

**Taking advantage  
of the opportunities  
of the future**

**Financial statements and  
management report**

**DEUTZ AG 2008**

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## Financial statements and management report

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# Management report DEUTZ AG

## STRUCTURE AND OPERATING ACTIVITIES

### Organisational structure

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

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

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

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

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

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

### Market and competitive environment

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

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

<b>Application segment</b>	<b>Application</b>	<b>Main competitors</b>
<b>Mobile Machinery</b>	Construction equipment Material handling equipment	Kubota (Japan), Yanmar (Japan), Perkins (UK)
<b>Stationary Equipment</b>	Generators Pumps Compressors	Perkins (UK), Cummins (USA), Kubota (Japan)
<b>Agricultural Machinery</b>	Tractors Harvesters Forestry equipment	Perkins (UK), Yanmar (Japan), Kubota (Japan), Deere & Company (USA)
<b>Automotive</b>	Trucks Buses Rail vehicles	Cummins (USA), Caterpillar (USA), Navistar (USA), Isuzu (Japan)

## STRATEGIC OBJECTIVES

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

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

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

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

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

Given the changes in economic conditions and in expectation of a difficult trading environment over the coming

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

## ECONOMIC ENVIRONMENT

### Global economic growth weaker than expected<sup>1</sup>

Optimism still prevailed during the first few months of 2008. Although there had already been a slight slowdown in the global economy as a result of the crisis in the financial markets, there still seemed to be little likelihood of a significant economic slump. Quite the opposite: experts were still forecasting further growth in the global economy of more than 3.0 per cent compared with 4.7 per cent in 2007. The tide turned in the middle of the year: a heightening of the financial markets crisis increasingly hit the real economy around the globe, with slowing growth even affecting Asian countries hitherto accustomed to exceptional growth rates. By the end of the year, a global economic slump had taken hold. Even in Germany, where the economic position initially remained robust, growth eased off significantly. Although the global economy still recorded overall growth of 3.0 per cent in 2008, there was nevertheless a significant drop in gross domestic product in almost all regions during the third and fourth quarters. In Germany and in the euro zone, which is particularly important for DEUTZ, gross domestic product grew in the year under review by 0.9 per cent and 0.7 per cent respectively (2007: 2.6 per cent in both cases). The US economy still grew by 1.3 per cent in 2008 (2007: 2.0 per cent), whereas Asia (excluding Japan) and China – increasingly important markets for DEUTZ – continued to record very high growth rates of 7.2 per cent and 9.0 per cent respectively (2007: 9.4 per cent and 11.9 per cent respectively).

### Downturn in orders in the German engineering industry<sup>2</sup>

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

### Construction equipment: end of the boom<sup>2</sup>

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

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<sup>1</sup> Global economic data from Deutsche Bank Economic Research Bureau Frankfurt

<sup>2</sup> Sectoral economic data from the German Engineering Federation (VDMA), EUROCONSTRUCT/CESifo and the European Automobile Manufacturers' Association (ACEA)

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

#### Noticeable downturn at year-end in the market for medium-heavy commercial vehicles<sup>1</sup>

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

#### Agricultural machinery industry continues to expand<sup>1</sup>

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

## DEUTZ AG BUSINESS PERFORMANCE

#### Economic slump impacts on business performance

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

#### New orders hit by economic downturn

At the end of 2008, new orders at DEUTZ AG amounted to €1,293.1 million; this compares with a figure of €1,470.7 million at the end of 2007. Demand therefore fell by 12.1 per cent. Despite the fact that new orders remained at the level of 2007 until the middle of 2008, the third and fourth quarters saw a double-digit decrease in line with the growing deterioration in economic conditions. The fall in new orders affected both segments. In Compact Engines, new orders worth €984.9 million were received, 12.9 per cent down on the equivalent period in 2007 (2007: €1,130.7 million). In DEUTZ Customised Solutions, new orders amounted to €308.2 million compared with a figure of €340.0 million in 2007.

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<sup>1</sup> Sectoral economic data from VDMA, EUROCONSTRUCT/CESifo and ACEA

This equates to a decrease of 9.4 per cent, which is attributable both to the conversion by one agricultural machinery customer from air-cooled to water-cooled DEUTZ engines and also to the general economic situation.

In line with the downturn in new orders in the second half of 2008, DEUTZ ended the year under review with orders on hand of €144.7 million (31 December 2007: €275.3 million).

#### Unit sales down significantly at the end of the year

As a result of the downward trend in new orders, DEUTZ AG's unit sales in the year under review amounted to 250,871 engines, 11.8 per cent down on 2007, which had been a record year with 284,331 engines sold. The decrease is primarily attributable to the downturn in unit sales in the fourth quarter; after the first nine months of 2008, the number of engines sold had still been at the level achieved in 2007. As regards the segments, both Compact Engines and DEUTZ Customised Solutions sold fewer engines than in 2007. Although unit sales of compact engines matched the level of unit sales in the corresponding period in 2007 until the end of the third quarter, the figure fell significantly in the fourth quarter and ended the year at 218,709 engines sold, which equates to a decrease of 12.8 per cent on 2007 (2007: 250,735 engines). DEUTZ Customised Solutions ended the year under review with unit sales of 32,162 engines (2007: 33,596 engines), a decline of 4.3 per cent. However this decrease is attributable to the conversion by one agricultural machinery customer from air-cooled to water-cooled DEUTZ engines (around 3,600 fewer engines than in 2007).

#### DEUTZ Customised Solutions revenue up on 2007

DEUTZ AG's revenue in 2008 amounted to €1,417.0 million and was therefore close to the 2007 revenue figure of €1,443.1 million (down 1.8 per cent). Up to the middle of the year, revenue had still been up by 16.1 per cent but in the second half of the year declined increasingly sharply. In the fourth quarter alone, revenue was down by a quarter on the equivalent period in 2007. The Compact Engines segment contributed €1,092.8 million to the total revenue for DEUTZ AG, 3.9 per cent less than in the corresponding period in 2007 (2007: €1,137.4 million). In contrast, an improvement in the product mix led to revenue in DEUTZ Customised Solutions of €324.2 million, which equates to a 6.1 per cent increase over 2007 (2007: €305.7 million).

Despite the drop in overall revenue in 2008, DEUTZ was able to continue the expansion of its service business: at €188.3 million, service business revenue was 7.0 per cent up on 2007 (2007: €176.0 million). However, given the global economic slowdown, the first signs of a downturn did begin to appear, primarily towards the end of the year: falling equipment utilisation rates and shorter operating periods at our end customers meant that some maintenance and repair work was being deferred.

#### Encouraging revenue performance in Germany

Considering 2008 as a whole, revenue held up well in Germany. However, the trend in the second half of the year was increasingly downward. In Germany, DEUTZ achieved revenue of €364.7 million, 8.6 per cent more than in 2007 (2007: €335.9 million). This increase was mainly attributable to the Agricultural Machinery application segment. Despite the deterioration in the general economic situation, there was excellent growth in the engines business for tractors and other agricultural equipment.

The fall in demand caused by the economic situation had significantly more impact on revenue outside Germany; revenue from non-German customers fell 5.0 per cent year-on-year from €1,107.2 million to €1,052.3 million. There was a corresponding change in the proportion of revenue accounted for by markets outside Germany: at the end of 2008, this figure was 74.3 per cent as against 76.7 per cent in 2007. Demand tailed off dramatically from the third quarter onwards. Revenue declined primarily in the Americas (North and South America), although this was also attributable to the less favourable exchange rate between the US dollar and the euro. As regards the individual regions, European countries excluding Germany accounted for the largest proportion of revenue at €725.0 million (2007: €740.3 million), followed by the Americas with revenue of €144.7 million (2007: €174.0 million) and the Asia-Pacific region with revenue of €107.6 million (2007: €113.7 million). More than half the revenue generated in Asia came from Chinese customers.

	2008	2007
€ million		
<b>Revenue</b>	<b>1,417.0</b>	<b>1,443.1</b>
EBIT	15.1	66.6
Net interest income/expense	-8.1	-14.3
<b>Profit from ordinary activities</b>	<b>7.0</b>	<b>52.3</b>
Net extraordinary expense	-17.8	119.5
Income taxes	4.2	-18.0
Other taxes	-0.8	-0.6
<b>Net loss/income</b>	<b>-7.4</b>	<b>153.2</b>
Profit carried forward	34.2	7.7
Addition to the legal reserve	0.0	-4.1
Addition to the other retained earnings	0.0	-74.6
<b>Accumulated income</b>	<b>26.8</b>	<b>82.2</b>

#### Significant fall in operating profit

In 2008, operating profit amounted to €15.1 million (2007: €66.6 million). This figure was adversely affected primarily by the sharp, rapid decrease in volume in the second half of the year as a result of the economic downturn, the higher cost of materials following increases in the price of materials and changes in the product mix. The DEUTZ AG operating profit margin fell accordingly from 4.6 per cent in 2007 to 1.1 per cent.

The cost of materials as a proportion of total output saw a further year-on-year increase of 3.4 percentage points. The main reason for this was the increasing number of engine series that met the Tier 3 emissions standards. This means our purchases of higher quality, complex components also increased and these series with the latest engine technology now account for a greater proportion of revenue. This trend primarily affects the Compact Engines segment. The rise in the price of commodities also forced up our cost of materials.

One of the reasons for the €2.0 million rise in staff costs to €239.0 million in the year under review was the collectively agreed wage and salary increases from April 2007, which impacted fully during the reporting period. The overall increase was, however, partially offset by lower expenditure on pensions and other post-retirement benefits.

The depreciation and amortisation expense in the year under review was €61.6 million (2007: €63.5 million).

The €8.3 million rise in other operating income to €87.2 million was largely the result of larger investment grants for development expenditure and higher foreign currency gains (€7.2 million increase), which were in turn offset by higher foreign currency losses (€1.7 million increase).

Other operating expenses remained close to the level of 2007 overall. In particular, the reduced cost of temporary staff was offset by higher expenses resulting from the recognition of other provisions and reserves.

At €14.4 million, net investment income was up €1.0 million on 2007, mainly as a result of higher profit distributions from the subsidiaries compared to 2007.

Net interest income increased by €6.2 million on 2007. The increase in interest expenses was more than compensated for by the increase in interest income resulting, in particular, from the fact that the significant amount of liquid funds from the sale of DEUTZ Power Systems were able to be invested over the whole twelve-month period of 2008.

#### Net income deteriorates

The profit from ordinary activities was €7.0 million (2007: €52.3 million).

Including an extraordinary item of minus €17.8 million (2007: €119.5 million) and tax income from the reversal of provisions of €4.2 million (2007: minus €18.1 million), the net loss for 2008 was €7.4 million (2007: net profit of €153.2 million). The extraordinary item of minus €17.8 million relates to capacity adjustments in connection with the MOVE action programme, impairment losses on an engine series for small engines of up to 27kW and expenses resulting from legacy effects of the sale of DEUTZ Power Systems. In 2008, we recognised provisions of €10.2 million for capacity adjustments.

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

For 2008, the Board of Management will propose to the Annual General Meeting that the distributable profit be carried forward to the new financial year.

## BUSINESS PERFORMANCE IN THE COMPACT ENGINES SEGMENT

#### Economic slump curbs demand

In 2008, the Compact Engines segment received new orders worth €984.9 million, 12.9 per cent down on 2007 (2007: €1,130.7 million). Demand, particularly demand for smaller engines (engines with a capacity of up to four litres), declined rapidly from the middle of the year onwards; new orders for four to eight-litre engines also contracted towards the end of the year. Furthermore, the significant economic uncertainty also meant that customers were postponing and, in some cases, cancelling existing orders. On the positive side, there was growth in the demand for engines in the Agricultural Machinery application segment and for customer support services: both areas of the business experienced an increase in new orders compared with 2007.

#### Unit sales down significantly at the end of the year

Overall, the Compact Engines segment sold 218,709 engines in the year under review; in 2007, DEUTZ had sold 250,735 engines. The 12.8 per cent drop in unit sales resulted primarily from the significant decrease in unit sales of engines with a capacity of less than four litres, which are mainly used in construction equipment and compressors. Unit sales of four to eight-litre engines were only slightly down, although unit sales in the Agricultural Machinery application segment were up significantly on 2007. Despite the fact that unit sales in the Compact Engines segment over the first nine months of the year were at the level of unit sales over the comparable period in 2007, these unit sales fell by 50 per cent in the fourth quarter as a result of the slump in demand.

#### Double-digit revenue growth in Agricultural Machinery

Up to the end of September 2008, revenue still exceeded the figure achieved over the equivalent period in 2007; in the fourth quarter, segment revenue fell by a third, primarily in the Mobile Machinery application segment. Total revenue in the Compact Engines segment in 2008 was €1,092.8 million, 3.9 per cent below the revenue achieved in 2007 (2007: €1,137.4 million). Within the overall segment, performance in the individual application segments varied: Agricultural Machinery again managed to notch up a significant increase, achieving revenue of €185.9 million (2007: €135.0 million), an increase of 37.7 per cent on the year before. This is also attributable in part to a major customer in this segment switching from air-cooled to water-cooled DEUTZ engines. The service business also generated an encouraging increase, with revenue rising by 11.6 per cent to €89.3 million (2007: €80.0 million), primarily as a result of the growth in the spare parts business in Europe. In the other application segments, the trend in revenue was downward: revenue from engines in the Mobile Machinery application segment, the largest generator of revenue in the Compact Engines segment, fell to €429.9 million in the year

under review (2007: €502.5 million), a decrease of 14.4 per cent. This application segment particularly felt the impact of the fall in demand for engines for construction and material handling equipment. Revenue also declined in the Stationary Equipment and Automotive application segments with decreases of 8.9 per cent to €164.2 million (2007: €180.3 million) and 6.4 per cent to €222.4 million (2007: €237.6 million) respectively. Whereas revenue for commercial vehicle engines remained slightly above the 2007 level until the end of September 2008, this business felt the impact in the fourth quarter of the significant slowdown in the European commercial vehicles industry. The drop in revenue in the Stationary Equipment application segment resulted, first and foremost, from the lower sales of engines for use in compressors – an end application closely linked to trends in the construction industry.

## BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS SEGMENT

### Growing signs of a downturn in new orders

There was a decrease in new orders in the DEUTZ Customised Solutions segment in the year under review, primarily in the new engines business. Total new orders amounted to €308.2 million (2007: €340.0 million), a year-on-year decrease of 9.4 per cent. A switch from air-cooled to water-cooled DEUTZ engines by one of the major customers in the Agricultural Machinery application segment was one reason for this, with new orders in this application segment falling by more than half. Demand for service support activities remained encouragingly buoyant, but the global economic downturn also resulted in an easing of demand in this area in the fourth quarter. The deterioration in market conditions also had an impact on the level of new orders in the new engines business towards the end of the year, particularly in the area of engines for construction equipment and mining equipment.

### Decrease owing to the change in unit sales structure

In the year under review, DEUTZ Customised Solutions sold 32,162 engines, 4.3 per cent fewer than in 2007 (2007: 33,596 engines). The switch by one of the agricultural machinery customers from air-cooled to water-cooled DEUTZ engines resulted in 2008 in an overall fall in unit sales of engines in air-cooled series, which account for around 87 per cent of unit sales in the segment. Only large air-cooled engines with a capacity of more than eight litres managed to achieve a double-digit increase. We were also able to generate a year-on-year increase in the unit sales of large liquid-cooled engines that are used, for example, in rail and marine applications.

### Encouraging growth in revenue

Despite the decline in unit sales, revenue in the DEUTZ Customised Solutions segment climbed by 6.1 per cent in the year under review. In 2008, segment revenue amounted to €324.2 million compared with €305.7 million in 2007. The Mobile Machinery application segment (first and foremost, the mining equipment segment) was able to achieve further improvements in revenue: a 31.1 per cent increase to €75.4 million (2007: €57.5 million). The engines business in the Stationary Equipment application segment recorded double-digit revenue growth with revenue rising in the year under review to €77.4 million (2007: €65.8 million), an increase of 17.6 per cent. This growth is primarily attributable to an improved product mix. Revenue relating to air-cooled engines for the Agricultural Machinery application segment fell to €8.8 million (2007: €27.5 million) for the reasons already explained. As in 2007, the largest proportion of segment revenue was the €99.0 million (2007: €96.0 million) generated by DEUTZ Customised Solutions in its service business, up 3.1 per cent on 2007. In addition to spare parts, the service business also includes the business involving reconditioned exchange parts and engines, referred to as 'Xchange' engines.

## NET ASSETS AND FINANCIAL POSITION

### Financial management centrally organised

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

To date, the current financial crisis has not had any direct impact on DEUTZ AG's net assets and financial position because DEUTZ AG does not currently have to make use of short-term lines of credit and the Company covered its long-term financing requirements with the placement of a bond in the USA in 2007 (US private placement). DEUTZ AG complied at all times with existing covenants – ancillary loan agreements specifying particular key performance indicators. It also has unused short-term lines of credit. We only had to accept a very small number of margin increases relating to short-term lines of credit made available by the banks.

#### Long-term funding via US private placement

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

The covenants are defined by key performance indicators based on the ratio of net debt to equity, net debt to EBITDA (before one-off items), and EBITDA (before one-off items) to net interest income/expense. Net debt includes all current and non-current interest-bearing financial liabilities (loans, bonds, notes, finance lease liabilities less any existing cash and cash equivalents).

#### Optimum receivables management by means of factoring

Over the last few years, factoring – the sale of receivables – has steadily become increasingly important. DEUTZ AG uses these opportunities to sell receivables in order to optimise receivables management. As at 31 December 2008, the volume of receivables sold under factoring agreements was around €83 million (2007: approximately €87 million).

#### Convertible bond issued in 2004 called in

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

#### Decrease in total assets

As at 31 December 2008, the total assets of DEUTZ AG amounted to €1,078.9 million, a decrease of €156.2 million on the total assets as at 31 December 2007. This was largely attributable to the reduction in trade receivables, which declined by €50.8 million to €74.5 million, and the reduction in cash and cash equivalents, which declined by €97.9 million to €200.2 million.

#### Slight increase in working capital

As at 31 December 2008, working capital (the total of inventories and trade receivables less trade payables) amounted to €112.2 million, an increase of €7.6 million on the working capital as at 31 December 2007 (€104.6 million). The main reason for this increase was an increase in inventories amounting to €5.8 million, caused by a slower turnover of inventories as a result of the economic situation. Given the sharp fall in business volume in the second half of 2008, there was a corresponding reduction in trade receivables (decrease of €50.8 million) and trade payables (decrease of €52.6 million).

#### Dividend distribution reduces equity

The reduction in total assets resulted in an equity ratio of 40.9 per cent, only about one percentage point higher than at 31 December 2007 (40.0 per cent). As at the balance sheet date, equity had decreased by €52.8 million to €441.7 million (31 December 2007: €494.5 million). In particular, the reasons for the decrease were the dividend distribution amounting to €48.0 million and the net loss of €7.4 million in the year under review.

#### Reduction in provisions and liabilities

Provisions for pensions and other post-employment benefits were reduced as planned by €7.7 million to €152.4 million (31 December 2007: €160.1 million).

Other provisions were reduced year-on-year by €29.7 million to €124.3 million (31 December 2007: €154.0 million). The necessary recognition of a provision for capacity adjustment costs amounting to €10.2 million was more than offset, amongst other things, by the utilisation of warranty provisions arising from the sale of DEUTZ Power Systems in 2007.

The fall of €52.6 million in trade payables as at 31 December 2008 to €117.4 million (31 December 2007: €170.0 million) was attributable to the reduction in purchasing volume as a result of the growing downturn in new orders in the second half of 2008.

#### Return on capital employed (ROCE) deteriorates

ROCE (the ratio of EBIT to the average capital employed, comprising the asset side of the balance sheet less cash and cash equivalents, less trade payables and less other liabilities) for 2008 was 2.0 per cent (2007: 9.1 per cent), the result of lower operating profit and a higher average capital employed.

#### Lower net financial position

As at 31 December 2008, the net financial position was minus €3.4 million. The equivalent figure as at 31 December 2007 was plus €90.1 million as a result of the significant inflow of funds from the proceeds of the disposal of DEUTZ Power Systems.

The net financial position is defined as the cash and cash equivalents available minus all current and non-current interest-bearing financial liabilities in the form of loans, bonds and notes.

#### Cash flow statement (condensed)

	2008	2007
€ million		
EBIT	15.1	66.6
Cash flow from operating activities before payment of compensation for vested company pension rights	49.1	8.0
Payment of compensation for vested company pension rights	-0.4	-69.6
Cash flow from operating activities	48.7	-61.6
Cash flow from investing activities	-81.4	156.9
Cash flow from financing activities	-65.2	166.1
<b>Change in cash and cash equivalents</b>	<b>-97.9</b>	<b>261.4</b>

Cash flow from operating activities was raised by €110.3 million on the previous year to €48.7 million (2007: minus €61.6 million). This increase results primarily from a €79.5 million reduction in the level of working capital required and from the absence of the payment of compensation for vested company pension rights totalling €69.6 million that had been made in the corresponding period in 2007.

In 2008, cash flow from investing activities was minus €81.4 million (2007: plus €156.9 million). In 2007, the sale of DEUTZ Power Systems after deduction of DEUTZ AG's transaction costs resulted in total cash inflows of €279.5 million. The 2008 figure for cash flow from investing activities includes payments for capital expenditure on intangible assets and property, plant and equipment as well as payments of €26.3 million resulting from legacy effects of the sale of the DEUTZ Power Systems segment to 3i.

Cash flow from financing activities amounted to minus €65.2 million (2007: plus €166.1 million). It includes interest paid, the payment of €48.0 million in dividends to shareholders and the repayment of bank debt amounting to €2.5 million. The positive cash flow from financing activities in the previous year included the inflow of funds from the US bond placement.

Free cash flow (cash flow from operating and investing activities minus interest expense) before payment of compensation for vested company pension rights amounted to minus €47.7 million in 2008 compared with plus €156.6 million in 2007.

## CAPITAL EXPENDITURE

### Volume of capital expenditure adjusted in line with the economic situation

Capital expenditure amounted to a total of €50.3 million in 2008 compared with €126.9 million in 2007. Approximately €58 million of the relatively high prior-year figure was spent on the 50 per cent stake in the DEUTZ Dalian joint venture in China.

Some of the capital expenditure planned for 2008, in particular expenditure on the expansion of capacity, was deferred as a result of the economic situation. We invested €42.5 million in property, plant and equipment (2007: €55.1 million) and €7.8 million in intangible assets (2007: €11.6 million).

### Capital expenditure in the Compact Engines segment

DEUTZ AG allocated the bulk of its capital expenditure to the Compact Engines segment, investing €44.8 million (2007: €119.6 million) in this segment. This expenditure largely related to replacement procurement and targeted adjustments in capacity at the production facilities in Cologne. A number of processing centres, lathes, grinding and milling machines for the production of crankcases, camshafts, crankshafts, conrods and cylinder heads were purchased.

### Capital expenditure in the DEUTZ Customised Solutions segment

The DEUTZ Customised Solutions segment accounted for €5.5 million of this capital expenditure (2007: €7.3 million); this included the implementation of measures to comply with environmental covenants at the Ulm facilities – the engine testing facility was equipped with a diesel filter installation. Other expenditure was also directed towards necessary replacement procurement in mechanical fabrication.

### Depreciation, amortisation expense and impairment losses below 2007 level

The depreciation/amortisation expense and impairment losses were slightly lower in 2008 than in 2007, amounting to €61.8 million (2007: €63.5 million).

## OVERALL ASSESSMENT OF 2008

### Performance affected by economic slump

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

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

The rapid and substantial drop in unit sales in the third quarter and above all in the fourth quarter of 2008 had a negative impact on operating profit and therefore also on the EBIT margin. Operating profit was also hit by the rise in the cost of materials: the cost of materials was adversely affected both by higher material prices and, more than anything else, by the higher proportion of unit sales accounted for by newly launched engine series containing components based on higher-cost technologies. The EBIT margin of 1.1 per cent in 2008 was markedly below our target figure.

#### Action programme to secure profitability and the future of the business

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

#### Sound balance sheet

ROCE fell to 2.0 per cent in the year under review, reflecting the change in net income. Working capital increased in the year under review to around €112 million, primarily as a result of the increase in inventories, itself the result of the slower turnover induced by the economic circumstances. The key balance sheet data as at 31 December 2008 shows that the financial structure of DEUTZ AG is sound. The Company enjoys an equity ratio of around 41 per cent and has a balance of cash and cash equivalents of around €200 million. Longer-term funding is secured primarily by way of a bond placed with US investors in 2007 (US private placement).

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

At the time of preparation of the 2007 annual financial statements, the sale of DEUTZ Power Systems, including the price adjustment mechanisms stipulated in the sale and purchase agreement, had not yet been completed. In October 2008, financial investor 3i, to whom DEUTZ AG had sold its gas and diesel engines business for decentralised power generation in September 2007, announced that it was pursuing a retrospective reduction in the purchase price by initiating an arbitration action. In November 2008, DEUTZ AG reached an out-of-court agreement with 3i on all its claims in connection with the acquisition of DEUTZ Power Systems. Under this settlement, DEUTZ AG has undertaken to make a compensation payment to 3i in full and final settlement of all claims on the part of 3i in connection with the sale and purchase agreement.

## RESEARCH AND DEVELOPMENT

#### Research and development (R&D) activities stepped up

Expenditure on research and development in 2008 amounted to €90.3 million (2007: €52.1 million). €78.7 million of this expenditure was attributable to the Compact Engines segment (2007: €43.6 million) and €11.6 million to the DEUTZ Customised Solutions segment (2007: €8.5 million). The increase in R&D expenditure in the year under review by more than 70 per cent was primarily attributable to development projects in connection with the next exhaust-gas emission stages. The R&D ratio – the ratio of R&D expenditure to revenue – rose accordingly in the year under review to 6.4 per cent (2007: 3.6 per cent). The number of employees in research and development also increased: as at 31 December 2008, DEUTZ AG had 431 R&D employees (31 December 2007: 388) at its Cologne facilities and at its Dursley site in the UK.

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

#### Focus on development of Tier 4 engines

In 2011, exhaust emissions standard EU III B in Europe and Tier 4 Interim in the USA come into force for mobile machinery engines with an output of 130kW or more. These emissions standards include a nitrogen oxide (NO<sub>x</sub>) emission limit of 2.0 g/kWh and a diesel particulate emission limit of 0.025 g/kWh. As the US name, Tier 4 Interim, already indicates, this is an interim standard to be followed in 2014 by Tier 4 Final in the US and EU IV in Europe. This subsequent standard will impose a further reduction in the emission limit for nitrogen oxide to 0.4 g/kWh. This statutory requirement means that, by 2014, emissions of the exhaust-gas components nitrogen oxide and diesel particulates will have to be reduced by a total of 95 per cent compared with the levels in 1999.

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

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

#### Exhaust aftertreatment systems for customer-specific solutions

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

#### Further development of the hybrid drive

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

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

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

#### Patent applications underline innovative strength

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

## PROCUREMENT

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

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

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

#### Collaboration with suppliers for forthcoming emission stages

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

#### Commodity prices at a record level

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

#### Cost of materials: foundry products account for significant proportion

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

## PRODUCTION

In line with the accelerating downturn in the economy during 2008, the figure of 250,045 engines produced by DEUTZ AG in 2008 was 11.6 per cent down on the production volume in the record year enjoyed in 2007 (282,692 engines).

### Downward market trend impacts on production in Cologne

In the year under review, the assembly plants at Cologne-Porz and Cologne-Deutz produced a total of 218,601 engines (2007: 251,384 engines), a year-on-year decrease of 13.0 per cent. The cut in production from the middle of the year particularly affected engines with a capacity of less than four litres, which are used mainly in construction equipment and compressors. Production of four to eight-litre engines was only scaled back in line with the reduced market volume in the fourth quarter of 2008. In the second full year of production for the TCD 013 4V engine, the assembly lines rolled out 32,784 engines, exceeding the high production figures achieved in the previous year (2007: 31,544 engines). However, by the end of 2008, there was a significant reduction in call-off orders for this engine series following a downturn in demand in the global commercial vehicles market, primarily in the fourth quarter.

### Production capacity adjustments and short-time working necessary

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

### Continuous improvement process ongoing

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

### Ulm: centre of competence for air-cooled diesel engines

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

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

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

have to adjust production at the Ulm plant during 2008.

#### Strict guidelines ensure consistently high level of quality

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

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

#### Steady downward trend in the number of workplace accidents

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

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

## EMPLOYEES

#### Number of employees rises slightly

As at 31 December 2008, 3,881 people (31 December 2007: 3,841) were employed by DEUTZ AG, which was an increase of 40 people or 1.0 per cent. In the year under review, an average of 306 persons were employed under temporary employment agreements, representing a decrease of 60 on 2008.

As a result of the high level of orders in the first half of 2008, DEUTZ had increased the number of employees on flexible contracts by around 400 to a total of approximately 900 temporary and contract employees at the mid-year point. As a result of the significant drop in new orders and unit sales in the second half of the year, this figure had to be reduced to around 350 people by the end of 2008.

Following the unexpectedly sharp drop in orders in the fourth quarter, DEUTZ AG introduced short-time working at the start of December 2008 for parts of its production and assembly operations; this affected the Cologne plants. The Ulm plant was not affected by the short-time working measures in 2008.

As at 31 December 2008, the Compact Engines segment employed 3,122 people (31 December 2007: 3,119), while the DEUTZ Customised Solutions segment had 759 employees (31 December 2007: 722). Although the number of research and development employees in the Compact Engines segment increased by 42 in Cologne, the increase was offset by a reduction in the production workforce. This reflected the step-up in our research and development activities, principally focused on the refinement of our engines to comply with the next stages in exhaust-gas emissions standards. The 5.1 per cent increase (37 employees) in the DEUTZ Customised Solutions segment only affected production units.

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<sup>1</sup> Known as TMQ (Tausend-Mann-Quote) in German

#### DEUTZ focuses on training

Even in tough economic conditions, DEUTZ AG invests in the vocational training of young people – and therefore in the future. In 2008, we offered 62 school leavers training and apprenticeship places in technical, trade or commercial vocations, for example in industrial technology, electronics and business administration. DEUTZ AG employed a total of 186 trainees and apprentices, of which 133 were in Cologne alone. The trainee ratio, i.e. the ratio of trainees and apprentices to DEUTZ's total workforce, again increased during the year under review and at 31 December 2008 stood at 4.8 per cent (31 December 2007: 4.5 per cent). All trainees and apprentices who successfully passed their examinations in 2008 were subsequently transferred by DEUTZ AG to specific departments for at least one year – in this way, we managed to retain 46 young, motivated employees in the Company.

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

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

#### Prospects for graduate recruits

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

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

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

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

#### Further development of strategic personnel activities

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

These new personnel development tools based on the DEUTZ competency model are to be introduced in other areas of the Company during the current 2009 financial year.

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

## ENVIRONMENT

#### Focus on energy management and reduction of emissions

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

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

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

#### Further improvement in environmental efficiency

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

#### Participation in Carbon Disclosure Project

DEUTZ has undertaken to make a comprehensive disclosure of its greenhouse gas emissions<sup>1</sup> and since 2008 has been taking part in the Carbon Disclosure Project (CDP). In future, DEUTZ will determine the total CO<sub>2</sub> emissions that it generates throughout the world and describe the action it has taken to reduce these emissions. The Carbon Disclosure Project is the world's largest collaboration between institutional investors to investigate the economic impact of climate change. The objective is to promote dialogue with companies on this subject. The Carbon Disclosure Project is based on a questionnaire sent to over 3,000 listed companies throughout the world and the results are assembled into a report. 2008 was the sixth time that the survey had been carried out. The survey is international; in Germany, over 50 per cent of the 200 largest German companies (measured on the basis of market capitalisation) took part in 2008.

In 2008, DEUTZ AG achieved a further reduction in carbon dioxide emissions of 4 per cent, principally as a result of fuel savings in engine testing. Apart from the reduction of CO<sub>2</sub> emissions as part of the production process, the CO<sub>2</sub> emissions from our own products play a critical role for us as a manufacturer of diesel engines. Our core competency lies in the development and production of low-emission engines with optimum fuel consumption that comply with the strict limits imposed by emissions legislation in Europe and the USA. We are also carrying out intensive research and development work in the areas of exhaust-gas aftertreatment and environmentally-friendly drive units. More information can be found in the section on research and development on page 13.

#### Safety management ensures problem-free operation in production

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

## DEPENDENCY REPORT

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

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

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<sup>1</sup> Carbon dioxide emissions

## DISCLOSURES PURSUANT TO SECTION 289 (4) GERMAN COMMERCIAL CODE (HGB)

### Composition of the issued capital

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

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

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

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

### 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, 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.

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

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

#### Further disclosures

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

No bearers of shares have any special rights conferring authority to control the Company. Numerous employees have direct shareholdings in DEUTZ AG. There are no restrictions affecting the direct exercise of rights of control in connection with these shares.

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

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

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

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

DEUTZ AG has no indemnification agreements with members of the Board of Management or 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 management report and group management report pursuant to sections 289 (4) and 315 (4) HGB relate to arrangements that may be significant in the success of any public takeover bid for DEUTZ AG. It is the opinion of the Board of Management that these arrangements are normal for publicly traded companies comparable with DEUTZ AG. Insofar as the terms of the private placement regarding a change of control link the premature repayment of the notes, among other things, to the withdrawal, downgrading or failure to achieve an upgrading in the rating of financial liabilities, the Board of Management hereby draws attention to the fact that DEUTZ AG currently does not hold any financial liabilities that are rated.

## REMUNERATION REPORT

### Remuneration of the Board of Management

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

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

Further information on remuneration can be found on page 47 in the notes to the financial statements.

### Remuneration of the Supervisory Board

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

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

Further information on the remuneration paid to the Supervisory Board can be found on page 48 in the notes to the financial statements.

## EVENTS AFTER THE BALANCE SHEET DATE

No events occurred after the balance sheet date that had a material impact on the net assets, financial position or results of operations of DEUTZ AG.

## RISK REPORT

### Risk management system

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

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

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

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

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

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

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

### Sales risks

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

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

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

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

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

#### Procurement risks

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

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

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

Given the significant global recessionary trends, the possibility of a financial squeeze also affecting DEUTZ suppliers cannot be ruled out. On an ongoing basis, DEUTZ therefore analyses which suppliers could be exposed to financial difficulties and liquidity problems. At the same time, DEUTZ works on backup solutions to minimise the risk from supplier default. These solutions may involve a switch to inhouse production or a shift to other suppliers.

#### Production risks

As a consequence of the financial crisis and the associated economic downturn, the production and assembly capacity that had been expanded in 2007 and at the start of 2008 was significantly higher than required for the level of unit sales in the second half of 2008. The number of shifts was reduced as early as July 2008, marking the start of an ongoing adjustment of capacity. Short-time working was also introduced in some parts of the business

in December 2008. Until further notice, short-time working will be continued in the current year in under-utilised units. A review is being carried out monthly to take into consideration any change in the level of new orders.

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

#### Technological risks

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

#### Quality risks

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

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

#### Financial risks

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

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

DEUTZ AG has sufficient existing credit facilities with leading banks, although the use of these facilities is currently minimal. With the issue of notes with a total value of US\$ 274 million under the US private placement in 2007, DEUTZ was able to open up broadly based financing from institutional investors in the US independently of the banks. The coupon is fixed for the entire maturity of the individual tranches (between five and ten years). Where interest payments and the repayment of the principal are due in US dollars, these payments are hedged over the entire term to maturity. With the placement of the bond, DEUTZ has undertaken to comply with certain covenants. The covenants are defined by key performance indicators based on the ratio of net debt to equity, net debt to EBITDA (before one-off items), and EBITDA (before one-off items) to net interest income/expense. In the event of failure to comply with the defined key performance indicators, the creditors (providing they have a majority) have the right to terminate the bond before the maturity date or to demand an adjustment to the terms of the contract, which would currently involve an increase in the interest payable. These key performance indicators

are subject to constant monitoring and must be reported by DEUTZ on a quarterly basis. To date, DEUTZ has met the targets for the key performance indicators at all times. Given that it is difficult to predict economic trends henceforward, our short-term and medium-term forecasts are subject to corresponding uncertainty. The aim of the MOVE action programme is to be able to react flexibly to changing economic circumstances in 2009 so as to achieve a small operating profit and thus to ensure continuing compliance with the covenants associated with the US private placement. In the event of a sustained and worsening crisis for the Company in terms of unit sales and revenue, there would be a risk of infringing these covenants with the negative consequences for DEUTZ AG described above.

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

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

#### Organisational risks

Organisational risks are risks that arise from inadequate or non-harmonised organisational structures, processes, communication and information flows, procedures and guidelines. At DEUTZ AG, special central units therefore provide support to the individual operating units so that such risks are avoided. Centralisation of functions and services for all locations and segments ensures the application of standardised processes throughout the Company. This is also supported by appropriate Company-wide guidelines.

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

#### IT risks

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

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

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

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

#### Human resources risks

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

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

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

#### Pension risks

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

#### Legal risks

Existing and imminent legal disputes are recorded and analysed on an ongoing basis at DEUTZ AG; they are assessed in terms of their legal and financial impact and covered by an appropriate amount added to ongoing risk provisioning.

On this basis, the management of DEUTZ AG can take appropriate action promptly and, where appropriate, recognise any necessary accounting provisions.

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

The claim by the Greek tax authorities against a Greek subsidiary of DEUTZ AG for supplementary tax payments and penalties amounting to a total of €35 million is pending. There are also two legal actions brought by private persons against the American subsidiary of DEUTZ AG alleging damage to health caused by asbestos. A further US asbestos lawsuit was dismissed in the year under review. In addition, a US customer is claiming damages of more than US\$ 40 million. This action is without substance in the opinion of the Company because the engines were used in a manner contrary to instructions and liability for consequential loss is contractually excluded. A provision has been recognised in the annual financial statements to cover the risk in connection with the litigation.

#### Planning risks

The preparation of the single-entity financial statements of DEUTZ AG requires estimates and assumptions to be made that have an impact, in particular, on the recognition, measurement and reporting of assets (including financial assets) and liabilities (for example, provisions). The estimates and assumptions are based on projections, which by their nature are subject to a degree of uncertainty, for example in relation to determining the fair value of long-term equity investments. Against the background of the crisis in the financial markets, it is difficult to predict how the economic situation will develop and forecasts are subject to a greater level of uncertainty. The possibility of routine adjustments to the estimates and assumptions and any associated negative impact on the net assets, financial position and results of operations of DEUTZ AG can therefore not be excluded at present.

#### Future tax risks

The external tax audit started in 2006 covering the tax assessment periods 2002 to 2005 is still in progress. We have not yet received the tax auditor's report. An appropriate provision for tax risks has been recognised. As things stand, the Company is not expecting any other material risks.

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

## OUTLOOK

#### The economy in 2009: global recession<sup>1</sup>

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

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

#### Drop in production in the engineering industry expected<sup>2</sup>

The crisis in the financial markets and the significant and sustained level of corporate uncertainty will continue to have a notable adverse impact on the real economy in 2009. Following a 29 per cent year-on-year drop in new orders in the fourth quarter of 2008 and a further significant fall in January (42 per cent), the German Engineering Federation (VDMA) is forecasting a decline in German production of 7 per cent on average in 2010 as a result of reduced spending or a complete freeze on capital investment amongst companies in Germany and abroad. However, the extent of this reduction will vary from sector to sector.

#### Prospects worse for the construction equipment sector<sup>2</sup>

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

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

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<sup>1</sup> Global economic data from Deutsche Bank Economic Research Bureau Frankfurt

<sup>2</sup> Sectoral economic data from VDMA, EUROCONSTRUCT/CESifo Group, ACEA and the Association of International Motor Vehicle Manufacturers (VDIK)

#### Substantial drop in demand for commercial vehicles<sup>1</sup>

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

#### Agricultural machinery: optimism for the first half of 2009<sup>1</sup>

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

#### Statutory regulations: exhaust-gas emissions standards

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

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

#### Commodities, US dollar, collective pay agreements

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

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

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

#### New orders, unit sales, revenue

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

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<sup>1</sup> Sectoral economic data from VDMA, EUROCONSTRUCT/CESifo Group, ACEA and VDIK

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

#### Operating profit

The forecast fall in new orders, unit sales and revenue will have a corresponding impact on operating profit. In fact, DEUTZ AG expects to make an operating loss. The aim of our MOVE action programme is to enable us to react flexibly to continually changing economic circumstances in 2009. The measures set out in the programme, including the announcement of short-time working, the reduction in the cost of materials and overheads and the adjustment of employee numbers in line with changing sales forecasts should bring about a positive contribution to operating profit in the current financial year. The achievement of our target for operating profit in 2009 hinges on the successful implementation of MOVE.

#### Capital expenditure, free cash flow

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

#### Research and development expenditure

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

#### Employees

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

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

#### Outlook for 2010

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

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

# Annual financial statements

## BALANCE SHEET OF DEUTZ AG

<b>Assets</b>	<b>31/12/2008</b>	<b>31/12/2007</b>
€ million		
<b>Expenses for the expansion of operations</b>	<b>10.4</b>	<b>20.8</b>
Intangible assets	24.9	29.6
Property, plant and equipment	279.4	280.1
Financial assets	181.9	181.9
<b>Fixed assets</b>	<b>486.2</b>	<b>491.6</b>
Inventories	155.1	149.3
Receivables and other assets	223.3	271.6
Cash and cash equivalents	200.2	298.1
<b>Current assets</b>	<b>578.6</b>	<b>719.0</b>
Prepaid expenses	3.7	3.7
<b>Total assets</b>	<b>1,078.9</b>	<b>1,235.1</b>
<b>Equity and liabilities</b>		
Issued capital	309.0	307.0
Additional paid-in capital	26.8	26.2
Retained earnings		
Legal reserve	4.5	4.5
Other retained earnings	74.6	74.6
Accumulated income	26.8	82.2
<b>Equity</b>	<b>441.7</b>	<b>494.5</b>
Provisions	278.6	320.9
Other liabilities	358.6	419.7
Deferred income	0.0	0.0
<b>Total equity and liabilities</b>	<b>1,078.9</b>	<b>1,235.1</b>

## INCOME STATEMENT OF DEUTZ AG

	<b>2008</b>	<b>2007</b>
€ million		
Revenue	1,417.0	1,443.1
Change in inventories	-0.1	13.1
Other own work capitalised	0.7	0.4
<b>Total output</b>	<b>1,417.6</b>	<b>1,456.6</b>
Other operating income	87.2	78.9
Cost of materials	-1,063.8	-1,043.2
Staff costs	-239.0	-237.0
Depreciation, amortisation and impairment	-61.8	-63.5
Other operating expenses	-139.5	-138.6
Net investment income	14.4	13.4
Net interest income (expense)	-8.1	-14.3
<b>Profit from ordinary activities</b>	<b>7.0</b>	<b>52.3</b>
Net extraordinary expense	-17.8	119.5
Income taxes	4.2	-18.0
Other taxes	-0.8	-0.6
<b>Net income</b>	<b>-7.4</b>	<b>153.2</b>
Profit carried forward	34.2	7.7
Additions to legal reserves	0.0	-4.1
Additions to other retained earnings	0.0	-74.6
<b>Accumulated income</b>	<b>26.8</b>	<b>82.2</b>

## Notes to the financial statements

### STATEMENT OF CHANGES IN FIXED ASSETS

	Gross figures Acquisition and production costs						Gross figures Depreciation, amortisation and impairment				Net figures	
	1/1/2008	Additions	Investment grants	Disposals	Reclassifications	31/12/2008	1/1/2008	Additions <sup>1)</sup>	Disposals	31/12/2008	31/12/2008	31/12/2007
€ thousand												
<b>Expenses for the expansion of operations</b>	<b>41,513</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>41,513</b>	<b>20,756</b>	<b>10,379</b>	<b>0</b>	<b>31,135</b>	<b>10,378</b>	<b>20,757</b>
Patents, licences, trademarks and similar rights and assets, including licences for such rights and assets	107,462	7,818	-943	23,385	412	91,364	77,799	12,087	23,385	66,501	24,863	29,663
<b>Intangible assets</b>	<b>107,462</b>	<b>7,818</b>	<b>-943</b>	<b>23,385</b>	<b>412</b>	<b>91,364</b>	<b>77,799</b>	<b>12,087</b>	<b>23,385</b>	<b>66,501</b>	<b>24,863</b>	<b>29,663</b>
Land, leasehold rights and buildings, including buildings on land owned by others	173,592	903	0	389	5,665	179,771	47,041	4,598	0	51,639	128,132	126,551
Technical equipment and machines	337,143	18,495	-4	3,602	14,328	366,360	245,357	23,080	3,450	264,987	101,373	91,786
Other equipment, furniture and fixtures	158,272	13,894	-831	6,252	1,272	166,355	118,249	13,006	5,656	125,599	40,756	40,023
Advances paid and construction in progress	21,713	9,144	0	0	-21,677	9,180	0	0	0	0	9,180	21,713
<b>Property, plant and equipment</b>	<b>690,720</b>	<b>42,436</b>	<b>-835</b>	<b>10,243</b>	<b>-412</b>	<b>721,666</b>	<b>410,647</b>	<b>40,684</b>	<b>9,106</b>	<b>442,225</b>	<b>279,441</b>	<b>280,073</b>
Investments in affiliated companies	150,882	0	0	0	0	150,882	65,878	0	0	65,878	85,004	85,004
Long-term equity investments	67,073	0	0	0	0	67,073	3,608	0	0	3,608	63,465	63,465
Loans to other long-term investees and investors	35,632	0	0	0	0	35,632	3,500	0	0	3,500	32,132	32,132
Other loans	2,103	0	0	5	0	2,098	796	0	0	796	1,302	1,307
<b>Financial assets</b>	<b>255,690</b>	<b>0</b>	<b>0</b>	<b>5</b>	<b>0</b>	<b>255,685</b>	<b>73,782</b>	<b>0</b>	<b>0</b>	<b>73,782</b>	<b>181,903</b>	<b>181,908</b>
<b>Fixed assets</b>	<b>1,053,872</b>	<b>50,254</b>	<b>-1,778</b>	<b>33,633</b>	<b>0</b>	<b>1,068,715</b>	<b>562,228</b>	<b>52,771</b>	<b>32,491</b>	<b>582,508</b>	<b>486,207</b>	<b>491,644</b>
<b>Total</b>	<b>1,095,385</b>	<b>50,254</b>	<b>-1,778</b>	<b>33,633</b>	<b>0</b>	<b>1,110,228</b>	<b>582,984</b>	<b>63,150</b>	<b>32,491</b>	<b>613,643</b>	<b>496,585</b>	<b>512,401</b>

1) The figure reported for depreciation, amortisation and impairment in the income statement differs by €1.3 million because impairment losses of €1.3 million have been included in net extraordinary expense.

## STATEMENT OF CHANGES IN EQUITY

	Issued capital	Additional paid-in capital	Retained earnings	Accumulated income	Total
€ thousand					
<b>Balance at 1 January 2007</b>	<b>292,271</b>	<b>21,922</b>	<b>406</b>	<b>7,705</b>	<b>322,304</b>
Increased through conversion of convertible profit-sharing rights & convertible bonds	14,721	4,306		0	<b>19,027</b>
Net profit for 2007				153,207	<b>153,207</b>
Additions to retained earnings			4,065	-4,065	<b>0</b>
Additions to other retained earnings			74,600	-74,600	<b>0</b>
<b>Balance at 31 December 2007</b>	<b>306,992</b>	<b>26,228</b>	<b>79,071</b>	<b>82,247</b>	<b>494,538</b>
Dividend paid to shareholders				-48,039	<b>-48,039</b>
Increased through conversion of convertible profit-sharing rights & convertible bonds	1,986	629		0	<b>2,615</b>
Net loss for 2008				-7,392	<b>-7,392</b>
<b>Balance at 31 December 2008</b>	<b>308,978</b>	<b>26,857</b>	<b>79,071</b>	<b>26,816</b>	<b>441,722</b>

## BASIS OF PRESENTATION

The annual financial statements of DEUTZ AG for the financial year 2008 have been prepared in accordance with the requirements of the German Commercial Code (HGB) (sections 238 et seq., sections 264 et seq.) and the supplementary requirements of the German Stock Corporation Act (AktG).

In the interest of clarity, some items on the face of the balance sheet and the income statement have been aggregated and are reported separately in the notes to the financial statements. The income statement has been prepared using the nature-of-expense method.

## ACCOUNTING POLICIES

### Expenses for the expansion of operations

This item comprises expenses incurred in connection with the development of the Commercial Vehicles market segment. Amortisation is over four years in accordance with section 282 HGB.

### Fixed assets

**Intangible assets** are recognised at amortised cost over a useful life of three to eight years.

**Property, plant and equipment** are recognised at cost and, if depreciable, take account of depreciation. Investment grants from customers are deducted from the cost of intangible assets and property, plant and equipment.

Buildings are depreciated in accordance with tax rules. They are depreciated over their estimated useful life. Movable assets are generally depreciated on a straight-line basis *pro rata temporis* over their typical useful life.

The following useful lives are generally used for depreciation purposes:

	Useful life (years)	Deprecia- tion rate (%)
Buildings and grounds	5 to 40	2.5 to 20
Technical equipment and machines	10 to 20	5 to 10
Other equipment, furniture and fixtures	3 to 10	10 to 33.3

Impairment charges are recognised if the fair value of the assets is lower at the balance sheet date.

Low-value assets with a value of more than €150 up to a maximum of €1,000 purchased after 31 December 2007 are consolidated in a single item for the financial year in which they were acquired and depreciated over five years.

**Investments in affiliated companies and long-term equity investments** are recognised at cost less commercially necessary impairment; loans are always recognised at their nominal value. Non-interest-bearing and low-interest **loans** are discounted to their present value.

Possible impairment is established on the basis of the difference between the book value and the fair value, whereby the company is valued using the discounted cash flow method. The plans on which the valuation is based rely on estimates and assumptions that are subject to an increased level of uncertainty due to the effects of the financial crisis and uncertainty about future economic growth.

## **Current assets**

**Raw materials, consumables and bought-in parts** are recognised at the lower of cost or market price. The cost of purchase is based on weighted average procurement prices. **Work in progress and finished goods** are valued at the cost of conversion, which includes directly attributable costs, a proportion of indirect labour and indirect materials and administration costs that are eligible for capitalisation pursuant to section 255 (2) HGB.

If the realisable selling price less future costs is lower, this amount is recognised. Additional write-downs are applied to cover risks resulting from inventories' period of storage and impaired usability as well as contract-related losses.

Appropriate impairment charges are recognised against **receivables and other assets** to take account of all identifiable commercial and political risks. General write-downs are recognised for non-specific credit risk. Non-interest-bearing receivables with maturities of more than one year are discounted. Foreign-currency receivables falling due within one year are recognised at the spot rates on the balance sheet date. Longer-term receivables are recognised at the hedging rate or at the lower of the rate on the date they were posted or the balance sheet date. Hedging transactions not associated with longer-term receivables or pending orders on hand are marked to market on the balance sheet date.

Expenses incurred before the balance sheet date are recognised as **prepaid expenses** provided that they relate to a period after the balance sheet date.

## **Provisions for pensions and other post-retirement benefits**

Provisions for pensions are recognised under the tax-based entry-age normal method (section 6a of the German Income Tax Act [EStG]) using the generation mortality tables 2005 G of Prof. Dr Klaus Heubeck with a discount rate of 6 per cent. Financing is based on the minimum pensionable age in accordance with the 1999 German Pension Reform Act (RRG99).

To improve the informative value of the annual financial statements, the accrued interest cost for pension obligations is not recognised as part of staff costs, but as interest expenses.

## **Tax provisions and other provisions**

Appropriate provisions have been recognised for all identifiable risks and contingent liabilities at the balance sheet date.

## **Liabilities**

All liabilities are recognised at their repayment amount. The same rules apply to the valuation of foreign-currency liabilities as described above for foreign-currency receivables.

The convertible bond issued in 2004 had a coupon of 3.95% and matured in 2009. The price of the conversion right determined on the basis of the discounted benefit of the low-interest-bearing nature was transferred to additional paid-in capital. Based on the option provided by section 250 (3) HGB, prepaid expenses were recognised in an equivalent amount and amortised over the term of the bond.

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

The discount was offset directly in equity against additional paid-in capital.

DEUTZ AG issued bonds worth USD 274 million (€203 million) as part of a private placement in the United States and recognised them at cost.

## NOTES TO THE BALANCE SHEET AND THE INCOME STATEMENT

### 1. EXPENSES FOR THE START-UP AND EXPANSION OF OPERATIONS

Capitalised expenses and amortisation charges for the financial year are shown in the statement of changes in fixed assets.

### 2. FIXED ASSETS

Fixed assets and the associated amortisation, depreciation and impairment charges for the financial year are reported by category in the statement of changes in fixed assets. Amortisation, depreciation and impairment include impairment losses of €0.2 million. In addition, impairment losses totalling €1.3 million were recognised in the financial year 2008 on property, plant and equipment and intangible assets, mainly due to discontinuation of a series in the low power range (< 4 litres). Impairment losses in connection with the discontinuation of this series were reported under net extraordinary expense.

### 3. INVENTORIES

	31/12/2008	31/12/2007
€ thousand		
Raw materials, consumables, bought-in parts and spare parts	108,586	103,987
Work in progress	32,086	34,562
Finished goods	12,718	10,378
	<b>153,390</b>	<b>148,927</b>
Advances paid	2,943	2,302
	<b>156,333</b>	<b>151,229</b>
Advances received for orders	-1,251	-1,968
<b>Total</b>	<b>155,082</b>	<b>149,261</b>

### 4. RECEIVABLES AND OTHER ASSETS

	Thereof residual maturity up to 1 year	Thereof residual maturity over 1 year	31/12/2008 Total	31/12/2007 Total	Thereof residual maturity over 1 year
€ thousand					
Trade receivables	74,487	0	74,487	125,342	0
Receivables from affiliated companies	92,641	0	92,641	82,599	0
Receivables from other long-term investees and investors	11,877	0	11,877	3,601	0
Other assets	37,040	7,254	44,294	60,097	5,649
<b>Total</b>	<b>216,045</b>	<b>7,254</b>	<b>223,299</b>	<b>271,639</b>	<b>5,649</b>

Trade receivables account for €26,023 thousand of the total receivables due from affiliated companies and €10,044 thousand of the total receivables from long-term investees and investors (31 December 2007: €44,669 thousand and €2,128 thousand respectively).

## 5. CASH AND CASH EQUIVALENTS

This item comprises cash on hand and credit balances held with banks.

## 6. PREPAID EXPENSES

Prepaid expenses amounting to €3.7 million (2007: €3.7 million) primarily comprise prepaid items for interest, pension payments and other expenses.

## 7. EQUITY

### Issued capital

At the end of 2008, the issued capital (share capital) of DEUTZ AG amounted to €308,978,241.98 (31 December 2007: €306,992,504.46) and was divided into 120,861,783 no-par-value bearer shares (31 December 2007: 120,085,030).

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

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

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

### Notifications under the German Securities Trading Act

The German Securities Trading Act (WpHG) obliges investors whose share of voting rights in listed companies reaches certain thresholds to notify the company accordingly. DEUTZ AG has been notified of the following shareholdings:

AB Volvo (publ), 40508 Gothenburg, Sweden, notified pursuant to sections 21 (1) and 24 WpHG that its shareholding in DEUTZ AG fell below the 10 per cent threshold on 23 October 2003 and now amounts to 7.09 per cent of the voting rights.

SAME DEUTZ-FAHR Group S.p.A., V. le Cassani 14, 24047 Treviglio (BG), Italy, notified pursuant to sections 21 (1) and 24 WpHG that the shareholding of SAME DEUTZ-FAHR Holding & Finance BV, Herengracht 548, 1017 CG Amsterdam, Netherlands, in DEUTZ AG exceeded the 25 per cent threshold on 2 July 2004 and now amounts to 29.90 per cent of the voting rights. These voting rights are attributable to SAME DEUTZ-FAHR Group S.p.A. pursuant to section 22 (1) number 1 WpHG.

In a letter dated 6 June 2006, INTAL INTERNATIONAL S.A., Luxembourg, notified the following pursuant to section 21 et seq. WpHG:

"The share of voting rights held by SAME DEUTZ-FAHR Holding & Finance B.V., Rokin 55, 1012 KK Amsterdam, Netherlands, in DEUTZ AG exceeded the threshold of 25 per cent on 2 July 2004; on 2 July 2004 this share amounted to 29.90 per cent and is now 38.88 per cent. Pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) WpHG, the voting rights are fully attributable to SAME DEUTZ-FAHR Group S.p.A., V. le Cassani 14, 24047 Treviglio (BG), Italy. As a result, the share of voting rights held by SAME DEUTZ-FAHR Group S.p.A. in DEUTZ AG on 2 July 2004 also exceeded the threshold of 25 per cent; on 2 July 2004 this share amounted to 29.90 per cent and is now 38.88 per cent.

We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you pursuant to section 21 et seq. WpHG in our own name and in the name of, and on the behalf of, the company and individuals specified under (i) and (ii) below that the share of voting rights held in DEUTZ AG by  
(i) Intractor B.V., Rokin 55, 1012 KK Amsterdam, Netherlands,  
(ii) Messrs Vittorio Carozza, Francesco Carozza and Aldo Carozza and Ms Carozza-Cassani, V. le Cassani 14, 24047 Treviglio (BG), Italy, and

(iii) INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, L-2210 Luxembourg, exceeded the threshold of 25 per cent on 2 July 2004, with the share on 2 July 2004 amounting to 29.90 per cent and now standing at 38.88 per cent. These voting rights are fully attributable to the companies and individuals specified under (i) to (iii) above pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) WpHG."

In a letter dated 15 November 2006, INTAL INTERNATIONAL S.A., Luxembourg, notified the following pursuant to section 21 et seq. WpHG:

"We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you pursuant to section 21 et seq. WpHG that the share of the voting rights held by INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, in DEUTZ AG on 8 November 2006 fell below the thresholds of 5 per cent, 10 per cent and 25 per cent and is now 0 per cent."

In a letter dated 15 November 2006, Belfort S.A., Luxembourg, notified the following pursuant to section 21 et seq. WpHG:

"We, Belfort S.A., 54, Boulevard Napoléon 1er, L-2210 Luxembourg, hereby notify you pursuant to section 21 et seq. WpHG that the share of the voting rights held by Belfort S.A., 54, Boulevard Napoléon 1er, L-2210 Luxembourg, in DEUTZ AG on 8 November 2006 exceeded the thresholds of 5 per cent, 10 per cent and 25 per cent and is now 40.32 per cent. These voting rights are attributable to us pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) WpHG."

DEUTZ AG did not receive any new notifications in 2008.

### **Authorised capital**

The Annual General Meeting held on 22 June 2006 approved a resolution to create new authorised capital. The Board of Management is authorised, subject to the consent of the Supervisory Board, to increase the issued capital on or before 21 June 2011 through the issue of new no-par-value shares against cash and/or non-cash contributions on one or more occasions by up to a total amount of €120,000,000.00. Capital increases against non-cash contributions may not exceed a total of €80,000,000.00.

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

- for fractional amounts;
- in so far as is necessary to grant holders of bonds with conversion rights, warrants or conversion obligations issued by DEUTZ AG pre-emptive rights to new shares to the extent that would be required if they were to exercise their conversion or option rights or fulfil their conversion obligations;
- if the issue price of the new shares is not significantly below the market price and the shares issued with the disapplication of pre-emptive rights pursuant to section 186 (3) sentence 4 of the German Stock Corporation Act (AktG) in total do not exceed 10 per cent of the issued capital either at the effective date or the exercise date of this authorisation. The aforementioned 10 per cent threshold includes shares that are acquired on the basis of an authorisation granted by the Annual General Meeting and sold during the period of this authorisation pursuant to section 71 (1) no. 8 sentence 5 AktG in conjunction with section 186 (3) sentence 4 AktG. This restriction also includes shares that have been or are to be issued in order to service bonds with conversion rights, warrants or conversion obligations insofar as the bonds were issued during the term of this authorisation with the disapplication of pre-emptive rights in application *mutatis mutandis* of section 186 (3) sentence 4 AktG.

The Board of Management is also authorised, subject to the consent of the Supervisory Board, to disapply pre-emptive rights in cases where the capital increase is made against non-cash contributions in the context of the acquisition of an entity, parts of an entity or investments in an entity.

### **Conditional capital**

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

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

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

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

Conditional capital amounted to € 174 thousand as at 31 December 2008.

#### **Additional paid-in capital**

The conversion of convertible bonds into no-par-value shares resulted in an increase of additional paid-in capital of €629 thousand.

#### **Retained earnings**

Retained earnings comprise DEUTZ AG's legal reserve amounting to €4.5 million together with other retained earnings of €74.6 million.

#### **Statement of changes in equity**

The statement of changes in equity is presented on page 35.

### **8. PROVISIONS**

	<b>31/12/2008</b>	<b>31/12/2007</b>
€ thousand		
Provisions for pensions and other post-retirement benefits	152,431	160,074
Provisions for taxes	1,942	6,831
Other provisions	124,236	153,975
<b>Total</b>	<b>278,609</b>	<b>320,880</b>

In financial year 2007, DEUTZ AG offered – where permitted by law – to pay compensation to its pensioners and those with pension entitlements in the form of a one-off payment for their vested company pension rights. A total amount of €0.4 million (2007: €69.6 million) was paid out.

Other provisions cover all identifiable risks and other contingent liabilities. The main items covered are the cost of warranties and potential risks (€27.0 million), discounts and price reductions (€16.0 million), provisions for staff costs and social insurance (€36.9 million) and provisions for impending losses (€10.2 million). In addition, provisions for personnel restructuring of €10.2 million has been set up in the reporting year.

Write-downs/provisions for impending losses in relation to orders on hand (firm orders) at the balance sheet date were recognised on the basis of full costs. Valuation of further anticipated engine orders arising from long-term supply agreements or framework agreements on the basis of variable costs did not give rise to the need for additional provisions.

It is not possible to make a meaningful calculation of a potential shortfall in coverage at full costs due to the variable contract structure for long-term supply agreements and framework agreements.

## 9. LIABILITIES

	Thereof residual maturity	Thereof residual maturity	Thereof residual maturity	31/12/2008 Total	31/12/2007 Total	Thereof residual maturity up to 1 year
	up to 1 year	1 to 5 years	over 5 years			
<b>€thousand</b>						
Convertible bonds	0	0	0	0	2,853	2,853
Bond (USPP)	0	40,353	162,884	203,237	203,237	0
Liabilities to banks	417	0	0	417	1,960	1,690
Trade payables	117,367	0	0	117,367	170,037	170,037
Liabilities to affiliated companies	18,137	0	5,615	23,752	22,078	15,923
Liabilities arising from taxes	40	0	0	40	52	52
Liabilities relating to social security	977	0	0	977	1,049	1,049
Sundry other liabilities	12,504	311	0	12,815	18,395	17,798
<b>Total</b>	<b>149,442</b>	<b>40,664</b>	<b>168,499</b>	<b>358,605</b>	<b>419,661</b>	<b>209,402</b>

### Bond (US private placement)

DEUTZ AG issued bonds worth US\$ 274 million (€203 million) in 2007 as part of a private placement in the United States and recognised them at cost. The placement was completed on 16 July 2007. The bonds – which carry maturities of five, seven and ten years – were purchased by US institutional investors. Around 20 per cent of the total volume was taken up directly in euros (€43.0 million), with the remainder in US dollars (US\$ 216.1 million) hedged in euros. Terms to maturity are four, six and nine years and the euro tranche has coupons of between 5.22 per cent and 5.27 per cent. Coupons for the US dollar tranche range from 5.89 per cent to 6.12 per cent.

Liabilities to affiliated companies as well as liabilities to long-term investees and investors include trade payables in an amount of €0 thousand (2007: €4,845 thousand), after setting off corresponding receivables.

The usual industry retention of title arrangements apply to trade payables.

## 10. DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments (currency forwards, currency options, interest-rate swaps) are used exclusively for hedging purposes in the context of operating activities.

The portion of the fair value changes recognised in profit or loss in the amount of €1.6 million (2007: €1.6 million) was reported in other provisions and is attributable to the measurement of commodity swaps (2008: €1.1 million; 2007: €0.8 million) and to currency hedging (2008: €0.5 million; 2007: €0.8 million).

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

	Notional amount 2008	Notional amount 2007	Fair value 2008	Fair value 2007
€ million				
Currency forwards	53.7	57.0	-1.2	1.9
Cross-currency swap	160.2	160.2	8.5	-7.8
Commodities	15.4	7.0	-1.1	-0.8

Bank assessments were used where available to ascertain fair value. The banks calculate the market values using a recognised valuation method (present value method) based on current market interest rates and foreign exchange rates.

## 11. CONTINGENT LIABILITIES AND OTHER FINANCIAL OBLIGATIONS

### Contingent liabilities

	2008	2007
€ thousand		
Liabilities on endorsed bills of exchange	2,626	2,478
Liabilities on guarantees	29,093	40,595
thereof for affiliated companies	27,616	30,682
Liabilities on warranties	1,974	11,174
thereof for affiliated companies	261	54
<b>Total</b>	<b>33,693</b>	<b>54,247</b>

### Other financial obligations

At 31 December 2008, DEUTZ AG had total other financial obligations of €84.7 million (31 December 2007: €104.3 million) that were neither reported on the balance sheet nor included under contingent liabilities. Of that total, €1.7 million (31 December 2007: €1.7 million) was due to affiliated companies.

These obligations relate to leases with a nominal value of €25.1 million (31 December 2007: €29.6 million), commitments to purchase property, plant and equipment and intangible assets amounting to €30.6 million (31 December 2007: €36.7 million), and commitments to purchase inventories amounting to €29.0 million (31 December 2007: €35.0 million).

DEUTZ AG's obligations under leases were offset by receivables of €0.4 million (31 December 2007: receivables of €0.3 million).

## 12. PENDING AND POTENTIAL LEGAL DISPUTES

DEUTZ AG is involved in a number of legal disputes and arbitration proceedings, mainly in relation to claims of defective performance, consequential losses resulting from defects and claims for damages.

Provisions have been recognised to cover the risks arising from this litigation.

At present it is not possible to predict the outcome of these pending cases with any degree of certainty. We do not expect them to have a significantly adverse impact on the net assets, financial position or results of operations of DEUTZ AG.

### 13. REVENUE

#### Breakdown by segment

	2008	2007
€ million		
Engines	1,003.5	1,057.4
Services	89.3	80.0
<b>DEUTZ Compact Engines</b>	<b>1,092.8</b>	<b>1,137.4</b>
Engines	225.2	209.7
Services	99.0	96.0
<b>DEUTZ Customised Solutions</b>	<b>324.2</b>	<b>305.7</b>
<b>Total</b>	<b>1,417.0</b>	<b>1,443.1</b>

#### Breakdown by region

	2008	2007
€ million		
<b>Europe/Middle East/Africa</b>	<b>1,164.7</b>	<b>1,155.4</b>
thereof Germany	364.7	335.9
thereof Europe	725.0	740.3
thereof Africa	39.3	35.5
thereof Middle East	35.7	43.7
<b>Americas</b>	<b>144.7</b>	<b>174.0</b>
<b>Asia-Pacific</b>	<b>107.6</b>	<b>113.7</b>
<b>Total</b>	<b>1,417.0</b>	<b>1,443.1</b>

### 14. CHANGE IN INVENTORIES AND OTHER OWN WORK CAPITALISED

#### Change in inventories

	2008	2007
€ thousand		
Inventories as at 1 January	45,028	31,897
Inventories as at 31 December	44,892	45,028
<b>Change in inventories</b>	<b>-136</b>	<b>13,131</b>

Other **own work** capitalised amounted to €0.7 million (2008: €0.4 million).

## 15. OTHER OPERATING INCOME

Other operating income comprises, amongst other things, income from other services including cost transfers within the Group for administrative expenses, income from the reversal of provisions, foreign currency gains, income from the reversal of write-downs and miscellaneous operating income.

Other operating income includes income from other accounting periods resulting from the reversal of miscellaneous provisions amounting to €8.8 million (2007: €11.4 million) and the reversal of write-downs amounting to €2.1 million (2007: €12.9 million).

## 16. COST OF MATERIALS

	2008	2007
€ thousand		
Cost of raw materials, consumables and purchased merchandise	1,005,621	1,000,744
Cost of services procured	58,186	42,438
<b>Total</b>	<b>1,063,807</b>	<b>1,043,182</b>

## 17. STAFF COSTS

	2008	2007
€ thousand		
Wages and salaries	201,314	196,248
Social security contributions and other employee benefits	35,758	34,697
Pensions and other post-retirement benefits	1,914	6,036
<b>Total</b>	<b>238,986</b>	<b>236,981</b>

## Average number of employees during the year

	2008	2007
Non-salaried employees	2,408	2,323
Salaried employees	1,299	1,187
Trainees	164	161
<b>Total</b>	<b>3,871</b>	<b>3,671</b>

## 18. DEPRECIATION AND AMORTISATION

	2008	2007
€ thousand		
Expenses for the expansion of operations	10,379	10,378
Intangible fixed assets	11,275	9,695
Property, plant and equipment	40,161	43,472
<b>Total</b>	<b>61,815</b>	<b>63,545</b>

## 19. OTHER OPERATING EXPENSES

Other operating expenses comprise, in particular, expenses for services, necessary risk provisions for pending transactions and warranties, the cost of rentals and leases, administrative and selling expenses including freight costs and commission, foreign currency losses, and losses and expenses arising from write-downs of current assets excluding inventories.

## 20. NET INVESTMENT INCOME

	2008	2007
€ thousand		
Income from profit transfer agreements	1,567	1,490
Income from long-term equity investments		
in affiliated companies	11,876	11,056
in other companies	967	822
<b>Total</b>	<b>14,410</b>	<b>13,368</b>

## 21. NET INTEREST EXPENSE

	2008	2007
€ thousand		
Income from other securities and lending of financial fixed assets	1,850	1,854
thereof received from affiliated companies	1,782	1,782
Other interest and similar income	24,267	12,911
thereof received from affiliated companies	3,293	4,707
Other interest and similar expenses	-34,157	-28,988
thereof owed to affiliated companies	-2,023	-2,158
<b>Total</b>	<b>-8,040</b>	<b>-14,223</b>

## 22. NET EXTRAORDINARY EXPENSE

	2008	2007
€ thousand		
Extraordinary income	0	119,515
Extraordinary expenses	-17,832	0
<b>Total</b>	<b>-17,832</b>	<b>119,515</b>

Provisions amounting to €10.2 million were recognised at year end due to the necessity of making staff adjustments. In addition, impairment losses were recognised on property, plant and equipment and intangible assets (€1.3 million) and in connection with the scrapping of inventory, mainly due to discontinuation of a series in the low power range (< 4 litres). In addition, the continuing process in relation to the disposal of DEUTZ Power Systems to 3i resulted in further extraordinary expenses of €5.0 million in financial year 2008, taking into account the provisions recognised in connection with the disposal and other countervailing effects.

## 23. INCOME TAXES

In financial year 2008, reversals of tax provisions recognised for previous periods resulted in income of €4.2 million.

## 24. OTHER INFORMATION

### Corporate governance

In December 2008, the Management Board and the Supervisory Board of DEUTZ AG issued a declaration of compliance with the recommendations of the German Corporate Governance Code government commission as amended on 14 June 2007 and 6 June 2008 pursuant to section 161 of the AktG and made this declaration permanently available to shareholders on the Company's website (<http://www.deutz.com>).

### Auditors' fees

The following fees were recognised as an expense in 2008 and 2007:

	2008	2007
€ thousand		
Auditing	354	210
Other advisory and attestation services	525	119
Other services	6	0
<b>Total</b>	<b>885</b>	<b>329</b>

### Total remuneration paid to the Board of Management, former members of the Board of Management, and the Supervisory Board

**Board of Management** The following table shows the breakdown of total remuneration for members of the Board of Management:

		Fixed remuneration	Variable remuneration	Other <sup>1)</sup>	Total	Number of virtual share options granted	Fair value at grant date
€ thousand							
Dr Helmut Leube	2008	619	550	168	1,337	225,000	760
(since 1 February 2008)	2007	0	0	0	0	0	0
Gino Mario Biondi	2008	450	65	155	670	60,000	178
(since 1 September 2007)	2007	150	60	50	260	0	0
Karl Huebser	2008	450	270	229	949	0	0
	2007	450	300	433	1,183	0	0
Helmut Meyer	2008	450	202	154	806	60,000	178
	2007	418	305	152	875	60,000	204
Gordon Riske	2008	0	0	0	0	0	0
(until 30 September 2007)	2007	408	548	125	1,081	0	0
<b>Total</b>	<b>2008</b>	<b>1,969</b>	<b>1,087</b>	<b>706</b>	<b>3,762</b>	<b>345,000</b>	<b>1,116</b>
<b>Total</b>	<b>2007</b>	<b>1,426</b>	<b>1,213</b>	<b>760</b>	<b>3,399</b>	<b>60,000</b>	<b>204</b>

<sup>1)</sup> including payment of life insurance premiums

Remuneration paid to former members of the Board of Management and their surviving dependants amounted to €1,482 thousand (2008: €1,438 thousand) for DEUTZ AG and the Group; a provision of €12,799 thousand (31 December 2008: €13,437 thousand) has been recognised to cover pension obligations to these persons.

**Supervisory Board** The following table shows the breakdown of total remuneration paid to members of the Supervisory Board:

	Fixed remu- neration	Meeting attendance fees	Total
€			
Dr Giuseppe Vita Chairman	25,000	30,000	55,000
Werner Scherer Deputy Chairman	18,750	24,000	42,750
Ing Massimo Bordi	12,500	7,000	19,500
Dr Francesco Carozza (since 21 May 2008)	7,684	3,000	10,684
Prof Klauf-Otto Fruhner (until 21 May 2008)	4,816	3,000	7,816
Reinhold Götz (until 21 May 2008)	4,816	3,000	7,816
Michael Haupt	12,500	21,000	33,500
Dr Helmut Lerchner	12,500	5,000	17,500
Lars-Göran Moberg <sup>1)</sup> (since 21 May 2008)	7,684	3,000	10,684
Helmut Müller	12,500	6,000	18,500
Karl-Heinz Müller	12,500	10,000	22,500
Dr Witich Roßmann	12,500	6,000	18,500
Susanne Scholtyssek (since 21 May 2008)	7,684	3,000	10,684
Prof Dr Marco Vitale (until 21 May 2008)	4,816	1,000	5,816
Egbert Zieher	12,500	6,000	18,500
<b>Total</b>	<b>168,750</b>	<b>131,000</b>	<b>299,750</b>

<sup>1)</sup> including remuneration of €50 thousand for consulting services

#### **Advances and loans to members of the Board of Management and the Supervisory Board**

As at 31 December 2008 there were no outstanding advances or loans to any members of the Board of Management or the Supervisory Board, nor had any guarantees or other warranties been issued in favour of any such persons.

#### **Shareholdings**

The principal shareholdings of DEUTZ AG are listed in the appendix to the notes to the financial statements on page 50. Full disclosure of shareholdings is published in the electronic German Federal Gazette.

### **Supervisory Board and Board of Management**

Information on the members of the Supervisory Board and the Board of Management, including directorships held at other companies, is given in a separate list on pages 51-54.

Cologne, 19 February 2009

DEUTZ Aktiengesellschaft  
The Board of Management

Dr Helmut Leube

Karl Huebser

Gino Mario Biondi

Helmut Meyer

## SHAREHOLDINGS OF DEUTZ AG

As at 31 December 2008

Ref. No.	Name and registered office of the company	Holding (%)	Equity (€thousand)	Net income (€thousand)
1	DEUTZ AG	-	441,722	-7,392

### Affiliated companies

#### Germany

2	Unterstützungsgesellschaft mbH der DEUTZ Aktiengesellschaft, Cologne	100.0	26	0
3	Deutz- Mülheim Grundstücksgesellschaft mbH, Düsseldorf	19.6	-3,171	-139
4	DEUTZ Beteiligung GmbH, Cologne	100.0	25	4

#### Outside Germany

5	DEUTZ DITER S.A., Zafra/Spain	100,0	13,844	-1,542
6	DEUTZ FRANCE S.A., Gennevilliers/France	100,0	12,732	1,242
7	DEUTZ UK Ltd., Cannock/UK	100,0	12,784	12,150
8	Nlle Ste MAGIDEUTZ S.A., Casablanca/Morocco	100,0	1,863	521

#### Americas

9	Deutz Corporation, Atlanta/USA	100,0	23,982	-2,545
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#### Asia-Pacific

10	DEUTZ Asia-Pacific (Pte) Ltd., Singapore/Singapore	100,0	4,625	1,568
11	Deutz Australia (Pty) Ltd., Braeside/Australia	100,0	4,346	287

#### Associates

#### Outside Germany

12	D. D .Power Holdings (Pty) Ltd., Elandsfontein/South Africa	30.0	8,225	5,079
13	DEUTZ AGCO MOTORES S.A., Haedo/Argentina	50.0	5,536	487
14	DEUTZ (Dalian) Engine Co., Ltd., Dalian/China	50.0	100,513	-15,902

## SUPERVISORY BOARD

### **Dr Giuseppe Vita**

Chairman

Chairman of the Supervisory Board of Axel Springer AG, Berlin

- a) Axel Springer AG, Berlin, Chairman  
HUGO BOSS AG, Metzingen, Chairman  
(until 30 June 2008)  
Vattenfall Europe AG, Berlin (until 19 June 2008)
- b) Allianz S.p.A., Milan, Italy, Deputy Chairman  
Gruppo Banca Leonardo, Milan, Italy, Chairman  
Barilla S.p.A., Parma, Italy  
Humanitas S.p.A., Milan, Italy

### **Werner Scherer<sup>1)</sup>**

Deputy Chairman

Chairman of the Group Works Council Cologne and of the Joint Works Council of DEUTZ AG, Cologne

### **Ing Massimo Bordi**

CEO of SAME DEUTZ-FAHR Group S.p.A., Treviso, Italy

- b) SAME DEUTZ-FAHR ITALIA S.p.A., Treviso, Italy  
SAME DEUTZ-FAHR Group S.p.A., Treviso, Italy

### **Dr Francesco Carozza**

(since 21 May 2008)

Vice President of SAME DEUTZ-FAHR ITALIA S.p.A., Treviso, Italy

- a) SAME DEUTZ-FAHR DEUTSCHLAND GmbH, Lauingen, Chairman
- b) SAME DEUTZ-FAHR INDIA Private Ltd., Ranipet, India, Chairman  
SAME DEUTZ-FAHR Trading (Dalian) Co. Ltd., Dalian, China  
SAME DEUTZ-FAHR Group S.p.A., Treviso, Italy  
SAME DEUTZ-FAHR Agricultural Machinery (Dalian) Co. Ltd., Dalian, China,  
Deputy Chairman  
I.T. International Transmissions S.A., Stabio, Switzerland, Chairman

### **Professor Klaus-Otto Fruhner**

(until 21 May 2008)

CEO of K.O.F.-Projektberatung GmbH, Cologne

### **Reinhold Götz<sup>1)</sup>**

(until 21 May 2008)

2. Deputy Chief Executive of IG Metall Administrative Office Mannheim, Mannheim

- a) MVV-Energie AG, Mannheim  
MWM GmbH, Mannheim
- b) Stadt Mannheim Beteiligungsgesellschaft mbH, Mannheim  
Sparkasse Rhein-Neckar-Nord, Mannheim

### **Michael Haupt**

Former member of the Group Board of SKF AB, Gothenburg, Sweden

**Dr Helmut Lerchner**

Management consultant

a) ElringKlinger AG, Dettingen/Erms, Chairman

**Lars-Göran Moberg**

(since 21 May 2008)

Management consultant and Supervisory Board member, Stockholm, Sweden

b) Haldex AB, Stockholm, Sweden,  
Volvo Construction Equipment NV, Beesd, Netherlands  
Volvo Aero AB, Trollhättan, Sweden

**Helmut Müller<sup>1)</sup>**

Chairman of the Senior Staff Committee of DEUTZ AG, Cologne

**Karl-Heinz Müller<sup>1)</sup>**

Deputy Chairman of the Joint Works Council of DEUTZ AG, Cologne

**Dr Witich Roßmann<sup>1)</sup>**

Chief Executive of IG Metall Cologne, Cologne

a) Ford Werke GmbH, Cologne  
Ford Holding Deutschland GmbH, Cologne

**Susanne Scholtyssek<sup>1)</sup>**

(since 21 May 2008)

Head of Personnel Development at IG Metall Cologne, Cologne

**Professor Dr Marco Vitale**

(until 21 May 2008)

President of Vitale-Novello & Co SRL, Milan, Italy

b) SAME DEUTZ-FAHR ITALIA S.p.A., Treviglio, Italy, Chairman  
BANCA POPOLARE DI MILANO, Milan, Italy  
C. BORGOMEIO & CO. SRL, Rome, Italy  
CONNECT SUD S.r.l., Palermo, Italy  
VINCENZO ZUCCHI S.p.A., Milan, Italy

**Egbert Zieher<sup>1)</sup>**

Chairman of the Ulm Works Council of DEUTZ AG, Ulm

<sup>1)</sup> Employee representatives 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**

Dr Giuseppe Vita, Chairman  
Werner Scherer, Deputy Chairman  
Michael Haupt

### **Audit Committee**

Michael Haupt, Chairman  
Werner Scherer, Deputy Chairman  
Karl-Heinz Müller  
Dr Giuseppe Vita

### **Arbitration Committee**

(Section 27 (3) German Codetermination Act (MitbestG))

Dr Giuseppe Vita, Chairman  
Michael Haupt  
Karl-Heinz Müller (until 21 May 2008)  
Werner Scherer  
Egbert Zieher (since 21 May 2008)

### **Nominations Committee**

Dr Giuseppe Vita, Chairman  
Michael Haupt  
Ing Massimo Bordi

## BOARD OF MANAGEMENT

### **Dr Helmut Leube (55)**, Hersching a.A.

(since 1 February 2008)

Chairman

Market and Product Lines

a) KUKA AG, Augsburg

b) Deutz Corporation, Atlanta, USA, Chairman (since 1 August 2008)

DEUTZ (Dalian) Engine Co. Ltd., Dalian, China, Deputy Chairman (since July 2008)

### **Gino M. Biondi (49)**, Brombach

Research and Development, Procurement, Logistics and Production

b) DEUTZ (Dalian) Engine Co. Ltd., Dalian, China

DEUTZ DITER S.A., Zafra, Spain, Chairman (since 8 October 2008)

### **Karl Huebser (63)**, Rottach-Egern

Overall responsibility for Asia

b) DEUTZ DITER S.A., Zafra, Spain, Chairman (until 8 October 2008)

DEUTZ (Dalian) Engine Co. Ltd., Dalian, China

Weifang Weichai Deutz Diesel Engine Co. Ltd., Weifang, China, Chairman

### **Helmut Meyer (59)**, Düsseldorf

Finance, Human Resources and Service

b) DEUTZ Corporation, Atlanta/USA, Chairman (Chairman until 1 August 2008)

DEUTZ Asia-Pacific (Pte) Ltd., Singapore, Singapore, Chairman

DEUTZ (Dalian) Engine Co. Ltd., Dalian, China

DEUTZ UK Ltd., Cannock/UK

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

# Miscellaneous

## RESPONSIBILITY STATEMENT

"To the best of our knowledge, and in accordance with the applicable accounting principles, the annual financial statements give a true and fair view of the net assets, financial position and results of operations of DEUTZ AG, and the management report presents a true and fair view of the development and performance of the business and the position of DEUTZ AG, together with a description of the principal opportunities and risks associated with the expected development of the DEUTZ AG."

Cologne, 19 February 2009

DEUTZ Aktiengesellschaft  
The Board of Management

Dr Helmut Leube

Karl Huebser

Gino Mario Biondi

Helmut Meyer

## AUDIT OPINION

We have audited the annual financial statements - comprising the balance sheet, the income statement and the notes to the financial statements - together with the bookkeeping system, and the management report of DEUTZ Aktiengesellschaft, Cologne/Germany, for the business year from 1 January to 31 December 2008. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's Board of Directors. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and on the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § 317 HGB ("German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer. 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 annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company 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 books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Board of Directors, as well as evaluating the overall presentation of the annual financial statements and 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 annual financial statements of DEUTZ Aktiengesellschaft, Cologne/Germany, comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Düsseldorf, 11 March 2009  
Deloitte & Touche GmbH  
Wirtschaftsprüfungsgesellschaft

signed: Crampton  
Wirtschaftsprüfer  
(German Public Auditor)

signed: Lammers  
Wirtschaftsprüferin  
(German Public Auditor)