New Drive

Financial statements and management report

DEUTZ AG 2009

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DEUTZ AG 2009

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Management report

OVERVIEW OF 2009

DEUTZ SUCCESSFULLY OVERCOMES THE CHALLENGES POSED BY THE CRISIS IN 2009

Global economic crisis The collapse of the Lehman Brothers investment bank in September 2008 was the trigger that caused the economic crisis, which had begun as a banking crisis, to spread to the real economy. In the first quarter of 2009, the German economy contracted by over 13 per cent compared with the previous quarter, the worst crisis since the 1920s and unprecedented in post-war history.

Dramatic slump in business Business performance fell well short of our original forecasts. Revenue and unit sales more than halved.

Capacity adjustment In response to the extremely sharp downturn, we adjusted production capacity as quickly as possible. At an early stage, we initiated an action plan – in the form of the MOVE restructuring programme – to cut costs and increase efficiency. This also included measures to reduce the workforce. Back in January 2009, we introduced extensive short-time working. We also terminated temporary employment contracts, did not renew fixed-term contracts when they expired and introduced early retirement schemes. Within a short period of time, we were able to make staff savings roughly equivalent to the cost of 25 per cent of our workforce and in a manner that minimised the impact on staff as far as possible. In a second stage, the workforce was reduced by a further 600 as part of a redundancy scheme. Again, we were able to achieve most of these job cuts in a socially responsible manner. Nevertheless, we were still unable to compensate in full for the contraction in volume with the result that DEUTZ AG reported a significant operating loss (EBIT) of €91.0 million.

Challenges surmounted Given the economic crisis in 2009, the order of the day was to scale back inventories and ensure the necessary liquidity. We achieved impressive results in this regard.

Inventories were almost halved, there was even a slight increase in liquidity and capital expenditure remained high.

Our equity ratio remains at a high level. The economic situation jeopardised our ability to comply with the financial covenants that form part of our funding arrangements. We therefore instigated negotiations as soon as possible with our US investors. We have now taken a significant step towards a long-term restructuring of our funding following the fundamental agreements we have now reached with our bankers and the investors. Considerable cash resources continue to be required for research and development, but we have been able to place ourselves in an excellent position to begin the financial year in 2010 with new vigour.

STRUCTURE AND OPERATING ACTIVITIES

OPERATING SEGMENTS AND PRODUCT RANGE

As an independent manufacturer of compact diesel engines with outputs of between 19kW and 500kW for both on-road and non-road applications[1], DEUTZ provides the power that people need for professional and mobility purposes.

DEUTZ AG's operating activities are divided into two segments: DEUTZ Compact Engines and DEUTZ Customised Solutions. The DEUTZ Compact Engines segment comprises liquid-cooled engines with capacities of less than four litres and engines with capacities of four to eight litres, while the DEUTZ Customised Solutions segment focuses on air-cooled engines and large liquid-cooled engines with capacities of more than eight litres. DEUTZ's field of activity covers development, design, production, sales and services for diesel engines that are cooled by water, oil or air.

Our range of products covers 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.

We round off this product range by offering complementary services that are closely aligned with our customers' needs and, to this end, are constantly being expanded. We guarantee a reliable supply of spare parts and help our customers to repair, service and maintain their DEUTZ vehicles and equipment. For this purpose the Company possesses a global service network consisting of its own subsidiaries and service centres, together with authorised agents. A key component of our 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.

Legal structure and production sites

DEUTZ maintains a strong international presence in a globalised market. DEUTZ customers are supported by nine distribution companies, nine sales offices and over 800 sales and service partners in more than 130 countries around the world. DEUTZ AG is the executive parent company in the DEUTZ Group; it is headquartered in Cologne, Germany, and has various domestic and foreign subsidiaries. The subsidiaries include a production facility in Spain and several companies that perform sales and service functions. DEUTZ also has two joint ventures in China – DEUTZ (Dalian) Engine Co., Ltd. and Weifang Weichai-Deutz Diesel Engine Co., Ltd. – and one in Argentina, DEUTZ AGCO MOTORES S.A. We therefore have a presence in the rapidly growing Chinese market.

Page 55 of the annex to the notes to the financial statements lists the principal shareholdings of DEUTZ AG as at 31 December 2009.

MARKET AND COMPETITIVE ENVIRONMENT

The global market for diesel engines is divided into several market segments that are defined by both technical and industrial criteria. A large sub-segment consists of diesel engines for passenger cars and small commercial vehicles up to a permissible gross weight of around 3.5 tonnes. Diesel engines for these applications are much lighter, are designed to bear smaller loads and always operate at higher speeds than the engines that DEUTZ manufactures for professional applications such as construction equipment, agricultural machinery, pumps, gensets, and medium-weight and heavy trucks and buses.

This much smaller market segment can itself be broken down into two further segments. First, a technically highly sophisticated segment with engine outputs between 19kW and 560kW in countries with very stringent environmental

[1])
On-road applications are defined as engine-powered commercial vehicles licensed for use on public roads, while non-road applications are engine-powered equipment that is not licensed for use on public roads.

standards, i.e. ones that prescribe low noise and exhaust emissions. Secondly, a segment based on older technology in countries with less demanding emissions standards that is dominated by very simple and inexpensive engines that are mainly manufactured in Asia and eastern Europe in what are often outdated production facilities.

The technically sophisticated segment comprises the following two markets: the captive market, which is virtually inaccessible to engine suppliers and in which the equipment manufacturers also produce their own engines, and the non-captive market, where the equipment manufacturers buy engines from other suppliers. It is in this technically advanced non-captive market that DEUTZ sells its high-quality engines around the globe. The only market in which DEUTZ does not offer any products is the North American commercial vehicles market, while the South American market is also largely closed, and DEUTZ only operates in the latter with a very restricted product range sold via its joint venture in Argentina.

In addition to DEUTZ, other engine providers from western Europe, North America and Japan are also major players in the non-captive engines market relevant to DEUTZ. Although the product ranges from these competitors are of a comparable technical standard, they are not identical to the range of products manufactured by DEUTZ. They differ significantly in some cases, especially in terms of the power outputs they cover and the products and services they offer for various application segments. Against this background of competition, DEUTZ has attained an outstanding position as one of the biggest suppliers in recent years.

DEUTZ AG BUSINESS PERFORMANCE

ECONOMIC ENVIRONMENT

First signs in Q4 of the anticipated upturn The global economic crisis that began in the second half of 2008 continued in the first six months of 2009. The first quarter of 2009, in particular, saw a sharp drop in figures compared with the first quarter of 2008 – a trend reflected in the main economic indicators across almost all regions and sectors of the economy. The downward momentum only began to ease in the second quarter before finally bottoming out in the third quarter both in the euro zone and in the USA – despite the weakness in the western industrialised countries caused by the summer holiday period. This recovery also continued in major markets, with the exception of Japan.

Sharp decline still the main feature of 2009 as a whole Just a glimpse at the economic data[2] highlights the extent to which the global economy continued to find itself in the grip of recession in 2009: gross domestic product (GDP) throughout the world was down 1.1 per cent year on year, capital spending was down 9.3 per cent and exports were down 12.2 per cent. GDP growth in Asia – excluding Japan – slowed to just 5.4 per cent, but the impact on the western industrialised countries was particularly hard: in the USA, GDP fell by 2.5 per cent, capital spending by 23.9 per cent, exports by 10.4 per cent and industrial output by 7.0 per cent. The contraction in GDP was even greater in the countries of the European Monetary Union at 3.9 per cent. These countries also saw their capital spending fall by 10.4 per cent and exports by 14.0 per cent. The significant dependency of the euro zone on exports was highlighted by the substantial drop in industrial output of 14.5 per cent. Germany, for many years the world's number one exporter, was one of the worst hit: GDP in DEUTZ AG's single largest market shrank by 4.9 per cent, capital spending by 8.3 per cent and exports by 14.8 per cent This had an enormous impact on industrial output, which plunged by 16.0 per cent.

Varying impact on DEUTZ customer industries The effects of the recession on our principal customer industries varied from sector to sector: EU-wide production of heavy trucks with a permissible gross weight of more than 3.5 tonnes plummeted by 66.4 per cent[3] in the year under review. The impact on engineering[4] was similar with global revenue in this sector declining by 19.0 per cent. Regional trends in engineering reflected the general trends in economic performance: whereas China still managed to generate a 10.0 per cent revenue increase, revenue in the USA and in western Europe fell by 25.0 per cent in both cases, and in Germany by 23.1 per cent. Germany's construction equipment industry was worse affected than the global average with revenue declining by 45.0 per cent and new orders by as much as 50.0 per cent. However, the impact was noticeably less severe on the German agricultural machinery sector where revenue was down by 25.0 per cent.

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[2]) Sources: Deutsche Bank AG, Economic Research Bureau Frankfurt

[3]) Source: European Automobile Manufacturers' Association (ACEA), Brussels

[4]) Source: German Engineering Federation (VDMA), Frankfurt

Global downturn in diesel engines market in 2009 The same trends were apparent from research for the global engines sector[5] carried out by Power Systems Research (PSR), an international market research organisation: unit sales of engines in this market[6], which is critical as far as DEUTZ is concerned, declined by approximately 24 per cent compared with 2008. The USA and Europe were hit particularly hard with a decrease in unit sales of approximately 39 per cent and 30 per cent respectively. Even the fast-growing Asian countries had to cope with a contraction of 13 per cent in the market for compact diesel engines used for industrial applications. The decline in unit sales of engines for medium-heavy commercial vehicles was particularly high at 42 per cent, followed by engines for marine applications, down approximately 32 per cent, and engines for mobile machinery down 25 per cent; the market for agricultural machinery diesel engines shrank by around 16 per cent. Regional differences were also apparent in the individual application segments: the drop in unit sales of engines was particularly severe in mobile machinery – unit sales were down by almost 41 per cent in the USA and approximately 33 per cent in Europe. In both cases, the contraction was far greater than the global average.

Reductions in inventories compound the negative effects In the year under review, reductions in inventory levels over the entire supply chain also compounded the effects of the sharp fall in demand caused by the economic conditions. Firstly, the trade was selling construction equipment, tractors and commercial vehicles held in stock before placing new orders. Secondly, equipment manufacturers themselves were scaling back their inventories of finished engines and equipment. The same also applied to the engine inventories held by the manufacturers' distribution organisations. All these inventories were reduced to an absolute minimum in order to achieve optimum inventory management from a business performance perspective with the result that only a proportion of actual market demand filtered through to the suppliers. The longer the supply chain to the market, the greater this effect: reductions in inventories over the supply chain in the year under review therefore had a significant impact on component suppliers such as DEUTZ, who are located up to five stages in the chain away from the end customer. The relevant market studies do not really take into account these supply chain effects, just as they do not take into account the compounding or compensating effects arising from the differences in individual company focus between the various regions, application segments and power output categories.

IMPACT OF ECONOMIC CONDITIONS ON BUSINESS PERFORMANCE

Europe (excluding Germany) was once again our most important market in 2009. We sold 65,859 engines in this region in 2009 (2008: 123,060 units), accounting for 58.9 per cent of our total unit sales of engines (2008: 49.1 per cent). Although unit sales in the first nine months were more than 50 per cent down on the same period in 2008, we did see an improvement in the fourth quarter of 2009: unit sales figures for Europe (excluding Germany) at 19,841 engines were only slightly below the figures for Q4 2008 (21,081 engines). This provided proof positive that the economic recovery, which already started to appear around mid-year in the euro zone and boosted economic output, had also reached DEUTZ.

As far as unit sales in the individual application segments are concerned, Agricultural Machinery stood out as the exception: unit sales in this segment 'only' fell by approximately 21 per cent in 2009, whereas sales volume in Mobile Machinery, for example, plummeted by around 71 per cent.

This confirmed our long-standing experience that the effects of economic cycles are felt later in agricultural machinery than in other engineering application segments; the changes, both positive and negative are also less extreme. We see this as a compelling reason to continue expanding our market position in the agricultural sector in future. We will be launching two new engine series with capacities of less than four litres that are due to go into series production in 2011 and 2012. This means that we will continue to offer engines that are designed to be used in tractors as well as in industrial applications.

Uptrend in revenue at the end of the year The revenue earned by DEUTZ AG in 2009 fell by over 40 per cent to €795.5 million owing to the global economic crisis. We had generated revenue of €1,417.0 million in 2008. However, the uptrend in the fourth quarter of 2009 shows that we have overcome the worst: the last three months were the strongest quarter in 2009 in terms of revenue. Revenue was up by almost 18 per cent on the third quarter, even if it was still approximately 28 per cent down year on year.

Revenue in Europe higher towards year-end The sharp fall in revenue was not equally pronounced everywhere, as

[5]) Sources: Power Systems Research (PSR), internal figures

[6]) Global market for diesel engines adjusted for regions, application segments, technology segments and power output classes not relevant to DEUTZ

illustrated by a breakdown of revenue by region. We were hit hardest by the decrease in our most important market: revenue in Europe (excluding Germany) fell by 39.6 per cent during the reporting year from €725.0 million (2008) to €438.2 million (2009). The good news was that, with the increase in unit sales in the final quarter of 2009, the European revenue generated outside Germany increased again, approaching the level of 2008.

The revenue earned from the German market during the reporting year fell by 44.5 per cent to roughly €202.4 million, while revenue from the Americas market plunged by 70.3 per cent to approximately €43 million. In contrast, the deterioration in the Asia-Pacific market was less severe, with revenue generated from this region declining by 36.9 per cent to €67.9 million.

Encouraging trend driven by construction equipment The application segment most severely affected by the low level of construction activity was our Mobile Machinery business – our strongest revenue driver – because construction equipment accounts for the largest component of this segment. The revenue generated in this application segment in 2009 plunged by two-thirds to only €169.8 million (2008: €505.3 million). However, we are turning the corner. There was a significant recovery in the construction equipment business in the fourth quarter of 2009: revenue was 58.8 per cent up on Q3, although still just under 22 per cent down year on year. The German Engineering Federation (VDMA) has confirmed this trend, commenting: "Recent year-on-year comparisons of new order volumes have become increasingly encouraging as each month has passed. […] Construction equipment is the main driver of the positive current trend."

PROCUREMENT

Purchasing managers faced with new challenges In common with all other areas of the organisation, DEUTZ's purchasing managers were faced with new challenges in 2009 as the global economic crisis affected the Company's procurement activities. Despite these tough economic conditions, we were determined to sustain our close relationships with our partners throughout the entire value chain. We achieved our objectives by cutting our costs, ensuring security of supply and – despite the financial instability of some suppliers – maintained our quality standards and averted price increases.

DEUTZ's purchasing department at head office is responsible for the procurement of forged and cast parts, components such as turbochargers and pumps and exhaust aftertreatment parts. This also includes the procurement of non-production materials. There are around 40 people working in purchasing at the Cologne-Porz site, which is the majority of the department's staff.

Falling commodity prices The international commodity markets for forged and cast parts underwent a significant downward correction in the first two quarters of 2009. Prices fell to the more normal levels they had been at before peaking in 2008. The price of cast-iron scrap, for example, fell by some 33 per cent year on year in 2009, which boosted DEUTZ's profitability.

Foundry products remain one of the main items in DEUTZ's cost of materials in 2009, followed by fuel injection equipment and measurement and control devices. A more detailed breakdown reveals that foundry products accounted for roughly 57 per cent of the total cost of materials, while fuel injection equipment accounted for 17 per cent, and measurement and control devices for 5 per cent. The remaining 25 per cent of the cost of materials was spread across generators, starters, exhaust-gas turbochargers, turned parts, sheet metal parts, standard and DIN parts, and forged parts.

Cost savings via technical improvements The idea behind our MOVE cost-cutting programme was to lower the cost of our materials and other purchased items – such as supplies and services – across DEUTZ. We achieved just under half of these total cost savings by making technical improvements, for example by reducing the complexity of components, simplifying processes or using new materials and alloys. We saved roughly the same proportion through our annual negotiations with existing suppliers on the prices of materials, supplies and related services.

PRODUCTION

Alignment of production with unit sales levels In the second half of 2008, and even more so in 2009, the Company was forced to adjust its production levels in line with the dramatic slump in its unit sales caused by the global economic crisis. DEUTZ adjusted its shift pattern as early as mid-2008, with most sites switching from three shifts to two shifts and some units even scaling back to one-shift operations. At the same time, the number of temporary staff and fixed-term workers was reduced significantly in all production units. In addition, the Company introduced short-time working at its German plants and at some international sites from December 2008 and throughout 2009 in order to bring its production capacities into line with the continuing contraction in demand without losing highly qualified core staff.

DEUTZ production system (DPS) The continuous improvement process (CIP), which we have been pushing ahead with since 2008, was stepped up and expanded in 2009. Manufacturing and assembly processes are being optimised as part of the cross-site DEUTZ production system (DPS). The established tools used include workshops on value stream mapping (VSM), the introduction of kanban processes to simplify logistical procedures and management, workshops on set-up times, and the smoothing of work flows. These measures are designed to significantly improve productivity, throughput times, inventories and delivery quality and are based on the philosophy of lean production with a focus on customers' needs and the constant optimisation of the value creation process.

Cologne plant The plants in Cologne-Porz and Cologne-Deutz assembled a total of 98,747 engines in 2009, which represented a year-on-year decrease of approximately 54.8 per cent (2008: 218,601 engines). Of this total, 71,753 engines were in the four to eight-litre category and 26,994 had capacities of less than four litres. Because this business had been hit particularly hard by the financial and economic crisis, its operations were reduced further to just a single shift in May 2009. The low level of capacity utilisation was used as an opportunity to fundamentally improve logistics processes. The establishment of DEUTZ's external just-in-sequence (JIS) assembly centre in November 2009 laid the foundations for bringing the assembly processes into line with the demands created by the growing range of product varieties on offer. By providing the materials just in time and just in sequence, this system removes logistical problems from the assembly process.

Ulm plant A total of 12,095 engines (2008: 31,444 engines) were assembled at the Ulm plant in 2009, 10,160 of which were air-cooled engines and 1,935 were water-cooled engines with capacities of more than eight litres. Capacity utilisation was some 61 per cent lower than in 2008.

New structures for even better quality The high quality of DEUTZ engines is one of the key factors in the Company's success. This was confirmed when its products were successfully re-certified to ISO 9001:2008 in the first quarter of 2009. We aim to maintain this standard, thereby meeting the increasing demands of the international market in future and taking into account the stricter statutory exhaust emission requirements. Over the past year, DEUTZ has therefore continued to work on expanding the existing quality management system into a total quality management system[7].

A major step in this direction was the reorganisation of quality management from the middle of 2009 onwards. This involved transferring responsibility for all operational quality assurance functions from the relevant departments at head office to the decentralised manufacturing and assembly units and to the purchasing and development functions, thereby ensuring that the operating units identify more closely with their quality targets and objectives. The quality system is coordinated and monitored by a TQM unit in the corporate management department at head office. Furthermore, DEUTZ AG totally redesigned its quality report (published in the fourth quarter of 2009) to make it more transparent. This will enable further measures aimed at even more quality and customer satisfaction to be identified sooner and implemented more effectively.

Further improvement in health and safety Since 2005, there has been a steady decline in the number of notifiable workplace accidents at DEUTZ. In 2009, the key indicator – the number of notifiable accidents per thousand employees[8] – again improved by around 33 per cent on the previous year. In 2009, there were 21 notifiable accidents per thousand employees compared with 33 in 2008. According to the latest available statistics from the engineering employers' liability insurance association, the number of notifiable accidents per thousand employees at DEUTZ is 56 per cent below the industry average based on figures from insurance companies.

[7]) Total quality management: a holistic approach to quality management across all business lines

[8]) Known as TMQ (*Tausend-Mann-Quote*) in German

The trend in this indicator shows that the strategies and measures we have in place to reduce workplace accidents are taking effect. These include the security-related approval of new installations, machinery and other resources and the authorisation procedure for hazardous materials.

NEW ORDERS

Business performance impaired by crisis in 2009 The global financial and economic crisis hampered the performance of DEUTZ's business in 2009 Key indicators – such as orders on hand and revenue – were significantly lower year on year. Nonetheless, the situation consolidated over the course of the year and even resulted in a significant recovery in the fourth quarter of 2009.

More orders received towards year-end New orders are a barometer of future performance: unit sales and revenue follow after some delay. The volume of new orders in 2009 contracted by roughly 39 per cent year on year to €792.3 million (2008: €1.293.1 million). However, this trend reversed towards the end of the year: the volume of new orders won in the fourth quarter grew by 7.8 per cent on the corresponding period of 2008 which, admittedly, had been fairly disappointing.

The last quarter of 2009 saw an increase in orders, primarily in Mobile Machinery. The renewed growth in orders was most particularly apparent in the construction equipment business.

Even though there was a significant upturn again in new orders in the fourth quarter with orders reaching €216.5 million – which equated to an increase of 7.8 per cent compared to Q4 2008 (2008: €200.8 million) – new orders at the end of 2009 were still only €139.4 million, approximately 4 per cent below the value at the end of 2008 (31 December 2008: €144.7 million).

UNIT SALES

Unit sales: downward trend slows from second half of the year onwards Unit sales during the reporting year fell by 55.4 per cent from 250,871 engines in 2008 to 111,881 in 2009. However, in line with the rise in new orders, there were also signs of a slight improvement in unit sales at the end of the year: in Q4 unit sales were up by as much as roughly 20 per cent on the previous quarter. Unit sales in the fourth quarter were therefore still approximately 33 per cent down on the same period in 2008, although construction equipment was only down by around 18 per cent compared with Q4 2008. The segments that suffered a particularly early and dramatic downturn appear to be the ones that are recovering the most swiftly.

RESULTS OF OPERATIONS

REVENUE

Mirroring the dramatic slump in unit sales, revenue fell sharply by €621.5 million, or 43.9 per cent, to €795.5 million in 2009 (2008: €1,417.0 million), which was the worst result of the past five years. Of the total revenue generated, €647.5 million (2008: €1,228.7 million) was attributable to engines and €148.0 million (2008: €188.3 million) to services. In the case of revenue earned from engines, the severe volume-related impact was slightly mitigated by an improved product mix and modest price increases in the market. The decrease in service revenue was a much more moderate 21.4 per cent because, when times are hard, our customers tend to invest in repairs and maintenance rather than in new engines.

The trend witnessed in the second half of the year gives us cause for optimism, because the fact that the volume of new orders exceeded our revenue in both quarters shows that we have overcome the worst. Even though total revenue for the whole year was down 43.9 per cent compared with 2008, we did see a Q4 increase of almost 18 per cent on the third quarter.

The Mobile Machinery and Stationary Equipment application segments, which are among our key revenue drivers, were hit particularly hard by the slump in revenue, reporting decreases of 66.4 per cent and 46.7 per cent respectively. These declines resulted primarily from the sharp fall in unit sales of engines with capacities of less than four litres, which are mainly used in construction equipment and compressors. In contrast, the fall in the level of revenue generated by Agricultural Machinery was significantly lower at 17.0 per cent. One of the main contributing factors here was the significantly higher revenue generated by a big-ticket customer in eastern Europe, However, this application segment experienced a slowdown in the fourth quarter, whereas in all other application segments –

primarily in the most severely affected application segment, Mobile Machinery – we experienced increases in revenue compared with the previous quarter.

The impact of the global economic crisis varied from one region to another. Our business suffered most from the downturn in the United States, where our revenue plunged by 70.3 per cent year on year in 2009, although the movement in the dollar/euro exchange rate had a slightly positive impact. The strength of the Asian economy is reflected in the 36.9 per cent drop in revenue generated by the Asia-Pacific region, a very modest decrease compared with that in the United States.

EBIT

DEUTZ launched its MOVE action programme in October 2008 which, since then, has boosted income by €136 million. MOVE improved the Company's profitability by some €126 million in 2009, in particular by lowering its operating and staff costs. By implementing structural measures, the programme will help strengthen the Company's earnings over the long term. The programme focuses on cutting overheads and the cost of materials, raising productivity and efficiency in research & development, production and quality, and on pricing products and services appropriately.

Nevertheless, MOVE was unable to fully compensate for the persistent and sharp contraction in business volumes caused by the recession. Accordingly, DEUTZ AG's EBIT in the period under review was minus €91.0 million (2008: plus €5.9 million). In addition to the sharp contraction in business volumes, investment income declined to €7.1 million (2008: €14.4 million) due to smaller dividend payments from affiliated companies, adversely affecting earnings. The rise in other operating income – especially owing to the reversal of provisions (€25.3 million) – had a slight positive impact.

Overview of the results of operations of DEUTZ AG	**2009**	**2008**
€ million		
Revenue	**795.5**	**1,417.0**
Change in inventories and other own work capitalised	-17.9	0.6
Total output	**777.6**	**1,417.6**
Other operating income	100.7	87.2
Cost of materials	-611.0	-1,063.8
Staff costs	-212.3	-248.2
Depreciation, amortisation and impairment	-54.2	-61.8
Other operating expenses	-98.9	-139.5
Net investment income	7.1	14.4
EBIT	**-91.0**	**5.9**
Net interest income/expense	-6.9	1.1
Profit (loss) from ordinary activities	**-97.9**	**7.0**
Net extraordinary expense	-25.8	-17.8
Income taxes	-7.3	4.2
Other taxes	-1.1	-0.8
Net loss	**-132.1**	**-7.4**
%		
Cost of materials as percentage of total output	78.6	75.0
Staff costs as percentage of total output	27.3	17.5

Cost of materials The cost of materials as a proportion of total output rose by 3.6 percentage points year on year. This was mainly because four to eight-litre engines – which require a large amount of materials – accounted for a higher proportion of unit sales and because there was a significant reduction in the inventories of finished goods and work in progress manufactured at comparatively higher prices. These effects were partly offset by the positive effect from lower commodity prices – the market price of foundry scrap steel fell by 22 per cent on average to around €280 per tonne in 2009.

Staff costs Targeted cuts in staff costs were achieved by reductions to the workforce and the use of short-time working. However, we were still unable to compensate in full for the contraction in volume caused by the economic situation. The staff costs ratio rose by 9.8 percentage points in 2009.

Since the first quarter of 2009 the interest cost of defined benefit pension obligations has been reported as part of staff costs. These expenses are no longer shown as part of net interest expense so that only effective interest is reported under net interest expense. This interest element amounted to €8.8 million in 2009 (2008: €9.1 million). The prior-year figures have been restated accordingly to improve comparability.

Other operating expenses Other operating expenses declined by €40.6 million to €98.9 million (2008: €139.5 million). This decrease was largely accounted for by lower expenses for general services such as logistics (including freight) and IT and the reduction in temporary staff, all of which were the consequence of the lower volume of business and of the MOVE action programme. The increased expenses arising from compensation payments for lower order volumes were more than offset.

Net interest expense Net interest expense increased by €8.0 million year on year to €6.9 million in 2009 (2008: net interest income of €1.1 million). This was primarily due to the lower level of interest received on deposits in connection with a decrease in cash and cash equivalents during the course of the year. As far as interest paid on borrowings is concerned, there was also an increase in the last quarter in the interest paid on the US private placement as a result of the suspension agreement with US investors.

Net extraordinary income/expense Extraordinary expenses in the year under review comprise, in particular, personnel restructuring costs of €19.4 million incurred in connection with the MOVE action programme and impairment losses totalling €5.6 million as a result of fixed assets being written down to fair value. The impairment losses are mainly recognised in respect of licences and resources for a series of small engines with outputs of up to 27kW and for engines with outputs between 15kW and 50kW.

Income taxes Income taxes in the year under review amounted to €7.3 million (2008: income of €4.2 million). The reasons behind the increase include the current tax expense arising from a tax audit at DEUTZ AG completed in the current year and covering the years 2002 to 2005, the current tax expense arising from the subsequent impact of this tax audit on the financial years 2006 to 2008, and an adjustment to the 2007 tax return in connection with the discontinued DEUTZ Power Systems segment.

Net income The net loss of €132.1 million overall was significantly higher year on year (2008: €7.4 million).

BUSINESS PERFORMANCE IN THE SEGMENTS

DEUTZ COMPACT ENGINES BUSINESS PERFORMANCE

Stabilisation of demand in fourth quarter In the DEUTZ Compact Engines segment, demand fell by 38 per cent in the year under review: new orders amounted to €608.5 million whereas in 2008 the figure had been €984.9 million. However, the last quarter of 2009 saw a recovery – new orders were 13.8 percent up on the same quarter in 2008. The turnaround was concentrated primarily in the Mobile Machinery and Stationary Equipment application segments. Both of these segments performed well in the fourth quarter.

Unit sales of engines halved The year under review saw a drop of more than 50 per cent in the number of engines sold: the DEUTZ Compact Engines segment sold 98,431 engines in 2009 compared with 218,709 in 2008. The impact was heaviest in the application segment with the greatest unit sales, Mobile Machinery, where unit sales plummeted by 71.2 per cent. DEUTZ only managed to sell 30,551 engines in this application segment (2008: 106,030).

Revenue consolidation for DCE The DEUTZ Compact Engines segment (DCE) generated revenue of €601.4 million in the year under review, 45.0 per cent below the figure achieved in 2008 (2008: €1,092.8 million). The trend in this segment was similar to that of DEUTZ AG as a whole: a drop in revenue of just under 40 per cent in European countries (excluding Germany), almost 50 per cent in Germany itself, and more than two thirds in the Americas. However, the fourth quarter of 2009 witnessed a significant recovery in a number of regions, with Europe (excluding Germany) recording revenue growth of 6.4 per cent.

The variation in the impact of the financial crisis on different sectors of the economy is highlighted by the following comparison: whereas construction equipment revenue in the DEUTZ Compact Engines segment was around two thirds lower in 2009 (€98.4 million compared with €295.8 million in 2008), revenue in the Agricultural Machinery application segment with its late cyclical business was down only by 17.0 per cent (2009: €154.3 million).

BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS SEGMENT

New orders: uptrend again in Q4 Lower demand, fewer orders: in the year under review, the DEUTZ Customised Solutions (DCS) segment posted order volumes of almost €184 million, 40.4 per cent down on order volumes in 2008 (2008: €308.2 million). However, there was an upturn in the fourth quarter, which was down only 8.8 per cent year on year.

Unit sales halved In the year under review, DEUTZ Customised Solutions sold 13,450 engines, over 50 per cent fewer than in 2008 (2008: 32,162 engines). Of the application segments, only Agricultural Machinery was able to hold the decline in check. In this application segment, unit sales rose slightly by 0.5 per cent to 1,879 engines in 2009 (2008: 1,869 engines).

DCS revenue slow to respond The large engines manufactured by DEUTZ Customised Solutions have longer ordering and delivery lead times compared with compact engines. There is therefore a slight delay in the response of this segment's revenue to the economic situation both in a downturn and in an economic recovery.

FINANCIAL POSITION

Overview of the financial position of DEUTZ AG	**2009**	**2008**
€ million		
Cash flow from operating activities	61.7	48.7
Cash flow from investing activities	-38.2	-81.4
Cash flow from financing activities	-13.2	-65.2
Change in cash and cash equivalents	10.3	-97.9
Free Cashflow	10.7	-47.7
Cash and cash equivalents at 31 December	210.5	200.2

Free cash flow: cash flow from operating activities before payment of compensation for vested company pension rights and investing activities minus interest expense

BASIC PRINCIPLES AND OBJECTIVES OF FINANCIAL MANAGEMENT

Financial management centrally organised The financial management of DEUTZ AG primarily comprises management of the lines of credit required by the Company, cash pooling and any necessary foreign exchange hedging. Centralised cash pooling ensures optimum use of cash within the Group. Foreign currency surpluses are to a large extent hedged by purchasing agreements in the relevant currency. 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.

FINANCE

US Private Placement – some measurement of KPIs under the covenants suspended By issuing bonds for US$ 274 million as part of a private placement in the United States in 2007, DEUTZ obtained long-term funding over periods of five, seven and ten years independently of banks. 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 currency risk in connection with the US private placement.

Part of the documentation for the US private placement consists of financial covenants, which oblige DEUTZ to comply with certain key performance indicators. These financial covenants are 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).

Following the sharp deterioration in revenue and profitability last year DEUTZ was in danger of breaching its earnings-related financial covenants at the end of the third quarter of 2009, which could have caused the creditors of the US private placement to terminate it. We therefore entered into negotiations with the private placement creditors at the earliest opportunity in order to secure our funding on a long-term basis and bring the financial covenants into line with the prevailing situation.

Starting on 29 September 2009 we agreed waivers with our creditors that exempt us from the obligation to comply with the financial covenants and postpone the dates on which our compliance with these covenants is assessed, which has enabled us to avoid breaching our contractual obligations. Over this period the coupon was increased by 2 percentage points. An agreement in principle and fourth waiver and deferral that we signed with the private placement creditors on 11 March 2010 finalised the key points of the amendments made to the private placement documentation. In particular, a term sheet stipulated the interest rates payable, the terms to maturity, the financial covenants to be complied with in future as well as other terms and conditions (including bank finance by means of working capital facilities and the provision of collateral), and the waiver agreement was extended until 30 April 2010. The most significant financial covenants will be the ratio of net financial debt to EBITDA, interest coverage and the ratio of free cash flow to interest and repayments of principal. We believe that we will comply with these financial covenants given the forecasts for our business over the next few years. The current interest rate is being increased by 2 percentage points on the rate in the original agreement. DEUTZ will also incur additional costs that are to be capitalised and will become due on redemption of the private placement, although the actual amount to be paid will vary depending on the timing of the final scheduled repayment or any premature repayment. This will incur a total annual cost in the low double-digit millions. The maturity of the tranche originally due in 2017 has been shortened by three years. The amendments made to the private placement documentation will also incur one-off costs in the low single-digit millions.

In addition, we have negotiated with German banks as part of a syndication process and have received binding funding commitments from the banks concerned for medium-term working capital facilities totalling €76 million.

In future, the banks and the private placement creditors will share *pari passu* in a comprehensive package of collateral to be lodged by DEUTZ.

The contractual documentation detailing the private placement amendments and the related bank finance will be finalised over the coming weeks.

If successful, these arrangements will secure DEUTZ AG's future funding and, consequently, the annual financial statements have been prepared on a going-concern basis.

As at 31 December 2009, we had unused short-term lines of credit of around €28 million.

Optimum receivables management by means of factoring Over the last few years, factoring – the sale of receivables – has steadily become increasingly important. DEUTZ uses these opportunities to sell receivables in order to optimise receivables management. As at 31 December 2009, the volume of receivables sold under factoring agreements was around €71 million (2008: approximately €83 million).

LIQUIDITY

Rigorous management of working capital and a systematic programme of cost savings has had a positive impact on liquidity: despite the year of crisis with a slump in revenue of 43.9 per cent, cash and cash equivalents increased to €210.5 million as at 31 December 2009, which represents an increase of €10.3 million on the figure at the end of 2008 (31 December 2008: €200.2 million).

Net cash used for investing activities declined by a total of €43.2 million to €38.2 million (2008: €81.4 million). The 2008 figure included payments for 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.

The net cash used for financing activities amounting to €13.2 million (2008: €65.2 million used) arose largely from the payment of interest. The figure for 2008 was significantly influenced by the payment of a dividend of €48 million to shareholders.

CAPITAL EXPENDITURE

Capital expenditure amounted to a total of €52.8 million in 2009 compared with €50.3 million in 2008. We invested €36.3 million in property, plant and equipment – largely related to the replacement of driverless vehicles at the Cologne site – and €9.5 million (2008: €7.8 million) in intangible assets. We also invested €7.0 million in affiliated companies in order to fulfil the requirements for government subventions for our Spanish subsidiary, which are linked to the capital structure.

NET ASSETS

Overview of the assets of DEUTZ AG	31/12/2009	31/12/2008
€ million		
Expenses for the expansion of operations	0.0	10.4
Non-current assets	482.3	486.2
Current assets	458.9	578.6
Prepaid expenses	0.8	3.7
Total assets	**942.0**	**1,078.9**
Equity	309.6	441.7
Provisions	257.7	278.6
Liabilities	374.0	358.6
Deferred income	0.7	0.0
Total equity and liabilities	**942.0**	**1,078.9**
Working Capital (€ million)	48.2	112.2
Working capital ratioat the balance sheet date (%)	6.1	7.9
Equity ratio (%)	32.9	40.9

Working capital: inventories and trade receivables less trade payables

Equity ratio: ratio of equity to total equity and liabilities

The total assets of DEUTZ AG as at 31 December 2009 were €942.0 million, which was a reduction of roughly 13 per cent compared with the end of 2008 (31 December 2008: €1,078.9 million).

Non-current assets Non-current assets fell slightly by €3.9 million to a total of €482.3 million (31 December 2008: €486.2 million), with the capital expenditure on financial assets more than offset by the decline in intangible assets.

Current assets Current assets declined by €119.7 million to €458.9 million (31. December 2008: €578.6 million). This was attributable to the significant reduction in inventories and the lower amount of receivables due from affiliated companies.

Working capital Working capital (inventories plus trade receivables minus trade payables) was reduced by approximately 57 per cent to €48.2 million as at 31 December 2009 (31 December 2008: €112.2 million). This was primarily attributable to the systematic reduction in inventories.

The working capital ratio on the balance sheet date was 6.1 per cent, an improvement of 1.8 percentage points over the ratio on 31 December 2008.

Receivables from related parties The decline can be attributed in particular to a lower amount of receivables from central financing by the parent company as a result of the reduced volume of business.

Intangible assets In addition to the assets recognised on the balance sheet, DEUTZ has further assets that are not recognised: the DEUTZ brand is synonymous with highly sophisticated technology, quality and reliability and the Company has been a firmly established player for over 140 years in the equipment manufacturing and operating industry. DEUTZ also enjoys valuable long-standing relationships with customers; it has entered into long-term cooperation agreements, particularly with its key customers.

High equity ratio As at the balance sheet date, equity had decreased by €132.1 million to €309.6 million (31 December 2008: €441.7 million). The main reason for this reduction was the net loss reported for the year. The equity ratio ended the period under review at 32.9 per cent, 8.0 percentage points lower than the ratio as at 31 December 2008 (40.9 per cent); despite its decrease, however, the ratio remained high.

Liabilities Provisions fell by € 20.9 million to €257.7 million (31 December 2008: €278.6 million) – mainly as a consequence of the reversal of provisions – whereas liabilities rose by €15.4 million to €374.0 million (31 December 2008: €358.6 million). This increase was attributable, in particular, to liabilities in connection with personnel restructuring.

OVERALL ASSESSMENT FOR 2009

The 2009 financial year was a year of economic crisis that presented DEUTZ with challenges of an exceptional nature. Revenue and unit sales plunged by approximately 50 per cent and, correspondingly, earnings fell significantly short of our forecasts. However, we were able to meet these challenges and can now demonstrate a sound equity base, a funding structure that can support us into the future and a permanent reduction in our costs base: all in all, DEUTZ is emerging from the crisis stronger than before and, as a long-established company with new vigour, it can look to the future with optimism.

EVENTS AFTER THE REPORTING PERIOD

In an agreement signed on 11 March 2010, DEUTZ reached a fundamental settlement with US investors on the restructuring of the funding facility provided by the US private placement, which represents a total volume of US$ 274 million. As explained in our disclosures on this funding in the section on DEUTZ AG's financial position, this agreement stipulated the interest rates payable, the terms to maturity, the financial covenants to be complied with in future as well as other terms and conditions (including bank finance by means of working capital facilities and the provision of collateral). For further information on the impact on DEUTZ AG's financial position and results of operations, please refer to the notes on funding in the section on our financial position.

RESEARCH AND DEVELOPMENT

Increased expenditure on research and development Researching, developing, being that one decisive step ahead: this is what motivates us at DEUTZ, what spurs us on and sets us apart from our competitors. This is why, despite the current difficult economic climate, we have not just maintained our R&D budget but actually increased it.

Expenditure on research and development in 2009 amounted to €104.6 million (2008: €90.3 million). €93.1 million (2008: €78.7 million) of this sum was invested in the DEUTZ Compact Engines segment and €11.5 million (2008: €11.6 million) in the DEUTZ Customised Solutions segment. This increase in research and development expenditure of almost 16 per cent in the year under review is mainly attributable to preparatory work to meet the next exhaust emissions standards. The R&D ratio, i.e. research and development expenditure as a proportion of revenue, doubled to 13.1 per cent in 2009 (2008: 6.4 per cent). The fall in revenue increased this ratio even more. This emphasises the huge effort that we are putting, now more than ever, into maintaining our market position as a technology leader.

In 2009, 84 per cent (2008: 77 per cent) of all R&D expenditure was accounted for by new engine development and engine refinement, 12 per cent (2008: 17 per cent) by customer applications and support for engine series production, and the remaining 4 per cent (2008: 6 per cent) by research and preliminary development.

Development of a new engine with a capacity of less than four litres The policy decision to opt for a new engine with a capacity of less than four litres in 2009 signalled the start of the development of a completely new DEUTZ engine. This engine with a cubic capacity of 2.9 litres and a power output range of 25kW to 56kW also completes our new product range intended to meet the next exhaust emissions standards. The new engine is designed for use in both industrial and agricultural applications. This, together with the other completely new 3.6 litre engine model series, which we began developing in 2008, means that we now also supply engines with a capacity of less than four litres for use in tractors with power output ranges of 28 to 85kW.

Concentrating on engine development to meet exhaust emissions standard 4 The new and more stringent emissions regulations, COM Stage III B in Europe and EPA Tier 4 Interim in the USA, come into force on 1 January 2011 for engines in mobile machinery with power outputs of between 130kW and 560kW. Corresponding regulations for the lower engine power categories of 56 to 130kW will follow on 1 January 2012 and on 1 January 2013 for the 37 to 56kW categories (this only applies to Europe; the regulations have already been in force since 1 January 2008 in the USA). As the American term already suggests, Tier 4 Interim is only an intermediate stage that will be gradually followed, between 1 January 2013 and 1 October 2014, by the even stricter EPA Tier 4 Final and COM Stage IV regulations. These statutory requirements demand reductions in nitrogen oxide (NOx) emissions by 95.7 per cent and in soot particle emissions by 96.5 per cent compared with the first limit levels set in 1999.

Our main R&D focus in the year under review has consequently been directed towards developing new engines and refining existing models that will meet the limits imposed by the next exhaust emissions standards. The key task has been to develop technologies for injection, supercharging, exhaust-gas recirculation and exhaust-gas aftertreatment. In addition to fine-tuning technical engine parameters and adapting designs to suit customer applications, we have carried out field trials of the new engines with power outputs in excess of 130kW. Customer feedback has been consistently positive: Fendt exhibited the first tractor to meet the future emissions standard, powered by an engine that we developed, at Agritechnica, Europe's largest agricultural equipment trade fair, held in Hannover, Germany. With a cubic capacity of six litres and capable of developing 280 bhp, high performance is not the only special feature of this innovative power unit; it is also outstandingly efficient and has a low fuel consumption ratio.

Development of engines designed for the future in all application segments With seven new or refined engine types with cubic capacities of between 2.9 and 16 litres and power outputs ranging from 28kW to 500 kW, DEUTZ will in future have a complete range of engines that are in line with customer needs and also meet the next exhaust emissions standards.

Exhaust-gas aftertreatment systems for customer-specific solutions It will no longer be possible to achieve the necessary reductions in nitrogen oxide and diesel particulate emissions required by the next stages in exhaust emissions regulations by making internal engine adjustments alone or by using exhaust gas recirculation. The use of exhaust aftertreatment systems will be required. These systems employ selective catalytic reduction (SCR) to reduce nitrogen oxide emissions, making use of our experience in manufacturing engines for on-road applications (commercial-vehicle engines) and transferring it to so-called 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 on-road and non-road applications that regenerates the filter element whenever this is required. This burner system allows regeneration of the diesel particulate filter (DPF) under all continuous operating conditions. Our objective is to offer customers exhaust-gas aftertreatment solutions optimally designed for their applications. The initial positive reaction from customers shows that we are on the right technological track with this burner system.

Development work is on schedule and we will be able to meet the deadlines demanded by our customers for the production launch of these systems.

DVERT®: customised technology Our answer to the challenge of balancing future emissions directives against the needs of our customers is DVERT®, a system of engineering modules, virtually all the elements of which can be combined with each other. "As much technology as necessary but not as much as possible" is the principle that will ensure the desired outcome as regards engine performance, compliance with emissions limits and competitiveness.

Further process optimisation and cost effectiveness The closure of our British research and development site in Dursley and the concentration of research and development activity in Cologne will further improve our cost structure and optimise our processes. In order to be able to respond flexibly to short-notice project requirements, we are also currently working with external engineering firms.

Sustainable and environmentally friendly: The hybrid drive DEUTZ had already presented its hybrid drive 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. In the meantime, our Alternative Drives team including experts with specialist skills in different technical areas such as electric motors, power electronics, data storage technology, software & systems development and system applications has continued developing various components, such as the electric motor, which is now significantly more compact and at the same time more powerful. Our engineers have also succeeded in downsizing the combustion engine and reducing fuel consumption. The interest shown by our customers is proof that construction equipment will offer outstanding opportunities for employing hybrid engines.

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 the year under review, patent applications were filed for a total of 33 inventions, of which 10 were in Germany and 23 elsewhere. At the end of 2009, DEUTZ held a total of 376 patent applications, patents and utility models, 197 of which were registered in Germany and 179 elsewhere.

EMPLOYEES

Headcount falls owing to the economic crisis As at 31 December 2009, DEUTZ AG employed 3,307 people (31 December 2008: 3,881). This is 574 fewer employees than at the end of 2008, which equates to a decrease of 14.8 per cent. Given the economic crisis, we had no other choice but to initiate job cuts. However, we have largely been able to achieve this in a manner that minimises the adverse impact on staff by offering early retirement schemes, cutting temporary employment contracts, and, not least, by setting up a job-creation company.

Short-time working: 480 jobs saved Over the year under review, short-time working was the primary human resources tool used by DEUTZ to combat the impact of the recession and the sharp drop in demand. Short-time working had been introduced at the end of 2008 and was extended during the course of 2009 to cover almost all units and all German sites. The only exception was our development unit, where we continued to work flat-out to develop our new series of engines with state-of-the-art exhaust gas technology. We cannot afford to ease off in this development work because stricter exhaust emission regulations will be coming into force in Europe and North America in the very near future.

DEUTZ has been authorised by the German Federal Employment Agency to continue short-time working until November 2010 and we will continue to benefit from these arrangements for the whole of this period. The arrangements allow DEUTZ to make considerable savings in staff costs – primarily because the German Federal Employment Agency assumes responsibility for all of the social insurance contributions. We managed to retain 480 jobs on average over the year by switching to short-time working, or put another way: the arrangements allowed the Company to save working hours equivalent to the work carried out by 480 employees.

Impact on staff from further job cuts minimised as far as possible The crisis nevertheless also forced us to reduce capacity in line with the fall in orders. Initially, we cut temporary staff and did not renew fixed-term employment contracts. In order to reduce the headcount in our regular workforce as painlessly as possible, we met with the works council to agree a reconciliation of interests (as required by German law) and set up a redundancy scheme for the Cologne site.

By the end of 2009, over 400 regular employees had left the Company. We were concerned to ensure that the solutions minimised the impact on our staff as much as possible. First, we agreed a special early retirement package with many employees. Secondly, we have been working with a company specialising in the transfer of employees: this company supports former employees with a change in their career direction and subsequent job search. The results of these efforts achieved a socially acceptable balance: we only had to make a total of 14 compulsory redundancies.

Most of our employees worked at our headquarters in Cologne and at the Ulm plant: 2,580 employees in Cologne (31 December 2008: 2,897) and 406 in Ulm (31 December 2008: 556).

We cut the number of temporary staff very significantly compared with 2008: in 2009 we only employed an average of 37 temporary staff, 269 fewer than in 2008 – a consequence of the sharp drop in orders in the year under review. DEUTZ maintained the short-time working that had been introduced in 2008: a further 348 employees moved to short-time working during the course of 2009 in addition to the 935 employees already on reduced hours at the end of 2008 (employees on short-time working as at 31 December 2009: 1,283).

Furthermore, in response to the marked change in economic conditions the Supervisory Board of DEUTZ AG decided in March 2009 to reduce the number of people on the Board of Management from four to three. Karl Huebser and Helmut Meyer stepped down from the Board of Management with effect from 31 March 2009. Dr Margarete Haase was appointed to the Board of Management with effect from 1 April 2009 and she is responsible for finance and human resources.

More employees in research and development As at 31 December 2009, 2,745 people were employed in the DEUTZ Compact Engines (DCE) segment (31 December 2008: 3,127[9]), while the DEUTZ Customised Solutions (DCS) segment employed 562 people (31 December 2008: 754[1)]).

Despite the economic crisis, DEUTZ is investing in the future of the business. A glance at the statistics shows that the number of employees in future-oriented roles increased in 2009. As at 31 December 2009, 512 people were employed around the world in the research and development unit – 38 more than twelve months previously (31 December 2008: 474[10]), which equates to an increase of 8.0 per cent.

Trainee ratio increased Despite the tough conditions in 2009, we continued to offer vocational training to young people – thereby continuing to invest in our own future as well. We offered 49 school leavers training and apprenticeship places in technical, trade or commercial vocations, for example in industrial technology, electronics and business administration. DEUTZ AG employed 180 trainees and apprentices as at 31 December 2009, of which 125 were in Cologne. The trainee ratio, i.e. the ratio of trainees and apprentices to DEUTZ's total workforce in Germany, again increased during the year under review and at 31 December 2009 stood at 5.5 per cent (31 December 2008: 4.9 per cent). But that is not the end of the story: all trainees and apprentices who successfully passed their examinations in 2009 were subsequently taken on by the relevant department for at least one year. In this way, we managed to retain 46 young, motivated employees in the Company.

We also continue to assume the social responsibility of offering young people with learning and social difficulties the opportunity to obtain skilled vocational training. To this end, we have been working in what is now a 17-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.

Demand for graduate recruits to secure the future Despite the crisis, DEUTZ is recruiting graduates so that the Company can remain competitive in the future. The development department continues to have a need for graduates from technical courses. Even though we had to cut staff in 2009 in line with the fall in demand, we still recruited around 30 trainee engineers from various universities. These recruits undergo on-the-job training to become specialists in engine development and application engineering – primarily in the area of exhaust gas emissions technology, an area that will be so important over the next few years.

There is fierce competition for highly qualified specialists. As a well-known technology enterprise and attractive employer, DEUTZ took part in various recruitment activities over the course of 2009, although this was to a much lesser degree than in 2008. There was brisk business around our stand at university recruitment fairs held in Aachen, Cologne and Ulm. We were also represented at 'Nacht der Technik', Cologne's first engineering and technology evening, in which companies in Cologne opened their doors for an entire evening under the slogan 'Technik sehen und verstehen' (seeing and understanding engineering and technology). The objective was to allow these companies to present and provide information on their various areas of expertise to engineering and technology enthusiasts.

[9]) To improve comparability, the figure for 2008 has been restated in line with the current allocation of staff to the DEUTZ Compact Engines and DEUTZ Customised Solutions segments.

)[10] To improve comparability, the figure for 2008 has been restated in line with the current allocation of R&D staff.

ENVIRONMENT

ENVIRONMENTAL MANAGEMENT SYSTEM

We initially committed to the introduction of the environmental management system on a voluntary basis back in 2003. DNV (Det Norske Veritas), an independent certification company, carried out a scheduled audit in September 2009 and confirmed that the reviewed production processes complied with the stipulations in the environmental management system in accordance with DIN EN ISO 14001.

The DNV auditing team carried out a detailed assessment, for example, of the DEUTZ AG environmental policy, the implementation of environmental objectives, the review of legal and internally imposed obligations, the functioning and effectiveness of our emergency management system and other important aspects of the EMS such as communications and documentation, and in conclusion issued an unconditional confirmation of certification.

DEUTZ has set itself two important environmental targets in the medium term in order to ensure continuous further improvement in environmental protection: energy savings and a reduction in emissions from production plants. In 2009, additional engine test rigs were equipped with generator brakes with the result that the proportion of electrical energy fed by the Company into its own electricity network was 4 per cent (2008: 2.1 per cent).

At the Ulm plant, the removal of exhaust gas from the engine testing facility was centralised and equipped with a particulate filter. This system meets the criterion of 'best available technology' and reduces particulate emissions to a level that satisfies the highest of technical standards.

PROBLEM-FREE OPERATION IN ENGINE PRODUCTION

For many years, the departments in DEUTZ AG responsible for safety management have shared information on a constructive basis with the supervisory department of the statutory accident insurer and with the German government supervisory authorities for health & safety at work and environmental protection. This ensures that any changes in the law can be taken into account and implemented in good time.

Preventive action in the form of regularly scheduled testing, which is generally carried out by certified specialists on potentially environmentally hazardous plant, maintains the availability of machinery capacity. The probability of downtime as a result of hazardous situations is thereby reduced to an acceptable minimum.

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."

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

Composition of the issued capital There were no changes to the issued capital (share capital) of DEUTZ AG in 2009. As at 31 December 2009, the issued capital amounted to €308,978,241.98 and was divided into 120,861,783 no-par-value bearer shares.

Direct or indirect shareholdings representing more than 10 per cent of voting rights At the end of 2009, SAME DEUTZ-FAHR Holding & Finance B.V., Amsterdam, Netherlands, held a direct shareholding in DEUTZ AG representing 44.97 per cent of voting rights (31 December 2008: 45.1 per cent). 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 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, 85 German Stock Corporation Act (AktG) and section 31 German Codetermination Act (MitbestG) also apply.

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

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

Authority of the 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, on or before 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 had been 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.

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.

The Technology Project Agreement between DEUTZ and Volvo can be terminated by Volvo for good cause with immediate effect if DEUTZ AG is directly or indirectly acquired by a competitor of Volvo, merged with such a competitor or in any other way falls under the control of such a competitor.

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 needs to repay a considerable proportion of the notes in the event of a change of control, it needs to raise the necessary funds some other way in the short term.

The other 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.

The agreement between DEUTZ, Bosch and Eberspächer for the establishment and management of a joint venture to produce fully integrated diesel exhaust aftertreatment systems grants stock-purchasing rights to the other parties to the agreement in the event of a change in control in DEUTZ AG. A change in control is deemed to have taken place if a third party directly or indirectly acquires a majority stake in DEUTZ AG or in any other way exercises, or is in a position to exercise, control over DEUTZ AG. A change in control is not deemed to have taken place if a competitor of DEUTZ AG acquires a majority interest in DEUTZ AG.

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) GERMAN COMMERCIAL CODE (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. The Board of Management also draws attention to the fact that the agreement between DEUTZ, Bosch and Eberspächer for the establishment and management of a joint venture to produce fully integrated diesel exhaust aftertreatment systems had not yet been approved by anti-trust authorities on the date the annual financial statements for the year ended 31 December 2009 were signed.

CORPORATE GOVERNANCE DECLARATION

DECLARATION OF COMPLIANCE ISSUED BY THE SUPERVISORY BOARD AND THE BOARD OF MANAGEMENT OF DEUTZ AG AS REQUIRED BY SECTION 161 OF THE GERMAN STOCK CORPORATION ACT (AKTG)

Pursuant to section 161 AktG, the Board of Management and Supervisory Board of DEUTZ AG declare that, apart from the exceptions below, DEUTZ AG has complied with, and continues to comply with, the recommendations of the German Corporate Governance Code (DCGK) government commission in the versions dated 6 June 2008 and 18 June 2009 since issuing the last declaration of compliance in December 2008:

1. The D&O insurance policy taken out by DEUTZ AG for members of the Board of Management will provide for the excess required in section 93 (2) sentence 3 AktG until 1 July 2010, the legally required date. In the case of Supervisory Board members, an excess of this type is not currently considered an appropriate means of control (item 3.8 (2) sentence 2 DCGK).

2. There is no age limit at DEUTZ for members of either the Board of Management or Supervisory Board (items 5.1.2 (2) sentence 3 and 5.4.1 sentence 2 DCGK). This deviation from DCGK means that DEUTZ retains the option of continuing to benefit from the long years of experience brought to the Company by older members of the Board of Management and Supervisory Board.

OPERATING PROCEDURES OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

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

Seven scheduled and two extraordinary Supervisory Board meetings were held in 2009.

In 2009, the members of the Supervisory Board also discussed the efficiency of their own activities. The overall findings were positive.

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

The principles by which the Board of Management operates are summarised in rules of procedure issued by the Supervisory Board, which can be downloaded from the DEUTZ AG website.

Board of Management meetings generally take place every two weeks.

BOARD OF MANAGEMENT, SUPERVISORY BOARD AND SUPERVISORY BOARD COMMITTEES

At DEUTZ, responsibility for the executive function lies with the Board of Management; the Supervisory Board monitors and advises the Board of Management in its activities. The Board of Management's rules of procedure define the transactions and actions for which the Board of Management must obtain the Supervisory Board's approval before carrying them out (reservations of approval).

The following changes to the membership of the Board of Management took place in 2009: Mr Huebser's and Mr Meyer's contracts were terminated with effect from 31 March 2009 and Dr Haase was appointed to the Board of Management as Human Resources Director with effect from 1 April 2009. Consequently, the DEUTZ AG Board of Management has consisted of three members instead of four since 1 April 2009.

At its meeting on 24 July 2009, the Supervisory Board held detailed discussions about the reorganisation of the Board of Management's responsibilities, which it approved. The existing matrix organisation was replaced with a linear organisation. Dr Leube, Chairman of the Board of Management, assumed responsibility for the Asia region and the DEUTZ (Dalian) Engine Co., Ltd joint venture, in addition to Sales and Service, Corporate Management and Internal Audit. Dr Haase is responsible for Finance, Human Resources and Investor Relations, while Mr Biondi heads up Procurement, Logistics, Production and Research & Development.

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

The Supervisory Board has created four committees to enable it to perform its duties effectively. They are the Human Resources Committee, the Audit Committee, the Arbitration Committee and the Nominations Committee. The Human Resources Committee consists of two representatives of the shareholders and one employee representative, the Audit and Arbitration Committees both consist of two shareholder representatives and two employee representatives, and the Nominations Committee has three members, all of whom represent the shareholders. The Audit Committee follows its own rules of procedure, while the other committees work according to the rules of procedure that apply to the (full) Supervisory Board.

The Human Resources Committee makes preparations to enable the Supervisory Board to decide about the appointment of members of the Board of Management, the content, conclusion and amendment of service contracts signed with members of the Board of Management appointed by the Supervisory Board, including remuneration as specified in their service contracts, and all issues arising between members of the Board of Management and the Company in this connection. The committee met twelve times in the year under review and its meetings focused primarily on the changes to the Board of Management detailed above, the reorganisation of Board of Management responsibilities, Board of Management remuneration issues and long-term incentive plans.

The work of the Audit Committee in the year under review focused on the single-entity and consolidated financial statements for 2008 and the corresponding auditors' reports, the condensed consolidated financial statements for the six months to 30 June 2009 and their review by the auditors, the interim reports for the periods ended 31 March and 30 September 2009, the discussion of the audit engagement for the year ended 31 December 2009, and risk management. The Audit Committee met on four occasions in 2009. The auditors attended three meetings of this committee.

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

The role of the Nominations Committee is to propose to the full Supervisory Board those candidates who are suitable as shareholder representatives on the Supervisory Board. It met on one occasion during the year under review. At this meeting on 10 July 2009, the committee discussed a successor for Dr Vita who resigned from the Supervisory Board with effect from 31 July 2009.

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

The following changes to Supervisory Board committees took place in 2009: after his election as chairman of the Supervisory Board, Mr Moberg replaced Dr Vita as chairman of the Human Resources Committee, chairman of the Arbitration Committee, chairman of the Nominations Committee and member of the Audit Committee.

DISCLOSURES RELEVANT TO CORPORATE MANAGEMENT PRACTICES; COMPLIANCE ORGANISATION

In 2008, as part of the systematic development of the compliance system, the Board of Management appointed a Compliance Officer who is responsible for coordinating all activities focusing on the promotion of compliance and who liaises with the member of the Board of Management with responsibility for compliance.

At the proposal of the Compliance Officer, the Board of Management agreed on insider trading guidelines and a code of conduct that were then announced within the DEUTZ Group.
The insider trading guidelines include statements about banned insider transactions, the insider list and directors' dealings. It also makes practical recommendations.

The code of conduct, which applies to all DEUTZ AG employees, managerial staff and members of the Board of Management, describes and explains the objectives and rules that reflect the obligations of everyone to whom it is addressed to behave responsibly, lawfully and ethically impeccably. It focuses on committing to abide by the law at all times, behaving with integrity and the proper treatment of company property, confidential business information, business associates and staff members, as well as responsibility for health and safety and the environment.

DEUTZ has been implementing health and safety management rigorously since 1991 and as early as 2003 we also introduced an initial, voluntary environmental management system. From the outset, our aim has been to obtain certification, which we have achieved. Our company environmental policy also focused on exceeding the minimum legal requirements for mitigating our impact on the environment. In September 2009, the independent certification body DNV again confirmed that the production processes they inspected conform to DIN EN ISO 14001 environmental management specifications. The areas assessed by the team of auditors from DNV also included DEUTZ AG's environmental policy, our achievement of environmental targets, our statutory and self-imposed obligations, the functionality and efficacy of our emergency contingency management, communications and documentation.

BASIC PRINCIPLES OF THE REMUNERATION SYSTEM

REMUNERATION OF THE BOARD OF MANAGEMENT

Board of Management remuneration in DEUTZ comprises fixed, variable and long-term performance-related components. The fixed component is paid monthly as basic salary. The performance-related variable component of remuneration is the annual bonus, which is linked to changes in specific key performance indicators in the DEUTZ Group, such as EBIT, cash flow and working capital, and to personal targets related to the individual's areas of responsibility.

The members of the Board of Management also receive options – intended to have a long-term incentive effect – related to the increase in shareholder value. These incentives are virtual share options that are issued on the basis of a Long-term Incentive Plan (LTI Plan) to reward the sustained contribution of management to the success of the business. Before they receive virtual share options, those eligible must invest some of their own capital in DEUTZ shares. The virtual share options include the right to receive a cash payment at the end of a lock-up period of three, four or 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.

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

The members of the Board of Management may defer some of their remuneration and add it to an occupational pension scheme. The Company does not grant the members of the Board of Management any pension entitlements.

Further information on the remuneration paid to the Board of Management can be found on page 52 of 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 guidelines set out in the German Corporate Governance Code. DEUTZ also pays each member of a committee a fee of €1,000 for each committee meeting they attend. The chairman of a committee is entitled to twice this sum, his deputy to one-and-a-half times the amount. In addition, DEUTZ reimburses the members of the Supervisory Board for any VAT they incur in connection with the performance of their mandate.

Further information on the remuneration paid to the Supervisory Board can be found from page 52 onwards in the notes to the financial statements.

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.

Our 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. DEUTZ therefore has an appropriate risk management system to ensure it can meet this requirement.

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

The basic principles, monitoring standards, 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 2009. These risk inventories are carried out in all functions and areas of the Company and in the main subsidiaries to identify whether new additional risks have arisen compared with the Company's 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 2009 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.

RISK MANAGEMENT IN RELATION TO FINANCIAL INSTRUMENTS

DEUTZ AG is exposed to various financial risks worldwide 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.

We therefore hedge financial risk in a number of different ways. Financial management is the responsibility of DEUTZ AG as the parent company. The Finance department identifies, measures and hedges financial risk in close collaboration with the Group's operating segments. The Board of Management specifies written principles for the Company's overarching risk management strategy as well as guidelines for certain areas, such as how to manage currency risk, interest-rate risk and credit risk and how to use derivative and non-derivative financial instruments. Derivative financial instruments are only used for hedging purposes, i.e. only in conjunction with corresponding hedged items from the Company's ordinary business activities or financial transactions that have a countervailing risk profile to that of the hedging transaction. The nature and scope of the hedged items are specified in a binding financial directive.

INTERNAL CONTROL SYSTEM RELATING TO THE ACCOUNTING SYSTEM

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

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

The internal control system relating to the accounting system is integrated into the accounting process with the objective of ensuring that accounting is carried out properly. The accounting process itself includes those significant operating processes that provide the value flows for financial reporting, the process for preparing the financial statements, and all information sources and processes from which the significant disclosures in the annual financial statements are derived.

In addition to separating functions and restricting access to data, DEUTZ AG has issued accounting guidelines and work instructions in order to ensure that the financial statements are properly prepared. These guidelines and instructions are regularly updated by head office and distributed throughout the Company. Additional control mechanisms covering the risks in the main processes, thereby guaranteeing a reliable accounting and reporting system, are normally set up locally at departmental level. Control activities also include systematic reviews carried out by the internal audit department.

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

The Supervisory Board's Audit Committee regularly discusses DEUTZ AG's annual financial statements as part of the full-year financial reporting procedure. In addition, the Audit Committee's monitoring function includes the ICS set up by the Board of Management as well as the accounting process itself.

The ICS is subject to regular reviews by the internal audit department, which reports directly to the Board of Management. The findings allow us to eliminate any deficiencies that have been identified and ensure that the ICS undergoes continuous refinement.

FINANCIAL RISKS

Credit risk Given the tough prevailing economic conditions, there is a risk of increasing levels of delayed payments or even defaults by our customers. We protect ourselves 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.

Currency risk Currency risk, which arises as a result of transactions with third parties denominated in foreign currency, is monitored by means of a central currency management system and mitigated by the use of derivative financial instruments. 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.

Interest rate and currency risk arising from funding arrangements The original interest payments and principal repayments in connection with the US dollar-denominated US private placement are hedged in euros over the entire term of the bonds through cross-currency swaps. Interest rates in euros and US dollars are fixed for the entire term. The agreement with the US investors provides for the early redemption of the last US dollar tranche in 2014 instead of 2017 and the associated hedge with the cross-currency swap will also be terminated early. Please also refer to the notes on funding in the section on our financial position. Depending on changes in interest rates and exchange rates, this could result in a risk or a reward affecting the financial position or results of operations of DEUTZ AG, but the effect is likely to be slight. Once negotiations on the new agreement have been concluded, it is planned to adapt the hedging of interest rate and currency risks to the new circumstances.

Funding risk Please refer to the notes in the section on our financial position for further information on the restructuring of the US private placement.

An obligation upon DEUTZ to comply with certain key performance indicators (financial covenants) forms part of the documentation for the US private placement. On the basis of our medium-term balance sheet and income plans, the adjusted financial covenants offer sufficient room for manoeuvre and our plans include adequate reserves. The MOVE restructuring programme and its successor MOVE FAST have laid the foundations for a sustained increase in the profitability of DEUTZ and have created the conditions that will enable us to comply with the financial covenants over the long term. We therefore believe that we will comply with the financial covenants based on the forecasts for our business over the next few years. If, however, there is a significant deterioration in the general economic situation, there is a risk of the covenants being breached.

OPERATIONAL AND OTHER RISKS

Market risk The global economy started to emerge from the lowest point of the financial and economic crisis in the third quarter of 2009. The level of new orders stabilised and the value of new orders was higher than revenue in the last two quarters. With the economy expected to continue its recovery, we anticipate continuing sales growth over the coming years. However, there is still a considerable degree of uncertainty about how quickly the global economy will recover from the worldwide recession. As a company operating at a global level, we are therefore exposed to the risks inherent in this recovery, which could impact negatively on the results of operations of DEUTZ AG.

In the medium and long term, we counter regional and application-related sales risks with development activities and alliances that are aligned with our product strategy.

Close alliances with key customers such as Volvo and SAME DEUTZ-FAHR are of considerable importance in enabling us to achieve these sales targets Our underlying strategy is to expand these long-term alliances with key customers. In addition, the economic crisis has demonstrated all too clearly that we are operating in a very cyclical market in our main application segments such as Mobile Machinery and in our principal sales regions. From an application segment and regional perspective, we will therefore be focusing on increasing the proportion of revenue accounted for by Agricultural Machinery, our less cyclical segment, and by the fast-growing Asian market where we laid the foundations with the establishment of the DEUTZ (Dalian) Engine Co., Ltd. joint venture in 2007.

We are well diversified and well positioned for the future in terms of the geographical and sectoral distribution of our customers. We supply the market-leading manufacturers in the various application segments.

Procurement risks Procurement risks resulting from bottlenecks in the market and unforeseen price increases cannot be fully ruled out. As a result of the economic crisis, our suppliers were also forced to cut capacity. This results in a risk that our suppliers will not be able to respond flexibly enough if there is an increase in demand and this could lead to further supply shortages for DEUTZ. These potential risks arise specifically in connection with the procurement of parts, components and services from third parties. This could have a negative impact on DEUTZ's net income and on its capacity utilisation.

We counter 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 our procurement strategy for strategic and production-critical components: firstly, 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.

As a result of the global recession, our suppliers also face the risk of financial bottlenecks. On an ongoing basis, we therefore analyse which suppliers could be exposed to financial difficulties and liquidity problems. At the same time, DEUTZ works on backup solutions to minimise the risk from supplier default. These solutions may involve a switch to in-house production or a shift to other suppliers.

Production risks The level of dependency on the general economic situation leads to fluctuations in capacity utilisation in production, which in turn can have a negative impact on profitability.

In order to avoid mistakes in planning and capital expenditure, the necessary production capacity is planned using different timescales: over a number of years as part of the medium-term planning process, which is revised each year, and for the following financial year as part of the budget planning process, which is then updated monthly for the next twelve months on a rolling basis. Production programme meetings are held at least once a month and capacity planning meetings each month to ensure that our capacity is adjusted in line with sales. In addition to the reduction in the workforce, active use is being made of short-term working in order to be able to adjust capacity flexibly to the level of orders on hand.

Technological risks Increasingly stringent emissions standards represent a major technological challenge for DEUTZ AG. 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. In 2014, the Tier 4 Final and EU IV exhaust emissions standards will follow. Engines for these markets are progressively being fitted with exhaust gas aftertreatment systems in all power output categories.

We are meeting these technological risks by expanding our development department and through ongoing research and development activities. Our development processes are subject to continuous optimisation. The product development process that we use includes systematic cooperation with our suppliers and close collaboration with our customers in order to satisfy the various requirements and ensure the outcome is a successful product.

Quality risks DEUTZ AG is exposed to liability and warranty risks. Potential warranty claims and claims for compensation could have a negative impact on the financial position or results of operations of the Company.

Quality assurance in all plants and areas of the Company is based on a centralised quality system Sources of errors and defects are systematically analysed, production processes optimised and action taken to minimise 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 has defined uniform standards for the selection of suppliers and, in close cooperation with the suppliers, continuously improves the quality of supplied parts. We also implement additional quality initiatives to handle the significant technical complexity of engines and to satisfy the steadily increasing quality requirements of our customers.

Provisions are recognised on the balance sheet to account for warranty risks.

IT risks Risks can arise, in particular, as a result of IT capacity adjustments and operating breakdowns in systems, leading to production stoppages and disruption of work processes.

We counter these risks with organisational improvements as well as ongoing intensive training and professional development for IT personnel. This enables us to keep up with the ever-increasing demands of our business. These activities are a key area of focus in the IT department.

Strategic business processes are handled using the proven SAP ERP 6.0 software. The IT service provider continues to operate the data processing centre on the basis of the principles in the current version of the de facto ITIL (IT Infrastructure Library) standard. The acquisition of DEUTZ's former outsourcing partner, EDS, by HP does not pose any identifiable risks. 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.

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

There are risks in this regard in connection with not being able to recruit additional personnel quickly enough to meet the requirements of growth in DEUTZ, and specifically, not being able to appoint suitably qualified managers and specialist employees to relevant posts promptly. This could have a negative impact on the company's development. We counter these human resources risks by systematically analysing the skills and qualifications of our 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, we are also well positioned from a human resources perspective to meet the challenges of demographic change.

Legal risks As a company with multinational operations, DEUTZ AG is subject to a variety of regulations under tax, antitrust and patent law. Existing and imminent legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and covered by an appropriate amount added to ongoing risk provisioning. On this basis, the management of 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 are refined on an ongoing basis and 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.

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 and liabilities. 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 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 our net assets, financial position and results of operations can therefore not be excluded at present.

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

Tax risks One of the consequences of the globalisation of DEUTZ AG's operating business is that the Company must observe a whole range of international and country-specific rules and regulations – most of which are statutory – as well as directives from national tax authorities. The Company faces tax risks if it fails to observe these laws and other regulations. In particular, tax audits and the findings from these audits can lead to additional expenses for DEUTZ AG in the form of interest, penalties and retrospective tax payments. DEUTZ AG recognises appropriate provisions when it becomes aware of such tax risks.

The external tax audit started in 2006, covering the tax assessment periods 2002 to 2005, was completed in 2009. The tax auditor filed a report dated 6 October 2009. An appropriate provision for tax risks has been recognised.

An external audit of employee income tax was started in 2008, covering the tax assessment periods 2004 to 2007, which was also completed in 2009. The external auditor filed a report dated 15 May 2009. The audit findings were sufficiently covered by the provisions recognised for possible risks.

OUTLOOK

THE ECONOMY IN 2010: A YEAR OF RECOVERY

Following the collapse in the global economy in 2009 with a 1.1 per cent decline in global economic output and a 5 per cent decline in Germany, there is generally expected to be a broad recovery in 2010. At a global level, all the private components of demand – consumer spending, capital investment and exports – are likely to contribute to the upturn in 2010, with domestic demand growing at a faster rate in the emerging markets than in the industrialised nations.

With anticipated global economic growth of 3.9 per cent for 2010, Deutsche Bank is forecasting economic growth of 2.6 per cent for the G7 countries, This growth will be driven primarily by the USA, where the economy is expected to grow by 3.6 per cent, while Germany is likely to be in the middle of the range with growth of 2.1 per cent. In contrast, economic output in Asia is forecast to grow by 7.6 per cent, led by China with expected growth of 9.0 per cent.

ROBUST GROWTH FORECAST TO RESUME IN 2011

The global economy is expected to show robust growth of 4 per cent again in 2011 and the emerging markets, primarily in Asia, are forecast to report significantly higher growth in economic output than the industrialised countries. However, there are some risks to the global economy arising from the end of economic stimulus packages and from tighter monetary and budget policies.

TRADE ASSOCIATIONS CAUTIOUSLY OPTIMISTIC

Industry associations in our principal customer sectors currently remain very cautious in forecasting economic growth. The German Engineering Federation (VDMA) is forecasting global engineering revenue to bounce back in 2010 with an increase of around 5 per cent. However, this very much depends on strong growth of approximately 15 per cent in China; VDMA forecasts that growth in western Europe and the USA will be just 1.0 per cent, with zero growth expected in Germany.

Euroconstruct, the European market research organisation for the construction industry, is forecasting that the sharp drop of 8.4 per cent in 2009 will be followed in 2010 by a further downturn of 2.2 per cent in construction activity in Europe, not just in house-building, but also in other construction projects. A slight recovery is expected only in 2011.

Nevertheless, as far as construction equipment and building-materials equipment is concerned, VDMA is predicting that there will be a slight recovery in 2010, the downturn having bottomed out in 2009. The world's largest construction equipment trade fair, bauma, which will be held in Munich in April 2010, will be hugely significant as an indicator of sentiment in the industry.

VDMA has a rather more cautious prognosis for the agricultural equipment sector in which the downward trend in revenue intensified in the second half of 2009. Demand in western Europe is not expected to pick up in 2010 because of the fall in agricultural incomes in the European Union. In contrast, VDMA believes there is relatively high pent-up demand in eastern Europe where capital investment in new equipment fell dramatically in 2009.
Initial signs of recovery are also noticeable in the commercial vehicle sector. The German Association of the Automotive Industry (VDA) has seen a gradual stabilisation of new orders in Germany since September 2009, and in export business since January 2010. This is the result of an upturn in transport demand accompanying the general economic recovery in Europe.

DIESEL ENGINE MARKET RECOVERY IN ALL SEGMENTS AND REGIONS

The same upward trends are apparent in the research carried out for the global diesel engines sector[11] by Power Systems Research (PSR), an international market research organisation. Global demand for engines in the market segments relevant to DEUTZ is forecast to rise by around 4 per cent in 2010 with an even stronger recovery of around 8 per cent in 2011. The same regional trends are also evident in these forecasts: Asia leads the upward trend in 2010 with growth of around 5 per cent. Growth of 3 per cent is forecast for Europe, the Middle East and Africa (EMEA), although North America is only expected to experience growth of 1.4 per cent. In the application segments, the most significant growth is expected to be in construction equipment, industrial trucks and commercial vehicle applications at around 4 per cent, followed by gensets, pumps and compressors at 3.4 per cent. Growth forecasts for agricultural equipment are significantly more cautious at just over 1 per cent.

NEW ORDERS, UNIT SALES, REVENUE

At the macro-economic level, there is still considerable uncertainty about how quickly the economy will recover from the global recession. Consequently, our forecasts do not yet have the same level of reliability as in previous years. Following the downturn in the global economy that started in the second half of 2008, we are expecting a significant increase in new orders, unit sales and revenue in 2010. In addition to the impact from the expected market recovery based on forecasts by the trade associations relevant to DEUTZ, we are predicting that our revenue will be boosted even further because we will also have the benefit of the following two effects in 2010. First, our customers significantly reduced their inventories in 2009 and sold considerably more engines than we produced. The result of this will be that unit sales by our customers in 2010 will translate directly into orders for DEUTZ. Secondly, given the imminent change in emissions standards, we expect to see increased unit sales towards the end of the year of engines built for the current standards (pre-buys) so that the manufacturers will still be allowed to include these engines in equipment built over the following year.

In the DEUTZ Compact Engines segment, we consider the application segments with the strongest potential for recovery to be construction equipment and commercial vehicles, i.e. those sectors that suffered the most last year. At DEUTZ Customised Solutions, we assume that both the service business and the new engines business, which contracted unexpectedly sharply in 2009, will deliver strong growth again in 2010.

OPERATING PROFIT (EBIT)

The anticipated increase in new orders, unit sales and revenue will have a correspondingly positive impact on operating profit. In addition, the MOVE action programme will help to permanently lower the break-even threshold. In 2010, the reduction in overhead costs and in the cost of materials, combined with a robust pricing policy, will have a significant impact. Overall, although we expect to again make an operating loss, we believe the loss will be significantly smaller as capacity utilisation increases on the back of rising unit sales and due to the improved cost structure.

[11] Sources: Power Systems Research (PSR), internal figures

CAPITAL EXPENDITURE, FREE CASH FLOW

In 2010, capital expenditure excluding research and development will be roughly at the level of 2009. To a lesser extent, we will also be investing in our joint venture with Bosch and Eberspächer ('Bosch Emission Systems GmbH & Co. KG'). This joint venture will be producing fully integrated exhaust aftertreatment systems for DEUTZ and the global market in time for the introduction of the Tier 4 Final exhaust emissions standard.

As at 31 December 2009, cash and cash equivalents stood at €210.5 million. In view of our considerable capital expenditure, we are still forecasting a significant negative free cash flow for 2010, although this can be covered by existing liquidity without the need to draw down additional funding.

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 2010, we are assuming that prices will rise, particularly for aluminium, on the back of the anticipated economic recovery and the strengthening US dollar. Consequently, we have already hedged around 60 per cent of our anticipated aluminium requirement through derivatives.

DEUTZ hedges sales transactions denominated in US dollars by entering into forwards and by purchasing components in US dollars. Overall, approximately 70 per cent of the US dollar surplus at DEUTZ is hedged.

The current collective pay agreement expires on 30 April 2010. On 18 February, the parties to the collective pay agreement signed a new agreement that runs until 31 March 2012. Very early in 2010, and well before 2011, the Company has therefore achieved some planning certainty as far as staff costs are concerned.

The decisions to make a one-off payment to the workforce in 2010 and to increase pay by 2.7 per cent in 2011 are appropriate given the general economic situation.

The additional new 'Future in work' collective agreement, that was also signed, offers the Company, if required, the opportunity to restructure jobs in line with orders on hand but is also linked to job security. This new agreement also extends the obligation of the Company to verify whether it is possible to transfer trainees and apprentices to full-time employment on qualification, but without extending the rights of the individuals concerned.

EMPLOYEES

The process of workforce reduction that was started in 2009 will be concluded in 2010. We will continue to use short-time working to a small extent in 2010 as a means of adjusting capacity flexibly to the level of orders on hand. Research and development remain unaffected by these measures. As far as the workforce in production areas is concerned, the need for further restructuring will depend on sales figures during the course of the year.

STATUTORY REGULATIONS: EXHAUST-GAS EMISSION STANDARDS

Sales of diesel engines are strongly influenced by statutory provisions on emissions. These provisions lay down significant requirements to be met by producers. The emissions standard EURO V for diesel engines in road vehicles entered into force in the European Union on 1 October 2009. From 1 January 2011, the exhaust emissions standard COM III B will apply in the European Union and the corresponding EPA Tier 4 Interim will apply in the USA for diesel engines between 130 and 560kW in 'non-road' applications – i.e. in construction equipment, material handling vehicles and agricultural equipment. Analogous regulations for the power output range from 56 to 130kW are being introduced a year later on 1 January 2012, and even more stringent exhaust emissions limits will be introduced in 2013 and 2014. These are the final thresholds currently planned and when they are reached, nitrogen oxide (NOx) emissions will have been reduced by 95.7 per cent and soot particles by 96.5 per cent relative to the first thresholds that were introduced in 1999.

This enormous improvement in diesel exhaust emissions has only been possible through major technological advances, particularly in the areas of fuel injection and combustion management. It will no longer be possible to satisfy the emissions regulations that are due to come into force between 2011 and 2014 by making internal engine refinements alone; instead, expensive additional exhaust aftertreatment systems will be necessary.

RESEARCH AND DEVELOPMENT EXPENDITURE

Expenditure on research and development to meet the new exhaust emissions standards from 2011 and 2014 and on the development of new engines with a capacity of less than four litres will be even higher than the levels of 2009.

OUTLOOK FOR 2011

Economic forecasts predict that the global economy will continue to recover in 2011. We expect to see a correspondingly positive trend in new orders, unit sales and revenue. We plan to achieve further improvements in operating profit in both segments, helped by continuing positive effects from the MOVE FAST efficiency enhancement programme, which builds on the previous MOVE action programme. Research and development expenditure will remain at a high level and will continue to demand significant financial resources.

However, free cash flow will improve owing to the positive effects from the MOVE programme, the growth in unit sales and the even greater growth in revenue, the latter being attributable to the additional exhaust aftertreatment systems.

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

Assets

	Note	31/12/2009	31/12/2008
€ million			
Expenses for the expansion of operations	1	**0.0**	**10.4**
Intangible assets		18.3	24.9
Property, plant and equipment	2	276.4	279.4
Financial assets	2	187.6	181.9
Fixed assets		**482.3**	**486.2**
Inventories	3	83.4	155.1
Receivables and other assets	4	165.0	223.3
Cash and cash equivalents	5	210.5	200.2
Current assets		**458.9**	**578.6**
Prepaid expenses	6	0.8	3.7
Total assets		**942.0**	**1,078.9**

Equity and liabilities

Issued capital		309.0	309.0
Additional paid-in capital		26.8	26.8
Retained earnings			
Legal reserve		4.5	4.5
Other retained earnings		74.6	74.6
Accumulated income		-105.3	26.8
Equity	7	**309.6**	**441.7**
Provisions	8	257.7	278.6
Other liabilities	9	374.0	358.6
Deferred income		0.7	0.0
Total equity and liabilities		**942.0**	**1,078.9**

INCOME STATEMENT OF DEUTZ AG

€ million	Note	**2009**	**2008**
Revenue	14	795.5	1,417.0
Change in inventories	15	-18.5	-0.1
Other own work capitalised	15	0.6	0.7
Total output		**777.6**	**1,417.6**
Other operating income	16	100.7	87.2
Cost of materials	17	-611.0	-1,063.8
Staff costs	18	-212.3	-248.2
Depreciation, amortisation and impairment	19	-54.2	-61.8
Other operating expenses	20	-98.9	-139.5
Net investment income	21	7.1	14.4
Net interest income (expense)	22	-6.9	1.1
Profit (loss) from ordinary activities		**-97.9**	**7.0**
Net extraordinary expense	23	-25.8	-17.8
Income taxes	24	-7.3	4.2
Other taxes		-1.1	-0.8
Net loss		**-132.1**	**-7.4**
Profit carried forward		26.8	34.2
Accumulated income		**-105.3**	**26.8**

Notes to the financial statements

STATEMENT OF CHANGES IN FIXED ASSETS

€ thousand	Gross figures Acquisition and production costs 1/1/2009	Additions	Investment grants	Disposals	Reclassi-fications	31/12/2009	Gross figures Depreciation, amortisation and impairment 1/1/2009	Additions [1]	Disposals	31/12/2009	Net figures 31/12/2009	31/12/2008
Expenses for the expansion of operations	**41,513**	**0**	**0**	**41,513**	**0**	**0**	**31,135**	**10,379**	**41,514**	**0**	**0**	**10,378**
Patents, licences, trademarks and similar rights and assets, including licences for such rights and assets	91,364	8,456	1,996	7,871	325	90,278	66,501	14,101	7,610	72,992	17,286	24,863
Advances paid	0	1,012	0	0	0	1,012	0	0		0	1,012	0
Intangible assets	**91,364**	**9,468**	**1,996**	**7,871**	**325**	**91,290**	**66,501**	**14,101**	**7,610**	**72,992**	**18,298**	**24,863**
Land, leasehold rights and buildings, including buildings on land owned by others	179,771	724	0	1,863	22	178,654	51,639	4,467	236	55,870	122,784	128,132
Technical equipment and machines	366,360	12,329	8	5,609	5,662	378,734	264,987	17,289	5,589	276,687	102,047	101,373
Other equipment, furniture and fixtures	166,355	15,811	1,903	8,966	472	171,769	125,599	13,583	8,947	130,235	41,534	40,756
Advances paid and construction in progress	9,180	7,453	94	0	-6,481	10,058	0	0	0	0	10,058	9,180
Property, plant and equipment	**721,666**	**36,317**	**2,005**	**16,438**	**-325**	**739,215**	**442,225**	**35,339**	**14,772**	**462,792**	**276,423**	**279,441**
Investments in affiliated companies	150,882	7,000	0	0	0	157,882	65,878	0	0	65,878	92,004	85,004
Long-term equity investments	67,073	0	0	0	0	67,073	3,608	0		3,608	63,465	63,465
Loans to other long-term investees		0	0	0	0							
and investors	35,632	0	0	1,338	0	34,294	3,500	0	0	3,500	30,794	32,132
Other loans	2,098	0	0	7	0	2,091	796	0	1	795	1,296	1,302
Financial assets	**255,685**	**7,000**	**0**	**1,345**	**0**	**261,340**	**73,782**	**0**	**1**	**73,781**	**187,559**	**181,903**
Fixed assets	**1,068,715**	**52,785**	**4,001**	**25,654**	**0**	**1,091,845**	**582,508**	**49,440**	**22,383**	**609,565**	**482,280**	**486,207**
Total	**1,110,228**	**52,785**	**4,001**	**67,167**	**0**	**1,091,845**	**613,643**	**59,819**	**63,897**	**609,565**	**482,280**	**496,585**

1) The figure reported for depreciation, amortisation and impairment in the income statement differs by €5.6 million because impairment losses of €5.6 million have been included in net extraordinary expense.

STATEMENT OF CHANGES IN EQUITY

€ thousand	Issued capital	Additional paid-in capital	Retained earnings	Accumulated income (loss)	Total
Balance at 1 January 2008	**306,992**	**26,228**	**79,071**	**82,247**	**494,538**
Dividend paid to shareholders				-48,039	**-48,039**
Increased through conversion of convertible profit-sharing rights & convertible bonds	1,986	629		0	**2,615**
Net loss for 2008				-7,392	**-7,392**
Balance at 31 December 2008	**308,978**	**26,857**	**79,071**	**26,816**	**441,722**
Net loss for 2009				-132,159	**-132,159**
Balance at 31 December 2009	**308,978**	**26,857**	**79,071**	**-105,343**	**309,563**

BASIS OF PRESENTATION

The annual financial statements of DEUTZ AG for the financial year 2009 have been prepared in accordance with the requirements of the German Commercial Code (HGB) 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

DEPARTURE FROM ACCOUNTING POLICIES

The interest included in pension costs is now reported as part of staff costs instead of net interest expense in order to show the effective interest included in net interest expense. The interest component amounted to €8.8 million in 2009 (2008: €9.1 million). The comparative prior-year figures have been restated accordingly to improve comparability.

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 expected to be permanently 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 based on the operational planning (five-year period). 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 ongoing 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 as far as it approximates normal capacity.

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 and income received before the balance sheet date are recognised as prepaid expenses or deferred income respectively 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). A branch of DEUTZ AG in the UK has a funded pension plan which is recognised in accordance with IAS 19 with a discount rate of 5.75 per cent.

TAXES 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.

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.

3. INVENTORIES

€ thousand	31/12/2009	31/12/2008
Raw materials, consumables, bought-in parts and spare parts	58,405	108,586
Work in progress	20,410	32,086
Finished goods	5,880	12,718
	84,695	**153,390**
Advances paid	0	2,943
	84,695	**156,333**
Advances received for orders	-1,338	-1,251
Total	**83,357**	**155,082**

4. RECEIVABLES AND OTHER ASSETS

€ thousand	Thereof residual maturity up to 1 year	Thereof residual maturity over 1 year	31/12/2009 Total	31/12/2008 Total	Thereof residual maturity over 1 year
Trade receivables	80,387	0	80,387	74,487	0
Receivables from affiliated companies	48,257	0	48,257	92,641	0
Receivables from other long-term investees and investors	7,896	0	7,896	11,877	0
Other assets	19,649	8,771	28,420	44,294	7,254
Total	**156,189**	**8,771**	**164,960**	**223,299**	**7,254**

Trade receivables account for €12,057 thousand of the total receivables due from affiliated companies and €5,951 thousand of the total receivables from long-term investees and investors (31 December 2008: €26,023 thousand and €10,044 thousand respectively).

5. CASH AND CASH EQUIVALENTS

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

6. PREPAID EXPENSES

Advance pension payments are the main item under prepaid expenses of €0.8 million (31 December 2008: €3.7 million). In the prior year, advance interest payments were also a major item included under prepaid expenses.

7. EQUITY

Issued capital
At the end of 2009, the issued capital (share capital) of DEUTZ AG amounted to €308,978,241.98 (31 December 2008: €308,978,241.98) and was divided into 120,861,783 no-par-value bearer shares (31 December 2008: 120,861,783).

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
Conditional capital as at 31 December 2009 amounted to €0 thousand (31 December 2008: €174 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 38.

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, 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, 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, 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 2009 or 2008.

8. PROVISIONS

€ thousand	31/12/2009	31/12/2008
Provisions for pensions and other post-retirement benefits	147,235	152,431
Provisions for taxes	6,556	1,942
Other provisions	103,913	124,236
Total	**257,704**	**278,609**

Other provisions cover all identifiable risks and other contingent liabilities. The main items covered are the cost of warranties and potential risks (€23.6 million), discounts and price reductions (€16.5 million), provisions for staff costs and social insurance (€18.6 million), provisions for personnel restructuring (€11.6 million) and provisions for impending losses (€6.7 million).

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.

9. LIABILITIES

€ thousand	Thereof residual maturity up to 1 year	Thereof residual maturity 1 to 5 years	Thereof residual maturity over 5 years	31/12/2009 Total	31/12/2008 Total	Thereof residual maturity up to 1 year
Bond (USPP)	0	100,864	102,374	203,238	203,237	0
Liabilities to banks	33	0	0	33	417	417
Trade payables	115,643	0	0	115,643	117,367	117,367
Liabilities to affiliated companies	18,961	0	5,275	24,236	23,752	18,137
Liabilities to other long-term investees and investors	77	0	0	77	0	0
Liabilities arising from taxes	27	0	0	27	40	40
Liabilities relating to social security	14,085	1,223	698	16,006	977	977
Sundry other liabilities	14,766	0	0	14,766	12,815	12,504
Total	**163,592**	**102,087**	**108,347**	**374,026**	**358,605**	**149,442**

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 2½, 4½ and 7½ 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. DEUTZ is under an obligation to comply with certain covenants. DEUTZ has responded promptly to the changes in economic

conditions and has started negotiations with investors about adjusting the key financial indicators. Starting on 29 September 2009 we agreed waivers with our creditors that exempt us from the obligation to comply with the financial covenants and postpone the dates on which our compliance with these covenants is assessed, which has enabled us to avoid breaching our contractual obligations. Over this period the coupon was increased by 2 percentage points. An agreement signed with the private placement creditors after the reporting period finalised the key points. In particular, a term sheet stipulated the originally agreed interest rates payable, the terms to maturity, the financial covenants to be complied with in future as well as other terms and conditions (including credit facility bank finance and the provision of collateral). The maturity of the tranche originally due in 2017 has been shortened by three years. Please also refer to our disclosures on funding in the 'Financial position' section of the management report and to the information provided on financial risks arising from the US private placement in the 'Risk report' section.

Liabilities to affiliated companies and liabilities to other long-term investees and investors include predominantly finance liabilities from loans and from central financing by the parent company.
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 following derivative financial instruments were reported as at the balance sheet date:

	Notional amount	Notional amount	Fair value	Fair value
	2009	2008	2009	2008
€ million				
Currency forwards	11.6	53.7	0.0	-1.2
Cross-currency swap	160.2	160.2	-10.3	8.5
Commodities	3.7	4.1	0.6	-1.1

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 foreign exchange rates, commodity prices, market interest rates and yield curves.

Under German accounting rules, these financial instruments are classified as pending transactions, which means that provisions have to be recognised for impending losses from pending transactions where applicable. At 31 December 2009, an other provision of €39 thousand had been recognised (31 December 2008: €1.1 million).

The cross-currency swaps are used for hedging interest payments and principal repayments in US dollars on the US private placement of US$ 274 million that was issued in 2007. Around 20 per cent of the total volume (€43.0 million) was taken up directly in euros with the remainder in US dollars (US$ 216.1 million) hedged in euros. Any excess loss from the underlying transaction or the hedging transaction is recognised in the income statement in accordance with the imparity principle.

11. CONTINGENT LIABILITIES AND OTHER FINANCIAL OBLIGATIONS

Contingent liabilities

	2009	2008
€ thousand		
Liabilities on endorsed bills of exchange	1,831	2,626
Liabilities on guarantees	21,349	29,093
thereof for affiliated companies	21,349	27,616
Liabilities on warranties	2,021	1,974
thereof for affiliated companies	282	261
Total	**25,201**	**33,693**

Other financial obligations
At 31 December 2009, DEUTZ AG had total other financial obligations of €90.0 million (31 December 2008: €84.7 million) that were neither reported on the balance sheet nor included under contingent liabilities. Of that total, €1.7 million (31 December 2008: €1.7 million) was due to affiliated companies.

These obligations relate to leases with a nominal value of €17.7 million (31 December 2008: €25.1 million), commitments to purchase property, plant and equipment and intangible assets amounting to €28.9 million (31 December 2008: €30.6 million), and commitments to purchase inventories amounting to €43.4 million (31 December 2008: €29.0 million).

DEUTZ AG's obligations under leases were not offset by any receivables (31 December 2008: receivables of €0.4 million).

12. OFF-BALANCE-SHEET TRANSACTIONS

Factoring
DEUTZ makes use of the opportunity to sell receivables in order to optimise receivables management. Based on past experience of average collection targets, €70.6 million of the receivables sold during the year under review would still have been open at 31 December 2009.

13. 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.

14. REVENUE

Breakdown by segment

€ million	2009	2008
Engines	525.8	1,043.5
Services	75.6	49.3
DEUTZ Compact Engines	**601.4**	**1,092.8**
Engines	120.4	225.2
Services	73.7	99.0
DEUTZ Customised Solutions	**194.1**	**324.2**
Total	**795.5**	**1,417.0**

Breakdown by region

€ million	2009	2008
Europe/Middle East/Africa	**685.3**	**1,104.7**
thereof Germany	202.4	304.7
thereof Europe	438.9	725.0
thereof Africa	21.2	39.3
thereof Middle East	22.8	35.7
Americas	**43.0**	**144.7**
Asia Pacific	**67.9**	**167.6**
Total	**796.2**	**1,417.0**

15. CHANGE IN INVENTORIES AND OTHER OWN WORK CAPITALISED

Change in inventories

€ thousand	2009	2008
Inventories as at 1 January	44,804	44,940
Inventories as at 31 December	26,290	44,804
Change in inventories	**-18,514**	**-136**

Other **own work** capitalised amounted to €0.6 million (2008: €0.7 million).

16. 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 €25.3 million (2008: €8.8 million) and the reversal of write-downs amounting to €0.7 million (2008: €2.1 million).

17. COST OF MATERIALS

€ thousand	**2009**	**2008**
Cost of raw materials, consumables and purchased merchandise	567,165	1,005,621
Cost of services procured	43,842	58,186
Total	**611,007**	**1,063,807**

18. STAFF COSTS

€ thousand	**2009**	**2008**
Wages and salaries	167,089	201,314
Social security contributions and other employee benefits	33,226	35,758
Pensions and other post-retirement benefits	11,980	11,087
Total	**212,295**	**248,159**

Average number of employees during the year

	2009	**2008**
Non-salaried employees	2,099	2,408
Salaried employees	1,257	1,299
Trainees	170	164
Total	**3,526**	**3,871**

19. DEPRECIATION, AMORTISATION AND IMPAIRMENT

	2009	2008
€ thousand		
Expenses for the expansion of operations	10,379	10,379
Intangible fixed assets	10,475	11,275
Property, plant and equipment	33,321	40,161
Total	**54,175**	**61,815**

Depreciation and amortization includes write-downs of €85 thousand (2008: €200 thousand). In addition, in 2009 impairment losses of a total of €5.6 million were recognized for items of intangible assets and property, plant and equipment. These write-downs were recognized as extraordinary expenses in the income statement.

20. 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, compensation payments for lower order volumes, 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.

21. NET INVESTMENT INCOME

	2009	2008
€ thousand		
Income from profit transfer agreements	1,592	1,567
Income from long-term equity investments		
in affiliated companies	4,555	11,876
in other companies	995	967
Total	**7,142**	**14,410**

22. NET INTEREST EXPENSE

€ thousand	2009	2008
Income from other securities and lending of financial fixed assets	1,837	1,850
thereof received from affiliated companies	1,759	1,782
Other interest and similar income	14,399	23,550
thereof received from affiliated companies	1,582	3,293
Other interest and similar expenses	-23,095	-24,267
thereof owed to affiliated companies	-435	-2,023
Total	**-6,859**	**1,133**

23. NET EXTRAORDINARY EXPENSE

€ thousand	2009	2008
Extraordinary income	0	0
Extraordinary expenses	-25,872	-17,832
Total	**-25,872**	**-17,832**

Extraordinary expenses in the year under review comprise, in particular, personnel restructuring costs of €19.4 million incurred in connection with the MOVE action programme and impairment losses totalling €5.6 million as a result of fixed assets being written down to fair value. The impairment losses are mainly related to capitalised development expenditure, including licences and equipment for a series of small engines with outputs of up to 27kW and for series of engines with outputs of between 15kW and 50kW.

24. INCOME TAXES

Income taxes of €7.3 million resulted from a tax audit at DEUTZ AG completed in the current year and covering the years 2002 to 2005, the subsequent impact of this tax audit on the financial years 2006 to 2008, and an adjustment/amendment to the 2007 tax return in connection with the discontinued DEUTZ Power Systems segment.

25. OTHER INFORMATION

Corporate governance
In December 2009, the Board of Management and the Supervisory Board of DEUTZ AG issued a declaration of compliance with the recommendations of the German Corporate Governance Code government commission pursuant to section 161 AktG and made this declaration publicly available to shareholders on the Company's website (www.deutz.com).

Auditors' fees
The following fees were recognised as an expense in 2009 and 2008:

	2009	2008
€ thousand		
Auditing	391	354
Other attestation services	313	525
Other services	10	6
Total	**714**	**885**

The details of the auditing fees for 2009 include an amount of €76 thousand which relates to auditing fees for 2008.

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:

€ thousand		Fixed remuneration	Variable remuneration[1]	Other[2]	Total	Number of virtual share options granted	Fair value at grant date	Recognised expense (+)/ income (-) for virtual share options
Dr Helmut Leube	2009	624	600	170	1,394	0	0	106
(since 1 February 2008)	2008	619	550	168	1,337	225,000	760	121
Gino Mario Biondi	2009	483	231	157	871	0	0	23
	2008	450	65	155	670	60,000	178	23
Dr Margarete Haase	2009	338	176	138	652	60,000	117	121
(since 1 April 2009)	2008	0	0	0	0	0	0	0
Karl Huebser	2009	113	180	7	300	0	0	0
(until 31 March 2009)	2008	450	270	229	949	0	0	0
Helmut Meyer	2009	113	0	41	154	0	0	-50
(until 31 March 2009)	2008	450	202	154	806	60,000	178	-37
Total	**2009**	**1,671**	**1,187**	**513**	**3,371**	**60,000**	**117**	**200**
Total	**2008**	**1,969**	**1,087**	**706**	**3,762**	**345,000**	**1,116**	**107**

1) The variable remuneration represents the provision for the annual bonus for the year under review including any surplus/shortfall from the previous year.

2) including payment of life insurance premiums

Termination arrangements The employment contracts of the members of the Board of Management provide for a compensation payment in the event of premature termination of the contract without good cause. In accordance with the rules under the German Corporate Governance Code, the amount of this compensation payment is limited to twice the amount of annual remuneration (severance cap) and may not exceed the remuneration due for the remaining term of the contract.

The contracts also provide for a subsequent prohibition of competition. In addition, members of the Board of Management are contractually prohibited from providing services to or for a competitor for a period of one year after leaving the Company. As compensation for this requirement, they receive a payment equivalent to two-thirds of the average remuneration they received in the preceding three years.

The total payments to Helmut Meyer in connection with his retirement from the Board of Management amount to €2.5 million; similar payments to Karl Huebser amount to a total of €1.0 million.

Remuneration paid to former members of the Board of Management and their surviving dependants This remuneration amounted to €1,485 thousand (2008: €1,482 thousand) for DEUTZ AG and the Group; a provision of €12,503 thousand (31 December 2008: €12,799 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
Lars-Göran Moberg Chairman (since 18 May 2009)	18,278	27,400	45,678
Dr Giuseppe Vita (until 31 July 2009) Chairman (until 18 May 2009)	10,788	19,800	30,588
Werner Scherer Deputy Chairman	16,875	32,550	49,425
Ing Massimo Bordi	11,250	9,400	20,650
Dr Francesco Carozza	11,250	8,500	19,750
Michael Haupt	11,250	25,400	36,650
Dr Helmut Lerchner	11,250	8,500	19,750
Dr Michael Lichtenauer (since 10 August 2009)	4,438	1,800	6,238
Helmut Müller (until 30 April 2009)	3,699	4,000	7,699
Karl-Heinz Müller	11,250	12,300	23,550
Dr Witich Roßmann	11,250	8,500	19,750
Susanne Scholtyssek	11,250	8,500	19,750
Dr Herbert Vossel (since 30 April 2009)	7,582	4,500	12,082
Egbert Zieher	11,250	8,500	19,750
Total	**151,660**	**179,650**	**331,310**

The Supervisory Board meeting held on 30 April 2009 decided that the members of the Supervisory Board would forego 10 per cent of both their fixed remuneration and their attendance fees for 2009.

Advances and loans to members of the Board of Management and the Supervisory Board
As at 31 December 2009 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 55. 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 52 and 53.

Cologne, 11 March 2010

DEUTZ Aktiengesellschaft
The Board of Management

Dr Helmut Leube Dr Margarete Haase Gino Mario Biondi

SHAREHOLDINGS OF DEUTZ AG

As at 31 December 2009

Ref. No.	Name and registered office of the company	Holding (%)	Equity (€ thousand)	Net income (€ thousand)
1	DEUTZ AG	-	309,563	-132,159
	Affiliated companies			
	Germany			
2	Unterstützungsgesellschaft mbH der DEUTZ Aktiengesellschaft, Cologne	100.0	-2,505	-34
3	Deutz- Mülheim Grundstücksgesellschaft mbH, Düsseldorf	19.6	-20,720	513
4	DEUTZ Beteiligung GmbH, Cologne	100.0	25	0
	Outside Germany			
5	DEUTZ DITER S.A., Zafra/Spain	100,0	22,828	1,984
6	DEUTZ FRANCE S.A., Gennevilliers/France	100,0	9,639	162
7	DEUTZ UK Ltd., Cannock/UK	100,0	12,860	-1,161
8	Nlle Ste MAGIDEUTZ S.A., Casablanca/Morocco	100,0	1,714	354
	Americas			
9	Deutz Corporation, Atlanta/USA	100,0	15,581	-8,272
	Asia-Pacific			
10	DEUTZ Asia-Pacific (Pte) Ltd., Singapore/Singapore	100,0	5,034	1,409
11	Deutz Australia (Pty) Ltd., Braeside/Australia	100,0	5,643	358
	Associates			
	Outside Germany			
12	D. D .Power Holdings (Pty) Ltd., Elandsfontein/South Africa	30.0	10,839	3,323
13	DEUTZ AGCO MOTORES S.A., Haedo/Argentina	50.0	4,592	-162
14	DEUTZ (Dalian) Engine Co., Ltd., Dalian/China	50.0	88,336	-10,465

SUPERVISORY BOARD

Lars-Göran Moberg

Chairman (since 18 May 2009)
Management consultant and supervisory board member, Stockholm, Sweden

b) Haldex AB, Stockholm, Sweden, Chairman
Volvo Construction Equipment NV, Beesd, Netherlands
Volvo Aero AB, Trollhättan, Sweden
Fourier Transform AB, Stockholm, Sweden
Cross Country System AB, Alfta, Sweden

Dr Giuseppe Vita

(until 31 July 2009)
Chairman (until 18 May 2009)
Chairman of the Supervisory Board of Axel Springer AG, Berlin

a) Axel Springer AG, Berlin, Chairman
Medical Park AG, Bad Wiessee
Dussmann Verwaltungs AG, Berlin

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[1)]

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

Ing Massimo Bordi

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

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

Dr Francesco Carozza

Vice President of SAME DEUTZ-FAHR ITALIA S.p.A., Treviglio, 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., Treviglio, Italy
SAME DEUTZ-FAHR Agricultural Machinery (Dalian) Co. Ltd., Dalian, China, Deputy Chairman
I.T. International Transmissions S.A., Stabio, Switzerland, Chairman

Michael Haupt

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

Dr Helmut Lerchner

Management consultant

a) ElringKlinger AG, Dettingen/Erms, Chairman

Dr Michael Lichtenauer

(since 10 August 2009)
Lawyer

a) Verwaltungsgesellschaft Otto mbH, Hamburg
Schwartauer Werke GmbH & Co. KGaA, Bad Schwartau
b) ELAFLEX-Hiby Tanktechnik GmbH & Co., Hamburg, Chairman
MPC Münchmeyer Petersen & Co. GmbH, Hamburg

Helmut Müller[1)]

(until 30 April 2009)

Chairman of the Senior Staff Committee of DEUTZ AG, Cologne

Karl-Heinz Müller[1)]

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

Dr Witich Roßmann[1)]

Chief Executive of IG Metall Cologne, Cologne

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

Susanne Scholtyssek[1)]

Head of Personnel Development at IG Metall

Dr Herbert Vossel[1)]

(since 30 April 2009)

Head of Legal and Patents at DEUTZ AG

Egbert Zieher[1)]

Chairman of the Ulm Works Council of DEUTZ AG, Ulm

[1)] 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

Lars-Göran Moberg, Chairman (since 28 May 2009)
Dr Giuseppe Vita, Chairman (until 18 May 2009)
Werner Scherer, Deputy Chairman
Michael Haupt

Audit Committee

Michael Haupt, Chairman
Werner Scherer, Deputy Chairman
Karl-Heinz Müller
Lars-Göran Moberg (since 18 May 2009)
Dr Giuseppe Vita (until 18 May 2009)

Arbitration Committee

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

Lars-Göran Moberg, Chairman (since 18 May 2009)
Dr Giuseppe Vita, Chairman (until 18 May 2009)
Michael Haupt
Werner Scherer
Egbert Zieher

Nominations Committee

Lars-Göran Moberg, Chairman (since 18 May 2009)
Dr Giuseppe Vita, Chairman (until 18 May 2009)
Michael Haupt
Ing Massimo Bordi

BOARD OF MANAGEMENT

Dr Helmut Leube (56)

Chairman

Sales, Service and Head Office Functions

a) KUKA AG, Augsburg (until 18 September 2009)

b) Deutz Corporation, Atlanta, USA, Chairman

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

Gino M. Biondi (50)

Procurement, Logistic, Production and Research & Development

b) DEUTZ DITER S.A., Zafra, Spain, Chairman

DEUTZ AGCO Motores S.A., Haedo, Argentina (since 30 June 2009)

Dr Margarete Haase (56)

Finance, Investor Relations and Human Resources

(since 1 April 2009)

b) DEUTZ (Dalian) Engine Co. Ltd., Dalian, China (since 2 April 2009)

Karl Huebser (64)

(until 31 March 2009)

b) DEUTZ (Dalian) Engine Co. Ltd., Dalian, China (until 31 March 2009)

Weifang Weichai Deutz Diesel Engine Co. Ltd., Weifang, China, Chairman (until 31 March 2009)

Helmut Meyer (60)

(until 31 March 2009)

b) DEUTZ Asia-Pacific (Pte) Ltd., Singapore, Singapore, Chairman (until 31 March 2009)

DEUTZ (Dalian) Engine Co. Ltd., Dalian, China (until 31 March 2009)

DEUTZ Corporation, Norcross, Georgia, USA (until 31 March 2009)

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, 11 March 2010

DEUTZ Aktiengesellschaft
The Board of Management

Dr Helmut Leube   Gino M. Biondi   Dr Margarete Haase

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 2009. 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.

Without qualifying our opinion, we draw attention to the statements given by Management in the Group Management Report. In the Section “Financing” it is stated that DEUTZ Aktiengesellschaft, Cologne, was heavily impacted in the financial year 2009 by the effects of the financial and economic crisis.

Due to the threatening breach at the end of the third quarter of 2009 of the financial covenants agreed as part of the US Private Placement negotiations were entered into with the creditors of the US Private Placement and a bank consortium with the aim of securing new financing and adjusting the credit conditions to the current economic situation. In addition, waiver agreements were concluded with respect to compliance with the Financial Covenants and a deferral of the measuring dates.

Based on the negotiations with the creditors of the US Private Placement and bank consortium and their expected successful completion, Management considers that the financing is adequately assured and that, based on the mid-term planning of DEUTZ Aktiengesellschaft, Cologne, the future Financial Covenants will be complied with.

Düsseldorf, 11 March 2010
Deloitte & Touche GmbH
Wirtschaftsprüfungsgesellschaft

signed: Crampton
Wirtschaftsprüfer
(German Public Auditor)

signed: Lammers
Wirtschaftsprüferin
(German Public Auditor)