4 million. The EBIT margin stood at 1.9 per cent, compared with 0.4 per cent in 2015. We therefore fully met our forecast of a moderate increase in the EBIT margin.

As well as the fall in the cost of materials and in depreciation and amortisation, we also benefited from the measures aimed at optimising our network of sites. These measures are fully on schedule and will deliver a positive contribution to earnings of around €10 million this year – and an even higher contribution in future years as capacity utilisation rises. Production of crankshafts and camshafts at the Cologne-Porz site is already in full swing – and with an improved environmental footprint. We will complete the relocation of activities from Übersee on Lake Chiemsee to Ulm during the course of this year.

The success of our Company depends heavily on our ability to impress our customers with innovative products that are at the leading edge of technology. In the year under review, we exhibited at a number of trade fairs, where we presented various new engines that will be launched on the market in 2019 in time for the EU Stage V emissions standard. These new engines will broaden our product portfolio, particularly at the lower and upper ends of the power output range. They include gas variants, the DEUTZ powerpack and larger engines to be developed as part of a planned strategic alliance with Liebherr. The new products attracted highly positive feedback from customers.

Dr Ing Frank Hiller
Chairman of the Board of Management, responsible for technical and head-office functions

Dr Margarete Haase
Board of Management member, responsible for finance, human resources, and investor and public relations

Michael Wellenzohn
Board of Management member, responsible for sales, service and marketing

Last year, we again succeeded in signing up new customers and finding new applications for our engines. At the same time, we are continuing to focus on steadily expanding our high-margin service business over the long term.

"We want to work together with our customers in stable, long-term partnerships and offer them assured and innovative technologies. Our objective is to further strengthen our market position and our commercial success and thus make ourselves more attractive to our customers and the capital markets."

Dr Ing Frank Hiller,
Chairman of the Board of Management of DEUTZ AG
(since 1 January 2017)

In summary, we can say that 2016 was in line with our expectations. DEUTZ shares performed very well, with the price rising by 45.0 per cent year on year. This positive trend has continued in the first few months of 2017. We also believe it is important to pay a consistent dividend. Together with the Supervisory Board, we therefore propose that the dividend for 2016 remain unchanged at €0.07 per share.

We would like to take this opportunity to particularly thank our employees, who work very hard to make our Company successful. Our sincere thanks also go to our business partners and shareholders for the trust that they place in us; we intend to continue to repay this trust in future.

Although we anticipate that the market will stagnate in 2017, or perhaps grow slightly, we can already see early signs of a potential improvement in the market. Our European customers should now be coming to the end of their inventories, which will be beneficial for us. In 2017, we expect revenue to improve significantly and the EBIT margin before exceptional items to rise moderately. We also predict substantial positive one-off effects from property transactions in the near future, or possibly as early as this year depending on the negotiations to be conducted.

Kind regards from Cologne,

Dr Ing Frank Hiller | Dr Margarete Haase | Michael Wellenzohn

DEUTZ SHARES

The world's stock markets were characterised by strong price volatility in 2016. Following a very weak start to the year and a subsequent period of recovery, the United Kingdom's vote to leave the European Union in June 2016 subdued the markets only temporarily. After rallying at the end of the year, the DAX closed on 30 December 2016 at its high for the year of 11,481.06 points. This was 6.9 per cent above the level at the end of 2015.

DEUTZ SHARES MAKE SUBSTANTIAL GAINS

The SDAX, in which DEUTZ shares are listed, rose in value by 4.6 per cent in 2016 and closed at 9,519.43 points (end of 2015: 9,098.57 points). The DAXsector Industrial, the index for German industrial companies, gained 19.3 per cent in the reporting year to close at 5,788.57 points (end of 2015: 4,853.88 points).

DEUTZ shares made significant gains in 2016. Having made a weak start to the year, the share price fell to its lowest point for the year of €2.65 on 11 February 2016. However, the shares then rebounded strongly, particularly at the end of the year. Shares in machinery manufacturers benefited from speculation about additional investment in government infrastructure projects following the presidential election in the United States. DEUTZ shares reached their high for the year of €5.58 on 12 December 2016. Their year-end closing price of €5.35 was 45.0 per cent higher than their price twelve months earlier of €3.69.

Market capitalisation stood at €646.6 million as at 30 December 2016, compared with €446.0 million at the end of 2015.

Key figures for DEUTZ shares

	2016	2015
Number of shares (31 Dec)	120,861,783	120,861,783
Average number of shares	120,861,783	120,861,783
Share price as at 31 Dec (€)	5.35	3.69
Share price high (€)	5.58	5.59
Share price low (€)	2.65	2.86
Market capitalisation as at 31 Dec (€ million)	646.6	446.0
Earnings per share (€)	0.14	0.04

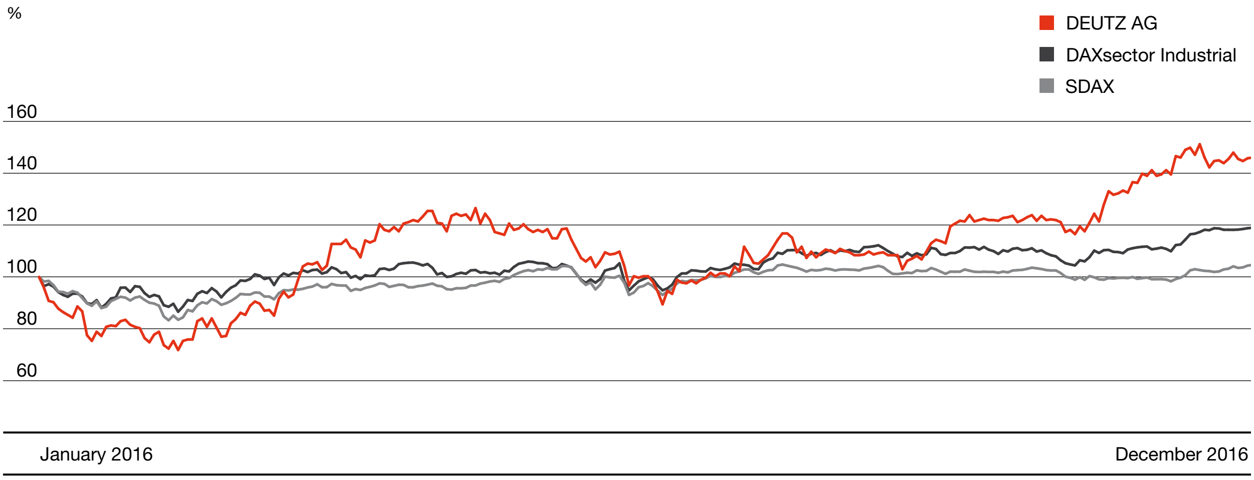
EARNINGS PER SHARE

Earnings per share is calculated by dividing the net income for the year attributable to the shareholders of DEUTZ AG by the weighted average number of shares in issue. In the year under review, the number of DEUTZ shares in issue was unchanged at 120.9 million. Basic earnings per share was therefore €0.14, compared with €0.04 in 2015.

Key data on stock market listing

ISIN	DE0006305006
WKN	630500
Reuters	DEZG.DE
Bloomberg	DEZ:GR
Market segment	Regulated Market/Prime Standard
Trading platforms	Xetra, Frankfurt/Main, Düsseldorf

DEUTZ share price performance in 2016



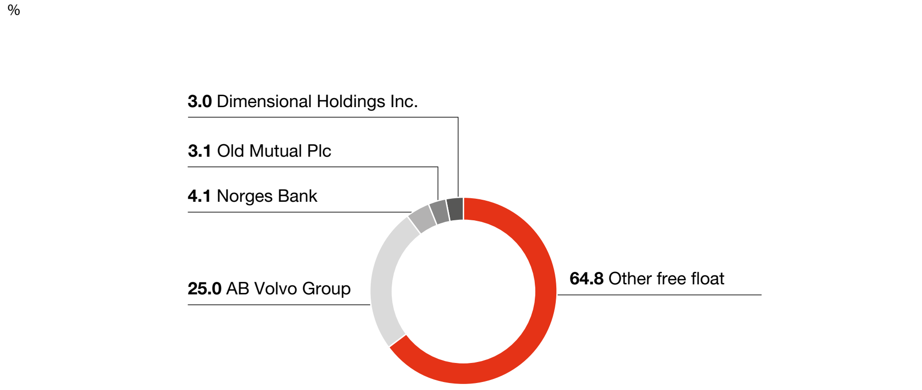
DIVIDEND ENABLES SHAREHOLDERS TO SHARE IN PROFITS

The Board of Management and Supervisory Board propose that the dividend paid for 2016 should remain unchanged at €0.07. This enables us to fulfil our aim of paying a consistent dividend. We plan to carry on enabling our shareholders to participate in the success of our Company in the form of a regular dividend. At the same time, we intend to continue funding a significant proportion of our growth ourselves, that is to say from our own capital.

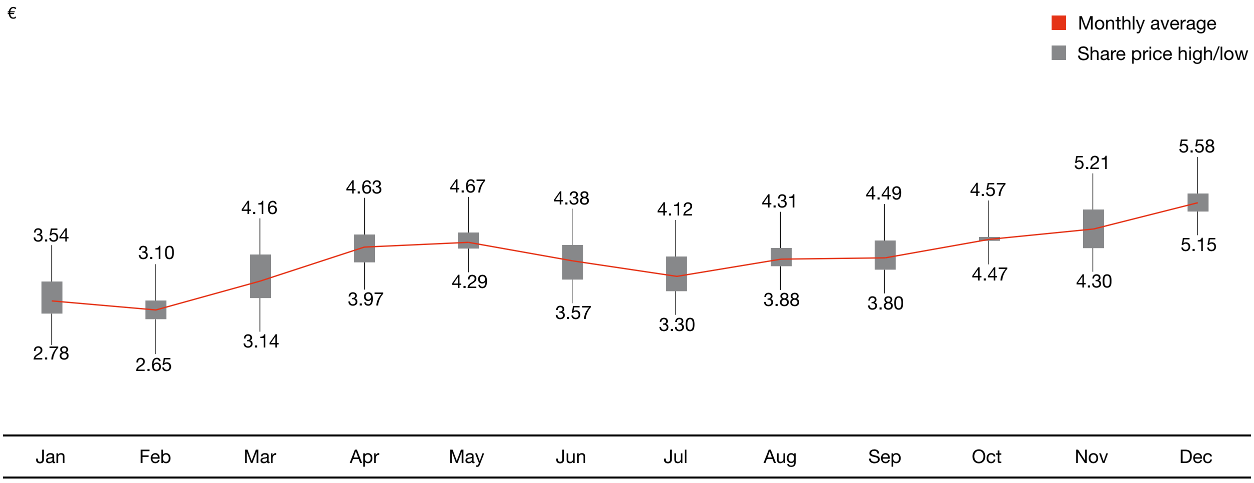
THREE-QUARTERS OF ALL DEUTZ SHARES IN FREE FLOAT

Swedish truck and construction equipment manufacturer AB Volvo is the largest individual shareholder in DEUTZ AG, with a stake of just over 25.0 per cent. The proportion of free float shares is almost 75.0 per cent, and they are held by a broadly diversified range of private and institutional shareholders both in Germany and abroad. Most of the private investors are in Germany, although fund management companies based in North America held the largest proportion among the institutional investors. At the end of 2016, Norges Bank held 4.1 per cent of our Company, while Old Mutual Plc held 3.1 per cent and Dimensional Holdings Inc. 3.0 per cent. These are considered non-controlling shareholdings.

Shareholder structure as at 31 December 2016



DEUTZ share price high and low for 2016



INTENSIVE INVESTOR-RELATIONS WORK

We provide all shareholders with prompt, transparent and comprehensive information about all significant events in our Company to ensure a high level of acceptance and long-term trust among our shareholders. Last year, we again worked closely with our shareholders, analysts and all other interested parties in the capital markets. The latest corporate information, such as presentations, financial reports, press releases and ad-hoc announcements, is always available on our website.

At our annual results press conference and analysts' meeting on 17 March 2016, we presented the DEUTZ annual financial statements and our future strategic direction. We also held conference calls when we published our quarterly results.

In 2016, we participated in a total of 16 roadshows and investor conferences in Germany, France, Denmark, the United Kingdom, Switzerland and the United States. We also met personally with analysts, institutional investors and private investors throughout the year.

EIGHT ANALYSTS MONITOR DEUTZ SHARES

As at the end of 2016, eight banks and securities houses were monitoring the performance of DEUTZ shares: Bankhaus Lampe, Commerzbank, DZ Bank, Equinet, HSBC Trinkaus & Burkhardt, M.M. Warburg, Quirin Bank and Solventis.

Further information can be found on our website at www.deutz.com under Investor Relations.

If you need more information, visit our website or give us a call:

INVESTOR RELATIONS

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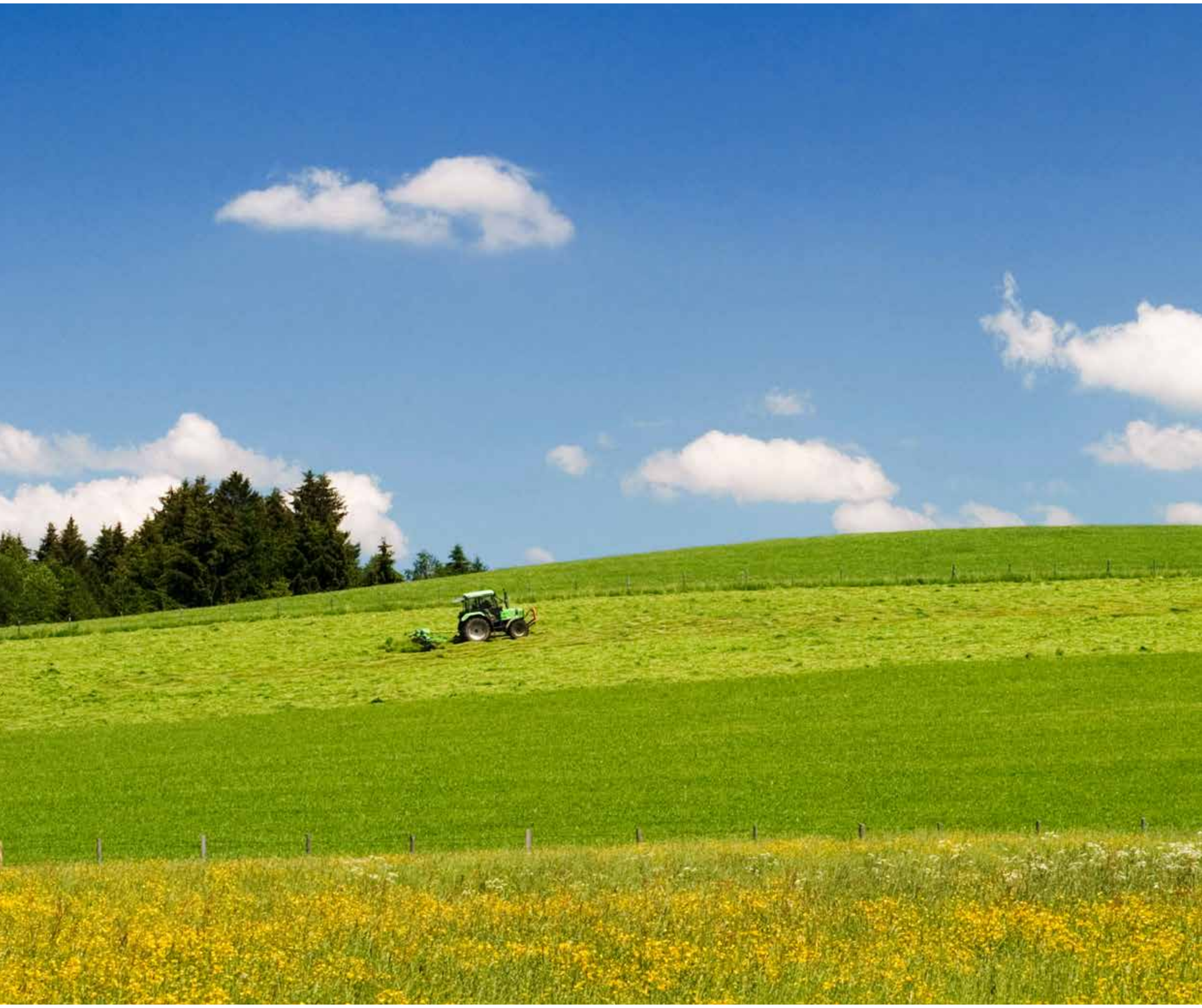
Website: www.deutz.com

A CLASSIC WITH EXCELLENT PROSPECTS

Engine manufacturers are always keeping an eye on the future because requirements, as regards emission levels, are constantly increasing. At the same time, emerging trends in technology need to be identified early on. DEUTZ has therefore decided to act by the principle 'Future Driven. Engine Technology for Tomorrow.' Whether it's new engines or innovative variants of our successful products, we always provide our customers with the solutions of tomorrow.



A CLEAN ENVIRONMENT

Practical steps to protect the environment are taken every day at DEUTZ; by employing the latest technology, DEUTZ engines significantly reduce pollutant emissions all around the world.

Running combustion engines produces emissions; soot particles, nitrogen oxides and other pollutants harm both people and the environment. Ever more stringent emissions standards can counter these effects. North America, Europe, Japan and now South Korea have, so far, enacted the strictest emissions standards and have largely harmonised them. Emissions legislation in many emerging markets is aligned to these standards and will catch up in the medium term.

In 2019 the EU will introduce its EU Stage V[1)] emissions standard for off-road engines and this will lower the particulate limit still further. This will be the first time that, in addition to the particulate mass, a limit will also have been placed on the number of particles, thus offering an answer to the fine dust problem. In order to achieve this, the technology for a sealed diesel particulate filter is required. Consequently, as of 2019, Europe will have the most stringent exhaust emissions standards in the world. Over the last two decades, the limits for nitrogen oxides and particulate mass (essentially soot particles) have been reduced by 95.7 per cent and 97.9 per cent[2)] respectively.

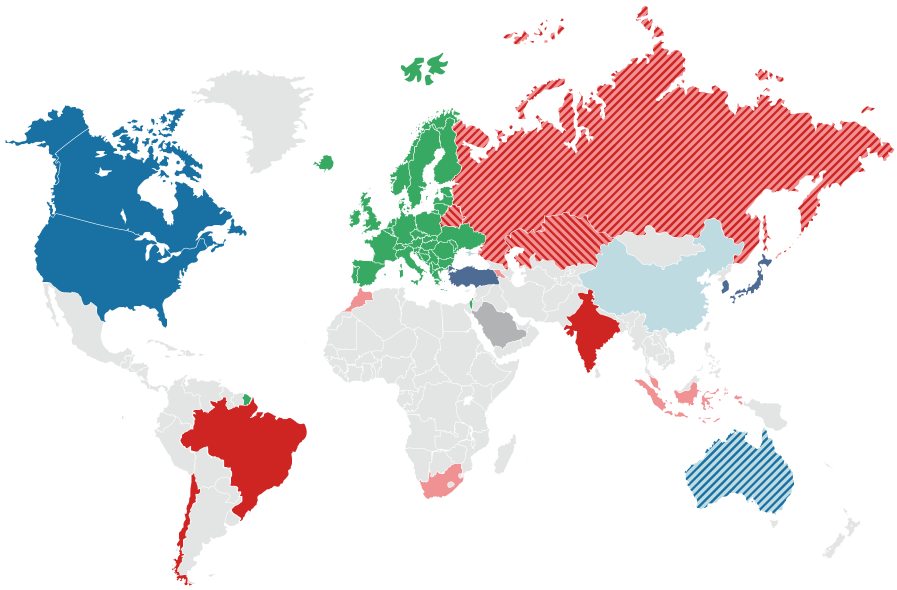
Our TCD engines with cubic capacities of up to 7.8 litres and fitted with diesel particulate filters to meet the current emissions

[1)] Regulation (EU) 2016/1628 of the European Parliament and of the Council dated 14 September 2016.

[2)] DEUTZ diesel engines reduce the particulate mass by more than 99 per cent.

Dr Ing Markus Schwaderlapp,
Head of Research & Development.

Emissions legislation for mobile machinery in 2020
DEUTZ AG's expectations for future global emissions legislation

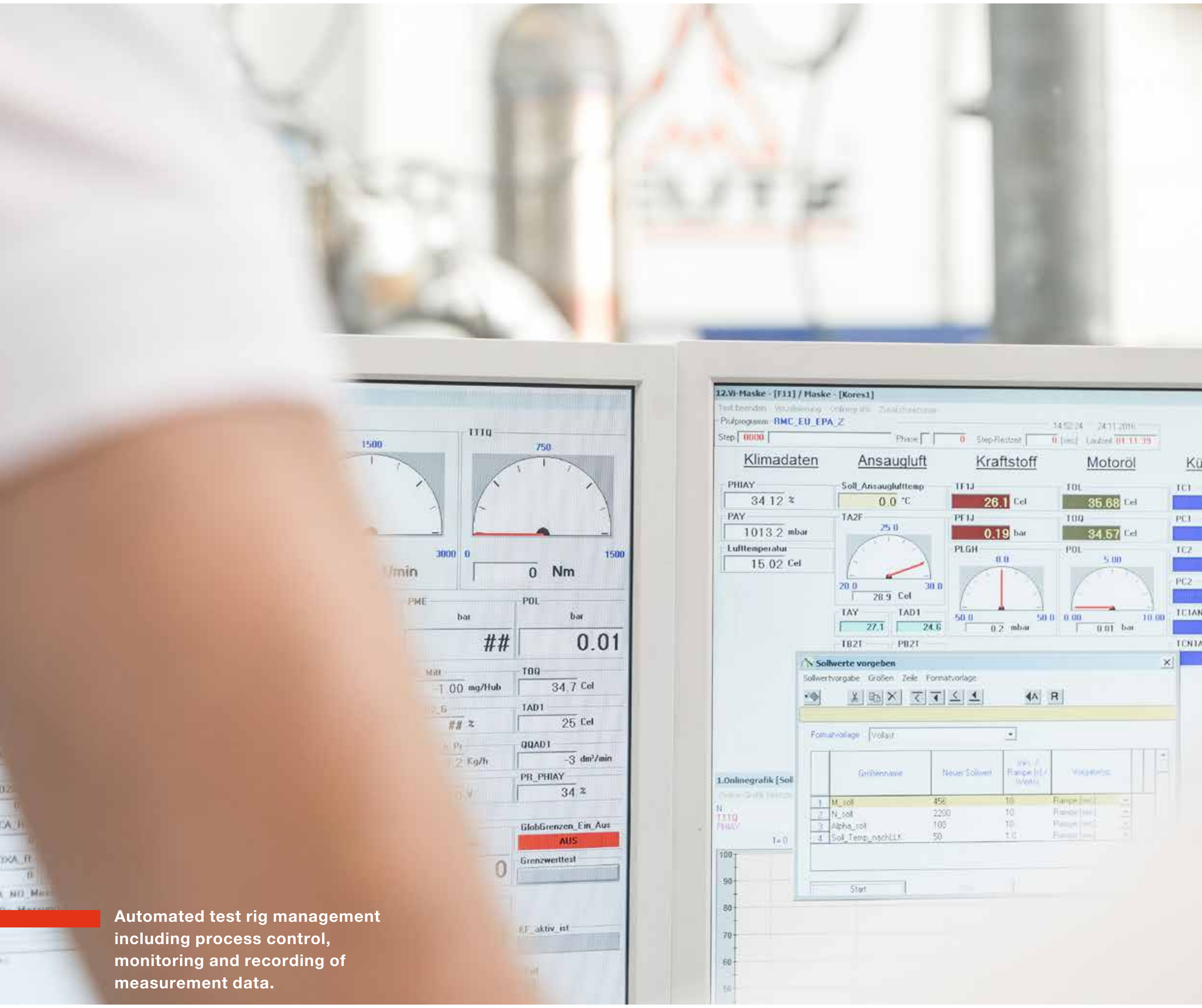


"DEUTZ diesel engines with particulate filters already meet the world's strictest emission levels, which will come into force in Europe from 2019. Exhaust aftertreatment is active over the entire characteristic map in DEUTZ engines, which means that our engines meet the prescribed emission levels even under real-life operating conditions."

Dr Ing Markus Schwaderlapp,
Head of Research & Development,
DEUTZ AG

standard (EU Stage IV) already satisfy the limits being introduced in 2019 for the next emissions standard (EU Stage V). Furthermore, our 'Stage V ready' label guarantees that the entire DEUTZ TCD engine range from 2.2 to 16 litres cubic capacity will meet EU Stage V without the need for modifications to customers' equipment.

DEUTZ engines offer high performance, a small installation space and, at the same time, reduced fuel consumption. In the last ten years fuel consumption by DEUTZ engines has fallen by considerably more than 10 per cent. This is to the benefit both of our customers and of the environment since less CO_2 is released. It also means that DEUTZ engines are making a positive contribution to environmental protection.



Automated test rig management including process control, monitoring and recording of measurement data.

THE FUTURE OF THE INTERNAL COMBUSTION ENGINE

The future of the combustion engine is today's hot topic. The diesel engine in particular is under close scrutiny. The question arises as to what contribution combustion engines might be able to make to industrial societies in future, given the current background of ecological challenges.

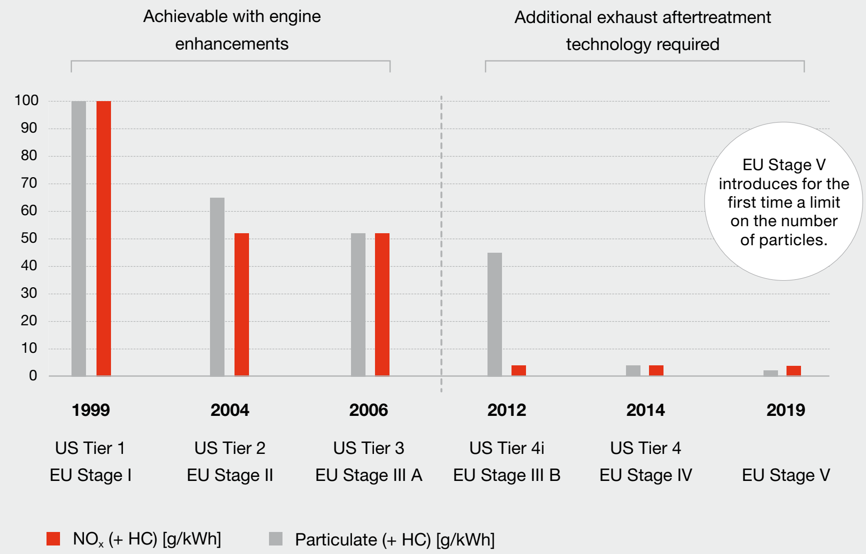
But environmentally compatible diesel engines are a possibility. The latest exhaust aftertreatment technology, consisting of a diesel oxidising catalytic converter (DOC), a diesel particulate filter (DPF) and selective catalytic reduction (SCR), eliminates virtually all nitrogen oxide emissions and soot particles. In the case of the DPF, this applies not just to the particulate mass but also to the number of particulates, thus providing an answer to the problem of fine dust. Within urban areas, the exhaust from diesel engines fitted with a DPF actually contains a lower particle concentration than the ambient air.

Truck engines and off-road diesel engines are being tested for compliance with emission limits across the entire mapping range. Exhaust aftertreatment is therefore active across the whole of the engine's power output range, including under real-life conditions. Emissions are thus being effectively reduced even under severe load conditions and at high engine speeds.[1)]

It can therefore be said that the diesel engine has shown itself under EU Stage V to be a very low-emission (almost zero-emission) form of propulsion.

[1)] In DEUTZ engines, exhaust aftertreatment is active over the entire engine map range as long as the exhaust temperature remains above the release temperature for AdBlue dosing.

Changes over time to emissions standards (%)



By 2019, NO_x emissions must be reduced by 95.7 per cent and particulate emissions by 97.9 per cent from 1999 levels

Determining particulate contamination in fuels.

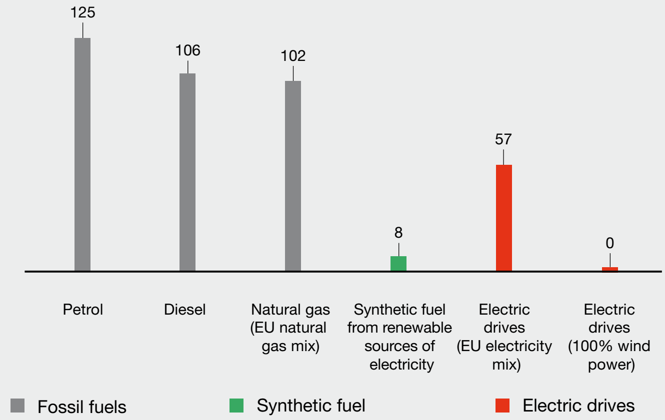
"The diesel engine's contribution to particulate pollution is made negligible by the introduction of the particulate filter. Measurements show a lower concentration of particles in the exhaust from diesel engines fitted with particulate filters than in the air in cities. Air quality in conurbations would improve if older engines were to be more quickly replaced by new engines using significantly better technology. In my view, the diesel will still be the most environmentally friendly drive system for a long time to come."

Professor Thomas Koch,
Head of the Institute of Reciprocating Engines
at the Karlsruhe Institute of Technology (KIT)

What exactly is the problem with CO_2? Burning fossil fuels releases carbon in the form of CO_2. It is not poisonous but an essential and integral element in photosynthesis; living creatures produce CO_2 and plants convert it into carbon and oxygen. The challenge lies in the fact that when fossil fuels are burned more CO_2 is released than nature is capable of processing within the same period of time. The increased proportion of CO_2 in the air results in the greenhouse effect, which leads to global warming. What are the responses to this challenge?

Energy efficiency: fuel consumption by today's diesel engines has noticeably improved compared with earlier generations; this particularly applies to DEUTZ engines. Lower consumption leads to an equivalent reduction in CO_2 emissions. Diesel engines are also some 15 to 20 per cent more energy-efficient than petrol engines. If, for example, all diesel engines were to be replaced by petrol engines, CO_2 emissions would increase by the same figure. On the other hand, the energy efficiency of natural

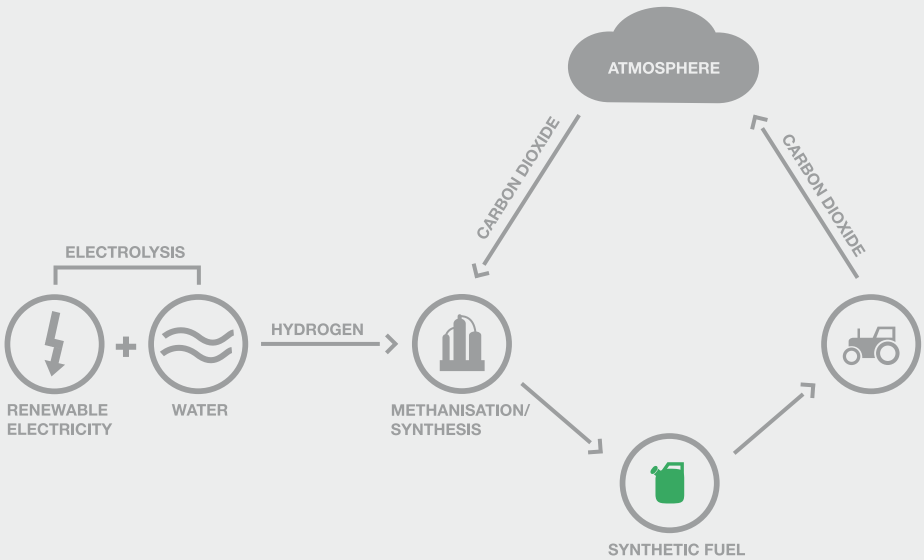
Greenhouse gas emissions in g CO_2 e/km



Greenhouse gas emissions measured in grams of CO_2 equivalents per km for cars; values can be applied to off-road; low CO_2 emissions for synthetic fuel assumes a residual quantity of process energy from the electricity mix.

Source: European Commission; EUR 26028 EN report, July 2013; JEC – Joint Research Centre-EUCAR-CONCAWE collaboration; dena.

CO_2 cycle – synthetic fuel for combustion engines



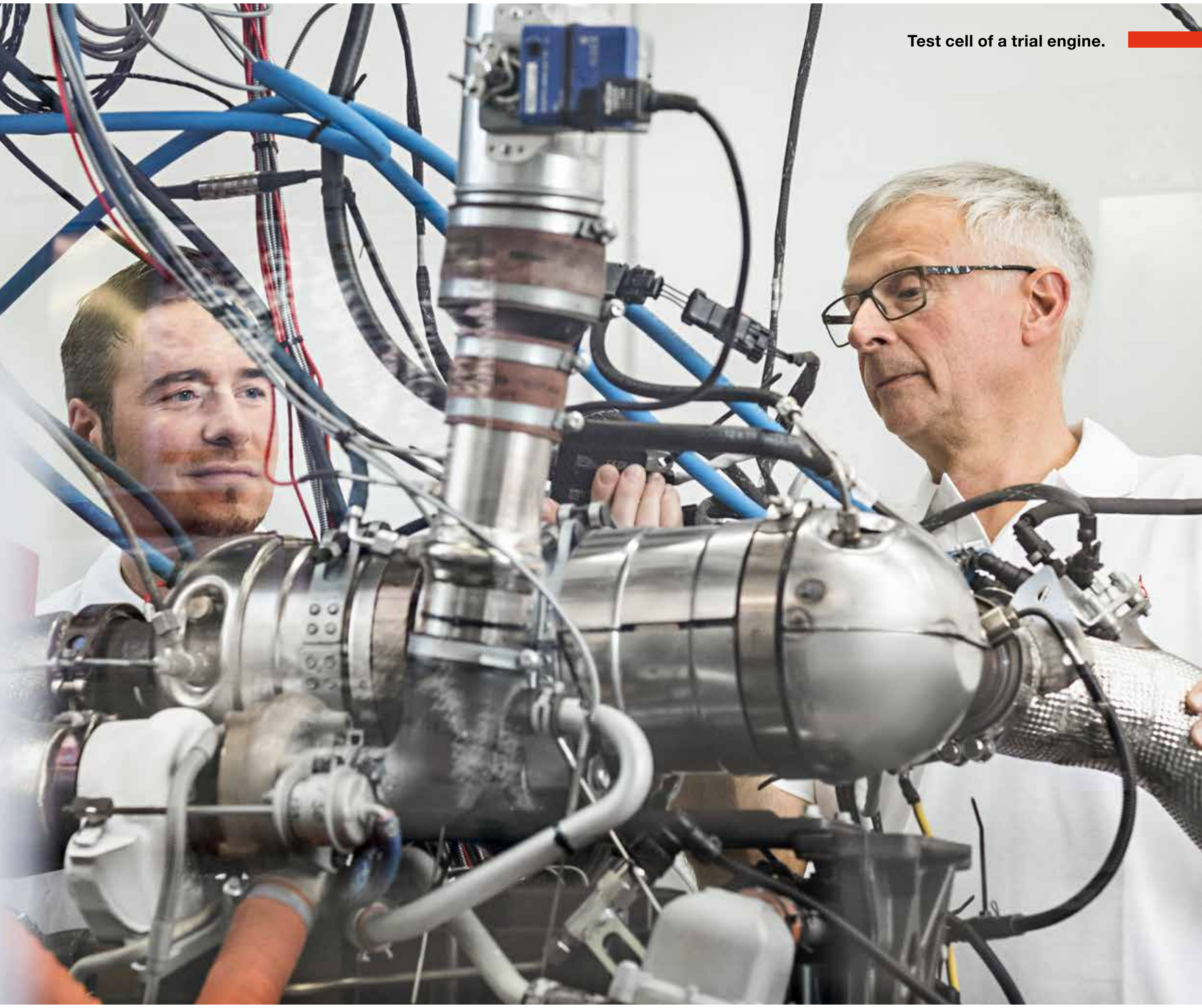
gas is better than that of diesel; and, as regards nitrogen oxide and particulate emissions, it should also be regarded as very clean with a much simpler method of exhaust aftertreatment.

Are electric motors the solution to our CO_2 problems? If the electricity is generated from renewable energy sources, the carbon footprint of electric motors is, of course, smaller than that of the fossil fuel powered combustion engines. This vision could well be blurred a little by the environmental impact of batteries. Standalone electric motors are also unsuitable for powering heavy-duty applications.

The diesel engine remains the instrument of choice when the requirement is for high power and high torque. As for 'off-road' applications, it is for the time being largely irreplaceable. To take one example of a heavy-duty application: a 600 litre tank of diesel that would allow a tractor[1)] to continue ploughing fields for ten hours would, with the currently available technology, equate to an electric motor battery with a volume of some 4,500 litres and weighing over 15 tonnes. This would obviously be inconceivable in practice. Nonetheless, hybrid technology is opening up realistic potential for saving fuel. Partial electrification will produce benefits for customers and the environment even in industrial applications once the cost of the electrical components has fallen. Hybrid drives, a combination of a diesel and an electric motor, are a good option especially where power requirements fluctuate. This is an area where we have already been able to demonstrate fuel savings – and corresponding CO_2 reductions – of up to 40 per cent.

Synthetic fuels can also offer an alternative route to a CO_2-free future. Essentially, these so-called 'e-fuels' are industrial imitations of photosynthesis; using clean green electricity, water is split into hydrogen and oxygen by the process of electrolysis. By adding CO_2 (methanisation), a carbon-based gas can be generated that

[1)] The example relates to a Fendt 939 tractor.



Test cell of a trial engine.

can then also be liquefied (gas-to-liquid). Combustion engines can be run CO_2-neutral by using synthetic fuels; as much CO_2 is recovered from the environment as is released into it by the combustion process.

Conclusion: even in the future, the diesel engine can justify being included in the mix of drive systems. On the emissions side, the diesel engine has done its EU Stage V homework; it even meets the strict legal pollution limits in inner-city areas. (Partial) electrification will also result in further fuel savings even in industrial applications. The combustion engine is potentially capable of being run CO_2-neutral on synthetic fuels, which would make it a sustainable source of power.

"Liquid hydrocarbons from renewable sources have a very high energy density. They are urgently needed for storing sufficient volumes of energy where the storage capacity is comparatively small, particularly for energy-intensive mobile applications such as commercial vehicles and off-road applications."

Professor Dr Ing Bert Buchholz,
Faculty of Mechanical Engineering and Marine Technology,
University of Rostock

The DEUTZ stand at the 2016 bauma trade fair in Munich.

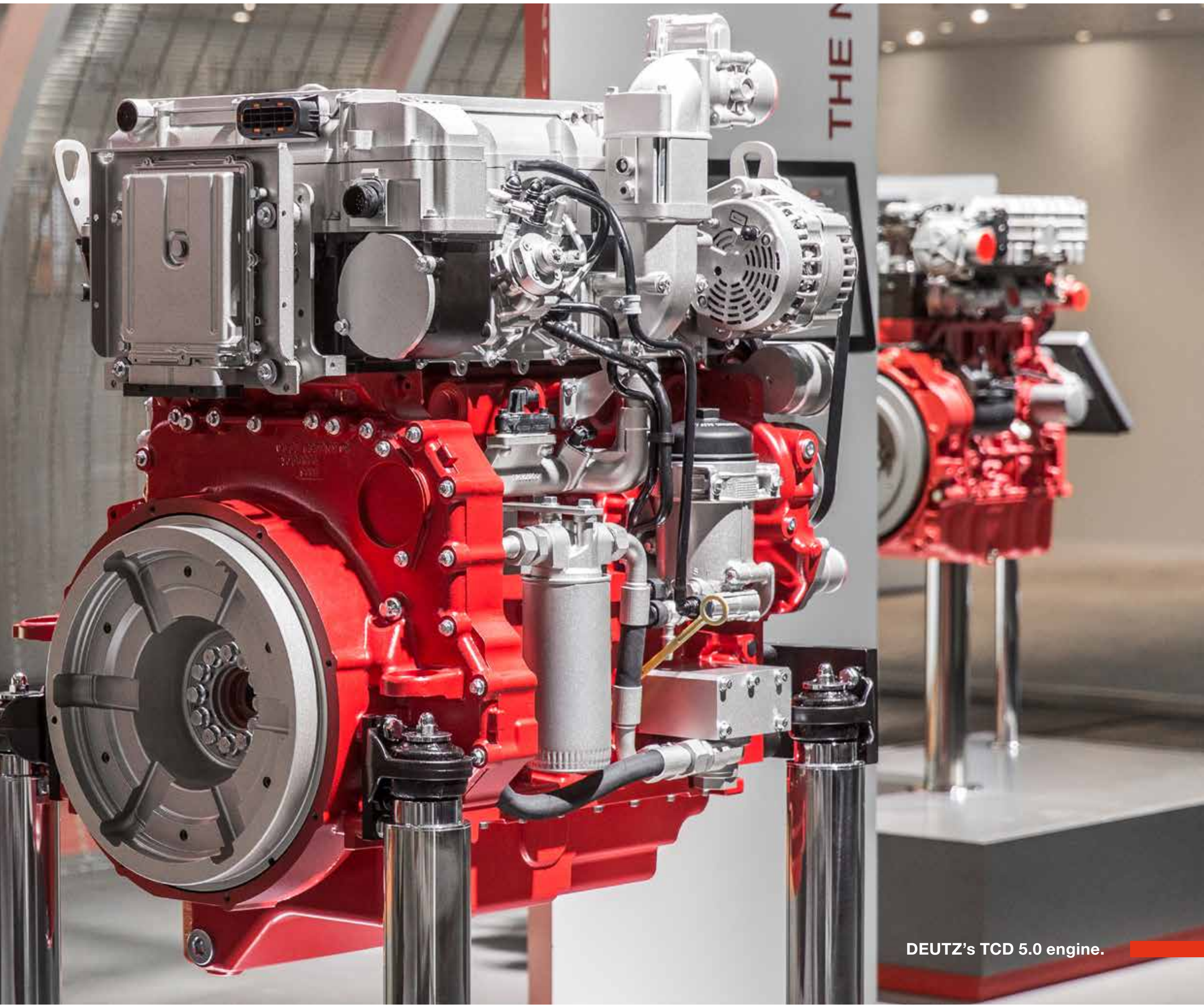
Visitors to bauma during the world premiere of the TCD 5.0.

STAGE V READY

It was in April 2016 at bauma, the world's biggest construction equipment trade fair, that DEUTZ unveiled its latest engines. In addition to the already well-established 'Stage V ready' product range, we presented in particular the new TCD 2.2 diesel and gas engines as well as the new gas variant of our tried-and-trusted TCD 2.9.

The new TCD 2.2 – a 2.2 litre cubic capacity engine, as the name suggests – is a three-cylinder variant of the successful four-cylinder TCD 2.9 engine; it generates up to 55 kW. Both engines are available as diesel or liquefied petroleum gas (also known as LPG or fuel gas) versions; this represents a first within the DEUTZ product range, which otherwise runs on diesel. The G 2.2 and 2.9 gas variants generate up to 42 and 55 kW respectively. Their size and design is the same as their self-igniting counterparts. This results in a high proportion of common components, with corresponding advantages for customers as regards servicing and obtaining spares. The gas variants are of particular interest for the material handling and compact construction equipment sectors. Not needing sophisticated exhaust aftertreatment, they are also particularly well suited for use in enclosed buildings, as liquid gas produces far fewer emissions than diesel. These engines need only a three-way catalytic converter to meet EU Stage V, and thus offer an alternative and provide our customers with additional flexibility. The TCD 2.2 and the gas variants will go into series production in 2019 in good time for the EU Stage V emissions standard, which will apply by then.

Gas engines are nothing new for DEUTZ; the very first DEUTZ engine, the 1867 atmospheric gas-powered engine, was of this design. And gas was also the fuel for the first four-stroke



DEUTZ's TCD 5.0 engine.

engine – the Ottomotor – developed in 1876 by the founder of DEUTZ, Nicolaus August Otto.

The TCD 5.0, which we also presented at bauma 2016, represents a completely new development. This 5 litre cubic capacity four-cylinder engine is being developed to meet the imminent EU Stage V emissions standard and will enhance our product portfolio in the 100 to 150 kW power range. A modular design has been used to treat emissions from this engine; this permits so-called 'emission downgrades' to the same basic engine by doing away with certain exhaust aftertreatment components. This is an important aspect for our installation customers, who export equipment fitted with our engines throughout the world. Due to its compact design, the new 5 litre engine can even be installed as a 'drop-in solution' in the installation space of a DEUTZ TCD 4.1. The TCD 5.0, which will go into series production from 2019, can be used both for industrial and agricultural applications.

As part of a collaborative partnership with Liebherr, DEUTZ is also planning to expand its product range in the upper power range by four new diesel engines. DEUTZ will be granted the global rights to market and service diesel engines in various applications from 200 to 700 kW. The engines produced by our partner comply with the latest emissions standards (EU Stage V); from 2019 they will be available as series production models for DEUTZ to supply and distribute under its own brand name.

We presented one of these upper power range engines - the new TCD 9.0 four-cylinder diesel engine - in November 2016 at the bauma trade fair in China. The TCD 9.0 will also be manufactured under licence by our Chinese joint venture company, the DEUTZ (Dalian) Engine Co. Ltd., in order to supply local customers in the most efficient manner.

"The product portfolio incorporating the innovations that DEUTZ showcased at bauma is the most complete and comprehensive in the power output range relevant to us of 40 to 170 kW. The new products for the III B, IV and V emissions standards have been launched at exactly the right time. The TCD 2.9 and 3.6 engines fill us with confidence."

Alexandre Marchetta,
Executive Vice President,
Groupe MECALAC S.A.

"This DEUTZ engine is a robust industrial engine whose design makes it possible for us to offer our customers compact vehicles. The engine's gear drive makes it suitable for use in extreme conditions, which enables us to produce forklift trucks for the widest possible range of applications. The fact that the engine is available in a large number of variants also means we can accommodate a wide range of specific customer requirements such as air conditioning or a larger alternator."

Ottmar Neuf,
Director for Engines and Drivetrain,
KION GROUP AG

"Naturally, we looked at a number of engine manufacturers as we were developing our TH range," said Malcolm Early, Vice President of Marketing for Skyjack, Inc. "In the end, DEUTZ won out as the most reliable, notable company providing a high-torque, 74 hp engine that met Tier-4-Final requirements. Their engines have been a key component in the successful launch of these new telehandlers."

Malcolm Early,
Vice President of Marketing,
Skyjack, Inc.

"We started the cooperation with DEUTZ with Tier 4 final products and valued the material handling purpose exhaust aftertreatment system, robust product quality and professional application engineering support."

T. W. Eom,
General Manager, R&D,
Clark Material Handling Asia

Employee removes a finished camshaft.

Quality control using a micrometer.

OPTIMISATION OF SITES

The measures aimed at comprehensively optimising our network of sites in Germany in order to increase efficiency are now either complete or well advanced. These measures include vacating the Cologne-Deutz site and building a new centre for manufacturing camshafts and crankshafts at our biggest site in Cologne-Porz. We are also closing our exchange engine plant in Übersee on Lake Chiemsee, which is being integrated into the Ulm plant in two stages.

THE NEW SHAFT CENTRE

Around €26 million has been invested in the new DEUTZ shaft centre in Cologne-Porz, which occupies 13,500 square metres – equivalent to almost two football pitches. The cornerstone ceremony was held in July 2015, and crankshaft and camshaft production was moved from the Cologne-Deutz site to the new building over a period of several months up to the beginning of 2017. Production did not stop while the total of 130 items of machinery and equipment were being relocated. This involved a huge amount of planning of the individual steps and overall it worked very well. At all times, the highest priority was given to making sure that customers were supplied with the products and parts that they needed.

The 'stresstech' machines, which are used to inspect the quality of the camshafts, represent a special highlight in the new shaft centre. They allow the inner structure of the shaft to be

Camshafts in the process of being finished.

inspected for weak points but without damaging any parts. The machines play a key role in the quality assurance strategy at the new shaft centre.

Production of crankshafts and camshafts at the Cologne-Porz site is now in full swing, signifying that this major project has now been successfully completed. This year, the efficiency gains of around €10 million a year envisaged by the consolidation programme will begin to be realised, primarily through the new shaft centre, the relocation of Xchange engine activities from Übersee to Ulm, and the absence of costs from the Cologne-Deutz site.

A development plan has been submitted for the vacated site in Cologne-Deutz, which covers around 16 hectares. This former industrial area is to be converted into a city district that will contain housing, commercial areas and green spaces. DEUTZ intends to sell the site.

SMALL PRODUCTION RUNS IN ULM

As part of the relocation of activities from Übersee on Lake Chiemsee to Ulm, the Ulm plant is being expanded to become the plant for small production runs, focusing on DEUTZ Customised Solutions products, project business, exchange engines and models that are soon to be discontinued. Assembly and order management were transferred in 2015. It is particularly encouraging that, despite the move, there was an increase in revenue from the reconditioned exchange engine business. Throughput times, which are critical in the Xchange process, were shortened and synergies were leveraged. These synergies largely derive from the use of the Ulm plant's infrastructure and from shared overheads. All other functions will move this year, completing the last stage of the comprehensive optimisation of our network of sites.

STRATEGY

Global megatrends such as demographic change and increasing urbanisation are causing global demand for engines to rise continually. DEUTZ benefits from this as an independent engine manufacturer in the premium segment and a driver of innovative, market-led technologies. We want to provide our customers not just with engines but with complete system solutions and a comprehensive range of services. Our long-standing strategy therefore includes the expansion of our customer and product base along with globalisation and internationalisation.

Our strategy for growth, which we have pursued consistently for many years, is based on three pillars:

- The first is the **expansion of our customer base** while achieving profitable growth. Our aim is to increase business in all regions with new and existing customers. Over the past few years, we have been able to achieve that and have won new customers in every region. In the year under review, we continued to launch many new products for our customers – this is demonstrated by the success of our current generation of engines. At the end of 2015, we entered into an agreement with the KION Group, one of the world's two leading suppliers of forklift trucks, to expand our long-standing cooperation. Last year, we were able to establish a partnership with the Japanese construction machinery manufacturer Takeuchi and broaden our collaboration with the Chinese construction equipment manufacturer Sany.

  In terms of application segments, our main focus remains off-road applications, particularly construction equipment, material handling equipment and agricultural machinery. We also serve the market for stationary equipment and niche applications. Our automotive business is increasingly shifting to Asia, where we occupy a very strong position in the market by virtue of our DEUTZ Dalian joint venture. We are working with our joint venture to prepare for the introduction of the China IV emissions standard, which will apply in the Chinese truck market from 2019.

  In addition, our high-margin service business has become another important pillar of our business. Going forward, we want to expand this area further with new engine-related products and services. In response to the growing complexity of engines, we are taking an active approach to dealer management and providing ongoing product training for our dealer network. We also intend to invest in our own service support centres in selected locations. In the year under review, for example, we opened our first DEUTZ Power Center in the USA, which offers our customers there application-specific development services as well as maintenance and repairs.

  Together with our dealers, we will use the internet as a sales channel to ensure that genuine DEUTZ parts are even more readily available.

Strategic programme up to 2020

Strategic programme	
Expanding the customer base	→ Growing the Asia business → Reinforcing sales activities → Growing the service business
Expanding the product base	→ Expanding and optimising the engine programme → Expanding the product portfolio by offering system solutions → Expanding and optimising the service programme
Globalisation/ internationalisation	→ Establishing an international production network → Establishing an international development network → Establishing an international procurement network → Establishing an international logistics network
Corporate principles, leadership and cooperation principles	

→ The second pillar is the **expansion of our product base** using products at the leading edge of technology. The current TCD engines in the 2.9 to 16.0 litre capacity range with a power output of between 25 and 520 kW for the EU Stage IV/ US Tier 4[1] emissions standards were introduced into the market by 2014. These engines feature very compact installed dimensions, intelligent exhaust aftertreatment systems and lower lifecycle costs than their predecessors. Furthermore, all the engines already meet the more stringent EU limits[2] that come into force in 2019. We are actively advertising this with our 'Stage V ready' campaign. The DEUTZ powerpack, a ready-to-install solution that includes the engine, cooling system and SCR tank, was showcased at bauma. This solution significantly reduces the application outlay, in particular for smaller OEMs. In addition, we are expanding our product range for series delivery from 2019, mainly at the lower and upper end of the power output range. This will include adding gas variants and replacing some products. More information on this, including details about the new products that we presented to the public last year, can be found in the 'Stage V ready' section on pages 16 and 17.

We will continue to work on developing solutions to further improve the energy efficiency of our products. In addition, we intend to continually expand our application expertise, an area in which we already have a leading market position.

Our profitable service business makes us less exposed to fluctuations in the economic cycle. This is based on the 1.6 million or so DEUTZ engines that are currently in operation around the world. The market share of these engines is being increased through new products; for example, we are expanding our programme of Xchange engines and components for economically viable repairs. The increased complexity of the engines for the new emissions standards calls for a high level of specialist knowledge on the part of our service partners and the appropriate diagnostic tools. For this reason, DEUTZ is investing in the provision of additional training courses and in the SERDIA 'electronic wrench', without which diagnosis would not be possible. Our reliable global service network ensures the availability of the machinery and equipment powered by DEUTZ engines – for the engines' entire lifetime. Customer satisfaction is also a key driver of new engine sales.

→ The third pillar is the **globalisation and internationalisation** of the DEUTZ Group, because the regional focus of our markets is shifting and the trend is increasingly towards basing assembly nearer to the customer. Against this background, we want to create structures in the three major economic areas of Europe, America and Asia that, in addition to their sales, marketing and service activities, will also encompass local assembly, purchasing, logistics and application development activities. All these activities will need to be closely interlinked and centrally coordinated.

Back in 2014, we decided to carry out a comprehensive optimisation of our network of sites in Germany in order to increase efficiency. In Cologne, we are consolidating two sites and, as part of the process, we have built a shaft centre for the production of camshafts and crankshafts at our largest site in Cologne-Porz. The relocation of production was completed in February 2017. At the same time, the site in Cologne-Deutz was vacated. We are currently applying for planning permission to create a new city district near the Rhine. The Cologne-Deutz site is to be sold within the next few years. Our exchange engine plant in Übersee on Lake Chiemsee is closing and being integrated into the plant in Ulm. We successfully moved the assembly line in 2015. All other functions will move in 2017.

ZERO-ERROR STRATEGY

We implemented our zero-error strategy in 2015. The purpose of this quality assurance programme is to detect errors when they first begin to materialise, i.e. before they actually occur. And if errors do occur, we must consistently learn from them so that we do not make the same mistakes again. The overarching aim, therefore, is to establish a culture of prevention and avoidance in relation to errors.

We strive to make the products that we supply to our customers perfect and to meet or even exceed our customers' expectations. The challenge here is that we produce a large number of variants in order to provide customers with bespoke solutions and the complexity of our products has risen significantly in recent years as a result of emissions legislation.

GLOBAL MEGATRENDS DRIVING ENGINE DEMAND

We build engines for applications that are heavily influenced by the megatrends of demographic change, increasing urbanisation and ongoing globalisation. Apart from the occasional downturn in the economic cycle, global demand is therefore continually rising. This also includes demand for agricultural machinery, infrastructure investment and transport.

However, there are only limited natural resources to cope with this structural growth in demand. In light of this, strict environmental and climate change regulations are being imposed in practically every industrialised country and emerging market. Consequently, emissions legislation has been the major technology driver in the diesel engine market in recent years. We are, of course, delighted to take up the emissions legislation challenge because, as a leading technology company, we regard this legislation as an opportunity. Emissions legislation in the emerging economies is generally at least one step behind.

To this extent, the structural growth drivers at DEUTZ are the engine systems that meet the new emissions standard, which are of considerably higher value and more complex than their respective predecessors.

[1] The EU Stage IV/US Tier 4 emissions standards are mentioned at various points in the annual report. This refers to the 97/68 Stage IV exhaust emissions standards in the European Union and the EPA Tier 4 rules for diesel engines in the USA.

[2] Regulation (EU) 2016/1628 of the European Parliament and of the Council dated 14 September 2016.

2016 COMBINED MANAGEMENT REPORT FOR DEUTZ AG AND THE DEUTZ GROUP

OVERVIEW OF 2016

Revenue and EBIT higher than in previous year Despite the market environment remaining difficult and companies still being reluctant to invest, we were able to expand our volume of business in the reporting year. Revenue rose by a moderate 1.0 per cent to €1,260.2 million. Unit sales fell by 3.8 per cent to 132,539 engines. There was a big increase in operating profit (EBIT), which climbed by €18.5 million to €23.4 million. This underlines the effectiveness of our measures aimed at increasing profitability.

Reporting changes We have divided our former Mobile Machinery application segment into two parts. From the 2016 financial year, information is provided for the Construction Equipment and Material Handling application segments. We are thus increasing transparency and reflecting the significance of various customer industries.

Steps to increase efficiency on schedule The measures aimed at comprehensively optimising our network of sites in Germany are now either complete or well advanced. The transfer of crankshaft and camshaft production from Cologne-Deutz to the new shaft centre in Cologne-Porz was finished in February 2017. Assembly and order management have already been relocated to Ulm from Übersee on Lake Chiemsee, and all other functions will move during the course of 2017.

Positive market response to products Our TCD engines equipped with a diesel particulate filter in the 2.9 to 7.8 litre cubic capacity range already meet EU Stage V, the next European emissions standard, which comes into effect in 2019. This benefits our customers, for whom we again launched many new products last year. The engines that we unveiled in 2016 to expand our portfolio at the upper and lower end of the power output range, including a new TCD 5.0 engine, gas variants and a DEUTZ powerpack, were well received.

New Chairman of the Board of Management appointed Dr Frank Hiller was appointed as a member of the Board of Management of DEUTZ AG and its Chairman with effect from 1 January 2017. He succeeds Dr Helmut Leube, who retired on 31 December 2016.

FUNDAMENTAL FEATURES OF THE GROUP

BUSINESS MODEL AND SEGMENTS

DEUTZ is one of the world’s leading engine manufacturers and was founded in 1864 by Nicolaus August Otto, developer of the four-stroke engine, and Eugen Langen. Since then, DEUTZ has been supplying reliable drive systems for mobile and standalone static applications. We are an independent producer of diesel and gas engines with a power output of 25 kW up to 520 kW for on-road and off-road use. The DEUTZ Group's customers include manufacturers of construction equipment, forklift trucks, tractors and other equipment as well as the buyers of such machines. Operating activities are divided into two segments: DEUTZ Compact Engines and DEUTZ Customised Solutions. The DEUTZ Compact Engines segment comprises liquid-cooled engines with capacities of up to 8 litres. The DEUTZ Customised Solutions segment specialises in air-cooled engines and large liquid-cooled engines with capacities of more than 8 litres. Operating under the name DEUTZ Xchange, the DEUTZ Customised Solutions segment also supplies reconditioned engines and parts.

DEUTZ also offers its customers advice and support on installing the engines and operating the machinery. Our services are closely aligned with each of our customers’ individual needs. We actively assist customers with the repair, maintenance and servicing of their vehicles and machines fitted with DEUTZ engines. The global DEUTZ service network, which comprises subsidiaries, service centres and authorised agents, guarantees a reliable and rapid supply of spare parts.

MAIN SITES AND SCOPE OF CONSOLIDATION

DEUTZ maintains a comprehensive presence in the global market: with 13 sales companies, seven sales offices and over 800 sales and service partners in more than 130 countries, we can offer our customers service and support virtually anywhere with very short response times. DEUTZ AG is the executive and operating parent company in the DEUTZ Group; it is headquartered in Cologne, Germany, and has various domestic and foreign subsidiaries. The subsidiaries include several companies that perform sales and service functions plus a production facility in Spain. The equity-accounted joint venture DEUTZ Dalian in China produces diesel engines that are primarily destined for the Chinese market.

In addition to DEUTZ AG, seven German companies (31 December 2015: six) and 12 foreign companies (31 December 2015: twelve) were included in the consolidated financial statements as at 31 December 2016. A complete list of DEUTZ AG shareholdings as at 31 December 2016 is given in the annex to the notes to the consolidated financial statements on page 119.

DEUTZ AG	
DEUTZ Compact Engines	**DEUTZ Customised Solutions**
• Liquid-cooled engines of up to 8 litres cubic capacity	• Air-cooled engines • Liquid-cooled engines of more than 8 litres cubic capacity

MARKET AND COMPETITIVE ENVIRONMENT

DEUTZ manufactures diesel engines for professional applications used in countries with stringent emissions standards, in particular EU Stage III A, III B and IV (as well as the equivalents in the US and other countries). These technically sophisticated applications include construction equipment, agricultural machinery, lifting and material handling equipment, pumps, gensets, medium-duty trucks and buses. The market for DEUTZ engines is therefore separate from the market segments for diesel engines used in passenger cars and small commercial vehicles up to a permissible gross weight of 3.5 tonnes. Engines that rely on outdated technology and that are intended for use in applications in countries or application segments with only very low requirements in terms of product quality, emissions and fuel consumption also do not feature in our target market. The market for technically sophisticated diesel engines can be divided into the captive segment and the non-captive segment. The captive segment comprises equipment manufacturers who produce their own engines; some of these manufacturers are also active as engine suppliers in the market. The non-captive segment is made up of equipment manufacturers who for the most part do not produce their own engines and who, therefore, buy in engines from suppliers. It is in this non-captive market that DEUTZ sells high-value engines with outputs between 25 kW and 520 kW around the globe.

We have attained a good position as one of the biggest suppliers in the non-captive market. We face competition from rival engine suppliers in western Europe, North America and Asia, but none of these competitors can offer an identical product range to DEUTZ in terms of the power outputs and application segments that they cover.

Main competitors

Application segments	Applications	Main competitors (in alphabetical order)
Construction Equipment	Excavators Wheel loaders Pavers Mining equipment	Cummins, USA Isuzu, Japan Weichai, China Yanmar, Japan
Material Handling	Forklift trucks Telehandlers Lifting platforms Ground support equipment	Cummins, USA VW, Germany Yanmar, Japan Zhejang Xinchai, China
Agricultural Machinery	Tractors Harvesters	Deere, USA Kubota, Japan Perkins, UK Yanmar, Japan
Stationary Equipment	Gensets Pumps Compressors	Cummins, USA Kubota, Japan Perkins, UK Yanmar, Japan
Automotive	Rolling stock Special vehicles Trucks Buses	Cummins, USA Fiat Powertrain, Italy MAN, Germany Mercedes, Germany

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 (KPIs). In order to increase profitability and achieve sustained growth, we manage the Group on the basis of the following financial performance indicators:

		2016	2015
Revenue growth	%	1.0	–18.5
EBIT margin (before exceptional items)	%	1.9	0.4
Working capital ratio [1] (average)	%	17.9	17.6
ROCE (before exceptional items) [1]	%	3.1	0.6
R&D ratio	%	4.0	3.3
Free cash flow [1]	€ million	4.7	35.0

[1] These KPIs are alternative performance measures that are not defined in the International Financial Reporting Standards (IFRS). A reconciliation of these KPIs to the amounts recognised in the financial statements is provided below.

Revenue growth Steadily increasing revenue is the basis for the profitable growth of the Company. The level and growth of revenue is determined on a monthly basis, broken down by product group, application segment and region. This data is provided to senior management promptly so that it can react quickly to changes as they materialise.

EBIT margin (before exceptional items) The main key performance indicator that we use to manage the Company's operating performance is the EBIT margin before exceptional items. This is based on the Group's earnings before interest and tax (EBIT). The EBIT figure is then adjusted for exceptional items and calculated as a percentage of revenue. We define exceptional items as significant income generated or expenses incurred outside the scope of the Company's ordinary business activities that are unlikely to recur. There were no exceptional items in 2016 or 2015. Adjusting for exceptional items enables a more accurate comparison of the Company's operating performance over time. The EBIT margin before exceptional items is, like revenue growth, calculated monthly and presented to senior management as part of internal reporting.

Working capital ratio (average) We manage the Company's tied-up capital using the average working capital ratio. This is the ratio of average working capital over the past four quarters to revenue for the preceding twelve months. Working capital comprises inventories plus trade receivables less trade payables. Along with revenue growth and the EBIT margin, this key figure is calculated monthly and presented to senior management.

ROCE (before exceptional items) The return on the capital employed in the Group is measured and managed on an annual basis using the key figure ROCE (before exceptional items). This is calculated as follows:

ROCE

€ million

	2016	2015
Total assets	1,059.7	1,088.1
Cash and cash equivalents	–91.8	–112.5
Trade payables	–162.3	–169.5
Other current and non-current liabilities	–57.3	–49.0
Capital employed	**748.3**	**757.1**
Capital employed (average for the year)	**752.7**	**792.7**
EBIT (before exceptional items)	**23.4**	**4.9**
ROCE (before exceptional items)	**3.1%**	**0.6%**

R&D ratio As a technology-focused company, we consider the R&D ratio to be one of the most significant performance indicators in our internal management system. It is the ratio of research and development expenditure (after reimbursements) to revenue in the period in question. The R&D ratio is calculated at least once a quarter and is reported to senior management.

Free cash flow The DEUTZ Group uses free cash flow as its main performance indicator for managing liquidity. It comprises net cash provided by, and used for, the operating activities and investing activities of the Group during the period in question less interest payments in connection with financing activities. We can thus show what cash flow generated in the relevant year is available to the Company, e.g. for repaying liabilities or paying a possible divided to shareholders. Free cash flow is reported to senior management at least once a quarter.

Based on these performance indicators, DEUTZ has set up an early warning system in order to be proactive and respond promptly. At the same time, we operate a sound system of causal analysis to ensure that we minimise risks and make the most of opportunities. Three times a year we produce an annual forecast for all key performance indicators. In this way, we ensure optimum transparency with regard to our business performance, benefiting both the Group and all our stakeholders.

In addition to the financial performance indicators which form part of the management system described above, we also employ a range of other parameters to measure our economic performance. These include, but are not limited to, new orders received, revenue and unit sales on the income side, the working capital as at the reporting date with regard to tied-up capital, and earnings before interest, taxes, depreciation and amortisation (EBITDA). Moreover, the Group net income and the DEUTZ AG statutory income in accordance with the German Commercial Code are significant factors for us as regards dividend payments.

CONTINUOUS OPTIMISATION OF THE CONTROL SYSTEM

Regardless of fluctuations in the economic cycle, one of the DEUTZ Group's overriding aims is the continuous optimisation of its management systems. This essentially involves the annual planning of all specified performance indicators. This planning is based on both internal estimates of future business and benchmark figures from competitors. Each organisational unit prepares detailed plans for its area of responsibility, which are then coordinated with the management strategy. Both the specific unit sales and revenue targets and the customer and product-related targets (EBIT margins) are aligned with the operating units each year, taking groupwide objectives into consideration. This means that they are available at the relevant hierarchical level for use in operational management.

We specify working capital targets for the individual companies in the DEUTZ Group in order to optimise the capital tied up in the business. These overall figures are then broken down and specific targets for inventories, trade receivables and trade payables are allocated to the relevant individual employees.

We are pursuing long-term growth objectives. In order to secure the financial basis for this, we have made the management of capital expenditure a central element in the management of tied-up capital: clearly specified budget figures set out the framework for the level of capital expenditure and development expenditure; actual requirements are derived from the medium-term planning of unit sales and the resulting requirements in terms of capacity and technologies. Annual budget meetings are held to coordinate individual projects, development expenditure and planned capital expenditure with the groupwide financial planning process and to record the outcomes. An additional detailed review is carried out before projects are actually approved. To this end, we use standard investment appraisal methods (internal rate of return, amortisation period, net present value, the impact on the income statement and cost comparisons). A project with an appropriate budget is only approved if there is a clear positive outcome from this investment appraisal.

BUSINESS PERFORMANCE IN THE DEUTZ GROUP

ECONOMIC ENVIRONMENT

Global growth rate at prior-year level Worldwide economic growth remained at a moderate level last year. The International Monetary Fund (IMF)[1] is expecting global economic growth of 3.1 per cent for 2016 as a whole, compared with 3.2 per cent in 2015.

The economy of the eurozone grew by 1.7 per cent in 2016, which was slightly weaker than the increase of 2.0 per cent in 2015. Germany's economy stepped up the pace of growth slightly, expanding by 1.7 per cent year on year (2015: growth of 1.5 per cent). The Spanish economy again performed very encouragingly with a growth rate of 3.2 per cent, which was the same as in 2015. France was also on a par with the previous year with growth of 1.3 per cent. Italy's growth increased slightly from 0.7 per cent in 2015 to 0.9 per cent in 2016.

The US economy expanded by 1.6 per cent (2015: 2.6 per cent). This slowdown in the pace of growth was due to declining levels of capital investment. The economy in China held steady over the course of the year thanks to more expansionary economic policy. Gross domestic product (GDP) rose by 6.7 per cent over 2016 as a whole, compared with 6.9 per cent in 2015. The Russian economy remains in recession; South America's performance was weaker than originally anticipated.

Overall, the economic environment was characterised by a variety of risks and uncertainties in 2016, such as the vote for Brexit in the United Kingdom, and these will continue to have an impact this year. China is in a state of transition with a lower growth rate than in previous years and a shift away from the strong export model. The economic effects of the outcome of the US election cannot yet be gauged.

Mixed picture in DEUTZ's customer industries The situation varied significantly across DEUTZ's main customer markets in 2016. According to DEUTZ's own estimates, demand for construction equipment rose by around 5 per cent in both Europe and China. However, unit sales of construction equipment fell by approximately 5 per cent in North America. The European agricultural machinery sector contracted again, with demand declining by 5 per cent in 2016.[2] Unit sales of light and medium-duty trucks in China improved by around 7 per cent according to DEUTZ's own estimates.

IMPACT OF ECONOMIC CONDITIONS ON BUSINESS PERFORMANCE

Uncertainties hold back investment activity Overall, the economic environment was characterised by a variety of risks and uncertainties in 2016 that will continue to have an impact this year. The tendency is therefore for a wait-and-see stance as far as investment activity is concerned. Moreover, prices for oil, commodities and agricultural goods were again at a very low level in 2016, although they did rise over the course of the year. However, higher prices would encourage investment in the relevant areas – and thus would benefit business at DEUTZ.

While the global economy grew by 3.1 per cent in 2016, revenue at DEUTZ rose by 1.0 per cent. The economy in the eurozone expanded by 1.7 per cent in the year under review. Against this backdrop, the situation varied significantly across DEUTZ's main customer markets in Europe. Whereas demand for construction equipment rose, there was a decline in the agricultural equipment sector. Nevertheless, DEUTZ was able to increase its unit sales of engines for agricultural equipment applications because demand in the previous year had been very low due to customers using up their inventories. In 2014, they had purchased significant volumes of engines ahead of a new emissions standard. DEUTZ's revenue in its largest market, EMEA (Europe, Middle East and Africa), rose by 3.3 per cent in 2016.

Economic growth in the United States slowed to 1.6 per cent in the reporting year (2015: 2.6 per cent). DEUTZ's revenue in North America fell by 13.0 per cent. This was largely caused by declining unit sales of engines for construction equipment in North America and by rental companies' reluctance to invest.

Momentum in China, our key international market, slowed again, with economic growth of 6.7 per cent (2015: 6.9 per cent). However, the markets for construction equipment and for light and

[1] IMF World Economic Outlook Update, January 2017.

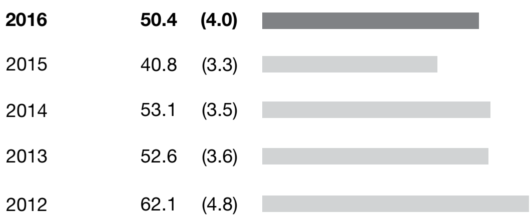
[2] Konjunkturbulletin of the German Engineering Federation (VDMA), February 2017.

medium-duty trucks stabilised following sharp decreases in previous years. DEUTZ's revenue in the Asia-Pacific region rose by 15.9 per cent thanks to the positive impact of new customer projects.

RESEARCH AND DEVELOPMENT

Research and development expenditure (after deducting grants)[1]

€ million (R&D ratio in %)



[1] Spending on research and development after deducting grants received from major customers and development partners.

R&D spending stepped up as planned Expenditure on research and development in 2016 amounted to €53.5 million (2015: €49.5 million). After deducting grants received from major customers and development partners, expenditure was €50.4 million (2015: €40.8 million). The R&D ratio (after deducting grants), i.e. the ratio of net development expenditure to consolidated revenue, increased as planned to 4.0 per cent (2015: 3.3 per cent). The rise in R&D expenditure compared to the low level of spending in the prior year was largely attributable to the expansion of our product range and the continuous improvements to current engine series. In the year under review, 18.1 per cent of development expenditure after deducting grants was capitalised (2015: 31.9 per cent).

R&D spending by the DEUTZ Compact Engines segment after deducting grants came to €47.7 million (2015: €38.2 million) and that of the DEUTZ Customised Solutions segment came to €2.7 million (2015: €2.6 million).

Stage V ready In previous years, we had completely overhauled our engine portfolio in connection with the introduction of the EU Stage IV/US Tier 4 emissions standards. Our latest 'Stage V ready' TCD engines in the 2.9 to 16.0 litre capacity range are already equipped to meet the next European emissions standard, EU Stage V[1], which comes into effect in 2019. The diesel particulate filters needed to ensure compliance are now available as standard or as an option for engines with a capacity up to 7.8 litres. A diesel particulate filter meeting the new emissions standard will be introduced for all the other engines that will not require much additional space for installation. It is not yet known whether a further emissions standard will be introduced in the USA.

Expansion of the product portfolio We plan to enhance our product range with further developments. One of these is the D/TD/TCD 2.2, a three-cylinder engine that we are developing on the basis of the existing four-cylinder engine with a 2.9 litre capacity. In addition, we will offer smaller engines not only in a diesel variant but also in a liquefied petroleum gas (LPG) variant. The latter is a particularly interesting option for forklift trucks and other material handling applications. We are also currently developing a completely new 5 litre engine with four cylinders. The TCD 5.0 will supplement the DEUTZ product range in the 100 to 150 kW power range and is, at the same time, the first step in renewing our medium-duty engine series. The design of the engine's underlying technology features minimum pipework, fewer components, strict separation between the hot and cold sides to avoid the need for heat protection measures and a reduction in performance losses from the oil and water circuits. Another feature is its overhead camshaft.

Preliminary development work at a high level Exhaustive research and development will continue to form the basis for innovative products and services from DEUTZ in future. We have recently expanded our activity in the field of alternative fuels. As well as looking at natural gas, we are also focusing on hydrogen and fuels that are generated from renewable sources, and we have taken steps to expand our work with universities and other research institutes. A key focus of our preliminary development work is the combination of internal combustion engines and electric motors (hybridisation). We have also continued to concentrate on data transfer and analysis (Industry 4.0) so that we can offer our customers new services in the future.

Intellectual property rights safeguard our know-how We protect our know-how from unauthorised outside use by means of patents, patent applications and utility models. In 2016, we submitted 14 new patent applications, eight of which were in Germany. We now hold a total of 147 patents registered in Germany and 178 registered elsewhere.

PROCUREMENT

Last year was characterised by an overall recovery in the commodities markets. Key purchasing objectives were achieved, such as reducing costs, ensuring continuity of supply, optimising quality and implementing embedded material group strategies.

Commodity prices rising While prices had continued to fall in the primary markets in 2015, the trend was reversed in 2016. Overall, all the average prices for the year were slightly higher than the ranges that had been forecast. However, commodity prices have only a limited influence on the price at which DEUTZ procures parts from suppliers because there is a very high element of value added.

[1] Regulation (EU) 2016/1628 of the European Parliament and of the Council dated 14 September 2016.

Measures implemented to reduce costs With regard to the material groups, we primarily focused on exhaust aftertreatment, exhaust gas recirculation and filtration last year and were able to reduce costs in the overall system. We see potential for achieving further savings by increasing the proportion of procurement from emerging markets. This applies, above all, to China because of the competitive environment, particularly as quality standards in the supplier industry are continuing to improve there. We have concluded a purchasing agreement with our joint venture DEUTZ (Dalian) Engine Co., Ltd., China, in order to coordinate procurement potential in the Chinese market.

Supply chain and supplier performance We have been able to further optimise supplier performance in the supply chain, with the overall trend continuing to improve.

PRODUCTION

In production and logistics, the areas of focus in 2016 were workplace safety and ergonomics, product and process quality, and efficiency. We also implemented a number of measures as planned as part of efforts to optimise our network of sites.

The Cologne plants, Germany Last year, we initiated various steps aimed at improving quality and safeguarding the assembly processes in Cologne-Porz, our largest assembly site for production engines. This included optimising and renewing the cleaning and drying sections of the painting area and the automated adjustment of valve clearance. We also held kaizen workshops to further refine processes and procedures. Numerous tasks were consolidated in connection with vacating the Cologne-Deutz site, such as the management of empties. We also expanded shop floor management.

Component manufacture The process of vacating the Cologne-Deutz site began at the start of 2016. In May, the two transfer lines for the processing of crankcase housing for the 2011 and 91x engine series were moved to our plants in Zafra, Spain and Ulm, Germany. The relocation of shaft production from Cologne-Deutz to the newly built shaft centre in Cologne-Porz got under way in April without production being disrupted and was completed in February 2017. A total of 130 pieces of machinery and equipment were removed and then brought back on stream.

The plants in Ulm and Übersee on Lake Chiemsee, Germany We continued with our expansion of the Ulm plant in 2016. This site is evolving into the plant for small production runs, focusing on DCS products, project business, exchange engines and models that are soon to be discontinued. The Xchange assembly activities, which had been relocated in 2015, were optimised, costs were lowered and throughput times were shortened. In addition, the necessary preparations for integrating all of the other functions from the Übersee plant were carried out. The relocation of the remaining functions in connection with the closure of the Übersee site will take place in 2017. In mechanical fabrication, all transfer lines were replaced with production machines; mechanical component production has thus been attuned to the flexibility that is required in small production runs.

The Zafra plant, Spain Our plant in Zafra, Spain produces the crankcases for engines of up to 4 litres in addition to the other major engine components already manufactured there, namely cylinder heads, conrods and gearwheels. Relocation of the production of crankcases for the 2011 engine series, which were previously built inhouse in Cologne-Deutz, was completed in 2016. Manufacturing of crankcases for the 2.9 engine series was also ramped up in 2016.

The Pendergrass plant, USA In the year under review, we extended our plant in Pendergrass, Georgia/USA, to cover the additional volume resulting from the growth of the exchange engine business. This included expanding capacity for removal and final assembly activities and increasing the number of production employees. There is now capacity for roughly 2,400 engines in one-shift operation.

QUALITY

Quality is part of our corporate culture The DEUTZ name has always been synonymous with high-quality engines. We intend to continue to live up to this reputation.

For this reason, we introduced our zero-error strategy. Our main aim in pursuing this quality assurance programme is to ensure that we always meet our customers' expectations. The idea is to detect errors before they actually occur. And where errors do occur, we have to learn from them quickly in order not to make the same mistakes again.

In 2016, we developed a concept to implement our quality assurance programme and provided multipliers with the necessary training to run workshops. A large number of employees, from both production and administrative areas, took part in these workshops. Managers and employees were given intensive training on topics such as customer satisfaction, quality of work and the constructive handling of errors during two half-day sessions.

In addition, we conducted a study on quality focus in collaboration with the Laboratory for Machine Tools and Production Engineering (WZL). The objective was to assess the quality focus of employees in middle management. The study showed that the quality culture at DEUTZ was very strong on average in terms of external customer focus. In departments with a well-developed culture of quality, there is greater satisfaction among the employees and they value the quality performance of their team more highly.

Certification attests to high quality standards Last year, DEUTZ was again certified in accordance with ISO 9001 (quality management), ISO 14001 (environmental management) and ISO 50001 (energy management). In 2016, we successfully completed our second monitoring audit.

The more wide-ranging requirements resulting from the revised ISO 9001:2015 and 14001:2015 standards are currently being integrated into the DEUTZ management system. This is expected to be completed in time for re-certification in 2017.

INTERNATIONAL JOINT VENTURES

Conditions in the Chinese market for capital equipment have been very challenging for a number of years. Growth forecasts have been revised down significantly, and there is considerable capacity in the engineering sector.

We have been operating the DEUTZ Dalian joint venture – in which our Chinese production activities are concentrated – with the First Automotive Works Group, one of China's leading vehicle manufacturers, since 2007. Here, we produce 3 to 8-litre diesel engines, mainly for automotive and industrial applications for the Chinese market. We will expand DEUTZ Dalian's product range from 2019, which is when the China IV emissions legislation comes into force. Local production ensures that we have the proximity to our customers that we need and enables us to seize market opportunities in various off-road applications.

In 2016, unit sales in the DEUTZ Dalian joint venture fell by 8.7 per cent to around 68,000 engines. Revenue declined by 10.8 per cent to €303.0 million. Adjusted for exchange rate effects, the decrease was 5.7 per cent. The company, accounted for under the equity method, had a negative impact of around €5.7 million (2015: €7.0 million) on the DEUTZ Group's operating profit.

DEUTZ AGCO MOTORES S.A. (DAMSA) is our joint venture with the AGCO Group and is located in Argentina. It builds engines for the local market, mainly for agricultural machinery, buses and industrial applications. In 2016, DAMSA sold almost 1,000 engines. Revenue dropped by 24.9 per cent to €14.5 million as a result of negative exchange rate effects. However, measured in the local currency, revenue increased by 19.1 per cent. The company's operating profit came to €0.2 million (2015: €0.7 million).

We hold a stake of 30 per cent in D.D. Power Holdings (Pty) Ltd., our South African joint venture. This sales and service company is active in the local market, focusing on sectors such as the local mining business. In the year under review, the company reported revenue of €14.6 million (2015: €20.2 million) and a profit of €1.9 million (2015: €2.5 million).

NEW ORDERS

DEUTZ Group: New orders

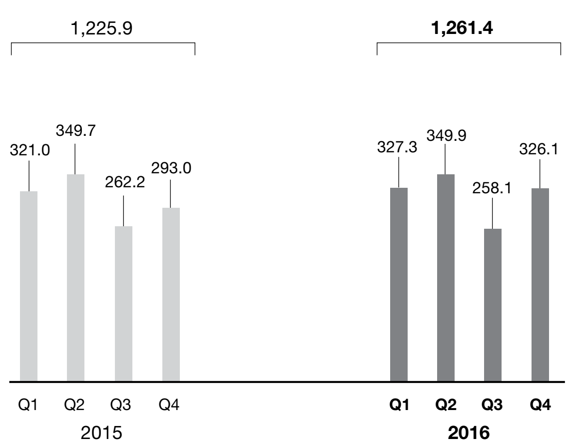
€ million

Year-on-year increase in new orders The DEUTZ Group received new orders worth €1,261.4 million in 2016, which was 2.9 per cent above the figure of €1,225.9 million achieved in the previous year. The former Mobile Machinery application segment has been divided into the Construction Equipment and Material Handling application segments in order to provide greater transparency in terms of the significance of various customer industries. In 2016, new orders increased by 9.6 per cent in the Construction Equipment application segment, by 6.9 per cent in Material Handling and by 6.4 per cent in Agricultural Machinery. The Automotive and Stationary Equipment application segments saw their new orders decline by 14.4 per cent and 16.7 per cent respectively. The service business maintained its positive trajectory with an increase of 2.2 per cent.

The level of new orders varied over the course of the year. New orders were up slightly year on year in the first quarter, unchanged year on year in the second quarter and down slightly year on year in the third quarter. In the fourth quarter, the volume of new orders increased by 11.3 per cent compared with the prior-year quarter to reach €326.1 million.

DEUTZ Group: New orders by quarter

€ million



Orders on hand totalled €191.0 million as at 31 December 2016, a decline of 5.0 per cent compared with €201.0 million at the end of 2015.

UNIT SALES

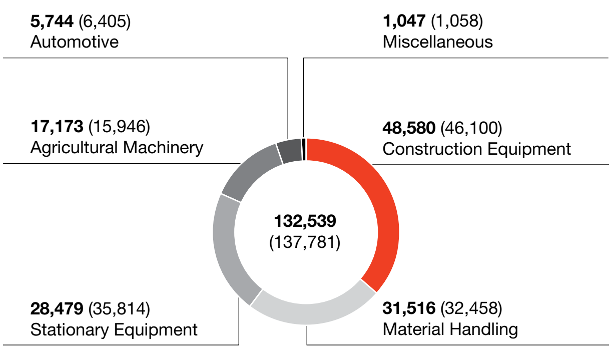
DEUTZ Group: Unit sales

units

Fewer engines sold DEUTZ sold 132,539 engines in the reporting year, which was 3.8 per cent fewer than in the prior year (2015: 137,781 engines). The decreases in the Stationary Equipment and Automotive application segments were particularly substantial at 20.5 per cent and 10.3 per cent respectively.

DEUTZ Group: Unit sales by application segment

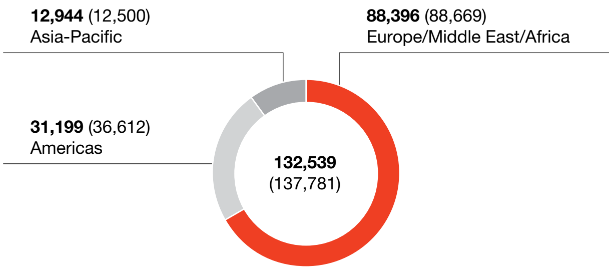
units (2015 figures)



The regional analysis shows a very mixed picture. Unit sales in our biggest market – EMEA (Europe, Middle East and Africa) – were on a par with 2015 at 88,396 engines. They were down by 14.8 per cent to 31,199 engines in the Americas. By contrast, unit sales in the Asia-Pacific region rose by 3.6 per cent to 12,944 engines.

DEUTZ Group: Units sales by region

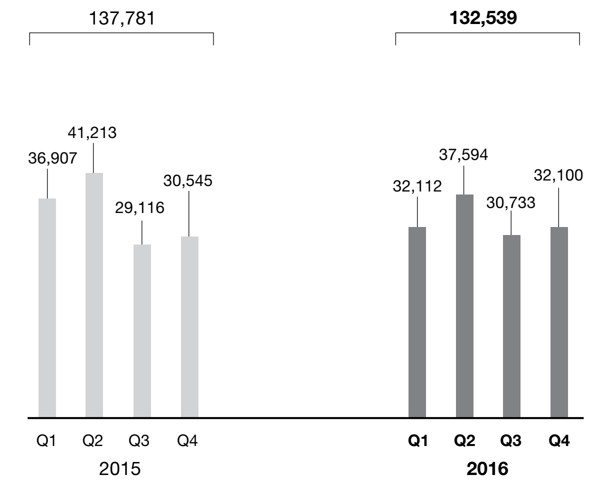
units (2015 figures)



In the first two quarters, unit sales were lower than in the corresponding periods of 2015. However, third-quarter and fourth-quarter unit sales were both up year on year. In the final quarter of 2016, DEUTZ sold 32,100 engines, which was an increase of 5.1 per cent compared to the fourth quarter of 2015 and a rise of 4.4 per cent on the third quarter of 2016.

DEUTZ Group: Consolidated unit sales by quarter

units



RESULTS OF OPERATIONS

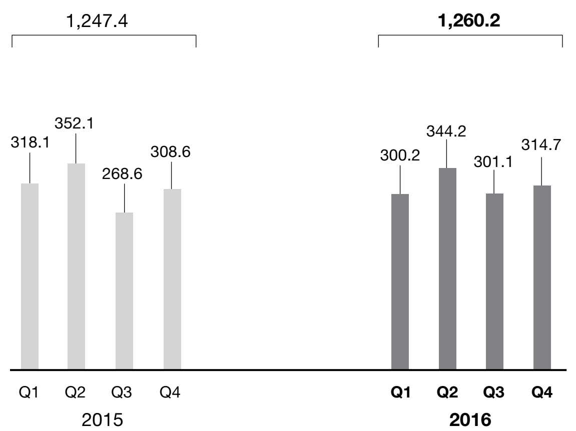
DEUTZ Group: Revenue

€ million

Revenue up slightly compared with prior year DEUTZ earned revenue of €1,260.2 million in 2016, an increase of 1.0 per cent on the previous year (2015: €1,247.4 million). We therefore met the forecast published in our 2015 annual report that revenue would stagnate or, at best, rise slightly. The average price of the engines sold went up again.

DEUTZ Group: Revenue by quarter

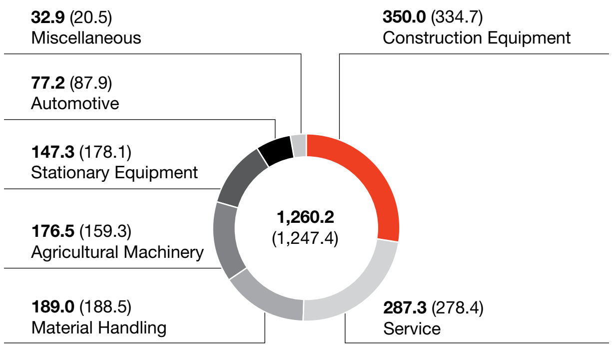
€ million



Revenue levels varied throughout the year. While revenue was down year on year in the first and second quarters, it was significantly higher year on year in the third quarter. In the fourth quarter, we generated revenue of €314.7 million, which was 2.0 per cent more than in the prior-year period and 4.5 per cent more than in the previous quarter. The second quarter, when revenue totalled €344.2 million, was the strongest quarter of 2016, as had been the case in 2015.

DEUTZ Group: Revenue by application segment

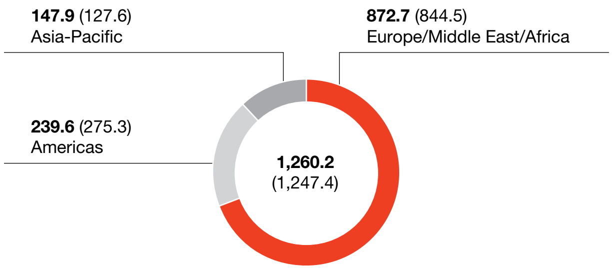
€ million (2015 figures)



The application segments presented a disparate picture. The Construction Equipment and Material Handling application segments, which were previously grouped together as Mobile Machinery, increased their revenue by 4.6 per cent and 0.3 per cent respectively. There were also rises in revenue, of 10.8 per cent and 3.2 per cent respectively, for Agricultural Machinery and the service business. By contrast, the Automotive and Stationary Equipment application segments reported decreases of 12.2 per cent and 17.3 per cent respectively.

DEUTZ Group: Revenue by region

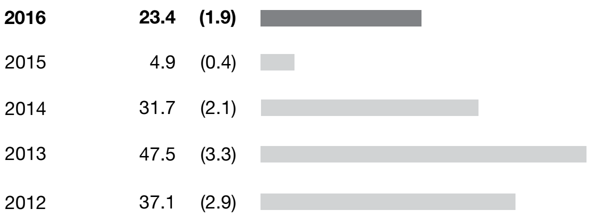
€ million (2015 figures)



Broken down by region, revenue in EMEA (Europe, Middle East and Africa) advanced by 3.3 per cent year on year to €872.7 million. In the Americas region, however, revenue was down by 13.0 per cent to €239.6 million. Thanks to new customer projects, the Asia-Pacific region again generated double-digit growth, with revenue climbing by 15.9 per cent to €147.9 million.

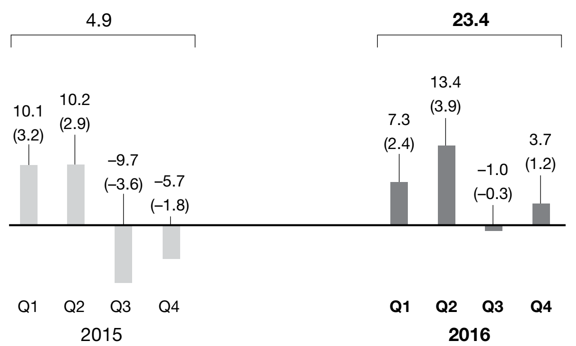
DEUTZ Group: Operating profit and EBIT margin (before exeptional items)

€ million (EBIT margin in %)



DEUTZ Group: Operating profit (EBIT) by quarter (before exeptional items)

€ million (EBIT margin in %)



Earnings performance Operating profit before depreciation and amortisation (EBITDA) came to €114.2 million in 2016, a year-on-year increase of €2.0 million (2015: €112.2 million). The EBITDA margin improved slightly to reach 9.1 per cent (2015: 9.0 per cent).

In the fourth quarter of 2016, EBITDA came to €26.3 million and was thus at the same level as the prior-year period (Q4 2015: €26.6 million). Compared with the third quarter of 2016, EBITDA rose by €5.3 million (Q3 2016: €21.0 million). The main reason for this increase was the larger volume of business.

Operating profit after depreciation and amortisation (EBIT) came to €23.4 million in 2016. The year-on-year increase was mainly attributable to lower production costs, far smaller impairment losses (2016: €1.5 million; 2015: €9.7 million) and a licensing transaction in the first quarter of 2016. The contribution to profits from the licensing transaction amounted to €5.5 million. The growth in service business and the first effects of the measures to optimise our network of sites also had a positive impact. The EBIT margin for 2016 was 1.9 per cent (2015: 0.4 per cent). At the start of the year, we had expected a moderate increase in the EBIT margin, so we met our forecast.

In the fourth quarter of 2016, operating profit amounted to €3.7 million (Q3 2016: loss of €1.0 million; Q4 2015: loss of €5.7 million), giving an EBIT margin of 1.2 per cent (Q3 2016: minus 0.3 per cent; Q4 2015: minus 1.8 per cent).

The higher operating profit resulted in a substantially improved return on capital employed (ROCE)[1], our internal KPI, which rose from 0.6 per cent in 2015 to 3.1 per cent in the reporting year. At the start of the year, we had expected ROCE to rise slightly compared with 2015. We exceeded this forecast for the reasons outlined above.

Overview of the DEUTZ Group's results of operations

€ million

	2016	2015
Revenue	**1,260.2**	**1,247.4**
Cost of sales	–1,041.6	–1,054.8
Research and development costs	–77.5	–76.3
Selling and administrative expenses	–104.7	–104.8
Other operating income	17.7	29.3
Other operating expenses	–26.7	–30.6
Profit/loss on equity-accounted investments	–5.1	–6.3
Other financial income	1.1	1.0
Operating profit (EBIT)	**23.4**	**4.9**
Interest expenses, net	–3.5	–4.0
Income taxes	–3.9	2.6
Net income	**16.0**	**3.5**

[1] Return on capital employed (ROCE): ratio of EBIT to average capital employed. 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.

Cost of sales In 2016, the cost of sales amounted to €1,041.6 million (2015: €1,054.8 million), a year-on-year decrease of €13.2 million or 1.3 per cent. This was mainly due to the lower cost of materials resulting from the reduction in the volume of unit sales as well as increased cost efficiency. The gross margin[1] improved from 15.4 per cent in 2015 to 17.3 per cent in the reporting period.

Research and development costs In the year under review, research and development costs totalled €77.5 million (2015: €76.3 million). They largely comprised staff costs, the cost of materials and amortisation on completed development projects, from which investment grants received and capitalised development costs were deducted. Whereas lower amortisation on completed development projects helped to reduce R&D costs, the smaller volume of investment grants and the sharp drop in the capitalisation rate meant that, overall, there was a small year-on-year rise in R&D costs of €1.2 million.

Other operating income Other operating income totalled €17.7 million in the reporting year, equating to a decline of €11.6 million compared with the prior year (2015: €29.3 million). This change was largely due to lower foreign currency gains, although foreign currency losses (recognised under other operating expenses) also fell sharply. Moreover, the 2015 figure had included income from the disposal of the shares in WEIFANG WEICHAI DEUTZ DIESEL ENGINE CO., LTD., Weifang, China, and income from the deconsolidation of DEUTZ Engine (China) Co., Ltd. Linyi, China.

Other operating expenses Other operating expenses totalled €26.7 million in the reporting year, a year-on-year decrease of €3.9 million (2015: €30.6 million). This was mainly attributable to substantially smaller foreign currency losses. The main countervailing effect came from higher additions to other provisions. Other operating expenses also included a loss of €1.4 million arising from the deconsolidation of the subsidiary DEUTZ Engine (Shandong) Co., Ltd., Linyi, China.

Profit/loss on equity-accounted investments In 2016, there was a loss on equity-accounted investments of €5.1 million, a small improvement of €1.2 million compared with the previous year (2015: loss of €6.3 million). This change is primarily attributable to the contribution to earnings from our Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd. Further information can be found in the 'International joint ventures' section on page 32.

Net interest expense Net interest expense amounted to €3.5 million (2015: €4.0 million). This year-on-year improvement of €0.5 million was attributable to lower utilisation of credit lines.

Income taxes The income tax expense amounted to €3.9 million in the year under review, whereas there had been tax income of €2.6 million in 2015. Current tax expenses came to €9.3 million, a year-on-year rise of €3.6 million (2015: €5.7 million). This was mainly the result of improved earnings at DEUTZ AG. The current tax expenses were partly offset by deferred tax income of €5.4 million (2015: €8.3 million). This mainly resulted from the reversal of deferred tax liabilities arising in connection with the capitalisation of development expenditure under IFRS.

Earnings per share Due to the higher operating profit, net income increased by €12.5 million to €16.0 million in the reporting period (2015: €3.5 million). This led to a significant improvement in earnings per share, which came to €0.14 (2015: €0.04).

BUSINESS PERFORMANCE IN THE SEGMENTS

DEUTZ Group: Segments

€ million

	2016	2015
New orders		
DEUTZ Compact Engines	1,011.6	958.4
DEUTZ Customised Solutions	249.8	267.5
Total	**1,261.4**	**1,225.9**
Unit sales (units)		
DEUTZ Compact Engines	123,179	125,214
DEUTZ Customised Solutions	9,360	12,567
Total	**132,539**	**137,781**
Revenue		
DEUTZ Compact Engines	1,000.8	967.2
DEUTZ Customised Solutions	259.4	280.2
Total	**1,260.2**	**1,247.4**
EBIT		
DEUTZ Compact Engines	–6.1	–31.9
DEUTZ Customised Solutions	32.7	31.3
Other	–3.2	5.5
Total	**23.4**	**4.9**

[1] Gross margin: ratio of revenue less cost of sales to revenue (excluding amortisation relating to development expenditure).

BUSINESS PERFORMANCE IN THE DEUTZ COMPACT ENGINES (DCE) SEGMENT

More orders than in 2015 In the year under review, the DEUTZ Compact Engines (DCE) segment received new orders worth €1,011.6 million, which was 5.6 per cent up on 2015 when orders worth €958.4 million were received. At 13.8 per cent, Construction Equipment recorded the highest growth among the application segments. Material Handling, Agricultural Machinery and the service business also saw increases of 7.8 per cent, 7.1 per cent and 6.7 per cent respectively. However, new orders fell in the Stationary Equipment and Automotive application segments by 17.9 per cent and 3.9 per cent respectively. Orders on hand amounted to €145.5 million at the end of the year, up by 6.0 per cent compared with the end of 2015.

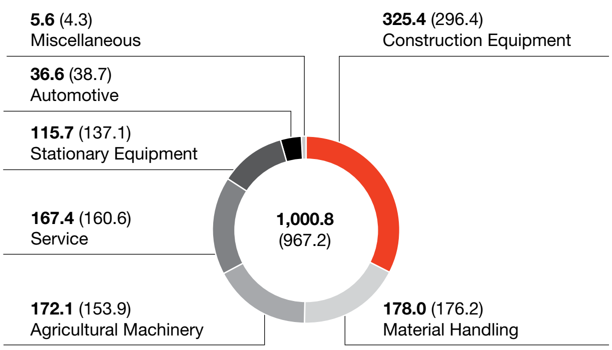
Slight year-on-year fall in unit sales The DCE segment's unit sales dropped by 1.6 per cent to 123,179 engines. The number sold in the previous year was 125,214 engines. In EMEA, our largest market, we sold 83,017 engines, which was 2.0 per cent more than in 2015. Unit sales went down by 13.1 per cent in the Americas region but rose by 9.8 per cent in the Asia-Pacific region. There were increases in the Construction Equipment, Agricultural Machinery and Miscellaneous application segments, while all other application segments sold fewer engines.

Higher revenue At €1,000.8 million, revenue in the DCE segment was up by 3.5 per cent year on year (2015: €967.2 million). As was the case at Group level, revenue thus increased despite the small decrease in unit sales. The EMEA region's revenue advanced by 5.5 per cent to €721.2 million. However, that of the Americas region dropped by 12.1 per cent to €200.4 million. The Asia-Pacific region's revenue climbed by a considerable 43.0 per cent to €79.2 million. Revenue rose by 11.8 per cent in the Agricultural Machinery application segment, by 9.8 per cent in the Construction Equipment application segment, by 4.2 per cent in the service business and by 1.0 per cent in the Material Handling application segment. By contrast, Stationary Equipment and Automotive revenue was down by 15.6 per cent and 5.4 per cent respectively.

Q4 2016 better than comparison periods In the DCE segment, new orders reached €267.9 million in the fourth quarter of 2016. This was 14.3 per cent more than in the fourth quarter of the previous year and 34.5 per cent up on the previous quarter. Unit sales rose by 8.2 per cent year on year to 29,869 engines and also exceeded the figure for the previous quarter by 4.8 per cent. Revenue in the final quarter of 2016 amounted to €251.1 million, which was 5.9 per cent more than in both the fourth quarter of 2015 and the third quarter of 2016.

DEUTZ Compact Engines: Revenue by application segment

€ million (2015 figures)



DCE's operating profit improved The DEUTZ Compact Engines segment reported an operating loss of €6.1 million in 2016 (2015: operating loss of €31.9 million). This substantial improvement of €25.8 million is mainly the result of savings on the cost of materials and the higher volume of business. A positive shift in the product mix that benefited our new engine series also contributed to this improved result for the segment. Moreover, the operating profit for the segment in the prior year had been adversely affected by impairment losses totalling €7.1 million on intangible assets and on property, plant and equipment. Impairment losses of €1.5 million were recognised in the reporting year, mainly on property, plant and equipment of our subsidiary DEUTZ Engine (Shandong) Co., Ltd.

BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS (DCS) SEGMENT

New orders fall year on year In 2016, the DEUTZ Customised Solutions (DCS) segment received new orders worth €249.8 million, which is 6.6 per cent less than in 2015 when orders worth €267.5 million were received. There were year-on-year decreases in all application segments. As at the end of 2016, orders on hand stood at €45.5 million, a decrease of 28.7 per cent on the figure reported a year earlier (31 December 2015: €63.8 million).

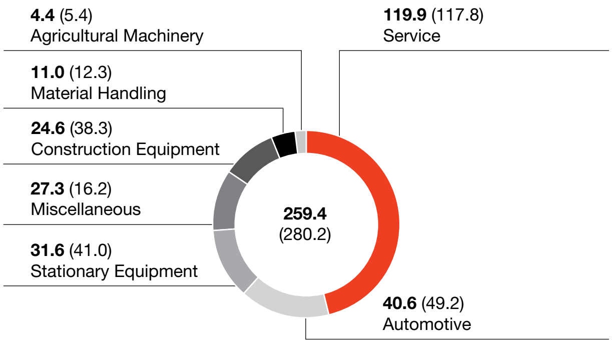
Engine sales down by a quarter Unit sales in the DCS segment declined by 25.5 per cent to 9,360 engines in 2016. This trend was repeated across all regions and, apart from Agricultural Machinery, across all application segments.

Far smaller drop in revenue than in unit sales In the reporting period, the DCS segment's revenue fell by 7.4 per cent to €259.4 million. All regions registered decreases in revenue: by 5.8 per cent in the EMEA region, by 16.9 per cent in the Americas and by 4.8 per cent in the Asia-Pacific region. Revenue also went down in all application segments; only the service business generated a further increase of 1.8 per cent to reach €119.9 million.

Weaker fourth quarter In the fourth quarter of 2016, new orders in the DCS segment totalled €58.2 million, down by 0.7 per cent year on year and down by 1.2 per cent on the previous quarter. A total of 2,231 engines were sold in the final quarter, which constituted a substantial year-on-year decrease of 23.8 per cent but was on a par with the third quarter of 2016. At €63.6 million, the DCS segment's revenue dropped by 11.0 per cent compared with the fourth quarter of 2015 and by 0.5 per cent compared with the previous quarter.

DEUTZ Customised Solutions: Revenue by application segment

€ million (2015 figures)



DCS's operating profit holds steady at a high level The operating profit of the DEUTZ Customised Solutions segment for the reporting year was €32.7 million (2015: €31.3 million). With the volume of business having reduced, this increase of €1.4 million is mainly attributable to a contribution to profits from the licensing transaction of €5.5 million at the start of the financial year. The operating profit for the segment in 2015 had been adversely affected by impairment losses totalling €2.6 million on intangible assets and on property, plant and equipment.

Other The operating loss reported by the Other segment came to €3.2 million (2015: operating profit of €5.5 million). In 2015, operating profit had been boosted by the sale of the shares in WEIFANG WEICHAI DEUTZ DIESEL ENGINE CO., LTD., Weifang, China. The figure for 2016 includes a loss of €1.4 million arising from the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd., Linyi, China. This company is currently being wound up and no longer has any operational or strategic significance to the DEUTZ Group, so it has been deconsolidated for reasons of materiality.

FINANCIAL POSITION

BASIC PRINCIPLES AND OBJECTIVES OF FINANCIAL MANAGEMENT

Overview of the DEUTZ Group's financial position

€ million

	2016	2015
Cash flow from operating activities	63.8	103.3
Cash flow from investing activities	–55.4	–64.4
Cash flow from financing activities	–26.8	–29.8
Change in cash and cash equivalents	–18.4	9.1
Free cash flow from continuing operations	4.7	35.0
Cash and cash equivalents at 31 Dec	91.8	112.5
Current and non-current interest-bearing financial debt at 31 Dec	60.2	73.5
Net financial position at 31 Dec	31.6	39.0

Free cash flow: cash flow from operating and investing activities less net expense.
Net financial position: cash and cash equivalents less current and non-current interest-bearing financial debt.

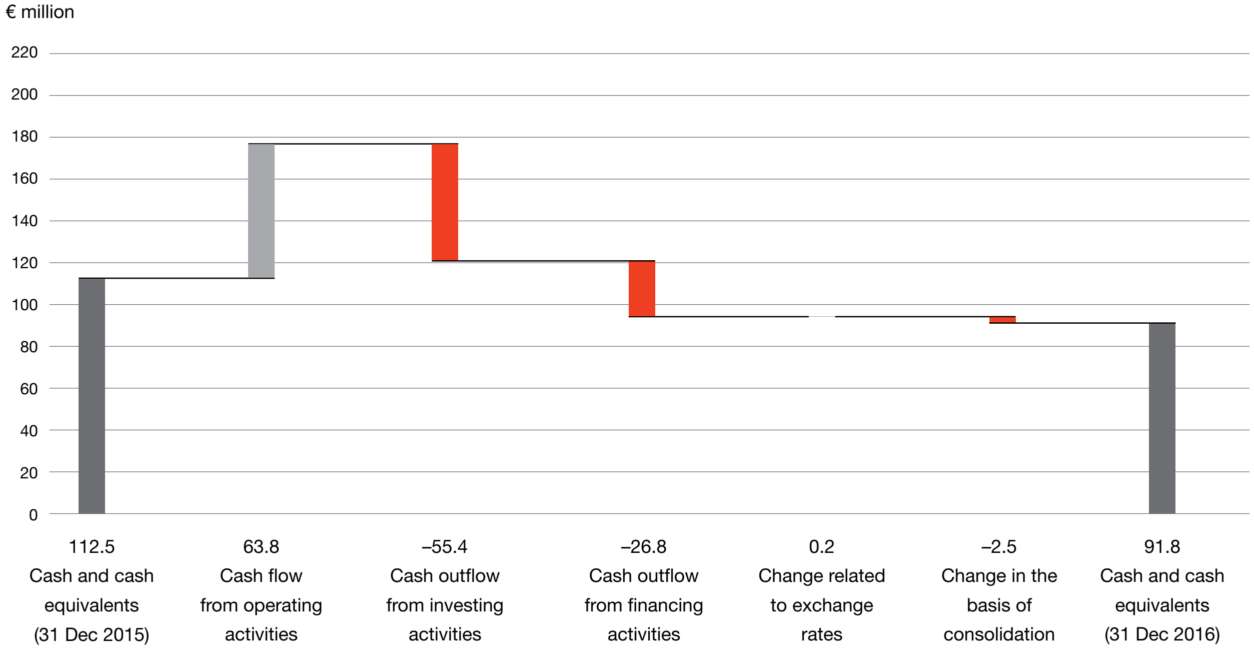
Central responsibility for treasury Responsibility for financial management in the DEUTZ Group lies with DEUTZ AG as the parent company of the Group. Financial management primarily consists of obtaining the necessary funds, managing their use within the Group, pooling cash resources and hedging interest-rate risk, currency risk and commodities risk throughout the Group.

FUNDING

Syndicated credit line and loan from the European Investment Bank ensure sufficient liquidity In order to ensure sufficient liquidity, DEUTZ has at its disposal a syndicated, revolving working capital facility of €160 million provided by a consortium of banks. It is a floating-rate, unsecured line and is due to mature in May 2020. DEUTZ can elect whether to utilise the cash line as a bilateral overdraft facility (up to €60 million) or to draw down amounts with interest periods of three to six months.

In addition, we have an amortising loan from the European Investment Bank with a remaining balance of €54 million at 31 December 2016. This loan, which is also unsecured, is repayable in instalments until July 2020. We have hedged the interest-rate risk arising from this loan.

DEUTZ Group: Change in cash and cash equivalents



As part of the contractual agreements for both loans, DEUTZ is obliged to comply with certain financial covenants. They do not limit our leeway for growth projects, however. The working capital facility and the loan from the European Investment Bank have enabled us to secure funding for our projects and for further growth over the coming years.

Receivables management optimised by means of factoring The sale of receivables is an important way of optimising receivables management. Because the credit quality of our customer receivables is excellent, factoring is also a cost-effective way of improving working capital, especially as considerable cash resources are tied up by the preliminary financing of production and due to the payment terms that we have granted to our customers. The volume of sales of receivables on the balance sheet date was higher than at the end of 2015 as a result of the business situation, the volume as at 31 December 2016 being around €111 million (31 December 2015: €99 million).

FREE CASH FLOW

Cash flow from operating activities amounted to €63.8 million in 2016 (2015: €103.3 million). This year-on-year fall of €39.5 million was mainly due to the change in working capital. Whereas there had been a marked decrease in working capital in 2015, the level of working capital rose significantly in the reporting period. This change was primarily due to the reporting date-related increase in trade receivables and the simultaneous reduction in trade payables caused by a drop in orders of raw materials and consumables at the end of the reporting year.

Cash outflow from investing activities came to €55.4 million in 2016. This represented a year-on-year decrease of €9.0 million that was caused, in particular, by lower cash payments in connection with development activities (2015: €64.4 million).

Financing activities in 2016 resulted in a net cash outflow of €26.8 million (2015: €29.8 million). As in the previous year, cash flow used for financing activities included a dividend payment to shareholders of €8.5 million.

Cash and cash equivalents as at 31 December 2016 had fallen by €20.7 million to €91.8 million (31 December 2015: €112.5 million). Of this decrease, €2.5 million was attributable to the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China. The net financial position[1] as at 31 December 2016 was €31.6 million, a decrease compared with the same date a year earlier of €7.4 million (31 December 2015: €39.0 million).

Free cash flow[2] decreased year on year, falling by €30.3 million to €4.7 million (2015: €35.0 million). This was due, above all, to the significant reduction in cash flow from operating activities. Consequently, we did not meet our forecast made at the start of 2016 that free cash flow would be in the low to mid-double-digit million euro range. This was primarily because of the aforementioned change in working capital.

CAPITAL EXPENDITURE

After deducting investment grants, capital expenditure on property, plant and equipment and on intangible assets totalled €62.0 million in 2016, which was €7.2 million less than in the previous year (2015: €69.2 million). As in 2015, the bulk of this spending (€49.3 million) went on property, plant and equipment (2015: €50.9 million). Capital expenditure on intangible assets accounted for €12.7 million (2015: €18.3 million). The investing activities relating to property, plant and equipment focused on the construction of the shaft centre in Cologne-Porz, where production was progressively ramped up from mid-2016 onward. There were also additions in connection with replacement investments in machinery and tools. Capital expenditure on intangible assets went mainly on the development of the new TCD 2.2 and TCD 5.0 engine series.

Before the capitalisation of development expenditure, capital investment amounted to €52.9 million (2015: €56.2 million). Capital investment was therefore slightly lower than we had predicted (forecast: €55.0 million). Including the capitalisation of development expenditure, our spending was almost €13.0 million less than the forecast amount of €75.0 million. This was mainly due to a far lower capitalisation rate as a result of the reprioritisation of the timing of development projects.

As in 2015, the bulk of the total capital expenditure after deducting investment grants was invested in the DEUTZ Compact Engines segment (€55.0 million in 2016 and €61.7 million in 2015). Capital expenditure in DEUTZ Customised Solutions was €7.0 million (2015: €7.5 million).

[1] Net financial position: cash and cash equivalents less current and non-current interest-bearing financial debt.
[2] Free cash flow: cash flow from operating and investing activities less interest expense.

NET ASSETS

Overview of the DEUTZ Group's assets

€ million

	31 Dec 2016	31 Dec 2015	Change
Non-current assets	563.6	589.6	–26.0
Current assets	495.7	498.1	–2.4
Assets classified as held for sale	0.4	0.4	–
Total assets	**1,059.7**	**1,088.1**	**–28.4**
Equity	491.1	495.6	–4.5
Non-current liabilities	265.0	280.8	–15.8
Current liabilities	303.6	311.7	–8.1
Total equity and liabilities	**1,059.7**	**1,088.1**	**–28.4**
Working capital (€ million)	204.3	183.6	20.7
Working capital ratio (31 Dec, %)	16.2	14.7	1.5
Working capital ratio (average, %)	17.9	17.6	0.3
Equity ratio (%)	46.3	45.5	0.8

Working capital: inventories plus trade receivables less trade payables.
Equity ratio: equity / total equity and liabilities.

Non-current assets Non-current assets of the DEUTZ Group totalled €563.6 million as at 31 December 2016 (31 December 2015: €589.6 million). The decline of €26.0 million was largely due to the reduction in intangible assets. In particular, additions to capitalised development expenditure were much lower than amortisation charges relating to capitalised development expenditure.

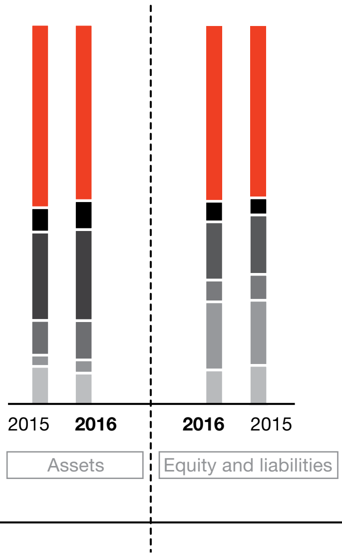
Current assets Current assets were only a little lower than at the end of 2015, falling by €2.4 million to €495.7 million (31 December 2015: €498.1 million). This was mainly attributable to the reduction in cash and cash equivalents and in tax receivables, although the reduction was partly offset by a reporting date-related increase in trade receivables and other receivables and assets.

DEUTZ Group: Balance sheet structure

in % (2015 figures)

Assets

■	**45.6**	(47.8)	Non-current assets
■	**7.6**	(6.4)	Deferred taxes
■	**23.9**	(23.2)	Inventories
■	**10.7**	(9.3)	Trade receivables
■	**3.5**	(3.0)	Other receivables and assets
■	**8.7**	(10.3)	Cash and cash equivalents



Equity and liabilities

■	**46.3**	(45.5)	Equity
■	**5.4**	(4.5)	Other liabilities
■	**15.3**	(15.6)	Trade payables
■	**5.7**	(6.8)	Financial liabilities
■	**17.9**	(17.1)	Pension provisions
■	**9.4**	(10.5)	Other provisions

Working capital Working capital had risen to €204.3 million as at 31 December 2016 (31 December 2015: €183.6 million). The main reason for this was the reporting date-related increase in trade receivables. Moreover, there was a year-on-year decrease in trade payables as at the balance sheet date due to a reduction in orders of raw materials and consumables. By contrast, there was only a slight rise in inventories. The decline in raw materials and consumables was offset by an increase in finished goods. Due to the higher level of working capital, the working capital ratio rose to 16.2 per cent as at 31 December 2016 (31 December 2015: 14.7 per cent). The average working capital ratio[1] went up slightly, reaching 17.9 per cent on the reporting date (31 December 2015: 17.6 per cent). Consequently, we did not quite achieve our forecast for an average working capital ratio of approximately 17 per cent, due mainly to the higher level of trade receivables and inventories.

Unrecognised intangible assets In addition to the assets recognised on the balance sheet, DEUTZ has further assets that are not recognised. The DEUTZ brand is synonymous with highly sophisticated technology, quality and reliability and the Company has been a firmly established player in the equipment manufacturing and operating industry for more than 150 years. DEUTZ also enjoys long-standing valuable relationships with customers; it has entered into long-term cooperation agreements, particularly with its key customers.

Equity As at 31 December 2016, equity had decreased to €491.1 million (31 December 2015: €495.6 million). This reduction of €4.5 million was predominantly attributable to the changes to non-controlling interests as a result of the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China. This company is currently being wound up and no longer has any operational or strategic significance to the DEUTZ Group. It was deconsolidated for reasons of materiality on 31 December 2016. However, there was a small increase in the Group equity attributable to the shareholders of DEUTZ AG due, above all, to the level of net income.

Despite the decrease in equity, the equity ratio rose slightly to 46.3 per cent (31 December 2015: 45.5 per cent) and thus continued to be within the range that we had forecast at the start of the reporting year of well above 40 per cent.

Non-current liabilities Non-current liabilities totalled €265.0 million as at 31 December 2016 (31 December 2015: €280.8 million). This fall of €15.8 million was largely attributable to the reduction in financial debt, which decreased as planned by €14.6 million to €44.0 million. Furthermore, there was a reduction in other provisions, mainly in connection with the changes to restructuring provisions. In view of their expected use, the bulk of the non-current restructuring provisions were reclassified as current.

[1] Working capital (inventories plus trade receivables less trade payables) as at the balance sheet date divided by revenue for the previous twelve months.

Current liabilities There was also a decline in current liabilities from €311.7 million as at 31 December 2015 to €303.6 million as at 31 December 2016. This drop of €8.1 million was mainly attributable to the lower level of trade payables.

Total assets fell to €1,059.7 million as at 31 December 2016 (31 December 2015: €1,088.1 million).

OVERALL ASSESSMENT FOR 2016

Last year, DEUTZ was able to offer new and existing customers a comprehensive and compelling product portfolio. DEUTZ diesel engines equipped with particulate filters already comply with the limits defined in the EU Stage V emissions standard, which comes into force in 2019. At bauma 2016, we presented new developments that are further expanding our product range, such as the TCD 2.2 diesel and gas engines, a gas variant of the tried-and-trusted TCD 2.9 and the TCD 5.0. As part of a collaborative partnership with Liebherr, we are also planning to expand our product portfolio in the upper power range by adding four new diesel engines. We are thus always quick to offer our customers the solutions of tomorrow.

Overall, our business performance in the year under review was in line with our expectations. Despite market conditions continuing to be difficult and our customers remaining reluctant to invest, we were able to meet or exceed our forecasts for revenue and earnings. Although unit sales were down by 3.8 per cent, revenue advanced by 1.0 per cent year on year to €1,260.2 million. In the 2015 annual report, we had predicted that revenue would stagnate or, at best, rise slightly. At €1,261.4 million, new orders were up by 2.9 per cent on the previous year. It is encouraging that our profitability improved significantly despite an only moderate increase in the volume of business. Operating profit (EBIT) rose from €4.9 million in 2015 to €23.4 million in 2016. The EBIT margin reached 1.9 per cent, compared with 0.4 per cent the year before. We had forecast a moderate increase in the EBIT margin. Net income grew from €3.5 million to €16.0 million. This led to a significant improvement in earnings per share, which came to €0.14 (2015: €0.04). Free cash flow dropped from €35.0 million to €4.7 million, largely because of the sharp rise in working capital. In operational terms, we implemented the measures to optimise the network of sites in Germany and consolidate our activities in China as planned and, in most cases, completed them. We achieved the first positive effects from the optimisation of our site network in the reporting year. Going forward, we will continue to focus on increasing efficiency and flexibility and lowering the break-even point still further. On that basis, we will be able to benefit significantly from a recovery in the market.

EMPLOYEES

Overview of the DEUTZ Group's workforce

Headcount

	31 Dec 2016	31 Dec 2015
DEUTZ Group	**3,665**	**3,730**
Thereof		
In Germany	2,827	2,910
Outside Germany	838	820
Thereof		
Non-salaried employees	2,177	2,221
Salaried employees	1,403	1,401
Trainees	85	108
Thereof		
DEUTZ Compact Engines	2,989	3,050
DEUTZ Customised Solutions	676	680

Number of employees adjusted At the end of 2016, the DEUTZ Group employed a total of 3,665 people, 65 fewer than at the end of 2015 (a fall of 1.7 per cent). As at 31 December 2016, we also had a further 182 people on temporary employment contracts, compared with 151 a year earlier. By offering fixed-term contracts and employing temporary workers, DEUTZ can respond flexibly to any fluctuations in demand. Around 6 per cent of all staff at DEUTZ had fixed-term or temporary contracts as at 31 December 2016.

77 per cent of our workforce is employed in Germany. Most of these employees are based in Cologne – 2,202 as at 31 December 2016. 411 employees are based at the Ulm facilities. Of the 838 employees outside Germany, 421 of them work at our DEUTZ Spain subsidiary.

DEUTZ Group: Breakdown of workforce by location

Headcount

	31 Dec 2016	31 Dec 2015
Cologne	2,202	2,269
Ulm	411	410
Other	214	231
In Germany	**2,827**	**2,910**
Outside Germany	838	820
Total	**3,665**	**3,730**

Looking at it by segment, DEUTZ Compact Engines employed 2,989 people as at 31 December 2016, 2.0 per cent fewer than it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 676, down by 0.6 per cent compared with the end of 2015.

New collective pay agreement for Zafra DEUTZ Spain has concluded a collective pay agreement with the works council that will remain in force until 2018. Employees will receive a cost-of-living allowance. In addition, new pay grades are being introduced for temporary employees and for work on new products in order to maintain our competitiveness and to be able to offer new products to third-party customers with a good prospect of success. This agreement is a reflection of the forward-looking and constructive collaboration between the Company, the trade union and the works council.

Vocational training at DEUTZ Young people in Germany embarking on their career have the opportunity to choose an apprenticeship in various occupations at DEUTZ, ranging from electronics, skilled metalworking and warehouse logistics to mechatronics and business administration. Last year, 27 young women and men started vocational training at our Company. Overall, 54 apprentices were employed at the Cologne site and 19 at the DEUTZ plant in Ulm. We employed six apprentices at both the components plant in Herschbach and the Xchange plant in Übersee, Bavaria.

Our training centre in Cologne also provides vocational training, on a part-time and full-time basis, for apprentices from 17 other companies. In 2016, our overall ratio of trainees to total employees was 3.0 per cent in Germany (2015: 3.7 per cent). All apprentices and trainees passing the final examination were given a permanent employment contract.

Again in 2016, our training centre received recognition and several of our apprentices were commended for their achievements. We also participated once again in various training fairs and careers information events to give young people the opportunity to establish personal contact with the Company. For many years, we have been striving to attract young women to engineering careers by taking part in events such as Girls' Day. Currently, around 8.0 per cent of apprentices at DEUTZ are female.

As part of our site optimisation programme, our training centre was relocated from the Cologne-Deutz site to new facilities in Cologne-Porz in summer 2016.

Recruitment activities successful By attending 'meet@thköln' in Cologne and 'bonding' in Aachen, we were again able to find students to help out in various areas of the Company. In the year under review, there were 171 interns employed in our Company, of whom 19 students wrote their bachelor dissertations with us and six wrote their master's dissertations. A total of 40 students spent a practical semester at DEUTZ.

Investing in people In 2016, we carried out succession planning from divisional head to team leader level to ensure that we are consistently able to appoint suitable successors for managerial positions with disciplinary responsibility. Another focus of our succession planning was to identify promising young professionals who should be given specific support with their career planning. This will allow us to continue fulfilling vacant managerial positions with people from within our own ranks.

After carrying out a joint analysis of the specific skills gaps with our managers, we have also expanded our range of inhouse courses for the professional development of our employees and made training on DEUTZ technologies a key focus. A total of 150 inhouse seminars attended by more than 1,100 people were held.

To upgrade the skills of our shop-floor staff, we continued to work with a training provider that specialises in production management and lean management and again made good use of the seminars on occupational health and safety offered by the professional association for the wood and metal industries. In 2016, we also continued our management development activities. At the Ulm site, for example, the 'management driving licence', a modular management training course, was completed by nine managers from different departments.

A rotation programme for high-potential candidates, covering production, quality and design, has been introduced at the Zafra site for the four best engineering graduates from the University of Extremadura and the two best graduates from the dual vocational training scheme. The programme aims to give potential employees for DEUTZ Spain the training they need over a twelve-month period.

Focus on promoting health After relocating from Cologne-Deutz to Cologne-Porz in early 2016, the occupational healthcare centre started operating from its new premises. The 'Ergonomics in the workplace' project continues unabated at the Cologne site. The focus was on the assembly area and the service warehouse. As part of the ERGO-DEUTZ initiative, 340 workstations in Ulm were ergonomically assessed, improvements made where necessary and employees shown how they could introduce exercises into their daily routine to alleviate the problems of sitting at a desk.

Rewards for creativity Our bonus-based ideas management system gathers creative suggestions for improvement from DEUTZ employees. Last year, more than 1,000 ideas were submitted.

CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility has a long tradition at DEUTZ. As a corporate citizen with operations around the world, we are aware of our duties and obligations. We assume responsibility for our decisions and our actions, for our products and services, for our customers and lenders, for the environment and for the society in which we live. We have been involved in corporate citizenship projects for many years, not only in our home region in the area around Cologne but also throughout Germany and beyond.

Learning about technology in the engine museum The number of visitors to the DEUTZ engine museum continues to rise. It includes exhibits on the origins and history of global motorisation and shows original machines from the early days of the engine. This all started more than 150 years ago with the founding of N.A. Otto & Cie., the predecessor of today's DEUTZ AG. The Company's history department, which is run on a voluntary basis, and the 'Friends of DEUTZ's Engine Collection' initiated joint projects with the Rhineland Regional Association, the Knowledge Foundation of the Sparkasse savings bank in Cologne/Bonn, the German Museum in Munich and the Luxembourg Science Center last year. DEUTZ also promotes a continual dialogue of ideas in order to nurture enthusiasm for technology among the general public, particularly young people.

As in previous years, DEUTZ took part in the 'Nacht der Technik' engineering and technology evening on 23 June 2016. Visitors were able to take a guided tour of our engine museum and the assembly hall at our Cologne-Porz site.

Helping young people and the unemployed into work For more than 25 years, we have been working with IN VIA – an association under the auspices of the German Caritas organisation – and the German Federal Employment Agency to provide career preparation courses for young people with learning and social difficulties. In 2015/2016, a total of 36 participants underwent basic metalwork training over a ten-month period at the DEUTZ training centre, which equipped them with a wealth of skills needed to take up a career. In 2016, 84 per cent of those who completed this training then enrolled on a vocational apprenticeship scheme, which is a relatively high proportion.

Valuable contribution from people with disabilities DEUTZ has been successfully working with NOSTRA GmbH for more than 30 years. People with disabilities work as full and equal employees at DEUTZ AG's Cologne-Kalk site, where they are responsible for the picking and packaging process for the entire range of engine spare parts. Day in, day out, they prove that people with disabilities make a valuable, economically viable contribution in the modern world of work. Today, for example, around 50 full-time employees pack engine parts and put together gasket sets and spare parts kits. Highly complex certification standards, such as DIN EN ISO 9001, have been achieved.

DEUTZ has also successfully worked in partnership with GWK, a not-for-profit organisation based in Cologne, for more than 40 years. Currently, over 110 people work for us at various sites on tasks including processing packaging and assembly orders, using machines to produce additional articles such as belt pulleys and oil level gauges and handling printing orders. The many different work steps enable the integration of employees with a variety of abilities who benefit from the continuity of the repetitive tasks.

Variety of community activities DEUTZ has been supporting the community with its 'DEUTZ fulfils your wish' Christmas initiative for a number of years. In 2016, around 120 youngsters from Kalker Kindermittagstisch wrote down their wishes on 'wish notes' and hung them on the Christmas tree so that DEUTZ employees had the chance to make their wishes come true. Kalker Kindermittagstisch serves a hot meal to the children every day and supervises them while they do their homework. Employees at the Cologne-Kalk plant also organised a donations drive as part of this community project.

Our employees demonstrated their generosity in various other ways during 2016. In the spring, apprentices at our Ulm site got involved with 'Guter Hirte' in Ulm, an organisation that looks after young single parents with small children, young people in need and child refugees without parents. And in December, employees in Ulm collected donations for 'Radio 7 Drachenkinder', a fundraiser organised by the radio station for traumatised local children who have experienced a lot of suffering as a result of illness, disability or severe setbacks in life.

DEUTZ choir reaches a milestone The 100 voices of the DEUTZ choir celebrated 70 years of singing in 2016. They marked the occasion with two gala concerts entitled 'Tales from Vienna' at the Cologne Philharmonic Hall on 25 and 26 June. Another highlight was a concert tour to Berlin, where the choir's appearances included a benefit concert at the Kaiser Wilhelm Memorial Church on 29 September. On 10 and 11 December, the choir again gave outstanding performances at its three Advent concerts in Cologne-Gürzenich, at which it was joined by the Domstadt Philharmoniker orchestra. At these concerts, donations were collected by 'Kölner Kreidekreis', which supports orphans and children who have been taken into care.

Engagement as a matter of course DEUTZ has also long been committed to diversity management: we value the diversity of our individual employees around the world – in terms of gender, origin, age, religion and disability – and we try to harness this for the success of the Company. For example, we have a clear target to increase the number of management positions within the DEUTZ Group that are occupied by women. Further information can be found in the corporate governance report on pages 129 et seq. of this annual report.

The members of the Board of Management and managers at DEUTZ AG are also fully aware of their responsibility to lead by example. They have been contributing personally to various charitable associations, trade associations, committees, trusts and other forums for many years.

ENVIRONMENT

DEUTZ upholds its responsibility for protecting the environment and preventing climate change in a variety of ways, and our environmentally friendly products and resource-efficient production methods play an important role in this regard. Our environmental management system enables us to keep track of aspects that are highly relevant to the environment, such as keeping the air clean, avoiding and correctly disposing of waste, protecting against soil and water pollution and sustainably reducing energy consumption. Furthermore, the Board of Management of DEUTZ AG set a core environmental target for 2016 of a year-on-year reduction in carbon dioxide emissions of 2 per cent per engine produced.

ENERGY MANAGEMENT SYSTEM

After successfully implementing the energy management system and obtaining certification for it in recent years, we made organisational and technological refinements to the system in 2016.

For example, the energy teams were reorganised in connection with the restructuring of the Cologne and Ulm sites and we introduced a KPI system for monitoring energy targets in the plants. Data capture was further improved by integrating mobile data entry technology into the energy monitoring system. This system provides a basis for identifying potential savings through the use of detailed analyses.

At operational level, this involved implementing the resulting measures as well as planning and implementing the energy concepts in new buildings. The energy teams' hard work enabled us to achieve annual savings of 715 MWh from a total of 20 projects.

As well as maintaining the continuous improvement process, our focus for 2017 is to raise awareness among employees in areas of production where energy consumption is high. We will also concentrate on carrying out an efficient closure of the plant in Cologne-Deutz and completing the energy concept in the new shaft centre.

DEUTZ Group: Energy consumption in our plants [1]

MWh

	2016	2015
Electricity	79,837	80,283
Natural gas	35,795	34,243
District heating	23,017	23,857
Heating oil	4,440	3,863
Diesel fuel [2]	20,144	21,335
LPG [3]	310	–

[1] Plants in the DEUTZ Group, excluding joint ventures.
[2] At 9.85 kWh/litre (mean).
[3] At 12.8 kWh/kg (mean).

ENVIRONMENTAL MANAGEMENT SYSTEM

One of the ways in which the effectiveness of DEUTZ AG's environmental management system can be seen is that key aspects, such as sustainability, are taken into consideration when workstations are being planned. The system has had its compliance with DIN EN ISO 14001 reconfirmed by the certification body DNV GL 2016.

For example, when shaft production was relocated from the Cologne-Deutz site to Cologne-Porz, the supply of coolant was centralised at the same time. This has a number of advantages in the machining of shafts. Centralised control of the system means it is no longer necessary to monitor a large number of individual machines. The useful life of the cutting fluid can now be used optimally, thereby conserving resources and reducing hazardous waste. Permanent, centralised monitoring of key parameters of the cutting fluid also ensures a high level of manufacturing quality. This is directly beneficial from both a financial and an environmental perspective. We anticipate that fluid consumption will decrease by between 5 and 10 per cent this year.

Internal environmental and energy audits, which are conducted by a team of specialists according to a defined schedule, help to ensure that the processes being audited comply with statutory requirements and that departmental targets are met. Our environmental management system also helps in this regard and its rule set is continuously updated and analysed to ascertain at an early stage whether any process changes are needed.

In 2016, DEUTZ AG began to implement the new requirements arising from the risk- and opportunity-based approach of the ISO 14001:2015 standard for environmental management. The first results, particularly the assessment of opportunities, will be examined by the external auditors in spring 2017.

Focus on reducing emissions The assessment of environmentally relevant processes has shown that the emissions from operating the engine test bays during development and production have a strong impact on our environmental footprint. To be able to better evaluate the overall impact, DEUTZ analyses total annual emissions of the greenhouse gas CO_2 as well as of the pollutants dust, nitrogen oxide and benzene.

DEUTZ Group: Annual CO_2 emissions in our plants [1]

Tonnes

	2016	2015
CO_2 emissions (Scope 1)	13,433	13,251
CO_2 emissions (Scope 2)	51,315	51,070
CO_2 emissions (Scope 3)	1,224	532
Total CO_2 emissions	65,972	64,853

Scope 1: CO_2 emissions caused by combustion in our own facilities.
Scope 2: CO_2 emissions relating to purchased energy (e.g. electricity, district heating).
Scope 3: CO_2 emissions from flying and the use of hire cars.
[1] Plants in the DEUTZ Group, excluding joint ventures.

Another analysis shows total CO_2 emissions resulting from the direct or indirect consumption of energy per engine produced during the reporting period:

DEUTZ Group: Emissions per engine in our plants [1)]

Emissions per engine

	2016	2015
Carbon dioxide (kg)	470	460
Nitrogen oxide (kg)	0.22	0.128
Dust (g)	2.7	2.6
Benzene (mg) [2)]	<85.0	44.8

[1)] CO_2 in plants in the DEUTZ Group, excluding joint ventures. The other data relates to German plants.
[2)] Measurement uncertainty is three times higher than the measured value.

There was a small year-on-year increase in carbon dioxide emissions per engine, which rose by 2.2 per cent. This means that the target of reducing carbon dioxide emissions by 2.0 per cent per engine produced was not achieved. The reason for this is that around two-thirds of the test bay emissions are attributable to research and development activities, whereas production testing only accounts for about a third. More endurance testing aimed at refining engines with large cubic capacities and improving product quality led to the increase. Ultimately, however, these tests play a part in ensuring that our future engines put fewer emissions and less CO_2 into the environment when they later go into operation. The per-engine level of other emissions (dust, nitrogen oxide and benzene) also increased in 2016 for the same reason, even though the revision rate in engine production has been successfully lowered and testing programmes have been significantly streamlined and further standardised.

The state-of-the-art, high-performance exhaust gas aftertreatment system used in the production test bays at the German sites ensures that DEUTZ remains comfortably within permitted limits and, in some cases, is very significantly below them.

FOCUS ON WATER POLLUTION CONTROL

The relocation of shaft production provided an opportunity to check that the production machines were not causing water pollution. This thorough inspection of the machines was carried out in order to pinpoint and completely eliminate any leaks from what are normally inaccessible places.

Moreover, the collection trays were designed with generous dimensions on-site by a specialist company. We invested €450 thousand in the installation of the collection trays, which play a key role in water pollution control.

All equipment that can contain or collect water pollutants and that is subject to mandatory inspection requirements is inspected at defined regular intervals by experts in order to comply with water pollution control requirements and increase technical uptime.

The risk of contaminating water courses and soil as a result of operating this equipment has been significantly reduced because we invested in renewing our machinery as part of the relocation of shaft production from Cologne-Deutz to Cologne-Porz.

SAFETY MANAGEMENT

Over the past few years, ongoing measures in the area of occupational health and safety have led to a reduction in the frequency of accidents.

However, the latest environmental KPIs show that the frequency of accidents [1)] and the number of notifiable accidents per thousand employees has increased despite safer workplaces being designed and improvements made to our health and safety organisation. Accident frequency, which is the number of notifiable workplace accidents in relation to the number of hours worked, stood at 20.9 in 2016 (2015: 12.9) and was thus significantly higher than in the previous year. Similarly, the number of notifiable accidents per thousand employees increased to 27.9 (2015: 17.7). The investigations carried out after the accidents did not reveal any clear systemic reasons for the accidents so, after reviewing the risk assessments, the necessary instructions were provided to the individuals affected in most cases.

One of the ways in which the DEUTZ AG safety organisation has been improved is the provision of cross-departmental training for fire wardens. This training, which consists of both theoretical and practical parts, was run by the works fire brigade.

[1)] Accident frequency: number of accidents per million hours worked (as defined by the employers' liability insurance association).

DEUTZ AG

The following remarks refer to the annual financial statements of DEUTZ AG. The annual financial statements of DEUTZ AG are prepared in accordance with the requirements of the German Commercial Code (HGB).

BASIC PRINCIPLES AND BUSINESS PERFORMANCE OF DEUTZ AG

DEUTZ AG is the parent company of the DEUTZ Group. At home and abroad, DEUTZ AG has various direct and indirect subsidiaries and equity investments. The subsidiaries include a production facility in Spain and several companies that perform sales and service functions. The Chinese production company – DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China – is currently being wound up. In 2016, the sales and service company DEUTZ (SHANGHAI) INTERNATIONAL TRADE Co., Ltd. was established in Shanghai, China. DEUTZ AG holds 100 per cent of the voting shares in this company. In total, DEUTZ AG has a direct or indirect stake in 28 companies (2015: 27 companies). DEUTZ AG is also by far the largest production company of the DEUTZ Group and provides the head-office functions for the Group. For details of DEUTZ AG's equity investments, please see the list of shareholdings on page 119 of the annual report.

Because the business performance and financial situation of DEUTZ AG are essentially the same as for the DEUTZ Group, we make reference here to the ‘Business performance in the DEUTZ Group’ section on page 29 et seq. of this combined management report.

Because of the significance of DEUTZ AG within the Group, and its heavy interdependencies with other Group companies, the Group is managed at the level of DEUTZ AG. In addition to the key performance indicators used for management at Group level, the net income of DEUTZ AG, as the relevant variable in the payment of dividends, is also an element of the management system of the Company. The internal management system for the DEUTZ Group is described on page 27 et seq. of this combined management report. The DEUTZ Group’s net income in accordance with IFRS is reconciled to DEUTZ AG’s net income in accordance with the German Commercial Code (HGB):

DEUTZ AG: Reconciliation

€ million	
DEUTZ Group net income (IFRS)	**16.0**
Consolidation of equity investments	10.5
DEUTZ AG income (IFRS)	**26.5**
Material differences due to different financial reporting standards	
Recognition of development expenditure	33.0
Measurement of provisions for pensions and other post-retirement benefits	–5.0
Recognition of deferred taxes	–8.6
Other differences relating to the financial reporting standards	–0.8
DEUTZ AG net income (HGB)	**45.1**

RESULTS OF OPERATIONS

Overview of DEUTZ AG’s results of operations

€ million	**2016**	2015
Revenue	**1,151.8**	**1,120.8**[1]
Cost of sales	–998.3	–978.0[1]
Research and development costs	–45.0	–43.6
Selling and administrative expenses	–69.3	–70.3[1]
Other operating income	37.7	38.6[1]
Other operating expenses	–21.4	–35.9[1]
Net investment income	4.4	5.6
Operating profit (EBIT)	**59.9**	**37.2**[1]
Interest expenses, net	–5.7	–8.2
Income taxes	–8.6	–1.7
Other taxes	–0.5	–0.5
Net income	**45.1**	**26.8**

[1] Following the initial application of the German Accounting Directive Implementation Act (BilRUG) in the annual financial statements of DEUTZ AG for the year ended 31 December 2016, the prior-year figures have been restated to improve comparability.

Revenue In 2016, the revenue generated by DEUTZ AG amounted to €1,151.8 million, an increase of 2.8 per cent compared with 2015 (€1,120.8 million). This trend was primarily due to increased demand in our largest application segments, Construction Equipment and Agricultural Machinery. In the Construction Equipment application segment, revenue rose by 8.3 per cent to €346.0 million (2015: €319.4 million). Agricultural Machinery saw an even bigger increase of 12.3 per cent to €177.0 million (2015: €157.6 million). As a result of the initial application of the German Accounting Directive Implementation Act (BilRUG) in the annual financial statements of DEUTZ AG for the year ended 31 December 2016, items amounting to €1.8 million are reported under revenue that were previously recognised under other operating income. To improve comparability, the prior-year figure has been adjusted by €2.2 million.

In terms of regions, revenue in the Asia-Pacific region rose by a substantial 17.2 per cent to €132.6 million. We also saw growth in our largest region, EMEA (Europe, Middle East and Africa), where revenue advanced by 3.1 per cent to €835.9 million. By contrast, revenue in the Americas region decreased by 5.5 per cent to €184.2 million.

Earnings performance In 2016, DEUTZ AG generated an operating profit (EBIT) of €59.9 million (2015: €37.2 million). The year-on-year increase of €22.7 million was mainly due to lower expenses resulting from the interest-rate-related adjustment to provisions for pensions and other post-retirement benefits, as well as the reversal of impairment losses recognised on our receivables from the equity investment Ad. Strüver KG. By disposing of the building lease for a plot of land that was no longer used for production purposes, Ad. Strüver KG improved its liquidity significantly, which means the receivables became recoverable again. The earnings of DEUTZ AG also benefited from the increased volume of business and lower cost of materials.

Earnings before interest, tax, depreciation and amortisation (EBITDA) at DEUTZ AG amounted to €105.6 million in 2016, compared with €93.5 million in 2015.

Cost of sales DEUTZ AG's cost of sales came to €998.3 million in 2016 (2015: €978.0 million). The year-on-year increase of €20.3 million was mainly attributable to the volume-related rise in the cost of materials. The gross margin improved from 12.7 per cent to 13.3 per cent. As the prior-year figure for revenue has been restated due to the initial application of the BilRUG, the prior-year figure for the cost of sales has also been adjusted upwards by €1.6 million in order to improve comparability. Correspondingly, selling expenses and general and administrative expenses have been reduced by €1.6 million.

Research and development costs Research and development costs rose only slightly year on year, by €1.4 million, to reach €45.0 million (2015: €43.6 million). Research and development costs largely comprised staff costs and cost of materials. Investment grants received and capitalised development expenditure were deducted. Unlike the development expenditure in the DEUTZ Group, which is recognised in accordance with IFRS requirements, the development expenditure in DEUTZ AG is recognised in accordance with HGB provisions and only expenditure relating to projects that started after initial application of the German Accounting Law Modernisation Act (BilMoG) at DEUTZ AG is capitalised.

Selling and administrative expenses Selling and administrative expenses in 2016 came to €69.3 million, a small decrease of €1.0 million compared with the previous year (2015: €70.3 million). This decrease was mainly the result of one-off transition costs in 2015 that were incurred in connection with the switch of IT service provider. When measured as a proportion of revenue, selling and administrative expenses also fell year on year, from 6.3 per cent in 2015 to 6.0 per cent in 2016. To improve comparability, the prior-year figure for selling and administrative expenses has been reduced by €1.6 million following the initial application of the BilRUG.

Other operating income Other operating income fell by €0.9 million year on year to €37.7 million (2015: €38.6 million). This decline was mainly the result of lower exchange-rate gains and the absence of the income in connection with the disposal of the shares in WEIFANG WEICHAI DEUTZ DIESEL ENGINE CO., LTD. in Weifang, China, that had been recognised in the previous year. These effects were offset by the reversal of impairment losses recognised on our receivables from the equity investment Ad. Strüver KG. As a result of the initial application of the BilRUG in the annual financial statements of DEUTZ AG for the year ended 31 December 2016, items that were previously recognised under other operating income have been reported under revenue. To improve comparability, the prior-year figure for other operating income has been adjusted by €2.2 million.

Other operating expenses Other operating expenses fell by €14.5 million year on year to €21.4 million (2015: €35.9 million). This decrease was predominantly caused by the much lower expenses relating to the interest-rate-related adjustment to provisions for pensions and other post-retirement benefits, as well as by foreign-currency transactions. The year-on-year reduction of €10.4 million in this interest-rate effect was due to using the ten-year average interest rate instead of the seven-year average interest rate to discount pension liabilities in 2016 for the first time following the implementation of new legal requirements.

As a result of the initial application of the BilRUG in the annual financial statements of DEUTZ AG, other operating expenses for 2016 include the annual addition of the difference of €2.3 million in provisions for pensions and other post-retirement benefits caused by the transition to the BilMoG. This was previously recognised under extraordinary expenses. To improve comparability, the prior-year figure has been adjusted.

Net investment income Net investment income was down on the previous year, declining by €1.2 million to €4.4 million (2015: €5.6 million). This was primarily because the prior-year figure for net investment income had been boosted by an exchange-rate gain in connection with the winding-up of the equity investment DEUTZ Engine (China) Co., Ltd. in Linyi, China.

Net interest expense Net interest expense amounted to €5.7 million in 2016 (2015: net expense of €8.2 million). This year-on-year improvement of €2.5 million was mainly attributable to reduced interest expenses for pensions and lower utilisation of credit lines.

Income taxes Income taxes came to €8.6 million in 2016 (2015: €1.7 million). Of this total, current tax expenses accounted for €6.0 million (2015: €2.7 million) and deferred tax expenses for €2.6 million (2015: deferred tax income of €1.0 million). The main reason for the rise in current tax expenses is the improvement in results of operations.

Net income Owing, in particular, to the much better level of operating profit, the net income for the reporting year increased significantly, rising by €18.3 million year on year to €45.1 million (2015: €26.8 million). At the start of 2016, we had predicted a year-on-year decrease in net income, which means we exceeded our forecast. One of the main reasons why we did better than the forecast was the reversal of impairment losses recognised on our receivables from the equity investment Ad. Strüver KG. Another reason was the change in the period, from seven years to ten years, used to determine the average interest rate for measuring pension liabilities. The contribution to earnings of €10.4 million from the positive effect arising from determination of the average interest rate cannot be distributed as a dividend.

In view of the positive level of net income, the Board of Management and Supervisory Board propose using €8.5 million of the accumulated income for the financial year to pay a dividend of €0.07 per share.

FINANCIAL POSITION

Overview of DEUTZ AG's financial position

€ million

	2016	2015
Cash flow from operating activities	50.7	88.7
Cash flow from investing activities	–44.5	–41.0
Cash flow from financing activities	–23.1	–23.9
Change in cash and cash equivalents	–16.9	23.8
Free cash flow	6.0	46.7
Cash and cash equivalents at 31 Dec	80.8	97.7

Free cash flow: cash flow from operating and investing activities less net interest expense.

Financial management in the DEUTZ Group is one of the core functions of the Group, and DEUTZ AG holds responsibility for this function. The basic principles and objectives of financial management at DEUTZ AG are therefore largely the same as those of the Group, as is the funding of DEUTZ AG. In this regard, please refer to the relevant sections on page 38 et seq. of this combined management report.

Liquidity Cash flow from operating activities amounted to €50.7 million last year (2015: €88.7 million). The sharp year-on-year fall of €38.0 million was mainly due to the higher volume of current receivables from affiliated companies and the change in working capital. Whereas there had been a marked decrease in working capital in 2015, the level of working capital fell only slightly in the reporting period. Another significant reason for the fall was the rise in income tax payments.

The cash flow from investing activities in 2016 was minus €44.5 million (2015: minus €41.0 million). This change was primarily due to lower cash receipts in connection with disposals of investments. In 2015, following the winding-up of DEUTZ Engine (China) Co., Ltd., headquartered in Linyi, China, an amount of approximately €5.0 million had been withdrawn from the additional paid-in capital of the holding company, DEUTZ Engine China GmbH, and repaid to DEUTZ AG.

Cash flow used for financing activities in 2016 totalled €23.1 million (2015: €23.9 million). This decrease was primarily due to lower interest expense. As in the previous year, cash flow used for financing activities included a dividend payment to shareholders of €8.5 million.

Free cash flow decreased year on year, falling by €40.7 million to €6.0 million (2015: €46.7 million). This was due, above all, to the significant reduction in cash flow from operating activities.

Capital expenditure After deducting investment grants, DEUTZ AG's capital expenditure in 2016 amounted to a total of €52.1 million (2015: €52.9 million). As in 2015, spending primarily related to property, plant and equipment, with €41.2 million being spent on these assets after deducting grants (2015: €42.2 million). The investing activities relating to property, plant and equipment focused on the construction of the shaft centre in Cologne-Porz, where production was progressively ramped up from mid-2016 onward. There were also additions in connection with replacement investments in machinery and tools. Capital expenditure on development projects totalled €7.5 million (2015: €6.1 million) and mainly related to the development of the new TCD 2.2 and TCD 5.0 engine series.

NET ASSETS

Overview of DEUTZ AG's net assets

€ million

	31 Dec 2016	31 Dec 2015
Non-current assets	494.4	493.4
Current assets	410.1	408.0
Prepaid expenses	1.6	1.8
Deferred tax assets	83.7	86.3
Total assets	**989.8**	**989.5**
Equity	508.8	472.2
Provisions	254.3	269.4
Liabilities	226.2	247.5
Deferred income	0.5	0.4
Total equity and liabilities	**989.8**	**989.5**
Working capital (€ million)	63.2	67.7
Working capital ratio (31 Dec, %)	5.5	6.1
Equity ratio (%)	51.4	47.7

Working capital: inventories plus trade receivables less trade payables.
Equity ratio: equity / total equity and liabilities.

Non-current assets Non-current assets at 31 December 2016 amounted to €494.4 million (31 December 2015: €493.4 million). The small year-on-year increase was primarily the result of the higher volume of internally generated intangible assets. Unlike the development expenditure recognised in the consolidated financial statements in accordance with IFRS, development expenditure in DEUTZ AG's annual financial statements is only capitalised if it relates to projects that began after the initial application of the BilMoG at DEUTZ AG. For this reason, only development expenditure on new engine projects that are still at the development stage is capitalised. As these development projects cannot yet be depreciated or amortised, the additions were not offset by depreciation or amortisation.

Current assets As at 31 December 2016, current assets amounted to €410.1 million. This increase of €2.1 million compared with twelve months earlier (31 December 2015: €408.0 million) mostly resulted from the higher volume of receivables from affiliated companies and other assets as at 31 December 2016. Decreases in inventories and in cash and cash equivalents largely offset the overall increase in current assets.

Working capital Working capital as at 31 December 2016 was €63.2 million (31 December 2015: €67.7 million), a small year-on-year decrease of €4.5 million. The main factor in this reduction was the lower level of raw materials and consumables and of bought-in parts at the end of 2016. Consequently, trade payables also declined. Trade receivables fell only slightly. The working capital ratio decreased to 5.5 per cent as at the balance sheet date[1] (31 December 2015: 6.1 per cent) owing to the reduction in working capital coupled with the increased volume of business.

Deferred tax assets Deferred tax assets contracted by €2.6 million year on year to €83.7 million (31 December 2015: €86.3 million). This reduction arose, in particular, from temporary differences between the carrying amounts in the tax accounts and in the financial statements under HGB for internally generated intangible assets. Whereas development expenditure is capitalised in the financial statements under HGB, this is prohibited in the tax accounts. The resulting deferred tax liabilities were offset against deferred tax assets as far as possible.

Equity ratio Owing to the positive level of net income, equity advanced by €36.6 million to €508.8 million (31 December 2015: €472.2 million). The rise was partly offset by the distribution of a dividend to the shareholders of DEUTZ AG of €8.5 million for 2015. The equity ratio increased slightly to reach 51.4 per cent (31 December 2015: 47.7 per cent).

Provisions At 31 December 2016, provisions stood at €254.3 million (31 December 2015: €269.4 million). This year-on-year decrease of €15.1 million was primarily attributable to the reduction in provisions for potential warranty claims in the future, as well as to lower provisions for pensions and other post-retirement benefits and lower provisions for income taxes.

Liabilities As at 31 December 2016, liabilities had fallen by €21.3 million to €226.2 million (31 December 2015: €247.5 million). The main factor here was the decline in liabilities to banks, which were scaled back as planned. Moreover, there was a year-on-year decrease in trade payables as at the balance sheet date due to a reduction in orders of raw materials and consumables.

EMPLOYEES

As at 31 December 2016, a total of 2,864 people were employed by DEUTZ AG. This meant that the number of employees had fallen by 79 year on year (31 December 2015: 2,943 employees). We also had a further 159 people on temporary employment contracts as at 31 December 2016, compared with 124 a year earlier. Employing temporary workers enables us to respond flexibly to any fluctuations in demand.

[1] Working capital ratio as at the balance sheet date: ratio of working capital (inventories plus trade receivables less trade payables) at the end of the reporting period to revenue for the preceding twelve months.

Looking at it by segment, DEUTZ Compact Engines employed 2,383 people as at 31 December 2016, 71 fewer than it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 481, which was eight fewer year on year.

OPPORTUNITY AND RISK REPORT

DEUTZ AG is integrated into the risk management system of the DEUTZ Group. As a head-office function, risk management for the Group is performed by DEUTZ AG. Information about the structuring and mechanics of the risk management system and of risk management with regard to financial instruments can be found in our notes on pages 57 et seq.

Because DEUTZ AG is closely integrated with the other Group companies, its risk and opportunities situation is essentially the same as that of the Group. Risks arising from subsidiaries may have an effect on DEUTZ AG because of the carrying amount of an equity investment, reduced dividend payments and the internal business relations. The risks and opportunities associated with the DEUTZ Group are described on pages 57 to 61 of this combined management report.

Information about DEUTZ AG's internal accounting-related control system and about risk management with regard to the use of financial instruments at DEUTZ AG can be found on page 60 et seq. of this combined management report.

OUTLOOK

DEUTZ AG performs the head-office functions of the DEUTZ Group and is the biggest production company within the Group by some margin. Because of DEUTZ AG's wide-ranging relationships with other Group companies and because of its size within the Group, the expectations presented in the Group outlook for 2017 are essentially the same as those for DEUTZ AG. We therefore anticipate that the revenue of DEUTZ AG will develop largely in line with the statements made for the DEUTZ Group. As the one-off effect resulting from the reversal of the impairment losses recognised on our receivables from Ad. Strüver KG in the reporting year will not be repeated, we expect net income in 2017 to be slightly lower than in 2016. Moreover DEUTZ AG's Board of Management decided in February 2017 to examine whether the Cologne-Deutz site can be sold quickly on attractive terms and has authorised the initiation of negotiations on selling the site. If the outcome of these negotiations is positive, DEUTZ AG may be able to generate a substantial one-off gain within a short period of time – and possibly recognise some of this gain in 2017 – depending on the specific contractual arrangements. Further information can be found in the outlook for the DEUTZ Group on pages 61 to 63.

CORPORATE GOVERNANCE DECLARATION PURSUANT TO SECTION 289A HGB

The corporate governance declaration pursuant to section 289a HGB is an integral element of the combined management report. We refer here to our remarks on pages 129 to 134 of the annual report.

DISCLOSURES PURSUANT TO SECTIONS 289 (4) AND 315 (4) HGB

Composition of the issued capital There were no changes to the issued capital (share capital) of DEUTZ AG in 2016. As at 31 December 2016, the issued capital amounted to €308,978,241.98 and was divided into 120,861,783 no-par-value bearer shares.

Direct or indirect shareholdings representing more than 10 per cent of voting rights Since 12 September 2012, AB Volvo of Gothenburg, Sweden, has held 30,246,582 shares in DEUTZ AG, giving it a voting share of 25.026 per cent.

Restrictions affecting voting rights or the transfer of shares According to the information available to us, the transferability of DEUTZ shares held by AB Volvo is restricted by a pre-emption right of the Same DEUTZ-FAHR Group S.p.A. of Treviglio, Italy.

Legal provisions and Statute provisions regarding the appointment and removal of members of the Board of Management and regarding changes to the Statutes According to articles 7 (1) and 7 (2) of the Statutes of DEUTZ AG:

"(1) The Board of Management shall comprise at least two members.
(2) The Supervisory Board shall determine the number of members of the Board of Management 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 Board of Management are concerned, sections 84 and 85 of the German Stock Corporation Act (AktG) and section 31 of the 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 and 133 AktG also apply in the case of changes to the Statutes.

Authority of the Board of Management, in particular with regard to share issue or buyback The authority of the Board of Management is derived from the legal provisions and from the rules of procedure laid down by the Supervisory Board.

The Board of Management is currently not authorised to issue or buy back shares.

FURTHER DISCLOSURES

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.

A consortium of banks has provided DEUTZ AG with a syndicated, revolving cash credit line of €160 million. DEUTZ AG also took out a loan with the European Investment Bank that has a remaining balance of €54.0 million. Under the terms of the loan agreements, the lenders can demand that the outstanding loan be repaid within a specified period in the event of a change of control, i.e. one or more people acting jointly acquire a direct or indirect shareholding of at least 50 per cent of all shares and/or voting rights in DEUTZ AG.

If DEUTZ AG needs to repay a considerable proportion of the loans prematurely in the event of a change of control, it needs to raise the necessary funds some other way in the short term.

The service contracts of the Board of Management members Dr Ing Helmut Leube (a member and the Chairman of the Board of Management until 31 December 2016), Dr Frank Hiller (a member and the Chairman of the Board of Management from 1 January 2017) and Dr Margarete Haase stipulate the following provision in the event of a change of control: if their appointment (1) is revoked within nine months of the change of control or (2) ends within nine months of a change to the legal form of DEUTZ AG and subject to certain other requirements, they will receive 150 per cent of the severance cap pursuant to article 4.2.3 of the German Corporate Governance Code. As set out in the service contracts, a change of control is deemed to occur when one or more other people or other companies acting jointly within the meaning of section 30 of the German Securities Acquisition and Takeover Act (WpÜG) acquire(s) more than 30 per cent of the voting rights and therefore control of the Company. No change of control will be deemed to have occurred if (in the case of Dr Hiller) the current major shareholder, AB Volvo, acquires more than 30 per cent of the voting rights in the Company alone or with others, or if (in the case of Dr Leube and Dr Haase) the current major shareholder, AB Volvo, or the former major shareholder, the Same DEUTZ-FAHR Group, acquires more than 30 per cent of the voting rights in the Company.

The long-term incentive plans (LTI), under which the most senior managers in the DEUTZ Group (executives and managing directors of major subsidiaries) are granted virtual options that they can exercise after a vesting period and upon achievement of certain performance targets (see pages 113 et seq. of this annual report), contain the following provision in the event of an entity – either alone or acting jointly with an affiliated company – acquiring a minimum of 50 per cent of the shares in DEUTZ AG: provided one of the performance targets has been achieved, the LTI participants may exercise their options within a short time frame after the acquisition, even if the vesting period has not yet expired.

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

EXPLANATORY STATEMENT BY THE BOARD OF MANAGEMENT IN CONNECTION WITH SECTIONS 289 (4) AND 315 (4) HGB

The disclosures contained in the combined management report and 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 Board of Management that these arrangements are normal for publicly traded companies comparable with DEUTZ AG.

REMUNERATION REPORT

REMUNERATION OF THE BOARD OF MANAGEMENT

The annual remuneration paid to the members of DEUTZ AG's Board of Management consists of fixed and variable components as well as a pension benefit contribution. The fixed component is paid monthly as basic salary. The variable component is performance-related and consists of two parts: the first is a bonus that is based on attainment of specific targets; the other comes in the form of virtual performance shares that offer a long-term incentive. For the pension contribution, an amount is paid into a benevolent fund; there is no other entitlement to a pension or surviving dependants' pension.

The calculation of the annual bonus is based on the degree of attainment of annual performance targets (short-term targets). The number, content and weighting of the short-term targets are set annually by the Supervisory Board at its due discretion after consulting with the respective Board of Management member. The minimum level of target attainment for the payment of a bonus is 75 per cent; the maximum level of target attainment relevant to the payment of the bonus is 150 per cent. The highest amount that can be paid as a bonus in the case of maximum target attainment is determined by the respective service contract. Only 60 per cent of the annual bonus is paid out at the end of the year. The rest of the bonus is paid out in two equal instalments of 20 per cent, subject to the attainment of further medium-term financial targets (medium-term targets), at the end of a further one year and two years, whereby the amount that is paid out is based on the level of attainment of these medium-term targets (to a maximum of 150 per cent). The highest permissible amounts for these further payments are also contractually agreed.

The targets for all payments are set at the beginning of the year for which the bonus is to be paid.

Details regarding the virtual performance shares are set forth in a long-term incentive plan for the Board of Management (LTI plan BoM), which forms part of the contractual agreements with the Board of Management members. The number of virtual performance shares allocated to a Board of Management member is calculated each year on the basis of the contractually specified euro amount divided by a reference price. The reference price is the average closing price of DEUTZ AG shares in Xetra trading (or a comparable successor system) on the Frankfurt Stock Exchange during the 60 trading days preceding the grant date. Virtual performance shares represent an entitlement to payment of a cash amount in accordance with the provisions of the LTI plan BoM. The cash amount per virtual performance share corresponds to the average closing price of DEUTZ shares in Xetra trading (or a comparable successor system) on the Frankfurt Stock Exchange during the last 60 trading days prior to the expiry of a vesting period of four years after the grant date, and is limited to a maximum of 1.5 times the reference price. Entitlement to the cash payment only arises, however, if either the market price of DEUTZ shares has increased by at least 30 per cent relative to the reference price or the market price of DEUTZ shares has outperformed the MDAX (or a future index replacing the MDAX) by at least 10 percentage points during the vesting period. A further requirement is that the Board of Management member makes a personal investment by holding one DEUTZ share for every 20 virtual performance shares received.

The variable remuneration is designed in a way that the majority of it is measured against performance over several years. The overall remuneration structure is designed to support the sustainable growth of the Company.

Additional benefits received by the members of the Board of Management include, in particular, a company car and allowances towards insurance policies.

Benefits granted

€ thousand

	Dr Ing Helmut Leube Chairman of the Board of Management Retired on 31 December 2016			
	2015	**2016**	2016 (min)	2016 (max)
Fixed remuneration	725	725	725	725
Additional benefits [1]	175	173	173	173
Total	**900**	**898**	**898**	**898**
One-year variable remuneration [2]	360	360	–	540
Multi-year variable remuneration				
2016–2017 deferral	240	–	–	–
2017–2018 deferral	–	240	–	360
LTI 2015–2019 [3]	222	–	–	–
LTI 2016–2020 [3]	–	207	–	300
Total	**822**	**807**	**–**	**1,200**
Total remuneration	**1,722**	**1,705**	**898**	**2,098**

Instead of the target values for one-year variable remuneration and for deferrals from one-year variable remuneration required under the German Corporate Governance Code (DCGK), the figures in the table below for total remuneration indicate the remuneration figures that are required to be disclosed under the applicable accounting standards. For the one-year variable remuneration, these represent the provision for the annual bonus for 2016, adjusted for any over- or under-allocation in the previous year. With regard to the deferrals from the one-year variable remuneration, the figures represent the amounts vested and recognised in provisions in 2016.

One-year variable remuneration	227	–		
2014–2015 deferral	26	–		
2015–2016 deferral	23	–		
Total remuneration	**1,398**	**1,105**		

[1] Includes payment into a life insurance policy.

[2] The figures given for one-year variable remuneration and for deferrals from one-year variable remuneration represent the amount granted for full achievement of targets.

[3] Share-based remuneration represents the fair value of the options on the date of grant. In 2016, the Board of Management members were granted a total of 147,577 options (2015: 125,657 options). Of this total, 58,446 options were granted to Dr Leube (2015: 52,357 options), 43,835 options to Dr Haase (2015: 39,268 options) and 45,296 options to Mr Wellenzohn (2015: 34,032 options). Please refer to Note 31 in the consolidated financial statements for a description of the structure of the share-based remuneration agreements. General contractual conditions are identical for all members of the Board of Management.

If the employment contract of a member of the Board of Management is terminated prematurely without good cause, the member of the Board of Management receives a severance payment equivalent to the total remuneration for the period until the original termination date of his or her contract of employment up to a maximum of two years. For the purpose of this severance payment, the amount of total remuneration is determined by the total remuneration paid for the last full financial year, or the anticipated total remuneration for the then current financial year, if appropriate (cap on severance pay in accordance with article 4.2.3 of the German Corporate Governance Code).

In connection with the premature termination of his Board of Management contract with effect from 31 December 2016, Dr Leube was granted a severance payment of €1,743 thousand in 2016. The severance payment reflects the total amount of remuneration that he would have received for the original remaining term of the contract. It includes performance-based components of €803 thousand and was paid in full in 2016. In accordance with Dr Leube's contract, an amount of €150 thousand was also paid into a benevolent fund in respect of 2017 on his behalf.

The service contracts of the Board of Management members Dr Ing Helmut Leube and Dr Margarete Haase stipulate a special provision in the event of a change of control. Further details can be found in the section 'Disclosures pursuant to sections 289 (4) and 315 (4) HGB' on page 52 et seq.

The table below presents the total remuneration of the Board of Management in accordance with the recommendation in the German Corporate Governance Code dated 5 May 2015. In line with this recommendation, the benefits granted in 2016 and those actually paid are reported separately.

The following table shows the breakdown of benefits granted to members of the Board of Management:

	Dr Margarete Haase				Michael Wellenzohn			
	2015	**2016**	2016 (min)	2016 (max)	2015	**2016**	2016 (min)	2016 (max)
	580	580	580	580	420	520	520	520
	147	146	146	146	111	109	109	109
	727	**726**	**726**	**726**	**531**	**629**	**629**	**629**
	270	270	–	405	210	255	–	383
	180	–	–	–	140	–	–	–
	–	180	–	270	–	170	–	255
	166	–	–	–	144	–	–	–
	–	155	–	225	–	160	–	233
	616	**605**	**–**	**900**	**494**	**585**	**–**	**870**
	1,343	**1,331**	**726**	**1,626**	**1,025**	**1,214**	**629**	**1,499**
	138	242			107	188		
	20	–			13	–		
	17	18			14	14		
	1,068	**1,141**			**809**	**991**		

The following table shows the breakdown of benefits actually paid to members of the Board of Management:

Benefits paid

€ thousand

	Dr Ing Helmut Leube Chairman of the Board of Management		Dr Margarete Haase		Michael Wellenzohn	
	2016	2015	**2016**	2015	**2016**	2015
Fixed remuneration	725	725	580	580	520	420
Additional benefits	173	175	146	147	109	111
Total	**898**	**900**	**726**	**727**	**629**	**531**
One-year variable remuneration	–	227	–	138	–	107
Multi-year variable remuneration						
2014–2015 deferral	28	60	21	45	13	29
2015–2016 deferral	23	–	17	–	14	–
Other	–	–	–	–	–	–
Total	**51**	**287**	**38**	**183**	**27**	**136**
Total remuneration	**949**	**1,187**	**764**	**910**	**656**	**667**

The total expense for share-based payments recognised in the reporting year amounted to €367 thousand for Dr Leube (2015: €92 thousand), €275 thousand for Dr Haase (2015: €90 thousand) and €242 thousand for Mr Wellenzohn (2015: €73 thousand).

REMUNERATION OF THE SUPERVISORY BOARD

The remuneration paid to the Supervisory Board is specified in article 15 of the Company's Statutes. This stipulates that the members of the Supervisory Board of DEUTZ AG receive fixed annual remuneration of €22,500. They also receive a fee of €2,500 for each Supervisory Board meeting they attend and are reimbursed for their out-of-pocket expenses. The chairman of the Supervisory Board receives double these amounts, and his deputy one-and-a-half times.

In addition, each member of a Supervisory Board committee receives an attendance fee of €2,500 for each committee meeting attended. 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.

The following table shows the breakdown of total remuneration paid to members of the Supervisory Board for their work as Supervisory Board members:

€	Fixed remuneration	Attendance fees	Total
Hans-Georg Härter Chairman	45,000	80,000	**125,000**
Werner Scherer Deputy Chairman	33,750	67,500	**101,250**
Sabine Beutert	22,500	22,500	**45,000**
Hans-Peter Finken	22,500	12,500	**35,000**
Gisela Füssel (from 1 June 2016)	13,156	10,000	**23,156**
Dr Ing Hermann Garbers	22,500	12,500	**35,000**
Göran Gummeson	22,500	12,500	**35,000**
Leif Peter Karlsten	22,500	12,500	**35,000**
Herbert Kauffmann	22,500	55,000	**77,500**
Alois Ludwig	22,500	12,500	**35,000**
Dietmar Paust (until 31 May 2016)	9,344	2,500	**11,844**
Dr Witich Roßmann	22,500	12,500	**35,000**
Dr Herbert Vossel	22,500	12,500	**35,000**
Total	**303,750**	**325,000**	**628,750**

RISK REPORT

RISK MANAGEMENT SYSTEM

To ensure their long-term survival, companies must act quickly – and react even faster – in a world in which economic conditions and the individual markets are constantly in a state of rapid change. 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 various organisational units: the operating segments of the Group's parent company, subsidiaries, sales offices and authorised dealers. This organisational structure presents the Company with opportunities, but also gives rise to business-specific risks.

Our objective is to generate profits on a sustained basis and to increase these profits significantly over the medium and long term 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. DEUTZ has an appropriate risk management system to ensure it can meet this requirement.

Such a system heightens employees' sense of responsibility and raises their awareness of potential or existing risks. It also helps everyone involved to identify, analyse and communicate risks in good time and to initiate effective corrective action.

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

The DEUTZ Group conducts risk inventories four times a year. These risk inventories are carried out in all functions and areas of the Company and in the main affiliated companies to identify whether new risks have arisen compared with the Company's short-term and medium-term planning. The risks are categorised by importance, based on estimated probability of occurrence and potential impact. At the same time, a review is carried out to establish whether and how action that has been agreed and implemented has successfully minimised the known risks or whether there is still a need for further action. The Risk Management Committee then analyses the risks and the progress of the action that is being taken and reports to the Board of Management on the results of the risk inventory. To enable the Company to respond promptly at all times to any possible risks that may arise, risk officers and their employees are under an obligation to submit immediate reports on any new material risks or if there is an increase in the threat from known risks. These reports are to be separate from the regular reporting requirements. The risk management system does not identify opportunities, only risks.

Each year, 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 to assess whether the system is functioning efficiently. Suggestions for improvements proposed by the internal audit department, the Risk Management Committee or the auditors are promptly implemented by DEUTZ.

RISK MANAGEMENT IN RELATION TO FINANCIAL INSTRUMENTS

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 sales, procurement, interest-rate and foreign-exchange markets. The overarching risk management strategy used is designed to mitigate potentially negative effects on the DEUTZ Group's financial position.

The management and early identification of financial risks is based on annual financial planning, together with updates and regular analyses of variances during the course of the year. Financial management in the Group is the responsibility of DEUTZ AG as the parent company.

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

The Finance Committee, which meets every quarter, or on an ad-hoc basis as required, provides a forum at which operational issues relating to risk management and other financially relevant decisions are discussed. The Finance Committee consists of the relevant member of the Board of Management plus representatives of the treasury and finance departments.

The objective of risk management is to mitigate fluctuations in profits and cash flows caused by volatility in commodity, interest-rate and foreign-exchange markets. Derivative financial instruments are used only for hedging purposes, i.e. only in connection with corresponding underlying transactions arising 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 financing directive.

DEUTZ works exclusively with leading banks in order to minimise counterparty risk.

The treasury department manages the lines of credit in accordance with the Group's financing principles. Subsidiaries are funded primarily by DEUTZ Group loans.

We manage the financial risk as follows:

Risk from bad debts We protect ourselves against the risk of bad debts by constantly monitoring our situation through electronic and other means and by regularly analysing receivables and their breakdown. The Company takes out credit insurance to cover a large proportion of its receivables where payment for goods has not been received in advance or is not covered by a letter of credit.

Currency risk arising from operating activities Currency risk, primarily in US dollars, which arises as a result of transactions with third parties denominated in foreign currency, is monitored by means of a central currency management system and mitigated by the use of derivative financial instruments. The DEUTZ Group's net currency exposure is normally hedged by forwards equivalent to 50 to 80 per cent of open items. 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.

Interest-rate risk arising from funding arrangements The DEUTZ Group is exposed to risk from interest rate changes, above all in relation to floating-rate loans and other loans that it has taken up. We hedged the interest-rate risk arising from the funding arranged in mid-2012 with the European Investment Bank. This means that, as far as some of our financial arrangements are concerned, we will not be affected by any rises in short-term interest rates in the future.

Liquidity risk The funding agreements concluded provide the Company with adequate liquidity for its further development. During the term of the agreement, DEUTZ AG must ensure that the DEUTZ Group complies with certain financial covenants (ratio of financial debt to equity and to EBITDA). The financial covenants allow sufficient leeway in line with our medium-term balance sheet and profit planning. If, however, there is a dramatic deterioration in the general economic situation, there is a risk of the covenants being breached.

Further information on financial risk management can be found in Note 26 on page 100 et seq.

RISK ASSESSMENT

The assessment of risks in the DEUTZ Group is based on the estimated probability of occurrence in conjunction with the potential impact of the risk on the business objectives. In the following risk report for the DEUTZ Group, the risks are categorised as either 'low', 'moderate' or 'high'. Risks that have been classified as 'low' would be expected to have a low impact of up to €10 million on financial position and financial performance. Risks classified as 'moderate', however, would have a significant impact (between €10 million and €50 million) and risks classified as 'high' would have a major impact of over €50 million on financial position and financial performance. Risks to the Company's survival as a going concern are described as such.

DEUTZ Group: Risk assessment

Probability of occurrence (%)	minor	moderate	significant	critical	very critical
80–99	low	moderate	moderate	high	high
60–79	low	moderate	moderate	high	high
40–59	low	moderate	moderate	moderate	high
20–39	low	low	moderate	moderate	moderate
1–19	low	low	low	moderate	moderate

Impact

RISK

As with the internal risk report, the following presentation of the current risk situation is focused on the risk factors that are important for the DEUTZ Group. Consequently, risks that are referred to were categorised at least as 'low' before measures to counter the risk were taken into account. In contrast to the internal risk management, the risks in the following description are more strongly aggregated and are listed by risk category. Unless otherwise stated, the risks refer to 2017 and relate to both the DCE and DCS segments.

EXTERNAL RISK

Market risk We operate in sales markets that are characterised by particular sensitivity to cyclical influences. Currently, they are also showing increasing protectionist tendencies. This can have a negative impact on the financial position and financial performance of the DEUTZ Group. As well as having a direct effect on unit sales and revenue, this may also impact negatively on the value of the assets on our balance sheet. We operate in very cyclical markets in our main application segments, Construction Equipment and Material Handling, and in our principal sales regions of Germany, western Europe and

North America. Our objective is to continue to reduce this cyclicality from a regional and application segment perspective. One of the ways in which we are doing so is by continuing to focus further efforts on expanding our Agricultural Machinery application segment, as it follows a different economic cycle to the other application segments.

In the medium and long term, we seek to mitigate regional and application-related sales risks by aligning our development activities with our product strategy and by entering into alliances. Close alliances with our key customers are of considerable importance in enabling us to achieve these sales targets, although there is a risk of becoming dependent on them in the long term. We therefore pursue a strategy of signing up new customers and progressively expanding our business with them. These business development activities are particularly focused on Asia.

We are very well diversified and well positioned for the future in terms of the geographical and sectoral distribution of our customers. We supply the market-leading manufacturers in the various application segments. Despite the countermeasures that are in place, we cannot completely control the external risks. In view of the measures in place, we continue to categorise the market risk as ‘moderate’ in respect of the achievement of our corporate targets for 2017 because the economic situation in our sales markets remains volatile.

By contrast, the United Kingdom's upcoming departure from the European Union does not constitute a material external risk because our volume of business in the country is comparatively low.

STRATEGIC RISK

Our business strategy is focused on expanding our customer and product base and on further globalisation and internationalisation. This strategy presents the DEUTZ Group with numerous opportunities but is, of course, also associated with risks. Target markets might not grow as anticipated, while new product developments may not be as well received by customers as predicted or may not be able to compete with rival products.

We attempt to mitigate these risks by precisely analysing trends in our markets and by taking into account external market research. For example, our analysis of the future viability of diesel technology confirms that it will continue to play a major role in our application segments over the long term. We also enter into close alliances with our major customers in the target markets. Finally, we closely monitor our strategic projects so that we are able to respond immediately to changes.

In view of the measures in place, we categorise the strategic risks with regard to the attainment of our financial targets as ‘low' in 2017 and as 'moderate’ in the medium term.

OPERATIONAL RISK

Quality risk The DEUTZ Group is exposed to liability and warranty risks. Potential warranty claims and claims for compensation could have a negative impact on our financial position and financial performance.

We have set up local quality departments to ensure quality in all plants and relevant areas of the Group. These departments systematically analyse sources of errors and defects, optimise production processes, take action to minimise the risk in production start-ups and reduce warranty risks. A central quality management organisation ensures that standardised processes and methods are in place and carries out regular audits. In addition, DEUTZ has defined uniform standards for the selection of suppliers and, in close cooperation with the suppliers, continuously improves the quality of supplied parts.

Regular certification audits and additional quality initiatives also enable us to handle the significant technical complexity of engines and to satisfy the steadily increasing quality requirements of our customers. In 2016, for example, we introduced the zero-error strategy. The idea of this quality assurance programme is to detect errors before they actually occur. And where errors do occur, we have to learn from them quickly in order to not repeat them.

Sufficient provisions are recognised on the balance sheet to account for warranty risks. In view of the precautionary measures that have been taken, we categorise any further quality risks that could negatively impact on our financial targets as ‘low’ for 2017.

Production risk Fluctuations in capacity utilisation in production that result from our level of dependency on the general economic situation can, just like breakdown-related production delays, have a negative impact on profitability.

In order to avoid mistakes in planning and capital expenditure, the necessary production capacity is regularly reviewed and planned using different timescales: over a number of years as part of the medium-term planning process, which is revised each year, and for the following financial year as part of the budget planning process, which is then updated quarterly for the current year. Production programme meetings and capacity planning meetings are held monthly to ensure that our capacity is adjusted in line with sales. We are using temporary employment contracts more and more as a way of flexibly adjusting capacity to the level of orders on hand.

In view of the measures in place to avoid or minimise these risks, we continue to categorise the level of production risk with regard to our financial targets as 'low'.

OTHER RISKS

Cyber risk We are a technology-driven company that is heavily focused on research and development. Being an innovation leader gives us a competitive advantage that forms the basis of our long-term success. The risk associated with this is that strictly confidential information, particularly concerning new technologies or partnerships in research and development, could find its way to our competitors through illegitimate means.

As well as the loss of confidential information, it is conceivable that forged documents could be used to siphon off capital without authorisation. Cyber risks such as these could have a negative impact on our market position and limit our financial flexibility. This might ultimately harm our reputation.

We have put a series of measures in place to protect against cyber risks. As well as regular security training for employees, these include security measures for computer hardware and IT security guidelines that have been laid down by management. In view of the precautions that have been taken, we continue to categorise these risks as 'low'.

Legal risks As a Group with multinational operations, DEUTZ is subject to a variety of regulations under tax, competition and patent law as well as to other legal and statutory requirements. Existing and potential legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and an appropriate amount is recognised in the risk provisions in the accounts. The outcome of legal disputes is uncertain, however. This means that there are further risks, not accounted for through provisions on the balance sheet, that could negatively impact on our financial targets.

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 are refined on an ongoing basis and reduce the level of new legal risks at DEUTZ. The legal affairs department and external lawyers are also regularly consulted about projects and the finalisation of contracts that fall outside the scope of the standards developed for day-to-day business. Given the positive overall progress in ongoing cases and in view of the measures that have been taken either to avoid or minimise risk, we now categorise the legal risk as only 'low'.

OVERALL ASSESSMENT OF THE RISK SITUATION

We identify and evaluate material risks on an ongoing basis using our risk management system. Appropriate action is taken to manage these risks and, as far as possible, bring them under control. Changes in material risks are monitored regularly at Group level. Currently, the DEUTZ Group has not identified any risks that either individually or in their totality could jeopardise the continued existence of the enterprise as a going concern. Legal and short-term strategic risks decreased in comparison with 2015. Other risk factors changed only marginally year on year. Consequently, the overall risk level fell slightly compared with 2015. Because of the precautions that have been taken and our position in the market, we are confident in our ability to successfully manage the existing risks and overcome the resulting challenges – despite conditions remaining difficult.

ACCOUNTING-RELATED INTERNAL CONTROL SYSTEM

The risk management system forms part of, and is closely linked to, the internal control system. Whereas the risk management system focuses on the identification, analysis, assessment, communication and management of risk, the internal control system (ICS) brings together activities aimed at avoiding or limiting risk.

The Board of Management is responsible for setting up, monitoring, refining and ensuring the effectiveness of the ICS. Even a properly structured ICS is unable to provide absolute security; it can only provide a relative amount of security in helping to achieve targets and/or avoid material misstatements.

The aim of the internal accounting-related control system is to ensure that accounting is carried out consistently and in accordance with statutory requirements, generally accepted accounting principles and internal guidelines. The accounting process itself includes those operating processes that provide the value flows for financial reporting, the process for preparing the consolidated financial statements, and all information sources and processes from which the significant disclosures in the consolidated financial statements are derived.

In order to ensure that the consolidated financial statements are properly and consistently prepared, the Group adheres to the fundamental principles of separation of functions, having work checked by a second member of staff and IT access restrictions to prevent unauthorised access to relevant data. There are written procedural instructions and, in particular, Group accounting guidelines that are regularly updated at head office and communicated throughout the Group. Each reporting entity is responsible for compliance with the guidelines, and the data reported to DEUTZ's Group accounting department is validated on an ongoing basis during the preparation of monthly financial statements. Data is reported to the Group head office using a standard reporting tool that has been implemented throughout the Group. Additional control mechanisms covering the risks in the main processes, thereby guaranteeing a reliable accounting and reporting system, are normally set up locally at departmental level. Where necessary, we also use external service providers, such as independent assessors of pension liabilities. The Group accounting department ensures that these requirements are adhered to across the Group.

Information relevant to accounting is shared on an ongoing basis with the Head of Finance, Accounting and Compliance and passed on to the Chief Financial Officer in regular meetings.

Besides discussing the single-entity and consolidated financial statements, the Audit Committee set up by the Supervisory Board regularly discusses the quarterly financial reporting. In addition, the Audit Committee's monitoring function includes the ICS set up by the Board of Management as well as the accounting process itself.

The internal audit department prepares a risk-based audit plan and verifies whether the statutory regulations and the DEUTZ Group's internal guidelines for its entire control and risk management system are being complied with. As part of its monitoring function it reviews whether the defined controls are functioning effectively. The findings of these reviews are reported directly to the Board of Management and allow us to eliminate any deficiencies that have been identified and ensure that the ICS is continually refined.

OPPORTUNITIES REPORT

In the fast-paced, dynamic markets in which the DEUTZ Group operates, there are, in addition to the aforementioned risk factors that can negatively impact on the attainment of the business objectives, also opportunities that can have a positive effect on the business objectives of the Group for 2017 and beyond. Identifying and harnessing these opportunities is the responsibility of the individual operating segments of the Group. Unlike risks, opportunities are not collated and assessed centrally.

Unless otherwise stated, the opportunities described below refer to 2017 and relate to the DCE and DCS segments.

Economic situation in relevant markets Developments in the global economy have a major effect on the financial position and financial performance of the DEUTZ Group. If our expectations regarding the macroeconomic situation in our most important markets of Europe, the USA and Asia are exceeded, and in view of the measures we have already taken to boost efficiency (particularly the optimisation of our network of sites in Germany), we may perform significantly better than we predicted.

Research and development Increasingly stringent emissions standards and general technological progress are placing huge demands on our entire industry. We are one of the innovation leaders and have a very strong competitive position thanks to our proven expertise, our many years of experience and our efficient processes in the research and development of diesel engines and other drive systems. The development of gas engines with a capacity of up to 4 litres and the expansion of our portfolio of products with a capacity of over 4 litres will enable us to reinforce this strong competitive position.

Production and quality The digital transformation of manufacturing, referred to as Industry 4.0, is exploring new approaches to production. The first projects in the service business are due to start soon. In combination with projects to improve quality and the introduction of the zero-error strategy, this may lead to substantial efficiency increases and greater customer satisfaction in the short to medium term.

OUTLOOK

ECONOMIC FORECASTS REMAIN UNCERTAIN

The International Monetary Fund (IMF)[1] has confirmed its forecasts for the next few years, anticipating a stronger rate of growth in industrialised countries as well as in developing countries and emerging markets. Following growth of 3.1 per cent in 2016, the IMF predicts that the global economy will expand by 3.4 per cent in 2017 and by 3.6 per cent in 2018.

The economy of the eurozone is likely to generate growth of 1.6 per cent, compared with 1.7 per cent last year. Germany's growth rate will probably be slightly lower, remaining unchanged at 1.5 per cent. The US economy is expected to receive further stimulus, growing at a rate of 2.3 per cent in 2017 and 2.5 per cent in 2018, compared with 1.6 per cent in 2016. The IMF also anticipates slower growth rates for China: having risen by 6.7 per cent last year, GDP is predicted to rise by 6.5 per cent in 2017 and 6.0 per cent in 2018.

[1] IMF World Economic Outlook Update, January 2017.

The business climate index[1] published by the ifo Institute of Economic Research, which covers trade and industry in Germany, dropped from 111.0 points to 109.8 points in January 2017. Although companies were more satisfied with their current business position, they were feeling slightly less optimistic about the coming months. The ISM purchasing managers' index[2] in the USA made a surprising jump to 56.0 points as at 1 February 2017 – its highest level since November 2014.

DIESEL ENGINES MARKET

For construction equipment in 2017, we anticipate that unit sales in North America will move within a range of –5 per cent to +5 per cent while the European market will expand by between 0 per cent and 5 per cent and the Chinese market by between 5 per cent and 10 per cent. We expect growth in the material handling market to be between 0 per cent and 10 per cent in Europe, whereas the North American and Chinese markets are likely to remain within a bandwidth of –5 per cent to +5 per cent. We also predict that the agricultural machinery market in Europe will remain fairly static within a range of –5 per cent to +5 per cent. In China, we expect the light and medium-duty truck sector to generate slight growth of between 0 per cent and 5 per cent.

As a rule, the diesel engines market largely follows the applications and markets of the machinery and equipment in which the engines are installed.

UNIT SALES, REVENUE

Although, as already said, we anticipate that the market will stagnate, or perhaps grow slightly, we can already see early signs of a potential improvement in the market. Last year, many of our European customers largely used up the inventories that they had built up in 2014 in anticipation of the new emissions standard. This provides a very strong base effect for us. Production for a number of projects with new customers is still being ramped up, which should also have a beneficial impact. We believe the service business's revenue will continue to go up.

Owing to the increasing proportion of higher-value engines to meet the new emissions standards in Europe and America, the value of the diesel engines market will continue to increase at a faster rate than its unit sales.

We therefore anticipate a marked rise in revenue overall. The increase in revenue will be fuelled by the DCE segment, whereas we expect the DCS segment's revenue to decrease slightly. This is because the effects of the advance production of engines for the new emissions standard and the projects with new customers are predominantly in the DCE segment. Given the current environment, our forecasts are of course subject to great uncertainty. The flexibility of our business therefore remains a key factor in our competitiveness.

[1] ifo Institute of Economic Research, January 2017.
[2] ISM purchasing managers' index, February 2017.

EARNINGS

We expect the EBIT margin before exceptional items to increase moderately. The margin will be boosted, above all, by better capacity utilisation and the positive effects of optimising our network of sites. However, unlike in 2016, we do not anticipate any licensing income this year. From this year, we reckon on annual efficiency gains of around €10 million from the optimisation of our network of sites, primarily in connection with the new shaft centre, the relocation of Xchange assembly activities to Ulm and the absence of costs from the Cologne-Deutz site. We already realised about half of this gain in 2016. We expect earnings to rise in both the DCE and the DCS segment.

Furthermore, we anticipate positive exceptional items from property transactions in the near future. Firstly, in 2016 we disposed of a building lease for a plot of land of our equity investment Ad. Strüver KG (GmbH & Co.), Hamburg, that was no longer being used for production purposes; this will result in a positive exceptional item of around €10 million this year. Secondly, DEUTZ AG's Board of Management decided in February 2017 to examine whether the Cologne-Deutz site, which covers an area of around 160,000 square metres and is no longer required for operational purposes following the successful optimisation of our site network, can be sold quickly on attractive terms. The Board of Management has authorised the initiation of negotiations on selling the site. If the outcome of these negotiations is positive, DEUTZ may be able to generate a substantial one-off gain within a short period of time, depending on the specific contractual arrangements. It may be possible to recognise some of this gain as early as 2017.

As a result of the anticipated slight increase in earnings – before positive exceptional items – we believe there will be a small year-on-year rise in return on capital employed (ROCE) before exceptional items in 2017.

COMMODITIES, COLLECTIVE PAY AGREEMENTS

Commodity prices We expect a further small rise in price levels in the primary markets this year, driven by slightly higher growth of the global economy.

No collective pay bargaining in 2017 The collective payment agreement from 2016 expires on 31 December 2017, and one of its key points is a 2 per cent pay increase with effect from 1 April 2017.

RESEARCH AND DEVELOPMENT EXPENDITURE

We predict that research and development spending will rise to between approximately €60 million and €70 million, of which up to €15 million will be capitalised. This is because of new engine projects in relation to the upcoming EU Stage V that will lead to the expansion of our engine portfolio.

CAPITAL EXPENDITURE

We forecast that our capital expenditure in 2017 (excluding capitalisation of research and development expenditure) will be around €70 million, of which up to €15 million for the planned project with Liebherr.

JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD

The market environment in China is likely to remain challenging in 2017. We expect the revenue and earnings of our joint venture DEUTZ (Dalian) Engine Co., Ltd. to improve slightly. Its performance will depend heavily on its capacity utilisation and thus on market conditions.

WORKING CAPITAL RATIO, FREE CASH FLOW AND EQUITY RATIO

Our prediction for the working capital ratio, measured as the quarter-end average, is for a slight improvement on the figure of 17.9 per cent as at 31 December 2016. In addition, we expect positive free cash flow to be at the same level as 2016. If negotiations on the sale of the Cologne-Deutz site are successful, we forecast that free cash flow will be in the mid- to high-double-digit million euro range.

We intend to maintain our equity ratio above 40 per cent, a level that it currently comfortably exceeds. The good level of equity reduces our dependency on capital markets in a volatile market environment.

EMPLOYEES

Optimisation of site network The measures to optimise our network of sites remain on schedule. Following the completion of the first stage of the relocation from Übersee to Ulm in 2015, the reconditioned exchange engine business went through a process of continuous improvement during 2016. The final stage of the relocation should be completed as scheduled on June 30, 2017.

Flexible employment So that we can respond appropriately to cyclical fluctuation in our industry, we will continue to make use of fixed-term and temporary contracts, even though the terms and conditions will change significantly as a result of the new German Labour Leasing Act (AÜG).

STATUTORY REGULATIONS, EXHAUST EMISSIONS STANDARDS

Regulation (EU) 2016/1628 on the introduction of Stage V from 2019 came into force on 6 October 2016. This will largely harmonise EU and US limits on gaseous emissions in all power categories. There will also be a limit on the number of particulates emitted by diesel engines for mobile machinery in the 19 to 560 kW power output range. Our TCD engines equipped with a diesel particulate filter in the 2.9 to 7.8 litre cubic capacity range already meet this new limit. Furthermore, our 'Stage V ready' label guarantees that the entire DEUTZ TCD engine range from 2.2 to 16 litres cubic capacity will meet EU Stage V without the need for modifications to customers' equipment. No further tightening of exhaust emissions limits in the USA is currently on the horizon.

Disclaimer 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 Board of Management cannot therefore make any guarantees with regard to the forward-looking statements made in this management report.

CONSOLIDATED FINANCIAL STATEMENTS 2016

INCOME STATEMENT FOR THE DEUTZ GROUP

€ million

	Note	2016	2015
Revenue	1	**1,260.2**	**1,247.4**
Cost of sales	2	–1,041.6	–1,054.8
Research and development costs	3	–77.5	–76.3
Selling expenses	4	–68.0	–68.3
General and administrative expenses	4	–36.7	–36.5
Other operating income	5	17.7	29.3
Other operating expenses	6	–26.7	–30.6
Profit/loss on equity-accounted investments	7	–5.1	–6.3
Other financial income	7	1.1	1.0
EBIT		**23.4**	**4.9**
Interest expenses, net	8	–3.5	–4.0
thereof finance costs	8	–3.8	–4.8
Net income before income taxes		**19.9**	**0.9**
Income taxes	9	–3.9	2.6
Net income		**16.0**	**3.5**
thereof attributable to shareholders of DEUTZ AG		16.6	5.4
thereof attributable to non-controlling interests		–0.6	–1.9
Earnings per share (€)	10	**0.14**	**0.04**

STATEMENT OF COMPREHENSIVE INCOME FOR THE DEUTZ GROUP

€ million

	Note	2016	2015
Net income		**16.0**	**3.5**
Amounts that will not be reclassified to the income statement in the future	11	**–9.1**	**3.1**
Remeasurements of defined benefit plans		–9.1	3.1
Amounts that will be reclassified to the income statement in the future if specific conditions are met	11	**–1.4**	**3.9**
Currency translation differences		0.2	2.8
thereof profit/loss on equity-accounted investments		–1.1	2.8
Effective portion of change in fair value from cash flow hedges		–1.6	1.3
Change in fair value of available-for-sale financial instruments		–	–0.2
Other comprehensive income, net of tax	11	**–10.5**	**7.0**
Comprehensive income		**5.5**	**10.5**
thereof attributable to shareholders of DEUTZ AG		6.3	13.1
thereof attributable to non-controlling interests		–0.8	–2.6

BALANCE SHEET FOR THE DEUTZ GROUP

€ million

Assets	Note	31 Dec 2016	31 Dec 2015
Property, plant and equipment	12	286.0	289.0
Intangible assets	13	148.5	176.6
Equity-accounted investments	14	41.7	48.5
Other financial assets	15	7.5	6.4
Non-current assets (before deferred tax assets)		483.7	520.5
Deferred tax assets	16	79.9	69.1
Non-current assets		**563.6**	**589.6**
Inventories	17	253.1	251.9
Trade receivables	18	113.5	101.2
Other receivables and assets	18	37.3	32.5
Cash and cash equivalents	19	91.8	112.5
Current assets		**495.7**	**498.1**
Non-current assets classified as held for sale	20	0.4	0.4
Total assets		**1,059.7**	**1,088.1**

Equity and liabilities	Note	31 Dec 2016	31 Dec 2015
Issued capital		309.0	309.0
Additional paid-in capital		28.8	28.8
Other reserves		17.1	18.3
Retained earnings and accumulated income		136.2	134.3
Equity attributable to shareholders of DEUTZ AG		**491.1**	**490.4**
Non-controlling interests		–	5.2
Equity	21	**491.1**	**495.6**
Provisions for pensions and other post-retirement benefits	22	175.9	172.3
Deferred tax liabilities	16	0.4	–
Other provisions	23	38.4	46.7
Financial debt	24	44.0	58.6
Other liabilities	25	6.3	3.2
Non-current liabilities		**265.0**	**280.8**
Provisions for pensions and other post-retirement benefits	22	14.1	14.3
Provision for current income taxes		4.1	7.5
Other provisions	23	55.9	59.7
Financial debt	24	16.2	14.9
Trade payables	25	162.3	169.5
Other liabilities	25	51.0	45.8
Current liabilities		**303.6**	**311.7**
Total equity and liabilities		**1,059.7**	**1,088.1**

STATEMENT OF CHANGES IN EQUITY FOR THE DEUTZ GROUP

€ million

	Issued capital[3]	Additional paid-in capital[3]	Retained earnings and accumulated income[3]	Fair value reserve[1),2)]	Currency translation reserve[1)]	Equity attributable to share-holders of DEUTZ AG	Non-controlling interests[3]	Total[3]
Balance at 1 Jan 2015	**309.0**	**28.8**	**134.3**	**–1.5**	**15.2**	**485.8**	**25.2**	**511.0**
Dividend payments to shareholders			–8.5			–8.5		–8.5
Repayment of capital contributions							–2.6	–2.6
Outstanding contributions from non-controlling interests							–14.8	–14.8
Net income			5.4			5.4	–1.9	3.5
Other comprehensive income			3.1	1.1	3.5	7.7	–0.7	7.0
Comprehensive income			8.5	1.1	3.5	13.1	–2.6	10.5
Balance at 31 Dec 2015	**309.0**	**28.8**	**134.3**	**–0.4**	**18.7**	**490.4**	**5.2**	**495.6**
Balance at 1 Jan 2016	**309.0**	**28.8**	**134.3**	**–0.4**	**18.7**	**490.4**	**5.2**	**495.6**
Dividend payments to shareholders			–8.5			–8.5		–8.5
Net income			16.6			16.6	–0.6	16.0
Other comprehensive income			–9.1	–1.6	0.4	–10.3	–0.2	–10.5
Comprehensive income			7.5	–1.6	0.4	6.3	–0.8	5.5
Changes to basis of consolidation			2.9			2.9	–4.4	–1.5
Balance at 31 Dec 2016	**309.0**	**28.8**	**136.2**	**–2.0**	**19.1**	**491.1**	**–**	**491.1**

[1)] On 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)] The items of equity are explained in Note 21 of the notes to the consolidated financial statements.

CASH FLOW STATEMENT FOR THE DEUTZ GROUP

€ million

	Note	2016	2015
EBIT		**23.4**	**4.9**
Income taxes paid		–9.2	–9.4
Depreciation, amortisation and impairment of non-current assets		90.8	107.3
Gains/losses on the sale of non-current assets		–0.3	–3.1
Profit/loss on equity-accounted investments		5.6	6.8
Other non-cash income and expenses		0.4	–0.9
Change in working capital		–18.7	23.1
Change in inventories		1.6	0.7
Change in trade receivables		–11.1	24.5
Change in trade payables		–9.2	–2.1
Change in other receivables and other current assets		–8.4	8.6
Change in provisions and other liabilities (excluding financial liabilities)		–19.8	–34.0
Cash flow from operating activities		**63.8**	**103.3**
Capital expenditure on intangible assets, property, plant and equipment		–57.8	–68.2
Capital expenditure on investments		–0.2	–0.1
Proceeds from the sale of non-current assets		2.6	3.9
Cash flow from investing activities		**–55.4**	**–64.4**
Dividend payments to shareholders	21	–8.5	–8.5
Interest income		0.2	0.6
Interest expense		–3.9	–4.5
Repayment of capital contributions to non-controlling interests		–	–2.6
Cash receipts from borrowings		–	–
Repayments of loans	24	–14.6	–14.8
Cash flow from financing activities		**–26.8**	**–29.8**
Cash flow from operating activities		63.8	103.3
Cash flow from investing activities		–55.4	–64.4
Cash flow from financing activities		–26.8	–29.8
Change in cash and cash equivalents		**–18.4**	**9.1**
Cash and cash equivalents at 1 Jan		**112.5**	**101.7**
Change in cash and cash equivalents		–18.4	9.1
Change in cash and cash equivalents related to exchange rates		0.2	1.7
Change in cash and cash equivalents related to the basis of consolidation		–2.5	–
Cash and cash equivalents at 31 Dec	19	**91.8**	**112.5**

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 in Cologne. The Board of Management approved these consolidated financial statements for publication by adoption of a resolution dated 17 February 2017.

DEUTZ AG shares are listed in the Deutsche Börse SDAX segment and are publicly traded on the stock exchanges in Frankfurt and Düsseldorf as well as 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 – DEUTZ 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 Construction Equipment, Material Handling, Agricultural Machinery, Automotive, and Stationary Equipment. Comprehensive after-sales service rounds off the product range offered. In 2015, the Construction Equipment and Material Handling application segments had been aggregated in the Mobile Machinery application segment.

BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The DEUTZ Group's consolidated financial statements prepared for the parent company DEUTZ AG are based on uniform accounting policies. The consolidated financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) and their interpretations as adopted by the European Union (EU) and are consistent with the statutory obligations applicable to publicly traded parent companies subject to disclosure requirements pursuant to 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 dated 19 July 2002 concerning the application of international accounting standards, as amended (IAS Regulation).

The consolidated financial statements are generally prepared using the cost method. Specific exceptions are derivative financial instruments and available-for-sale financial assets, which are measured at fair value. The consolidated financial statements are prepared in euros. Unless otherwise stated, all figures are rounded up or down to the nearest million euros.

APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

1) Amendments to accounting policies

The accounting policies on which the consolidated financial statements are based are fundamentally the same as the policies applied in 2015 with the exceptions set out below.

'Disclosure Initiative' (Amendments to IAS 1) The IASB published these amendments to IAS 1 in December 2014. The amendments largely consist of clarifications regarding the use of discretion in the presentation of financial statements. Initial application of the amendments has not had any material impact on the consolidated financial statements.

'Clarification of Acceptable Methods of Depreciation and Amortisation' (Amendments to IAS 16 and IAS 38) The IASB published these amendments in May 2014. These amendments clarify the methods that can be used for the depreciation and amortisation of property, plant and equipment and intangible assets. The amendments come into force for financial years commencing on or after 1 January 2016. Initial application of these rules has not had any impact on the consolidated financial statements.

'Defined Benefit Plans: Employee Contributions' (Amendments to IAS 19) The amendments to IAS 19 were published in November 2013. Under certain circumstances, these amendments by the IASB allow contributions made by employees and third parties during the period in which the benefit was earned to be recognised as a reduction in the current service cost. Adoption of the amendments into EU law has resulted in the timing for mandatory initial application changing from the original date of 1 July 2014 to financial years beginning on or after 1 February 2015. Initial application of the amendments has not had any material impact on the Group's financial position or financial performance.

'Investment Entities: Applying the Consolidation Exception' (Amendments to IFRS 10, IFRS 12 and IAS 28) The amendments were published in December 2014 and include clarifications relating to the application of the consolidation exception for investment entities. The amendments apply to reporting periods beginning on or after 1 January 2016. As the Company does not apply the exception for investment entities, initial application of the amendment has not had any impact on the consolidated financial statements.

'Accounting for Acquisitions of Interests in Joint Operations' (Amendments to IFRS 11) The IASB published these amendments in May 2014. The amendments clarify that the acquirer of an interest in a joint operation that constitutes a business, as defined in IFRS 3 'Business Combinations', is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs with the exception of those principles that conflict with the guidance in IFRS 11. The amendments apply to financial years beginning on or after 1 January 2016. They have not had any impact on the DEUTZ Group's consolidated financial statements.

Collective standard amending various IFRSs (2010–2012) The amendments were published in December 2013 and are primarily intended to clarify certain ambiguous provisions in the standards. Adoption of the amendments into EU law has resulted in the timing for mandatory initial application changing from the original date of 1 July 2014 to financial years beginning on or after 1 February 2015. Initial application of these amendments does not have a material impact on the consolidated financial statements.

Collective standard amending various IFRSs (2012–2014) The amendments published by the IASB in September 2014 primarily contain additional guidance for clarifying ambiguous provisions in standards. The amendments come into force for financial years commencing on or after 1 January 2016. Initial application of these amendments does not have a material impact on the consolidated financial statements.

2) Published standards, interpretations and amendments that have already become part of EU law but are not yet mandatory

The International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC) have published the following standards and amendments to standards that have already become part of EU law via the comitology procedure. However, the application of these standards was not yet mandatory in 2016 and DEUTZ has not opted to apply these interpretations or amendments to standards before the mandatory application date.

IFRS 9 'Financial Instruments' Following completion of the final phase of the project to replace IAS 39 'Financial Instruments: Recognition and Measurement', the IASB published the final version of IFRS 9 in July 2014. IFRS 9 introduces new requirements for the classification and measurement of financial assets. The standard defines the basis for this as the contractual cash flow characteristics and the objective of the business model under which the assets are being managed. The standard also includes new requirements for hedge accounting, with the specific aim of linking hedge accounting more closely to the risk management of entities. IFRS 9 also sets out a new impairment model based on expected default. The new standard comes into force for financial years beginning on or after 1 January 2018; early adoption is permitted. DEUTZ will apply IFRS 9 for the first time for the financial year beginning 1 January 2018 and is currently examining the potential impact of initial application of this standard on the Group's financial position and financial performance. It is planned to complete this examination phase by mid-2017. The initial findings do not lead us to believe there will be any material impact on the consolidated financial statements.

IFRS 15 'Revenue from Contracts with Customers' The IASB published IFRS 15 in May 2014. This new standard replaces IAS 11 'Construction Contracts', IAS 18 'Revenue' and the interpretations relating to them. One of the objectives of the new standard was to amalgamate the numerous requirements previously included in several standards and interpretations and to establish consistent underlying principles to be used for all categories of revenue-related transaction across all sectors. According to IFRS 15, the amount recognised as revenue is the amount expected in return for providing goods or services to customers. The point at which control over the goods or services is transferred to the customer determines the point in time at which or the period of time over which revenue is recognised. Full control can be transferred at a certain point in time or gradually over a period. In an amendment in September 2015, the IASB changed the original initial application date from 1 January 2017 to financial years beginning on or after 1 January 2018; early adoption is permitted. The Company will apply IFRS 15 for the first time for the financial year beginning 1 January 2018 taking the modified retrospective approach. Under this modified approach, the cumulative effect of applying IFRS 15 for the first time is recognised as an adjustment to the opening balance of retained earnings as at the date of initial application. The Company is currently examining the impact of the new standard on the consolidated financial statements. Initially, existing customer contracts will be examined for possible changes to their accounting treatment. It is planned to complete this analysis phase by mid-2017. In view of our business model and the analyses conducted so far, we do not currently believe there will be any material impact in terms of the total amount of revenue or the timing of its recognition. Currently, we also believe that the impact on the balance sheet from the possible recognition of new items, such as contract assets and liabilities, will be very limited. However, the Group does expect additional qualitative and quantitative disclosures in the notes to the financial statements.

3) Published standards, interpretations and amendments that have not yet been adopted by the EU

The International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC) have published the following standards and interpretations that have not yet been adopted by the EU and have not yet been applied by the DEUTZ Group.

IFRS 16 'Leases' The IASB published IFRS 16 in January 2016. This new standard replaces IAS 17 'Leases' and the interpretations relating to them (IFRIC 4, SIC 15 and SIC 27). IFRS 16 governs the recognition, measurement, presentation and disclosure of leases with the aim of ensuring that lessees and lessors provide relevant information about the impact of leases. As a result of this model, lessees must recognise assets and liabilities for all leases on the balance sheet, unless the lease term is twelve months or less or the underlying asset has a low value. The new standard comes into force for financial years beginning on or after 1 January 2019; early adoption is permitted if IFRS 15 has already been applied. DEUTZ will apply the new standard for the first time with effect from 1 January 2019 taking the modified retrospective approach. Under the modified retrospective approach, the prior-year comparative figures are not restated; instead, all adjustments may be recognised in the opening balance of retained earnings for the year of initial application. The Company is currently investigating the impact of the new standard on the consolidated financial statements. The first quantitative results from the analysis are expected at the end of 2017. The Group also anticipates more extensive qualitative and quantitative disclosures in the notes to the financial statements.

IFRIC 22 'Foreign Currency Transactions and Advance Consideration' The IASB published this interpretation in December 2016. IFRIC 22 clarifies that the date of a transaction, for the purpose of determining the exchange rate, is the initial recognition of the non-monetary prepayment asset or the non-monetary deferred income liability. If there are multiple payments or receipts in advance, a date of transaction is established for each payment or receipt. The interpretation comes into force for financial years commencing on or after 1 January 2018. However, it is not expected to have any material impact on the consolidated financial statements.

'Disclosure Initiative' (Amendments to IAS 7) The amendments to IAS 7 'Statement of Cash Flows' were published in January 2016. The aim of these amendments is to clarify IAS 7 and to improve the information about an entity's financing activities that is made available to users of financial statements. The amendments apply to financial years beginning on or after 1 January 2017.

'Recognition of Deferred Tax Assets for Unrealised Losses' (Amendments to IAS 12) The amendments to IAS 12 'Income Taxes' were published in January 2016. These amendments clarify a number of requirements regarding the recognition of deferred tax assets for unrealised losses. The amendments apply to financial years beginning on or after 1 January 2017. They are not expected to have any material impact on the DEUTZ Group's consolidated financial statements.

'Transfers of Investment Property' (Amendments to IAS 40) The amendments to IAS 40 'Investment Property' were published in December 2016. The amendments provide clarification regarding transfers to or from investment property. The amendments apply to financial years beginning on or after 1 January 2018. They are not expected to have any impact on the DEUTZ Group's consolidated financial statements.

'Classification and Measurement of Share-based Payment Transactions' (Amendments to IFRS 2) The amendments were published in June 2016 and serve to clarify the classification and measurement of certain transactions involving share-based payments. The amendments apply to financial years beginning on or after 1 January 2018. They are not expected to have any impact on the DEUTZ Group's consolidated financial statements.

'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture' (Amendments to IFRS 10 and IAS 28) The IASB issued these amendments in September 2014. They clarify that in a transaction involving an associate or joint venture the extent of gain or loss recognition depends on whether the assets sold or contributed constitute a business as defined by IFRS 3 'Business Combinations'. The amendments have been postponed indefinitely owing to inconsistencies between the standards.

Collective standard amending various IFRSs (2014–2016) The amendments published by the IASB in December 2016 primarily serve to clarify ambiguous provisions in standards. The amendments relating to IFRS 12 come into force for financial years commencing on or after 1 January 2017. Other amendments are required to be applied from 1 January 2018. The initial application of these amendments is not expected to have a material impact on the Group's consolidated financial statements.

Significant estimates and assumptions

To a certain extent, the preparation of the consolidated financial statements in accordance with IFRS requires estimates and assumptions 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 below. Adjustments to estimates are recognised in income when better knowledge becomes available.

Impairment of non-financial assets The DEUTZ Group conducts tests at each balance sheet date to determine whether there are any indications that non-financial assets may be impaired. In order to estimate the value in use, the management must estimate future cash flows expected to be derived from the asset or from the cash-generating unit and select an appropriate discount rate to determine the present value of these cash flows.

Deferred tax assets The DEUTZ Group is obliged to pay income taxes in various countries. It therefore needs to make estimates on the basis of which tax provisions and deferred taxes can be recognised. When determining the amount of deferred tax assets, the management must make judgements – 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. They are recognised for all unused tax loss carryforwards to the extent that it is probable that future taxable profit will be available against which the loss carryforwards can actually be set off. Planning forecasts over a period of five years are used to determine the future taxable profit that is likely to be available.

As at 31 December 2016, the carrying amount of deferred tax assets recognised in respect of tax loss carryforwards amounted to €66.9 million (31 December 2015: €68.3 million). Further details can be found under Note 16 on page 87 et seq.

Pension benefits The expense for defined benefit plans is determined using actuarial calculations. These actuarial calculations are based on assumptions regarding discount rates, future increases in wages and salaries, staff turnover, mortality and future increases in pensions. These estimates are subject to material uncertainty owing to the long-term nature of these plans.

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.

Development expenditure is capitalised in accordance with the accounting policies described below. Management makes assumptions about the amount of future cash flows expected to be generated from the development projects, the discount rates to be applied and the period over which the cash is expected to flow into the Company. As at 31 December 2016, the carrying amount of capitalised development expenditure was €139.8 million (31 December 2015: €165.7 million).

Pending or potential legal disputes DEUTZ AG and other companies in the DEUTZ Group are subject to a variety of regulations under tax, competition and patent law as well as to other legal and statutory requirements. Existing and potential legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and an appropriate amount is recognised in the risk provisions in the accounts. At present, it is not possible to predict the outcome of 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 as regards the legal risks facing the DEUTZ Group is explained in more detail in Note 28 on page 111.

BASIS OF CONSOLIDATION

All subsidiaries, joint ventures and associates are included in the consolidated financial statements.

Subsidiaries are all entities directly or indirectly controlled by DEUTZ AG. Subsidiaries are consolidated from the point at which the parent company acquires control. Consolidation ends when the parent company no longer has control. In addition to DEUTZ AG, the consolidated financial statements include seven German subsidiaries (2015: six) and nine foreign subsidiaries (2015: nine).

Having previously been unconsolidated for reasons of materiality, the subsidiary Ad. Strüver KG (GmbH & Co.), Hamburg, was included in the consolidated financial statements of DEUTZ AG with effect from 1 January 2016. The company was included in the consolidated entities of DEUTZ AG again in view of a significant transaction in the second half of 2016. Ad. Strüver KG (GmbH & Co.), Hamburg, in which DEUTZ AG has an interest, concluded a contract for the disposal of a building lease for a plot of land that is no longer used for production purposes. The contract came into force on 4 July 2016. Transfer of the use and encumbrances takes place on 1 February 2017 and the sale price agreed is €10.5 million. The consolidation has not had a material effect on the Group's financial position or financial performance because the company has not been operational for approximately ten years. The company's losses, which were largely accrued as a result of ceasing production, had already been reported in the consolidated financial statements via DEUTZ AG or DEUTZ Beteiligung GmbH by recognising impairment losses on the carrying amount of the equity investment and on receivables due from the company. The impact of the changes to the basis of consolidation on the Group's financial performance in 2016 amounted to minus €0.2 million. There was no material impact on the Group's financial position in 2016.

In addition, the subsidiary DEUTZ (SHANGHAI) INTERNATIONAL TRADE Co., Ltd. which has its registered office in Shanghai, China, was included in the consolidated financial statements of DEUTZ AG for the first time in the second half of 2016. The capital contribution to this newly founded company of RMB 5.0 million (equivalent to €664 thousand) was paid in August 2016. DEUTZ AG holds 100 per cent of the voting shares in the company. Inclusion of the company in the consolidated financial statements for the first time had no material impact on the financial position or financial performance of the DEUTZ Group because the company is only at the development phase.

By contrast, the subsidiary DEUTZ Engine (Shandong) Co., Ltd., Linyi, China, was deconsolidated with effect from 31 December 2016 due to its lack of materiality for the consolidated financial statements. This company no longer has any operational or strategic significance to the DEUTZ Group and is currently being wound up. Deconsolidation had the following effects on the consolidated financial statements:

€ million	
Financial position	
Cash and cash equivalents	–2.5
Other receivables and assets	–2.8
Sundry financial and other assets (addition of equity investment)	+2.0
Other liabilities	–0.3
Equity	–1.5
thereof non-controlling interests	–4.4
thereof equity attributable to shareholders of DEUTZ AG	+2.9
Financial performance	
Net income	–1.4
Other income	–0.1
Earnings per share	–0.01

The loss of €1.4 million arising from the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd., was recognised under other operating expenses.

Page 119 of the annex to the notes to the financial statements lists the shareholdings of DEUTZ AG as at 31 December 2016.

PRINCIPLES OF CONSOLIDATION

The separate financial statements of the individual entities included in the consolidated financial statements have been prepared using uniform accounting policies in accordance with the regulations on consolidation. The consolidated financial statements comprise the financial statements of DEUTZ AG and of its subsidiaries prepared each year for the twelve months ended 31 December.

The acquisition method has been used to account for business combinations since 1 January 2010. The acquisition cost is measured at the fair value of the assets transferred, the liabilities incurred or assumed (including conditional liabilities) and of the equity instruments issued at the acquisition date, irrespective of the amount of any non-controlling interests. For each business combination, the Group decides whether to measure the non-controlling interest in the acquiree at fair value (full goodwill method) or at the proportionate fair value of the assets acquired and the liabilities assumed. Acquisition-related costs are expensed as incurred.

The acquisition method was used to account for acquisitions between the transition to accounting based on IFRS on 1 January 2005 and 31 December 2009. Under this method, the carrying amount of the investment was offset against the DEUTZ Group's proportionate share of equity in the consolidated subsidiary remeasured at fair value on the acquisition date. Transaction costs directly attributable to the acquisition constituted some of the acquisition-related costs.

The non-controlling interest is the share of net profit/loss and net assets not attributable to the DEUTZ Group. The Shandong Changlin Machinery Group's holding of 30 per cent of the voting shares in DEUTZ Engine (Shandong) Co., Ltd., Linyi, China, had been reported as a non-controlling interest as at 31 December 2015. Following deconsolidation of this company at the end of 2016, there were no non-controlling interests as at 31 December 2016.

Income and expenses, receivables and payables, and intercompany profits and losses generated between the consolidated entities are eliminated unless they are of no material significance.

JOINT VENTURES AND ASSOCIATES

Investments in joint ventures and associates are accounted for using the equity method. Under the equity method, investments in an associate or joint venture are recognised on the balance sheet at cost plus any changes in the DEUTZ Group's share of the entity's net assets that have occurred since the acquisition. The goodwill related to the associate or joint venture is included in the carrying amount of the investment and is not amortised. The income statement includes the DEUTZ Group's share of the profit or loss generated by the associate or joint venture. Unless they are material, gains and losses on transactions between the Group and its associates or joint ventures are eliminated. Changes recognised directly in the equity of the associate or joint venture are recognised by the DEUTZ Group in the amount of its investment and, as such, are appropriately presented in the statement of changes in equity. With one exception, the financial statements of the associates and joint ventures are prepared to the same balance sheet date as the financial statements for the parent. Interim financial statements have not been prepared for reasons of materiality. Where required, figures are restated in line with the uniform accounting policies throughout the DEUTZ Group.

CURRENCY TRANSLATION

The items in the financial statements of each individual entity in the DEUTZ Group are measured in the currency that corresponds to the currency of the primary economic environment in which the entity operates (functional currency). Transactions denominated in foreign currency are translated into the functional currency using the relevant exchange rates on the date of the transaction. Subsequently they are translated on every balance sheet date using the closing rate. All currency translation differences are recognised in profit or loss unless they are in connection with qualified cash flow hedges, in which case they are recognised in other comprehensive income.

With the exception of equity, balance sheet items in separate financial statements denominated in foreign currency are translated into the functional currency of the DEUTZ Group (euros) at closing rates. Income and expense items – including net income or loss – are translated at the average rates for the year. Equity – with the exception of net income or loss – is translated at the prevailing historical closing rates.

Differences arising from the translation of equity at historical rates and the translation of net income or loss at average rates for the year are reported in other comprehensive income in a separate item.

The main exchange rates used for currency translation purposes are shown in the following table (€1 translated into foreign currencies):

		Average rates		Closing rates at 31 Dec	
		2016	2015	**2016**	2015
USA	USD	1.10	1.10	1.05	1.09
UK	GBP	0.82	0.72	0.86	0.73
China	CNY	7.34	6.95	7.32	7.06
Australia	AUD	1.49	1.48	1.46	1.49
Morocco	MAD	10.84	10.80	10.65	10.75
Russia	RUB	73.31	68.77	64.30	80.67

ACCOUNTING POLICIES

Significant accounting policies used to prepare these consolidated financial statements are described below.

REVENUE RECOGNITION

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

Revenue and other income is recognised as follows:

Revenue from the sale of engines Revenue from the sale of engines is recognised once a DEUTZ Group entity has delivered to a customer and the risks and rewards have passed to the customer. Estimates of future price reductions 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.

Income from the awarding of engine licences and any related project business This income is either deferred and recognised pro rata temporis in accordance with the substance of the relevant agreements or recognised when risks and rewards have been transferred.

Interest income, dividends and other income Interest income is recognised pro rata temporis using the effective interest method. Dividend income is recognised at the time the right to receive the payment arises. Other income is recognised according to contractual agreement on the transfer of risks and rewards.

BORROWING COSTS

Borrowing costs that can be directly attributed to the construction or manufacture of an asset for which a substantial period is required to bring the asset to its intended usable condition are capitalised as part of the costs of the relevant asset. All the other borrowing costs are expensed as incurred. Borrowing costs are the interest and other costs incurred by a company in connection with borrowing funds.

ADDITIONAL DISCLOSURES

In addition to the information required by IFRS, the DEUTZ Group reports a figure for EBIT adjusted for exceptional items, which it uses for internal purposes to gauge the profitability of its business. Such exceptional items are defined as significant income generated or expenses incurred outside the scope of the Company's ordinary business activities that are unlikely to recur. We use this KPI internally so that we can compare the Company's operating performance over time. There were no exceptional items in 2016 or 2015.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is recognised at cost and, if depreciable, less any depreciation on a straight-line basis and any additional impairment losses. Cost comprises the purchase price and any directly attributable costs incurred to bring the asset to the required location and working condition.

The costs of conversion of property, plant and equipment constructed internally comprise directly attributable costs, pro rata material and production overheads as well as administrative expenses related to production or delivery of the service.

Subsequent costs are added to the carrying amount of the asset concerned as incurred, provided that the recognition criteria are satisfied. Repair and maintenance costs are expensed as incurred.

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 for the main asset categories:

	Useful life (years)
Buildings and grounds	15–33
Technical equipment and machines	10–15
Other equipment, furniture and fixtures	3–10

Residual carrying amounts, useful lives and depreciation methods are reviewed at the end of each year and adjusted where appropriate.

An item of property, plant or equipment is derecognised either on disposal or if no further economic benefit is expected from further use or sale of the asset. Gains or losses arising from the derecognition of the asset are calculated as the difference between the net disposal 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. The cost of purchase or conversion includes directly attributable costs. The cost of conversion also includes a proportion of overheads and borrowing costs for long-term projects provided the recognition criteria are met. In subsequent periods, intangible assets are reported at cost less amortisation on a straight-line basis and any additional impairment losses. Investment grants from customers are deducted from cost. The useful lives of both purchased and internally generated intangible assets are limited. The amortisation expense and impairment losses are reported in the income statement accordingly.

The following principles are applied:

Internally generated intangible assets The accounting treatment of internally generated intangible assets is based on an implemented development process with defined milestones. During this process, the development costs for the products are capitalised provided that

- they are technically and commercially feasible,
- a future economic benefit is likely,
- there is the intention to complete their development and sufficient resources are available to do so, and
- the costs of development can be reliably determined.

The review of whether these criteria are met takes place in connection with the achievement of defined milestones in the development process. Development projects at DEUTZ relate almost exclusively to the development of new engine series. The fact that these development projects are technically feasible and will actually be completed is borne out by a multitude of evidence from the past. Until this point, the development and research costs incurred are recognised in the income statement in the period in which they are incurred. As a rule, completed development projects are amortised on a straight-line basis over the expected production cycle of three to nine years.

As at 31 December 2016, the material, completed development projects had the following remaining useful lives:

Engine series 12.0/16.0	3 years
Engine series 7.8	9 years
Engine series 6.1	3 years
Engine series 4.1	4 years
Engine series 3.6	4 years
Engine series 2.9	5.5 years

The useful lives and amortisation methods for completed development projects are reviewed at every year-end, if not more frequently. If any changes in their useful lives are required, they are treated as changes in accounting estimates.

Other intangible assets These are measured at amortised cost and amortised on a straight-line basis over their estimated useful life of three to ten years.

Gains or losses arising from the derecognition of intangible assets are the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement in the period in which the asset is derecognised.

IMPAIRMENT OF NON-FINANCIAL ASSETS

At each balance sheet date the DEUTZ Group carries out tests to establish whether there are any indications that an asset may be impaired. An impairment test is carried out at least once a year on intangible assets that are not yet available for use.

Impairment is determined by comparing the carrying amount with the recoverable amount. The recoverable amount of an asset or cash-generating unit is the higher of its fair value less costs to sell and its value in use. If future cash inflows cannot be allocated to an individual asset separately from cash flows generated independently by other assets, the impairment test is applied to the cash-generating unit that includes the asset concerned. When impairment tests are conducted, assets are aggregated into cash-generating units at the lowest-possible level at which cash inflows can largely be independently identified.

Value in use is calculated by discounting estimated future cash flows to their present value. The calculation uses a discount rate that reflects current market expectations in respect of the time value of money and the risks inherent in the asset or cash-generating unit. The cash flows used in the calculation are derived and extrapolated from operational planning (five-year period). If the reasons for previously recognised impairment losses no longer exist, these impairment losses are reversed.

In 2016, lower unit sales forecasts gave rise to indications of impairment ('trigger events') on some property, plant and equipment and some completed internally generated intangible assets. However, the impairment tests carried out did not identify a need to recognise impairment losses.

The estimates and assumptions used in the impairment tests are based on projections, which by their nature are subject to uncertainty, particularly with regard to future prices and volumes. Adjustments to the estimates made, e.g. due to unexpectedly poor economic conditions, could result in an impairment loss, especially in the case of individual engine series.

GOVERNMENT GRANTS

Government grants are recognised when there is sufficient certainty that the associated conditions will be fulfilled and the grants will actually be awarded. The DEUTZ Group deducts government grants relating to purchases of non-current assets 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. In the case of an interest-free government loan that has been received, the value of the interest benefit has been quantified in accordance with the provisions in IAS 39. The loan has been measured at fair value and the interest benefit recognised as deferred income.

INCOME TAXES

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

Deferred tax assets are recognised to the extent that sufficient future taxable income is likely to be generated over the planning period against which the deductible temporary differences and the as yet unused tax loss carryforwards can be offset.

Deferred tax liabilities that arise from temporary differences in connection with investments in subsidiaries, joint ventures and associates are always recognised unless the timing of the reversal of the temporary differences can be controlled and it is unlikely that the temporary differences will reverse in the foreseeable future.

Deferred taxes relating to items recognised in other comprehensive income are likewise recognised in other comprehensive income and not in the income statement.

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 Current income taxes for the current period and for previous periods are recognised at the amount that is expected to be paid to (or recovered from) the tax authorities or has already been paid. The tax amount is calculated on the basis of tax rates and tax legislation enacted or substantively enacted as at the relevant balance sheet date.

INVENTORIES

Inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price achievable in the ordinary course of business less estimated costs still to be incurred.

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

Work in progress and finished goods are measured at the cost of conversion, which includes production materials and production wages as well as a proportion of material and production overheads.

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

NON-CURRENT ASSETS CLASSIFIED AS 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

In the DEUTZ Group, financial assets within the meaning of IAS 39 can be in any of the following categories and are classified accordingly:

- financial assets designated at fair value through profit or loss,
- loans and receivables, or
- available-for-sale financial assets.

On initial recognition, financial assets are measured at fair value. In the case of financial assets other than those classified as at fair value through profit or loss, transaction costs directly attributable to the acquisition of the assets are also included.

Financial assets are classified in one of the measurement categories on initial recognition. Assets may be reclassified if this is permitted and necessary.

Except in the case of held-for-trading financial assets, all regular way purchases and sales of financial assets are recognised on the settlement date, i.e. the date on which the asset is delivered to or by DEUTZ. Held-for-trading financial assets are recognised on the trade date, i.e. the date on which the DEUTZ Group enters into the obligation to buy or sell the asset. Regular way purchases and sales are purchases or sales of financial assets that provide for the delivery of the asset within a period determined by market regulations or conventions.

Financial assets at fair value through profit or loss In the DEUTZ Group, financial assets designated as at fair value through profit or loss include held-for-trading financial assets. To date, the DEUTZ Group has not made use of the option to designate financial assets as at fair value through profit or loss on initial recognition.

Derivatives, including separately recognised embedded derivatives, are classified as held for trading unless they are derivatives designated as hedging instruments and are determined to be effective. Gains and losses on financial assets held for trading are recognised in the income statement. At the time the DEUTZ Group first becomes a party to a contract, it determines whether an embedded derivative needs to be accounted for separately from the host contract. This decision is only reassessed if there is a substantial amendment to the terms of the contract and this amendment results in a significant change to the cash flows that would otherwise have been derived from 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 as well as 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 or more after the balance sheet date, in which case they are reported as non-current assets. After initial recognition, loans and receivables are measured at amortised cost using the effective interest method less any necessary write-downs. A gain or loss is recognised in profit or loss when the loan or receivable is derecognised or written down, 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 stipulated in IAS 39. After initial measurement, available-for-sale financial assets are measured at fair value. Financial 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 and losses are recognised in other comprehensive income. If a financial asset in this category is derecognised or written down, any cumulative gains or losses previously recognised in other comprehensive income are reclassified to the income statement.

IMPAIRMENT OF FINANCIAL ASSETS

At every balance sheet date, financial assets (with the exception of financial assets at fair value through profit or loss) are subjected to an impairment test to establish whether there are any indications of impairment (for example, substantial financial difficulties on the part of the debtor, significant probability of insolvency proceedings against the debtor, the disappearance of an active market for the financial asset, significant changes in the technological, economic, legal and/or market environment in which the issuer operates, a sustained fall in the fair value of the financial asset below amortised cost).

Financial assets accounted for at amortised cost If there are objective indications that a financial asset accounted for at amortised cost is impaired, the amount of the impairment loss is determined as the difference between the carrying amount of the asset and the present value of the estimated future cash flows (with the exception of estimated future loan defaults that have not yet occurred), the discount rate being the original effective interest rate for the financial asset, i.e. the effective interest rate determined on initial recognition. The impairment loss is recognised in the income statement.

If the amount of this impairment loss is found to be lower in subsequent reporting periods and this decrease can be attributed objectively to factors occurring after the recognition of the impairment loss, the previously recognised impairment loss is reversed. However, the new carrying amount of the asset must not exceed what the amortised cost would have been at the time the impairment loss is reversed if the impairment loss had not been recognised. The reversal of the impairment loss is recognised in the income statement.

In the case of trade receivables, if there are objective indications that not all due and payable amounts will be received in accordance with the originally agreed invoicing terms and conditions (for example, insufficient creditworthiness on the part of the debtor, dispute regarding the existence or amount of the receivable, legal reasons preventing the enforcement of the receivable, etc.) an impairment loss is recognised on a valuation allowance account. Receivables classified as uncollectible are then derecognised.

If other receivables or assets are found to be impaired, a direct write-down is applied to the relevant carrying amounts.

Available-for-sale financial assets If an available-for-sale financial asset is impaired, an amount equal to the difference between the cost and the current fair value (less any impairment losses on that asset already recognised in the income statement at an earlier point) is reclassified from other comprehensive income to the income statement. Reversals of impairment losses on equity instruments classified as available for sale are not recognised in the income statement. Impairment losses related to available-for-sale equity instruments that are not publicly traded and that are recognised at cost must not be reversed. The reversal of impairment losses on debt instruments classified as available for sale are recognised in the income statement if the increase in fair value can be objectively related to an event that occurred after the impairment loss was recognised in the income statement.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand, short-term deposits with an original term of up to three months, and credit balances held with banks.

FINANCIAL LIABILITIES

In the DEUTZ Group, financial liabilities within the meaning of IAS 39 can be in either of the following categories:

- financial liabilities at fair value through profit or loss, or
- 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 held-for-trading financial liabilities. To date, the DEUTZ Group has not made use of the option to designate financial liabilities as at fair value through profit or loss on initial recognition.

Derivatives, including separately recognised embedded derivatives, are classified as held for trading unless they are derivatives designated as hedging instruments and determined to be effective. If the fair value of these derivatives is negative, they are recognised under financial liabilities. Gains and losses on financial liabilities held for trading are recognised in the income statement.

Other financial liabilities in the DEUTZ Group for the most part comprise the following:

- financial debt (liabilities to banks),
- trade payables and
- other liabilities.

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

Other financial liabilities are initially recognised at their fair value including transaction costs. They are subsequently measured at amortised cost using the effective interest method.

DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGES

DEUTZ only uses derivative financial instruments (interest-rate and currency derivatives) for hedging purposes as part of its business operations, in particular to reduce foreign currency risk in forecast transactions involving foreign currencies and to reduce interest-rate risk through the use of interest-rate swaps.

Derivatives are initially recognised at their fair value on the day they are entered into 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 as at the balance sheet date.

Changes in the fair value of non-hedging derivatives are immediately recognised in the income statement.

Cash flow hedges Forecast transactions (cash flows) in foreign currency and interest-rate risk are hedged using cash flow hedges. The effective portion of the changes in the fair value of derivatives designated as cash flow hedges is recognised in other comprehensive income. The ineffective portion of the changes in fair value is reported in the income statement under other income or other expenses.

The changes in fair value reported in the reserve for cash flow hedges are reclassified to 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. Changes in the cash flow hedge reserve are reported under a separate item in other comprehensive income (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.

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 1995, employees in Germany can no longer acquire any further employer-funded pension entitlements. Currently, therefore, existing pension entitlements are simply increased each year by unwinding the discount applied to calculate the present value of the obligation, or they are paid out. Besides entitlements to an employer-funded pension, employees in Germany can build up an employee-funded pension by participating in a deferred compensation plan. There is one funded pension plan in the UK (branch of DEUTZ AG), and the subsidiaries in the US and France have pension liabilities. The pension plans outside Germany are employer-funded entitlements.

The Group's liabilities arising from employer-funded defined benefit pension plans are calculated separately for each plan using actuarial principles. First, the pension benefits vested in earlier periods and in the current period are estimated. The next step is to discount these benefits using the projected unit credit method. The resulting present value represents the defined benefit obligation. The fair value of the plan asset is then deducted from the defined benefit obligation to determine the net liability to be reported on the balance sheet.

The interest rate used to discount the estimated pension benefits is determined using the yields available in the market on each valuation date for investment-grade, fixed-income corporate paper. The currency and terms to maturity of the underlying corporate paper match the currency and predicted duration of the post-retirement pension liabilities to be met.

The net interest cost is calculated by multiplying the net liability at the beginning of the reporting period by the interest rate used to discount the pension obligations at the beginning of the period.

The effects of the revaluation include the actuarial gains and losses on the valuation of the gross defined benefit obligation and the difference between the actual return on plan assets and the typical return on plan assets assumed at the beginning of the period when calculating the net interest cost.

While the revaluation effects are recognised in other comprehensive income, the net interest cost and the current service cost are reported as gains or losses in the reporting period. Net interest cost is reported in operating profit.

The calculation of the individual cost components in the net liability to be reported on the balance sheet on each reporting date is based on a report by a qualified actuary.

In the case of the employee-funded deferred compensation plan, the Company has taken out a reinsurance policy with a life insurance company based on the amount of salary contribution and undertakes to pay a pension based on the guaranteed capital that has been underwritten. The present value of the benefit obligation corresponds to the fair value of the entitlements to reinsurance cover on the basis of the asset values calculated by the insurer. For the purposes of recognition on the balance sheet, the present value of the benefit obligation is offset against the fair value of the entitlements to reinsurance cover in an equal amount.

As well as defined benefit pension plans, there are also **defined contribution pension plans** (e.g. direct insurance policies). 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 cash outflows. Furthermore, it must be possible to estimate the obligation reliably. 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. Provisions for warranty obligations are recognised when products are sold or when new warranties are initiated. The measurement of potential warranty liabilities is based primarily on historical experience.

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 that, 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.

NOTES TO THE INCOME STATEMENT

1. REVENUE

The table below gives a breakdown of revenue for the DEUTZ Group:

€ million	**2016**	2015
Engines	972.9	969.0
Service	287.3	278.4
Total	**1,260.2**	**1,247.4**

The breakdown of revenue by segment and region is shown in the notes on segment reporting on page 98 et seq.

2. COST OF SALES

The cost of sales comprises the following cost items:

€ million	**2016**	2015
Cost of materials	712.0	723.8
Staff costs	165.0	164.8
Depreciation on property, plant and equipment	46.4	50.8
Other cost of sales items	118.2	115.4
Total	**1,041.6**	**1,054.8**

3. RESEARCH AND DEVELOPMENT COSTS

The table below gives a breakdown of research and development costs:

€ million	**2016**	2015
Cost of materials	10.1	7.6
Staff costs	29.8	29.8
Depreciation and amortisation	39.9	51.9
Own work capitalised and reimbursements	–8.8	–19.7
Other research and development costs	6.5	6.7
Total	**77.5**	**76.3**

4. SELLING EXPENSES AND GENERAL AND ADMINISTRATIVE EXPENSES

Selling expenses amounted to €68.0 million in the year under review (2015: €68.3 million). General and administrative expenses came to €36.7 million (2015: €36.5 million). Both the selling expenses and the general and administrative expenses predominantly consist of staff costs.

5. OTHER OPERATING INCOME

€ million	2016	2015
Foreign currency gains	7.1	13.3
Income from recharged costs and services	5.3	6.2
Income from the derecognition of liabilities	0.9	0.5
Income from the reversal of provisions	0.8	1.1
Income from the disposal of non-current assets	0.6	0.3
Income from the measurement of derivatives	0.4	1.4
Income from the disposal of investments and deconsolidation	–	3.9
Sundry other income	2.6	2.6
Total	**17.7**	**29.3**

The decrease in other operating income was largely the result of smaller foreign currency gains.

6. OTHER OPERATING EXPENSES

€ million	2016	2015
Expenses for pensions and other post-employment benefits	6.6	4.4
Other expenses from the adjustment of provisions	5.4	3.5
Foreign currency losses	3.8	13.6
Other cost of fees, contributions and advice	2.5	1.5
Expenses in connection with the measurement of derivatives	0.8	1.2
Rental and lease expenses	0.9	0.7
Sundry other expenses	6.7	5.7
Total	**26.7**	**30.6**

The decline in other operating expenses was attributable to far lower foreign currency losses. The expenses for pensions and other post-employment benefits primarily consist of the net interest cost for provisions for pensions and other post-retirement benefits and of the severance payment in relation to Dr Leube's early departure from the Company on 31 December 2016.

7. PROFIT/LOSS ON EQUITY-ACCOUNTED INVESTMENTS AND OTHER INVESTMENT INCOME

€ million	2016	2015
Profit/loss on equity-accounted investments		
Income from equity-accounted investments	0.6	0.7
Expenses relating to equity-accounted investments	–5.7	–7.0
Total	**–5.1**	**–6.3**
Other investment income	**1.1**	**1.0**
Total	**–4.0**	**–5.3**

Income from equity-accounted investments consisted of DEUTZ AG's share in the profits of its associate D.D. Power Holdings (Pty), South Africa.

The expenses relating to equity-accounted investments were attributable to the share of the loss of the joint venture DEUTZ (Dalian) Engine Co., Ltd., Dalian, China.

As in the previous year, other net investment income related to profits transferred by DEUTZ Sicherheit GmbH, Cologne.

8. INTEREST EXPENSES, NET

€ million	2016	2015
Interest income on credit balances with banks	–	0.1
Other interest income	0.3	0.7
Interest income	**0.3**	**0.8**
Interest paid on liabilities to banks	–2.5	–2.9
Interest paid on sales of receivables	–0.7	–1.1
Other interest expense and similar charges	–0.6	–0.8
Interest expense and similar charges (finance costs)	**–3.8**	**–4.8**
Interest expenses, net	**–3.5**	**–4.0**

In 2016, borrowing costs of €0.1 million were capitalised. No borrowing costs had been capitalised in 2015.

9. TAXES

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

€ million	2016	2015
Current tax expense	9.3	5.7
thereof unrelated to the reporting period	–0.3	–0.6
Deferred taxes	–5.4	–8.3
thereof from temporary differences	–8.1	–7.5
thereof from loss carryforwards	2.7	–0.8
Total income taxes	**3.9**	**–2.6**

The current income tax expenses of €9.3 million predominantly related to additions to provisions for anticipated tax payments on current income generated by Group companies in 2016.

The deferred tax income included income of €8.1 million arising from temporary differences (2015: €7.5 million). This resulted, in particular, from the reduction of deferred tax liabilities in connection with the capitalisation of development expenditure under IFRS.

There are no income tax implications for DEUTZ AG arising from the distribution of dividends to shareholders by DEUTZ AG.

The tax reconciliation table shows the reconciliation from anticipated income taxes to effective taxes as shown in the income statement. Effective income taxes include current and deferred taxes. The applicable tax rate is 31.61 per cent (2015: 31.61 per cent) comprising corporation tax at 15 per cent, the solidarity surcharge (5.50 per cent of the corporation tax) and trade tax at 15.78 per cent based on an average assessment rate.

€ million	2016	2015
Net income before income taxes	**19.9**	**0.9**
Anticipated tax expense (+)/income (–)	6.3	0.3
Effect from trade tax add-backs and deductions	0.2	0.3
Tax rates outside Germany	0.3	–0.2
Changes arising from the recognition of deferred taxes on loss carryforwards and on temporary differences and the utilisation of loss carryforwards	–6.8	–2.6
Effect of non-deductible expenses	0.4	–0.4
Effect of consolidation adjustments	2.6	–
Effect of partnership’s supplementary tax accounts	1.3	–
Share of profit (loss) of equity-accounted investments	1.8	2.1
Effect of tax-exempt income	–0.7	–0.8
Effects not related to the reporting period		
Prior-year tax payments	–0.2	–0.6
Deferred taxes resulting from prior-year adjustments	–1.2	–0.6
Other	–0.1	–0.1
Effective tax expense (+)/income (–)	**3.9**	**–2.6**
Effective tax rate (%)	19.6	–288.9

The change arising from the recognition of deferred taxes on loss carryforwards and on temporary differences and the utilisation of loss carryforwards was largely attributable to the utilisation of loss carryforwards in the reporting year.

10. EARNINGS PER SHARE

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

There were no dilutive effects in 2016 or 2015 because there are no exercisable options to convert financial instruments with equity components.

	2016	2015
Net income attributable to shareholders of DEUTZ AG (€ thousands)	16,558	5,345
Weighted average number of shares outstanding (thousands)	120,862	120,862
Earnings per share (€)	**0.14**	**0.04**

NOTES TO THE STATEMENT OF COMPREHENSIVE INCOME

11. OTHER COMPREHENSIVE INCOME

Other comprehensive income comprises the elements of the statement of comprehensive income not reported in the income statement. The taxes resulting from other comprehensive income are shown in the following table:

€ million	2016			2015		
	Before taxes	**Taxes**	**After taxes**	Before taxes	Taxes	After taxes
Amounts that will not be reclassified to the income statement in the future	**–13.3**	**4.2**	**–9.1**	**4.6**	**–1.5**	**3.1**
Remeasurements of defined benefit plans	–13.3	4.2	–9.1	4.6	–1.5	3.1
Amounts that will be reclassified to the income statement in the future if specific conditions are met	**–2.1**	**0.7**	**–1.4**	**4.5**	**–0.6**	**3.9**
Currency translation differences	0.2	–	0.2	2.8	–	2.8
Effective portion of change in fair value from cash flow hedges	–2.3	0.7	–1.6	1.9	–0.6	1.3
Change in fair value of available-for-sale financial instruments	–	–	–	–0.2	–	–0.2
Other comprehensive income	**–15.4**	**4.9**	**–10.5**	**9.1**	**–2.1**	**7.0**

In 2016, losses of €32 thousand on cash flow hedges (2015: losses of €8.1 million) recognised in other comprehensive income during the year (prior to the inclusion of deferred taxes) were reclassified to other operating expenses or other operating income in the consolidated income statement.

NOTES TO THE BALANCE SHEET

12. PROPERTY, PLANT AND EQUIPMENT

Gross figures Cost of purchase/conversion	Land, leasehold rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Advances paid and construction in progress	Total
€ million					
Balance at 1 Jan 2016	**205.3**	**537.6**	**239.8**	**23.1**	**1,005.8**
Currency translation differences	–	0.2	–	–0.2	–
Additions	9.1	16.2	16.3	7.7	49.3
Investment grants	–	–	–	–	–
Disposals	–2.0	–42.0	–7.3	–	–51.3
Changes to basis of consolidation	–	–	–2.0	–4.0	–6.0
Reclassifications	6.2	9.9	1.4	–17.5	–
Balance at 31 Dec 2016	**218.6**	**521.9**	**248.2**	**9.1**	**997.8**

Gross figures Depreciation and impairment	Land, leasehold rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Advances paid and construction in progress	Total
€ million					
Balance at 1 Jan 2016	**89.0**	**436.3**	**189.0**	**2.5**	**716.8**
Currency translation differences	–	0.1	–	–	0.1
Depreciation	5.3	24.8	18.7	–	48.8
Impairment	–	–	–	1.5	1.5
Disposals	–0.2	–42.0	–7.2	–	–49.4
Changes to basis of consolidation	–	–	–2.0	–4.0	–6.0
Reclassifications	–	–	–	–	–
Balance at 31 Dec 2016	**94.1**	**419.2**	**198.5**	**–**	**711.8**
Net carrying amount at 31 Dec 2016	**124.5**	**102.7**	**49.7**	**9.1**	**286.0**

Gross figures Cost of purchase/conversion	Land, leasehold rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Advances paid and construction in progress	Total
€ million					
Balance at 1 Jan 2015	**199.2**	**536.4**	**240.5**	**9.7**	**985.8**
Currency translation differences	0.1	0.6	0.4	0.2	1.3
Additions	6.0	11.6	14.5	19.1	51.2
Investment grants	–	–	–0.3	–	–0.3
Disposals	–0.8	–15.4	–16.0	–	–32.2
Reclassifications	0.8	4.4	0.7	–5.9	–
Balance at 31 Dec 2015	**205.3**	**537.6**	**239.8**	**23.1**	**1,005.8**

Gross figures Depreciation and impairment	Land, leasehold rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Advances paid and construction in progress	**Total**
€ million					
Balance at 1 Jan 2015	**84.2**	**425.9**	**182.2**	**1.6**	**693.9**
Currency translation differences	0.1	0.3	0.2	0.1	0.7
Depreciation	5.4	25.2	21.0	–	51.6
Impairment	–	0.1	1.4	0.8	2.3
Disposals	–0.7	–15.2	–15.8	–	–31.7
Reclassifications	–	–	–	–	–
Balance at 31 Dec 2015	**89.0**	**436.3**	**189.0**	**2.5**	**716.8**
Net carrying amount at 31 Dec 2015	**116.3**	**101.3**	**50.8**	**20.6**	**289.0**

Additions to property, plant and equipment mainly related to the construction of the shaft centre in Cologne-Porz. There were also additions in connection with replacement investments in machinery and tools.

Impairment losses related to property, plant and equipment of our subsidiary DEUTZ Engine (Shandong) Co., Ltd., Linyi, China, which is being wound up. As there was no alternative use for it, the property, plant and equipment was written off in full. The company was finally deconsolidated at the end of the reporting year.

The disposals in connection with changes to the basis of consolidation resulted from the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd., Linyi, China.

Government grants at our Spanish subsidiary were deducted from the cost of purchasing the property, plant and equipment. Total government grants recognised as at 31 December 2016 amounted to €1.4 million (31 December 2015: €1.9 million). In 2016, grants of €0.5 million (2015: €0.6 million) were reclassified to the income statement (as a reduction of the depreciation expense).

Purchase commitments for property, plant and equipment are described on page 111.

13. INTANGIBLE ASSETS

Gross figures Cost of purchase/conversion	Internally generated intangible assets, completed	Internally generated intangible assets, in development	Other intangible assets	**Total**
€ million				
Balance at 1 Jan 2016	**411.9**	**5.6**	**120.0**	**537.5**
Currency translation differences	–	–	0.2	0.2
Additions	1.6	7.5	3.6	12.7
Disposals	–1.8	–	–0.2	–2.0
Balance at 31 Dec 2016	**411.7**	**13.1**	**123.6**	**548.4**

Gross figures Amortisation and impairment	Internally generated intangible assets, completed	Internally generated intangible assets, in development	Other intangible assets	**Total**
€ million				
Balance at 1 Jan 2016	**246.9**	**4.9**	**109.1**	**360.9**
Currency translation differences	–	–	0.2	0.2
Amortisation	34.7	–	5.8	40.5
Disposals	–1.5	–	–0.2	–1.7
Balance at 31 Dec 2016	**280.1**	**4.9**	**114.9**	**399.9**
Net carrying amount at 31 Dec 2016	**131.6**	**8.2**	**8.7**	**148.5**

Gross figures Cost of purchase/conversion	Internally generated intangible assets, completed	Internally generated intangible assets, in development	Other intangible assets	**Total**
€ million				
Balance at 1 Jan 2015	**404.5**	**–**	**122.5**	**527.0**
Currency translation differences	–	–	0.4	0.4
Additions	7.4	5.6	5.6	18.6
Investment grants	–	–	–0.3	–0.3
Disposals	–	–	–8.2	–8.2
Reclassifications	–	–	–	–
Balance at 31 Dec 2015	**411.9**	**5.6**	**120.0**	**537.5**

Gross figures Amortisation and impairment	Internally generated intangible assets, completed	Internally generated intangible assets, in development	Other intangible assets	**Total**
€ million				
Balance at 1 Jan 2015	**205.1**	**–**	**110.2**	**315.3**
Currency translation differences	–	–	0.4	0.4
Amortisation	39.3	–	6.7	46.0
Impairment	2.5	4.9	–	7.4
Disposals	–	–	–8.2	–8.2
Reclassifications	–	–	–	–
Balance at 31 Dec 2015	**246.9**	**4.9**	**109.1**	**360.9**
Net carrying amount at 31 Dec 2015	**165.0**	**0.7**	**10.9**	**176.6**

Other intangible assets mainly comprise grants for tool costs, licences, purchased development services and software.

Under internally generated intangible assets, the additions largely relate to the capitalisation of development expenditure relating to the development of new engines and the refinement of existing models.

14. 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	2016	2015
1 Jan	**48.5**	**52.4**
Additions	–	–
Pro-rata profit/loss on equity-accounted investments	–5.1	–6.3
Disposals	–	–
Impairment	–	–
Other changes arising from measurement using the equity method	–1.7	2.4
31 Dec	**41.7**	**48.5**

A summary of further financial information about associates and joint ventures is provided in Note 27 ‘Interests in other entities’.

15. OTHER FINANCIAL ASSETS (NON-CURRENT)

€ million	31 Dec 2016	31 Dec 2015
Equity investments	2.3	0.2
Non-current securities	3.2	2.9
Cost of borrowing	0.9	1.2
Loans	–	1.3
Other	1.1	0.8
Total	**7.5**	**6.4**

Equity investments

The year-on-year increase was due to the deconsolidation of our subsidiary DEUTZ Engine (Shandong) Co., Ltd. at the end of the reporting year. The DEUTZ Group’s 70 per cent stake in the company was recognised with a fair value of €2.0 million.

Non-current securities

This line item on the balance sheet includes securities in the form of equities and bonds. The securities are used to hedge the pension obligations of the Group company DEUTZ Corporation, Atlanta, USA.

Cost of borrowing

The cost of borrowing directly associated with the working capital facility is accounted for as a non-current asset and is recognised in the income statement in instalments over the capital commitment period. The financial debt (including the pro rata cost of borrowing) is recognised when the working capital facility is drawn down as a loan and is subsequently measured using the effective interest method.

16. DEFERRED TAXES, CURRENT TAX ASSETS AND LIABILITIES

At the balance sheet date, DEUTZ AG had unutilised tax losses carried forward of €921.9 million for corporation tax (2015: €950.6 million) and €1,039.3 million for trade tax (2015: €1,068.7 million). The figures disclosed in 2015 for tax loss carryforwards (corporation tax: €698.4 million; trade tax €787.6 million) were restated as a result of changes to the tax rules on the offsetting of losses.

Further tax loss carryforwards were also available to international companies in the Group.

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

€ million	31 Dec 2016	31 Dec 2015
Non-current		
Deferred tax assets	79.9	69.1
Deferred tax liabilities	0.4	–
Current		
Current tax assets	0.8	4.3
Provision for income taxes	4.1	7.5
Income tax liabilities	0.5	0.5

In 2016, the deferred tax assets net of deferred tax liabilities amounted to €79.9 million. They were largely the result of capitalising deferred tax assets on tax losses carried forward and of temporary differences, particularly those between the carrying amount of provisions for pensions and other post-retirement benefits in the consolidated balance sheet and their tax base in the financial statements of DEUTZ AG. Deferred tax assets from items recognised in other comprehensive income amounted to €21.9 million for provisions for pensions and other post-retirement benefits and €1.0 million for measurement of cash flow hedges and interest rate derivatives.

The following table shows the breakdown of deferred tax assets and liabilities:

€ million	31 Dec 2016		31 Dec 2015	
	Assets	**Liabilities**	Assets	Liabilities
Intangible assets	–	44.2	–	52.4
Property, plant and equipment	10.0	3.3	10.8	3.3
Equity-accounted investments and financial assets	0.5	1.8	0.5	–
Inventories	11.3	0.1	10.9	0.1
Receivables and other assets	4.9	–	3.4	–
Pensions	26.0	–	24.0	–
Other liabilities	9.5	0.2	7.2	0.2
Tax loss carryforwards	66.9	–	68.3	–
Deferred taxes (gross)	**129.1**	**49.6**	**125.1**	**56.0**
Netting	49.2	49.2	56.0	56.0
Deferred taxes (net)	**79.9**	**0.4**	**69.1**	**–**

The tax asset in excess of deferred tax liabilities – for which tax planning indicates sufficient taxable profit will be available in future – amounted to €79.9 million (31 December 2015: €69.1 million). Of this total, €5.9 million was attributable to two Group companies that generated a loss in the reporting period or in the prior year.

The decrease in deferred taxes in respect of temporary differences, which was recognised in other comprehensive income, was €5.0 million at 31 December 2016 (31 December 2015: decrease of €1.4 million) and largely resulted from changes in provisions for pensions.

As at 31 December 2016, the DEUTZ Group had not recognised any deferred tax liabilities on temporary differences of €15.5 million (31 December 2015: €24.3 million) in respect of taxes on untransferred profits from subsidiaries, associates or joint ventures because the timing of the reversal of the differences can be controlled or the sums are mostly tax exempt and no material impact on taxes is expected in the near future.

Deferred tax assets are only recognised to the extent that sufficient future taxable income is likely to be generated over a certain planning period against which the as yet unused tax loss carryforwards can be offset. Consequently, as well as tax loss carryforwards on which deferred taxes have been recognised, there are loss carryforwards for which deferred taxes have not been recognised because the losses cannot be utilised. The following table shows the amounts and expiry dates of the tax loss carryforwards:

Loss carryforwards on which deferred taxes have not been recognised

€ million	**31 Dec 2016**	31 Dec 2015
Corporation tax/solidarity surcharge	733.2	756.7
Trade tax	840.2	859.9

Thereof: expiry periods for German and international loss carryforwards

€ million	**31 Dec 2016**	31 Dec 2015
Up to 5 years	–	–
6 to 9 years	–	–
Indefinite		
Corporation tax/solidarity surcharge	733.2	756.7
Trade tax	840.2	859.9

The figure disclosed in 2015 for loss carryforwards on which deferred taxes had not been recognised in full was restated, mainly as a result of changes to the tax rules on the offsetting of losses.

17. INVENTORIES

€ million	**31 Dec 2016**	31 Dec 2015
Raw materials, consumables, bought-in parts and spare parts	124.5	129.1
Work in progress	42.1	47.1
Finished goods	86.5	75.7
Total	**253.1**	**251.9**

Write-downs on raw materials, bought-in parts and spare parts totalled €1.4 million in the reporting year (2015: €5.3 million). As at 31 December 2016, the carrying amount of inventories written down to net realisable value was €82.1 million (31 December 2015: €78.7 million).

The following table shows the change in the valuation allowance account for inventories:

€ million	**2016**	2015
1 Jan	**30.4**	**26.1**
Changes	6.6	4.3
31 Dec	**37.0**	**30.4**

18. RECEIVABLES AND OTHER ASSETS

€ million	31 Dec 2016	31 Dec 2015
Trade receivables	118.0	103.6
Less write-downs	–4.5	–2.4
Trade receivables (net)	**113.5**	**101.2**
Other receivables and assets		
Receivables due from investments	3.1	0.9
thereof trade receivables	3.1	0.2
thereof other receivables	–	0.7
Advances paid	0.2	0.1
Receivables remaining after sale of receivables	6.5	3.1
Receivables arising from income tax assets	0.8	4.3
Receivables arising from other taxes	5.6	5.1
Sundry other receivables	21.1	19.0
Total	**37.3**	**32.5**

As at 31 December 2016, the volume of receivables sold under factoring agreements was €111.4 million (31 December 2015: €99.1 million). Essentially, all the opportunities and risks connected with title to the receivables that were sold were transferred to the factor. While the entire credit risk was transferred, a risk of late payment remains, but it is not material so the receivables were not reported in the consolidated financial statements of DEUTZ AG. The remaining exposure in respect of the receivables that have been assigned is largely limited to the administration and collection of these receivables. As at 31 December 2016, the Group had access to factoring lines totalling €160.0 million (31 December 2015: €196.0 million). They are revolving lines. In 2016, interest expense of €0.7 million (2015: €1.1 million) was recognised in connection with the sale of receivables.

As at 31 December 2016, the receivables sold were offset by receivables amounting to €6.5 million due from one factor (31 December 2015: €3.1 million). The fair value of these receivables was also €6.5 million (31 December 2015: €3.1 million). The risk arising from the factoring transaction was the credit risk of the factor, which was lower than the credit risk of the original debtors. The maximum downside risk as at 31 December 2016 was limited to the amount receivable of €6.5 million (31 December 2015: €3.1 million).

Trade receivables with a principal amount of €4.7 million were written down as at 31 December 2016 (31 December 2015: €11.7 million). The following table shows the change in the valuation allowance account:

€ million	31 Dec 2016	31 Dec 2015
Balance at 1 Jan	**2.4**	**5.0**
Additions	2.9	0.3
Utilised	–0.1	–2.4
Reversals	–0.7	–0.5
Balance at 31 Dec	**4.5**	**2.4**

If other receivables or assets are found to be impaired, a direct write-down is applied to the relevant carrying amounts. Total impairment losses of €17.6 million were recognised on receivables and other assets as at 31 December 2016 (31 December 2015: €28.1 million).

19. CASH AND CASH EQUIVALENTS

As at 31 December 2016, cash and cash equivalents including cash on hand, short-term deposits and credit balances with banks amounted to €91.8 million (31 December 2015: €112.5 million). There were no access restrictions, as had also been the case in the previous year.

20. NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE

The non-current assets classified as held for sale as at 31 December 2016 relate to some of the land and buildings of Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf, which are situated in Cologne. The land and buildings of Deutz-Mülheim Grundstücksgesellschaft mbH are allocated to the DEUTZ Compact Engines segment.

21. EQUITY

€ million	31 Dec 2016	31 Dec 2015
Issued capital	309.0	309.0
Additional paid-in capital	28.8	28.8
Other reserves	17.1	18.3
Retained earnings and accumulated income	136.2	134.3
Equity attributable to the shareholders of the parent	491.1	490.4
Non-controlling interests	–	5.2
Total	**491.1**	**495.6**

Issued capital

At the end of 2016, the issued capital (share capital) of DEUTZ AG amounted to €308,978,241.98 (unchanged on the end of 2015) and was divided into 120,861,783 no-par-value bearer shares (also unchanged).

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 convertible profit-sharing rights and low-interest-bearing convertible bonds. The value of the conversion right linked to previous profit-sharing rights and bonds was recognised in equity on the issue date at fair value less pro rata transaction costs, taking account of deferred taxes.

No such compound financial instruments were in issue, either in 2016 or in 2015.

Other reserves

Currency translation Translation differences allocated to the shareholders of DEUTZ AG 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 the year under review, this item increased other comprehensive income by €0.4 million (2015: increase of €3.5 million). The cumulative gain on translation differences recognised in other reserves amounted to €19.1 million at the end of 2016 (31 December 2015: gain of €18.7 million recognised). Total differences arising from currency translation amounted to a gain of €0.2 million (2015: gain of €2.8 million), of which a loss of €0.2 million was attributable to non-controlling interests (2015: loss of €0.7 million).

Fair value reserve This reserve is used for the recognition of changes in the fair value of available-for-sale financial instruments. That portion of the gain or loss on a cash flow hedging instrument determined to be an effective hedge is also recognised in the fair value reserve.

Retained earnings and accumulated income

This item includes DEUTZ AG's legal reserve of €4.5 million (31 December 2015: €4.5 million).

Non-controlling interests

In 2015, non-controlling interests had arisen from the 30 per cent equity investment held by Shandong Changlin Machinery Group Co., Ltd. in our subsidiary DEUTZ Engine (Shandong) Co., Ltd., Linyi, China. Following the deconsolidation of this company at the end of the reporting year, there were no non-controlling interests as at 31 December 2016.

Dividend

According to the German Stock Corporation Act (AktG), the dividend is paid from the accumulated income reported in the annual financial statements of DEUTZ AG prepared in accordance with the German Commercial Code (HGB). In 2016, DEUTZ AG distributed a dividend of €8.5 million to its shareholders (€0.07 per share) from the accumulated income reported for 2015.

The Board of Management proposes using €8.5 million of the accumulated income reported by DEUTZ AG for the 2016 financial year to pay a dividend of €0.07 per no-par-value share.

22. PROVISIONS FOR PENSIONS AND OTHER POST-RETIREMENT BENEFITS

DEUTZ AG has 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. At DEUTZ, there are also further direct insurance policies that are financed by employees. These plans are treated as defined contribution plans because the Company has no obligation beyond the payment of contributions to 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 2016 came to €15.3 million (2015: €15.6 million). In addition, a further €2.2 million (2015: €2.3 million) was paid for pension and direct insurance policies in connection with deferred compensation.

Defined benefit plans

The DEUTZ Group maintains several defined benefit pension plans in Germany and abroad. The largest pension plans are in Germany and the UK. Together, they accounted for more than 95 per cent of defined benefit obligations and 100 per cent of plan assets, as was the case in 2015.

In all, there are four defined benefit pension plans in Germany (2015: three). The year-on-year increase is attributable to the inclusion of the subsidiary Ad. Strüver KG (GmbH & Co.), Hamburg, in the consolidated financial statements of DEUTZ AG. While three of the plans are employer funded, the fourth is a deferred compensation plan. As a rule, the employer-funded pension plans comprise a general employee retirement pension for life, a disability pension and a surviving dependants' pension. The level of the monthly pension paid under the employer-funded pension plans is based on earned income and years of service in the DEUTZ Group. No employer-funded pension entitlements have been granted to new employees joining the DEUTZ Group since 1995. In the case of the deferred compensation plan, the Company has taken out a reinsurance policy with a life insurance company based on the amount of salary contribution and undertakes to pay a pension based on the guaranteed capital that has been underwritten. In Germany, occupational pension schemes are governed by the Occupational Pensions Act (BetrAVG), according to which the DEUTZ Group has sole responsibility for meeting the requirements of defined benefit pension plans. The normal retirement age is 67.

The existing defined benefit plan in the UK entitles pension beneficiaries to a pension which depends on the level of their basic salary and the number of eligible years of service. The retirement age is between 62 and 65. The pension scheme is closed to new members. The annual pension paid is between 1/55 and 1/60 of the highest basic salary received in the final five years of service for each eligible year of service. The pension plan is primarily funded by converting pension beneficiaries' basic salary and employer contributions into plan assets. The DEUTZ Group undertakes to compensate for any shortfall in the scheme. Every year, the amount for which the Company is liable is determined with reference to a report by an independent pensions actuary.

According to legislation in the UK, the pension plan, including the plan assets, must be administered by independent trustees. The investment policy for the pension plan specifies that 50 per cent of the accumulated plan assets must be invested in equity instruments and 50 per cent in debt instruments. This investment strategy is specifically intended to counteract capital market risk and the associated risk of mismatches between the Company's payment obligations arising from the pension plan on the one hand and the plan assets on the other.

In connection with the defined benefit pension plans, the Group is exposed to capital market risk arising from its investment of the plan's assets in addition to general actuarial risks such as interest-rate risk, the risk of rising annuity rates and longevity risk.

Funded status of pension plans

€ million	**2016**	2015
Pension plans in Germany		
Present value of defined benefit obligation	183.1	182.0
Fair value of plan assets	5.0	4.9
Deficit (net liability)	**178.1**	**177.1**
Pension plans in the UK		
Present value of defined benefit obligation	28.7	26.7
Fair value of plan assets	22.8	22.9
Deficit (net liability)	**5.9**	**3.8**
Other pension plans		
Present value of defined benefit obligation	6.0	5.7
Fair value of plan assets	–	–
Deficit (net liability)	**6.0**	**5.7**
Total		
Present value of defined benefit obligation	217.8	214.4
Fair value of plan assets	27.8	27.8
Deficit (net liability)	**190.0**	**186.6**

The following table shows the breakdown of separate groups to which the pension plans in Germany and the UK have obligations to pay benefits:

Breakdown of defined benefit obligation by beneficiary

€ million	**2016**	2015
Pension plans in Germany		
Active members	11.6	11.7
Deferred members	10.9	12.8
Pensioners	160.6	157.5
Present value of defined benefit obligation	**183.1**	**182.0**
Pension plans in the UK		
Active members	–	3.8
Deferred members	15.4	13.1
Pensioners	13.3	9.8
Present value of defined benefit obligation	**28.7**	**26.7**

The change in the net liability for defined benefit pension plans is shown in the table below:

Change in the net liability for defined benefit pension plans

€ million	2016	2015
Net liability as at 1 Jan	**186.6**	**201.8**
Changes to basis of consolidation	0.9	–
Amounts recognised on the income statement	4.0	3.9
Amounts recognised in other comprehensive income	13.3	–4.6
Employer contributions	–0.5	–0.6
Pension benefits paid	–13.8	–14.6
Effects of changes in foreign exchange rates	–0.5	0.7
Net liability as at 31 Dec	**190.0**	**186.6**

The following table shows the change in the present value of the defined benefit obligation:

Change in present value of defined benefit obligation

€ million	2016	2015
Defined benefit obligation as at 1 Jan	**214.4**	**228.3**
Changes to basis of consolidation	0.9	–
Service cost	0.2	0.2
Employee contributions	0.1	0.2
Interest expense	4.6	4.5
Remeasurements	16.2	–5.2
thereof: experience adjustments	1.6	–0.3
thereof: actuarial (gains)/losses arising from changes in biometric assumptions	–0.3	–
thereof: actuarial (gains)/losses arising from changes in financial assumptions	14.9	–4.9
Effects of changes in foreign exchange rates	–3.9	2.0
Pension benefits paid	**–14.7**	**–15.6**
Defined benefit obligation as at 31 Dec	**217.8**	**214.4**

At 31 December 2016, the weighted average life of the bulk of the defined benefit obligation was 9.8 years (31 December 2015: 9.7 years).

The increase in the present value of the defined benefit obligation resulting from changes to the basis of consolidation was attributable to the inclusion of the subsidiary Ad. Strüver KG (GmbH & Co.), Hamburg, in DEUTZ AG's consolidated financial statements for the first time with effect from 1 January 2016.

The following two tables show the change in the fair value of the plan assets and the breakdown of the plan assets:

Change in fair value of plan assets

€ million	2016	2015
Fair value of plan assets at 1 Jan	**27.8**	**26.5**
Employer contributions	0.5	0.6
Employee contributions	0.1	0.2
Interest income	0.8	0.8
Return on (+)/expenses from (–) plan assets (excl. interest income)	2.9	–0.6
Pensions paid from plan assets	–0.9	–1.0
Currency translation differences	–3.4	1.3
Fair value of plan assets at 31 Dec	**27.8**	**27.8**

Breakdown of plan assets

€ million	**31 Dec 2016**	31 Dec 2015
Cash and cash equivalents	–	–
Equity instruments (by region)		
UK	3.5	5.4
Europe (excl. UK)	2.1	1.8
North America	2.5	1.4
Japan	1.0	0.7
Asia-Pacific	1.0	0.7
Other	1.4	1.4
	11.4	11.5
Debt instruments		
Government bonds	3.9	3.9
Corporate bonds	7.5	7.5
	11.4	11.4
Reinsurance policies	5.0	4.9
Total	**27.8**	**27.8**

Market prices were available for all the equity and debt instruments because they are traded in active markets.

The breakdown of the portions of the net pension cost recognised in current income and expense for 2016 and 2015 is as follows:

Net pension cost

€ million	2016	2015
Current service cost	0.2	0.2
Net interest cost	3.8	3.7
	4.0	3.9

The actual return on plan assets in 2016 was €3.7 million (2015: €0.2 million).

The measurement of pension obligations is based on actuaries' reports. The tables below show the main actuarial assumptions underlying the calculations for the defined benefit obligation as at the balance sheet date. The discount rates and pension increases are reported in the form of weighted averages.

Actuarial assumptions

%	2016	2015
Discount rate		
Germany	1.54	2.06
UK	2.70	3.90
Rate of pension increase		
Germany	2.00	2.00
UK	2.20	2.10

Mortality tables

Germany	Heubeck 2005G mortality tables
UK	S1 YoB (standard mortality tables for self-administered plans taking into account future changes in mortality)

The following sensitivity analysis for each material actuarial assumption as at the balance sheet date shows the impact that potential changes in the assumptions at the relevant balance sheet date would have on the defined benefit obligations in Germany and the UK.

Sensitivity analysis

2016	Impact on defined benefit obligation of:	
€ million		
	0.50% rise	0.50% fall
in discount rate		
Germany	–8.2	9.1
UK	–2.6	2.8
in rate of pension increase		
Germany	8.8	–8.1
UK	2.3	–2.1

Sensitivity analysis

2015	Impact on defined benefit obligation of:	
€ million		
	0.50% rise	0.50% fall
in discount rate		
Germany	–8.1	8.9
UK	–2.2	2.5
in rate of pension increase		
Germany	8.7	–7.9
UK	1.4	–1.4

Furthermore, we also believe it is possible that the life expectancy of eligible DEUTZ employees will change. If the life expectancy of eligible DEUTZ employees had increased by one year, the increases in the defined benefit obligation arising from the pension plans in Germany and the UK as at 31 December 2016 would have been €16.5 million and €0.8 million respectively (31 December 2015: €15.4 million and €0.5 million respectively).

The sensitivity calculations are based on the average duration of the pension obligations calculated as at 30 November 2016. In order to highlight the impact on the present value of the defined benefit obligations calculated as at 31 December 2016 separately, the calculations were carried out for each of the actuarial parameters deemed to be material and capable of changing.

Future cash flows

For 2017, the DEUTZ Group forecasts that its payments into pension plans will amount to €0.4 million (2016: €0.6 million).

Expected benefit payments

€ million	31 Dec 2016
2017	14.9
2018	14.3
2019	13.7
2020	13.2
2021	12.7
2022–2026	55.7

Expected benefit payments

€ million	31 Dec 2015
2016	15.1
2017	14.6
2018	14.0
2019	13.4
2020	12.9
2021–2025	57.7

23. OTHER PROVISIONS

The following table gives a breakdown of other provisions:

€ million	2016			2015		
	Total	**Residual term of up to 1 year**	**Residual term of more than 1 year**	Total	Residual term of up to 1 year	Residual term of more than 1 year
Warranties	61.6	36.2	25.4	72.2	43.5	28.7
Obligations to employees	15.8	6.5	9.3	12.4	4.8	7.6
Restructuring	7.8	6.9	0.9	10.7	3.0	7.7
Onerous contracts	3.5	3.5	–	3.4	3.4	–
Other	5.6	2.8	2.8	7.7	5.0	2.7
Total	**94.3**	**55.9**	**38.4**	**106.4**	**59.7**	**46.7**

Other provisions are recognised at their settlement value calculated as at the balance sheet date and take account of projected cost increases. Non-current provisions are discounted at a rate of 2.5 per cent (31 December 2015: 2.75 per cent).

Other provisions cover all identifiable risks and other contingent liabilities. The main items are the cost of warranties and potential risks, provisions for restructuring and provisions for obligations to employees and onerous contracts. The provisions for restructuring relate to our decision to optimise our network of sites.

The following table shows the changes to other provisions in 2016:

€ million	Warranties	Obligations to employees	Restructuring	Onerous contracts	Other	**Total**
1 Jan 2016	**72.2**	**12.4**	**10.7**	**3.4**	**7.7**	**106.4**
Additions	0.7	11.9	–	0.1	1.3	14.0
Currency translation differences	–	–	–	–	0.1	0.1
Amounts utilised	–4.4	–8.3	–2.9	–	–3.4	–19.0
Reversals	–7.3	–0.2	–0.3	–	–0.2	–8.0
Basis of consolidation	–	–	–	–	0.1	0.1
Accrued interest/effect of changes in interest rates	0.4	–	0.3	–	–	0.7
31 Dec 2016	**61.6**	**15.8**	**7.8**	**3.5**	**5.6**	**94.3**

24. FINANCIAL DEBT

€ million	31 Dec 2016 Total	31 Dec 2016 Residual term up to 1 year	31 Dec 2016 Residual term 1–5 years	31 Dec 2016 Residual term > 5 years	31 Dec 2015 Total	31 Dec 2015 Residual term up to 1 year	31 Dec 2015 Residual term 1–5 years	31 Dec 2015 Residual term > 5 years
Liabilities to banks	58.5	16.0	41.9	0.6	71.7	14.7	57.0	–
Other financial debt	1.7	0.2	0.8	0.7	1.8	0.2	0.7	0.9
Total	**60.2**	**16.2**	**42.7**	**1.3**	**73.5**	**14.9**	**57.7**	**0.9**

Liabilities to banks

Liabilities to banks include a loan from the European Investment Bank with a remaining balance of €54.0 million. This unsecured loan is repayable in instalments until July 2020.

The syndicated working capital facility had not been drawn down as at 31 December 2016. This revolving line of credit for a total of €160 million provided by a consortium of banks is a floating-rate facility and is also unsecured.

As part of the contractual terms for both loans, DEUTZ is obliged to comply with certain financial covenants (ratio of financial debt to equity and ratio of financial debt to EBITDA).

Banco Bilbao Vizcaya Argentaria has also granted two loans via our Spanish subsidiary; they have a total remaining balance of €4.1 million. The interest rate on the loans is 1.78 per cent. Because the loans have been used for capital expenditure in Spain, finance costs up to an interest rate of 3.0 per cent are reimbursed by the Spanish government as part of a subsidy programme.

Finally, a financial liability of MAD 12.4 million (Moroccan dirhams) existed as at 31 December 2016 through our subsidiary Nlle Ste MAGIDEUTZ S.A., Casablanca, Morocco, in respect of a property leasing agreement with the leasing company WAFABAIL. Translated into the reporting currency, this financial debt amounted to €1.1 million.

Other financial debt

Other financial debt comprises an interest-free government loan.

The fair value of financial debt is described in Note 26 on page 100 et seq.

The weighted average interest rates (after hedging) of the financial debt are:

%	**31 Dec 2016**	31 Dec 2015
Liabilities to banks	2.78	2.87
Other financial debt	–	–

As in 2015, all current financial debt was denominated in euros. Of the non-current financial debt, €1.1 million was denominated in Moroccan dirhams and the remainder in euros.

25. TRADE PAYABLES AND OTHER LIABILITIES

€ million	**31 Dec 2016**	31 Dec 2015
Trade payables	**162.3**	**169.5**
Other liabilities		
Price reduction liabilities	13.0	10.8
Personnel-related liabilities	12.3	7.7
Liabilities to investments	3.0	3.4
Liabilities arising from other taxes	3.1	3.2
Advances received	1.9	2.8
Derivative financial instruments	3.6	1.0
Sundry other liabilities	20.4	20.1
Total	**57.3**	**49.0**

The liabilities from derivative financial instruments resulted from the marking to market of derivatives used to hedge currency and interest-rate risks.

The sundry other liabilities include interest benefits of €1.0 million (31 December 2015: €1.3 million) derived from a loan from the European Investment Bank and of €0.1 million (31 December 2015: €0.2 million) derived from an interest-free government loan. The loans were initially recognised at fair value and are reported as non-current and current financial debt.

NOTES TO THE CASH FLOW STATEMENT

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand, short-term deposits and credit balances held with banks.

Dividend income of €0.6 million was included in cash flow from operating activities (2015: €0.5 million).

The cash flow from financing activities includes the dividend paid to the shareholders of DEUTZ AG for 2015, amounting to €8.5 million.

Cash and cash equivalents had reduced by €20.7 million to €91.8 million at the end of 2016 (31 December 2015: €112.5 million). Of this decrease, €2.5 million was attributable to the deconsolidation of the subsidiary DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China.

SEGMENT REPORTING

The following table provides an overview of the segments in the DEUTZ Group for 2016 and 2015.

2016	DEUTZ Compact Engines	DEUTZ Customised Solutions	**Total segments**	Reconciliation (Other)	**DEUTZ Group**
€ million					
External revenue	1,000.8	259.4	1,260.2	–	1,260.2
Intersegment revenue	–	–	–	–	–
Total revenue	**1,000.8**	**259.4**	**1,260.2**	**–**	**1,260.2**
Depreciation and amortisation	78.8	10.5	89.3	–	89.3
Impairment	1.5	–	1.5	–	1.5
Profit/loss on equity-accounted investments	–5.1	–	–5.1	–	–5.1
Income from the reversal of provisions	0.6	–	0.6	0.2	0.8
Operating profit/loss (EBIT)	–6.1	32.7	26.6	–3.2	23.4

2015	DEUTZ Compact Engines	DEUTZ Customised Solutions	**Total segments**	Reconciliation (Other)	**DEUTZ Group**
€ million					
External revenue	967.2	280.2	1,247.4	–	1,247.4
Intersegment revenue	–	–	–	–	–
Total revenue	**967.2**	**280.2**	**1,247.4**	**–**	**1,247.4**
Depreciation and amortisation	86.1	11.5	97.6	–	97.6
Impairment	7.1	2.6	9.7	–	9.7
Profit/loss on equity-accounted investments	–6.3	–	–6.3	–	–6.3
Income from the reversal of provisions	0.7	–	0.7	0.4	1.1
Operating profit/loss (EBIT)	–31.9	31.3	–0.6	5.5	4.9

Reconciliation from overall profit (loss) of the segments to net income

€ million	2016	2015
Overall profit (loss) of the segments	**26.6**	**–0.6**
Reconciliation (Other)	–3.2	5.5
Operating profit (EBIT)	23.4	4.9
Financial income, net	**–3.5**	**–4.0**
Net income before income taxes	19.9	0.9
Income taxes	–3.9	2.6
Net income	**16.0**	**3.5**

External segment reporting is based on intragroup corporate management and internal financial reporting and, in line with the nature of the products and services offered, covers the following reportable operating segments:

DEUTZ Compact Engines This segment comprises new business and the servicing of liquid-cooled engines with capacities of up to 8 litres.

DEUTZ Customised Solutions This segment focuses on air-cooled engines and large liquid-cooled engines with capacities exceeding 8 litres. It also includes customer-specific solutions (gensets) and service. A key component of the service business is the supply of reconditioned exchange parts and engines.

Reconciliation (Other) This contains Group activities that are not allocated to any of the segments. Where relevant, the reconciliation table also shows the elimination of intercompany relationships between the segments. There were no such eliminations in the reporting year or in 2015.

The designation of a business area as an operating segment is based on internal reporting by segment regularly used by the Board of Management to monitor performance and allocate resources. When the DEUTZ Compact Engines reporting segment was defined, the operating segments ‘product line less < 4 litres’ and ‘product line 4–8 litres’ were grouped together to form the ‘DEUTZ Compact Engines’ reportable segment due to their similar economic characteristics and the aggregation criteria in IFRS 8.12. The product programme of the ‘product line less < 4 litres’ comprises new business and the servicing of liquid-cooled engines with capacities of up to 4 litres. ‘Product line 4–8 litres’ also consists of new business plus the servicing of liquid-cooled engines with capacities of 4 to 8 litres. The economic characteristics of the two product lines were deemed to be similar on the basis of their future levels of return on revenue.

The measurement principles applied to the DEUTZ Group’s segment reporting are based on the IFRS principles applied in the consolidated financial statements. The Board of Management, in its capacity as the senior decision-making body, assesses the performance of the segments in terms of their operating profit (EBIT). If entities included in the consolidated financial statements using the equity method are directly attributable to a particular segment, the relevant share of the net income or loss for the period is reported under that segment. Finance costs, financial income and income taxes are reported for the DEUTZ Group as a whole and are not allocated to individual operating segments. External revenue constitutes the revenue that the segments generate from their customers. Revenue generated between segments – where relevant – is reported as inter-segment revenue. Transfers between segments are reported at fair value.

Information about products and services

€ million	2016	2015
Engines	833.4	806.6
Service	167.4	160.6
DEUTZ Compact Engines	**1,000.8**	**967.2**
Engines	139.5	162.4
Service	119.9	117.8
DEUTZ Customised Solutions	**259.4**	**280.2**
Total	**1,260.2**	**1,247.4**

Geographical information about external revenue

€ million	2016	2015
Germany	**221.8**	**163.5**
Outside Germany	**1,038.4**	**1,083.9**
Rest of Europe	588.6	585.5
Middle East	18.5	28.6
Africa	43.8	66.9
Americas	239.6	275.3
Asia-Pacific	147.9	127.6
Total	**1,260.2**	**1,247.4**

Of the European countries outside Germany, Switzerland accounted for €148.6 million in the reporting year (2015: €141.7 million), Sweden for €116.2 million (2015: €125.5 million) and France for €74.1 million (2015: €59.6 million).

The above information is presented according to customer location. Two customers accounted for at least 10 per cent of our total revenue in 2016 (2015: one customer). The revenue from these customers amounted to €242.7 million (2015: €250.8 million) and €132.1 million (2015: €122.5 million) respectively and was reported predominantly in the DEUTZ Compact Engines segment.

Geographical information about non-current assets

€ million	**31 Dec 2016**	31 Dec 2015
Germany	394.8	424.9
Outside Germany	81.4	89.2
Total	**476.2**	**514.1**

The non-current assets comprise property, plant and equipment, intangible assets and equity-accounted investments. They are presented by location of the consolidated entity.

OTHER INFORMATION

26. FINANCIAL RISK MANAGEMENT AND ADDITIONAL INFORMATION ON CAPITAL MANAGEMENT

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 sales, procurement, interest-rate and foreign-exchange markets. Information about the principles of risk management with regard to financial instruments can be found in the risk report on page 57 to 58 of the DEUTZ Group's combined management report.

Liquidity risk

Prudent liquidity management includes holding a sufficient reserve of cash and cash equivalents, ensuring the option of obtaining funding through bank loans and the ability to issue short-term and long-term capital market instruments. Because the business environment is constantly changing, the treasury department aims to ensure that it has sufficient unused credit lines at its disposal at all times.

The management of liquidity risk in the DEUTZ Group has a number of components: annual planning with interim updates, rolling four-week planning updated weekly and monthly planning updated monthly up to the end of the financial year. Liquidity risk is also assessed in the regular meetings of the Finance Committee.

In order to ensure sufficient liquidity, DEUTZ has at its disposal a syndicated, revolving cash credit line amounting to €160 million that runs until May 2020 and two long-term amortising loans with a total remaining balance of €54.0 million. These are being repaid in equal instalments between July 2014 and July 2020. As part of the loan agreements, the Company is required to comply with certain covenants.

The liquidity analysis also provides information about contractually agreed interest payments and capital repayments in connection with financial liabilities as at the balance sheet date. As far as the utilisation of revolving credit facilities was concerned, it was assumed that the amounts already drawn down by the balance sheet date would continue to apply until the facilities expire.

31 Dec 2016	2017 cash payments	2018–2021 cash payments	> 2021 cash payments	Total
€ million				
Primary financial instruments	**–230.2**	**–49.9**	**–**	**–280.1**
Derivative financial instruments	**–4.0**	**–0.4**	**–**	**–4.4**
Currency derivatives				
thereof settled gross: cash payments	–64.0	–	–	–64.0
thereof settled gross: cash receipts	60.3	–	–	60.3
Interest rate derivatives				
Presentation of net cash flow	–0.3	–0.4	–	–0.7

31 Dec 2015	2016 cash payments	2017–2020 cash payments	> 2020 cash payments	Total
€ million				
Primary financial instruments	**–231.2**	**–64.3**	**–**	**–295.5**
Derivative financial instruments	**–0.9**	**–0.6**	**–**	**–1.5**
Currency derivatives				
thereof settled gross: cash payments	–47.5	–	–	–47.5
thereof settled gross: cash receipts	46.9	–	–	46.9
Interest rate derivatives				
Presentation of net cash flow	–0.3	–0.6	–	–0.9

Credit risk

The overview of written-down financial assets and of the age structure of past due financial assets that have not been written down does not include cash and cash equivalents of €91.8 million (31 December 2015: €112.5 million) or available-for-sale financial assets of €5.5 million (31 December 2015: €3.2 million).

There are no significant concentrations of potential credit risk in the DEUTZ Group. The risk from bad debts is restricted 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. The maximum credit risk exposure is limited to the carrying amount in the case of trade receivables and other financial assets such as cash and cash equivalents, available-for-sale financial assets and derivative financial instruments. Credit risk in connection with financial instruments is limited by careful selection of counterparties.

As regards trade receivables and other receivables and assets that were neither past due nor written down as at the balance sheet date, there were no indications that the customers concerned would be unable to meet their payment obligations. The bulk of the DEUTZ Group's trade receivables are insured with the EULER HERMES Group. There is usually 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 by letters of credit confirmed by a bank or similar instruments. DEUTZ does not produce any standardised credit rating for its customers itself but usually sets the maximum customer exposure in accordance with the level of cover provided by the credit insurance agency. In addition, we have received collateral in the form of payment guarantees and comfort letters amounting to €0.6 million (31 December 2015: €0.6 million) for foreign trade receivables.

31 Dec 2016			thereof written down at the balance sheet date		thereof past due at the balance sheet date but not written down			
€ million								
	Carrying amount	thereof neither past due nor written down at the balance sheet date	Gross amount before write down	Write down	up to 90 days	91 to 180 days	181 to 360 days	over 360 days
Non-current financial assets	**0.5**	**0.5**	**–**	**–**	**–**	**–**	**–**	**–**
Current financial assets	**142.6**	**109.6**	**25.5**	**–22.1**	**31.4**	**–1.2**	**–**	**–0.6**
Trade receivables	113.5	83.6	4.8	–4.5	31.4	–1.2	–	–0.6
Other receivables and assets	29.1	26.0	20.7	–17.6	–	–	–	–

31 Dec 2015			thereof written down at the balance sheet date		thereof past due at the balance sheet date but not written down			
€ million								
	Carrying amount	thereof neither past due nor written down at the balance sheet date	Gross amount before write down	Write down	up to 90 days	91 to 180 days	181 to 360 days	over 360 days
Non-current financial assets	**1.3**	**1.3**	**–**	**–**	**–**	**–**	**–**	**–**
Current financial assets	**122.8**	**91.0**	**40.7**	**–30.5**	**21.3**	**–**	**0.1**	**0.2**
Trade receivables	101.2	70.3	11.7	–2.4	21.3	–	0.1	0.2
Other receivables and assets	21.6	20.7	29.0	–28.1	–	–	–	–

Currency risk

The DEUTZ Group operates internationally and, consequently, is exposed to currency risk arising from fluctuating exchange rates, principally US dollar exchange rates. Exchange-rate risks are monitored under a centralised currency management system and mitigated by the use of hedging transactions. The treasury department uses hedges, primarily currency forwards, to hedge currency risk emanating from the net position of estimated future cash flows in foreign currency. Between 50 per cent and 80 per cent of the net positions anticipated in the budget for the year are usually hedged.

DEUTZ also takes specific action to increase the volume of purchasing in US dollars; this enables the Company to counteract currency risk arising from sales invoiced in US dollars by creating a ‘natural hedge’. Risks arising from the translation of financial statements of subsidiaries prepared in currencies other than the euro are not hedged.

Currency sensitivity analysis

The Group is mainly exposed to exchange-rate risks from the currency of the USA (US dollars).

The following table illustrates the sensitivity – from a Group perspective – to a 10 per cent rise or fall in the euro against the US dollar. The sensitivity analysis only takes into account outstanding monetary positions denominated in foreign currency and adjusts the period-end translation of those amounts to reflect a 10 per cent change in the exchange rate. The positions involved include currency forward contracts that form part of an effective cash flow hedge, the purpose of which is to hedge fluctuations in foreign-currency payments and receipts caused by changes in exchange rates. Because hedging transactions are measured at fair value, changes in the exchange rates for the currencies underlying these transactions have an impact on the hedging reserve in other comprehensive income. Other positions involved are currency forward contracts that are no longer used as hedges. Changes in the exchange rates for the currencies underlying these financial instruments result in gains or losses due to restating these instruments at their fair value. Primary instruments (trade receivables and trade payables) denominated in foreign currency and outstanding as at the balance sheet date are also included in the sensitivity analysis. Changes in the exchange rates for the currencies underlying these items result in gains or losses when they are marked to market.

The following tables show the impact on net income and on equity if the euro rises or falls by 10 per cent against the US dollar.

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

Euro rises by 10 per cent

€ million **2016**	Notional amounts	Impact on net income	Notional amounts	Impact on equity
USD	91.7	–7.3	58.8	5.2

€ million 2015	Notional amounts	Impact on net income	Notional amounts	Impact on equity
USD	74.2	–6.2	55.2	4.9

Euro falls by 10 per cent

€ million **2016**	Notional amounts	Impact on net income	Notional amounts	Impact on equity
USD	91.7	9.0	58.8	–6.4

€ million 2015	Notional amounts	Impact on net income	Notional amounts	Impact on equity
USD	74.2	7.6	55.2	–6.1

Interest-rate risk and sensitivity analysis

The DEUTZ Group is exposed to risk from interest rate changes, primarily in relation to floating-rate loans and other debt. As at 31 December 2016, there were no material loans or other debt exposed to interest-rate risk. The floating-rate loan from the European Investment Bank outstanding on the balance sheet date, which had a remaining balance of €27.0 million, was hedged using interest-rate swaps that form part of an effective cash flow hedge. Because hedging transactions are measured at fair value, changes in interest rates have an impact on the hedging reserve in other comprehensive income. The following table shows the impact of the interest-rate swaps on other comprehensive income if market interest rates rise or fall by 100 basis points.

Interest rates rise by 100 basis points

€ million **2016**	Notional amounts	Impact on equity
	27.0	0.5

€ million 2015	Notional amounts	Impact on equity
	34.2	0.8

Interest rates fall by 100 basis points

€ million **2016**	Notional amounts	Impact on equity
	27.0	–0.5

€ million 2015	Notional amounts	Impact on equity
	34.2	–0.8

Capital management

The DEUTZ Group manages its capital with the primary objective 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 DEUTZ Group is endeavouring to achieve a balance-sheet structure that meets 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, it is under an obligation towards the banks from which it has obtained loans to ensure that its ratio of net financial debt to equity does not exceed a certain level. This external requirement has been integrated into capital management and was met at all times.

As at the balance sheet date, the net financial position (cash and cash equivalents less interest-bearing financial debt) was €31.6 million, which equated to a year-on-year deterioration of €7.4 million (31 December 2015: €39.0 million). In addition to the net financial position, free cash flow (defined as cash flow from operating activities and investing activities less interest payments) is an essential part of active capital management and is used as a key figure to show changes in the liquidity situation. The free cash flow from continuing operations was €4.7 million in 2016 (2015: €35.0 million). The year-on-year reductions in the net financial position and free cash flow were mainly due to the change in working capital.

The equity ratio is another indicator used by the DEUTZ Group to monitor its capital. This indicator reflects the ratio of total assets to Group equity as reported on the consolidated balance sheet. As at 31 December 2016, the equity ratio for the DEUTZ Group was 46.3 per cent (31 December 2015: 45.5 per cent) and therefore remained at a high level and met all 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.

Financial instruments (assets)

31 Dec 2016	**Measured at amortised cost**	**Measured at fair value**				**Assets not within the scope of IAS 39**	
€ million	Loans and receivables	Available-for-sale financial assets	Available-for-sale financial assets	Derivatives designated as hedging instruments (recognised as other comprehensive income/ loss)	Held-for-trading financial assets	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial assets	**0.5**	**0.3**	**5.2**	**–**	**–**	**1.5**	**7.5**
Current financial assets	**234.4**	**–**	**–**	**–**	**–**	**8.2**	**242.6**
Trade receivables	113.5	–	–	–	–	–	113.5
Other receivables and assets	29.1	–	–	–	–	8.2	37.3
Cash and cash equivalents	91.8	–	–	–	–	–	91.8

Financial instruments (assets)

31 Dec 2015	**Measured at amortised cost**	**Measured at fair value**				**Assets not within the scope of IAS 39**	
€ million	Loans and receivables	Available-for-sale financial assets	Available-for-sale financial assets	Derivatives designated as hedging instruments (recognised as other comprehensive income/ loss)	Held-for-trading financial assets	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial assets	**1.3**	**0.2**	**2.9**	**–**	**–**	**2.0**	**6.4**
Current financial assets	**235.3**	**–**	**–**	**–**	**–**	**10.9**	**246.2**
Trade receivables	101.2	–	–	–	–	–	101.2
Other receivables and assets	21.6	–	–	–	–	10.9	32.5
Cash and cash equivalents	112.5	–	–	–	–	–	112.5

Financial instruments (liabilities)

31 Dec 2016	**Measured at amortised cost**	**Measured at fair value**		**Liabilities not within the scope of IAS 39**	
€ million	Financial liabilities	Derivatives designated as hedging instruments (recognised as other comprehensive income/loss)	Held-for-trading financial liabilities	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial liabilities	**47.0**	**0.9**	**–**	**2.4**	**50.3**
Financial debt	42.9	–	–	1.1	44.0
Other liabilities	4.1	0.9	–	1.3	6.3
Current financial liabilities	**219.9**	**2.4**	**0.3**	**6.9**	**229.5**
Financial debt	16.2	–	–	–	16.2
Trade payables	162.3	–	–	–	162.3
Other liabilities	41.4	2.4	0.3	6.9	51.0

Financial instruments (liabilities)

31 Dec 2015	**Measured at amortised cost**	**Measured at fair value**		**Liabilities not within the scope of IAS 39**	
€ million	Financial liabilities	Derivatives designated as hedging instruments (recognised as other comprehensive income/loss)	Held-for-trading financial liabilities	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial liabilities	**59.3**	**0.9**	**–**	**1.6**	**61.8**
Financial debt	58.6	–	–	–	58.6
Other liabilities	0.7	0.9	–	1.6	3.2
Current financial liabilities	**219.6**	**0.1**	**–**	**10.5**	**230.2**
Financial debt	14.9	–	–	–	14.9
Trade payables	169.5	–	–	–	169.5
Other liabilities	35.2	0.1	–	10.5	45.8

The following table shows the carrying amounts and fair values of all financial instruments included in the consolidated financial statements that fall within the scope of IFRS 7 'Financial Instruments: Disclosures' and that are not reported at fair value.

€ million	31 Dec 2016		31 Dec 2015	
	Carrying amount	**Fair value**	Carrying amount	Fair value
Financial assets	**235.2**	**234.9**	**236.8**	**236.6**
Other loans	–	–	1.3	1.3
Available-for-sale financial assets measured at cost	0.3	–	0.2	–
Trade receivables	113.5	113.5	101.2	101.2
Other receivables and assets	29.6	29.6	21.6	21.6
Cash and cash equivalents	91.8	91.8	112.5	112.5
Financial liabilities	**268.0**	**269.8**	**278.9**	**281,7**
Financial debt – liabilities to banks	60.2	62.0	73.5	76.3
Trade payables	162.3	162.3	169.5	169.5
Other liabilities	45.5	45.5	35.9	35.9

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

The available-for-sale financial assets with a carrying amount of €0.3 million (31 December 2015: €0.2 million) are investments. They are measured at amortised cost because their fair value cannot be reliably determined due to their not being listed on a market and due to a lack of market data for comparable instruments. There was no intention to dispose of these instruments as at 31 December 2016.

The fair value of non-current financial assets and liabilities is computed by discounting estimated future cash flows using arm's length discount rates and taking into account our own credit risk and that of our counterparties based on credit ratings and exchange rates on the balance sheet date.

The following table shows the classification in the IFRS 13 measurement hierarchy of the fair values as at the balance sheet date of financial assets and liabilities that were measured at fair value in the consolidated financial statements, or for which a fair value was disclosed in the notes to the financial statements:

31 Dec 2016

€ million	**Carrying amount**	**Fair value**	Level 1	Level 2	Level 3
Financial assets					
Securities	3.2	3.2	3.2	–	–
Available-for-sale financial assets measured at fair value	2.0	2.0	–	–	2.0
Financial liabilities					
Currency forwards	2.9	2.9	–	2.9	–
Interest-rate swaps	0.7	0.7	–	0.7	–
Financial debt	60.2	62.0	–	–	62.0

31 Dec 2015

€ million	**Carrying amount**	**Fair value**	Level 1	Level 2	Level 3
Financial assets					
Securities	2.9	2.9	2.9	–	–
Financial liabilities					
Currency forwards	0.1	0.1	–	0.1	–
Interest-rate swaps	0.9	0.9	–	0.9	–
Financial debt	73.5	76.3	–	–	76.3

Level 1: Measurement is based on the price of identical assets or liabilities in active markets.
Level 2: Measurement is based on the price of a similar instrument in active markets/measurement using a method in which all the critical input factors are based on observable market data.
Level 3: Measurement using a method in which critical input factors are not based on observable market data.

The fair value of securities is derived from prices in active markets.

The available-for-sale financial assets measured at fair value relate to the equity investment in DEUTZ Engine (Shandong) Co., Ltd., Linyi, China. As this company is no longer operational and is currently being wound up, the fair value of the equity investment was determined on the basis of the company's net asset value as at 31 December 2016. There was no intention to dispose of these financial assets as at 31 December 2016.

The fair value of derivative financial instruments (currency forwards and interest-rate swaps) is calculated over the remaining term of the instrument using current exchange rates, market interest rates, yield curves and, in the previous year, commodity prices. Our own credit risk and that of our counterparties are also taken into account. The disclosures are based on valuations by banks.

Net gains and losses on financial instruments

Net gains or losses recognised in the income statement are broken down by measurement category in IAS 39 as follows:

2016	Loans and receivables	**Derivatives designated as hedging instruments**	Held-for-trading financial assets	Financial liabilities measured at amortised cost	Held-for-trading financial liabilities
€ million					
Net gains/losses	0.8	–0.4	–	–2.6	–0.3

2015	Loans and receivables	**Derivatives designated as hedging instruments**	Held-for-trading financial assets	Financial liabilities measured at amortised cost	Held-for-trading financial liabilities
€ million					
Net gains/losses	–2.0	–0.4	0.2	–2.9	–

The net gains or losses for each measurement category primarily comprise gains and losses recognised in profit or loss resulting from the measurement of financial instruments at fair value, currency translation of financial instrument carrying amounts, impairment losses and/or reversal of impairment losses on financial instruments and interest income and expense.

In the year under review, no unrealised losses on available-for-sale financial assets were recognised in other comprehensive income (2015: losses of €0.2 million). As had been the case in 2015, no realised gains or losses were reclassified from other comprehensive income to the income statement in 2016.

Total interest income and interest expense

In 2016, interest income of €0.3 million (2015: €0.8 million) and interest expense of €2.5 million (2015: €2.9 million) were attributable to financial assets and financial liabilities that were not measured at fair value through profit or loss.

Hedging

Cash flow hedging As at 31 December 2016, there were currency futures and interest-rate swaps which were classified as hedging instruments. Interest-rate swaps are used to hedge the interest-rate risk associated with floating-rate loans. Currency futures are used to hedge the currency risk arising from forecast transactions in foreign currencies.

Unrealised losses of €2.3 million on cash flow hedges were recognised in other comprehensive income in 2016 (2015: gains of €1.9 million), taking into account deferred tax assets of €0.7 million (2015: deferred tax liabilities of €0.6 million). These changes in fair value represent the effective portion of the hedge. In 2016, prior to the inclusion of deferred taxes, losses of €32 thousand (2015: losses of €8.1 million) recognised in other comprehensive income during the year were reclassified to other operating income or expenses in the consolidated income statement. There was no hedging ineffectiveness requiring reclassification from the reserve for cash flow hedges to the income statement in the year under review. Hedges relating to foreign-currency transactions in the operating business are expected to be unwound within the next twelve months and those relating to future interest-rate risks are expected to be unwound after a period of three and a half years. The associated gains that have been recognised in other comprehensive income will be reclassified to the income statement.

Derivative financial instruments

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

€ million	**Notional amounts 2016**	Notional amounts 2015	**Fair value 2016**	Fair value 2015
Currency forwards				
not used as hedges	6.9	2.9	–0.3	–[1]
used as cash flow hedges	58.8	55.2	–2.6	–0.1
Interest-rate swaps				
used as cash flow hedges	27.0	34.2	–0.7	–0.9

[1] Rounded figures are below €0.1 million.

Netting

Netting agreements with financial institutions covering derivatives exist within the DEUTZ Group. In accordance with these master agreements, amounts in the same currency relating to outstanding transactions owed by each counterparty on a specific settlement date are aggregated into a net amount.

As at 31 December 2016, there were also netting agreements with customers that permit the DEUTZ Group to net receivables and liabilities with each other that are in the same currency.

The following table shows the financial assets and liabilities that are subject to netting agreements:

31 Dec 2016	Gross amounts	Figures netted on the balance sheet	Net amounts reported on the balance sheet	Related amounts not netted on the balance sheet	Potential net amounts
€ million					
Financial liabilities					
Other liabilities	2.2	1.2	1.0	–	1.0
Derivative financial instruments	0.1	–	0.1	–	0.1

31 Dec 2015	Gross amounts	Figures netted on the balance sheet	Net amounts reported on the balance sheet	Related amounts not netted on the balance sheet	Potential net amounts
€ million					
Financial liabilities					
Derivative financial instruments	0.1	–	0.1	–	0.1

27. INTERESTS IN OTHER ENTITIES

As well as the parent company DEUTZ AG, the consolidated financial statements for 2016 included 16 subsidiaries, two joint ventures and one associate.

The Group subsidiary Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf, is a structured entity. DEUTZ holds a total of 19.6 per cent of the voting shares in the entity. The purpose of the company is to sell real estate that was previously purchased by DEUTZ AG to third parties and to lease it to DEUTZ AG in the interim. The entity's activities are controlled by DEUTZ AG as part of its business operations. For this reason, Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf, constitutes a subsidiary and has to be included in the consolidated financial statements of DEUTZ AG.

At the end of 2016, the DEUTZ Group extended the term of its loan to Deutz-Mülheim Grundstücksgesellschaft mbH by a further 15 months, although it has no obligation to provide financial assistance of this kind.

Subsidiaries and non-controlling interests

Following the deconsolidation of the subsidiary DEUTZ Engine (Shandong) Co., Ltd., Linyi, China, at the end of the reporting year, there were no non-controlling interests as at 31 December 2016.

Joint ventures

DEUTZ (Dalian) Engine Co., Ltd., Dalian, China, is an unlisted joint arrangement in which the Group shares joint control and has an ownership interest of 50 per cent. The company, which is structured as a separate vehicle, was established jointly with the First Automotive Works Group (China), Dalian, China. It is a strategic partnership for the production and distribution of diesel engines with a capacity of between 3 and 8 litres for the Chinese market. The interest is classified as a joint venture and accounted for in the consolidated financial statements using the equity method.

A summary of financial information for DEUTZ (Dalian) Engine Co., Ltd. based on its annual financial statements prepared in accordance with IFRS is shown in the following table.

€ million	**2016**	2015
Revenue	303.0	339.5
Depreciation and amortisation	–22.3	–18.3
Interest expenses, net	–9.6	–8.8
Income taxes	–	–
Profit (loss) from continuing operations	–15.4	–18.4
Net income	–15.4	–18.4
Current assets	210.4	233.4
thereof cash and cash equivalents	2.3	3.3
Non-current assets	292.6	322.6
Current liabilities	236.0	245.8
thereof current financial liabilities	95.3	113.0
Non-current liabilities	176.9	200.8
thereof non-current financial liabilities	175.2	198.6
Net assets	**90.1**	**109.4**
Group's share of net assets at 1 Jan	54.7	59.7
Share of net income	–7.7	–9.2
Dividends received in 2016	–	–
Effect of currency translation	–1.9	4.2
Group's share of net assets at 31 Dec	45.1	54.7
Elimination	–6.2	–8.5
Impairment	–	–
Carrying amount using the equity method at 31 Dec	**38.9**	**46.2**

Non-material joint ventures

Financial information is shown below for the Group's interest in DEUTZ AGCO MOTORES S.A., Haedo, Argentina, which is classified as a non-material joint venture.

€ thousand	**2016**	2015
Carrying amount of interests	**–**[1]	**–**[1]
Group's share of:		
Loss from continuing operations	–154	–23
Other comprehensive income	–	–
Net income	**–154**	**–23**

[1] As the carrying amount of the interests was zero, total losses of €203 thousand (2015: €49 thousand) were not recognised under the equity method.

Non-material associates

A summary of financial information is shown below for the Group's interest in D. D. Power Holdings (Pty) Ltd., Elandsfontein, South Africa, which is classified as a non-material associate. The company has a different financial year (ending on 30 November). Annual financial statements for the year ended 31 December have not been prepared for reasons of materiality.

€ thousand	2016	2015
Carrying amount of interests	**2,783**	**2,344**
Group's share of:		
Profit from continuing operations	571	763
Other comprehensive income	–	–
Net income	**571**	**763**

28. CONTINGENT LIABILITIES

Contingent liabilities

The DEUTZ Group's contingent liabilities as at the balance sheet date were as follows:

€ million	31 Dec 2016	31 Dec 2015
Guarantee liabilities	0.1	3.0
Warranty liabilities	0.3	0.5
Total	**0.4**	**3.5**

The guarantee liabilities disclosed in 2015 were almost exclusively liabilities to the subsidiary Ad. Strüver KG (GmbH & Co.), Hamburg. The decrease in guarantee liabilities in 2016 was the result of this subsidiary being included in DEUTZ AG's consolidated financial statements again with effect from 1 January 2016.

Other financial obligations

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

€ million	31 Dec 2016	31 Dec 2015
due in less than 1 year	8.6	8.5
due in 1 to 5 years	17.2	18.8
due in more than 5 years	–	–
Total	**25.8**	**27.3**

The above obligations largely relate to rental agreements and leases on real estate, movable assets and financial obligations in connection with IT services. Obligations under rental agreements and leases were partly offset by receivables of €18 thousand (2015: €40 thousand) from sub-leases. In 2016, the cost of rentals and leases for real estate and movable assets totalled €9.8 million (2015: €11.9 million).

Commitments to purchase property, plant and equipment and intangible assets amounted to €36.6 million as at 31 December 2016 (31 December 2015: €34.8 million) and commitments to purchase inventories amounted to €80.5 million (31 December 2015: €63.9 million).

Legal disputes

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

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, an obligation is probable and the amount of the obligation can be determined with a sufficient degree of reliability.

Claims for compensation have been made in respect of isolated product liability cases in the USA although the extent of these is as yet unknown. Due to the low probability of losses occurring, no provisions have been recognised on the balance sheet. The outcome of these legal disputes cannot be predicted with any degree of certainty. It is therefore possible that they might have a negative impact on the financial position or financial performance. However, the level of existing insurance cover means that if the outcome is negative, this impact will only be a maximum of €1.5 million.

We do not expect the above risks to have a significantly adverse long-term 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:

- AB Volvo (publ), Gothenburg, Sweden (group)

Related parties also include the Supervisory Board and the Board of Management.

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

€ million	Goods and services provided		Other expenses for services received		Receivables 31 Dec		Payables 31 Dec	
	2016	2015	**2016**	2015	**2016**	2015	**2016**	2015
Associates	–	–	–	–	–	–	–	–
Joint ventures	7.8	3.2	–	–	2.9	–	–	0.5
Other investments	0.5	0.6	4.7	4.5	0.2	0.9	3.0	2.9
Total	**8.3**	**3.8**	**4.7**	**4.5**	**3.1**	**0.9**	**3.0**	**3.4**

The goods supplied and services rendered to joint ventures are largely attributable to goods supplied to our Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd.

Receivables due from joint ventures amounting to €3.7 million (31 December 2015: €3.4 million) had been written off in full as at 31 December 2016; the expense in 2016 amounted to €0.3 million (2015: €0.4 million). As at 31 December 2016, impairment losses of €13.9 million (31 December 2015: €24.7 million) had been recognised on €14.0 million (31 December 2015: €25.6 million) of the Company's receivables due from other investments. The resulting expense came to €0.1 million in 2016 (2015: €0.1 million). The sharp decline in impaired receivables due from other investments and the corresponding impairment losses resulted from the inclusion of the subsidiary Ad. Strüver KG in the basis of consolidation of DEUTZ AG as at 1 January 2016.

Of these receivables, €6.8 million related to loans granted by DEUTZ (31 December 2015: €6.8 million) on which impairment losses of €6.8 million had been recognised (31 December 2015: €6.8 million). Taken together, neither the interest and similar income nor the interest expense and similar charges arising from the interest paid on these loans are material.

The following table gives a breakdown of the significant business relationships between the DEUTZ Group and its shareholders, including their subsidiaries:

€ million	Volvo Group	
	2016	2015
Engines & spare parts supplied	242.7	250.8
Services	1.7	7.1
Receivables as at 31 Dec	7.1	13.6

All transactions were concluded at arm's-length market rates. DEUTZ has an agreement with the Volvo Group that grants Volvo companies extended credit periods in return for payment of a fee.

The following payments were made to the Supervisory Board and the Board of Management as related parties of the DEUTZ Group.

€ million	Supervisory Board		Board of Management	
	2016	2015	**2016**	2015
Short-term remuneration[1]	1.0	1.1	2.7	2.7
Termination benefits	–	–	1.9	–
Share-based remuneration[2]	0.1	–[3]	0.9	0.3

[1] The current remuneration for members of the Supervisory Board includes both remuneration for their work as Supervisory Board members and the regular salaries of the salaried employee representatives.
[2] The disclosure of share-based remuneration corresponds with the expense (+) or income (–) recognised in the operating profit in 2016 from the changes in provisions made for distributed virtual share options.
[3] Rounded figures are below €0.1 million.

The termination benefits relate to Dr Leube's early departure from the Company on 31 December 2016.

The DEUTZ Group did not maintain material business relationships with any other related parties.

30. EVENTS AFTER THE REPORTING PERIOD

In connection with the optimisation of our network of sites, the relocation from the Cologne-Deutz site to the Cologne-Porz site was completed at the start of 2017. A development proposal for the Cologne-Deutz site, which covers around 160,000 square metres, is currently going through the planning process. The aim is to redevelop the site and create a new city district. In February 2017, DEUTZ AG's Board of Management decided to examine whether the site can be sold quickly – before the development planning process has been completed – on attractive terms. The Board of Management also authorised the initiation of negotiations on selling the site. If the outcome of these negotiations is positive, DEUTZ may, depending on the specific contractual arrangements, be able to realise a gain in the mid to high double-digit million euros in the short to medium term that would have a positive impact on the Group's financial position and financial performance.

31. SHARE-BASED REMUNERATION PROGRAMMES

Between 2007 and 2016, DEUTZ AG launched long-term incentive plans as long-term components of remuneration. Under these long-term incentive plans, virtual stock options are issued to reward management for its sustained contribution to the Company's success.

General description of the incentive plans of DEUTZ AG

Under DEUTZ AG's incentive plans, virtual options are issued on shares in DEUTZ AG. The Company decides at its discretion who is eligible to participate in the plans. However, only members of the DEUTZ Group's senior management and members of the Supervisory Board of DEUTZ AG may be considered for inclusion. It is at the discretion of the Company to decide how many options are granted.

By the balance sheet date, the following long-term incentive plans (LTI) that were still in existence, with the number of options shown, had been granted free of charge:

Incentive plan	Date of grant	Number of options
LTI no. IV	1 July 2010	330,000
LTI no. V	1 June 2011	280,000
LTI no. VI	1 August 2012	270,000
LTI BoM 2013	1 January 2013 and 1 March 2013	104,079 and 32,663
LTI no. VII	1 July 2013	260,000
LTI BoM 2014	1 January 2014	72,389
LTI no. VIII	1 September 2014	320,000
LTI BoM 2015	1 January 2015	125,657
LTI no. IX	1 June 2015	320,000
LTI BoM 2016	1 January 2016	147,577
LTI no. X	1 September 2016	340,000

A total of 482,365 of these options had been granted to current and former members of the DEUTZ AG Board of Management.

Information on the exercise of options

One of the fundamental requirements for exercising options is that the option holders themselves invest in the Company at a ratio of one share per ten options, or one share per 20 options in the case of LTI BoM 2013 to 2016. The absolute earliest that options can be exercised is three or four years after the date of grant (vesting period) and then only within four years from the end of the vesting period and only within ten days from the date of publication of quarterly financial statements. However, options under the LTI BoM 2013 to 2016 are exercised automatically four years after the date of grant. The Company may delay the start of the exercise window for the options or accelerate the exercise and vesting periods, but cannot change the exercise or vesting periods of the options relating to LTI BoM 2013 to 2016.

Furthermore, options may only be exercised

- if the market price of DEUTZ AG shares has risen by at least 30 per cent relative to the reference price (dividend distributions by DEUTZ AG must be 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 DEUTZ AG share price), or
- if, 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, or
- in the case of LTI BoM 2013 to 2016, if, in the period starting from the grant date of the option and ending on the date of exercise, DEUTZ AG shares outperform the MDAX – or any future index that replaces the MDAX – by at least 10 percentage points.

A request to exercise options must be submitted to the Company in writing.

The following specific terms and conditions apply to the incentive plans still in existence:

Incentive plan	Earliest or automatic exercise date	Reference price
LTI no. IV	1 July 2014	€4.39
LTI no. V	1 June 2015	€6.10
LTI no. VI	1 August 2016	€3.89
LTI BoM 2013	1 January 2017 and 1 March 2017	€3.36 and €3.98
LTI no. VII	1 July 2017	€4.45
LTI BoM 2014	1 January 2018	€6.63
LTI no. VIII	1 September 2018	€5.37
LTI BoM 2015	1 January 2019	€3.82
LTI no. IX	1 June 2019	€4.40
LTI BoM 2016	1 January 2020	€3.42
LTI no. X	1 September 2020	€3.94

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. Under the LTI BoM 2013 to 2016, however, beneficiaries receive a cash payment equivalent to the average closing price of DEUTZ AG shares on the 60 trading days prior to the end of the vesting period up to a maximum of 1.5 times the reference price. No beneficiary receives shares in the Company.

The following table shows the changes to the number of outstanding options in 2016:

Incentive plan	Outstanding options at 1 Jan	Options granted	Options exercised	Options expired	Outstanding options at 31 Dec
LTI no. II	75,000	–	–	–75,000	–
LTI no. IV	230,000	–	–	–	230,000
LTI no. V	240,000	–	–	–	240,000
LTI no. VI	250,000	–	–	–10,000	240,000
LTI BoM 2013	136,742	–	–	–	136,742
LTI no. VII	250,000	–	–	–	250,000
LTI BoM 2014	72,389	–	–	–	72,389
LTI no. VIII	300,000	–	–	–20,000	280,000
LTI BoM 2015	125,657	–	–	–	125,657
LTI no. VIII	320,000	–	–	–20,000	300,000
LTI BoM 2016	–	147,577	–	–	147,577
LTI no. X	–	340,000	–	–	340,000
	1,999,788	487,577	–	–125,000	2,362,365

Notes on the fair value of options

Because the 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 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 factors in the aforementioned exercise prices, the term and the value of the underlying asset (DEUTZ AG shares).

LTI no. IV

The risk-free interest rate (2.50 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2010. The assumed volatility (48.87 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. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.10 on 1 July 2010. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI no. V

The risk-free interest rate (3.25 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2011. The assumed volatility (51.35 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. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €6.82 on 1 June 2011. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI no. VI

The risk-free interest rate (1.75 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2012. The assumed volatility (57.30 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. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €3.07 on 1 August 2012. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2013

The risk-free interest rate (0.4 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes with terms of two to five years issued at the start of 2013. The assumed volatility (61.80 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2013. It is assumed that no option holders leave the Company. These assumptions were also used in the calculation for the options issued on 1 March 2013.

The calculation on the grant date was based on the DEUTZ AG share price of €3.76 on 1 January 2013 and €4.40 on 1 March 2013. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. VII

The risk-free interest rate (1.75 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2013. The assumed volatility (54.18 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. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.77 on 1 July 2013. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2014

The risk-free interest rate (0.625 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes with terms of two to five years issued at the start of 2014. The assumed volatility (50.44 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2014. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €6.49 on 1 January 2014. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. VIII

The risk-free interest rate (0.63 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in the second half of 2014. The assumed volatility (57.72 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. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.52 on 1 September 2014. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2015

The risk-free interest rate (0.1 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes issued at the start of 2015. The assumed volatility (45.34 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2015. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.24 on 1 January 2015. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. IX

The risk-free interest rate (0.63 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in the second half of 2015. The assumed volatility (58.58 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. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €5.24 on 1 June 2015. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2016

The risk-free interest rate (0.1 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes issued at the start of 2016. The assumed volatility (49.71 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2016. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €3.535 on 1 January 2016. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. X

The risk-free interest rate (0.0 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in the second half of 2016. The assumed volatility (44.30 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. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.00 on 1 September 2016. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were 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 €5.35 on 31 December 2016 (31 December 2015: €3.69), which resulted in an expense of €2,373 thousand in 2016 (2015: €330 thousand).

A total provision of €3,836 thousand was recognised at the end of 2016 (31 December 2015: €1,463 thousand). The amount is broken down as follows:

Incentive plan	**31 Dec 2016 € thousand**	31 Dec 2015 € thousand
LTI no. IV	407	223
LTI no. V	375	220
LTI no. VI	674	123
LTI BoM 2013	692	373
LTI no. VII	284	117
LTI BoM 2014	290	134
LTI no. VIII	256	94
LTI BoM 2015	336	116
LTI no. IX	267	63
LTI BoM 2016	189	–
LTI no. X	66	–
	3,836	**1,463**

Of the total expenses in 2016 and the total provisions as at 31 December 2016, the sum attributable to members of the Board of Management and Supervisory Board of DEUTZ AG was €1,003 thousand (2015: €266 thousand) and €1,693 thousand (31 December 2015: €689 thousand) respectively.

The options granted had the following intrinsic values, provided the vesting conditions were met:

Incentive plan	**Intrinsic value per option, provided the vesting conditions are met (€)**	
	31 Dec 2016	**31 Dec 2015**
LTI no. IV	–	–
LTI no. V	–	–
LTI no. VI	1.46	–
LTI BoM 2013	5.04 and 5.35	–
LTI no. VII	–	–
LTI BoM 2014	–	–
LTI no. VIII	–	–
LTI BoM 2015	5.35	–
LTI no. IX	–	–
LTI BoM 2016	5.13	–
LTI no. X	1.41	–

32. STAFF COSTS

€ million	2016	2015
Wages	108.0	107.2
Salaries	119.1	114.0
Social security contributions	43.0	42.7
Net interest cost for provisions for pensions and other post-retirement benefits	3.8	3.7
Cost of post-employment benefits and other long-term benefits	1.6	1.6
Cost of severance payments/personnel restructuring	2.9	1.2
Total	**278.4**	**270.4**

The following table shows the breakdown of staff costs by functional area:

€ million	2016	2015
Cost of sales	165.0	164.8
Research and development costs	29.8	29.8
Selling expenses	47.5	45.8
Administrative expenses	29.5	25.6
Other operating expenses	6.6	4.4
Total	**278.4**	**270.4**

The average number of employees during the year is given in the section about disclosures under German accounting standards in Note 33.

DISCLOSURES UNDER GERMAN ACCOUNTING STANDARDS

33. AVERAGE NUMBER OF EMPLOYEES DURING THE YEAR (PURSUANT TO SECTION 314 (1) NO. 4 HGB)

	2016	2015
Non-salaried employees	2,216	2,274
Salaried employees	1,390	1,409
	3,606	**3,683**
Trainees	86	106
Total	**3,692**	**3,789**

34. CORPORATE GOVERNANCE

In December 2016, the Board of Management and the Supervisory Board of DEUTZ AG issued a declaration of conformity with the recommendations of the German Corporate Governance Code government commission pursuant to section 161 AktG and made this declaration permanently and publicly available on the Company's website (http://www.deutz.de/investor_relations/corporate_governance/declaration_of_conformity.en.html).

35. AUDITORS' FEES

The total fees reported for auditing the consolidated financial statements for 2015 and 2016 are broken down as follows:

€ thousand	2016	2015
Auditing	336	318
Other attestation services	134	181
Total	**470**	**499**

36. TOTAL REMUNERATION FOR THE BOARD OF MANAGEMENT, FORMER BOARD OF MANAGEMENT MEMBERS AND THE SUPERVISORY BOARD

Board of Management

The total remuneration for the Board of Management of DEUTZ AG in 2016 was €3,238 thousand (2015: €3,275 thousand). This consisted of short-term employee benefits of €2,716 thousand (2015: €2,743 thousand) and other long-term benefits as part of the long-term incentive plans amounting to €522 thousand (2015: €532 thousand).

Further details about the remuneration system for members of the Board of Management and details of individual remuneration can be found in the 'Remuneration report' section of the 2016 combined management report.

Remuneration for former members of the Board of Management or their surviving dependants amounted to €3,340 thousand (2015: €1,550 thousand) for DEUTZ AG and the Group. It includes payments of €1,893 thousand in connection with the premature termination of the Board of Management contract of Dr Leube with effect from 31 December 2016. Provisions of €15,293 thousand (31 December 2015: €15,521 thousand) have been recognised to cover pension obligations to former members of the Board of Management.

Supervisory Board

The total remuneration for the Supervisory Board of DEUTZ AG in 2016 was €629 thousand (2015: €613 thousand). In addition, the employee representatives on the Supervisory Board who are also employees of the DEUTZ Group received normal salaries in line with their employment contracts. The level of their salaries represented appropriate remuneration for corresponding functions and tasks in the Group.

Further details about the Supervisory Board remuneration system and details of individual remuneration can be found in the 'Remuneration report' section of the 2016 combined management report.

Advances and loans to members of the Board of Management and the Supervisory Board

As at 31 December 2016, there were no outstanding advances or loans to any members of the Board of Management or the Supervisory Board, nor had any guarantees or other warranties been issued in favour of any such persons.

37. 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 received the following voting right notifications in 2016:

On 22 January 2016, pursuant to section 21 (1) WpHG, the Ministry of Finance on behalf of the State of Norway, Oslo, Norway, notified us that its voting share in our Company had fallen below the 3 per cent threshold on 19 January 2016 and amounted to 2.98 per cent (3,603,758 voting rights) on that date. Pursuant to section 22 (1) sentence 1 no. 1 WpHG, 2.98 per cent (3,603,758 voting rights) are attributable to it.

On 8 April 2016, pursuant to section 21 (1) WpHG, the Ministry of Finance on behalf of the State of Norway, Oslo, Norway, notified us that its voting share in our Company had exceeded the 3 per cent threshold on 4 April 2016 and amounted to 3.05 per cent (3,680,200 voting rights) on that date. Pursuant to section 22 (1) sentence 1 no. 1 WpHG, 3.05 per cent (3,680,200 voting rights) are attributable to it. The voting rights attributable to it are held by the following company under its control, whose voting share in DEUTZ AG is 3 per cent or more: Norges Bank (the Central Bank of Norway).

On 5 September 2016, pursuant to section 21 (1) WpHG, the Ministry of Finance on behalf of the State of Norway, Oslo, Norway, notified us that its voting share in our Company had exceeded the 3 per cent threshold on 19 August 2016 and amounted to 3.95 per cent (4,774,952 voting rights) on that date. Pursuant to section 22 (1) sentence 1 no. 1 WpHG, 3.95 per cent (4,774,952 voting rights) are attributable to it. The voting rights attributable to it are held by the following company under its control, whose voting share in DEUTZ AG is 3 per cent or more: Norges Bank (the Central Bank of Norway).

38. SUPERVISORY BOARD AND BOARD OF MANAGEMENT

Information on the members of the Supervisory Board and the Board of Management, including non-executive directorships held at other companies, is given in a separate list on page 120 et seq.

Cologne, 17 February 2017

DEUTZ Aktiengesellschaft
The Board of Management

Dr Ing Frank Hiller

Dr Margarete Haase

Michael Wellenzohn

SHAREHOLDINGS OF DEUTZ AG

As at 31 December 2016

Ref. no.	Name and registered office of the company	Held via	Holding (%)	Equity (€ thousand)	Net income (€ thousand)
1	DEUTZ AG, Cologne	–	–	508,823	45,106
Consolidated companies in Germany					
2	Ad. Strüver KG (GmbH & Co.), Hamburg[1]	6	94.0	–10,980	4
3	DEUTZ Abgastechnik GmbH, Cologne[1,2]	1	100.0	25	–
4	DEUTZ Amerika Holding GmbH[1,2]	1	100.0	92,274	–
5	DEUTZ Asien Verwaltungs GmbH, Cologne[1,2]	1	100.0	16,125	–
6	DEUTZ Beteiligung GmbH, Cologne[1]	1	100.0	91	–393
7	Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf[1]	6	19.6	–21,592	–671
8	Unterstützungsgesellschaft mbH der DEUTZ Aktiengesellschaft, Cologne[1]	1	100.0	–2,256	140
Consolidated companies outside Germany					
9	DEUTZ ASIA-PACIFIC (PTE.) LTD., Singapore (Singapore)[1]	1	100.0	7,996	2,079
10	Deutz Australia (Pty) Ltd., Braeside (Australia)[1]	1	100.0	6,824	252
11	DEUTZ (Beijing) Engine Co., Ltd., Beijing (China)[1]	1	100.0	5,103	470
12	Deutz Corporation, Atlanta (USA)[1]	4	100.0	35,104	1,831
13	DEUTZ FRANCE S.A.S., Gennevilliers (France)[1]	1	100.0	10,608	1,503
14	DEUTZ Spain S.A., Zafra (Spain)[1]	1	100.0	28,670	1,079
15	DEUTZ (SHANGHAI) INTERNATIONAL TRADE Co., Ltd., Shanghai (China)	1	100.0	683	–
16	Nlle Ste MAGIDEUTZ S.A., Casablanca (Morocco)[1]	13	100.0	4,692	1,509
17	OOO DEUTZ Vostok, Moscow (Russia)[1]	1	100.0	2,396	1,371
18	D.D. Power Holdings (Pty) Ltd., Elandsfontein (South Africa)[3,4]	1	30.0	10,142	1,903
19	DEUTZ AGCO MOTORES S.A., Haedo (Argentina)[3]	1	50.0	1,834	–308
20	DEUTZ (Dalian) Engine Co., Ltd., Dalian (China)[3]	1	50.0	77,798	–11,286
Unconsolidated companies in Germany					
21	DEUTZ Sicherheit Gesellschaft für Industrieservice mbH, Cologne[2]	1	100.0	26	–
22	Feld & Hahn GmbH i. L., Cologne[2]	1	100.0	455	–
Unconsolidated companies outside Germany					
23	DEUTZ Engine (Shandong) Co., Ltd., Linyi (China)[1,6]	3	70.0	5,033	–1,865
24	AROTRIOS S.A., Nea Filadelfia (Greece; inactive)	1	100.0	–	–
25	DEUTZ DO BRASIL LTDA., São Paulo (Brazil)	1	100.0	–5,183	95
26	DEUTZ ENGINEERING druzba za projektiraje, proizvodnjo in trgovino d.o.o., Maribor (Slovenia)	1	100.0	12	29
27	DEUTZ Engines (India) Private Limited, Pune (India)[5]	1	100.0	337	31
28	DEUTZ UK LTD, Cannock (UK)	1	100.0	157	68
29	OOO DEUTZ, Moscow (Russia)	1	100.0	–	–

[1] Equity and net income in accordance with the annual financial statements prepared for consolidation purposes.
[2] Profit-and-loss transfer agreement with DEUTZ AG.
[3] Consolidated using the equity method.
[4] Figures as at 30 November 2016.
[5] Figures as at 31 March 2016 measured using exchange rate as at 31 December 2016.
[6] The company was deconsolidated on 31 December 2016.

SUPERVISORY BOARD

Hans-Georg Härter
Chairman
Proprietor of HGH-Consulting
a) ZF Friedrichshafen AG, Friedrichshafen, Germany
(until 10 August 2016)
Kiekert AG, Heiligenhaus, Germany
Knorr-Bremse AG, Munich, Germany
b) Zeppelin University, Friedrichshafen, Germany
Unterfränkische Überlandzentrale Lülsfeld eG, Lülsfeld, Germany
Klingelnberg AG, Zurich, Switzerland
Faurecia S.A., Paris, France
Altran S.A., Paris, France
Axega GmbH, Zurich, Switzerland

Werner Scherer[1)]
Deputy Chairman
Chairman of the Cologne Works Council and of the General Works Council of DEUTZ AG, Cologne, Germany

Sabine Beutert[1)]
Trade Union Secretary, IG Metall Cologne-Leverkusen Administrative Office, Cologne, Germany

Gisela Füssel[1)]
(since 1 June 2016)
Member of DEUTZ AG Works Council

Hans-Peter Finken[1)]
Member of DEUTZ AG Works Council

Dr Ing Hermann Garbers
Management consultant
a) Rational AG, Landsberg, Germany (until 31 December 2016)

Göran Gummeson
Senior management consultant
b) European Furniture Group AB, Tranås, Sweden
Nimbus Boats AB, Gothenburg, Sweden
Clean Oil Technology AB, Anderstorp, Sweden
German-Swedish Chamber of Commerce, Stockholm, Sweden

Leif Peter Karlsten
CEO of Confiar AB, Gothenburg, Sweden
b) Bulten AB, Gothenburg, Sweden
Prevas AB, Västerås, Sweden
Real Holding AB, Stockholm, Sweden
Alelion Energy System AB, Gothenburg, Sweden

Herbert Kauffmann
Management consultant
a) adidas AG, Herzogenaurach, Germany

Alois Ludwig
Management consultant
b) CARAT Systementwicklung- und Marketing GmbH & Co. KG, Mannheim, Germany

Dietmar Paust[1)]
(until 31 May 2016)
Member of DEUTZ AG Works Council

Dr Witich Roßmann[1)]
Chief Executive of IG Metall Cologne-Leverkusen, Cologne, Germany
a) Ford Werke GmbH, Cologne, Germany
Ford Holding Deutschland GmbH, Cologne, Germany

Dr Herbert Vossel[1)]
Head of Legal at DEUTZ AG, Cologne, Germany

[1)] Employee representative on the Supervisory Board.
a) Membership of statutory German supervisory boards within the meaning of section 125 AktG.
b) Membership of comparable German or international supervisory bodies within the meaning of section 125 AktG.

SUPERVISORY BOARD COMMITTEES

HUMAN RESOURCES COMMITTEE

Hans-Georg Härter, Chairman
Werner Scherer, Deputy Chairman
Herbert Kauffmann

AUDIT COMMITTEE

Herbert Kauffmann, Chairman
Werner Scherer, Deputy Chairman
Sabine Beutert
Hans-Georg Härter

ARBITRATION COMMITTEE (SECTION 27 (3) OF THE GERMAN CODETERMINATION ACT (MITBESTG))

Hans-Georg Härter, Chairman
Herbert Kauffmann
Dietmar Paust (until 31 May 2016)
Werner Scherer

NOMINATIONS COMMITTEE

Hans-Georg Härter, Chairman
Göran Gummeson
Herbert Kauffmann

BOARD OF MANAGEMENT

Dr Ing Frank Hiller (50)
(from 1 January 2017)
Chairman
Technical and head-office functions

b) Deutz Corporation, Atlanta, USA, Chairman (from 1 January 2017)
DEUTZ (Dalian) Engine Co., Ltd., Dalian, China, Deputy Chairman (from 1 January 2017)

Dr Ing Helmut Leube (63)
(until 31 December 2016)
Chairman
Technical and head-office functions

b) Deutz Corporation, Atlanta, USA, Chairman (until 31 December 2016)
DEUTZ (Dalian) Engine Co., Ltd., Dalian, China, Deputy Chairman (until 31 December 2016)

Dr Margarete Haase (63)
Finance, human resources and investor relations

a) Fraport AG, Frankfurt am Main, Germany
ZF Friedrichshafen AG, Friedrichshafen, Germany

b) DEUTZ (Dalian) Engine Co., Ltd., Dalian, China
DEUTZ Engine (Shandong) Co., Ltd., Linyi, China, Chairwoman

Michael Wellenzohn (50)
Sales, service and marketing

b) DEUTZ ASIA-PACIFIC (PTE) LTD., Singapore, Singapore
Deutz Corporation, Atlanta, USA
DEUTZ (Dalian) Engine Co., Ltd., Dalian, China

a) Membership of statutory German supervisory boards within the meaning of section 125 AktG.
b) Membership of comparable German or international supervisory bodies within the meaning of section 125 AktG.

ANNUAL FINANCIAL STATEMENTS IN ACCORDANCE WITH THE GERMAN COMMERCIAL CODE (HGB)

BALANCE SHEET OF DEUTZ AG

€ million

Assets	31 Dec 2016	31 Dec 2015
Intangible assets	16.3	11.3
Property, plant and equipment	243.2	244.6
Investments	234.9	237.5
Non-current assets	**494.4**	**493.4**
Inventories	153.3	165.5
Receivables and other assets	176.0	144.8
Cash and cash equivalents	80.8	97.7
Current assets	**410.1**	**408.0**
Prepaid expenses	1.6	1.8
Deferred tax assets	83.7	86.3
Total assets	**989.8**	**989.5**

Equity and liabilities	31 Dec 2016	31 Dec 2015
Issued capital	309.0	309.0
Additional paid-in capital	26.8	26.8
Retained earnings		
Legal reserve	4.5	4.5
Other retained earnings	152.9	122.9
Accumulated income	15.6	9.0
Equity	**508.8**	**472.2**
Provisions	254.3	269.4
Other liabilities	226.2	247.5
Deferred income	0.5	0.4
Total equity and liabilities	**989.8**	**989.5**

INCOME STATEMENT OF DEUTZ AG

€ million

	2016	2015
Revenue	**1,151.8**	**1,120.8** [1]
Cost of sales	–998.3	–978.0 [1]
Gross profit	**153.5**	**142.8**
Research and development costs	–45.0	–43.6
Selling expenses	–41.3	–42.3 [1]
General and administrative expenses	–28.0	–28.0 [1]
Other operating income	37.7	38.6 [1]
Other operating expenses	–21.4	–35.9 [1]
thereof expenses pursuant to art. 67 (1) and (2) of the Introductory Act to the HGB (EGHGB)	*–2.3*	*–2.3* [1]
Net investment income	4.4	5.6
Interest expenses, net	–5.7	–8.2
Income taxes	–8.6	–1.7
Profit after income taxes	**45.6**	**27.3**
Other taxes	–0.5	–0.5
Net income	**45.1**	**26.8**
Profit carried forward	9.0	8.5
Dividend payments to shareholders	–8.5	–8.5
Additions to other retained earnings	–30.0	–17.8
Accumulated income	**15.6**	**9.0**

[1] Following the initial application of the German Accounting Directive Implementation Act (BilRUG) in the annual financial statements of DEUTZ AG for the year ended 31 December 2016, the prior-year figures have been restated to improve comparability.

RESPONSIBILITY STATEMENT

“To the best of our knowledge, and in accordance with the applicable accounting principles, the consolidated financial statements give a true and fair view of the net assets, financial position and results of operation of the Group, and the group management report presents a true and fair view 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, 17 February 2017

DEUTZ Aktiengesellschaft
The Board of Management

Dr Ing Frank Hiller

Dr Margarete Haase

Michael Wellenzohn

AUDIT OPINION

We have audited the consolidated financial statements prepared by the DEUTZ Aktiengesellschaft, Cologne, comprising the statement of financial position, income statement, the statement of comprehensive income, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report, which is combined with the management report of the DEUTZ Aktiengesellschaft, Cologne, for the business year from 1 January to 31 December 2016. The preparation of the consolidated financial statements and the combined management report in accordance with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § (Article) 315a Abs. (paragraph) 1 HGB (»Handelsgesetzbuch«: German Commercial Code) are the responsibility of the parent Company's Board of Managing Directors. Our responsibility is to express an opinion on the consolidated financial statements and the combined management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). 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 combined 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 accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the combined 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 the entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the Company´s Board of Managing Directors as well as evaluating the overall presentation of the consolidated financial statements and the combined 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 comply with the IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315a Abs. 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 provisions. The combined 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.

Cologne, 8 March 2017

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Bernd Boritzki Wirtschaftsprüfer	ppa. Gerd Tolls Wirtschaftsprüfer

REPORT OF THE SUPERVISORY BOARD

CLOSE COOPERATION BETWEEN SUPERVISORY BOARD AND BOARD OF MANAGEMENT

In 2016, the Supervisory Board of DEUTZ AG continued its ongoing monitoring of the management of the business in accordance with the requirements of the German Stock Corporation Act (AktG) and the German Corporate Governance Code and provided advice to the Board of Management on key decisions. The Supervisory Board was directly involved in all material decisions taken by the Board of Management. In particular, the Board of Management coordinated closely with the Supervisory Board on the Company's corporate strategy.

Four ordinary meetings of the Supervisory Board were held in 2016. A further meeting was dedicated solely to strategy. Apologies for absence were received from one member for this meeting; otherwise, all members of the Supervisory Board were present at all meetings.

At each of the ordinary meetings of the Supervisory Board, the Board of Management reported on the general economic, market and competitive environment for the DEUTZ Group, presented a business update and sales report that included detailed information on the actual performance of the business over the immediately preceding period, submitted an up-to-date risk report, provided information on key operational issues and offered an overview of the results forecast for the year as a whole. These reports were made on the basis of the key performance indicators that were already familiar to the Supervisory Board members from the Company's written monthly reports. These key performance indicators included new orders, orders on hand, revenue, unit sales, EBIT, research and development expenditure, capital expenditure, working capital and headcount data, in each case compared against the prior-year figures and budget. Reports from the Human Resources and Audit Committees presented by their chairperson were also a regular item on the agenda of the Supervisory Board meetings.

FOCUS OF SUPERVISORY BOARD DELIBERATIONS

The deliberations and discussions of the Supervisory Board in the year under review focused on the current business position and risk situation of the DEUTZ Group as well as on the operational and strategic development of the business. Particular attention was paid to the alliance with Liebherr, the development of new business and the measures initiated by the Board of Management to sustainably improve quality as part of the company-wide zero-error project. In its strategy meeting, the Supervisory Board mainly discussed the topic of service, the alliance with Liebherr again, possible additions to the product portfolio and potential new areas of business. Also on the agenda were current indications of how the DEUTZ Group strategy will see it progress in the long term up to 2030.

Other key decisions concerned the 2017 budget, the medium-term planning up to 2021 and the approval of capital expenditure and development projects. As is the case every year, the Supervisory Board also adopted resolutions concerning the achievement of targets by the Board of Management – and consequently its variable remuneration for the previous year – as well as the setting of its targets for the current year and its medium-term targets.

The Board of Management ensured that it provided the Supervisory Board with comprehensive, regular and timely information at all times. Between meetings, the Board of Management informed the members of the Supervisory Board in writing about all important events. In addition, the chairman of the Supervisory Board and the chairman of the Board of Management remained in close and regular contact to discuss all important transactions, imminent decisions and optimisation measures. All the decisions that the Supervisory Board was required to take in accordance with the law and Statutes were taken on the basis of the reports and draft resolutions submitted by the Board of Management and, where necessary, following preparation by the relevant committees of the Supervisory Board.

COMPOSITION OF THE BOARD OF MANAGEMENT

There were no changes to the Board of Management of DEUTZ AG in 2016. At its meeting on 22 September 2016 the Supervisory Board, following preparation by the Human Resources Committee, approved the intention of Dr Helmut Leube to step down as a member and the Chairman of the Board of Management with effect from 31 December 2016; at the same time it appointed Dr Frank Hiller as a member and the Chairman of the Board of Management with effect from 1 January 2017 and for a term of five years up to 31 December 2021. The appointments of Dr Margarete Haase and Mr Michael Wellenzohn continue until 30 April and 31 December 2018 respectively.

CORPORATE GOVERNANCE: DECLARATION OF COMPLIANCE WITH THREE EXCEPTIONS

At its meeting on 22 September 2016, the Supervisory Board also held in-depth discussions on the German Corporate Governance Code as amended 5 May 2015 and, together with the Board of Management, issued a declaration of compliance pursuant to section 161 AktG. This declaration includes just three variances from the Code and since 22 September 2016 has been available in the 'Investor Relations / Corporate Governance' section of the Company's website at www.deutz.com, where it can be downloaded.

Hans-Georg Härter
Chairman of the Supervisory Board

MATTERS HANDLED EFFICIENTLY BY FOUR COMMITTEES

The Supervisory Board has created four committees to enable it to perform its duties effectively. These committees prepare various topics and resolutions for the full Supervisory Board. Details of all members of the Supervisory Board and its committees, as well as other directorships held by its members, are shown separately on pages 120 to 121 of this annual report.

The Human Resources Committee makes preparations for all Supervisory Board decisions concerning the appointment of members of the Board of Management and their contracts of employment, including the remuneration specified therein, and all issues arising in this connection. The committee met on nine occasions in 2016. Among the main matters addressed were the preparation of the resolutions to be adopted by the full Supervisory Board in relation to Dr Hiller succeeding Dr Leube as Chairman of the Board of Management, to the achievement of the Board of Management's targets for 2015 and to the setting of Board of Management targets, including medium-term targets, for 2016.

The work of the Audit Committee in the year under review focused on monitoring the financial accounting process, on assessing the annual and consolidated financial statements and the combined management report of DEUTZ AG and the Group for 2015 and the corresponding auditors' reports, the condensed consolidated financial statements for the six months to 30 June 2016 and their review by the auditors, the interim management statements for the periods ended 31 March and 30 September 2016, and the discussion of the audit engagement for the year ended 31 December 2016, including a review of auditor quality and independence. Other matters addressed by the committee included risk management, compliance, the internal control system, internal audit, strategic planning, key performance indicators and the new statutory regulations on auditing, particularly in connection with the stricter rules that will be coming into force concerning the provision of non-audit services by auditors. In 2016, the Audit Committee held four meetings, three of which were also attended by the external auditors.

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 is tasked with proposing to the Supervisory Board suitable candidates as shareholder representatives on the Supervisory Board. It also did not convene last year.

The entire Supervisory Board was informed of the outcome of all discussions in the committees and gave its approval to the recommendations for board resolutions submitted by the committees.

ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS AUDITED IN DETAIL AND APPROVED

The annual financial statements of DEUTZ AG prepared by the Board of Management in accordance with the German Commercial Code (HGB), the consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS) and the combined management report for DEUTZ AG and the DEUTZ Group, in each case for the year ended 31 December 2016, were audited by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Cologne, Germany, the auditors appointed by the Annual General Meeting on 28 April 2016. The auditors issued unqualified opinions.

The annual financial statements of DEUTZ AG, the consolidated financial statements, the combined management report, the Board of Management's proposal for the appropriation of profit and the auditors' reports were made available to all members of the Supervisory Board and were examined by the Supervisory Board. The auditors explained their audit findings in detail to the Audit Committee meeting held on 28 February 2017 and to the Supervisory Board meeting held on 9 March 2017 and answered any supplementary questions raised.

The Supervisory Board approved 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 annual financial statements or the consolidated financial statements, and the Supervisory Board has therefore approved them. The annual financial statements have thus been adopted.

The Supervisory Board also approved the Board of Management's proposal to use the accumulated income reported for the 2016 financial year to pay a dividend of €0.07 per dividend-bearing share.

COMPOSITION OF THE SUPERVISORY BOARD AND ITS COMMITTEES

The changes in the composition of the Supervisory Board in 2016 are described below.

At the request of the Board of Management, and in accordance with the proposal by the General Works Council, the local court in Cologne on 21 April 2016 appointed Ms Gisela Füssel as an employee representative on the Supervisory Board of DEUTZ AG with effect from 1 June 2016 for the remaining term of the current Supervisory Board membership cycle. The appointment became necessary when Mr Dietmar Paust stepped down from his post with effect from 31 May 2016.

The Supervisory Board would like to thank Mr Paust for his work and valuable contribution.

The membership of the Supervisory Board committees did not change in 2016. At its meeting on 9 March 2017 the Supervisory Board elected Ms Füssel to succeed Mr Paust as a member of the Arbitration Committee.

CONFLICTS OF INTEREST/INDEPENDENCE OF SUPERVISORY BOARD MEMBERS/THANKS

No conflicts of interest between members of the Supervisory Board and DEUTZ AG arose in the year under review.

The current members of the Supervisory Board of DEUTZ AG are all considered independent within the meaning of article 5.4.2 sentence 2 of the German Corporate Governance Code.

The Supervisory Board would like to express its thanks and appreciation to all employees of DEUTZ AG in Germany and abroad, to the elected employee representatives and to the Board of Management for their valuable efforts and the considerable dedication they showed in 2016.

Cologne, March 2017
The Supervisory Board

Hans-Georg Härter
Chairman

CORPORATE GOVERNANCE DECLARATION AND 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 (DCGK) and ensure quality and transparency in all key decisions and processes in our Company.

CORPORATE GOVERNANCE DECLARATION PURSUANT TO SECTION 289A HGB

Declaration of conformity with some exceptions

In 2016, the Board of Management 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 DCGK. As a result, DEUTZ AG complies with the recommendations of the Code, as amended on 5 May 2015, with the following exceptions:

1. The D&O insurance taken out by DEUTZ AG for the members of the Supervisory Board does not provide for any excess, contrary to article 3.8 (2) and (3) DCGK. In the case of Supervisory Board members, an excess of this type is, as before, not considered an appropriate means of control.

2. There is no age limit at DEUTZ AG for members of either the Board of Management or Supervisory Board, contrary to articles 5.1.2 (2) sentence 3 and 5.4.1 (2) sentence 1 DCGK. Furthermore, there is no general limit on length of membership of the Supervisory Board, contrary to article 5.4.1 (2) sentence 1 DCGK. These exceptions enable DEUTZ AG to retain the option of benefiting from the experience brought to the Company by older members of the Board of Management and Supervisory Board and by long-standing members of the Supervisory Board.

The current declaration of conformity in accordance with section 161 of the German Stock Corporation Act (AktG), which the Board of Management and Supervisory Board submitted on 22 September 2016, can be accessed in the Investors / Corporate Governance section of the Company's website at www.deutz.com. Declarations of conformity from previous years can also be viewed and downloaded there.

Description of the operating procedures of the Board of Management and Supervisory Board

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

With the long-term development of the Company in mind, the Board of Management and Supervisory Board maintain an open, ongoing dialogue on all strategic decisions in the Company – a process that 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 Board of Management provides the Supervisory Board with regular, comprehensive and timely reports on all relevant issues relating to planning, business performance, risk position and risk management.

The Supervisory Board's work is based on rules of procedure, which can be downloaded from the DEUTZ AG website at www.deutz.com.

Five meetings of the Supervisory Board took place in 2016.

No former members of the DEUTZ AG Board of Management are now members of the Supervisory Board.

The Supervisory Board is elected for a period that runs until the Annual General Meeting in 2018.

The principles by which the Board of Management operates are summarised in rules of procedure issued by the Supervisory Board, which can also be downloaded from the DEUTZ AG website.

Board of Management meetings generally take place every two weeks.

Composition of the Board of Management and Supervisory Board; composition and operating procedures of Supervisory Board committees

The Company's Board of Management consists of three people: Dr Frank Hiller (chairman, responsible for technical and head-office functions), Dr Margarete Haase (responsible for finance, HR and investor and public relations) and Mr Michael Wellenzohn (responsible for sales, service and marketing).

At its meeting on 22 September 2016 the Supervisory Board, following preparation by the Human Resources Committee, approved the intention of Dr Helmut Leube to step down as a member and the Chairman of the Board of Management with effect from 31 December 2016; at the same time it appointed Dr Hiller as a member and the Chairman of the Board of the

Management with effect from 1 January 2017 and for a term of five years up to 31 December 2021. The appointments of Dr Haase and Mr Wellenzohn continue until 30 April and 31 December 2018 respectively.

In accordance with the provisions of the German Codetermination Act (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.

The changes in the composition of the Supervisory Board in 2016 are described below.

At the request of the Board of Management, and in accordance with the proposal by the General Works Council, the local court in Cologne on 21 April 2016 appointed Ms Gisela Füssel as an employee representative on the Supervisory Board of DEUTZ AG with effect from 1 June 2016 for the remaining term of the current Supervisory Board membership cycle. The appointment became necessary when Mr Dietmar Paust stepped down from his post with effect from 31 May 2016.

The Supervisory Board has created four committees to enable it to perform its duties effectively. They are the Human Resources Committee, the Audit Committee, the Arbitration Committee and the Nominations Committee. The Human Resources Committee consists of two representatives of the shareholders and one employee representative; the Audit and Arbitration Committees both consist of two shareholder representatives and two employee representatives; and the Nominations Committee has three members, all of whom represent the shareholders. The Audit Committee follows its own rules of procedure, which can be viewed on the DEUTZ AG website, while the other committees work according to the rules of procedure that apply to the (full) Supervisory Board.

The Human Resources Committee makes preparations for all Supervisory Board decisions concerning the appointment of members of the Board of Management and their contracts of employment, including the remuneration specified therein, and all issues arising in this connection. The committee met on nine occasions in 2016. Among the main matters addressed were the preparation of the resolutions to be adopted by the full Supervisory Board in relation to Dr Hiller succeeding Dr Leube as Chairman of the Board of Management, to the achievement of the Board of Management's targets for 2015 and to the setting of Board of Management targets, including medium-term targets, for 2016.

The work of the Audit Committee in the year under review focused on monitoring the financial accounting process, on assessing the annual and consolidated financial statements and the combined management report of DEUTZ AG and the Group for 2015 and the corresponding auditors' reports, the condensed consolidated financial statements for the six months to 30 June 2016 and their review by the auditors, the interim management statements for the periods ended 31 March and 30 September 2016, and the discussion of the audit engagement for the year ended 31 December 2016, including a review of auditor quality and independence. Other matters addressed by the committee included risk management, compliance, the internal control system, internal audit, strategic planning, key performance indicators and the new statutory regulations on auditing, particularly in connection with the stricter rules that will be coming into force concerning the provision of non-audit services by auditors. In 2016, the Audit Committee held four meetings, three of which were also attended by the external auditors.

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 is tasked with proposing to the Supervisory Board suitable candidates as shareholder representatives on the Supervisory Board. It also did not convene last year.

The entire Supervisory Board was informed of the outcome of all discussions in the committees and gave its approval to the recommendations for board resolutions submitted by the committees.

The membership of the Supervisory Board committees did not change in 2016. At its meeting on 9 March 2017 the Supervisory Board elected Ms Füssel to succeed Mr Paust as a member of the Arbitration Committee.

Full details of all members of the Supervisory Board and its committees, as well as other directorships held by its members, are shown separately on pages 120 to 121.

Targets and timeframes in accordance with sections 76 (4), 111 (5) AktG

On 12 August 2015, the Board of Management of DEUTZ AG set certain targets and timeframes in accordance with section 76 (4) AktG. The proportion of women employed by DEUTZ AG at the top level of senior management below the Board of Management is to be increased to 13 per cent by 30 June 2017. The proportion of women at the second level of senior management below the Board of Management is to be increased to 7 per cent over the same period. The top level of senior management below the Board of Management encompasses all managers in Germany who report directly to a member of the Board of Management. The second level of senior management below the Board of Management comprises all managers in Germany who report directly to a manager in the top level of senior management.

To ensure that women are taken into consideration for vacant managerial positions, DEUTZ AG has adopted a staff development programme. When positions in the top and second levels of senior management below the Board of Management become available, the Board of Management and the HR department are striving to ensure that at least one woman is always shortlisted for the post (article 4.1.5 DCGK). This means that external recruitment must focus on female managers.

At the time of publication, the proportion of women in the top level of senior management below the Board of Management is 11.11 per cent and in the second level of senior management below the Board of Management 5.26 per cent. Although these figures are an improvement on last year (9.19 per cent and 3 per cent), DEUTZ AG has not yet attained the targets specified above. This is because only very few management positions have been newly filled since the Board of Management set the targets on 12 August 2015. Furthermore, it remains the case that women continue to be under-represented in the scientific and technical degree courses that are of particular relevance to DEUTZ AG.

At its meeting on 24 September 2015, the Supervisory Board of DEUTZ AG set the following target in accordance with section 111 (5) AktG: on 30 June 2017, the members of the Board of Management of DEUTZ AG should still include at least one woman.

Disclosures regarding compliance with the statutory quotas for women and men on the Supervisory Board

In accordance with the Law for the equal participation of women and men in managerial positions in the private and public sectors (law on the quota for women), the Supervisory Board of DEUTZ AG must have at least four female members and four male members after the elections scheduled for 2018, if not before.

At the time this law came into effect on 1 January 2016 the Supervisory Board of DEUTZ AG comprised eleven men and one woman. Since 1 June 2016, following the appointment of Ms Füssel to succeed Mr Paust, it has had ten male members and two female members.

As both women are employee representatives, and the Supervisory Board decided that the minimum quota has to be met separately for shareholder and employee representatives, the employee representatives are already in compliance with the statutory quota.

This is not currently the case for the shareholder representatives, as it has not been necessary to appoint new shareholder representatives to the Supervisory Board since the law on the quota for women came into effect.

Disclosures relevant to corporate management practices: compliance management system, environmental and quality management, energy management

DEUTZ AG has a compliance management system that is firmly anchored in the Company's organisational structure. The system is continually enhanced in order to meet changing requirements. Dr Haase is the member of the Board of Management responsible for compliance.

The overriding objective of the compliance management system is to use preventive measures to ensure that the business practices of DEUTZ AG and the internal regulations and policies are known across the Group. This is primarily achieved through a structured policy management system in which existing policies are reviewed on an ongoing basis to see if they need updating and new policies are published. The policy management system is based on the code of conduct, which provides a framework for ensuring that behaviour towards business partners and employees is fair and in compliance with the law. Employees can access the code of conduct via the internal communications platform. Third-parties can view the code of conduct on the DEUTZ AG website. The guidelines set out in the code of conduct are formalised in specific policies, including a zero-tolerance policy, a policy on gifts and entertainment, a policy on engaging external sales service providers, an anti-money laundering policy and an insider trading policy, that help to ensure that employees are aware of the relevant laws and policies and are able to apply them correctly.

The Board of Management supports and promotes ethical conduct. It is unreservedly committed to corporate compliance and declines to be involved in any transactions that are inconsistent with these values. The Board of Management does not tolerate any form of corruption and is fully committed to compliance with competition law and to incorporating the notion of sustainability into the Company's activities.

Training is intended to ensure that employees are aware of the relevant laws and corporate policies, and that they comply with them at all times in their day-to-day work. Salaried staff in the head office sales, procurement, research and development and administration units, as well as in the subsidiaries, generally receive annual training sessions that are specifically tailored to their areas of activity. In the production plants, compliance training takes place in conjunction with the regular safety training.

A Compliance Officer appointed by the Board of Management coordinates compliance activities at DEUTZ AG. The individual business units and subsidiaries have their own compliance coordinators, who are responsible for compliance in their organisations and submit regular structured reports in writing to the Compliance Officer, who in turn reports to the Board of Management and Audit Committee. The basic principles of the compliance organisation are described in rules of procedure. The duties of the relevant employees are set out in job descriptions.

Employees can supply information or direct questions to line managers, compliance coordinators, the Compliance Officer or the managers responsible for the legal affairs or internal audit units. Furthermore, since the beginning of 2017, the DEUTZ AG website has featured a whistleblowing system that can also be accessed by non-employees. Any information supplied is rigorously followed up. Any necessary investigations are carried out by internal audit, with external support if required.

Regular meetings are held to develop, discuss and coordinate compliance initiatives. These activities focus on preventing corruption, tackling money laundering and complying with export regulations (including export controls). They also ensure safety in the workplace, IT & data security, corporate security and product safety. A further aim is to prevent breaches of environmental, antitrust and insider trading laws.

As and when needed, the Board of Management and the Compliance Officer take legal advice on establishing and continuously improving the compliance management system. The internal audit department reviews the activities, and the Audit Committee monitors them on behalf of the Supervisory Board.

Compliance activities during the year under review again centred on the continuation and stepping up of regular staff training (including for staff at affiliated companies abroad), focusing on the code of conduct, money laundering, gifts, commission, export controls, competition law and contract law. A further focus was the introduction of a web-based e-learning programme in July 2016, which featured modules on antitrust law, data security and prevention of corruption.

In 2016 almost 800 employees took part in classroom-based training and around 1,500 employees successfully completed all or individual modules of the e-learning programme.

As part of the ongoing review of our organisational policies, we expanded the policy on business trips, revised the insider trading policy and issued new policies on EPA compliance and on the pre-approval of non-audit services provided by our external auditors.

Another essential element of corporate management at DEUTZ AG is rigorous environmental, quality and energy management.

In the year under review, DEUTZ AG continued to satisfy the quality management requirements in accordance with ISO 9001, the environmental management requirements in accordance with ISO 14001 and the energy management requirements in accordance with ISO 50001. The relevant certificates from Det Norske Veritas/Germanischer Lloyd can be found on the DEUTZ website.

All standards set by the Deutsches Institut für Normung e.V., Berlin (DIN) can be inspected free of charge at DIN standards repositories.

CORPORATE GOVERNANCE REPORT

Basic principles and objectives of the composition of the Supervisory Board; particularly, conflicts of interest/independence of Supervisory Board members and the consideration of women

The Supervisory Board re-drafted the specific objectives regarding its composition in accordance with articles 5.4.1 (1) and (2), 5.4.2 DCGK at its meeting held on 24 September 2015. The new version is as follows:

“The Supervisory Board must be composed in such a way that its members as a group possess the knowledge, ability and expert experience required to properly complete its tasks. In particular, the following applies:

a) Internationality

To reflect the international nature of the Company’s activities, at least two Supervisory Board members shall have several years’ experience of international business – preferably acquired abroad.

b) Potential conflicts of interest

The composition of the Supervisory Board shall also take account of potential conflicts of interest of its members.

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

Supervisory Board members shall not be directors of major competitors of DEUTZ AG.

c) Number of independent Supervisory Board members

The Supervisory Board is limiting its target concerning this aspect to the shareholder representatives. It considers this group to have an adequate number of independent members if the number of independent members equals the number of members who are not independent, i.e. at least three.

d) Standard age limit

At DEUTZ AG, there is no age limit for Supervisory Board members or for Board of Management members. Nor is there a standard limit on length of membership of the Supervisory Board. This is because DEUTZ AG wants to retain the option of benefiting from the experience brought to the Company by older members of the Board of Management and Supervisory Board and/or long-serving members of the Supervisory Board.

e) Diversity/proportion of women on the Supervisory Board

The Supervisory Board shall primarily take the appropriate skills of its members, and also its diversity, into consideration when deciding on its composition. The Supervisory Board welcomes the fact that the law for the equal participation of women and men in managerial positions in the private and public sectors has now come into force and that, as a consequence, the Supervisory Board will have at least four women members after the elections marking the start of the next membership cycle in 2018, if not before."

Except for the target relating to female representation, the Supervisory Board has continuously met these objectives since 2012. It has even exceeded them in cases such as the international experience available on the Supervisory Board and the number of independent members. The current members of the Supervisory Board are all considered independent within the meaning of article 5.4.2 sentence 2 DCGK. No conflicts of interest between members of the Supervisory Board and DEUTZ AG arose in the year under review.

Consideration of women when making appointments to the Board of Management

The Board of Management of DEUTZ AG currently has three members, one of whom is female, equating to a ratio of 33.3 per cent.

Responsible risk management

A forward-looking, prudent and responsible approach to corporate risks is a core aspect of good corporate governance and forms the basis for the risk management system at DEUTZ. The Board of Management 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 57 to 61.

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 stakeholders ensures trust in a 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 on the performance and development of its business and on significant changes and events four times a year in its interim management statements, half-year report and annual report. The interim management statements and half-year reports are published within 45 days of the end of a reporting period; the annual report is published within 90 days of the end of the financial year. The Company 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 financial statements are published, conference calls for analysts and institutional investors also take place when the interim management statements and half-year report are published. 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 reports, half-year reports and interim management statements, 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 are also available 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 in the public domain but that could have a significant impact on DEUTZ's share price were they to become known. The Company's reporting policy therefore complies both with legal requirements and DCGK guidelines.

Accounting and auditing

DEUTZ AG's consolidated financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The consolidated financial statements are prepared by the Board of Management and reviewed by the auditors.

The auditors have agreed to inform the chairman of the Supervisory Board or the chairman of the Audit Committee without delay if grounds for disqualification or release of the auditors, or any misrepresentations in the declaration of conformity, come to light during the audit. The auditors inform the chairman of the Supervisory Board without delay of any issues or incidents relevant to the role of the Supervisory Board that arise during the audit of financial statements.

Conflicts of interest and consultancy agreements

Information about conflicts of interests in relation to Supervisory Board members can be found under 'Basic principles and objectives of the composition of the Supervisory Board' at the start of this corporate governance report.

The Company does not have any consultancy agreements with members of the Supervisory Board.

The members of the Board of Management must disclose any conflicts of interest to the Supervisory Board. The Supervisory Board then reports these cases, along with any conflicts of interest relating to its own members, to the Annual General Meeting.

Remuneration report

The remuneration of the Board of Management complies with the German Act on the Appropriateness of Management Board Remuneration (VorstAG) and DCGK recommendations.

A description of the main features of the remuneration systems for the Board of Management and Supervisory Board, along with details of the remuneration for each member, can be found in the remuneration report on pages 53 to 56 of the combined management report.

Dealings subject to reporting requirements

Section 15a of the German Securities Trading Act (WpHG) and (since mid-2016) article 19 of the Market Abuse Regulation (MAR) state that persons with executive functions or persons with whom they are closely associated must notify both the company and the German Federal Financial Supervisory Authority (BaFin) of their own dealings in shares of the company or in financial instruments of the company based on such shares.

In 2016, Mr Wellenzohn disclosed the purchase of DEUTZ shares in accordance with section 15a WpHG. No other persons required to make such a disclosure did so before the adoption of the 2016 annual financial statements. Transactions disclosed in previous years are published on the DEUTZ AG website.

There were no shareholdings of Board of Management or Supervisory Board members that were subject to reporting requirements pursuant to article 6.2 DCGK in the year under review or before the 2016 annual financial statements were adopted.

GLOSSARY

AdBlue® 32.5% aqueous urea solution (AdBlue® is a registered trade mark of the German Association of the Automotive Industry [VDA])

BilMoG (Bilanzrechtsmodernisierungsgesetz) German Accounting Law Modernisation Act, enacted and came into force on 25 May 2009.

Captive market / segment Market segment in which original equipment and commercial vehicle manufacturers have their own engine production facilities to meet their engine needs. Consequently, the captive market is not generally accessible to independent engine manufacturers.

Cash flow statement Shows the Group's inflows and outflows of cash over the financial year. It distinguishes between cash flow from operating activities, cash flow from investing activities and cash flow from financing activities. It also shows the change in cash and cash equivalents.

Compliance Denotes the entirety of measures taken by a company to comply with laws, regulations and directives and also to comply with contractual obligations and self-imposed obligations. Compliance is a key element of corporate governance.

Corporate citizenship Denotes a company's corporate social responsibility activities.

Corporate governance Responsible management and control of a company with a view to long-term value creation and increasing shareholder value.

Deferred taxes Differences between the calculation of profit under tax law and under IAS result in differing tax calculations. These differences in the amount of tax are recognised on the balance sheet as deferred tax assets or liabilities.

DIN EN ISO 9001 (Deutsches Institut für Normung – European Norm – International Organization for Standardization – 9001) A German, European and international industrial standard for environmental management.

Diversity Acceptance of the differences between individual employees, which – when embedded in a tolerant corporate culture – can be utilised to boost the success of a company. Employees should not suffer discrimination due to ethnic origin, gender, age, religion, sexual orientation, disability, etc. They should all have equal opportunities.

Earnings per share A key figure calculated by dividing the net income attributable to the shareholders of DEUTZ AG by the average number of shares in issue.

EBIT (earnings before interest and tax) Income from operating activities (before interest and tax).

E-fuel Synthetic fuel produced from water and carbon dioxide using electricity.

Emerging market A newly industrialising country.

Emissions downgrade Conversion of used engines to ensure they are below current or future permitted emissions levels as defined in emissions legislation.

EU Tier 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 oxide, hydrocarbons and soot particulates in exhaust gas.

Exhaust aftertreatment Ensures compliance with statutory emissions limits for gaseous pollutants such as nitrogen oxides (NOx) and soot particles through the cleansing of combustion exhaust gases. In vehicles, exhaust aftertreatment is achieved by the use of catalytic converters and diesel particulate filters.

Forward Individually structured, non-exchange-traded forward transaction.

Free float The proportion of shares in a public limited company (Aktiengesellschaft) not held by a major shareholder. According to the Deutsche Börse AG definition, shareholdings of less than 5 per cent are classified as free float.

Hedging Countering interest-rate, currency, price or similar risks through the use of derivative financial instruments that limit the risk associated with the underlying transactions.

Kaizen The Japanese term for a process of continuous improvement (CIP) describing a way of thinking aimed at making a company more competitive through a series of small, progressive steps. CIP is applied to products, processes and service quality. Specific CIP teams are set up to implement small improvements (as opposed to major, dramatic changes). CIP is a basic principle of quality management and an essential part of ISO 9001. The method of having specific CIP teams develop suggestions for improvement is usually bracketed under the term 'ideas management' together with the company suggestion scheme.

Liquefied petroleum gas (LPG) A liquefied mixture of butane and propane that can be used in automotive internal combustion engines.

Long-term incentive (LTI) plan A form of incentive-based remuneration offered to members of the Board of Management 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.

Material handling Equipment for moving goods within contained areas, such as airports or factories. Examples include forklift trucks, telehandlers, lifting platforms and ground support equipment.

Non-captive market/segment Market segment in which original equipment and commercial vehicle manufacturers purchase engines from third-party manufacturers to meet their engine needs. The non-captive market is accessible to independent engine manufacturers.

On-road applications Engine-powered applications, such as commercial vehicles and buses, that are licensed for use on public roads.

Option Contract that, until the expiry date, gives the holder the right to buy – and the writer the obligation to sell – an underlying instrument (a security or a product/commodity) at an exercise price that has been fixed in advance.

Prime Standard The minimum 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.

Rating Used to assess the creditworthiness of a company. It gauges the extent to which the company will be able to repay the principal and interest on its outstanding liabilities at the agreed date.

Return on capital employed (ROCE) Ratio of EBIT to average capital employed. 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.

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, in which the exhaust gas penetrates a porous wall; and flow filters, in which the exhaust gas flows through the filter itself.

Shop floor management Processes, rules, approaches, methods and systems for ensuring optimum efficiency in production.

Supply chain The structure and management of integrated logistics processes (flow of material and information) along the entire value creation process, including the sourcing of raw materials and the various processing stages.

US EPA TIER 1, 2, 3, 4 US emissions standard for off-road applications. Sets limits for pollutants such as nitrogen oxide, hydrocarbons and soot particulates in exhaust gas.

Working capital Inventories and trade receivables less trade payables.

Working capital ratio Ratio of working capital (inventories plus trade receivables less trade payables) at the end of the reporting period to revenue for the preceding twelve months.

Xetra 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

	Continuing operations 2012	Continuing operations 2013	Continuing operations 2014	Continuing operations 2015	**Continuing operations 2016**
New orders	1,237.1	1,649.7	1,379.0	1,225.9	1,261.4
Unit sales (units)	178,774	184,028	196,403	137,781	132,539
DEUTZ Compact Engines	161,899	167,964	183,125	125,214	123,179
DEUTZ Customised Solutions	16,875	16,064	13,278	12,567	9,360
Revenue	1,291.9	1,453.2	1,530.2	1,247.4	1,260.2
DEUTZ Compact Engines	1,005.0	1,188.8	1,279.9	967.2	1,000.8
DEUTZ Customised Solutions	286.9	264.4	250.3	280.2	259.4
EBITDA[1)]	121.7	142.0	120.3	112.2	114.2
EBITDA (before exceptional items)[1)]	121.7	142.0	137.4	112.2	114.2
EBIT[1)]	37.1	47.5	12.8	4.9	23.4
EBIT (before exceptional items)[1)]	37.1	47.5	31.7	4.9	23.4
EBIT margin (%)[1)]	2.9	3.3	0.8	0.4	1.9
EBIT margin (before exceptional items) (%)[1)]	2.9	3.3	2.1	0.4	1.9
Net income	21.0	36.0	19.5	3.5	16.0
thereof from continuing operations	22.1	36.0	19.5	3.5	16.0
thereof from discontinued operations	–1.1	–	–	–	–
Earnings per share (basic/diluted, €)	0.17	0.30	0.18	0.04	0.14
thereof from continuing operations	0.18	0.30	0.18	0.04	0.14
thereof from discontinued operations	–0.01	–	–	–	–
Dividend per share (€)	–	0.07	0.07	0.07	0.07
Total assets[2)]	1,035.9	1,121.0	1,149.2	1,088.1	1,059.7
Non-current assets	621.3	596.6	563.6	520.5	483.7
Equity[2)]	452.6	504.7	511.0	495.6	491.1
Equity ratio (%)[2)]	43.7	45.0	44.5	45.5	46.3
Cash flow from operating activities[3)]	104.9	105.0	114.1	103.3	63.8
Free cash flow	12.6	13.8	52.0	35.0	4.7
Net financial position[4)]	–48.6	–31.7	13.7	39.0	31.6
Working capital[5)]	141.6	172.3	196.2	183.6	204.3
Working capital ratio (31 Dec, %)	11.0	11.9	12.8	14.7	16.2
Capital expenditure (excl. capitalisation of R&D, after deducting grants)	66.4	42.5	40.3	56.2	52.9
Depreciation and amortisation	84.6	94.5	107.5	107.3	90.8
Research and development (after deducting grants)	62.1	52.6	53.1	40.8	50.4
thereof capitalised	44.2	33.8	26.3	13.0	9.1
Employees (31 Dec)	3,991	3,952	3,916	3,730	3,665

1) Since 2013, the income statement has been structured according to the function-of-expense method. Other taxes are no longer reported separately after operating profit/loss and are instead allocated to functional costs within operating profit/loss. The comparative prior-year figures have been restated accordingly to improve comparability.

2) Starting in 2013, the accounting treatment of provisions for pensions and other post-retirement benefits has changed (IAS 19R). The figures for 2012 have been restated for comparison purposes.

3) Starting in 2012, interest income has been reported in cash flow from financing activities and is no longer shown in cash flow from operating activities. The prior-year figures have been restated accordingly to improve comparability.

4) Net financial position: cash and cash equivalents less current and non-current interest-bearing financial debt.

5) Working capital: inventories plus trade receivables minus trade payables.

	Continuing operations 2012	Continuing operations 2013	Continuing operations 2014	Continuing operations 2015	**Continuing operations 2016**
Revenue by region € million	1,291.9	1,453.2	1,530.2	1,247.4	1,260.2
Europe/Middle East/Africa	984.2	1,155.4	1,166.2	844.5	872.7
Americas	190.9	190.6	256.6	275.3	239.6
Asia-Pacific	116.8	107.2	107.4	127.6	147.9
Revenue by application segment € million	1,291.9	1,453.2	1,530.2	1,247.4	1,260.2
Construction Machinery	332.8	325.1	429.0	334.7	350.0
Material Handling	144.7	156.5	286.3	188.5	189.0
Stationary Equipment	204.2	173.7	179.2	178.1	147.3
Agricultural Machinery	152.5	325.6	257.5	159.3	176.5
Automotive	192.1	188.5	82.0	87.9	77.2
Service	250.3	253.7	259.3	278.4	287.3
Miscellaneous	15.3	30.1	36.9	20.5	32.9
Key figures for DEUTZ shares					
Number of shares (31 Dec)	120,861,783	120,861,783	120,861,783	120,861,783	120,861,783
Number of shares (average)	120,861,783	120,861,783	120,861,783	120,861,783	120,861,783
Share price (31 Dec, €)	3.54	6.49	4.00	3.69	5.35
Share price high (€)	5.72	7.45	7.94	5.59	5.58
Share price low (€)	2.96	3.71	3.35	2.86	2.65
Market capitalisation (31 Dec, € million)	427.9	784.4	483.4	446.0	646.6
Earnings per share (basic/diluted, €)	0.17	0.30	0.18	0.04	0.14
thereof from continuing operations	0.18	0.30	0.18	0.04	0.14
thereof from discontinued operations	–0.01	–	–	–	–

FINANCIAL CALENDAR

2017	
4 May 2017	Annual General Meeting in Cologne
9 May 2017	Interim management statements 1st quarter 2017
3 August 2017	Interim report 1st half year 2017
7 November 2017	Interim management statements 1st to 3rd quarter 2017

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CREDITS

Published by
DEUTZ AG
51057 Cologne, Germany

Concept and layout
Kirchhoff Consult AG, Hamburg

Photographer
Nils Hendrik Müller, Braunschweig
Ludwig Drathen, Cologne

Lithography and print
Druckpartner, Essen

ISSN 2191-0569

FSC www.fsc.org
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Paper from responsible sources
FSC® C017894

This is a complete translation of the original German version of the Annual Report.

DEUTZ AG
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www.deutz.com