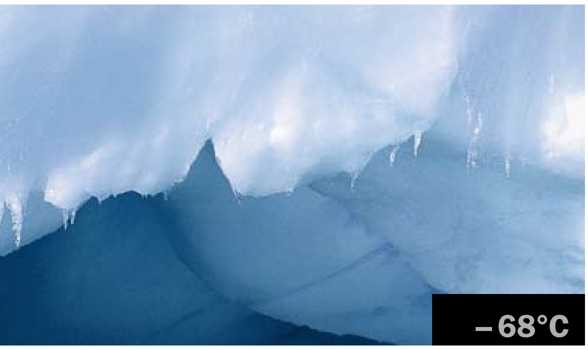
Working together to meet the challenges ahead



Annual Report 2007

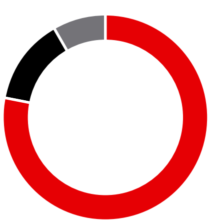
DEUTZ

DEUTZ Group: Key figures

IFRS		2004	2005	Continuing operations 2006	Continuing operations 2007	Change in %
New orders	€ million	1,265.1	1,350.5	1,296.9	1,584.5	22.2
Unit sales	No.	173,440	195,843	236,679	285,861	20.8
Compact Engines	No.	172,684	195,082	199,202	248,971	25.0
DEUTZ Customised Solutions	No.	–	–	37,477	36,890	–1.6
DEUTZ Power Systems	No.	756	761	–	–	–
Revenue	€ million	1,242.3	1,322.8	1,183.6	1,524.2	28.8
thereof excl. Germany	%	74.5	73.0	74.6	78.0	–
Compact Engines	€ million	909.9	999.7	868.3	1,186.0	36.6
DEUTZ Customised Solutions	€ million	–	–	315.3	338.2	7.3
DEUTZ Power Systems	€ million	332.4	323.1	–	–	–
EBITDA	€ million	81.8	180.0	125.3	161.0	28.5
EBITDA (before one-off items)	€ million	113.9	121.5	125.3	161.0	28.5
EBIT	€ million	18.5	114.7	66.6	95.5	43.4
Operating profit (EBIT before one-off items)	€ million	53.5	62.5	66.6	95.5	43.4
EBIT margin before one-off items	%	4.3	4.7	5.6	6.3	–
Net income/loss	€ million	–18.7	71.4	61.5	183.3	–
continuing operations	€ million	–	–	38.5	59.4	54.3
discontinued operations	€ million	–	–	23.0	123.9	–
Total assets	€ million	1,029.1	1,063.8	1,162.9	1,378.6	18.5
Non-current assets	€ million	462.5	479.2	499.1	511.3	2.4
Equity	€ million	158.7	247.0	358.5	557.1	55.4
Equity ratio	%	15.4	23.2	30.8	40.4	–
Cash flow from operating activities before payment of compensation for vested company pension rights	€ million	111.9	143.4	84.4	41.1	–51.3
Cash flow from operating activities	€ million	111.9	143.4	84.4	–38.7	–
Net financial position [1]	€ million	–232.4	–89.7	–34.0	89.7	–
Working capital [2]	€ million	314.1	238.1	133.1	196.9	47.9
as a percentage of revenue	%	25.3	18.0	11.2	12.9	–
Capital expenditure (excl. capitalisation of R&D)	€ million	43.0	67.6	81.9	143.5	75.2
Depreciation	€ million	63.3	65.3	58.7	65.5	11.6
Research and development	€ million	69.5	66.9	54.8	55.8	1.8
Employees as at 31 December	Number	5,472	5,058	4,331	4,617	6.6

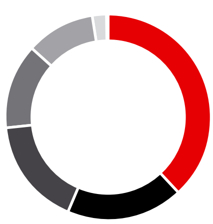
[1] Net financial position: cash and cash equivalents less current and non-current interest-bearing financial liabilities.
[2] Working capital: inventories plus trade receivables minus trade payables.

DEUTZ Group: Revenue by region
€ million (2006 figures)



- **1,193.2** (896.3): Europe/Middle East/Africa
- **207.2** (210.2): Americas
- **123.8** (77.1): Asia-Pacific

Compact Engines: Revenue by application segment
€ million (2006 figures)

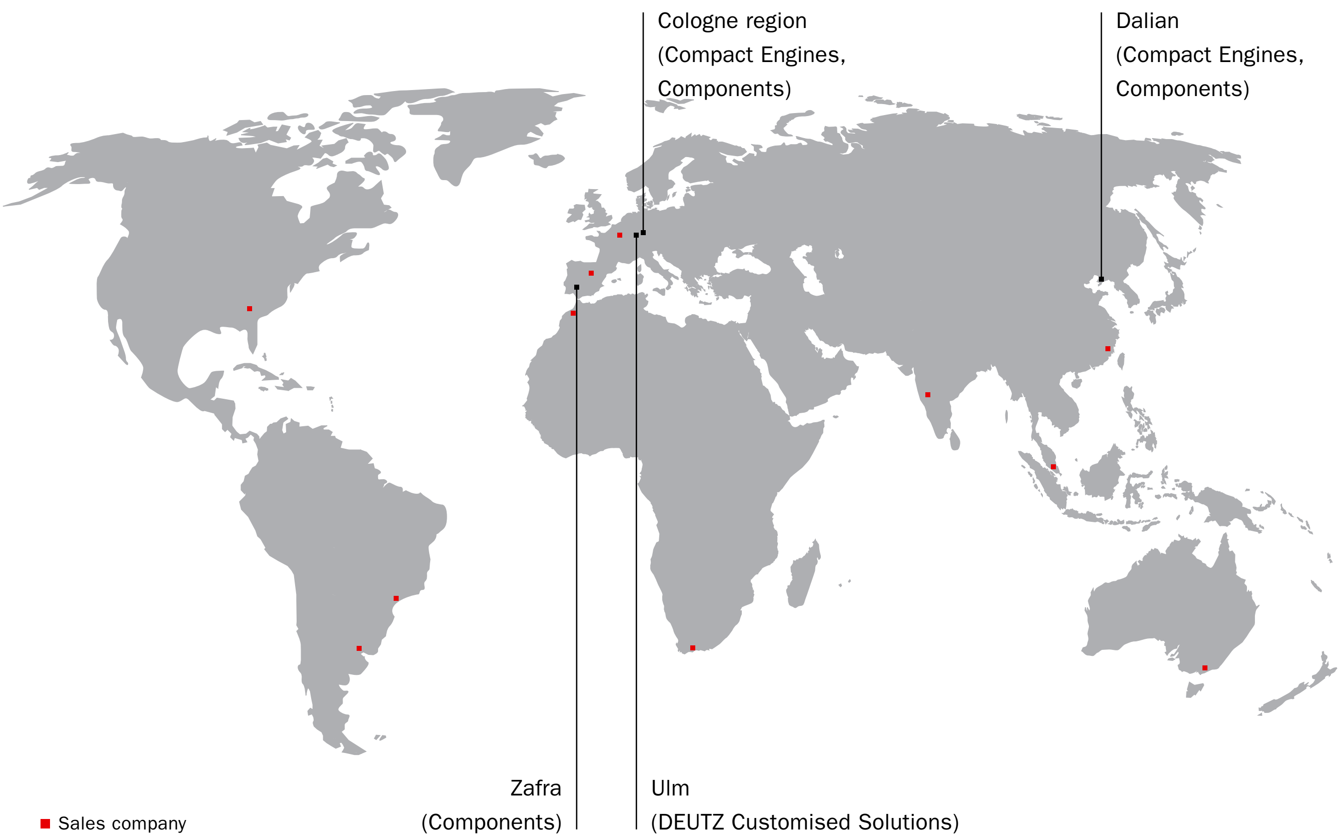


- **581.3** (440.9): Mobile Machinery
- **279.8** (119.4): Automotive
- **258.8** (260.4): Stationary Equipment
- **203.5** (179.7): Service
- **163.7** (146.8): Agricultural Machinery
- **37.1** (36.4): Miscellaneous

DEUTZ segments

	1–12/2007	1–12/2006
€ million		
New orders		
Compact Engines	**1,203.9**	**950.4**
DEUTZ Customised Solutions	380.6	346.5
Continuing operations	**1,584.5**	**1,296.9**
Unit sales		
Compact Engines	248,971	199,202
DEUTZ Customised Solutions	36,890	37,477
Continuing operations	**285,861**	**236,679**
Revenue		
Compact Engines	1,186.0	868.3
DEUTZ Customised Solutions	338.2	315.3
Continuing operations	**1,524.2**	**1,183.6**
Operating profit (EBIT before one-off items)		
Compact Engines	45.3	37.8
DEUTZ Customised Solutions	44.7	30.5
Other	5.5	–1.7
Continuing operations	**95.5**	**66.6**

Worldwide presence



Highlights 2007

January 2007 Nine months after the decision was taken to assemble all air-cooled diesel engines in Ulm, production commences at this site. This move increases the annual capacity of the Ulm plant to approximately 35,000 engines.

March 2007 DEUTZ presents its comprehensive range of diesel engines for agricultural applications at the SIMA exhibition. The four-cylinder engines of the highly successful 2011 series will for the first time also be available as water-cooled engines from the end of 2007.

The one-millionth engine of the 1011/2011 series leaves the production line in Cologne-Porz. The reliability and robustness of the 2011 have made it the most successful industrial engine in its category. These oil-cooled engines have been fitted in over 200 different types of equipment to date.

April 2007 The Bauma exhibition – the leading trade fair for the construction and mining industries – is all about innovation this year. DEUTZ becomes the first manufacturer to exhibit a hybrid drive system for use in mobile machinery. Working with Atlas Weyhausen, a manufacturer of construction equipment, DEUTZ develops this drive system to production standard.

July 2007 DEUTZ sells its business in gas engines and diesel engines used for decentralised power generation (DEUTZ Power Systems) for a price of €360 million.

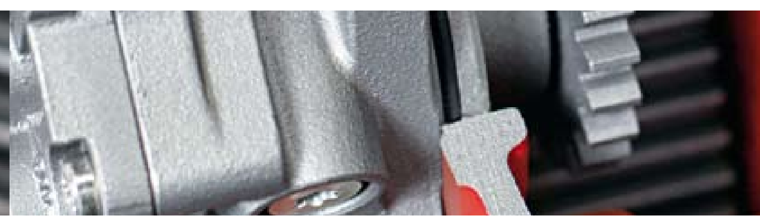
August 2007 A further milestone in the history of DEUTZ is the official launch of its Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd. on 1 August. DEUTZ has invested €58 million in this company in return for 50 per cent of its shares. Its initial annual capacity of 150,000 engines can be increased to 200,000 over the medium term.

Official inauguration ceremony for the technology centre in Cologne-Porz, where DEUTZ now exhibits the world's most impressive collection of engines. The highlight of the exhibition is the atmospheric gas-powered engine (DEUTZ engine number 1) dating from 1867.

November 2007 DEUTZ presents its Natural Fuel Engines® – a world first – at the Agritechnica exhibition, the largest trade fair for agricultural equipment.

Contents

The face of engine construction is changing. Future-proof solutions are being created by engine and equipment manufacturers who are **interlinking their core competencies** to overcome the challenges of an **increasingly complex** environment.



Read more in our magazine section from page 11.

Foreword

Dear shareholders,
friends and partners of our company,

"Working together to meet the challenges ahead" is the main theme of our annual report for 2007. But it is more than just an eye-catching heading; it is also the main theme of the financial year just ended, and our maxim for the years ahead.

The year 2007 was a good year for DEUTZ and was characterised by exceptional growth. We can look back with pride on the 286,000 engines we sold in 2007 – 21 per cent more than in 2006 – and on the revenue of roughly €1.5 billion this generated, a huge year-on-year increase of 30 per cent. We raised our operating profit by 43 per cent to €95.5 million, thereby improving our EBIT margin by 0.7 percentage points to 6.3 per cent. We are pleased with this return, even though we did not quite achieve our original target of 7 per cent, owing to capacity bottlenecks for components and related cost inefficiencies. The first year of series production of our new TCD 2013 4V engine, of which we manufactured over 31,000 units, was also highly successful.

This encouraging level of growth – not only at DEUTZ but throughout the engineering sector – meant that our production capacities, as well as those of our suppliers and partners, were fully utilised. This resulted in supply bottlenecks with both internal and external deliveries of components, which, in turn, caused cost inefficiencies and longer delivery periods. By working closely with our suppliers we managed to largely eradicate these capacity bottlenecks over the course of the year. To achieve this we invested some €86 million in property, plant and equipment and intangible assets, established additional sources of supply and continued to make our engine production more flexible by introducing new shift-working patterns and using temporary staff.

Our overriding objective is to remain a reliable partner to our customers, because we are well aware that our success depends crucially on our commitment, efficiency and expertise. Our customers can rely on the fact that we will never fail to meet their needs at all times, while offering them future-proof solutions. The development of innovative engines and gensets that meet the full range of our clients' technological demands and requirements, therefore, continues to be the challenge we have set ourselves. For this reason we spent €56 million – or 3.7 per cent of our total revenue – on research and development in 2007. The introduction of new emissions standards will necessitate further capital expenditure in this field, to ensure that we can continue to offer innovative products to our customers.

from left to right:
Dr Helmut Leube Chairman of the Management Board
Helmut Meyer Management Board: Finance/Personnel
Gino Mario Biondi Management Board: Logistics/Procurement
Karl Huebser Management Board: Technology

DEUTZ is a dynamic company. We are constantly adjusting to new demands and market conditions. Therefore, we are using the proceeds from the disposal of DEUTZ Power Systems, which we completed on 30 September last year, to continue growing our Compact Engines business. We aim to achieve a leading position in the market for exhaust-gas aftertreatment, in particular.

In 2007, we demerged DEUTZ Customised Solutions from our Compact Engines business in order to focus on profitable niche applications based on air-cooled engines. The results so far are highly encouraging: the start-up of assembly operations following their relocation from Cologne to Ulm was a great success, as was our presentation of a new range of gensets based on air-cooled engines at the Bauma exhibition in April 2007.

“Our objective for the coming years is clear: technology leadership and the even greater internationalisation of our company.”

Dr Helmut Leube

But DEUTZ has ambitious plans, not just in Germany, but also for its international activities – especially in China, where, in December 2006, we signed an agreement with FAW Jiefang to set up the joint venture DEUTZ (Dalian) Engine Co., Ltd. (DEUTZ Dalian), which started trading on 1 August 2007. In its first five months alone it manufactured over 42,000 engines, roughly 3,000 of them featuring DEUTZ’s cutting-edge technology. We are currently focusing our efforts on finding local suppliers for our production that meet our exacting quality standards. This year we aim to produce between 100,000 and 120,000 engines in Dalian, equipping as many as 20,000 of them with DEUTZ technology, increasing this figure to over 40,000 units in 2009, with a target capacity of 100,000 engines in 2010.

We have set ourselves challenging targets for the current financial year. We aim to manufacture over 300,000 engines (excluding those produced by our Chinese joint venture), and we plan to raise our consolidated revenue by a further 10 to 15 per cent and achieve an EBIT margin of around 7 per cent.

Dear shareholders, we can look back on a successful 2007 that demonstrates the achievements of our efforts. As you have continued to support DEUTZ AG over this period, we have decided that you should share in the fruits of this success. Therefore, we are delighted that for 2007, we will be able to pay you a dividend for the first time in over 20 years which, because of the sale of DEUTZ Power Systems, will be higher than originally planned. We will propose to the Annual General Meeting in Cologne on 21 May this year that a dividend of €0.40 per share be paid.

Our aim is to ensure that our company remains attractive for you, our shareholders, and all other stakeholders. Although we will no doubt have to overcome some challenges facing the Company's future over the next two to three years, we have already made good headway in this direction by steadily improving our operating profit, achieving an ROCE of 13.5 per cent and planning to pay a dividend for 2007.

Finally, we would like to express our gratitude to our shareholders and customers for the trust they have placed in our organisation. We wish to thank our customers, suppliers and partners in both services and distribution for their outstanding contribution and, last but not least, our staff, who demonstrated considerable enthusiasm and dedication in enabling our company to make such significant progress in 2007.

We are convinced that DEUTZ can sustain this success.

Kind regards,

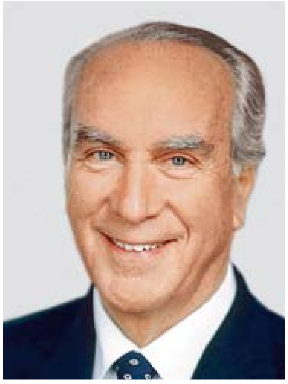
Dr Helmut Leube

Karl Huebser

Gino Mario Biondi

Helmut Meyer

Report of the Supervisory Board



Dr Giuseppe Vita
Chairman

Close working relationship between Management Board and Supervisory Board

In 2007, the Supervisory Board once again constantly monitored the governance of the Company and advised the Management Board on major decisions. The key issues in this connection were the Company's strategy, the development and performance of its business, and changes of personnel at senior management level.

The flow of information between the Supervisory Board and the Management Board that is essential to the smooth functioning of such a relationship was, once again, forthcoming in all respects during the year under review. The Management Board notified the Supervisory Board regularly, comprehensively and promptly, both in writing and orally, about the Company's business operations, its risk position and risk management, all relevant aspects of strategic planning, and transactions requiring the Supervisory Board's consent. Outside the meetings, the Management Board regularly informed the members of the Supervisory Board in writing about important events. Furthermore, the Chairman of the Management Board remained in constant contact with the Supervisory Board Chairman and kept him informed in a timely manner about all major transactions and decisions that needed to be made. The Supervisory Board adopted all resolutions required by law and the Company's statutes based on the reports and draft resolutions submitted by the Management Board.

Eleven Supervisory Board meetings

Five scheduled and six extraordinary Supervisory Board meetings were held in 2007. No member of the Supervisory Board was absent for more than half of the meetings.

Internationalisation and focus on core business

The lengthy discussions and deliberations between the Management Board and the Supervisory Board focussed on two strategic decisions of great importance for the Company's future: first, the implementation of the agreement signed by DEUTZ and FAW Jiefang at the end of 2006, to set up a 50/50 joint venture to produce diesel engines in China (DEUTZ Dalian) and, second, the disposal of the DEUTZ Power Systems division. At its extraordinary meeting on 12 January 2007, the Supervisory Board unanimously approved the joint-venture agreement with FAW Jiefang; at several meetings held during the further course of the year it discussed the implementation status of the joint-venture agreement. In particular, it examined the structure of the deal, the material content of the agreement, management topics, finance issues and key performance indicators.

Prior to the sale of DEUTZ Power Systems the Supervisory Board scrutinised the strategic options available for this business and the impact they would have on the DEUTZ Group. The main topics of discussion here were product- and market-related aspects, HR issues, the capital expenditure and finance needed, questions of risk and liability, and the impact on the DEUTZ Group's key financial ratios. At its extraordinary meeting on 10 August 2007, the Supervisory Board unanimously approved the sale of DEUTZ Power Systems to the financial investor 3i.

Personnel

The Supervisory Board decided on the following personnel-related issues after the relevant details had been prepared by the Human Resources Committee: the extension of the Chief Financial Officer's contract, the appointment of a fourth Management Board member, the annulment of the CEO's contract and the appointment of a new Chairman of the Management Board.

On 26 June 2007, the Supervisory Board extended the contract of Chief Financial Officer (CFO) Helmut Meyer by five years until 31 May 2013. At the same time, Gino Mario Biondi was appointed to the Management Board of DEUTZ AG with effect from 1 September 2007, since when he has been responsible for procurement and logistics.

Gordon Riske, the previous Chairman of the Management Board, left the Company at his own request on 30 September 2007. The Supervisory Board would like to thank him for his extraordinarily valuable contribution to DEUTZ AG. On 13 September 2007, the Supervisory Board appointed CFO Helmut Meyer as acting Chairman of the Management Board with effect from 1 October 2007. He performed this function until Mr Riske's successor was in post.

At the Supervisory Board meeting held on 29 November 2007, Dr Helmut Leube was appointed as Chairman of the Management Board of DEUTZ AG for a five-year term. He took up this post on 1 February 2008. The new Chairman of the Management Board has extensive experience of the automotive industry, both in Germany and abroad. After gaining a university degree and PhD in mechanical engineering, Dr Leube worked for 17 years in managerial roles at BMW AG, which included production and procurement functions, managing a plant in Munich, where the company is headquartered, and working as president of BMW Manufacturing Corp. in Spartanburg, USA. His most recent position, which he held for more than three years, was that of Chief Operating Officer on the Management Board of Webasto AG, Munich, where he was responsible for purchasing, production, quality and development, and for the Convertible Roof & Body division.

Positive assessment of corporate governance

At its meeting on 29 November 2007, the Supervisory Board held an in-depth discussion of the German Corporate Governance Code in the version dated 14 June 2007, and issued a declaration of compliance pursuant to section 161 of the German Stock Corporation Act (AktG). Since December 2007, the declaration of compliance for the year under review has been available in the 'Investors/Corporate Governance' section of the Company's website at www.deutz.com, where it can be downloaded.

All members of the Supervisory Board completed a comprehensive questionnaire on the effectiveness of this body and subsequently discussed the findings in detail. The overall findings were positive.

Other important issues

Other important issues included the latest developments in the Company's business, with due regard to the risk report. In this connection the Supervisory Board also discussed the measures taken to improve DEUTZ's earnings power and the results achieved. It also examined the Company's strategic planning, its capital expenditure and the contribution made by this to strengthening future earnings power, the private placement in the United States, the compensation paid for vested company pension rights, the availability of internally produced and bought-in components and the related logistics issues.

Work of the committees

The Supervisory Board has set up four committees to enable it to perform its duties effectively; these committees expertly prepare the various topics and resolutions for the full Supervisory Board. The composition of the Supervisory Board and its committees, as well as the further mandates held by its members, are shown separately on pages 149 to 151.

The Human Resources Committee decides on the content, conclusion and amendment of service contracts signed with the Management Board members appointed by the Supervisory Board. Its remit also covers all remuneration-related issues specified in service contracts. In addition, it includes all questions arising from the relationship between Management Board members and the Company. Furthermore, the Human Resources Committee prepares the appointment of members of the Management Board.

This committee met on eight occasions in 2007, when it discussed the extension of the contract of CFO Helmut Meyer, the appointment of Gino Mario Biondi as the fourth member of the Management Board, the replacement for the Chairman of the Management Board, and issues of Management Board remuneration. It also discussed in detail a long-term incentive (LTI) plan for the Management Board and the top level of senior management. The LTI plan was introduced before the end of 2007.

The work of the Audit Committee in 2007, focussed on the appointment of a new firm of auditors, the single-entity and consolidated annual financial statements for 2006 and the relevant auditors' reports, risk management and compliance-related issues, the condensed consolidated financial statements for the six months to 30 June 2007 and their review by the auditors, and the discussion and issuance of an audit engagement to the new auditors Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft, Düsseldorf. The Audit Committee met on three occasions in 2007. The auditors attended all three meetings of this committee.

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

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

The Nominations Committee was set up in 2007. It consists of three Supervisory Board members elected by the Annual General Meeting and is tasked with proposing to the Supervisory Board suitable candidates as shareholder representatives on the Supervisory Board so that the Supervisory Board can then propose to the Annual General Meeting that these candidates be elected. The Nominations Committee did not meet in 2007. At its first meeting at the beginning of March 2008, the committee selected six candidates and submitted their names to the full Supervisory Board so that it could recommend their appointment to the Annual General Meeting.

Single-entity and consolidated financial statements for 2007 approved

The single-entity annual financial statements of DEUTZ AG, prepared by the Management Board in accordance with the German Commercial Code (HGB), the consolidated annual financial statements, prepared in accordance with International Financial Reporting Standards (IFRS), and the respective management reports (on the 2007 financial year in each case) were audited by Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft, Düsseldorf, Germany, the auditors appointed by the Annual General Meeting on 24 May 2007. The auditors issued unqualified opinions. They also audited the report on relationships with subsidiaries (dependency report) prepared by the Management Board pursuant to section 312 of the German Stock Corporation Act (AktG).

The single-entity annual financial statements of DEUTZ AG, the consolidated annual financial statements, the respective management reports, the dependency report and the auditors' reports were made available to all members of the Supervisory Board and were examined by it. The auditors explained their audit findings in detail to the Audit Committee meeting held on 7 March 2008, and to the Supervisory Board meeting held on 19 March 2008, and answered any supplementary questions raised.

The Supervisory Board noted with approval the findings of the auditors' reports on DEUTZ AG and the DEUTZ Group. The conclusive findings of the Supervisory Board's own audit have not led to any reservations about either the single-entity annual financial statements or the consolidated annual financial statements, and the Supervisory Board has, therefore, approved them. The annual financial statements have thus been adopted.

Dividend approved after close examination

The Supervisory Board agrees with the Management Board’s proposal for the appropriation of profits, which is to pay a dividend of €0.20 plus a special dividend of €0.20. This decision was preceded by a close examination of its potential consequences, on which the Supervisory Board will report to the Annual General Meeting. In particular, the Supervisory Board discussed the impact of the dividend payment on DEUTZ’s liquidity and capital expenditure potential, the effects on the capital markets and the consistency of the Company’s accounting and dividend distribution policies. The Supervisory Board evaluated and weighed up the interests of the Company and its shareholders and then gave its approval.

No reservations about the dependency report

The auditors endorsed the dependency report submitted by the Management Board pursuant to section 312 of the German Stock Corporation Act (AktG) for the 2007 financial year, and issued the following opinion:
“Having conducted our audit and assessment in accordance with the terms of our engagement, we hereby confirm that

1. the actual disclosures in the report are accurate
2. in the legal transactions mentioned in the report, payments made by the Company were either not unreasonably high
3. the activities mentioned in the report provide no justification for an assessment that differs significantly from that given by the Management Board.”

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

Changes to the membership of the Supervisory Board

There were two changes to the membership of the Supervisory Board in 2007.

Gino Mario Biondi stepped down as a member of the Supervisory Board with effect from 12 January 2007. On 17 January 2007, the local court in Cologne decided, at the request of the Management Board of DEUTZ AG, to appoint Dr Massimo Bordi as his successor until the Annual General Meeting on 24 May 2007. This Annual General Meeting extended Dr Bordi’s mandate until the Annual General Meeting in 2008.

On 16 October 2007, the local court in Cologne decided, at the request of the Management Board of DEUTZ AG, to appoint Egbert Zieher as a member of the Supervisory Board to replace Peter Schwab until the Annual General Meeting in 2008. The Supervisory Board is extremely grateful to Mr Schwab for his years of service and his tremendous work. Mr Schwab had worked for DEUTZ Power Systems and, when this division was sold to 3i on 30 September 2007, his mandate on the Supervisory Board of DEUTZ AG expired.

The Supervisory Board would like to express its thanks and appreciation to all employees, the elected employee representatives and the Management Board for their valuable contribution and the considerable dedication they have shown. This commitment was a critical factor in making 2007 a highly successful year for DEUTZ.

Cologne, March 2008

The Supervisory Board

Dr Giuseppe Vita
Chairman

There was a time when engines only had to do one thing, namely:

work – no matter how harsh the conditions were outside. But ...

First compressorless

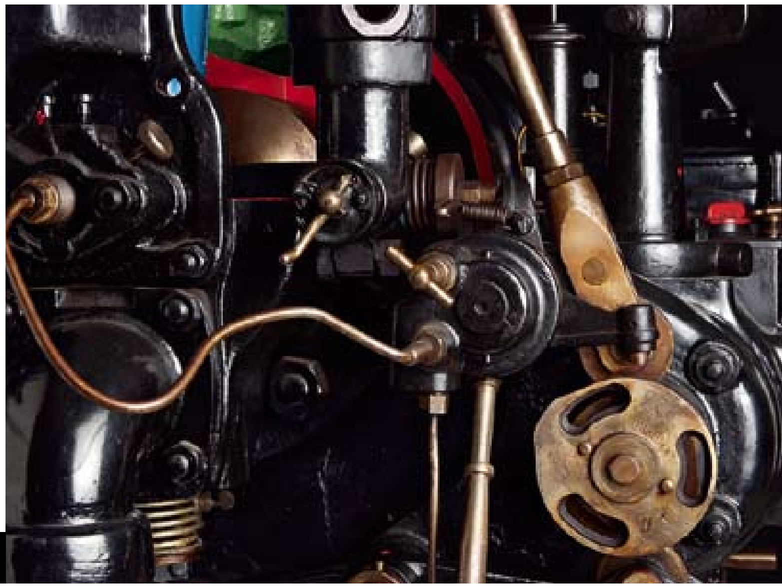
diesel engine

from the DEUTZ AG gas engine factory, including

displacing piston

and direct fuel injection

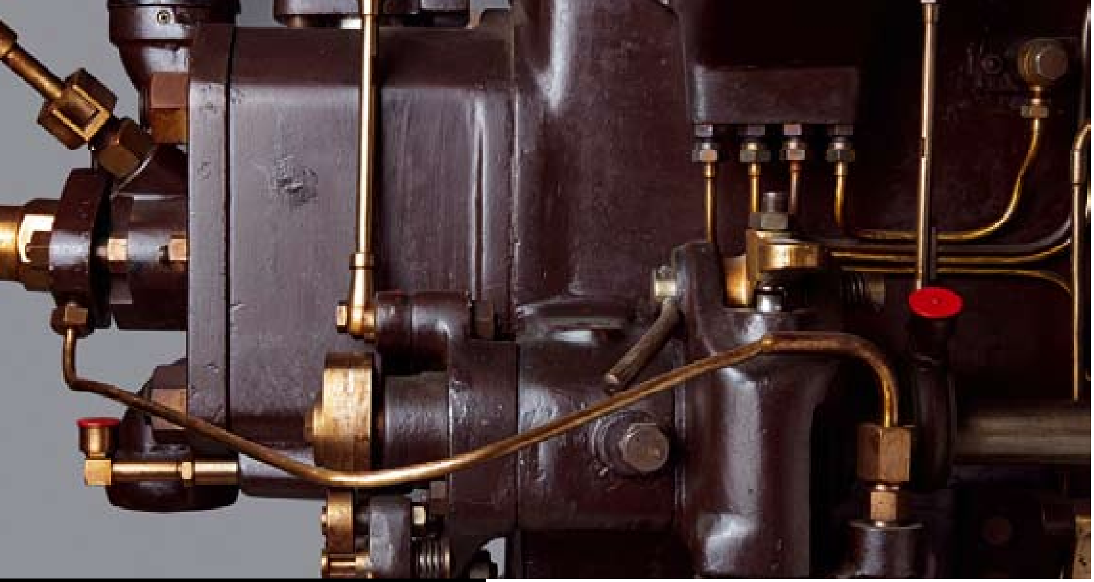
1911 MKV 136



Traditional engine construction requirements Just a few years ago, performance, ruggedness and reliability were the essential criteria when choosing efficient and effective drive systems. The engine had to run smoothly, even under extreme loads and in the most adverse environmental conditions – whether scorching desert heat or the piercing cold in permanently ice-bound regions. Fulfilling this customer desire for virtually indestructible drive systems producing the maximum power has been a daily challenge for the Research & Development staff at DEUTZ for over 140 years. Numerous DEUTZ engines, some of which have been in operation for decades, have made DEUTZ a synonym for performance, ruggedness and reliability. It remains our aim to build the best engines to suit our customers' needs – but the challenges we face when developing state-of-the-art engines have become ever more complex.

New engine construction challenges As well as traditional requirements, our customers increasingly take other selection criteria into account. Rising oil prices make engine buyers and operators look more closely at fuel consumption and, for many applications, environmentally acceptable operation is becoming a more significant factor.

But nothing has had such a major influence on engine development in recent years as the increasingly strict emissions legislation. After the USA and the EU, which still play a pioneering role as regards reducing exhaust gas-emissions, other countries, including Japan, China, Brazil and Russia, have now introduced limits on pollutant levels in the exhaust gases from internal combustion engines. Over the coming years, these limits will become ever more restrictive. Consequently, whether engine manufacturers are successful will depend quite significantly on their ability, as development cycles become shorter, to achieve the balancing act between lower consumption and continuously reducing emissions, on the one hand, and the desire for greater power, on the other.



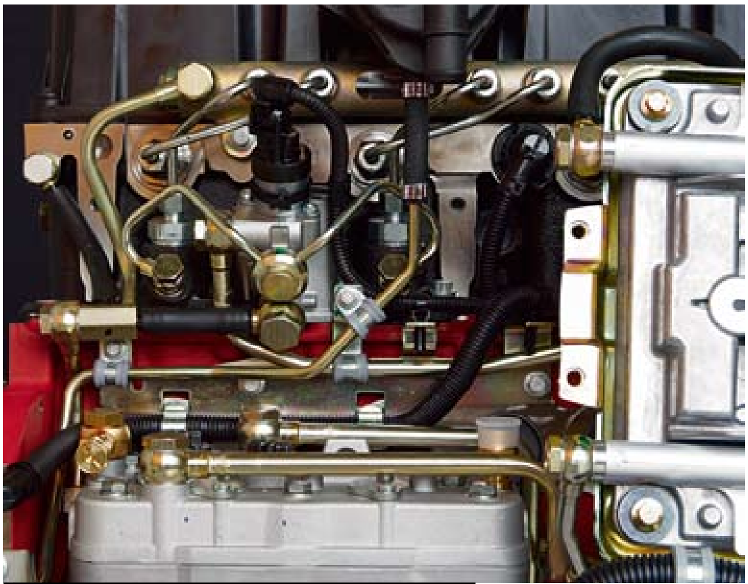
1924 MAH 122

Single-cylinder standard engine
for agricultural and commercial use.
Combustion type: prechamber,
cooling: water/vaporisation
Started by: sparking paper and
crank handle

Demand for high performance Despite the continuous tightening of emissions legislation and increasing environmental awareness, our customers are not prepared to forego performance. On the contrary, each year sees demands for increased performance from DEUTZ engines.

Quite understandably, the DEUTZ engines installed in construction plant and machinery are expected to have sufficient power in reserve so that, if needs be, they can demonstrate even greater capability, using bigger shovels or blades.

Equally, ergonomic aspects have entered into the design of the drivers' stations in trucks, construction machines, agricultural machinery and materials-handling equipment, because, as in other fields of activity, there are greater demands for comfort and ease of operation. There is hardly any place in agriculture today for tractors without those cabs which protect the driver from wind and weather. Air-conditioning with sophisticated filtration systems are just as much in demand as pneumatic suspensions and high-quality sound systems. The engine delivers the energy needed for these comforts, which are intended to make work as easy and pleasant as possible even under adverse weather conditions. Despite this additional energy requirement, the engine must have adequate potential power to cope with peak load demands for the task it is actually engaged on.



2007 TCD_2013_L06_4

DEUTZ Common Rail:
the latest generation
injection system

... times change. Increasingly stringent environmental standards and our customers' desire for ...

A variety of installation situations DEUTZ engines are used throughout the world in road vehicles, and in the non-road sector, in extremely varied installation situations. The customer's determination not to compromise as regards the drive system and our claim that we offer each of our customers tailor-made drives for any installation circumstances present our Research & Development staff with a further challenge.

In recent years, we have noticed a significant and increasing trend towards individualisation. At DEUTZ, this has led to a manageable number of basic engines having to be supplied in a variety of customer-specific engine variants. Adapting the engines to suit different applications is made possible by the well-proven DEUTZ modular design system. As well as modifying the engine itself, it can also be adapted by fitting a variety of attachments or sub-assemblies. Naturally aspirated or turbocharged engines with differing numbers of cylinders, engines employing 2-valve or 4-valve technology, air-cooled or water-cooled drives with or without charge air cooling are just some examples of these variants.

True to our principle of "As much technology as necessary but not as much as possible", our flexible system is able to ensure that only just the necessary and reasonable degree of technology is used in each case. For example, as well as providing our customers with electronic engine control, we frequently offer a mechanical engine control variant.

Evaluating the installation situation in close consultation Our developers constantly meet the challenge of finding comprehensive solutions for divergent requirements, i.e. greater engine output but in more compact installation dimensions and ever tighter limits for exhaust gas emissions. The key to solving complex requirements when developing demanding drive systems such as these lies in close liaison between engine and equipment developers.

The need for close consultation between all those involved will intensify every time the emissions limits are tightened a little further. When Standard III B and Interim Tier 4 emissions limits come into force in Europe and the USA, respectively, as of 2011, exhaust-gas aftertreatment will become absolutely essential for almost all engine-power classes. The additional space required for the particulate filter and a catalytic converter for nitrogen oxides will pose engine and equipment manufacturers with an increasingly complicated installation task. The optimum solution for each installation situation can only be developed in close collaboration.

+50°C

For underground equipment, DEUTZ has a world market share of approximately 40 per cent. For air-cooled engines, we are the undisputed global market leaders, thanks to the effective DEUTZ two-stage combustion® technology. Our latest generation of direct injection engines was further optimised for underground applications. They lead the way in terms of economy and ecology.

30 m³/h

Clean technology already in series production Our answer to the requirements in the current emissions legislation – Euro IV for the on-road sector and Standard III A for the non-road sector – is called DVERT® (DEUTZ Variable Emission Reduction Technology) which we supply with our compact engines in the power range up to 500 kW. Virtually all the elements in this modular and extremely flexible system for reducing noise and emissions can be used in combination. This allows DEUTZ to meet individual customer needs, and to ensure that each engine is installed so as to produce the best possible engine performance, to comply fully with emissions limits and to achieve maximum competitiveness. At the same time, it avoids any "excess technology" – only just the necessary and reasonable degree of technology is used. Thanks to the flexibility of the various systems, components and processes which can be combined in DVERT®, DEUTZ will be able to provide optimised customer solutions even if emissions legislation is tightened still further.

Any job.

Engines from DEUTZ set the pace

around the clock.

There are no tasks which they cannot solve. Nor are there

any geographical boundaries.

Regardless of where they are operated;
in the desert, at the polar caps, in the jungle, on the steppes or in major cities around the world.

... optimum economic efficiency combined with maximum power output have completely rewritten the rule book of engine construction. In this ...

Pioneering self-regenerative particulate filters DEUTZ has had many years of experience of particulate filter systems, even though this technological approach was not the focus of emissions reduction until a few years ago. DEUTZ has been supplying these systems for diesel engines since the 1990s. Developed for plant and equipment used in mining and tunnelling, these particulate filters have, for many years, already demonstrated very high filtration efficiency rates – virtually 100 per cent! In fact, due to their efficiency, in many areas where these filters are used – on building sites or in mines, for example – the exhaust gases contain less fine dust and are cleaner than the air taken in. Depending on the engine power output and the application, either open, passive particulate filter systems or enclosed, thermally self-regenerative systems were used. The real challenge lies less with filter performance, which can hardly be improved, but in achieving the greatest possible efficiency in regenerating the filter system. DEUTZ has developed its own, electronically controlled burner system for this task. When the engine is running, the exhaust gases flow through the filter unit, gradually clogging it up with soot particles. The engine management system monitors the exhaust-gas backpressure and, when a certain threshold value is reached, triggers the thermal regeneration of the filter, also controlled by the engine management system. The soot particles collected in the filter are then combusted by the burner developed by DEUTZ, by raising the post-turbine exhaust-gas temperature.

German research station Neumayer II
The power supply is provided by DEUTZ diesel units. If one source of power fails, the emergency unit cuts in to guarantee the survival of the Antarctic researchers. The waste heat from the diesel generators is used to heat Neumayer II. The engine heat is also used to obtain drinking water – the engines melt ice to form water. A 20 kilowatt wind power system is also being used to provide environmentally friendly energy – a real novelty at these latitudes.

–68°C

In contrast to the systems used so far, where the burner is incorporated into the machine's exhaust line, in future, DEUTZ is relying on a different solution. Although the filter element itself will be installed as usual in the silencer in the exhaust line, the DEUTZ burner will be mounted directly onto the engine during final assembly.

The advantage of this technical solution is that customers are supplied with an engine which includes the most appropriate regeneration system for its intended application; they do not need to worry about special design solutions to fit into the space available. And, since it is part of the engine, the filter and burner system will also display the "Made by DEUTZ®" seal of quality.

Reducing nitrogen oxides Selective Catalytic Reduction (SCR) is an effective method for reducing NO_x emissions. The basis of this technology is an aqueous urea solution, which is sprayed into the exhaust flow upstream of a special catalytic converter. A passive conversion process caused by the urea produces ammonia (NH_3), which reacts in the catalytic converter with the NO_x and oxygen. This produces nitrogen – the main element in the air in the atmosphere – and water. In order to comply with the Euro IV on-road emissions limits, we have already been successfully employing this promising SCR technology in our DEUTZ commercial vehicle and bus engines since the end of 2006.

Ever shorter development cycles From the initial concept to production readiness, the engine goes through a complex development process which, for a completely new development, can last up to three years. During this period, the engine is built and developed via trials models and prototypes to production readiness. But constantly reducing emissions legislation limits and highly competitive market conditions necessitate ever shorter development cycles. There is always less time for implementing technical improvements. DEUTZ, as an international engine manufacturer, is able to profit from the pressure imposed on development by emissions legislation because such pressure separates the wheat from the chaff; in other words, in fiercely competitive conditions, only innovative companies prepared to invest in advanced technologies can be successful. In order to cope with the challenges of ever more stringent emissions legislation, DEUTZ has invested significantly in Research & Development. Expenditure in this area in the 2006 and 2007 financial years amounted to €55 and €56 million, respectively, and, in both this year and next, with a view to meeting emissions standards III B/Interim TIER 4 which will apply as of 2011, expenditure will rise to over €80 million.

Ice-cold passion.
The permanent ice presents extreme challenges – not only for human beings. Machines also need to show what they can do.

... environment, the way to success is through cooperation. If you share knowledge and interlink ...

Specialisation by engine and equipment manufacturers In the face of ever more complex requirements, massive development pressure and the not inconsiderable development risks, more and more equipment manufacturers are choosing not to develop and produce their own engines. Instead, they are concentrating on their core equipment development skills and are buying in their drive systems from an independent engine manufacturer such as DEUTZ. The equipment manufacturer enjoys the benefits of reduced costs and can, at the same time, ensure he retains the innovative edge by collaborating with a technology leader in the field of engine construction.

We too, as engine builders, benefit from collaboration with the equipment manufacturer through long-term capacity utilisation and economies of scale. Our goal, as an independent engine manufacturer, to offer each of our customers tailor-made drives for any installation circumstances, leads to different forms of business relationships, from outsourcing models to joint ventures.

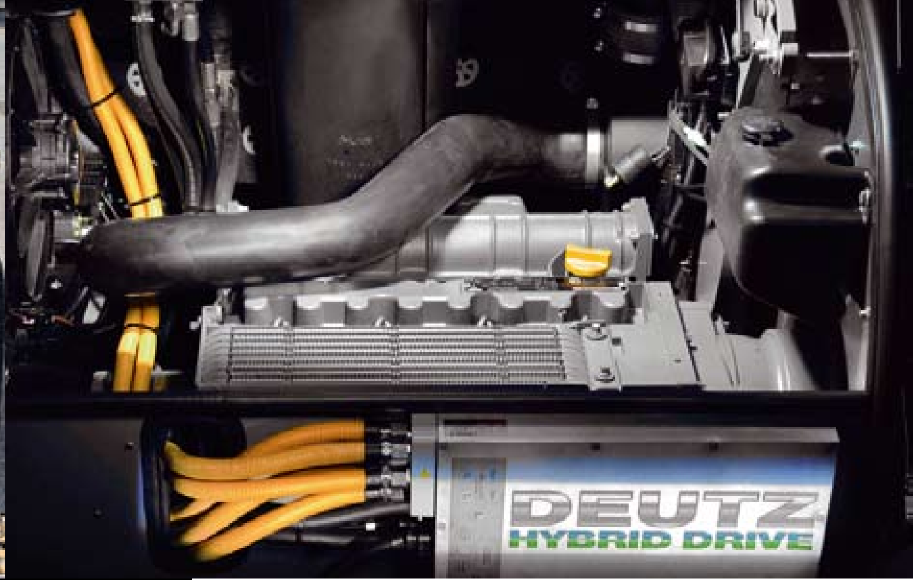
Exploiting the DEUTZ modular system From the initial enquiry and first contact to the ultimate installation of the drive system in a new construction machine, tractor or commercial vehicle, collaboration between equipment manufacturers and DEUTZ follows distinct phases, involving various departments from both companies. Their views about an efficient drive system for a particular application are coordinated between the customer's purchasing department and the sales department at DEUTZ. Technical and commercial aspects such as power output, installation position and dimensions and, of course, financial orders of magnitude are determined first. The sales department at DEUTZ is assisted in this task by the so-called "Electronic Handbook" (ELTAB).

This "handbook" acts as an information database for the salesperson and the customer by offering possible combinations from the existing range of variants. It can display the complete delivery volume and its availability. This enables orders from all over the world to be received directly into the logistics and production systems. ELTAB is also available off-line and can be used without the need for a telecommunications link.

Dialogue is the main feature

Sales and production management: "We deliver on time"

Foreman and shop floor mechanic optimising the assembly



Hybrid drive

A twin-pack of performance.
DEUTZ is the first
engine manufacturer to introduce
a hybrid drive for
mobile machinery.

Detailing the installation position Once the outline design of the new drive system has been established, the DEUTZ application engineers closely coordinate the details of the engine installation and of the mechanical and electronic interfaces between the engine and the machine with the customer's engineers. Where installation difficulties arise, the engineers can generally find alternative solutions by turning to the DEUTZ modular system, which offers modified components such as oil sumps or turbochargers. And, occasionally, joint work is carried out to modify the installation space. The aim of this joint engineering work is to produce the optimum drive system to match each installation situation, if possible, by using existing standard solutions.

Implementing the customer-specific solution The first prototypes emerge following this period of intensive coordination. The process is similar to developing new engines: tests are first conducted on test rigs and then under harsh everyday working conditions. If these tests are satisfactory, series production can start up.

Customer-specific engine development The starting point for the development of a new engine is the demands which our customers will make of their machines and, accordingly, of our engines. From these, a concept for their technical realisation will emerge, a concept which must, of course, take account of emissions legislation requirements.

Virtual testing down to the last detail In view of the huge financial cost of development and its associated risk, round-table design meetings are held to analyse market opportunities, the engineering concept and the profitability of the new engine. Only once it is clear that a development project has sufficient potential as a reasonable addition to the product range will the planners and development engineers start work.

The engine emerges The days are long gone when engines first saw the light of day on the drawing board. For years now, DEUTZ developers have been designing engines, assemblies and components on computers. Instead of two-dimensional drawings, three-dimensional designs are produced with the help of Computer Aided Design (CAD) programs. As development progresses, this virtual world transfers to the real world and, using 3D modelling, the virtual models become the first prototypes of the components. Then the first trial engines are built and proved on test rigs. The initial tests subject the drives to extreme stresses, giving our engineers some initial feedback as to how well the innovations behave under operating conditions. At the same time, performance data is collected, individual parts are tested to their limits and constantly re-assessed. This initial testing provides numerous findings which are fed back into the overall development process. Once everyone involved has given the green light, a variety of field tests are conducted; the prototypes have first to prove their worth under harsh everyday conditions with selected customers. The results will be fed back into development before series production starts. This is how we ensure that, right from the start of series production, customers are getting a fully developed engine.

... expertise, you're in a good position to continue to play a leading part as future chapters of the history of engine construction are written.

Both DEUTZ and our customers and partners benefit from the close working relationship.

Long-term collaboration with the customer There is a long tradition of this concentrated form of customer relationship at DEUTZ; this has been our practice for many years with selected partners. From integrating an individual drive into an application to developing a separate engine, anything is feasible given the wide-ranging DEUTZ portfolio. The basic rule here is: the greater the agreed sales volume, the more unusual the product's characteristics can be and the more specific to the particular customer the engineering design can be. One example of this particularly concentrated form of collaboration between DEUTZ and its customer is the TCD 2013 4V commercial vehicle engine, developed jointly with Volvo, and which went into series production in 2006. This "best-in-class" engine, with particularly high power density, is used in medium-heavy Volvo and Renault trucks and buses.

Joint ventures The most intensive form of collaboration between companies is a "joint venture", a new and legally independent joint undertaking in which the companies which establish it invest not just capital but, generally speaking, technology, intellectual property, technical and marketing know-how or production equipment.

For many years, DEUTZ has run a very successful joint venture with DEUTZ AGCO Motores S.A. (DAMSA) in Argentina, where 913 and 1013 series engines are produced. Another joint venture partnership which trades under the name of DEUTZ (Dalian) Engine Co., Ltd. (DEUTZ Dalian), is the Chinese company FAW Jiefang Automobile Co., Ltd. Since the company's inauguration on 22 August 2007, 2012 and 1013 series engines have been assembled in the Chinese city of Dalian, in parallel with locally produced engines. DEUTZ retains responsibility for the industrial management of DEUTZ Dalian.

win

DEUTZ is pushing on with its internationalisation objectives with joint ventures in important markets.

Joint ventures allow DEUTZ to secure access to strategically important markets. Production is located wherever our customers are already active internationally. However, joint ventures are nothing new for DEUTZ. For example, “Schleicher, Schumm & Co.”, founded in 1877 in Philadelphia, developed in 1894 into a joint venture with DEUTZ. Under the name of “The Otto Gas Engine Works AG”, it produced agricultural locomotives powered by petrol engines. Then as now, the following principle applies to all collaborative ventures: DEUTZ guarantees to provide each customer with a drive system which is both economical and innovative and suited to the particular work for which it will be used.

Optimum results through intensive discussion Regardless of the way in which DEUTZ works together with its customers, the relationship is always based on trust, engineering competence, innovative skill and the certainty that intensive discussion will produce the optimum results. Both DEUTZ and its customers profit in equal measure from the advantages of such close collaboration; development costs are shared between the partners and are, consequently, lower. The customer is spared costly in-house engine production, while large volumes mean that DEUTZ can work to capacity for long periods and exploit economies of scale. At the same time, our partners ensure they retain that innovative edge, which only a technology leader like DEUTZ can provide. And optimising the interfaces between engine and machine produces tailor-made solutions, allowing both DEUTZ and its customers to consolidate and, in future, to extend their market position, competitive strength and shareholder value.

Strategy

SUSTAINABLE SUCCESS IS BASED ON A NUMBER OF FACTORS: VISION, INNOVATIVE STRENGTH, AND THE ABILITY TO ANALYSE THE MARKET AND THE OPPORTUNITIES AND DEDUCE THE RIGHT CORPORATE STRATEGY. AND THE WILL TO RIGOROUSLY PURSUE THE CHOSEN PATH. A CLEARLY DEFINED STRATEGY LEADS YOU QUICKLY TO YOUR OBJECTIVE; MORE QUICKLY TO TECHNOLOGICAL LEADERSHIP AND INNOVATIVE PRODUCTS. TO GREATER COMPETITIVE STRENGTH, SATISFIED CUSTOMERS, HIGHER REVENUE AND BETTER FINANCIAL RESULTS.

Milestones: focus on core competence and internationalisation

A clearly defined strategy is key to long-term success. It was with this imperative in mind that we sold DEUTZ Power Systems in 2007, enabling us to sharpen our focus on our core competence of manufacturing compact diesel engines. At the same time, our diversification across various regions and application segments promotes sustainable growth and enables us to compensate for sales fluctuations in individual markets.

Two of our long-term goals are to become one of the world's top-three suppliers of four- to eight-litre engines and to double our unit sales of engines with a capacity of up to four litres. We also plan to consolidate our leading position in the international market for air-cooled engines. We are continuing to expand our services business and expect that this will soon generate 20 per cent of our consolidated revenue.

Joint venture set up in China

We have significantly expanded our footprint in the Chinese market by setting up the joint venture DEUTZ (Dalian) Engine Co., Ltd. (DEUTZ Dalian), which was a further major step in the DEUTZ Group's long-term internationalisation strategy. This will enable us to exploit further growth potential and put us in an even better position to meet our customers' needs.

Well-balanced portfolio

In 2007, we sharply increased the proportion of our revenue that we generate from commercial-vehicle engines. As a result, our Automotive application segment now accounts for 18 per cent of consolidated revenue, which is similar to the proportion generated by the Stationary Equipment business. As usual, engines for mobile machinery accounted for the largest share of revenue in our portfolio (38 per cent), while engines used in agricultural machinery generated 11 per cent of revenue.

Benefiting from strategic partnerships

We continued to achieve strong growth in 2007 by focusing on strategic partnerships, working with equipment manufacturers and dealers to achieve well-balanced growth. This strategy benefits DEUTZ in several ways: by collaborating with major equipment producers it can reap economies of scale, and by working with dealers and small equipment manufacturers it can boost its high-margin and service business.

Customised expertise in air-cooled engines

In 2007, we demerged our business in air-cooled engines, liquid-cooled engines with a more than an eight-litre capacity and our Xchange business (reconditioned exchange engines and parts) from the Compact Engines segment and combined them in the DEUTZ Customised Solutions segment. This reorganisation demonstrably underlines our long-standing tradition and specialist expertise in the field of air-cooled engines. This internal restructuring also places us in an even better position to offer customised solutions to our clients. This means that our operating business is now split into the two segments Compact Engines and DEUTZ Customised Solutions.

Landmark strategic decisions in 2007

Focus on diesel engines

In 2007, we sold our business in gas engines used for decentralised power generation, which came under the umbrella of the DEUTZ Power Systems segment, for a price of €360 million. There were several compelling reasons for this decision. First, the synergies between this business and our diesel-engines operations had proved to be very limited owing to their differing business processes, customer profiles and market conditions. And second, we would have had to provide considerable, sustained investment to exploit the full growth potential of DEUTZ Power Systems. In order to sharpen our strategic focus, we will be investing the proceeds from this disposal in our core Compact Engines business.

Strengthening our presence in the fast-growing Asian market

Our DEUTZ Dalian joint venture was launched on 1 August 2007. This company is jointly owned by DEUTZ AG and a subsidiary (FAW Jiefang Automotive Co., Ltd.) of China First Automobile Works Group Corp. (FAW), which is China's largest supplier of commercial vehicles. DEUTZ Dalian manufactures and markets diesel engines, primarily for our international clientele in Asia and for the FAW Group. We have invested roughly €58 million in our share of the joint venture, and FAW Jiefang has contributed a total of four production plants. These include the new plant that produces four- to eight-litre licensed DEUTZ engines, and three other plants that manufacture engine models based on Chinese technology. The joint venture's total initial capacity is 150,000 engines per year, of which 50,000 units are licensed DEUTZ engines and approximately 100,000 engines are equipped with local technology. The engines will be used in commercial vehicles and industrial applications, such as construction equipment and agricultural machinery. The capacity of the new plant producing engines based on DEUTZ technology will be increased to 100,000 engines over the medium term.

Our investment in DEUTZ Dalian represents a major step in our internationalisation and growth strategy. This joint venture is the logical response to the importance of the Asian market for DEUTZ. What's more, this investment in China will bring us a number of benefits from day one. First, the demand for engines is constantly rising in the rapidly growing Chinese market. Second, it offers us the opportunity to supply major European equipment manufacturers that either already have their own production sites in China or are planning to take this step. Third, the joint venture enables us to expand our close and long-standing business relationship with FAW Jiefang, thereby strengthening our position in the global market for commercial vehicles. And fourth, the joint venture gives us access to a low-cost location for manufacturing engines and components. The start-up of production at the new engine plant this year will enable us to further increase our share of the Chinese market.

Strategic priorities keep DEUTZ firmly on track

Successful launch of particularly environmentally friendly engines

The revenue generated by the Automotive application segment rose significantly, by roughly €160 million in 2007. Last year saw a major premiere when the TCD 2013 4V commercial-vehicle engine, jointly developed with Volvo, had its first full year of production. This engine meets the Euro IV and V emissions standards. This innovative engine is mainly being used in tractors and in medium-sized trucks and buses manufactured by Volvo and Renault. The Company's team of developers is already working on variations of this environmentally friendly engine for use in mobile machinery.

The TCD 2013 4V was in great demand right from the outset. The assembly hall, built especially to produce the new engine, has an annual capacity of roughly 30,000 engines, which was fully utilised in 2007. This capacity will be increased from 2008 onwards and should be capable of producing 50,000 engines in 2009.

Growth boosted by international strategic partnerships

Our close, long-term collaborations with major equipment and vehicle manufacturers was, once again, a huge success in 2007. Our business relationships with strategic partners and major equipment producers have played a decisive role in enabling us to grow our Compact Engines business significantly in recent years.

Since 1998, we have been working with AB Volvo to develop four- to eight-litre engines that are used in construction equipment, gensets and commercial vehicles. Both parties have continually stepped up this collaboration over the last ten years. We benefit from the Volvo Group's growth, from the fact that the relationship has been extended to other applications and from our close collaboration on engine development.

We work with the high-end manufacturers Fendt and SAME DEUTZ-FAHR in the field of agricultural machinery. We have been collaborating with the Italian agricultural-equipment producer SAME DEUTZ-FAHR Group S.p.A. since 1995, and expanded this relationship in 2003. As part of this move, SAME DEUTZ-FAHR will discontinue its own production of engines in Italy and DEUTZ will become the Italian group's main engine supplier.

DEUTZ and the FAW Group have a long-standing and successful business relationship, which has taken on a new dimension as a result of the DEUTZ Dalian joint venture, and will considerably strengthen our position in the Chinese market.

We continued to step up our collaboration with major equipment and vehicle manufacturers in 2007, significantly increasing our unit sales of four- to eight-litre engines. During the year under review, unit sales in this engine category – excluding the joint venture – rose by roughly 38 per cent to over 139,000 engines. We are, therefore, now one of the world's top-three suppliers.

Engines with a capacity of up to four litres: new models fuel growth

In recent years, we have added new models to our product portfolio of engines with a capacity of up to four litres. By pursuing this strategy we generated growth of roughly 11 per cent in this category in 2007, selling in excess of 109,000 engines. We plan to raise our unit sales by between 10 and 15 per cent in 2008.

There is an increasing trend towards compact units in this market segment. The main growth potential lies in the European and North American markets for engines that are used in mobile machinery.

DEUTZ Customised Solutions on track for success

Since it was demerged from the Compact Engines segment, the DEUTZ Customised Solutions segment has been focusing on profitable niche markets such as applications in underground equipment, drilling equipment, forestry, railways and the marine sector.

In 2007, we sold over 32,000 air-cooled engines, which was roughly in line with the previous year's figure. Therefore, we maintained our leadership of the global market in this type of engine across all output categories.

As part of this strategy, we relocated the assembly of our air-cooled engines from Cologne to Ulm in January 2007. Last year we invested some €7 million in the expansion of the Ulm production facility, recruited over 100 people and made this site our new centre of competence for air-cooled engines.

We continue to invest in the successful development of new products to consolidate our market position. The latest product to be developed as part of the DEUTZ family is the Air-cooled Diesel Genset (ADG), a genset based on an air-cooled engine. The benefits of air-cooled engines in this end product hold out the prospect of a fairly successful performance in the market. At the same time, we are constantly refining the technology in these engine models. For example, our engineers are currently preparing these air-cooled engines based on common-rail injection systems for the next emissions standard, which will apply as from 2011.

Service revenue increased

DEUTZ raised its service revenue for 2007 by 13 per cent to €204 million, which means that services accounted for 13 per cent of total consolidated revenue. The share of our service business in Group revenue was impacted by several factors in 2007. First, because of the strong business in new engines (which does not initially generate any service business); second, owing to the successful performance of our business with major equipment manufacturers (which are needed to reap economies of scale but tend to require fewer services); and third, due to the sale of the gas-engines business (DEUTZ Power Systems), which required considerable amounts of servicing because of the large number of engines and the high volume of operating hours involved.

We aim to achieve greater penetration of the market for services, in particular, by conducting detailed evaluations of the market potential, providing more IT support and offering attractive service packages. The performance of our service revenue in absolute terms is already showing signs of success.

Further measures relate to our spare-parts business, which forms the core of DEUTZ's services. Our logistics centre in Cologne now processes and dispatches 1,000 orders for spare parts every day. In order to further optimise the flow of materials in 2007, we renewed our warehouse management system, introduced wireless data technology and constructed a new hall for receiving incoming goods. This enabled us to shorten our throughput times, increase the availability of parts and, consequently, improve our customer service.

Improved customer service using telemetry

By introducing our new telemetry system for industrial engines, we became the first engine manufacturer to develop an innovative product for monitoring the condition of engines and customers' equipment. The current condition of the engine can be reliably evaluated in real time using key engine data, such as the coolants and the oil and fuel levels, which are transmitted to a central server. The telemetry system also ensures that the capacity utilisation and availability of engines are constantly monitored. This enables customers to identify overcapacities and significantly improve the efficiency of their fleets by making suitable adjustments. Further benefits for customers are that this new system considerably reduces downtimes and enables maintenance to be planned better.

Xchange: DEUTZ quality and warranty for exchange engines

A further mainstay of the DEUTZ Customised Solutions segment is the business in reconditioned engines and parts – the 'Xchange' business – which we plan to step up for engines that are no longer in series production. This offers customers the advantage that exchange engines do not require the end device to be modified or a new piece of equipment to be purchased. The revenue from DEUTZ's Xchange business grew by 9.5 per cent year on year to €39 million in 2007. This rate of increase is proof positive that more and more customers are using this quick and inexpensive form of replacement that offers the same DEUTZ quality and warranty as new products.

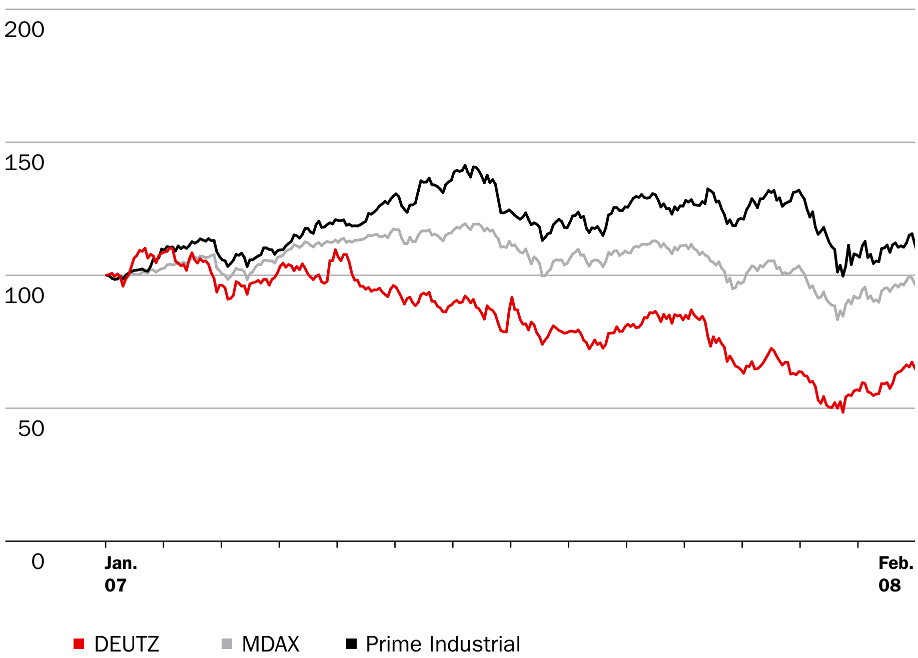
DEUTZ shares

THE YEAR 2007 WAS AN EVENTFUL YEAR FOR DEUTZ – INCLUDING ON THE STOCK MARKET. DESPITE A GOOD START TO THE YEAR AND CONSISTENTLY STRONG FINANCIAL RESULTS, THE COMPANY'S SHARE PRICE PERFORMED DISAPPOINTINGLY – EVEN WITHIN ITS OWN SECTOR – AND FELL BY 31 PER CENT. ONE ENCOURAGING PIECE OF NEWS IS THAT IN 2008, WE WILL BE PAYING A DIVIDEND FOR THE FIRST TIME IN ROUGHLY 20 YEARS.

Share price significantly underperformed sectoral index

DEUTZ's shares lost around one third of their value during the year under review, closing 2007 at €6.95; this was 31 per cent down on their level at the end of 2006, although the share price had jumped by 143 per cent in 2006. Its shares, therefore, significantly underperformed both the MDAX index, which rose by 5 per cent, and the Prime Industrial sectoral index, which gained 34 per cent. The DAX, Germany's leading share index, added 22 per cent year on year in 2007.

Price performance of DEUTZ share
in %

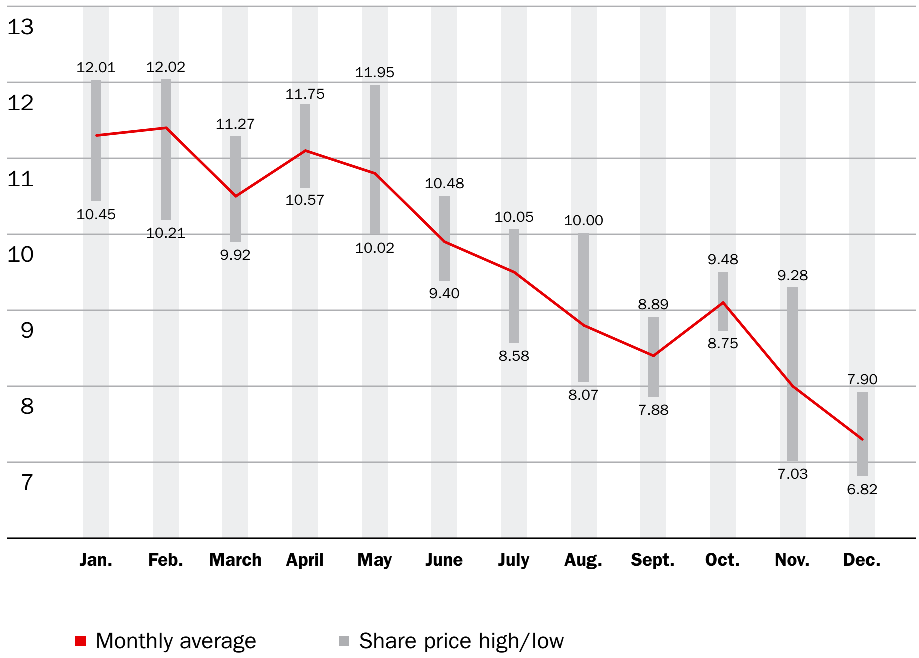


Key figures DEUTZ shares

	2003	2004	2005	2006	2007
Number of shares (31 Dec.)	91,147,905	91,149,075	95,003,621	114,326,416	120,085,030
Share price					
Share price high (€)	3.45	4.70	4.68	10.40	12.02
Share price low (€)	1.35	2.41	2.86	4.00	6.82
Share price as at 31 December (€)	3.22	2.93	4.14	10.05	6.95
Market capitalisation as at 31 December (€ million)	289.7[1)]	267.1	393.3	1,148.9	834.6

[1)] of which 26,861,760 new shares (with closing price as at 31 December 2003: €3.08)

Share price high and low of DEUTZ share in 2007
in €



High volatility

Having started 2007 at €10.90, DEUTZ's share price initially outperformed the MDAX and Prime Industrial indices. It largely remained within a range of €10.00 to €12.00 in the first quarter, hitting its high for the year of €12.02 on 2 February. The share price fell increasingly in the second quarter and after the first six months, was below its level at the end of 2006, whereas the MDAX and Prime Industrial rose during the same period. At the halfway point on 30 June, the share price was €9.62, having dipped below €10.00 for the first time on 6 June. It failed to stay above the €10.00 mark for very long in the third quarter, despite the fillip provided by the announcement of the disposal of DEUTZ Power Systems at the end of July and the publication of strong half-year results on 1 August. It fluctuated between €8.00 and €9.00 for much of the rest of the year.

The share price came under renewed pressure in the fourth quarter of 2007, on the back of forecasts of a deterioration in the US market, especially its construction sector, and owing to the uncertain outlook for the European economy in 2008. Several research firms revised their target share prices downwards in response to pessimistic economic forecasts for 2008. Our share price had failed to recover from this move by year-end and closed 2007 at €6.95, hitting its low for the year of €6.82 on 27 December.

Conversion of profit-sharing rights and bonds

By 31 December 2007, the number of shares in issue had been further increased by the conversion of profit-sharing rights and bonds. A total of 5,758,434 debt securities issued under the bond launched in 2004 were converted into shares in 2007. This means that a total of 18,953,735 conversion rights have been exercised since the bond was issued. A total of 839,263 debt securities – or 4.2 per cent of the total bond issue – had not been converted by the end of 2007. Likewise, a total of 1,194 profit-sharing rights had not been converted by 31 December 2007, after 18 profit-sharing rights had been converted into 180 shares during the year. Consequently, the exercise of profit-sharing rights and convertible bonds had raised the number of shares in issue by 5,758,614 to 120,085,030 by the balance sheet date (31 December 2006: 114,326,416 shares).

On 19 November 2007, DEUTZ cancelled the remaining profit-sharing rights with effect from 22 May 2008, and on 6 February 2008, it terminated the convertible bond issue. Holders of the bonds had the option to convert the bonds one for one into shares up to 3 March 2008, by which date the total number of shares had been increased to 120,861,063 by the conversion of profit-sharing rights and bonds.

Lower market capitalisation

Despite the higher number of shares in issue, DEUTZ AG's market capitalisation had fallen by 27 per cent year on year to roughly €834.6 million at 31 December 2007, owing to the decline in the Company's share price (31 December 2006: €1.15 billion). At the end of December 2007, DEUTZ was therefore ranked 60th in Deutsche Börse AG's share rankings (which only take the free float into account). It was ranked 46th in terms of trading volume.

Stronger liquidity

DEUTZ's shares are traded on the floor of the Frankfurt and Düsseldorf stock exchanges as well as in the XETRA electronic trading system, which is used to settle some 86 per cent of all transactions. The average daily volume of trading grew sharply from 482,800 in 2006, to roughly 703,800 in 2007.

Earnings per share of €0.51 (from continuing operations)

Earnings per share is calculated by dividing the net income for the year by the weighted average number of shares in issue. In 2007, the average number of shares in issue was 117.3 million. Basic earnings per share from continuing operations amounted to €0.51. In 2006 it had been €0.36, with a weighted average number of 107.2 million shares in issue.

Basic earnings per share including discontinued operations amounted to €1.56 in 2007.

Proposed dividend of €0.40 per share

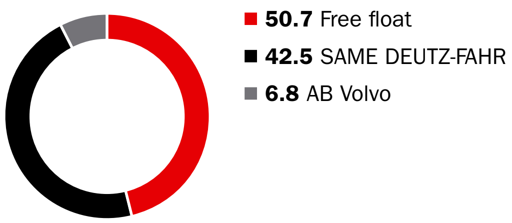
In 2008, DEUTZ will be paying a dividend to its shareholders for the first time in over 20 years. The Management Board and the Supervisory Board will propose to the Annual General Meeting on 21 May 2008 that a dividend of €0.40 per share be paid. This distribution will comprise a dividend generated by the Company's operating business and a special dividend resulting from the gain on the disposal of DEUTZ Power Systems.

The dividend yield is 5.8 per cent, based on the share price at the end of December 2007. If only the "operating" dividend is taken into account, the dividend yield comes to 2.9 per cent. The total dividend payout amounts to €48.0 million.

Shareholder structure remains stable

DEUTZ's largest single shareholder is still SAME DEUTZ-FAHR Group S.p.A., whose shareholding increased from 39.8 per cent at the end of 2006 to 42.5 per cent at the end of 2007. AB Volvo's holding came to 6.8 per cent at the end of 2007. FMR Corp., USA, which is a member of the Fidelity Group, announced in July 2007 that its shareholding had fallen below the reporting threshold of 3 per cent. The total free float at the end of 2007 amounted to 50.7 per cent of the Company's share capital.

Breakdown of shareholders as at 31 December 2007
in %



A further eight banks and brokerage houses added DEUTZ to their research coverage in 2007. The following 19 institutions, therefore, now report regularly on DEUTZ:

Research base considerably broadened

- Bankhaus Lampe
- Berenberg Bank
- BHF-Bank
- Cazenove
- Crédit Agricole Cheuvreux
- Credit Suisse Securities
- Deutsche Bank
- Dresdner Kleinwort
- DZ Bank
- Goldman Sachs
- HSBC Trinkaus & Burkhardt
- Landesbank Baden-Württemberg
- Merck Finck & Co.
- M. M. Warburg
- Oppenheim Research (Sal. Oppenheim)
- Solventis Wertpapierhandelsbank
- UBS
- Viscardi Securities
- WestLB

At the end of February 2008, 13 analysts were advising investors to buy DEUTZ's shares, two were recommending that they sell them and four thought that they should hold them. An overview of the analysts' recommendations and target share prices can be found in the section 'Investors/Shares' on DEUTZ's website at www.deutz.com.

We maintain a constant dialogue with our institutional and private investors. DEUTZ publishes comprehensive, timely and reliable information on the latest developments in its business in the form of quarterly reports, conference calls and press releases. Pertinent presentations are made available simultaneously on the Internet. DEUTZ's Management Board and the Investor Relations team presented the Company to domestic and international investors at roadshows, at conferences and in one-on-one meetings at locations such as London, Frankfurt, Zurich and Vienna. All the necessary information on DEUTZ's shares and the forthcoming events in its 2008 financial calendar can be found on our website at www.deutz.com.

DEUTZ shares

ISIN	DE0006305006
WKN	630500
Reuters	DEZG.F
Bloomberg	DEZ.GR
Market segment	Official market (Prime Standard)
Traded at	Xetra, Frankfurt, Düsseldorf

	2007	2006
Number of shares (as at 31 December)	120,085,030	114,326,416
Number of shares (average)	117,315,867	107,161,106
Share price as at 31 December (€)	6.95	10.05
Share price high (€)	12.02	10.40
Share price low (€)	6.82	4.00
Market capitalisation (€ million)	834.6	1,148.9
Basic earnings per share (€)	1.56	0.57
of which from continuing operations	0.51	0.36
of which from discontinued operations	1.05	0.21
Diluted earnings per share (€)	1.52	0.52
of which from continuing operations	0.50	0.33
of which from discontinued operations	1.02	0.19

Based on XETRA closing price

Corporate governance report

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

Declaration of compliance with few exceptions

In 2007, the Management Board and the Supervisory Board once again carefully considered to what extent it was appropriate and proper for DEUTZ to apply the guidelines and recommendations of the German Corporate Governance Code (DCGK) in detail. As a result, DEUTZ AG complies with the recommendations of the Code, as amended on 14 June 2007, with the following exceptions:

1. The D&O insurance taken out by DEUTZ AG for the members of the Management Board and the Supervisory Board does not provide for any excess because the adjustment of the contracts to accommodate this change would incur considerable additional cost for the Company (item 3.8 (2) DCGK).

2. There is no age limit at DEUTZ for members of either the Management Board or the Supervisory Board (items 5.1.2 (2) sentence 3 and 5.4.1 sentence 2 DCGK).

The latest version of the declaration of compliance can be found in the 'Investors/Corporate Governance' section of the Company's website at www.deutz.com, where you can also view and download the declarations of compliance from previous years.

Responsible cooperation between Management Board and Supervisory Board

The Management Board and the Supervisory Board work together closely and responsibly in order to add value for the Company over time. Both Boards attach particular importance to a continuous and open dialogue on all long-term and strategically key decisions. The overriding objective of this cooperation is to honour the trust that our shareholders, employees and business partners have placed in us.

The Supervisory Board is elected for a period that runs until the end of the Annual General Meeting on 21 May 2008.

Appropriate risk management

A key element of good corporate governance is a responsible attitude to risk; DEUTZ's risk management systems guarantee and facilitate such an approach. The Management Board regularly notifies the Supervisory Board of any existing or anticipated risks. Details of the Company's risk management systems can be found on pages 69 to 73 of the risk report in this annual report.

Transparent reporting and shareholder services

Transparency is key to any sound system of corporate governance. One aspect of this transparency is the provision of timely, simultaneous and identical information to all relevant target groups. We have created various platforms for this purpose. The Company reports four times a year in its interim reports and the annual report on the performance and development of its business and on significant changes and events. It maintains constant contact with investors and analysts through our investor relations activities. In addition to the annual analysts' meeting, held when the Company's consolidated annual financial statements are published, conference calls for analysts and investors take place when its interim reports appear. The Annual General Meeting is usually held in the first five months of the year; shareholders who do not attend the AGM in person can instruct proxies to vote on their behalf. The Company's website at www.deutz.com also offers a wide range of up-to-date information, including press releases, ad-hoc statements, analysts' recommendations and investor relations presentations. The online financial calendar provides the latest information on key events in the Company's financial year. The Company's statutes and the rules of procedure for the Supervisory Board can be found on the website, as can the annual and interim reports. Virtually all information is provided in both German and English. Apart from regularly publishing information, DEUTZ AG also provides details of circumstances that are not publicly known but that could have a significant impact on DEUTZ's share price were they to become known. The Company's reporting policy, therefore, complies with both the legal requirements and the guidelines contained in the German Corporate Governance Code.

Management Board, Supervisory Board and Supervisory Board committees

At DEUTZ, the management function is performed by the Management Board and the supervisory functions by the Supervisory Board.

There were a few changes to the membership of the Management Board during the year under review. At the beginning of September 2007, this Board's membership was increased from three to four persons by the appointment of Gino Mario Biondi, who is responsible for procurement and logistics. The departure of CEO Gordon Riske at the end of September 2007, reduced the membership of the Management Board to three persons again until the end of January 2008. Since Dr Helmut Leube became the new CEO on 1 February 2008, the Management Board has once again comprised four members.

The Supervisory Board of DEUTZ AG consists of twelve persons, as required by the German Codetermination Act. Six of them are shareholder representatives and six are employee representatives. No member of the Supervisory Board has ever been a member of the Company's Management Board. The Supervisory Board advises and monitors the Management Board.

The four committees set up by the Supervisory Board perform some of the Supervisory Board's functions. These are – pursuant to paragraph 7 (1) and (2) of the rules of procedure for the Supervisory Board – the Human Resources Committee, the Audit Committee and the Nominations Committee, which was set up in 2007. These are supplemented by the Arbitration Committee, which is required by section 27 (3) of the German Codetermination Act. Each of these committees comprises representatives of both the shareholders and the employees. The one exception to this rule is the Nominations Committee, which consists solely of shareholder representatives. Further information on the functions and remit of each of the committees can be found in the report of the Supervisory Board in this annual report. The membership of the committees is shown on page 151.

Avoidance of conflicts of interest

All members of the Supervisory Board are obliged to notify the Supervisory Board of any conflicts of interest, especially those arising from an advisory function or directorship at customers, suppliers, lenders or other business partners. During the year under review, there were no consultancy or other service agreements in existence between Supervisory Board members and the Company.

The members of the Management Board must also disclose any conflicts of interest, such as those mentioned above, to the Supervisory Board, which then reports these cases to the Annual General Meeting. There were no such conflicts of interest on the part of either the Management Board or Supervisory Board in 2007.

Related-party disclosures are shown on page 138 of the notes to the consolidated financial statements.

Remuneration report

Remuneration of the Management Board

The remuneration paid to the individual members of the Management Board consists of fixed, variable and long-term components. The variable portion of the remuneration is profit-related and is linked to the performance of certain key figures, such as the DEUTZ Group's revenue, EBIT margin, ROCE and net financial position. In 2007, the Company launched a long-term incentive (LTI) plan for the Management Board and the top level of senior management. Under this plan, virtual stock options are issued to senior executives to reward them for their sustained contribution to the Company's success. Before they receive stock options, those eligible must invest some of their own capital in DEUTZ shares. The stock options confer the right to receive a cash payment after a lock-up period of three years has elapsed, provided that DEUTZ's share price performance has met one of the two criteria stipulated in the LTI plan. Either DEUTZ's share price must be 30 per cent above the specified reference price at the time the options are exercised (with the reference price being the weighted average price of DEUTZ shares in the three months before the options were issued), or DEUTZ's share price must have outperformed the Prime Industrial Index by 30 per cent. Further information on the remuneration paid to the Management Board can be found on page 143 of the notes to the consolidated financial statements.

Remuneration of the Supervisory Board

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

The chairmanship and membership of Supervisory Board committees are remunerated separately in accordance with the German Corporate Governance Code. DEUTZ 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, we reimburse the members of the Supervisory Board for any VAT they incur in connection with the performance of their mandate. Further information on the remuneration paid to the Supervisory Board can be found on page 144 of the notes to the consolidated financial statements.

Dealings subject to reporting requirements

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

One member of the Supervisory Board, one member of the Management Board and three employees at the top senior management level disclosed their purchase of shares in accordance with this regulation in 2007. Two further members of the Management Board had purchased shares by the time the annual financial statements were adopted. The table below gives a breakdown of the relevant dealings in shares:

Trade date	Person subject to reporting requirements	Function	Securities	ISIN	Stock exchange	Type of transaction	Quantity	Price per share	Business volume
01/08/2007	Helmut Meyer	Management Board member	DEUTZ shares	DE0006305006	Xetra/ Frankfurt	Purchase	6,000	€9.59	€57,540
01/08/2007	Wilhelm Schiele	Divisional head	DEUTZ shares	DE0006305006	Frankfurt	Purchase	2,520	€10.05	€25,326
02/08/2007	Alexander Städtler	Divisional head	DEUTZ shares	DE0006305006	Frankfurt	Purchase	1,000	€9.50	€9,500
06/08/2007	Alexander Städtler	Divisional head	DEUTZ shares	DE0006305006	Xetra	Purchase	2,000	€9.30	€18,600
14/08/2007	Thorsten Van der Tuuk	Divisional head	DEUTZ shares	DE0006305006	Frankfurt	Purchase	3,000	€8.61	€25,830
20/11/2007	Dr Helmut Lerchner	Supervisory Board member	DEUTZ shares	DE0006305006	Stuttgart	Purchase	3,000	€7.45	€22,350
18/02/2008	Gino M. Biondi	Management Board member	DEUTZ shares	DE0006305006	Düsseldorf	Purchase	6,000	€6.48	€38,880
19/02/2008	Helmut Meyer	Management Board member	DEUTZ shares	DE0006305006	Hamburg	Purchase	6,000	€6.98	€41,880

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

There were no shareholdings subject to reporting requirements pursuant to item 6.6 of the German Corporate Governance Code as at 31 December 2007.

Where this corporate governance report refers to the notes to the consolidated financial statements for further details of remuneration, the information disclosed therein forms part of the corporate governance report.

Group management report 2007

Group management report

INTRODUCTION

Segment disposal has significant impact on annual financial statements

Up to now, the DEUTZ Group has consisted of the Compact Engines, DEUTZ Customised Solutions, DEUTZ Power Systems and Other segments. For strategic reasons, DEUTZ Power Systems was sold with effect from 30 September 2007, and was consequently reclassified as a discontinued operation in accordance with IFRS 5. This segment's income and expenses are reported separately on the face of the income statement as net income attributable to discontinued operations and are explained in the notes to the consolidated financial statements. The comparative figures for 2006 for the DEUTZ Group have been restated accordingly.

The assets and liabilities attributable to DEUTZ Power Systems are no longer carried on the consolidated balance sheet as at 31 December 2007. As specified by IFRS 5.40, the balance sheet as at 31 December 2006 has not been restated.

Unless stated otherwise, the comments in this management report relate to the Group's continuing operations, which comprise the Compact Engines, DEUTZ Customised Solutions and Other segments.

Disclosures regarding the operating activities of DEUTZ Power Systems are reported in the management report under discontinued operations. Information on the effects of the disposal of this segment can be found in the notes to the consolidated financial statements on page 105.

A further change in the reporting structure relates to the DEUTZ Customised Solutions segment, which was newly created in 2006. This segment primarily comprises all air-cooled engine series activities, together with those involving liquid-cooled engines with a capacity greater than 8 litres. In 2006, these activities formed part of the Compact Engines segment; from the first quarter of 2007, DEUTZ Customised Solutions has been reported as an individual segment. The comparative figures for 2006 have been restated accordingly.

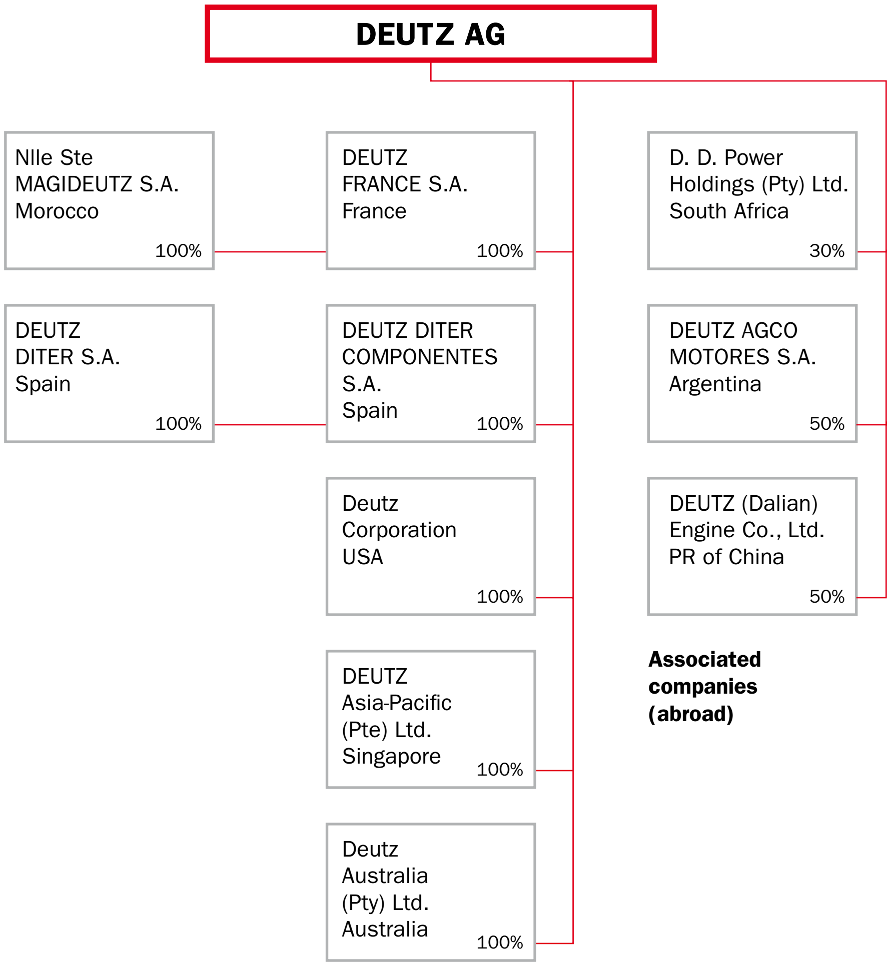
In addition, from the first quarter of 2007, we have no longer reported revenue for the Marine application segment as a separate item. From that point, figures for Marine (including prior-year comparative figures) have been included in the Other application segment.

GROUP STRUCTURE AND BUSINESS ACTIVITIES

Organisational structure

Independence and decades of engine expertise – these are the defining features of the DEUTZ Group: DEUTZ is a non-captive manufacturer of engines, primarily diesel-powered engines. The Group's activities are divided into two segments: Compact Engines and DEUTZ Customised Solutions.

DEUTZ AG is the executive and operating parent company in the DEUTZ Group, which also comprises various German and international subsidiaries. These subsidiaries are a production company and companies with sales and service functions. DEUTZ customers are supported by 11 distribution companies, 9 sales offices and approximately 700 sales and service partners in more than 130 countries around the world.



Diesel engines up to 500 kW for an extensive range of applications

In its two segments, DEUTZ focuses on value creation processes involving the development, design, production, sales and service of liquid-cooled and air-cooled engines. The product range includes engines with air, water and oil cooling systems and engine outputs up to 500 kW. The engines are targeted at a number of applications, classified into application segments, as follows:

- Mobile Machinery: construction equipment, material handling equipment, ground support equipment, mining equipment
- Automotive: commercial vehicles (trucks, buses), rail vehicles
- Stationary Equipment: generators, pumps, compressors
- Agricultural Machinery: tractors and other agricultural equipment
- Other: marine and other applications

The product range is complemented by comprehensive service support, which is continuously expanded and tailored to customer requirements. An extensive global network comprising subsidiaries and authorised dealers provides customer support services, including the supply of spare parts, repairs, and servicing and maintenance of the supplied engines.

DEUTZ – the engine company
Independent engine manufacturer of compact diesel engines (up to 500 kW)
for on-road and non-road applications

DEUTZ AG

Compact Engines

- liquid-cooled engines
  - < 4 litres and 4 – 8 litres
- high unit sales

DEUTZ Customised Solutions

- air-cooled engines
  - < 4 litres, 4 – 8 litres, > 8 litres
- liquid-cooled engines
  - > 8 litres
- customised solutions

Market and competitive environment

Diversity is one of our strengths. DEUTZ supplies customers in different industries and, as a result, has a diversified customer base.

The market is divided into captive manufacturers, who produce equipment and vehicles as well as their own engines, and non-captive manufacturers, whose core competence is specifically the production of engines. DEUTZ is a non-captive manufacturer.

According to our own calculations, the size of the market relevant to DEUTZ in 2007, was around two million engines. DEUTZ has a strong international position in this non-captive market with a market share of around 14 per cent. In the last few years, DEUTZ has entered into strategic alliances to open up additional potential that was previously the preserve of the captive market. For example, DEUTZ has entered into alliances with the Volvo Group in Sweden for 4-litre to 8-litre capacity engines to be used in commercial vehicles, construction machinery and gensets, and with the SAME DEUTZ-FAHR Group in Italy for agricultural machinery engines. The year under review saw the establishment of a further partnership: DEUTZ entered into a joint venture at Dalian in China with FAW Jiefang, for the manufacture and sale of engines with a capacity of 4 to 8 litres. These engines are not included in the calculation of market share because the joint venture is accounted for using the equity method.

In various market segments, DEUTZ faces competitors whose range of services and applications is, in part, comparable with that offered by DEUTZ:

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

INTERNAL CONTROL SYSTEM

Transparent performance measures as the basis for prudent corporate management

Documentation, analysis, control: a meaningful base data, followed by timely analysis combined with the skills to respond and act quickly, and purposely enable DEUTZ to exercise the flexible control demanded by dynamic markets – control that is indispensable if DEUTZ is to achieve its corporate objectives.

We define our budget and medium-term targets using selected key performance indicators recorded within an internal control system. The key performance indicators to ensure profitable growth include unit sales and revenue, together with EBIT margin. In addition, capital tie-up is controlled via the working capital ratio (ratio of average working capital over four quarters to revenue for the last twelve months) and capital expenditure; together with optimisation of EBIT, this impacts on return on capital employed (ROCE) (the indicator used being the ratio of EBIT to average capital employed).

In order to enable us to act proactively and respond promptly, we have defined fixed deadlines for analysis and reconciliation. A monthly reporting process enables the Management Board to track changes in the performance indicators. Selected issues are also discussed at weekly management meetings so that we can respond promptly if there are any variances from budgeted values; in combination with sound causal analysis, this allows us to minimise risks and exploit additional potential. Three times a year we produce an annual forecast for all key performance indicators. In this way, we ensure optimum transparency in our business performance, benefiting both the Company and its stakeholders.

In 2007, we achieved improvements in all key performance indicators, including:

- Unit sales up 20.8 per cent
- Revenue up 28.8 per cent
- EBIT margin 6.3 per cent (2006: 5.6 per cent)
- ROCE 13.5 per cent (2006: 10.7 per cent on a like-for-like basis).

Stringent streamlining in corporate management

Our overarching objective is to achieve continuous improvement. Streamlining is based on annual planning of all key performance indicators. The indicators are determined using internal estimates of future business and competitor benchmarks. Strategic planning is carefully broken down into the key performance indicators and then applied to the operating business: concrete unit sales and revenue targets as well as customer-related and product-related targets (EBIT margins) are agreed annually with operating units on the basis of profitability targets for the Group.

Detailed working capital targets are specified for the individual companies to ensure that capital tie-up is optimised. In a subsequent stage, specific targets for inventories, trade receivables and trade payables are then allocated to individual managers.

The management of capital expenditure is a key element in the control of capital tie-up in DEUTZ because of the capital invested in plants over the long term and because of the Group's growth strategy. Capital expenditure is fixed by means of clearly specified budgets, actual requirements being derived mainly from medium-term unit sales planning and the resulting capacity and technology requirements. The levels of capital expenditure and individual projects are agreed and fixed in conjunction with the financial planning department in the context of annual budget meetings. An additional detailed review is required before projects are actually approved. To this end, DEUTZ uses standard investment appraisal methods (internal rate of return, amortisation period, net present value, income statement, cost comparisons).

Ambitious objectives

DEUTZ is pursuing the ambitious but realistic objective of winning additional market shares, specifically in Asian markets. At the same time, it is aiming to generate a further long-term improvement in the operating EBIT margin and in return on capital employed (ROCE). To achieve this, the priority is on continuous improvement of the product mix and simultaneous expansion of high-margin services.

STRATEGIC OBJECTIVES

The strategic objectives of DEUTZ are as follows:
- To become one of the top-three suppliers in the global market for engines with a capacity of 4 to 8 litres
- To double unit sales of engines with a capacity of up to 4 litres
- To consolidate its position as an international market leader in air-cooled engines
- To expand its range of services so that services account for 20 per cent of consolidated revenue.

Expansion on leading market position

In 2007, we continued to expand on our market position: we increased unit sales of 4-litre to 8-litre engines to 139,719 units, an increase of 38.2 per cent. A significant contributing factor was the new commercial-vehicle engine for Volvo, although production of this engine had started in 2006, 2007 was the first full year of production. Therefore, we are now one of the world's top-three suppliers. Unit sales of engines with a capacity of up to 4 litres rose by 11.4 per cent to 109,252 engines, whereas unit sales of air-cooled engines were slightly below the 2006 level at 32,417 units. Overall, therefore, we managed to expand our market share from 12 per cent to over 14 per cent. Our service revenue in 2007 increased by around €24 million to €203.5 million; service revenue thereby accounted for 13.4 per cent of consolidated revenue. Despite the growth in the service business, the proportion of consolidated revenue accounted for by service revenue fell slightly compared with 2006, because of the disproportionate growth in new-engine business, particularly with major equipment manufacturers. However, the sharp rise in unit sales of new engines over the last few years will ultimately lead to higher service revenue in the future. In the year under review, we were also able to add 16 new service partners in markets where we are experiencing strong growth. These new partners will strengthen our service network in future, contributing to the growth in revenue and corresponding profits. Seven of these new service partners are in Russia, four in Africa and five in south-eastern Europe.

Presence in Asian growth regions

With the establishment of the DEUTZ (Dalian) Engine Co., Ltd. (DEUTZ Dalian) joint venture, we will significantly expand our presence in the emerging Asian markets, thereby sharing in the market growth in this region, particularly in China. Activities will focus on the supply of 4-litre to 8-litre engines based on DEUTZ technology to the FAW Group and international DEUTZ customers in Asia. Components manufactured in Dalian will also be used in DEUTZ assembly plants in Germany; we also want to use our local presence to develop the supply of components from local manufacturers for use in our German production facilities.

ECONOMIC ENVIRONMENT

Business performance in the DEUTZ Group is being driven primarily by continually increasing global industrialisation and simultaneous growing demand for environmentally friendly equipment and vehicles. The market for diesel engines is characterised by continuing development towards increasingly efficient, but at the same time, more economical, quieter engines with lower emissions. This is not least the result of more stringent legal requirements regarding permissible emissions. The capacity to meet increasing customer requirements for efficient, service-friendly engines also demonstrates the competitiveness of the Company. The same also applies to our innovative strength, i.e. our ability to ensure that engine systems continue to be developed on an ongoing basis.

The global economy grew by 4.7 per cent in 2007. However, the pace of growth eased off as a result of the mortgage crisis and credit crunch in the USA, which then also hit Europe in the second half of the year. As in 2006, the growth continued to be driven by Asia (excluding Japan). In the year under review, gross domestic product in this region increased by over 9 per cent. In contrast, the USA could only manage economic growth of around 2 per cent. Countries in the euro zone still managed growth of 2.7 per cent; in this case, the economy was driven by exports and capital investment in house building. In Germany, gross domestic product increased by 2.5 per cent in 2007. Compared with the excellent year in 2006, it therefore lost some momentum, the strong euro causing a fall in export demand.

Global economy in 2007: slowing growth[1)]

The DEUTZ customer base is concentrated particularly in the construction equipment, agricultural machinery and commercial vehicles industries. All three sectors registered growth in 2007, with a corresponding positive impact on DEUTZ.

Strong growth in key industries

The German Engineering Federation (VDMA) raised its growth forecast several times during the course of 2007. At the end of the year, production volume had risen to €181 billion, an increase of 11 per cent – making 2007 another record year for German engineering. Double-digit growth rates were registered primarily by the industrial plant, turbines, engines and pump sectors.

2007: boom year for engineering and commercial vehicles[1)]

There were also positive trends in the construction industry across Europe. Experts at EUROCONSTRUCT, the network of research institutes and consulting organisations in the construction and property sector, from 15 countries in Western Europe and four countries in Central and Eastern Europe, confirmed that the construction industry registered growth of around 2.5 per cent. This growth had an indirect impact on the construction-equipment sector important to DEUTZ.

There was also positive growth in the commercial-vehicles sector in 2007, evidenced by registrations of commercial vehicles over 3.5 tonnes (excluding buses and coaches). According to the European Automobile Manufacturers' Association (ACEA), 428,482 vehicles were registered across the whole of Europe, 5.1 per cent more than in 2006. Western Europe accounted for 87 per cent of this total. Central and Eastern Europe also saw very dynamic growth of around 39 per cent.

In 2007, the global agricultural machinery industry saw growth in both production and revenue. Revenue in the German agricultural machinery industry reached €6.1 billion, an increase of 16.7 per cent. Half of the revenue was accounted for by tractors, the other half by other agricultural equipment. The critical period in this surprisingly high growth was the fourth quarter. In the last three months of the year, revenue increased by a further 37 per cent, although a record figure had already been achieved in the equivalent period in 2006.

German agricultural machinery industry grows by 17 per cent[1)]

In the year under review, the driver behind the business of German manufacturers was again demand from abroad – exports accounted for 74 per cent of revenue. This was manifested in a year-on-year increase of 24 per cent in revenue from abroad. The most important market outside Germany continued to be France, which accounted for 15 per cent of total exports. The second-largest export market is now Russia. However, there was also a very significant increase in revenue from most of the new European Union (EU) countries, such as Poland and Hungary. In addition, there was an effect from generally good economic conditions in important Western European markets, such as the United Kingdom. Exports to the USA fell by 9 per cent, primarily owing to the change in exchange rates.

[1)] Global economic data: Deutsche Bank Research
Industry data: German Engineering Federation (VDMA), EUROCONSTRUCT,
European Automobile Manufacturers' Association (ACEA),
VDMA Agricultural Equipment

DEUTZ Group in brief (continuing operations)

	2007	2006	Change (%)
€ million			
Orders on hand	316.0	261.1	21.0
New orders	1,584.5	1,296.9	22.2
Unit sales (units)	285,861	236,679	20.8
Revenue	1,524.2	1,183.6	28.8
thereof excl. Germany (%)	78.0	74.6	–
EBIT	95.5	66.6	43.4
EBIT margin (%)	6.3	5.6	–
Net income[1)]	183.3	61.5	–
ROCE (%)	13.5	10.7	–
Total assets	1,378.6	1,162.9	18.5
Equity	557.1	358.5	55.4
Equity ratio (%)	40.4	30.8	–
Net financial position	89.7	–34.0	–
Working capital	196.9	133.1	47.9
as a percentage of revenue (as at 31 Dec)	12.9	11.2	–
as a percentage of revenue (average)	13.3	13.0	–
Cash flow from operating activities	–38.7	84.4	–
Capital expenditure (excl. capitalisation of R&D)	143.5	81.9	75.2
Research and development costs	55.8	54.8	1.8
Number of employees as at 31 December	4,617	4,331	6.6

[1)] including discontinued operations

BUSINESS PERFORMANCE IN THE DEUTZ GROUP

Introductory note: DEUTZ Power Systems

The operating activities previously brought together in the DEUTZ Power Systems segment were sold on 30 September 2007. The comments and figures for new orders, orders on hand, unit sales, revenue and operating profit, therefore, only relate to the continuing operations in Compact Engines and DEUTZ Customised Solutions. The comparative figures for 2006 have also been restated accordingly.

Overall, the purpose of the sale of our operating activities involving medium-sized and large gas-powered engines (DEUTZ Power Systems) was to strengthen our core business and technological activity: the development and production of compact diesel engines.

Growth as a challenge

In 2007, DEUTZ again increased unit sales and revenue – and significantly beyond the planned increase. This presented a huge challenge for both our own components manufacturing capability and our suppliers. The strong demand temporarily caused material bottlenecks and, subsequently, higher logistics costs. To continue to expand capacity as fast as possible, we invested heavily in our manufacturing and assembly facilities, and in suppliers. In 2007, we also achieved the targeted full utilisation of assembly capacity for the new TCD 2013 4V series (over 30,000 engines). In addition, the planned relocation of air-cooled engine production from Cologne to Ulm was completed on schedule at the start of 2007; following expansion, the Ulm facilities now have a total capacity of 35,000 engines.

Following the issue of all the necessary official approvals, the joint venture between DEUTZ and FAW Jiefang commenced operations on 1 August 2007. Currently, the joint venture is producing engines primarily for the local Chinese market; these engines are mainly used in commercial vehicles. The greatest challenge at the new facilities in China is the start-up at the new plant for the manufacture of licensed DEUTZ engines, including localisation of parts procurement and the integration of the joint venture into the existing structures covering the group of DEUTZ production sites.

New orders across the Group were up by 22.2 per cent: new orders in 2007 amounted to €1,584.5 million compared with €1,296.9 million in 2006. Demand for compact engines was particularly strong. At €1,203.9 million, new orders were up 26.7 per cent on 2006. DEUTZ Customised Solutions also saw an increase of 9.8 per cent, new orders rising to €380.6 million. As at 31 December 2007, orders on hand stood at €316.0 million (31 December 2006: €261.1 million). This provided us with a very good cushion to start the new financial year.

Sharp increase in new orders

Unit sales
units

There was equally positive growth in unit sales. Total unit sales across the whole of the Group were 285,861 units, a year-on-year increase of 20.8 per cent. The increase was particularly strong outside Germany, where unit sales rose to 224,844, an increase of 28.3 per cent. Demand in Germany remained close to the level of 2006 at 61,017 units.

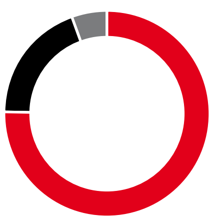
Further high level of growth in unit sales

As far as the individual segments were concerned, there was a substantial increase in unit sales, particularly in Compact Engines. In this segment, 248,971 engines were sold in 2007, which equates to an increase of 25.0 per cent. In DEUTZ Customised Solutions, unit sales were almost at the same level as in 2006 at 36,890 units; the segment therefore exceeded budget by just under 8 per cent.

Analysed on a regional basis, there was a sharp rise particularly in unit sales in the Asia-Pacific region to 15,274 units (up 70.4 per cent). This was the result of an increase in supplies of engines to Chinese customers. However, there will be a change in this trend because the region will be supplied increasingly in the future by the joint venture. There was also significant expansion in the Europe/Middle East/Africa region, where sales reached 215,660 units, a rise of 24.6 per cent. The increasing volume of transport combined with a rise in the requirement for mobility led to more capital investment in infrastructure, particularly in the major cities of Eastern Europe. For DEUTZ, this resulted in an appreciable increase in demand from manufacturers of buses, trucks and construction equipment. There was also a positive effect from the high level of construction activity in southern Europe, which gave a boost to unit sales of engines for construction equipment, and from long-term infrastructure projects for the decentralisation of energy supply in the Middle East, which stimulated demand for gensets. Despite the economic downturn in the second half of the year, unit sales in the USA exceeded our expectations, with the result that the 54,927 engines sold in the Americas region was roughly the same as the figure achieved in 2006 (54,626).

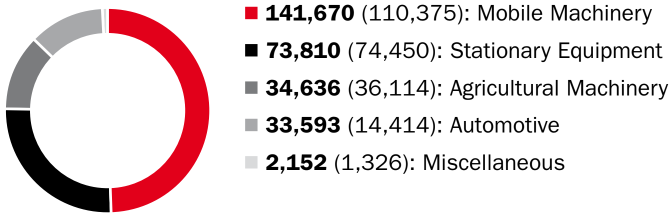
Strong growth in the Asia-Pacific region

DEUTZ Group: Unit sales by region
units (2006 figures)



- **215,660** (173,091): Europe/Middle East/Africa
- **54,927** (54,626): Americas
- **15,274** (8,962): Asia-Pacific

DEUTZ Group: Unit sales by application segment
units (2006 figures)

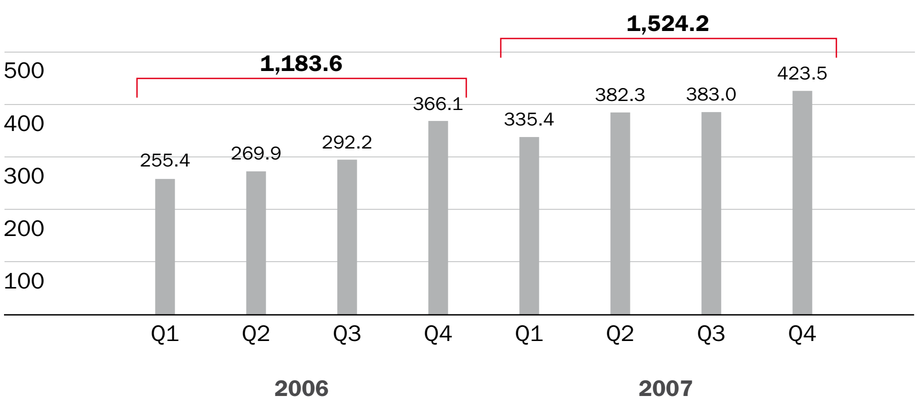


Business outside Germany as revenue driver

The revenue figures reflect the excellent figures for new orders and unit sales: consolidated revenue climbed from €1,183.6 million in 2006 to €1,524.2 million in 2007, an increase of 28.8 per cent. Of this revenue, 78.0 per cent was generated outside Germany. The performance of the individual segments varied considerably, again reflecting the unit sales figures. Whereas there was a very significant 36.6 per cent rise in revenue in Compact Engines to €1,186.0 million, DEUTZ Customised Solutions saw a comparatively moderate increase in revenue of 7.3 per cent to €338.2 million, although this increase exceeded our original expectations and was, therefore, encouraging.

Group revenue
€ million

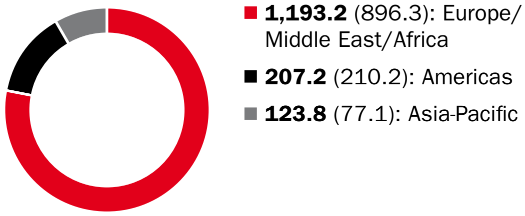
Revenue by quarters 2006/2007
€ million



Viewed on a regional basis, growth was higher outside Germany than within Germany. Outside Germany, revenue rose by 34.6 per cent, whereas the figure within Germany was 11.7 per cent. Relatively speaking, the Asia-Pacific region returned the sharpest increase with revenue of €123.8 million (an increase of 60.6 per cent) – the result of the increase in supplies of engines and parts to China. The Europe/Middle East/Africa region recorded growth in revenue of 33.1 per cent to €1,193.2 million, whereas North America experienced a slight drop of 1.4 per cent to €207.2 million due to changes in the exchange rate.

Within the Europe/Middle East/Africa region, which accounted for the greatest proportion of revenue, growth in Europe was particularly strong, both in absolute and relative terms, as a result of the commercial-vehicle engines supplied to Volvo. The commercial-vehicle engine series went into production in 2006, with 2007 being the first full year of production. Revenue in Europe rose over the year by 49.6 per cent to €769.0 million. A substantial increase in business with new customers in the commercial vehicles, agricultural machinery and construction equipment industries in Eastern Europe also had a positive impact.

DEUTZ Group: Revenue by region
€ million (2006 figures)

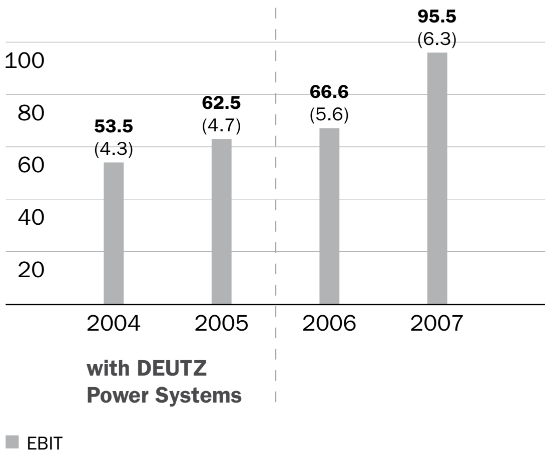


Further improvement in operating profit

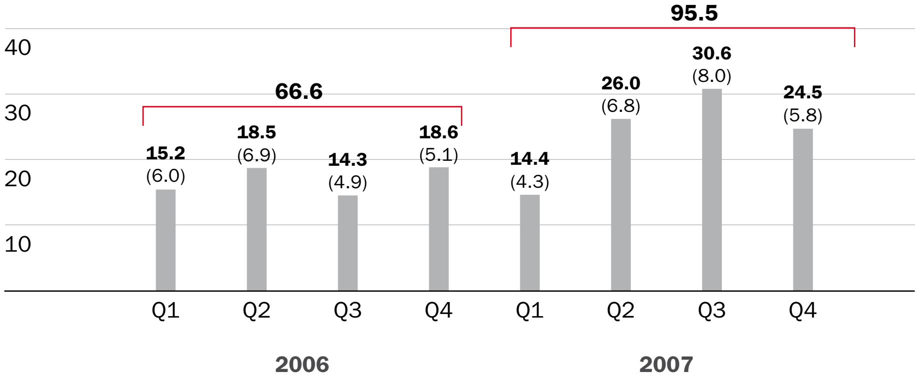
In 2007, DEUTZ was able to increase operating profit (EBIT before one-off items) from €66.6 million to €95.5 million, an increase of 43.4 per cent. The EBIT margin therefore rose to 6.3 per cent (2006: 5.6 per cent). Of this operating profit, €45.3 million was contributed by Compact Engines (up 19.8 per cent) and €44.7 million by DEUTZ Customised Solutions, the latter equating to a jump in operating profit of 46.6 per cent.

We also generated an operating profit of €5.5 million (2006: loss of €1.7 million) in the Other segment as a result of the reversal of provisions on expiry of warranty periods related to the sale of the Marine Service business.

Operating profit and EBIT margin before one-off items
€ million
(EBIT margin in %)



Operating profit by quarters 2006/2007
€ million
(EBIT margin in %)



The year under review saw a further rise in the cost-of-materials ratio to 66.2 per cent (2006: 62.9 per cent). The reasons for this were the increase in the number of engine series complying with Stage 3 emissions standards and the corresponding need to purchase an increased number of high-quality technology components (e.g. electronic components), and newly introduced engine series that have a higher material content and that are now also being produced in higher numbers.

In contrast, advances in productivity and economies of scale meant that we were able to achieve a significant reduction in the staff costs ratio over the same period. The ratio for 2007 was 17.7 per cent, 3.2 percentage points lower than in 2006.

The increase in other operating income arose from the reversal of warranty provisions in connection with the sale of the Marine Service business, and from the reversal of pension provisions in connection the surrender of vested company pension rights for which a compensation payment was made.

Other operating expenses also rose in the year under review, specifically because of higher expenses for logistics, temporary staff and consultancy.

The profit on equity-accounted investments decreased significantly in 2007, this reflected the negative impact from start-up costs of €3.5 million related to the DEUTZ Dalian joint venture consolidated for the first time in 2007.

Although there was significant growth in business volume in the year under review, there was a slight improvement in net interest income/expense, primarily owing to the conversion of bonds and profit-sharing rights during the course of the year.

Significant increase in net income before taxes

There was a corresponding increase in net income before taxes attributable to continuing operations to €76.1 million (2006: €45.9 million). Income taxes amounted to €16.7 million (down € 7.4 million). The income tax rate was therefore 21.9 per cent (2006: 16.1 per cent). The reason behind this increase in the tax rate on continuing operations was a reduction in deferred tax assets in respect of the loss carry forward following the disposal of DEUTZ Power Systems. The net income attributable to continuing operations after tax amounted to €59.4 million (2006: €38.5 million). In the year under review, the net income attributable to discontinued operations was €123.9 million, comprising €147.1 million from the disposal of DEUTZ Power Systems and the operating profit for the segment of €9.4 million net of income taxes. The figure of €23.0 million in 2006, comprised the segment operating profit and the one-off item in connection with the sale of the Marine Service business, including the associated income tax expense.

DEUTZ was therefore able to increase total net income to €183.3 million (2006: €61.5 million) and, for the first time in over 20 years, is once again in a position to pay a dividend.

The basic earnings per share is €1.56 (2006: €0.57), of which €0.51 is attributable to continuing operations (2006: €0.36) and €1.05 to discontinued operations (2006: €0.21). Basic earnings per share attributable to continuing operations has therefore increased by 41.7 per cent.

Earnings per share

DEUTZ Group segments

	1–12/2007	1–12/2006	Change (%)
€ million			
New orders			
Compact Engines	**1,203.9**	**950.4**	**26.7**
DEUTZ Customised Solutions	380.6	346.5	9.8
Continuing operations	**1,584.5**	**1,296.9**	**22.2**
Unit sales (units)			
Compact Engines	248,971	199,202	25.0
DEUTZ Customised Solutions	36,890	37,477	–1.6
Continuing operations	**285,861**	**236,679**	**20.8**
Revenue			
Compact Engines	1,186.0	868.3	36.6
DEUTZ Customised Solutions	338.2	315.3	7.3
Continuing operations	**1,524.2**	**1,183.6**	**28.8**
Operating profit (EBIT before one-off items)			
Compact Engines	45.3	37.8	19.8
DEUTZ Customised Solutions	44.7	30.5	46.6
Other	5.5	–1.7	–
Continuing operations	**95.5**	**66.6**	**43.4**

BUSINESS PERFORMANCE IN THE COMPACT ENGINES SEGMENT

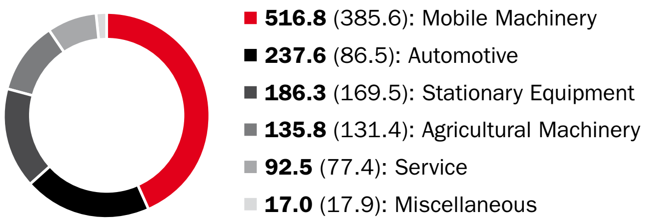
Strong growth in Compact Engines

Over the entire year under review, the Compact Engines business recorded very strong growth – first and foremost, a direct consequence of the first full year of production for the commercial-vehicle engine manufactured for Volvo. A further reason was the positive economic climate, which stimulated demand, specifically for construction equipment, material handling equipment and tractor engines. This resulted in a corresponding increase in new orders to €1,203.9 million, a rise of 26.7 per cent.

Unit sales up 25 per cent

Unit sales rose significantly to 248,971 engines, an increase of 25.0 per cent. The upward trend was particularly marked in 4-litre to 8-litre engine series, where sales reached 139,719 units (2006: 101,110 units), an increase of 38.2 per cent. The growth in sales of engines in this particular class was attributable specifically to the commercial-vehicle engine launched in 2006; in the first full year of production there was almost a fourfold increase in unit sales of this engine. However, even engines with a smaller capacity of under 4 litres saw an increase in unit sales of 11.4 per cent, total unit sales in this category reaching 109,252 engines (2006: 98,092).

Compact Engines: Revenue by application segment
€ million (2006 figures)



Revenue growth in the Automotive application segment

Excellent unit sales also led to a significant rise in segment revenue to €1,186.0 million, a year-on-year increase of 36.6 per cent. The increase was particularly noticeable in the Automotive application segment. Given the significant revenue generated by the commercial-vehicle engines, Automotive revenue was around €238 million, almost three times higher than in 2006, when full production of these engines was started. Within the Compact Engines segment, the largest revenue contributor was the Mobile Machinery application segment, which again generated double-digit revenue growth of 34 per cent, driven primarily by the high demand for construction and material handling equipment. In addition, revenue generated by engines in the Stationary Equipment application segment, such as gensets, compressors and pumps, saw an encouraging increase of around 10 per cent. Service revenue also continued to grow significantly, up 19.5 per cent on 2006. Apart from the contribution from the very successful spare-parts business, this was also the outcome of numerous intensive marketing activities undertaken by the service organisation.

Foremost among these activities was the “Service 20%” programme, which included projects on a global basis to win market share, expand the DEUTZ lubricants business and increase price differentiation in the spare-parts business.

The substantial growth in revenue in the new engines business, in particular, led to an increase of 19.8 per cent in the segment operating profit to €45.3 million (2006: €37.8 million). However, the EBIT margin fell slightly by around half of one percentage point to 3.8 per cent, the result of unbudgeted expenses. In order to secure the supply of parts to support the extraordinarily high increase in unit sales, the Company had to incur additional logistics expenses running into the double-digit millions of euros. Start-up costs amounting to a total of €6 million related to the Chinese joint venture – which commenced operations in the third quarter of 2007 – were also recognised when the joint venture was consolidated for the first time using the equity method. These expense items were partly offset by the reversal of pension provisions of approximately €8.0 million, in connection with the surrender of vested company pension rights in return for a compensation payment.

Successful start-up for the DEUTZ Dalian joint venture

The first few months of 2007 focused on developing the necessary organisational structures and management processes for the joint venture, the agreement on which had been signed in December 2006.

In the period from August to December 2007, DEUTZ Dalian – currently there are just under 2,000 employees at the facilities – produced over 42,000 engines, of which 3,000 were based on DEUTZ technology. This generated revenue of over €80 million. We had budgeted for the operating loss of €6 million.

We signed initial supply agreements with DEUTZ customers active in China. It had also been decided that, in the start-up year of the joint venture, we would ratchet up crankcase production for 4-litre to 8-litre engines from 50,000 to 60,000 units. It is aimed to have this additional capacity available in the second half of 2009. All current and future capital expenditure will be financed either by the joint venture’s own resources or by loans taken out locally.

BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS SEGMENT

In DEUTZ Customised Solutions, new orders over the entire year increased by 9.8 per cent to €380.6 million, and thereby exceeded our expectations. Although unit sales of engines were 1.6 per cent down on 2006, the figure was significantly above budget: 36,890 units were sold in 2007 (2006: 37,477). Despite the slight fall in unit sales, the high proportion of engines with a capacity greater than 8 litres meant that revenue grew by 7.3 per cent to €338.2 million.

Order volume at a high level

However, the trend varied depending on the application segment. Whereas revenue from Stationary Equipment engines dropped by 20.2 per cent owing to a downturn in project business and a fall in the US business caused by the strong euro, revenue in the Automotive application segment rose by 28.3 per cent, with revenue in the Mobile Machinery application segment also growing by 16.6 per cent. The Agricultural Machinery application segment saw excellent growth of 81.2 per cent. In the year under review, a significant number of engines were built in advance for several customers, the reason being that the Stage III A/TIER 3 emissions standard for engines with an output of between 37 and 75 kW was due to come into force on 1 January 2008. Service revenue also rose; the increase of 8.5 per cent was specifically the result of the volume of Xchange business involving reconditioned exchange parts and engines. The Xchange business experienced a strong rate of growth of 9.5 per cent. We were also able to achieve significant expansion in the spare-parts business.

DEUTZ Customised Solutions: Revenue by application segment
€ million (2006 figures)

- **111.0** (102.3): Service
- **72.5** (90.9): Stationary Equipment
- **64.5** (55.3): Mobile Machinery
- **42.2** (32.9): Automotive
- **27.9** (15.4): Agricultural Machinery
- **20.1** (18.5): Miscellaneous

Operating profit in DEUTZ Customised Solutions amounted to €44.7 million (2006: €30.5 million), which equates to an increase of 46.6 per cent. The reasons for this sharp rise were the overall increase in revenue and an improved product mix, i.e. a higher proportion of project business with a correspondingly higher margin. We also continued to expand the Xchange business. There was also an increase in operating margin, which rose to 13.2 per cent compared with 9.7 per cent in 2006.

Operating profit at a high level

DISCONTINUED OPERATIONS: DEUTZ POWER SYSTEMS

Disposal on 30 September 2007

The DEUTZ Power Systems segment was sold on 30 September 2007, at a price of €360 million. There were further effects from this transaction in the fourth quarter. DEUTZ UK Ltd.'s shareholdings in ASIA POWER (PRIVATE) LIMITED, Sri Lanka, and AP OPERATION & MAINTENANCE Ltd., Jersey, which formed part of the DEUTZ Power Systems segment, were transferred to the buyer together with assets from three DEUTZ subsidiaries. The sale of this segment after nine months and the transfers in the fourth quarter mean that a comparison between the operating activities in 2007, and those over the twelve months of 2006, is not particularly meaningful because, as far as project business is concerned, most of the revenue and operating profit in respect of large gas engines is normally recognised in the last quarter of the year.

DEUTZ Power Systems: Revenue by application segment
€ million (2006 figures)

New orders in 2007 were €249.6 million (2006: €334.4 million), with unit sales of 367 engines (2006: 705 engines). Segment revenue amounted to €207.1 million (2006: €314.6 million). These positive trends were reflected – for the period of nine months – in an operating profit of €9.4 million; over the full twelve-month period in 2006, the segment achieved an operating profit of €14.9 million.

Capital expenditure amounted to €6.5 million (2006: €3.9 million). Research and development expenditure in the segment in the year under review was €9.1 million (2006: €11.6 million). At the end of September 2007, DEUTZ Power Systems employed 961 people (Q3 2006: 1,002). A further 39 employees from DEUTZ subsidiaries involved in the gas engines business were transferred to the buyer of DEUTZ Power Systems on 31 December 2007.

NET ASSETS AND FINANCIAL POSITION

The assets and liabilities attributable to DEUTZ Power Systems are no longer carried on the consolidated balance sheet as at 31 December 2007. As specified by IFRS 5.40, the balance sheet as at 31 December 2006 has not been restated. The main changes in carrying amounts between the balance sheet dates are, therefore, largely explained by the deconsolidation of DEUTZ Power Systems.

Financial management centrally organised

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

With the issue of notes (bonds) as part of a private placement in the United States, DEUTZ has put in place long-term, non-bank-based financing with maturities of five, seven and ten years. The bondholders are institutional investors in the US. With the placement in the early summer of 2007 – that is, before the mortgage crisis in the US – DEUTZ tapped into a very receptive capital market: the bonds, initially worth US$ 150 million, were more than three times oversubscribed and were, therefore, raised to US$ 274 million (equivalent to €203.15 million). The average coupon was 5.4 per cent. 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, there is no risk to DEUTZ from changes in the exchange rate between US dollars and the euro. There are currently no other material financial liabilities denominated in foreign currency.

US private placement with a total value of US$ 274 million completed

The proceeds have been used for the joint venture in China, the payment of compensation for the surrender of vested company pension rights and the repayment of outstanding bank debt. Current lines of credit with banks are largely unused; all are unsecured. We do not expect to see a deterioration in our terms of credit in the future.

Over the last few years, factoring – the sale of receivables – has steadily become increasingly important. We make use of these opportunities to sell receivables in order to optimise our receivables management. As at 31 December 2007, the volume of receivables sold under factoring agreements was around €95 million (2006: €119 million). The average volume in 2007 was over 14 per cent lower than in 2006.

Optimum receivables management by means of factoring

For historical reasons, there has been a substantial imbalance in the DEUTZ Group between the number of employees and the number of beneficiaries of vested company pension rights. At the end of 2006, there were three such beneficiaries for every active employee. The majority of retirees or pension beneficiaries only had a maximum monthly pension entitlement of €200. Given this background, a voluntary one-off compensatory payment seemed to us to be a promising option that would allow us, to the extent permitted by law, to encourage surrender of these vested pension rights – especially as such compensation payments would be exempt from personal tax and social security obligations for many of our pension recipients.

Pension provisions reduced by one-off payments

DEUTZ circulated a compensation offer to just under 14,000 pension beneficiaries – more than 8,500 pension beneficiaries and active employees accepted the offer. As a result, the ratio of pension beneficiaries to active employees at the end of 2007 was two to one. The pension provisions assigned to the Compact Engines and DEUTZ Customised Solutions segments were also reduced correspondingly by around €80 million.

Of the original issue of 19,792,998 convertible bonds, 839,263 were still outstanding at the end of 2007. Since the outstanding volume represented less than 10 per cent of the original issue, we made use of the provision in the terms of the bond to call the bond. The effective date for redeeming the bond was 7 March 2008, although up to 3 March, bondholders still had the option to exchange one convertible bond for one DEUTZ share. On 19 November 2007, DEUTZ notified holders that it intended to redeem a further 1,194 convertible profit-sharing rights with an effective date of 22 May 2008.

Convertible bond issued in 2004 almost completely converted

Currently, none of the rating agencies has set a credit rating for DEUTZ. However, the covenants imposed on DEUTZ in connection with the US private placement are equivalent to those imposed on companies classified as investment grade by rating agencies or by the National Association of Insurance Commissioners (NAIC) in the US. These covenants are defined by key performance indicators based on the ratio of net debt to equity, net debt to EBITDA (before one-off items), and EBITDA (before one-off items) to net interest income/expense.

Covenants provide evidence of investment-grade rating

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).

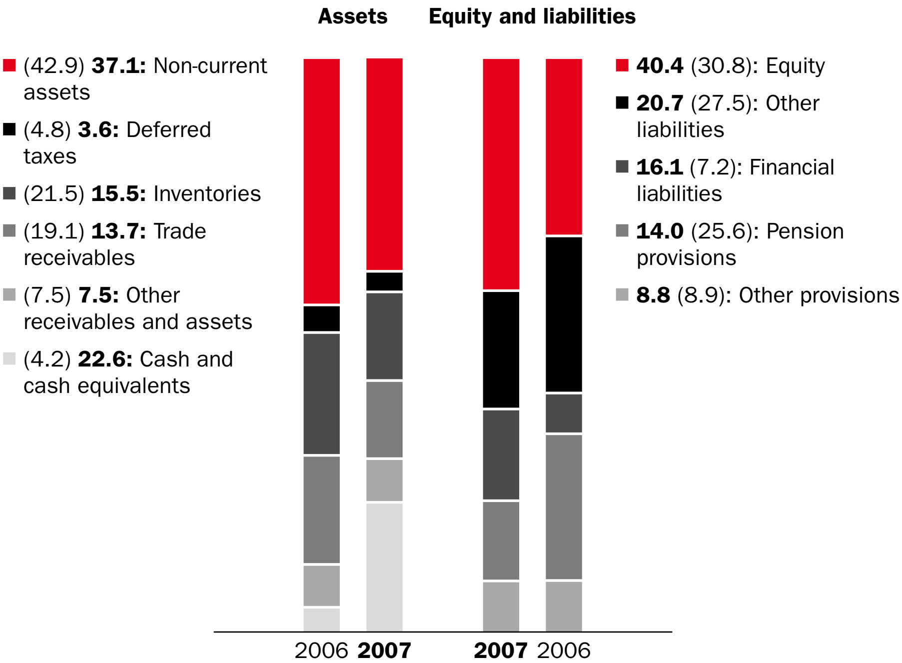
Disposal of DEUTZ Power Systems increases liquidity

DEUTZ Power Systems was sold on 30 September 2007. This gave rise to cash inflows in DEUTZ of €317 million. Together with the current credit facilities, this means that DEUTZ has sufficient funding available to cover capital expenditure, any acquisitions and the further expansion of the Compact Engines business.

Changes to balance sheet structure

There were significant changes to the structure of the balance sheet of the DEUTZ Group as at 31 December 2007, compared with the corresponding structure as at 31 December 2006. Essentially, these changes were the result of the disposal of the DEUTZ Power Systems segment on 30 September 2007. As at 31 December 2007, the consolidated balance sheet no longer included the assets and liabilities of DEUTZ Power Systems, whereas the sale price received was for the most part included under cash and cash equivalents.

Balance sheet structure DEUTZ Group
in %



Increase in total assets

As at 31 December 2007, total assets in the DEUTZ Group had risen to €1,378.6 million, an increase of €215.7 million (18.5 per cent) on the equivalent figure for 31 December 2006. The derecognition of DEUTZ Power Systems assets worth approximately €277 million was more than offset by two items: first, the purchase price received for the sale of DEUTZ Power Systems which, after debt repayments, increased cash and cash equivalents by approximately €262 million; and secondly, by the addition of financial assets worth €52.6 million for the 50-per-cent share in the DEUTZ Dalian joint venture, after taking into account start-up costs. In addition, inventories and receivables attributable to continuing operations increased by a total of roughly €95 million, owing to the large order volumes and the growth in revenue.

At the end of 2007, working capital – inventories plus trade receivables less trade payables – stood at €196.9 million, €38.2 million lower than the balance as at 31 December 2006. The reduction of roughly €102 million resulting from the disposal of DEUTZ Power Systems was partially offset by an increase of approximately €64 million in continuing operations. This includes an increase in inventories of €45.1 million to support the high level of orders on hand. Despite the decrease in working capital, the average working capital ratio (ratio of average working capital over four quarters to the revenue for twelve months) was 13 per cent and, therefore, close to the like-for-like figure for continuing operations in 2006.

Fall in working capital owing to segment disposal

A significant structural change was also evident on the equity and liabilities side of the balance sheet as a result of the realignment of the Group. Equity rose to €557.1 million (2006: €358.5 million), primarily owing to the high level of consolidated net income, which also included the effect of the disposal of DEUTZ Power Systems, in particular, and owing to the conversion of bonds and profit-sharing rights. As at 31 December 2007, the equity ratio was 40.4 per cent (before dividend distribution), a year-on-year increase of over nine percentage points.

Equity ratio up nine percentage points

To avoid distortions caused by the high level of cash and cash equivalents in 2007, we have amended our definition of return on capital employed (ROCE), used hitherto in line with the standard definition. Henceforward, this key figure will be the ratio of EBIT before one-off items to capital employed, comprising the asset side of the balance sheet (average figures) less cash and cash equivalents and less trade payables and other current liabilities.

The excellent result and improved working capital pushed up ROCE to 13.5 per cent. The like-for-like ROCE in 2006 for continuing operations would have been 10.7 per cent.

Further increase in ROCE

Current and non-current pension provisions decreased significantly by €104.3 million to €193.4 million compared with the end of December 2006. A total of €98.8 million of this reduction was attributable to continuing operations and resulted from the surrender of vested company pension rights in return for the payment of compensation.

Surrender of vested company pension rights in return for compensatory payment reduces pension provisions

Following implementation of the US private placement in 2007, we used this opportunity to bring our existing definition of net financial debt into line with the standard definition used by capital markets. Previously, this key debt figure was derived from bank debt less cash and cash equivalents. The key figure now known as “net financial position” represents existing cash and cash equivalents less all current and non-current interest-bearing financial liabilities in the form of loans, bonds, notes and finance lease liabilities. Given the high level of cash inflows resulting from the significant proceeds in connection with the disposal of DEUTZ Power Systems, we ended the year under review with a positive net financial position of €89.7 million (2006: negative figure of €34.0 million).

Net financial position positive for the first time

DEUTZ Group: summary cash flow statement

	2007	2006
€ million		
EBIT	**95.5**	**66.6**
Cash flow from operating activities before payment of compensation for vested company pension rights (continuing operations)	**41.1**	**84.4**
Payment of compensation for vested company pension rights (continuing operations)	–79.8	–
Cash flow from operating activities (continuing operations)	**–38.7**	**84.4**
Cash flow from operating activities (discontinued operations)	–9.1	25.8
Cash flow from operating activities (total)	**–47.8**	**110.2**
Capital expenditure on intangible assets, property, plant and equipment and investments	–159.0	–92.2
Cash receipts from the sale of businesses and proceeds from the sale of non-current assets	14.9	0.9
Cash flow from investing activities (continuing operations)	**–144.1**	**–91.3**
Cash flow from investing activities (discontinued operations)	296.4	–5.5
Cash flow from investing activities	**152.3**	**–96.8**
Cash flow from financing activities	**161.9**	**–11.8**
Change in cash and cash equivalents	**266.4**	**1.6**

Cash flow significantly influenced by one-off items

As at 31 December 2007, the cash flow from operating activities attributable to continuing operations was minus €38.7 million, which was €123.1 million below the cash flow of €84.4 million generated in 2006. Essentially, the difference is attributable to the non-operating payments of €79.8 million made by DEUTZ in compensation for the surrender of vested company pension rights. A further reason was the expansion of working capital in Compact Engines and in DEUTZ Customised Solutions as a consequence of the growth in business volume.

In the discontinued operations, there was a negative cash flow of around €9 million, principally caused by an increase in working capital during the course of the year.

The rise in capital expenditure and the investment of around €58 million in the DEUTZ Dalian joint venture in China meant that the cash flow from investing activities attributable to continuing operations reached minus €144.1 million, compared with minus €91.3 million in 2006. This figure includes cash inflows of €14.2 million arising from the legacy effects of the disposal of the Marine Service business.

The cash flow of €296.4 million from investing activities attributable to discontinued operations includes cash inflows of €317 million from the disposal of DEUTZ Power Systems.

Cash flow from financing activities amounted to €161.9 million (2006: minus €11.8 million). This includes the proceeds of €203 million from the US bond placement and the repayment of bank debt amounting to €79.4 million.

CAPITAL EXPENDITURE

In 2007, total capital expenditure amounted to €167.8 million (2006: €104.3 million). This includes approximately €58 million paid for the 50-per-cent share in the DEUTZ Dalian joint venture in China. In addition, we invested €73.9 million in property, plant and equipment (2006: €67.3 million) and €36.0 million (2006: €36.4 million) in intangible assets. The capital expenditure on intangible assets in 2007 included €24.3 million on capitalised development costs (2006: €22.4 million).

Volume of capital expenditure influenced by investment in China and expansion of capacity

Capital expenditure without financial assets 2007 (2006) by usage
€ million

- **44.1** (47.0): New products/ engine refinement/R&D
- **37.7** (18.3): Expansion of capacity
- **10.4** (9.6): Replacement procurement
- **10.0** (25.2): Other
- **7.7** (3.6): Structural measures

Overall, capital expenditure in the Compact Engines segment was considerably higher than in 2006 at €160.5 million (2006: €99.6 million). Apart from our investment in the Chinese joint venture, the focus of this capital expenditure was on projects to expand capacity. These projects included the TCD 2013 4V engine series for commercial-vehicle and industrial applications, the 2011 series for industrial applications, and the expansion of capacity at our production facilities in Cologne, Germany, and Zafra, Spain, and at the assembly facilities in Cologne. This resulted in the creation, for example, of numerous processing centres and the purchase of lathes and grinding and milling machines allowing us to expand the manufacturing of crankcases, camshafts, crankshafts, conrods and cylinder heads. There was also a considerable amount of capital expenditure on tools to be used by suppliers.

Further increase in capacity for compact engines

In DEUTZ Customised Solutions, capital expenditure of €7.3 million (2006: €4.7 million) was used to expand this segment into a centre of competence for air-cooled diesel engines. The funds were used to support both pioneering and environmentally oriented projects, such as an innovative paint facility in which only environmentally friendly water-based paint is used, new test rigs, a new goods-inward area and modified infrastructure and energy supplies. Finally, the new logistics centre came into operation in September. The centre comprises a high-bay storage facility, a small-parts store and a dispatch hall.

Investment in the future and in the environment

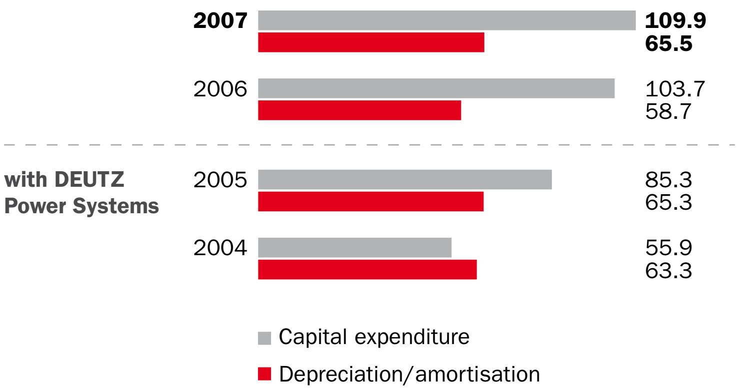
Capital expenditure without financial assets 2007 (2006) by location
€ million

- **60.9** (67.4): Cologne
- **21.9** (12.5): Zafra/Spain
- **18.0** (17.0): Suppliers
- **7.3** (4.7): Ulm and Übersee/Germany
- **1.8** (2.1): Other international locations

Depreciation/amortisation expense above 2006 level

The depreciation/amortisation expense in the DEUTZ Group was higher in 2007 than in 2006, amounting to €65.5 million (2006: €58.7 million). The breakdown of this figure is €17.9 million on intangible assets and €47.6 million on property, plant and equipment. Since 2005, capital expenditure has been significantly in excess of depreciation, amortisation and impairment losses, reflecting the objective of stronger growth and the associated expansion of capacity.

Capital expenditure and depreciation (without financial assets)
€ million



RESEARCH AND DEVELOPMENT

Core competence: diesel engines

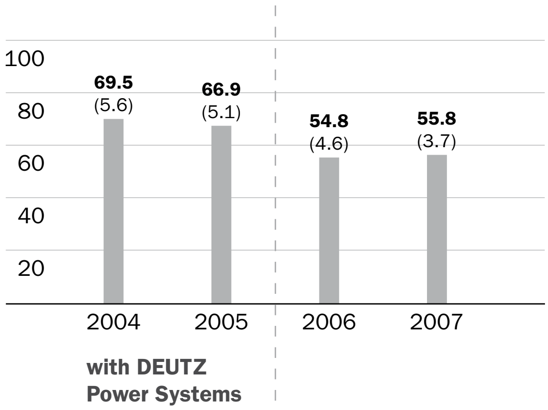
We – and our engines – are driven by technological progress. We have firm research and development goals related to the reduction of emissions, optimisation of fuel consumption, the reduction of engine noise and the achievement of the highest-possible advances in efficiency.

Within the DEUTZ Group, 388 people (2006: 393) at the Cologne site in Germany and at the Dursley site in the UK are employed on the development of diesel engines. In the year under review, R&D expenditure amounted to €55.8 million (2006: €54.8 million). A total of €47.3 million of this expenditure was attributable to the Compact Engines segment (2006: €46.3 million) and €8.5 million to the DEUTZ Customised Solutions segment (2006: €8.5 million). Given a level of expenditure similar to that in 2006 in absolute terms and a disproportionate increase in revenue, the ratio of R&D expenditure to consolidated revenue fell to 3.7 per cent, a drop of 0.9 percentage points on 2006.

In the year under review, 66 per cent (2006: 70 per cent) of R&D expenditure was accounted for by new engine development and engine refinement, 23 per cent (2006: 22 per cent) by customer applications and support for engine series production, and the remaining 11 per cent (2006: 8 per cent) by research and preliminary development.

A feature of development in 2007 was again the further reduction in emission values for our engines by means of internal exhaust-gas recirculation. The main priority was to ensure that, by the start of 2008, production of various engine variants had been modified to ensure compliance with the Stage III A/TIER 3 standard for engines with outputs of 37 kW to 75 kW.

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



[1)]R&D ratio = R&D expenditure/Group revenue

Successful production start-ups

In 2007, the most important production start-ups for engine series complying with the Stage III A/TIER 3 standard for engines with outputs of 75 kW to 130 kW were the engine series with four-valve technology, the DEUTZ common-rail injection system and cooled external exhaust-gas recirculation, and those variants with mechanical injection and internal exhaust-gas recirculation. Depending on customer requirements and the emissions standard, designs were further optimised in the application. We found the first practical tests carried out by trade publications very encouraging. The 2012 and 2013 series achieved outstanding results, in terms of both engine characteristics and fuel consumption, when tested in tractor applications.

Innovative engine designs: biofuels and hybrid drive systems

While one side of research and development work in DEUTZ is the optimisation of proven drive designs, the other side is pioneering work on the development of new types of engines. In the case of the latter, one of the key areas of research and development activities has been the DEUTZ Natural Fuel Engine, an engine in the TCD 2012 series that has been developed to run on rapeseed oil and has now been certified. We successfully showcased this innovative engine for the first time at Agritechnica in November 2007. The German Agricultural Society (DLG) awarded this engine the silver medal for “outstanding innovation in the field of drive technology”.

The hybrid drive is a further focus of research and development activities. DEUTZ used the opportunity of the Bauma trade fair in April 2007 to present the first construction equipment hybrid drive in the world; the drive was installed in a wheel loader. We have now also started development of a production model, which we are planning to have ready for presentation at Bauma in 2010.

What exactly is the hybrid design? The design combines a diesel engine with an electro-motor and an electrical energy storage capability. The advantage of this approach is the more powerful torque provided by the combination of diesel engine and electro-motor. In addition, the engine is automatically stopped when idle; it also regains kinetic energy on braking.

The advantages for customers are obvious: lower operating costs as a result of lower fuel consumption and, therefore, also lower carbon dioxide emissions to the benefit of the environment. However, there are also advantages from increased efficiency, a reduction in the size of the internal combustion engine and more comfort as a result of the reduction in idle running.

Emissions legislation requires exhaust-gas aftertreatment

Further statutory reductions in emissions limits will be introduced, for example, through the implementation of Stage III B in Europe and Interim TIER 4 in the USA from 2011. As a consequence, the development of exhaust-gas aftertreatment systems is becoming increasingly important for DEUTZ. In these emission stages, it is no longer possible to achieve a further reduction in emissions from within the engine alone – for non-road applications (as is currently already standard in the case of some on-road applications), it is necessary to use exhaust-gas aftertreatment systems. The development of basic principles in the areas of injection, supercharging, combustion and exhaust-gas aftertreatment has been systematically accelerated. In mid-2007, DEUTZ began development of production engines that comply with the next stage of emissions standards. These engines use SCR (selective catalytic reduction) systems to reduce nitrogen oxide. This development is able to make use of our experience in manufacturing such engines for on-road applications (commercial-vehicle engines). In addition, special filter systems are required for the soot particles arising in the combustion of diesel fuel. In this regard, we have many years of experience, particularly from our retrofitting business. We have already developed an electronically controlled burner system for the regeneration of the filter element that is sometimes required.

DEUTZ Customised Solutions: first end-customer product

Apart from the preliminary development of engines to comply with the next stage of emissions standards, a key area of development in the DEUTZ Customised Solutions segment was the provision of support for the production start-up of engines complying with the Stage 3 emissions standard. In addition, the focus in 2007 was also on the successful completion of the development of the first end-customer product – a genset with the product name ADG (air-cooled diesel genset) based on an air-cooled engine. The first practical tests have confirmed our high expectations. The ADGs are particularly robust, durable and low-maintenance – like all air-cooled DEUTZ engines, they are particularly suitable for use in extreme conditions (dust, heat, cold). Even the noise values far exceeded our expectations. Production start-up is planned for the first half of 2008.

Over 300 industrial property rights

The culture of innovation in DEUTZ is also mirrored in the industrial property rights owned by the Group. In 2007, patent applications were filed for a total of 36 inventions, of which 29 were in Germany and seven elsewhere. At the end of 2007, the DEUTZ Group held a total of 305 patent applications, patents and utility models, of which 172 were in Germany and 133 elsewhere.

PROCUREMENT

High level of demand leads to supply bottlenecks

The strong growth in the DEUTZ Group in conjunction with the general boom in the German economy meant that the procurement of raw materials and components was under some strain in 2007: there were supply bottlenecks, particularly in the first half of the year, creating significant challenges for materials planning and supply chain management. The particular materials affected by bottlenecks were cast parts, cooler packages, injection systems and valves. The situation was relieved from the middle of the year by expansion in both supplier and our own capacity, and by increased cooperation with reserve suppliers. However, we were also able to make use of the production opportunities provided by the joint venture in China. This all enabled us to improve procurement processes in the second half of the year and gradually scale back the special logistics measures we had introduced.

In the year under review, we again stepped up collaboration with suppliers. DEUTZ entered into an agreement with the global market leader for injection systems that secures the long-term supply of high-quality mechanical injection systems to meet our increasing requirements. We also renewed our long-standing partnerships with leading manufacturers of valves for air admission and venting in engines; the objective is to establish very long-term and innovation-oriented alliances. Finally, we increased the number of our suppliers of grey cast-iron cylinder crankcases to provide us with more security of supply.

Price rises in key raw materials

Steel scrap is the main material used by iron foundries, and the market for steel scrap is the most important raw materials market as far as DEUTZ is concerned. In 2007, steel scrap prices were 9 per cent higher than in 2006 on average. Average prices for non-ferrous metals, such as copper and aluminium, fell slightly.

Foundry products account for over one third of the cost of materials

Significant items in the cost of materials are foundry products, fuel injection equipment and measurement and control devices. In the year under review, foundry products accounted for 28 per cent of the cost of materials, followed by fuel injection equipment, which accounted for around 16 per cent. Measurement and control devices together accounted for more than 7 per cent of the cost of materials. Other important material subcategories are generators and starters, turned parts, sheet metal parts, DIN and standard parts, together with forged parts.

PRODUCTION

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

Assembly and component manufacturing

	Germany Cologne region	Spain Zafra	Germany Ulm	China JV Dalian	Argentina JV Buenos Aires
Assembly	●	● [1]	●	● [2]	● [2]
Component manufacturing					
Crankcases	●		●	●	
Cylinder heads	●	●		●	
Crankshafts	●		●		
Camshafts	●			●	
Conrods		●			

[1] Engine assembly ceased at the end of 2007.
[2] Joint ventures in Dalian and Argentina are accounted for using equity method.

The unit sales figures show that we had a record year. Following a year-on-year unit sales increase in 2006 of 21 per cent, we posted a further increase of around 21 per cent in 2007, with the number of engines sold rising from 236,679 to 285,861.

Further increase in assembly and manufacturing of engines at Cologne

The Cologne plants in Germany, comprising mechanical fabrication at Cologne-Deutz, Cologne-Kalk and Herschbach, together with assembly at Cologne-Deutz and Cologne-Porz, produced a total of 251,384 engines in 2007 (2006: 198,266), representing an increase of 27 per cent on 2006. The number of employees in manufacturing and assembly over the same period rose from 1,247 to 1,336, an increase of over 7 per cent.

The factors that made this record level of production possible included the introduction of three-shift operation at the principal assembly plant for industrial engines. At the same time, we also increased productivity. Average production line output per hour in 2007 was 42 engines, compared with 40 engines previously. This equates to an increase of over 5 per cent.

The year 2007 saw the first full year of production for the new 2013 4V engine series. This engine, which first went into production in 2006, is produced in an assembly hall specially constructed for this purpose in 2005 and is primarily used in commercial-vehicle applications. Output figures mirrored this ramp-up in production: in 2006 only 8,277 units were produced, whereas output in 2007 was 31,544 engines from a two-shift operation, almost a fourfold increase.

Continuous improvement process increases productivity

There were also a number of organisational changes in 2007. The Company brought together the Cologne plants under one production management structure – with the objective of continuing to increase productivity and, at the same time, securing output. To this end, a new uniform concept was introduced as part of the continuous improvement process (CIP). This concept defines the steady streamlining of manufacturing processes as the most important and urgent task of each individual manager. However, CIP is not restricted to management – it applies to every individual employee in the Company. The success of the concept is impressive: productivity at the principal assembly plant rose by approximately 5 per cent. This was achieved even though there were sometimes bottlenecks in the supply of parts.

Ulm: more production, more employees

We also ramped up production at the Ulm facilities in 2007. The assembly of air-cooled engines had only been relocated from Cologne to Ulm at the start of the year – since then, a total of 31,308 engines have been produced at the site, of which 27,656 units were air-cooled engines and 3,652 units were liquid-cooled engines in engine series with a capacity greater than 8 litres. In 2006, total production stood at just 5,173 engines, of which air-cooled series accounted for 1,270. The headcount was increased accordingly and by the end of 2007, the number of employees at the site was 542 (2006: 407).

Zafra: components for Germany

At our Zafra plant in Spain, we produced 4,276 air-cooled engines in 2007, compared with 4,400 engines in 2006. Production of the engine series concerned was discontinued at the end of 2007, because it was no longer possible to manufacture the engines economically. As a consequence, the plant in Spain will operate, in future, exclusively as a supplier of components within the Group's network of production facilities. It will concentrate primarily on the manufacturing of conrods, cylinder heads and gearwheels to be supplied directly to the assembly lines in Germany.

DEUTZ Dalian is the Company's most important joint venture

Strategically, the most important of all our joint ventures is the DEUTZ Dalian joint venture, which commenced operations in August 2007. Over the whole of 2007, the production facilities of the joint venture manufactured over 100,000 engines, of which over 42,000 were produced in the period August to December. Of the latter, 3,000 engines were assembled in the new plant with DEUTZ technology. Our Argentinian joint venture, DEUTZ AGCO Motores S.A. (DAMSA), produced over 3,000 engines in 2007 for the local market.

High level of quality

Our products are subject to ongoing quality control – in the end, a sustained high level of product quality is one of the outstanding factors in our success. Quality is measured on the basis of the additional costs that arise from rejects, defects or goodwill repairs and replacements. However, these costs are a purely internal measure; they cannot be compared with competitors because there is no benchmark and are, therefore, not published.

Health and safety: better than the industry as a whole

The rate of notifiable accidents per thousand employees is an important key indicator in evaluating accidents in the Company. The efficiency of health and safety management systems, and, in particular, the success of corrective measures, can be measured on the basis of this value. In the last few years, the number of workplace accidents per thousand employees in DEUTZ AG has regularly been below the figure supplied by the engineering employers' liability insurance association, the figure used as the benchmark in the industry. In 2007, there were 39 accidents notifiable in accordance with this method (2006: 38). This figure is approximately 15 per cent lower than the industry average determined by our accident insurers.

EMPLOYEES

DEUTZ Group: employees

	31 Dec 2007	31 Dec 2006
Headcount		
DEUTZ Group	4,617	4,331
Thereof		
Germany	3,766	3,502
Outside Germany	851	829
Thereof		
Non-salaried employees	2,830	2,627
Salaried employees	1,613	1,545
Apprentices	174	159
Thereof		
Compact Engines[1)]	3,698	3,510
DEUTZ Customised Solutions[1)]	919	821

[1)] Including apprentices

Another substantial increase in employee numbers

DEUTZ is on a growth trajectory – this is also mirrored in the headcount trend. Overall, the Company had 4,617 employees worldwide at the end of 2007, an increase of 286 (6.6 per cent) on the figure at the end of 2006. Of this total, 3,766 (2006: 3,502), i.e. the majority, were based in Germany, the largest site being Cologne with 2,891 employees, followed by Ulm with 542 employees. DEUTZ employed 851 (2006: 829) people outside Germany. In the period under review, an average of 366 persons were employed under temporary employment agreements, representing an increase of 118 over 2006. This rise was accounted for by the increase in the number of jobs related to the sharp expansion in volume.

DEUTZ Group: breakdown of employees by location

	31 Dec 2007	31 Dec 2006
Cologne	2,891	2,777
Mannheim	1	2
Ulm	542	407
Other German locations	332	316
Germany	**3,766**	**3,502**
Outside Germany	**851**	**829**
Total	**4,617**	**4,331**

At the end of 2007, the Compact Engines segment employed 3,698 people (2006: 3,510), while the DEUTZ Customised Solutions segment had 919 employees (2006: 821). The increase of 5.4 per cent in personnel numbers in the Compact Engines segment was concentrated in the Cologne manufacturing and assembly facilities, and was the result of the significant growth in the production programme. The growth of 11.9 per cent in DEUTZ Customised Solutions is attributable to the expansion of the Ulm facilities to become the competence centre for air-cooled engines.

DEUTZ Group: staff costs

	2007	2006
€ million		
Wages	126.5	108.7
Salaries	102.7	96.8
Social security contributions	44.2	41.2
Cost of severance payments and post-employment benefits	1.6	5.6
DEUTZ Group	**275.0**	**252.3**

Training is the future

As a forward-looking company with a long-term future, we are always thinking about tomorrow. For this reason, we added more training and apprenticeship places in 2007, and now have 174 apprentices (2006: 159 apprentices) in future-oriented technical and commercial vocations, for example, industrial technicians, electricians and industrial managers. Apprentices accounted for 4.6 per cent of employees in 2007 (2006: 4.5 per cent).

In recognition of its commitment to the training of young people, DEUTZ was given a training award in 2007, by the German Federal Employment Agency, for its contribution to initial training. This award was for the high technical standard, the significant personal commitment of the trainers and the 15 years of cooperation with IN VIA e.V. in Cologne. In cooperation with IN VIA, an association under the auspices of the German Caritas organisation, and the German Federal Employment Agency, we have, over this period, prepared 430 young people in our training workshop and production facilities for vocational training. The target group is formed by young people who have left school with few educational qualifications and who lack social skills. A total of 330 participants have gone on to find a training place and 100 participants are now employed by DEUTZ. There are 38 participants in the current-year group.

Further acceleration in professional development

We have now reached the fourth "generation" in our trainee programme. Under this programme, we offer professional development opportunities in the Company for young, very well-educated graduates. In the year under review, DEUTZ offered four more university graduates the opportunity to take part in a 16-month trainee programme. The trainees are supported by personal mentors and work on four different projects, each lasting four months, in different areas of the business. In this way, we offer potential managers the opportunity to take on responsibility at an early stage. One of the projects takes place at a Company site outside Germany. This enables the trainees to gain new professional and cultural experience and also improve their language skills. In return, DEUTZ AG is able to access new internationally oriented employees and continue to expand the strategic internationalisation of the Company. For these very reasons, we have, for many years, been paying close attention to the right mix of cultural, academic and personal backgrounds. With the regular presentation of their results to the Management Board, the trainees learn to hold discussions and communicate with management.

All trainees to date have successfully completed the programme. The DEUTZ Group has been able to offer further positions to 19 of the 24 trainees that have participated in the programme to date (including the current-year group).

At our Ulm plant, we have taken further steps to develop a skilled workforce, capable of meeting the challenges that lie ahead. In Ulm, we are offering school leavers with the German Abitur the opportunity to study for a bachelor of engineering degree on a sandwich course operated by DEUTZ in cooperation with the Heidenheim University of Cooperative Education.

At the start of 2007, large-scale structural changes were imminent at the Ulm site. First, the air-cooled engine series were relocated to Ulm from Cologne-Deutz at the start of the year. Then in September, a state-of-the-art, fully automatic high-bay storage facility came into operation at the site. To support these changes, around 110 new employees with a variety of skills were taken on during the course of the year. Given a rate of unemployment in the Ulm area of significantly below 3 per cent, this represented a particular challenge, especially as regards the recruitment of managers and employees with specialist skills.

Ulm: changes create jobs

Within the context of a realignment of the HR department, we carried out a detailed review of personnel development processes and tools. Our objective is to ensure that employees are prepared for the challenges of the future on a more targeted basis, and that valuable managers and specialists are encouraged to remain with the Company by offering them systematic career progression and succession planning. This also includes efforts to face up to the demographic challenge. We have, therefore, analysed the age structure of our workforce and taken action to ensure that employees can be replaced promptly by successors with the right skills and qualifications.

Reorganisation of employee skills development

Around 7 per cent of employees have variable salary components based on the achievement of a combination of corporate and personal targets. Depending on the employment contract, up to 33 per cent of remuneration is linked to company and personal performance.

Performance-related remuneration

ENVIRONMENT

Over the last few years, there has been a significant increase in environmental awareness among many people. Particularly as a manufacturer of engines, DEUTZ feels that it is under an obligation to commit to long-term environmental protection – so that the environment can be maintained intact for future generations.

Innovations to combat global warming and climate change

First, we carry out intensive research and development in the field of environmentally friendly drives, thereby bringing together perfectly our own core competence and environmental objectives. More information on our innovative drive units, the hybrid drive and the rapeseed-oil-powered engine, can be found in the “Research and development” section on page 56 of this annual report.

Secondly, we have also espoused the cause of sustainable environmental protection in many other areas, for example, with the well-thought-out energy-saving heating design in the new administrative building, where almost 80 per cent of the heat will be taken from the production areas. DEUTZ is also making further advances in the avoidance of waste. Since the start of 2007, a yearly total of around 400 tonnes of sludge contaminated with oil is no longer burnt, but is reprocessed so that it can be used again in other industrial processes as a basic oil. In this way, DEUTZ is making an important contribution to reducing its carbon footprint.

The importance enjoyed by environmental protection in DEUTZ is documented, not least by our environmental protection management system, in accordance with DIN EN ISO 14001, which covers all environmentally relevant processes in the business. The system ensures that these processes are monitored, analysed and evaluated on an ongoing basis, and that systematic improvements are introduced as required. At the end of 2007, the environmental protection management system was audited by an independent expert from DNV Zertifizierung und Umweltgutachter GmbH, Essen, Germany, who confirmed that the system complies with the international ISO 14001 standard. Since then, the certification has also been extended to cover the Cologne site’s own fire service, which is also officially recognised by the German authorities. In addition, eco-audits have already been carried out several times at the Cologne-Porz and Cologne-Kalk facilities, each time ending with certification in accordance with DIN/ISO 14001.

Certified environmental protection management system

The total expenses in DEUTZ for environmental protection activities, including health and safety, amounted to €5.7 million in 2007. This compares with €5.4 million in 2006.

RESULTS OF OPERATIONS FOR DEUTZ AG

DEUTZ AG: income statement

	2007	2006
€ million		
Revenue	1,443.1	1,103.0
Profit from ordinary activities	**52.3**	**20.6**
Net extraordinary income/expenses	119.5	12.0
Income taxes	–18.0	–2.2
Other taxes	–0.6	–0.7
Net income	**153.2**	**29.7**
Profit/loss carried forward	7.7	–21.6
Addition to the legal reserve	–4.1	–0.4
Addition to the other retained earnings	–74.6	–
Accumulated income	**82.2**	**7.7**

The annual financial statements of DEUTZ AG are prepared in accordance with the requirements of the German Commercial Code (HGB) and the German Stock Corporation Act (AktG). In 2007, DEUTZ AG generated revenue of €1,443.1 million (2006: €1,103.0 million).

The profit from ordinary activities was €52.3 million (2006: €20.6 million). Including an extraordinary item of €119.5 million from the disposal of DEUTZ Power Systems (2006: €12.0 million), and after taxes, this produced a net income of €153.2 million (2006: €29.7 million). After taking into account profit of €7.7 million brought forward from 2006, an addition to the legal reserve of €4.1 million and an addition to the other retained earnings of €74.6 million, the accumulated income before appropriation of profit was €82.2 million. The result is that DEUTZ AG is in a position to pay a dividend for the first time in around 20 years.

Given the level of operating profit, the Management Board is proposing a distribution to the shareholders of a dividend of €0.20 per share as well as payment of a further special dividend, also of €0.20 per share, from the gain on the disposal of DEUTZ Power Systems. The Management Board is, therefore, proposing a total dividend of €0.40 per share. On this basis, an amount of €48.0 million will be distributed from the accumulated income for 2007.

DEPENDENCY REPORT

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

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

DISCLOSURES PURSUANT TO SECTION 315 (4) HGB

Composition of the issued capital

The issued capital (share capital) of DEUTZ AG amounted to €306,992,504.46 at the end of 2007 (2006: €292,270,841.53) and was divided into 120,085,030 (2006: 114,326,416) no-par-value bearer shares.

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

At the end of 2007, SAME DEUTZ-FAHR Holding & Finance B.V., Amsterdam, Netherlands, held a direct investment in DEUTZ AG representing 42.5 per cent of voting rights. Via SAME DEUTZ-FAHR Holding & Finance B.V., the following companies and persons held an indirect investment in DEUTZ AG equivalent to the same percentage:

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

Legal provisions and statute provisions regarding the appointment and removal of members of the Management Board and regarding changes to the statutes

According to articles 7 (1) and 7 (2) of the statutes of DEUTZ AG:

“(1) The Management Board shall comprise at least two members.

(2) The Supervisory Board shall determine the number of members of the Management Board and the allocation of responsibilities. It may draw up and issue rules of procedure.”

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

According to article 14 of the statutes of DEUTZ AG:

“The Supervisory Board may change the wording but not the spirit of the statutes.”

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

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

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

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

Further disclosures

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

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

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

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

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

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

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

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

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

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

REMUNERATION REPORT

Salaries of the members of the Management Board: fixed, variable and long-term components

Total Management Board remuneration for 2007 in DEUTZ AG and the Group was €3.4 million. The remuneration paid to the individual members of the Management Board comprises fixed, variable and a long-term performance-related components. The variable component of the remuneration is also performance-related and depends on the trend in performance indicators, such as revenue, EBIT margin, ROCE and net financial position in the Group. In 2007, the Company launched a long-term incentive plan for the Management Board and the top level of senior management. Under this plan, virtual stock options are issued to senior executives to reward them for their sustained contribution to the Company's success. Before they receive stock options, those eligible must invest some of their own capital in DEUTZ shares. The stock options include the right to receive a cash payment at the end of a lock-up period of three years, providing the performance of DEUTZ shares meets the criteria specified in the plan. Under these criteria, the price of DEUTZ shares on the exercise date either must be 30 per cent above the defined reference price – the weighted average price of DEUTZ shares in the three months prior to the option grant date – or must have outperformed the Prime Industrial index by 30 per cent. Further information on remuneration can be found on page 141 of this annual report.

Remuneration of the Supervisory Board

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

The chairmanship and membership of Supervisory Board committees are remunerated separately in accordance with the German Corporate Governance Code. DEUTZ 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, we reimburse the members of the Supervisory Board for any VAT they incur in connection with the performance of their mandate. Further information on the remuneration paid to the Supervisory Board can be found on page 144 in the notes to the consolidated financial statements.

OVERALL ASSESSMENT OF 2007

Multiple upward forecast adjustments

Orders, unit sales and revenue all significantly exceeded the forecasts made at the start of the year. For this reason, we twice made an upward adjustment to our revenue forecast during the course of the year. Although we forecast growth of between 6 and 10 per cent initially, we were able to raise this forecast during the course of the year to 25 to 30 per cent. The actual revenue growth achieved of 29 per cent was at the upper end of our forecast band. We also significantly exceeded our expectations in unit sales of engines. At the start of the year, we were predicting sales of 260,000 engines, but the actual figure of over 285,000 engines sold was right in the middle of the revised target range of 280,000 to 290,000 engines – and this gain was hard earned.

In order to ensure that we were seen as a reliable partner by our customers, we did our utmost to ensure that we could meet customer engine requirements, which turned out to be significantly greater than originally planned, even though this meant higher costs for us in the short term (logistics, production) owing to capacity bottlenecks both in our plants and at suppliers.

Exceptional factors increase costs

In 2007, costs were influenced by various exceptional factors. These included the start-up of production for engines between 75 and 130 kW complying with Stage III A/TIER 3, the first full year of production for the Euro IV TCD 2013 engine and the ramp-up in production of the new engine series with capacities below four litres. There was also an impact from the commencement of production of air-cooled engines at the Ulm plant – production had been relocated there from Cologne at the start of the year – and from bottlenecks in the supply of parts.

These factors had an adverse impact on our EBIT margin, such that we were unable to achieve an improvement in the margin to 7 per cent, specified as the original target. Nevertheless, the actual increase to 6.3 per cent (2006: 5.6 per cent) means that we have made a great deal of progress.

Encouraging key financials

The key financials also continued to improve in 2007. The excellent operating profit, the proceeds from the disposal of DEUTZ Power Systems and the conversion of bonds all contributed to an increase in the equity ratio to a level of around 40.4 per cent (before dividend distribution) – well above our earlier target of 25 per cent. This capital structure means that we are extremely well equipped to meet the challenges of the future.

The growth in net income combined with asset management activities also improved ROCE in the year under review – the 13.5 per cent achieved in 2007 is already an excellent figure. We believe that the figures we have managed to achieve for the working capital ratio and ROCE are a huge success, especially as we have also undertaken significant expansion of the business at the same time. These figures represent an excellent starting point for further advances. The substantial proceeds from the disposal of DEUTZ Power Systems meant that, for the first time, we were able to report a positive net financial position, the figure as at 31 December 2007 being around €90 million.

First dividend distribution for 20 years

Not least, we have achieved our long-term objective: to restore DEUTZ AG’s ability to pay dividends based on 2007 performance onwards. For the first time in over 20 years, we will be distributing a dividend to our shareholders.

EVENTS AFTER THE BALANCE SHEET DATE

In mid-February, DEUTZ received notification of the threat of legal proceedings by an American customer claiming damages of more than US$ 40 million. The action, which has only been justified in general terms, 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.

On 22 February 2008, the American subsidiary of DEUTZ AG was also notified of a new action to be brought against the Company for the recovery of damages of an unspecified amount for alleged damage to health caused by asbestos. This action is being brought by two private persons against a total of more than 100 companies.

RISK REPORT

Risk management system: identifying both risks and opportunities

The changes in markets and economic conditions are ongoing and dynamic. Companies must act fast and respond even faster if they want to be successful over the long term. This requires systematic risk management as an important basis, especially against the background of increasingly complex corporate structures and growing internationalisation.

DEUTZ operates in a variety of industries and regions worldwide, and manages its business through a number of organisational units, i.e. 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 years in order to develop the Company and secure its future. It is, therefore, essential to identify and assess business risks at an early stage and take corrective action where required. Since 1998, DEUTZ has, therefore, had an appropriate risk management system as required by the law.

A system of this kind is an important prerequisite for the success of a business. It raises employee awareness of existing and potential risks and heightens their sense of responsibility – and it provides them with support in identifying, analysing and communicating risks in good time and in taking effective corrective action where required.

The DEUTZ risk management system meets the requirements of the German Control and Transparency of Companies Act (KonTraG). The basic principles, monitoring standards, responsibilities, functions and procedures in the risk management system have been identified by the Management Board of DEUTZ AG and have been set out and defined in a manual that is continually updated in the light of new knowledge. 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.

Normally – and this was the case in 2007 – risk inventories take place four times a year. These risk inventories are carried out in all functions and areas of the Company, and in the main subsidiaries, to identify whether new risks have arisen in respect of short-term and medium-term planning and whether and how any corrective action approved has affected or continues to affect risks already identified. The Risk Management Committee assesses the risks and makes proposals to the Management Board, which then decides on appropriate measures to prevent or minimise the risk. In addition, risk officers and their employees are under an obligation to make ad-hoc reports independently of the regular reporting requirements if any new material risks arise, or if there is an increase in the threat from known risks.

The Group's internal audit department and the independent auditors each year carry out an audit of risk management in DEUTZ AG to assess whether the system is functioning efficiently. The findings of the audits carried out in 2007 confirmed that the risk management system was functioning efficiently. As in prior years, suggested improvements, whether from the internal audit department, the independent auditors or from the Risk Management Committee, were implemented promptly.

Sales risks

In 2007, DEUTZ continued to minimise sales risks as far as possible.

In addition to the alignment of our development activities with our product strategies, close alliances with key customers, such as Volvo and SAME DEUTZ-FAHR, are also of considerable importance in enabling us to achieve our sales targets. Equally important is the further expansion of our market position in the Asia growth region. In August 2007, DEUTZ (Dalian) Engines Co., Ltd., a joint venture between DEUTZ AG and FAW Jiefang Automotive Co., Ltd., commenced operations in the northern Chinese city of Dalian. This joint venture provides DEUTZ with significantly better access to the fast-growing domestic market in China and lower-cost production facilities in the wider Asian market, which is extremely price-sensitive.

New product developments incorporating the efficient use of energy resources also provide us with some security against future sales risks. In cooperation with the construction equipment manufacturer Atlas Weyhausen, we have become the first engine manufacturer to develop a hybrid drive design for construction equipment delivering improved performance with simultaneous fuel savings of up to 20 per cent. The hybrid drive is planned to be ready for production by 2010. This innovative technology was demonstrated publicly for the first time in spring 2007 at Bauma, the world's largest trade fair for construction equipment held in Munich, Germany. At Agritechnica, the world's largest agricultural equipment trade fair held in Hanover, Germany, in the autumn, DEUTZ then became the first engine manufacturer to exhibit yet another new technology: the DEUTZ Natural Fuel Engine®, the production version of which can be run on rapeseed oil, a renewable fuel. Whereas the rapeseed-oil-powered engine is meeting short-term and medium-term market requirements, the hybrid drive is already anticipating market developments in the medium and long term.

With customers distributed across a number of regions and industries, the sales structure in DEUTZ is well diversified. However, a critical factor influencing the success of DEUTZ in its markets is the trend in markets served by DEUTZ customers, and DEUTZ itself has no influence over these markets.

Production risks

In order to avoid mistakes in planning and capital expenditure, the necessary production capacity is planned using different timescales: over a number of years in medium-term planning generated once a year, for the following financial year in the context of budget planning (which is then updated monthly for the next twelve months on a rolling basis) and weekly by means of operating production planning with unit sales forecasts for the individual engine series and types. In the last few years, a rationalisation of production and a focus on core competences has also reduced the risk of under-utilising capacity. In addition, the Company is well equipped for the forecast growth in production. The specific expansion of capacity, particularly at Cologne in Germany and Zafra in Spain, the future procurement of core components from DEUTZ Dalian in China, and the allocation of supplementary production to externally contracted manufacturers will ensure reliable production output in future.

IT risks

In the year under review, DEUTZ AG continued the systematic development of its information and communication technology infrastructure and the range of applications used in line with the Company's strategic objectives. The Company's hardware and software technologies and systems continue to be updated by DEUTZ, in close cooperation with external service providers. Further subsidiaries and associates of DEUTZ AG were integrated into existing DEUTZ processes and systems. Strategic business processes are handled using mySAP ERP 2005, which is proven software. To minimise the operating risk in DEUTZ's SAP system, we migrated, in 2006, to an IT system with high-availability adaptive computing technology. The system is operated by the service provider on the basis of the principles in the current version of the de facto ITIL (IT infrastructure library) standard and is audited annually in accordance with the requirements of SAS 70 (Statement on Auditing Standard 70) issued by the American Institute of Certified Public Accountants. The strategy to consolidate information and communication technology will also be continued in 2008; the key area of development will be the integration of the subsidiaries in the Asia-Pacific region into the DEUTZ SAP system.

Organisational risks

Organisational risks are risks that arise from inadequate or non-harmonised organisational structures, processes, communication and information flows, procedures and guidelines. In DEUTZ, therefore, special central units provide support to the individual operating units so that such risks are avoided. The organisational combination into head office functions and services of responsibilities covering all locations and segments guarantees the application of standardised processes throughout the Group. This is also supported by appropriate Group-wide guidelines. All operating levels, including subsidiaries outside Germany, are integrated into a detailed planning, control and reporting system. The core elements of the system are revolving short-term and medium-term plans, monthly budget/actual analyses, quarterly forecasts and regular review/planning meetings. This early-warning system ensures that management is in a position to instigate any necessary corrective action promptly.

Since 2006, a risk analysis has been added to medium-term planning. Worst-case and best-case scenarios are developed from the results of these analyses and reported to the Supervisory Board.

With the disposal of more subsidiaries in 2007, we were able to bring about a further reduction in the complexity of the Group, and the time and effort required to manage it. This includes the disposal of DEUTZ Power Systems GmbH & Co. KG with its subsidiaries. We also continued the process of selling strategically unnecessary investments begun in 2004. As a result, corporate processes have become simpler, more transparent, less expensive and also less prone to risk.

Human resources risks

In a technology-oriented international company such as DEUTZ, highly skilled employees are indispensable and irreplaceable as the basis for a successful business.

There are various risks in this regard: not keeping the skills of managers and specialist personnel up-to-date; not being able to recruit additional personnel quickly enough to meet the requirements of growth; and not being able to appoint suitably qualified managers and specialist employees to relevant posts. We counter these human resources risks by specifically analysing the skills and qualifications we need from our current and future employees and using this analysis to draw up appropriate measures targeting the development of individual managerial and technical capabilities. In addition, we offer our employees professional development opportunities both in Germany and abroad and demanding responsibilities in the various areas of the business. These activities allow us to align the capabilities of our employees with the growing requirements of the market on an ongoing basis and also to enhance employee loyalty to the Company by promoting personal success.

The systematic analysis of our demographic structure, together with targeted, proactive succession planning and skills development, prevents problems in recruiting personnel for managerial and technical positions that become available as existing employees reach retirement age. A focus of our activities in this regard is the development of suitable young managerial talent. Each year, young, highly qualified management trainees with an international outlook are recruited to our internationally oriented management trainee programme, where the participants are groomed for later managerial responsibility.

Quality risks

We operate a central quality management system delivering quality assurance across all plants and segments of the business. Sources of defects are systematically analysed, our own production processes optimised and the risks in production start-ups minimised. 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 uses process audits to achieve continuous improvement in supplier quality. Over the past few years, these quality activities have led to a significant reduction in the costs of errors and defects.

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

Financial risks

Annual financial planning and regular analysis of variances during the course of the year minimise our financial risks. A weekly rolling forecast is produced showing the cash inflows and outflows for the subsequent four weeks. Responsibility for financial management in the Group is held by DEUTZ AG as the overall parent company in the Group. Head office cash pooling ensures optimum use of cash in the Group. The central finance department is also responsible for managing the investment of available cash and the arrangement of lines of credit or other financing to cover financing requirements in accordance with internal financing guidelines. The DEUTZ Group has sufficient existing credit facilities with leading banks, although the use of these facilities is currently minimal.

With the issue of notes with a total value of US$ 274 million under the US private placement during the year under review, we were able to open up broadly based financing from institutional investors in the US independently of the banks. The coupon is fixed for the entire maturity of the individual tranches (between five and ten years). Where interest payments and the repayment of the principal are due in US dollars, these payments are hedged over the entire relevant maturity.

We protect ourselves against the risk from bad debts by constant IT-supported monitoring and regular analysis of receivables and their breakdown. The Company, to a large extent, minimises the risk in its receivables by the use of credit insurance. Exchange-rate risks are monitored under a centralised currency management system and reduced by the use of hedging transactions. DEUTZ also takes 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.

Pension risks

Even after the surrender of over 8,500 vested company pension rights in 2007, in return for a compensatory payment, we still have a significant number of defined pension benefit obligations. The amount of these obligations is subject to certain risks arising, specifically in connection with the change in life expectancy, the future amount of pension adjustments and the movement in interest rates on capital markets.

Procurement risks

It is not possible to fully rule out procurement risks caused by market bottlenecks and unforeseen price increases, particularly in the procurement of components, primary materials and services from third parties. 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 throughout the world by local implementation of procurement and logistics offices that make use of the infrastructure in DEUTZ subsidiaries outside Germany. These offices enable the Group to ensure a high level of quality and supply performance, and, at the same time, to benefit from advantageous labour costs in growth markets.

Besides these global activities, there are three cornerstones to our procurement strategy for strategic components and parts for which supply is critical: long-term supplier relationships and supply agreements, increased dual sourcing and, where appropriate, allocation of production to subcontractors. These cornerstones amount to a proven strategy that allows us largely to minimise risk and secure capacity, thus actively supporting the path of growth taken by the Group.

In the case of components with an aluminium content, price escalation clauses have been agreed with our suppliers based on market prices for aluminium. Our aluminium requirement for a full financial year is 9,600 tonnes. In the middle of 2007, we entered into raw-material swaps to hedge our exposure in respect of 3,000 tonnes of this aluminium. Exposure in respect of a further 3,300 tonnes was hedged in this way at the start of 2008. The price of aluminium is relatively volatile and has been subject to enormous increases over the last few years.

Legal risks

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

On this basis, the management of the Group can take appropriate action promptly and, where appropriate, recognise any necessary accounting provisions. Group-wide standards, such as the “General terms and conditions of business”, sample contracts for various uses and implementation provisions in the form of organisational guidelines reduce the level of new legal risks. 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.

In the year under review, we again managed to scale back the risks from litigation, in particular, by the disposal of DEUTZ Power Systems. 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 still 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 the year under review, two further American asbestos-related actions were concluded: one of the cases was dismissed; in the other case, we reached a settlement.

Risks in accounting for deferred taxes

Under IFRS, deferred tax assets are recognised in respect of loss carry forwards that it will be possible to offset against future profits, thus reducing the tax liability. The changes arising under the reform of corporate taxes in Germany in 2008, relevant to the 2007 financial year, have been fully accounted for in the consolidated financial statements. Currently, there are no identifiable future changes and risks that could have a negative impact on whether these loss carry forwards could, in fact, be used and, therefore, also on the recoverability of the deferred tax assets recognised by the DEUTZ Group in its financial statements.

Future tax risks

The year under review saw the start of an external tax audit covering the tax assessment periods 2002 to 2005. We have not yet received the tax auditor’s report. As things stand, the Company is not expecting any material risks.

Overall assessment of risk situation

There are no risks that, in themselves or in combination with other risks, have jeopardised or could jeopardise the DEUTZ Group as a going concern in the year under review or thereafter.

OUTLOOK

Growth slackens [1)]

Following several outstanding years, global economic growth will settle down at a slightly lower level in 2008. Nevertheless, a growth rate of 3.8 per cent is still expected, with a slight increase in economic risk. There is still some uncertainty, primarily in connection with the effects of the problems on financial markets and also as a result of possible further increases in the price of oil and raw materials. In addition, the mortgage crisis in the US has not yet come to an end and there could be a further noticeable slowdown in the US economy. The construction industry and consumer spending, in particular, could be hit by the fall in property values. However, capital expenditure outside the housing sector remains robust, and sustained export growth is expected to provide further support for the American economy with the result that gross domestic product in the US is likely to grow by 1.6 per cent in 2008.

The prospects for Asia remain outstanding. With the exception of Japan, economic growth is forecast at 8.0 per cent. China continues to be the driving force with growth of 10.0 per cent, even though restrictive economic measures and a resulting weakening in capital expenditure growth are causing a slight cooling-off in the Chinese economy. Overall, the Asian economies, which are strongly dependent on exports to the US and, therefore, on the US economy, will ease off a little, but at a high level.

[1)] Global economic data: Deutsche Bank Research
Industry economic data: German Engineering Federation (VDMA), EUROCONSTRUCT, VDMA Agricultural Equipment

In the euro zone, the sustained strength of the euro – experts are predicting an exchange rate of US$ 1.36 to €1.00 at the end of 2008 – will act as a brake on the economy, particularly in terms of exports. Gross domestic product is forecast to grow at approximately 1.6 per cent. In Germany, the upturn is likely to continue in 2008, but will be adversely affected by factors such as the increase in the oil price and the strong euro. Economic growth will be stimulated within Germany, particularly by strong domestic demand, primarily from consumers: gross domestic product is expected to rise by around 2.0 per cent in 2008. However, the strong euro will depress exports, and there will also be an easing-off in capital expenditure, despite the sharp increases seen in 2007.

Economic forecasts until 2009 [1)]

In 2009, the forecast is for global growth of 4.2 per cent. A slight recovery is predicted for the USA, where the growth rate is forecast at 2.6 per cent. Asia (excluding Japan) will again generate growth of 8.0 per cent, consolidating at the level achieved in 2008, but still the strongest growth rate anywhere in the world. The forecast for growth in the countries of the euro zone is around 1.9 per cent, with Germany continuing to experience an upwards trend with growth of 2.1 per cent.

Industry perspective

For DEUTZ, economic growth in certain engineering-related industries is particularly important. These industries include the construction equipment industry, especially in Europe and the US, and the commercial-vehicles sector of the automotive industry, in which the 3.5 tonne to 16 tonne vehicles segment in Europe is particularly relevant for DEUTZ, as is, increasingly, the Chinese market, owing to the DEUTZ Dalian joint venture. DEUTZ is also dependent on growth in the agricultural machinery industry, especially in Europe.

Continuing boom in commercial vehicles [1)]

The commercial-vehicle boom in Europe is forecast to continue in 2008, driven by demand from Central and Eastern Europe. This demand is being stimulated by increasing mobility and logistics requirements. The largest global manufacturers of trucks also include Volvo – our alliance partner and largest customer for commercial-vehicle engines. As in 2007, Volvo is endeavouring to generate further growth in 2008. Demand in the European commercial-vehicles market is expected to grow by between 5 and 10 per cent in 2008.

Agricultural machinery on the up [1)]

The growth in the global population that needs to be fed, increasingly sophisticated consumer habits, climate change and the use of renewable resources are central issues that impact on the growth in demand and on the development of the global agricultural machinery industry. The basic conditions as far as agricultural policy in Europe is concerned are fixed until 2013 – until then, we are only likely to see minor adjustments in the current subsidy policy.

Global tractor production, which rose in both 2006 and 2007, is expected to continue to grow in 2008 and 2009. Manufacturers in the European Union – first and foremost in Germany and Italy – are the strongest players in the global market. As far as DEUTZ is concerned, the European agricultural machinery market, specifically the market for tractor engines, is particularly important. The upturn in the market will continue in 2008, especially in Western Europe, because capital expenditure on agricultural equipment is benefiting from increasing farming incomes and better opportunities resulting from new operating models. The current market is dominated by four major manufacturers, each with several brands. Two of these well-known manufacturers have been key customers of DEUTZ for many years.

[1)] Global economic data: Deutsche Bank Research
Industry economic data: German Engineering Federation (VDMA), EUROCONSTRUCT, VDMA Agricultural Equipment

Engineering: slackening in the rate of growth [1)]

In 2008, the German engineering industry will be growing at a slower rate. The German Engineering Federation (VDMA) is predicting that production will rise in real terms by 5 per cent. The order cushion will cover at least six months; currently 92 per cent of capacity is utilised. However, in the US, the most important export market for German engineering companies, there is now a downturn in demand, although this can be offset by deliveries to other export markets. Further problems could arise if there is a continuing rise in the value of the euro, since 75 to 80 per cent of German engineering output is export-oriented.

Moderate growth in the construction industry [1)]

EUROCONSTRUCT, the European trade association, is predicting that growth in 2008 will be just 1.8 per cent (2007: 2.5 per cent) for the housing, commercial and public-sector property, and civil engineering sectors. The critical factor is that there is expected to be a significant contraction in the housing sector in 2008, whereas the strongest stimulus is expected to come from civil engineering.

Statutory regulations: emissions standards come into force

Growth and unit sales of engines are strongly influenced by statutory provisions on emissions. These provisions lay down significant requirements to be met by producers. From 1 January 2008, the Stage III A emissions standard for non-road applications in the 37 to 75 kW engine class became mandatory in the countries of the European Union (EU). From the same date, the TIER 3 standard for engines of 37 to 75 kW and the Interim TIER 4 standard for engines of 19 to 56 kW came into force in the US. From January 2011, further emissions standards, depending on engine output class, will gradually come into force in the EU and in the US in the period up to 2014/2015.

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

Raw materials prices, collective pay agreements, US dollar

Changes in the prices of steel scrap, copper and aluminium have a significant impact on our cost of materials. We anticipate that prices in 2008 will be maintained at the high level experienced in 2007. A further basic assumption is that, following the end of the current binding collective pay agreement in October 2008, there will be further pay increases for the remainder of the financial year, equivalent to those in the previous agreements. We have hedged over 70 to 80 per cent of our exposure to movements in exchange rates for the US dollar; this does not take into account natural hedging, whereby we use US dollar revenue for component procurement denominated in US dollars.

Further growth in new orders, revenue and employee numbers

We predict that both new orders and consolidated revenue will increase by 10 to 15 per cent in 2008. Our underlying assumption is that the Compact Engines segment will achieve double-digit growth, and the DEUTZ Customised Solutions segment single-digit growth. In 2008, DEUTZ will expand in all regions, with the exception of North America; the distribution of revenue among the regions will be similar to that in 2007. This means that there will be a drop in the proportion accounted for by the Americas. However, the increase in the revenue in the DEUTZ Dalian joint venture means that there will be a reduction in the consolidated revenue in Asia because the figures for the joint venture are not consolidated.

The number of employees is expected to rise slightly, and we are predicting that there will be just under 5,000 employees at the end of 2008.

Unit sales up again

In 2008, unit sales are expected to grow at 10 per cent, thereby exceeding 300,000 engines with no significant changes in the product mix. However, unit sales of air-cooled engines are predicted to decline by 15 to 20 per cent. The reason for this is the phasing-out of the air-cooled engine series that we hitherto manufactured in Spain. There are no replacements for these engine series. Given the purchases planned by some of our key customers, we are forecasting that unit sales of engine series with capacities greater than four litres will rise sharply compared with 2007.

[1)] Global economic data: Deutsche Bank Research
Industry economic data: German Engineering Federation (VDMA), EUROCONSTRUCT, VDMA Agricultural Equipment

Further increase in operating profit

Operating profit is expected to see a further improvement in 2008, with the EBIT margin reaching the target of around 7 per cent. The tax rate will be around 15 per cent. Double-digit growth is forecast in both absolute and percentage terms for consolidated net income attributable to continuing operations.

Working capital ratio and equity ratio

Our estimates for 2008 are based on a working capital ratio of under 15 per cent. The equity ratio is expected to remain stable at around 40 per cent.

Capital expenditure continues to be financed from the Group's own resources

In 2008, capital expenditure will amount to over €100 million (property, plant and equipment and intangible assets); over 85 per cent of this figure will be accounted for by the Compact Engines segment and around 15 per cent by the DEUTZ Customised Solutions segment. In the current circumstances, there are no plans to raise any financing in connection with the planned capital expenditure. Of this capital expenditure, around 25 per cent will be used for the expansion of capacity and around 23 per cent for replacement investment. Over 10 per cent in each segment will be invested in the development of new products, the refinement of existing engines and in structural changes. These figures do not include strategic capital expenditure, such as the DEUTZ Dalian joint venture. Any such expenditure in 2008 would be financed from the available funds.

The greatest proportion of this capital expenditure (over 30 per cent) will go to the Cologne-Porz site; around 10 per cent, respectively, will be invested in Cologne-Deutz (mechanical fabrication) and Spain (component production). However, close cooperation with our suppliers is playing an increasingly important role, and over 20 per cent of the funds will be dedicated to new tools for our suppliers.

In 2008, free cash flow, comprising cash flow from operating activities and cash flow from investing activities less interest expense, is expected to be a moderate negative double-digit million-euro amount owing to the extensive capital expenditure.

Research and development for the future

Our future success is critically dependent on the innovative capabilities of our developers and on our ability to turn technological requirements into products that can be used in practice. A culture of technical innovation, therefore, continues to remain one of the key elements in our success. In 2008, DEUTZ will consequently allocate over €80 million to research and development – around 5 per cent of forecast consolidated revenue. A high priority will be given to the systematic further development of our products for the Stage III B emissions standard in Europe and Interim TIER 4 standard in the US, both due to come into force from 2011 onwards. Our efforts will be concentrated, primarily, on reducing emissions within the engines themselves and by the use of exhaust-gas aftertreatment systems.

Up to 120,000 engines from Dalian

In 2008, we will continue to focus on the smooth start-up of DEUTZ engine production at the new plant and – associated with this – on securing the supply of materials from local suppliers. Our intention is also to develop supplier relationships so that they can supply parts to meet the requirements of the German assembly plants. We will also continue to expand the production capacity for cylinder heads and crankcases in DEUTZ Dalian to meet the requirements of the joint venture itself and those of the German assembly plants.

To date, the organisation and processes have been primarily oriented around the commercial-vehicle engines business; in the course of 2008, these structures will be expanded and modified to include non-road applications, such as engines for construction equipment. At the same time, we intend to build up marketing and distribution of "made in China" DEUTZ engines so that we can secure and gain a further share of the Chinese market.

The DEUTZ Dalian joint venture is forecast to manufacture approximately 100,000 to 120,000 engines in 2008, generating revenue in excess of €300 million. We are expecting sales of 80,000 to 100,000 units for engines with local technology. The new plant, manufacturing engines with DEUTZ technology, is expected to achieve unit sales of around 20,000 engines.

The joint venture is accounted for using the equity method and the revenue attributable to DEUTZ is, therefore, not included in consolidated revenue. In the first full financial year of the joint venture, which is still the start-up phase for the project, we are expecting the contribution to net income to be a moderate negative single-digit million-euro amount.

We are also forecasting a further increase in new orders and revenue for 2009, although the growth rates will be lower than in 2008, and we are expecting a single-digit growth rate, but close to 10 per cent. We intend to continue to improve operating profit in both segments, resulting in a slight increase in the EBIT margin. This includes the achievement of break-even in DEUTZ Dalian.

Outlook for 2009

Capital expenditure will again be around €100 million. R&D expenditure will be maintained at a high level, similar to the amount allocated in 2008.

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

Consolidated financial statements 2007

Consolidated financial statements

INCOME STATEMENT FOR THE DEUTZ GROUP

€ million	Note	2007	2006
Revenue	1	**1,524.2**	**1,183.6**
Changes in inventories and other own work capitalised	2	30.1	22.5
Other operating income	3	66.7	52.1
Cost of materials	4	–1,029.7	–758.9
Staff costs	5	–275.0	–252.3
Depreciation and amortisation	6	–65.5	–58.7
Other operating expenses	7	–155.3	–124.4
Profit/loss on equity-accounted investments	8	–1.7	1.2
Other investment income	8	1.5	1.3
Reversal of impairment losses on non-current financial assets	8	0.2	0.2
EBIT		**95.5**	**66.6**
thereof one-off items		**–**	**–**
thereof operating profit (EBIT before one-off items)		**95.5**	**66.6**
Interest expenses, net	9	–18.1	–19.2
thereof finance costs		–29.6	–23.4
Other taxes	10	–1.3	–1.5
Net income before taxes on continuing operations		**76.1**	**45.9**
Income taxes	10	–16.7	–7.4
Net income on continuing operations		**59.4**	**38.5**
Net income on discontinued operations	11	**123.9**	**23.0**
Net income		**183.3**	**61.5**
thereof minority interest		–	–
thereof attributable to the shareholders of the parent enterprise		183.3	61.5
Earnings per share	12		
Basic earnings per share (€)		1.56	0.57
of which from continuing operations		0.51	0.36
of which from discontinued operations		1.05	0.21
Diluted earnings per share (€)		1.52	0.52
of which from continuing operations		0.50	0.33
of which from discontinued operations		1.02	0.19

CONSOLIDATED BALANCE SHEET FOR THE DEUTZ GROUP

Assets

	Note	31 Dec. 2007	31 Dec. 2006
€ million			
Property, plant and equipment	13	334.6	374.6
Intangible assets	14	110.6	100.3
Equity-accounted investments	15	57.6	12.8
Other financial assets	16	8.5	11.4
Non-current assets (before deferred tax assets)		**511.3**	**499.1**
Deferred tax assets	17	49.4	56.2
Non-current assets		**560.7**	**555.3**
Inventories	18	214.2	249.6
Trade receivables	20	188.8	222.0
Other receivables and assets	17/20	102.9	84.2
Cash and cash equivalents	21	311.1	49.4
Current assets		**817.0**	**605.2**
Non-current assets and disposal groups held for sale	19	0.9	2.4
Total assets		**1,378.6**	**1,162.9**

Equity and liabilities

	Note	31 Dec. 2007	31 Dec. 2006
Issued capital		307.0	292.3
Additional paid-in capital		28.1	24.1
Other reserves		–5.3	–1.8
Retained earnings		79.1	0.4
Accumulated income		148.2	43.5
Equity attributable to the shareholders of the parent enterprise (DEUTZ Group's interest)		**557.1**	**358.5**
Equity	22	**557.1**	**358.5**
Provisions for pensions and other post-retirement benefits	23	176.7	271.2
Deferred tax provisions	17/23	–	0.5
Other provisions	23	46.5	52.0
Financial liabilities	24	216.0	69.5
Other liabilities	24	10.0	2.8
Non-current liabilities		**449.2**	**396.0**
Provisions for pensions and other post-retirement benefits	23	16.7	26.5
Provision for current income taxes	17/23	11.3	6.5
Other provisions	23	63.7	44.7
Financial liabilities	24	5.4	13.9
Trade payables	24	206.1	236.4
Other liabilities	24	69.1	80.4
Current liabilities		**372.3**	**408.4**
Total equity and liabilities		**1,378.6**	**1,162.9**

STATEMENT OF CHANGES IN EQUITY FOR THE DEUTZ GROUP

	Issued capital	Additional paid-in capital	Retained earnings	Fair value reserve[1), 2)]	Currency translation reserve[1)]	Accu-mulated income/ loss	Total Group interest	Minority interest	Total
€ million									
Balance at 1 Jan. 2006	**242.9**	**20.1**		**–1.3**	**2.9**	**–18.2**	**246.4**	**0.6**	**247.0**
Increase from exercise of conversion rights on convertible bonds	23.9	6.1					30.0		30.0
Increase from exercise of conversion rights on profit-sharing rights	25.5	–2.1					23.4		23.4
Accumulated other comprehensive income/loss (thereof reversals recognised in period net income)				2.3[3)] (0.5)	–5.7		–3.4 (0.5)		–3.4 (0.5)
Net income						62.1	62.1	–0.6	61.5
Total of net income and accumulated other comprehensive income/loss in reporting period				2.3	–5.7	62.1	58.7	–0.6	58.1
Appropriations to retained earnings			0.4			–0.4	–		–
Balance at 31 Dec. 2006	**292.3**	**24.1**	**0.4**	**1.0**	**–2.8**	**43.5**	**358.5**	**–**	**358.5**
Balance at 1 Jan. 2007	**292.3**	**24.1**	**0.4**	**1.0**	**–2.8**	**43.5**	**358.5**	**–**	**358.5**
Increase from exercise of conversion rights on convertible bonds	14.7	4.0					18.7		18.7
Accumulated other comprehensive income/loss (thereof reversals recognised in period net income)				3.1[3)] (2.1)	–6.6[5)]		–3.5 (2.1)		–3.5 (2.1)
Net income						183.3	183.3		183.3
Total of net income and accumulated other comprehensive income/loss in reporting period				3.1	–6.6	183.3	179.8	–	179.8
Appropriations to retained earnings			78.7			–78.7	–		–
Balance at 31 Dec. 2007	**307.0**	**28.1**	**79.1**	**4.1**	**–9.4**	**148.2**[4)]	**557.1**	**–**	**557.1**

1) On the face of the balance sheet these items are aggregated under “Other reserves”.

2) Reserves from the measurement of cash flow hedges and reserves from the measurement of available-for-sale financial assets.

3) See Note 22 for further information.

4) There is a rounding difference of €0.1 million in the reconciliation of the accumulated income at 1 January 2007 to that shown at 31 December 2007.

5) This includes income of €0.7 million that was recognised in income and offset against the sales proceeds on disposal of the DEUTZ Power Systems segment.

CASH FLOW STATEMENT FOR THE DEUTZ GROUP

See Note 30 for cash flow disclosures

	2007	2006
€ million		
EBIT	**95.5**	**66.6**
Interest income	4.8	1.2
Other taxes paid	–1.3	–1.5
Income taxes paid	–19.4	–9.6
Depreciation and amortisation on non-current assets (before deferred tax assets)[2]	66.8	58.7
Gains/losses on the sale of non-current assets	0.1	0.5
Gains/losses on the measurement of equity-accounted investments	2.6	–0.9
Other non-cash income and expenses	–24.5	–13.5
Change in working capital	–73.6	–8.8
Change in inventories	–49.5	–38.5
Change in trade receivables	–51.3	–22.3
Change in trade payables	27.2	52.0
Change in other receivables and other current assets	–15.3	1.3
Change in provisions and other liabilities (excluding financial liabilities)	5.4	–9.6
Cash flow from operating activities before payment of compensation for vested company pension rights (continuing operations)	**41.1**	**84.4**
Payment of compensation for vested company pension rights (continuing operations)	–79.8	–
Cash flow from operating activities (continuing operations)	**–38.7**	**84.4**
Cash flow from operating activities (discontinued operations)	–9.1	25.8
Cash flow from operating activities (total)	**–47.8**	**110.2**
Capital expenditure on intangible assets, property, plant and equipment	–100.8	–91.6
Capital expenditure on investments	–58.2	–0.6
Cash receipts from the sale of businesses	14.2	–
Proceeds from the sale of non-current assets	0.7	0.9
Cash flow from investing activities (continuing operations)	**–144.1**	**–91.3**
Cash flow from investing activities (discontinued operations)	296.4	–5.5
Cash flow from investing activities (total)	**152.3**	**–96.8**
Interest expenses	–8.5	–7.9
Cash receipts from borrowings	249.8	46.2
Repayments of loans	–79.4	–50.1
Cash flow from financing activities[1]	**161.9**	**–11.8**
Cash flow from operating activities	–47.8	110.2
Cash flow from investing activities	152.3	–96.8
Cash flow from financing activities	161.9	–11.8
Change in cash and cash equivalents	**266.4**	**1.6**
Cash and cash equivalents at 1 January	**49.4**	**48.4**
Change in cash and cash equivalents	266.4	1.6
Change in cash and cash equivalents related to exchange rates	–4.7	–0.6
Cash and cash equivalents at 31 December	**311.1**	**49.4**

[1] Cash receipts and cash payments from financing activities for discontinued operations are not directly allocable. DEUTZ AG finances discontinued operations centrally through clearing accounts.

[2] There is a discrepancy of €1.3 million from the figure for depreciation and amortisation in the income statement because impairment losses of €1.3 million in connection with the sale of DEUTZ Power Systems are reported under other operating expenses.

See Note 31 for segment reporting disclosures

Breakdown by business segment	Compact Engines		DEUTZ Customised Solutions		Other	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
€ million						
External revenue	1,183.8	860.6	336.9	315.3	–	–
Intersegment revenue	2.2	7.7	1.3	–	–	–
Total revenue	**1,186.0**	**868.3**	**338.2**	**315.3**	**–**	**–**
Total depreciation, amortisation and impairment	**59.5**	**53.4**	**5.9**	**5.3**	**0.1**	**–**
thereof depreciation and amortisation	59.5	53.4	5.9	5.3	0.1	–
thereof impairment	–	–	–	–	–	–
thereof reversal of impairment losses	–	–	–	–	–	–
Segment earnings before one-off items[1]	**45.3**	**37.8**	**44.7**	**30.5**	**5.5**	**–1.7**
One-off items	–	–	–	–	–	–
Less result on equity-accounted investments	1.7	–1.2	–	–	–	–
Less result on investments and on the disposal of financial assets	–1.3	–0.4	–	–	0.2	–0.5
Segment earnings in accordance with IFRS	45.7	36.2	44.7	30.5	5.7	–2.2
Net income	–	–	–	–	–	–
Segment assets	752.0	628.2	171.5	149.1	21.2[2]	0.8
Segment liabilities	469.4	492.0	40.9	49.7	54.8[2]	30.1
Segment capital expenditure	160.5	99.6	7.3	4.7	–	–
Material non-cash expenses (excl. depreciation)	15.6	12.0	1.5	1.4	1.1	0.7
Carrying amounts of equity-accounted investments	57.6	4.7	–	–	–	–

[1] Before one-off items including share of profit/loss from equity-accounted investments, net investment income and profits/losses from the sale of investments.

[2] All assets and liabilities in the Power Systems segment were disposed of with the sale of the DPS Group. Any remaining assets and liabilities associated with the disposal process are reported under Other in 2007.

Breakdown by region	Revenue from external customers		Segment assets		Capital expenditure	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
€ million						
Europe	1,104.4	814.2	865.4	698.3	108.4	103.1
Africa	45.0	44.5	8.1	7.1	–	0.1
Europe/Africa	1,149.4	858.7	873.5	705.4	108.4	103.2
Americas	207.2	210.2	56.1	56.5	1.6	1.0
Asia-Pacific	123.8	77.1	15.1	16.2	57.8	0.1
Middle East	43.8	37.6	–	–	–	–
DEUTZ Group	**1,524.2**	**1,183.6**	**944.7**	**778.1**	**167.8**	**104.3**

	Total for segments: continuing operations		Discontinued operations: DEUTZ Power Systems		Total for segments: continuing and dis-continued operations		Reconciliation/ consolidation		DEUTZ Group	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
	1,520.7	1,175.9	206.9	314.1	1,727.6	1,490.0	–	–	1,727.6	1,490.0
	3.5	7.7	0.2	0.5	3.7	8.2	–	–	3.7	8.2
	1,524.2	**1,183.6**	**207.1**	**314.6**	**1,731.3**	**1,498.2**	**–**	**–**	**1,731.3**	**1,498.2**
	65.5	**58.7**	**4.3**	**6.6**	**69.8**	**65.3**	**–**	**–**	**69.8**	**65.3**
	65.5	58.7	4.3	6.6	69.8	65.3	–	–	69.8	65.3
	–	–	–	–	–	–	–	–	–	–
	–	–	–	–	–	–	–	–	–	–
	95.5	**66.6**	**9.4**	**14.9**	**104.9**	**81.5**	**–**	**–**	**104.9**[1)]	**81.5**[1)]
	–	–	147.1	12.0	147.1	12.0	–	–	147.1	12.0
	1.7	−1.2	−1.3	−2.0	0.4	−3.2	−0.4	3.2	–	–
	−1.1	−0.9	–	–	−1.1	−0.9	1.1	0.9	–	–
	96.1	64.5	155.2	24.9	251.3	89.4	0.7	4.1	252.0[1)]	93.5[1)]
	–	–	–	–	–	–	−68.7	−27.9	183.3	61.5
	944.7	778.1	–	249.4	944.7	1,027.5	433.9	135.4	1,378.6	1,162.9
	565.1	571.9	–	136.9	565.1	708.8	813.5	454.1	1,378.6	1,162.9
	167.8	104.3	6.5	3.9	174.3	108.2	–	–	174.3	108.2
	18.2	14.1	12.7	11.3	30.9	25.4	–	–	30.9	25.4
	57.6	4.7	–	8.1	57.6	12.8	–	–	57.6	12.8

Notes to the consolidated financial statements

INTRODUCTION

The new DEUTZ Customised Solutions business unit was created at the beginning of the 2007 financial year. The business unit specifically covers all air-cooled series activities, together with those involving liquid-cooled engines with a capacity greater than 8 litres. Previously, these activities formed part of the Compact Engines segment. The major change to the reporting structure is the reporting of DEUTZ Customised Solutions as a separate segment. The prior-year figures affected by this new segment structure have been broken down and assigned to Compact Engines and DEUTZ Customised Solutions accordingly.

Up to now, the DEUTZ Group has consisted of the Compact Engines, DEUTZ Customised Solutions, DEUTZ Power Systems and Other segments. DEUTZ Power Systems was sold with effect from 30 September 2007, and was consequently reclassified as a discontinued operation in accordance with IFRS 5. This segment's income and expenses are reported separately on the face of the income statement as net income attributable to discontinued operations and are explained in the notes to the consolidated financial statements. The comparative figures for 2006 have been restated accordingly in the income statement. The assets and liabilities attributable to DEUTZ Power Systems are no longer carried on the balance sheet as at 31 December 2007. As specified by IFRS 5.40, the balance sheet as at 31 December 2006 has not been restated.

1. BASIS OF PRESENTATION

1.1 Parent company

The parent company is DEUTZ AG. Its registered office is located at Ottostrasse 1, 51149 Cologne, Germany, and the company is entered under no. HRB 281 in the commercial register at the local court in Cologne.

DEUTZ AG shares are publicly traded on the stock exchanges in Frankfurt and Düsseldorf and on the XETRA electronic trading platform. They have been listed in the MDAX segment since 18 September 2006.

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

1.2 Accounting standards

The DEUTZ Group's consolidated financial statements prepared for the parent company DEUTZ AG have been prepared in accordance with uniform accounting policies. The consolidated financial statements of DEUTZ AG for the year ended 31 December 2007 have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU. The standards comprise the IFRSs and International Accounting Standards (IAS), promulgated by the International Accounting Standards Board (IASB), together with the interpretations of both the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC).

The consolidated financial statements are consistent with the statutory obligations applicable to publicly traded parent companies, subject to disclosure requirements pursuant to section 315a (1) of the German Commercial Code (HGB) in conjunction with Article 4 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council dated 19 July 2002, concerning the adoption of current international accounting standards in the version applicable at the time (IAS Regulation).

The supplementary provisions of the German Stock Corporation Act (AktG) have been applied. The Group management report, as at 31 December 2007, has been prepared in accordance with the HGB.

The accounting policies described below have been consistently applied. The figures for the previous year have also been calculated based on the standards and interpretations adopted as at 31 December 2006. The financial statements of the consolidated German and foreign enterprises have been prepared as at the balance sheet date of the consolidated financial statements (31 December 2007) and are based on uniform accounting policies.

1.3 Adoption of the International Financial Reporting Standards (IFRS)

Changes to accounting policies

The International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) have issued some amendments to existing International Financial Reporting Standards (IFRS), together with some new IFRSs and IFRICs, the application of which is mandatory for financial years beginning on or after 1 January 2007.

The following new and revised IFRSs and IFRIC interpretations were applied for the first time for the 2007 financial year:

IFRS 7 "Financial instruments: disclosures" and the associated amendment to **IAS 1 "Presentation of financial statements"** were applied in the 2007 financial year. The application of IFRS 7 and the amendment of IAS 1 resulted in further disclosures on financial instruments of DEUTZ AG reported in these consolidated financial statements and the management of capital.

IFRIC 7 "Applying the restatement approach" pursuant to IAS 29 "Financial reporting in hyperinflationary economies" contains guidelines on the application of IAS 29 when hyperinflation is ascertained for the first time. As hyperinflation has not been ascertained at any of the companies included in the consolidated financial statements, the interpretation is not relevant to the DEUTZ Group's consolidated financial statements.

IFRIC 8 "Scope of IFRS 2" extends the scope of IFRS 2 "Share-based payment" to cover transactions in which the company is unable to clearly identify the goods or services received. The application of this interpretation will have no impact on the financial position, financial performance or cash flows of DEUTZ AG.

IFRIC 9 "Reassessment of embedded derivatives" for the interpretation of IAS 39 examines if the assessment of whether an embedded derivative has to be accounted for separately from the host contract only has to be made at the time the contract is concluded or on an ongoing basis. Under IFRIC 9, reassessment is not permissible unless the stream of payments associated with the contract is significantly altered as a result of a change in the terms of the contract. This interpretation had no impact on the DEUTZ Group's consolidated financial statements for the period ended 31 December 2007.

IFRIC 10 "Interim financial reporting and impairment" stipulates that impairment losses on goodwill and certain equity instruments reported in interim financial statements cannot be reversed in subsequent financial statements. No goodwill is reported in the consolidated financial statements at present, so this interpretation has no impact on the Group.

Published but not yet mandatory standards, interpretations and amendments The International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) have issued further standards (IFRSs) and interpretations (IFRICs), the application of which was not yet mandatory in 2007. Before they can be applied, these rules require formal recognition by the EU, which has not yet occurred in all cases.

IAS 23 (revised) "Borrowing costs" is to be adopted for financial years beginning on or after 1 January 2009, and has not yet been enacted by the European Union. The material change to the standard relating to the removal of the option to expense all borrowing costs as incurred is unlikely to have any impact on the DEUTZ Group's consolidated financial statements.

The application of IFRS 8 "Operating segments" is mandatory for financial years that commence on or after 1 January 2009. IFRS 8 provides for the mandatory application of the "management approach" in segment reporting. Under this approach, the classification of segments and the presentation of disclosures are based on the breakdown used internally by the most senior levels of management for the purposes of the allocation of resources and the assessment of the performance of segments.

Apart from amended disclosures in the notes, the first-time adoption of IFRS 8 is not expected to have any material impact on the DEUTZ Group's financial position, financial performance or cash flows. There are, however, changes in the breakdown of the segments.

IFRIC 11 "IFRS 2: Group and treasury share transactions" has to be applied for financial years commencing on or after 1 March 2007. IFRIC 11 deals with the recognition of share-based remuneration agreements under IFRS 2. The interpretation stipulates that if a company receives goods or services under such an agreement and in return grants equity instruments, the agreement is to be accounted for as equity-settled, regardless of how the instruments are obtained. There are also further stipulations on how subsidiaries have to account for share-based remuneration agreements in their single-entity or consolidated financial statements under IFRS if the parent company grants its own equity instruments to employees of a subsidiary. The first-time adoption of this interpretation is not expected to have any material impact on the DEUTZ Group's consolidated financial statements.

IFRIC 12 "Service concession arrangements"(applicable for financial years commencing on or after 1 January 2008); IFRIC 12 deals with the issue of how companies have to account for the rights and obligations arising from this type of contractual arrangement. IFRIC 12 has not yet been incorporated into European law. The first-time adoption of this interpretation is not expected to have any material impact on the DEUTZ Group's consolidated financial statements.

The application of IFRIC 13 "Customer Loyalty Programmes" is mandatory for financial years that commence on or after 1 July 2008. IFRIC 13 deals with the measurement and recognition of customer-loyalty programmes, such as frequent flyer rewards with airlines and loyalty cards at retail outlets. These customer-loyalty programmes generally involve the customer acquiring points that enable him or her to obtain goods or services from the vendor or a third party either free of charge or at a reduced price. The first-time adoption of this interpretation is unlikely to have any impact on the DEUTZ Group's consolidated financial statements as it does not operate any such customer-loyalty programmes.

IFRIC 14 "IAS 19 – The limit on a defined-benefit asset, minimum funding requirements and their interaction" has to be applied for financial years commencing on or after 1 July 2008. This interpretation explains how the limit for an excess that can be recognised as a defined-benefit asset is fixed under IAS 19, and what impact the legal obligation for minimum funding has on the measurement of assets and provisions in connection with defined-benefit plans. IFRIC 14 has not yet been incorporated into European law by the European Union. The first-time adoption of this interpretation is not expected to have any material impact on the DEUTZ Group's consolidated financial statements.

Recently published accounting guidelines In September 2007, the IASB published amendments to IAS 1 (Presentation of financial statements). These include proposals for renaming individual components of financial statements, the obligation to disclose an opening balance for the prior year under certain circumstances, the separate presentation of equity transactions with shareholders and of changes to equity resulting from transactions with non-shareholders, and the recognition in income and individual reporting of each component of the “statement of recognised income and expense” that was previously taken directly to equity. The amendments come into force for financial years commencing on or after 1 January 2009. The DEUTZ Group is currently examining what impact these amendments will have on the Group’s financial performance and cash flow statement.

In January 2008, the IASB published the revised standards IFRS 3 (Business combinations) and IAS 27 (Consolidated and separate financial statements). Under IFRS 3 (revised 2008), business combinations continue to be accounted for using the purchase method. The revisions affect the way in which minority interests’ possible share of goodwill is recognised and how it is reported in equity. IAS 27 (revised 2008) comes into force for financial years commencing on or after 1 July 2009. The new rules may be applied in advance of this date provided that both revised standards are applied at the same time. The DEUTZ Group is currently examining the possible impact of applying the standards.

In February 2008, the IASB published amendments to IAS 32 (Financial instruments: presentation) and IAS 1 (Presentation of financial statements). These relate to the distinction between equity and borrowing when accounting for share capital with termination rights. Until now, shareholders’ capital with termination rights had to be classified as a liability. In future, such instruments with termination rights may be classified as equity if certain conditions are met. The amendments come into force for financial years commencing on or after 1 January 2009. The DEUTZ Group is currently examining what impact the amendments will have on the Group’s financial position and financial performance.

On 17 January 2008, the IASB published amendments to IFRS 2 (Share-based payment). Subject to incorporation into law by the EU, the amendments are to be applied for reporting periods commencing on or after 1 January 2009. The amendments clarify that only service conditions and performance conditions are to be treated as vesting conditions. They also provide that the rules governing termination during the vesting period apply regardless of whether the termination was effected by the company or the employee. The DEUTZ Group is currently examining the possible impact of applying the revised standard.

1.4 Critical estimates and assumptions made for the purposes of recognition

The preparation of the consolidated financial statements in accordance with IFRS requires estimates and assumptions to be made that have an impact on the recognition, measurement and reporting of assets and liabilities, the disclosure of contingent liabilities at the balance sheet date and the reporting of income and expenses. Estimates and assumptions giving rise to a material risk in the form of adjustments to the carrying amounts of assets or liabilities over the next financial year are discussed below in the notes to the income statement and balance sheet. They essentially relate to pension provisions, doubtful accounts receivable, deferred tax assets on losses carried forward, the determination of assets’ useful life and the recognition of provisions for pending or imminent litigation. Adjustments to estimates are recognised in income when better knowledge becomes available.

1.5 Miscellaneous

The consolidated financial statements have been prepared in euros. Unless stated otherwise, the figures in the notes to the consolidated financial statements are stated in millions of euros (€ million).

The balance sheet is structured by maturity (current and non-current); the income statement is presented under the nature-of-expense method. In the interest of clarity, some items on the face of the balance sheet and the income statement have been aggregated and are mentioned and explained separately in the notes to the consolidated financial statements.

These consolidated financial statements, prepared in accordance with IFRS, were approved for publication by resolution of the Management Board on 29 February 2008, and received the consent of the Supervisory Board on 19 March 2008.

2. BASIS OF CONSOLIDATION

The financial statements of the consolidated German and foreign enterprises have been prepared and audited as at the balance sheet date of the consolidated financial statements (31 December 2007).

Consolidated enterprises and associates

Subsidiaries are all enterprises (including special-purpose entities) in which DEUTZ AG exerts direct or indirect control over financial and business policy. The ability to exert control is generally deemed to exist in cases where more than 50 per cent of the enterprise's voting rights are held. Any assessment of whether control can be exerted will include potential voting rights that can currently be exercised or converted. Subsidiaries are fully consolidated from the point at which control passes to DEUTZ AG. They are deconsolidated from the point at which this control ends.

The consolidated financial statements include DEUTZ AG as well as three (2006: five) German enterprises and eight (2006: ten) foreign enterprises in which DEUTZ AG holds the majority of voting rights, either directly or indirectly or – as in the case of the special-purpose entity Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf – possesses a majority of the opportunities and risks.

In Germany, DEUTZ Power Systems GmbH & Co. KG, Mannheim, part of the DEUTZ Power Systems segment, was sold to the financial investor 3i with effect from 30 September 2007. Ad. Strüver KG (GmbH & Co.), Hamburg, was deconsolidated in 2007, due to the discontinuation of its operating activities and reclassified under other affiliated companies.

DEUTZ POWER SYSTEMS IBERIA S.A., Madrid/Spain (formerly DEUTZ IBERIA S.A., Madrid), DEUTZ Power Systems B.V., Rotterdam/Netherlands, and DEUTZ POWER SYSTEMS ASIA-PACIFIC PTE. LTD., Singapore/Singapore (formerly DEUTZ ASIA-PACIFIC (PTE.) LTD., Singapore) were also sold as part of the disposal of the DEUTZ Power Systems segment. DEUTZ Asia-Pacific (Pte) Ltd., Singapore/Singapore, was consolidated for the first time.

Associates are enterprises over which DEUTZ AG exerts a significant influence but does not have control. These are generally deemed to be enterprises in which DEUTZ AG holds between 20 per cent and 50 per cent of the voting rights. Two (2006: one) joint ventures have been consolidated and one (2006: two) foreign enterprise has been consolidated according to the rules governing associates. The joint venture DEUTZ (Dalian) Engine Co., Ltd., Dalian/China, was consolidated for the first time. ASIA POWER (PRIVATE) LIMITED, Colombo/Sri Lanka, was sold as part of the disposal of the DEUTZ Power Systems segment.

Page 146 of the annex to the notes to the consolidated financial statements lists the companies consolidated as part of the DEUTZ Group as at 31 December 2007. Full disclosure of shareholdings is published in the electronic German Federal Gazette.

3. PRINCIPLES OF CONSOLIDATION

The separate financial statements of the consolidated companies (including the financial statements of associates and joint ventures) have been consistently prepared and audited in accordance with the regulations on consolidation based on uniform accounting policies.

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

Business combinations are accounted for using the purchase method. The cost of an acquisition corresponds to the fair value of assets transferred, equity instruments issued and liabilities incurred or assumed at the time of the transaction, plus the costs directly attributable to the acquisition. Assets, liabilities and contingent liabilities identifiable as part of a business combination are measured at their fair value at the time of the transaction for the purposes of first-time consolidation, irrespective of the extent of any minority interest.

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

Equity attributable to third parties outside the DEUTZ Group is reported on the face of the consolidated balance sheet as minority interest.

Income, expenses, assets and liabilities arising between consolidated enterprises are eliminated. Unrealised losses are also eliminated unless the losses indicate an impairment of the asset transferred.

The consolidation of associates and joint ventures under the equity method follows the same principles with respect to positive and negative goodwill and the timing of the consolidation of equity. The DEUTZ Group's share of these enterprises' net income is reported as investment income on the face of the income statement. If an associate's share of losses equals or exceeds the DEUTZ Group's shareholding in this enterprise (including other unsecured receivables), the DEUTZ Group must not recognise any further losses unless it has assumed obligations or made payments on behalf of the associate.

4. CURRENCY TRANSLATION

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

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

Translation differences arising from the translation of equity at historical rates, and the translation of the net income or loss at average rates for the year, are reported under accumulated other comprehensive income/loss. In 2007, a loss of €6.6 million (2006: loss of €5.7 million) was reported.

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

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

		Average exchange rates		Closing rates at 31 Dec.	
		2007	2006	2007	2006
USA	1 USD	0.72	0.79	0.68	0.76
UK	1 GBP	1.45	1.47	1.36	1.49
Singapore	1 SGD	0.48	0.50	0.47	0.50
Australia	1 AUD	0.61	0.60	0.60	0.60

5. ACCOUNTING POLICIES

The material recognition and measurement rules used to prepare these consolidated financial statements are described below.

5.1 Income statement

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

Revenue and other income is recognised as follows:

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

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

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

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

Income from embedded derivatives requiring bifurcation is also reported under other operating income.

5.2 Balance sheet

Property, plant and equipment

Property, plant and equipment are recognised at cost and, if depreciable, take account of depreciation and any impairment.

The cost of purchase or cost of conversion includes expenses directly attributable to the acquisition. Borrowing costs are recognised as a current expense.

Any subsequent cost of purchase or conversion is only recognised as part of the cost of the asset if future economic benefits are likely to accrue to the DEUTZ Group and the cost of the asset can be reliably determined. Repairs and maintenance are expensed in the year in which they are incurred.

Land is not depreciated.

Buildings are depreciated over their estimated useful life.

Mobile assets are always depreciated on a straight-line basis pro rata temporis over their useful life, allowing for a residual value.

The following useful lives are generally used for depreciation purposes:

	Useful life in years	**Depreciation rate** (%)
Buildings and grounds	15–33	3.03–6.67
Plant and equipment	10–15	5–6.67
Office furniture and equipment	3–10	10–33.3

Gains and losses on the disposal of assets represent the difference between sales proceeds and carrying amount and are recognised in the income statement.

Intangible assets
Acquired intangible assets are recognised at the cost of purchase at the time of acquisition and internally produced assets are recognised at the cost of conversion, less amortisation and impairment in each case. The cost of purchase or conversion includes directly attributable costs. The cost of conversion also includes an appropriate proportion of overheads.

The following principles are applied:

Concessions, trademarks and similar rights These are recognised at amortised cost and amortised on a straight-line basis over their estimated useful life of three to ten years.

Internally produced intangible assets Development costs are capitalised if they can be clearly allocated to a newly developed product or process that is technically feasible and is intended for the enterprise's own use or marketing activities. They are generally amortised on a straight-line basis over the expected production cycle.

Costs involved in the development or maintenance of computer software are expensed as incurred. Costs directly incurred by the manufacture of certain individual software products at the disposal of the DEUTZ Group are recognised as an intangible asset if the enterprise is likely to derive an economic benefit for more than one year as a result and this benefit exceeds the costs incurred. The useful life of this capitalised cost of computer software is three to ten years.

Impairment of property, plant and equipment and intangible assets The DEUTZ Group checks, at each balance sheet date, whether there is any indication that an asset may be impaired (IAS 36.9).

An impairment test is conducted at least once a year on intangible assets with an indeterminable useful life, intangible assets not yet available for use and construction in progress (IAS 36.10).

An impairment loss corresponding to the amount by which the carrying amount exceeds the recoverable amount is recognised. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use.

When impairment tests are conducted, assets are aggregated at the lowest-possible level at which cash flows can be separately identified (cash generating units (CGUs)). Bottom-up tests are used to allocate assets to the CGUs. The starting point of this process is the individual asset, which is aggregated at the level of individual locations with other assets, up to a point at which independent cash inflows can largely be allocated to the emerging CGU.

Determination of cost of capital DEUTZ calculates its cost of capital as the average equity and debt capital weighted according to the respective market values (weighted average cost of capital (WACC)).

The cost of equity capital corresponds to the rates of return expected by our shareholders and is derived from capital market information.

Our borrowing costs are based on the financing terms and conditions of our pension benefit obligations and interest-bearing financial liabilities.

Government grants

IAS 20 states that government grants for specific assets should be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate. The DEUTZ Group deducts government grants relating to purchases of non-current assets from the cost of the respective asset. The amount of depreciation and amortisation is based on the cost of purchase after deduction of such grants.

Income taxes

1. Deferred taxes As required by IAS 12, deferred taxes are recognised on all temporary differences between the tax base of assets and liabilities and their carrying amounts in the IFRS financial statements.

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

DEUTZ recognises deferred tax liabilities resulting from temporary differences in connection with investments in subsidiaries and associates. They are not recognised if the reversal of the temporary differences can be controlled and these are unlikely to be reversed in the foreseeable future. The amount of temporary differences for which no deferred tax liabilities have been recognised is stated in the notes to the consolidated financial statements.

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

Deferred taxes are recognised at the rates anticipated on recognition of the asset or liability. The anticipated tax rate is the rate that is either already in force or has been announced at the balance sheet date, provided this announcement is equal to the material effect of the rate actually coming into force.

2. Current tax expense Current income taxes, for the current period and for previous periods, are recognised at the amount that is expected to be paid to, or reimbursed by, the tax authorities, or has already been paid.

3. Assumptions and estimates The DEUTZ Group is obliged to pay income taxes in various countries. It needs to make estimates for the recognition of tax provisions and deferred taxes. It also has to make estimates to determine whether it needs to recognise deferred tax assets or make adjustments to deferred tax assets. DEUTZ mainly recognises deferred tax assets on losses carried forward. DEUTZ AG has losses carried forward of approx. €0.9 billion for corporation tax purposes and around €1.1 billion for trade tax purposes. Deferred tax assets are not recognised or their amount is adjusted if it is not sufficiently certain that the tax asset actually exists. There are uncertainties with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Differences between the actual amounts and our assumptions or future revisions of these assumptions can cause changes in the amounts of tax paid in future periods. If the actual amounts (in areas affected by estimates) differed by 10 per cent from the Management Board's estimates, the DEUTZ Group would have to increase its current tax liability by 10 per cent and reduce its deferred tax asset if this difference were to its detriment; conversely, it would have to reduce its current tax liability by 10 per cent and increase its deferred tax asset by 10 per cent if the difference were to its advantage.

Inventories

Raw materials and consumables, as well as bought-in and spare parts, are recognised at cost or at the lower of cost and net realisable value less further costs incurred. The cost of purchase is based on weighted average procurement prices.

Work in progress and finished goods are recognised at the cost of conversion, which includes directly attributable costs as well as a proportion of production overheads. If the net realisable value less further costs incurred is less than the cost of conversion, the latter figure is recognised.

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

Borrowing costs are not capitalised.

Non-current assets held for sale

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

Primary financial assets

Primary financial assets in the DEUTZ Group cover the following categories in accordance with IAS 39:

- Loans and receivables
- Available-for-sale financial assets

Financial assets are classified at the time of acquisition on the basis of their nature and purpose.

Effective interest method

The effective interest method is a method for calculating the amortised cost of financial assets and allocating interest or similar income to the respective periods. The effective interest rate is the interest rate at which the estimated future proceeds (including all fees, transaction costs, premiums, discounts, etc) from a financial instrument over its anticipated term – or a shorter period, if applicable – can be discounted to its carrying amount. Income from debt instruments is recognised on the basis of the effective interest rate. This does not apply to instruments measured at fair value and recognised in income.

Loans and receivables

Loans and receivables comprise trade receivables and interest-bearing assets. They are initially recognised at their fair value and subsequently measured at amortised cost under the effective interest method. Their cost of purchase corresponds to their principal amount. If assets in this category do not bear market rates of interest, they are recognised at their present value. Impairment losses are recognised if there are objective indications that contracts have not been performed as agreed. The impairment loss represents the difference between the carrying amount and the present value of future cash flows under the effective interest method.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not traded in an active market. They arise when the DEUTZ Group provides money, goods or services directly to a customer or other debtor. They are classified as current assets, except for those that do not fall due until twelve months after the balance sheet date. These are reported as non-current assets. This category comprises interest-bearing assets, trade receivables, and cash and cash equivalents.

The loans granted by the DEUTZ Group are initially recognised at their fair value, as required by IAS 39, and subsequently at amortised cost in accordance with the effective interest method; they are discounted to their present value under the effective interest method. Receivables and other assets are initially recognised at their fair value and subsequently at amortised cost.

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

Non-interest-bearing primary financial assets with maturities of more than one year have been discounted at the usual market rate of interest.

Doubtful accounts receivable are recognised at an amount that is deemed feasible based on historical default rates. As soon as it becomes known that the risk attaching to a certain receivable exceeds the general credit risk (e.g. insufficient creditworthiness on the part of the customer, disagreement on the existence or amount of the receivable, inability to enforce the receivable for legal reasons, etc.), the receivable is examined and – if there are indications that it is irrecoverable – written off. Changes in the default ratio have no material impact.

Available-for-sale financial assets

Available-for-sale financial assets comprise investments and all financial instruments for which an active market exists when the asset is first recognised. Available-for-sale securities and equity instruments are recognised at their fair value; the fair value of assets traded in an active market is derived from their market price at the respective balance sheet date. Assets whose fair value cannot be determined either using recognised measurement methods (e.g. discounted cash flow) or from their market prices are recognised at amortised cost.

Changes in fair value are recognised as accumulated other comprehensive income/loss (revaluation reserve). Tests are conducted at each balance sheet date to determine whether there are any objective indications that a financial asset or group of financial assets may be impaired. A material or permanent fall in the fair value below the carrying amount is regarded as an indication of impairment. If such an indication exists, the losses reported in the revaluation reserve are removed from this reserve and recognised in the income statement.

Other investments Other investments are initially recognised at their fair value plus transaction costs. Permanent impairment losses are recognised in income. Reversals of impairment losses are reported as accumulated other comprehensive income/loss.

Impairment of financial assets With the exception of financial assets measured at fair value and recognised in income, financial assets are examined at each balance sheet date for indications that they may be impaired. A financial asset is deemed to be impaired if, as a result of one or more events after initial recognition of the asset, there is an objective indication that the anticipated future cash flows from that asset have reduced.

Primary financial obligations

The DEUTZ Group's primary financial instruments on the liabilities side comprise

- Financial liabilities (convertible profit-sharing rights, convertible bonds, bond US private placement), liabilities to banks, liabilities from finance leases,
- Trade payables and other liabilities.

Liabilities are classified as “current” unless the DEUTZ Group has a right not to repay the liability until at least twelve months after the balance sheet date. DEUTZ classifies all financial liabilities as “other liabilities”.

Liabilities are usually initially recognised at their fair value less transaction costs. They are subsequently recognised at amortised cost; any differences between the amount disbursed (less transaction costs) and the amount repaid are recognised in the income statement under the effective interest method over the term of the liability.

Recognition of derivatives

Derivative financial instruments DEUTZ only uses derivative financial instruments (primarily interest-rate and currency derivatives) for hedging purposes as part of its business operations.

DEUTZ only regularly uses derivative financial instruments to reduce the foreign currency risk in planned transactions involving foreign currencies and to reduce interest rate risk. It mainly uses forwards, options, option combinations and interest-rate swaps.

Non-derivative financial instruments in all asset categories are recognised on the trade date. They are initially recognised at their fair value on the day they are concluded and are subsequently measured at the fair value prevailing at the time. The fair value of derivatives corresponds to the present value of estimated future cash flows. The fair value of currency forwards is based on the forward exchange rate at the balance sheet date.

Changes in the fair value of derivatives not used for hedging purposes under hedge accounting guidelines (non-hedging derivatives) are immediately recognised in the income statement.

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

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

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

Equity Ordinary shares (no-par-value bearer shares) are classified as equity.

Costs directly attributable to the issuance of new shares and options are deducted from the issue proceeds and reported in equity, less any tax advantages. The cost of issuing new shares or options that are directly related to a business combination is added to the cost of purchase.

The right to exercise profit-sharing rights and convertible bonds is recognised in equity at fair value less pro rata transaction costs, taking account of deferred taxes. The fair value derives from the beneficial fact that these instruments bear no interest or less interest than similar debt instruments without conversion rights.

Provisions

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

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

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

When defined-benefit pension plans are measured, pension obligations are recognised in accordance with IAS 19. The provisions recognised on the face of the balance sheet correspond to the defined benefit obligation at the balance sheet date less the fair value of plan assets, adjusted for cumulative unrecognised actuarial gains and losses and unrecognised past service cost.

The defined benefit obligation is calculated once a year by an independent actuary using the projected unit credit method. The anticipated future pension benefits vested at the balance sheet date are discounted using the interest rate on investment-grade corporate bonds that are denominated in the same currency in which the benefits are paid, and whose terms to maturity correspond to those of the defined benefit obligations. This calculation also factors in assumptions and estimates about future staffing levels, wage and salary increases, future pension increases and – where available – the anticipated long-term return on plan assets.

Given this scenario, the DEUTZ Group uses various statistical and other models to measure its pension obligations accurately. The discount rate used is mainly based on an index of high-quality fixed-income investments at the plans' valuation dates and on a plan-specific estimate of the age structure of staff. These calculations also factor in statistical information such as natural wastage and mortality probabilities. Calculations of the anticipated return on plan assets are based on a long-term view of global capital market returns that considers the duration of pension obligations and a diversified investment strategy.

Because of changes in economic and market conditions, the costs and liabilities actually incurred may differ significantly from the estimates made on the basis of actuarial assumptions. The rate of pension and salary increases, the longevity of those entitled to pension benefits and the discount rate used can have a material impact on the amount of the defined benefit obligation and, consequently, on future pension costs. A change of 0.5 percentage points in the discount rate used is estimated to cause the majority of pension benefit obligations to be adjusted by between 4 per cent and 5 per cent. A change of 0.5 percentage points in the projected rate of pension increase would cause the majority of pension benefit obligations to rise by 4.5 per cent. These changes in assumptions result in actuarial gains or losses, which the DEUTZ Group recognises in income over the anticipated remaining service period of the persons with the active pension entitlement. They are only recognised in income when they exceed a band of 10 per cent of the obligation.

Other provisions Other provisions are recognised if there are legal or constructive obligations towards third parties that arise from past events and are likely to result in an outflow of resources. Furthermore, it must be possible to estimate the obligation reliably. Provisions are not recognised for future operating losses.

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

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

Contingent liabilities Contingent liabilities are potential obligations that arise from past events and whose existence will only be confirmed by the occurrence of one or more uncertain future events, which, however, are beyond the control of the DEUTZ Group. Furthermore, present obligations may constitute contingent liabilities if the likelihood of an outflow of resources is not sufficiently probable for the recognition of a provision and/or the amount of the obligation cannot be sufficiently reliably estimated.

Discontinued operations pursuant to IFRS 5

IFRS 5 stipulates that any material discontinued segment or business that is deconsolidated must be reported separately. Income and expenses up to the point of deconsolidation and any gain on disposal must be reported separately on the income statement under discontinued operations. Prior-year figures must be restated accordingly.

Pending and potential legal disputes

DEUTZ AG and some of its subsidiaries are involved in a number of legal disputes and arbitration proceedings. These relate to risks concerning liability for defects of quality, tax law, competition law and antitrust law. Financial provision has been made to cover the risks arising from this litigation.

At present, it is not possible to predict the outcome of these pending cases with any degree of certainty beyond the provisions already recognised. We do not expect them to have a significantly adverse impact on the DEUTZ Group's financial position or financial performance.

The overall position of the legal risks facing the DEUTZ Group is explained in more detail in Note 28. A change of 5 per cent in the level of provisions recognised for litigation can increase or reduce the Group's profits by €0.3 million. A 5 per cent variation in the interest rate or a 5 per cent increase or decrease in the assumed probability of a certain risk or event materialising would not have a material impact on the Group's profits.

NOTES TO THE INCOME STATEMENT

(figures given in millions of euros unless stated otherwise)

INTRODUCTION

In the 2007 financial year, the DEUTZ Power Systems segment was sold, with effect from 30 September 2007, and consequently reclassified as a discontinued operation in accordance with IFRS 5. This segment's income and expenses are reported separately on the consolidated income statement as net income attributable to discontinued operations and are explained in Note 11 to the consolidated financial statements. The following notes relate to the continuing operations of the DEUTZ Group. The comparative figures for 2006 have been restated accordingly in the income statement.

1. REVENUE

The tables below give a breakdown of revenue by application segment, segment and geographical sales region:

Segments

	2007	2006
€ million		
Engines	1,093.5	790.9
Service	92.5	77.4
Compact Engines	**1,186.0**	**868.3**
Engines	227.2	213.0
Service	111.0	102.3
DEUTZ Customised Solutions	**338.2**	**315.3**
Total	**1,524.2**	**1,183.6**

Sales regions

	2007	2006
€ million		
Europe/Middle East/Africa	**1,193.2**	**896.3**
thereof Germany	335.4	300.3
thereof rest of Europe	769.0	513.9
thereof Middle East	43.8	37.6
thereof Africa	45.0	44.5
Americas	**207.2**	**210.2**
Asia-Pacific	**123.8**	**77.1**
Total	**1,524.2**	**1,183.6**

2. CHANGES IN INVENTORIES AND OTHER OWN WORK CAPITALISED

Changes in inventories

Changes in inventories of finished goods and work in progress in 2007 amounted to €16.4 million (2006: €9.7 million).

Other own work capitalised

Other own work capitalised amounted to €13.7 million (2006: €12.8 million). This primarily comprised the costs of new engine development and the further development of existing engines to comply with current and future exhaust emissions standards and development costs for the 2009 engine series.

3. OTHER OPERATING INCOME

€ million	2007	2006
Income from recharged costs and services	37.8	32.3
Income from the settlement of pension claims	9.0	–
Income from the reversal of warranty provisions following disposal of Marine Service business	5.0	–
Exchange rate gains	3.2	1.6
Income from the measurement of derivatives (excl. interest rate derivatives)	3.0	4.4
Rentals and leases	4.1	4.7
Income from the disposal of non-current assets and deconsolidations	0.1	0.3
Sundry other income	4.5	8.8
Total	**66.7**	**52.1**

The increase in other operating income from continuing operations arose primarily from the reversal of pension provisions in connection with the settlement of pension claims, and from the reversal of provisions on expiry of warranty periods in connection with the sale of the Marine Service business.

4. COST OF MATERIALS

€ million	2007	2006
Cost of raw materials and consumables, bought-in parts and goods procured	984.7	725.6
Cost of services procured	42.8	27.2
Impairment of raw materials, bought-in parts and goods procured	2.2	6.1
Total	**1,029.7**	**758.9**

5. STAFF COSTS

€ million	2007	2006
Wages	126.5	108.7
Salaries	102.7	96.8
Social security contributions	44.2	41.2
Cost of severance payments	0.1	2.3
Cost of post-employment benefits	1.5	3.3
Total	**275.0**	**252.3**

The average number of employees during the year is given in the section “Information under German accounting standards”.

6. DEPRECIATION, AMORTISATION AND IMPAIRMENT

This item gives details of depreciation and amortisation – which represent the scheduled apportionment of the cost of purchase over the assets' useful life – and impairment, which was determined using an impairment test as described under IAS 36.

Depreciation and amortisation

	2007	2006
€ million		
Property, plant and equipment	47.6	41.3
Intangible assets	17.9	17.4
Total	**65.5**	**58.7**

No impairment losses were recognised in 2007.

7. OTHER OPERATING EXPENSES

	2007	2006
€ million		
Expenses for general services	55.7	47.3
Special selling expenses	25.2	25.1
Cost of rentals and leases	13.2	13.6
Office, postal, telecommunications, advertising and other administrative expenses	10.3	9.8
Cost of fees, contributions and advice	12.3	10.3
Exchange rate losses	4.5	3.9
Expenses in connection with the measurement of derivatives	2.3	–
Costs of disposal of non-current assets	0.4	0.7
Temporary staff	14.3	10.4
Sundry other expenses	17.1	3.3
Total	**155.3**	**124.4**

Income from the reversal of provisions reduces the amount of expenses and is credited to the expense items under which the provisions were originally recognised.

8. PROFIT/LOSS ON EQUITY-ACCOUNTED FINANCIAL ASSETS, OTHER INVESTMENT INCOME AND IMPAIRMENT ON NON-CURRENT FINANCIAL ASSETS

	2007	2006
€ million		
Profit/loss on equity-accounted assets		
Profit distributions on equity-accounted financial assets	0.8	0.3
Income from equity-accounted financial assets	1.0	0.9
Expenses from equity-accounted financial assets	–3.5	–
Total	**–1.7**	**1.2**
Other investment income	**1.5**	**1.3**
Reversal of impairment losses on non-current financial assets	**0.2**	**0.2**
Total	**–**	**2.7**

9. INTEREST EXPENSES, NET

	2007	2006
€ million		
Interest received on credit balances held with banks	3.7	0.6
Other interest income	7.8	3.6
Interest income	**11.5**	**4.2**
Interest paid on liabilities owed to banks	–3.8	–3.7
Interest paid on convertible bonds and profit-sharing rights	–6.1	–3.2
Interest cost of pension reserves and similar obligations	–12.1	–13.8
Other interest expense	–7.6	–2.7
Interest expenses (finance expenses)	**–29.6**	**–23.4**
Net interest expense	**–18.1**	**–19.2**

Net interest income/expense from financing instruments		
Loans and receivables, cash and cash equivalents	6.5	3.5
Available-for-sale financial assets (at cost)	–	–
Hedging derivatives pursuant to IAS 39	4.2	–
Financial liabilities	–9.9	–7.0
Liabilities from hedging derivatives pursuant to IAS 39	–3.9	–
Total	**–3.1**	**–3.5**

10. TAXES

Other taxes Other taxes essentially comprise real-property taxes.

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

2007	Continuing operations	Discontinued operations	Total
€ million			
Current tax expense (thereof unrelated to the reporting period)	12.7 –	30.8 –	43.5 –
Deferred taxes	4.0	–0.3	3.7
of which deferred tax assets on losses carried forward	8.6	–	8.6
Total tax expense	**16.7**	**30.5**	**47.2**
2006			
€ million			
Current tax expense (thereof unrelated to the reporting period)	7.5 –	1.7 –	9.2 –
Deferred taxes	–0.1	–0.9	–1.0
of which deferred tax assets on losses carried forward	–7.1	–	–7.1
Total tax expense	**7.4**	**0.8**	**8.2**

The accumulated other comprehensive income/loss recognised in the reporting year gave rise to a deferred tax benefit of €1.9 million (2006: €0.6 million). The accumulated other comprehensive income/loss does not incur any current taxes.

The tax reconciliation table shows the reconciliation from anticipated income taxes to effective taxes as shown on the face of the income statement. Effective income taxes include actual and deferred taxes. The applicable tax rate is 39 per cent (2006: 39 per cent) and comprises corporation tax at 25 per cent, the solidarity surcharge at 5.5 per cent and the average trade tax rate of approx. 13 per cent.

	2007	2006
€ million		
Net income before income taxes	**230.5**	**69.7**
Anticipated tax	89.9	27.2
Difference in local basis of assessment	–9.5	0.3
Tax rates outside Germany	–2.2	–0.8
Change in adjustment of deferred tax assets on losses carried forward, change in deferred tax assets capitalised for losses carried forward/temporary differences	–38.0	–18.0
Change in tax rates	10.0	–
Effect of non-deductible expenses	0.1	1.4
Effect of tax-free income	–0.5	–
Other	–2.6	–1.9
Effective tax expense	**47.2**	**8.2**
Effective tax rate (%)	20.5	11.8

Following the German corporate tax reform, which became effective on 1 January 2008, the tax rates applicable to DEUTZ are 15 per cent corporate income tax, a solidarity surcharge of 5.5 per cent of the corporate income tax amount and municipal trade tax of 16 per cent.

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

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

No deferred taxes were recognised on "outside basis differences" because the reversal of differences (e.g. dividend payments) can be controlled and the (German) tax assessment basis is essentially disregarded, and no material tax effects are to be expected in the foreseeable future.

11. DISCONTINUED OPERATIONS (SALE OF DEUTZ POWER SYSTEMS)

There is relatively little overlap between the Compact Engines business and the medium-sized and large engines business of DEUTZ Power Systems, because of their differing business processes, customer profiles and market conditions. The Management Board has, therefore, sold the DEUTZ Power Systems segment, including its associates and subsidiaries, to the financial investor 3i.

After DEUTZ AG's Supervisory Board and the relevant antitrust regulator had given their approval, the disposal of the gas-engines and diesel-engines business for decentralised power generation (DEUTZ Power Systems) was completed with commercial effect from 30 September 2007.

The agreed purchase price amounted to €360.0 million and included the shares in the following consolidated companies:

- DEUTZ Power Systems GmbH & Co. KG, Mannheim
- DEUTZ Power Systems B.V., Rotterdam/Netherlands
- DEUTZ POWER SYSTEMS IBERIA S.A., Madrid/Spain (formerly DEUTZ IBERIA S.A., Madrid)
- DEUTZ POWER SYSTEMS ASIA-PACIFIC PTE. LTD., Singapore/Singapore.

In addition, material assets that were essential to the business operations of the DEUTZ Power Systems segment, but did not belong to any of the companies being sold, were also sold.

Payments of €317.1 million were received from the disposal in 2007, after deduction of tax payments, one-off expenses and purchase price adjustments.

At the time of preparation of the 2007 consolidated financial statements, the sale of DEUTZ Power Systems, including the price adjustment mechanisms stipulated in the sale and purchase agreement, had not yet been completed. Any resulting changes could have either a positive or negative impact on the gain on the disposal.

The transaction is reported as a discontinued operation in accordance with IFRS 5:

Net income on discontinued operations

	2007	**2006**
€ million		
Gain on disposal (after taxes)	118.3	–
Current net income (after taxes)	5.6	23.0
Total	**123.9**	**23.0**

The gain on disposal is calculated as follows:

€ million	2007	2006
Selling price	**360.0**	**–**
• Assets and liabilities	–148.0	–
• One-off expenses	–64.9	–
Gain on disposal before income taxes	**147.1**	**–**
Income taxes	–28.8	–
Gain on disposal after income taxes	**118.3**	**–**

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

€ million	2007	2006
Revenue	**207.1**	**314.6**
Changes in inventories and other own work capitalised	31.1	–0.6
Cost of materials	–140.2	–183.1
Staff costs	–49.1	–65.8
Other income and expenses	–39.5	–38.2
EBIT on discontinued operations	**9.4**	**26.9**
thereof one-off items	**–**	**12.0**
thereof operating profit (EBIT before one-off items) on discontinued operations	**9.4**	**14.9**
Net interest expense/other taxes	–2.1	–3.1
Current net income on discontinued operations	**7.3**	**23.8**
Income taxes	–1.7	–0.8
Current net income after income taxes on discontinued operations	**5.6**	**23.0**
Gain on disposal before income taxes	147.1	–
Income taxes	–28.8	–
Gain on disposal after income taxes on discontinued operations	**118.3**	**–**
Net income on discontinued operations	**123.9**	**23.0**

12. EARNINGS PER SHARE

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

To calculate diluted earnings per share, it factors in dilutive effects from profit-sharing rights and convertible bonds. In doing so, it assumes that these profit-sharing rights and convertible bonds are converted into shares. Consequently, net income is increased by the derecognition of the interest cost. The resultant tax expense is recognised.

	2007	2006
€ million/shares in thousands		
Net income	183.3	61.5
Weighted average number of shares outstanding	117,316	107,161
Basic earnings per share (€)	**1.56**	**0.57**
thereof from continuing operations	0.51	0.36
of which from discontinued operations	1.05	0.21
Dilutive effect		
Increase in net income resulting from derecognition of interest cost on dilutive convertible profit-sharing rights and convertible bonds	0.9	3.2
Current and deferred taxes	–0.3	–1.2
Adjusted net income for the period	**183.9**	**63.5**
Weighted average number of shares outstanding (diluted)	120,936	120,936
Diluted earnings per share (€)	**1.52**	**0.52**
thereof from continuing operations	0.50	0.33
thereof from discontinued operations	1.02	0.19

NOTES TO THE BALANCE SHEET

INTRODUCTION

The sale of the DEUTZ Power Systems segment had a material impact on the figures reported on the consolidated balance sheet as at 31 December 2007.

The following table shows the assets and liabilities sold:

	31 Dec. 2007
€ million	
Non-current assets (before deferred tax assets)	69.5
Inventories	122.9
Trade receivables	67.7
Other assets[1)]	16.7
Assets sold	**276.8**
Current and non-current provisions	38.2
Trade payables	47.9
Other liabilities	42.7
Liabilities sold	**128.8**
Total	**148.0**

[1)] Of which €4.2 million cash and cash equivalents.

13. PROPERTY, PLANT AND EQUIPMENT

Gross figures
Cost of purchase/conversion

€ million	Land, leasehold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
Balance at 1 Jan. 2006	**229.4**	**462.4**	**195.5**	**10.8**	**898.1**
Exchange differences	−0.1	–	−0.3	–	−0.4
Additions	14.9	22.2	19.5	14.2	70.8
Capital investment grants	–	−2.8	−4.9	–	−7.7
Disposals	−0.8	−17.6	−13.0	−0.1	−31.5
Reclassifications	2.1	8.5	0.2	−10.8	–
Balance at 31 Dec. 2006	**245.5**	**472.7**	**197.0**	**14.1**	**929.3**

Gross figures
Depreciation and impairment

€ million	Land, leasehold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
Balance at 1 Jan. 2006	**62.6**	**318.7**	**156.3**	**–**	**537.6**
Exchange differences	−0.1	−0.1	−0.2	–	−0.4
Additions	5.5	31.5	10.7	–	47.7
Disposals	−0.4	−16.9	−12.9	–	−30.2
Balance at 31 Dec. 2006	**67.6**	**333.2**	**153.9**	**–**	**554.7**
Net carrying amount at 31 Dec. 2006	**177.9**	**139.5**	**43.1**	**14.1**	**374.6**

Gross figures
Cost of purchase/conversion

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

Gross figures
Depreciation and impairment

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

The additions to property, plant and equipment comprised capital expenditure for the expansion of capacity in Cologne and Zafra in connection with the growth strategy of the Compact Engines segment and capital expenditure in the DEUTZ Customised Solutions segment on pioneering and environmentally friendly projects in Ulm, including a new logistics centre.

Government grants at a Spanish subsidiary were deducted from the cost of purchasing the property, plant and equipment. In 2007, government grants of €3.5 million were received. Total government grants recognised at 31 December 2007 amounted to €6.5 million (2006: €4.4 million). In 2007, €1.5 million (2006: €0.8 million) was recognised in income (thus reducing depreciation).

Commitments to purchase property, plant and equipment and intangible assets (purchase commitments) amounted to €39.8 million (2006: €36.8 million).

There is no longer any bank debt secured by mortgages (2006: €29.5 million).

14. INTANGIBLE ASSETS

Gross figures
Cost of purchase/conversion

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
Balance at 1 Jan. 2006	**104.3**	**67.2**	**171.5**
Exchange differences	–0.1	–	–0.1
Additions	14.3	22.5	36.8
Capital investment grants	–6.3	–7.4	–13.7
Disposals	–1.9	–	–1.9
Reclassifications	–	–	–
Balance at 31 Dec. 2006	**110.3**	**82.3**	**192.6**

Gross figures
Amortisation and impairment

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
Balance at 1 Jan. 2006	**68.6**	**8.0**	**76.6**
Exchange differences	–	–	–
Additions	9.4	8.2	17.6
Impairment	–	–	–
Disposals	–1.9	–	–1.9
Reclassifications	–	–	–
Balance at 31 Dec. 2006	**76.1**	**16.2**	**92.3**
Net carrying amount at 31 Dec. 2006	**34.2**	**66.1**	**100.3**

Gross figures
Cost of purchase/conversion

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

Gross figures
Amortisation and impairment

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

The additions to intangible assets essentially relate to the capitalisation of the costs of new engine development and the further development of existing engines to comply with current and future exhaust emissions standards, and capitalisation of the costs of enhancing the 2009 engine series. The capital expenditure grants relate to alliance partners.

The income statement includes research and development costs of €40.6 million for 2007, and €44.0 million for 2006.

15. EQUITY-ACCOUNTED FINANCIAL ASSETS

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

	2007	2006
€ million		
1 January	**12.8**	**13.1**
Additions	57.8	–
Disposals	–8.1	–
Start-up losses on DEUTZ Dalian	–3.5	–
Other changes arising from measurement using the equity method	–1.4	–0.3
31 December	**57.6**	**12.8**

Additions comprise the 50 per cent share in the joint venture DEUTZ (Dalian) Engine Co., Ltd., Dalian/China.

Disposals essentially comprise the sale of ASIA POWER (PRIVATE) LIMITED, Colombo/Sri Lanka, as part of the sale of the DEUTZ Power Systems segment.

One associate has a different financial year (ending on 30 November 2007).

The following table shows the principal balance sheet and income statement items for equity-accounted investments:

	31 Dec. 2007	31 Dec. 2006
€ million		
Assets	258.3	61.4
Liabilities	139.8	22.1
Revenue	123.0	69.8
Net loss/income	–2.0	9.3

16. OTHER FINANCIAL ASSETS (NON-CURRENT)

Summary

	31 Dec. 2007	31 Dec. 2006
€ million		
Investments[1)]	5.8	5.9
Non-current securities[2)]	1.4	1.5
Loans[3)]	1.3	3.4
Derivatives[4)]	–	0.6
Total	**8.5**	**11.4**

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

Re 1): Available-for-sale financial assets

Changes in investments were as follows:

€ million			
Balance at 1 Jan. 2007	**5.9**	**Balance at 1 Jan. 2006**	**5.6**
Additions	–	Additions	0.4
Disposals	–0.1	Disposals	–0.1
Balance at 31 Dec. 2007	**5.8**	**Balance at 31 Dec. 2006**	**5.9**

Re 2): Non-current securities

This item includes €1.4 million (2006: €1.5 million) in securities in the form of shares and bonds. The securities are used as a form of investment for the pension obligations of a foreign subsidiary (Deutz Corporation).

Re 3): Loans

Impairment losses are recognised to cover the existing risks attaching to loans. The fair value of loans approximates to their carrying amount. Disposals relate to loans of DEUTZ Asia-Pacific (Pte) Ltd., Singapore, in connection with the sale of DEUTZ Power Systems.

17. DEFERRED TAXES, CURRENT TAX ASSETS AND LIABILITIES

At the balance sheet date, DEUTZ AG had unutilised tax losses carried forward of €936.2 million for corporation tax and €1,093.8 million for trade tax.

Further tax loss carry forwards were also available to international companies in the Group. Under IAS 12.34 et seq., these have been recognised to the extent that future taxable profits are sufficiently likely to be available, against which the unutilised tax losses can be offset.

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

	2007	**2006**
€ million		
Non-current		
Deferred tax assets	29.1	56.2
Deferred tax provisions	–	0.5
Current		
Current tax assets	0.7	0.3
Provision for income taxes	11.3	6.5
Income tax liabilities	0.2	0.6
Deferred tax assets	20.3	–

The main reason for the €6.8 million decrease in deferred tax assets is explained below.

The disposal of DEUTZ Power Systems has reduced the recognised losses carried forward by approximately €10.4 million; the corresponding deferred tax expense is reported under continuing operations. An offsetting amount of €9.9 million has been recognised as a result of the extrapolation of medium-term profit projections. The lowering of tax rates from 2008 onwards reduces the recognised losses carried forward by roughly €9.9 million.

The provision for income taxes of €11.3 million comprises, primarily, the tax expense for the one-off gain on the disposal of DEUTZ Power Systems.

The beginning of April 2007 saw the start of an external tax audit covering the tax assessment periods 2002 to 2005.

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

	Deferred taxes in 2007		**Deferred taxes in 2006**	
	Assets	**Liabilities**	**Assets**	**Liabilities**
€ million				
Assets				
Intangible assets	–	25.2	–	27.3
Property, plant and equipment	10.9	–	12.6	–
Equity-accounted investments and financial assets	–	–	–	1.6
Inventories	0.9	1.7	0.5	1.8
Receivables and other assets	0.5	6.4	0.6	12.6
Liabilities	**27.1**	**2.4**	**34.5**	**6.0**
Losses carried forward	**43.5**	**–**	**53.4**	**–**
Tax credits	**–**	**–**	**–**	**–**
Consolidation	**2.2**	**–**	**2.1**	**–1.1**
Other	**–**	**–**	**0.4**	**0.2**
Deferred taxes (gross)	**85.1**	**35.7**	**104.1**	**48.4**
Netting	35.7	35.7	–47.9	–47.9
Deferred taxes (net)	**49.4**	**–**	**56.2**	**0.5**

No deferred taxes were recognised on “outside basis differences” because the reversal of differences (e.g. dividend payments) can either be controlled or is tax-exempt for the most part, and no material tax effects are to be expected in the foreseeable future.

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

Loss carry forwards on which deferred taxes have not been recognised

	2007	**2006**
€ million		
Corporation tax	780.8	867.5
Trade tax	880.0	900.6
Tax credits/loss carry forwards outside Germany	16.5	54.1

Thereof: expiry periods for German and international losses carried forward

	Corporation tax		Trade tax	
	2007	2006	2007	2006
€ million				
Less than 5 years	6.6	14.0	–	4.2
5–9 years	9.9	21.4	–	2.6
Indefinite	780.8	832.1	880.0	893.8

18. INVENTORIES

	31 Dec. 2007	31 Dec. 2006
€ million		
Raw materials and consumables, bought-in parts and spare parts	125.0	140.5
Work in progress	39.2	50.7
Finished goods	50.0	58.4
Total	**214.2**	**249.6**

The change in inventories comprises both the increase in inventories for continuing operations required to service the high level of orders and the reduction resulting from the sale of DEUTZ Power Systems.

The carrying amount of inventories at 31 December 2007, written down to net realisable value, was €42.4 million (2006: €38.2 million).

The following table shows the impairment of inventories:

	2007	2006
€ million		
Balance at 1 January	**58.9**	**53.4**
Changes	–40.4	+5.5
Balance at 31 December	**18.5**	**58.9**

The reduction of impairment relates, primarily, to the sale of DEUTZ Power Systems.

19. NON-CURRENT ASSETS HELD FOR SALE

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

The land and buildings of the Deutz-Mülheim special-purpose entity are assigned to the Compact Engines segment.

20. RECEIVABLES AND OTHER ASSETS (EXCLUDING TAXES)

	31 Dec. 2007	31 Dec. 2006
€ million		
Trade receivables[1)]	194.1	234.8
Less adjustments	–5.3	–12.8
Trade receivables (net)	**188.8**	**222.0**
Other receivables and assets		
Receivables from investments[1)]	6.7	5.8
thereof trade receivables	(5.1)	(4.2)
thereof other receivables	(1.6)	(1.6)
Advances paid on property, plant and equipment and inventories	14.0	8.9
Derivative financial instruments[2)]	7.2	6.0
Sundry other receivables[3)]	60.4	54.1
Receivables arising from other taxes	9.4	6.7
Prepaid expenses	4.5	2.4
Total	**102.2**	**83.9**

As at 31 December 2007, the volume of receivables sold under factoring agreements was around €95 million (2006: €119 million).

Adjustments to trade receivables were as follows:

	2007	2006
€ million		
Balance at 1 January	**12.8**	**11.9**
Change in basis of consolidation	–7.1	–
Amounts added	1.6	4.4
Consumption	–1.6	–1.7
Amounts reversed	–0.4	–1.8
Balance at 31 December	**5.3**	**12.8**

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

The DEUTZ Group is exposed to a credit risk with respect to its operating activities and its outstanding accounts. Appropriate write-downs are applied to account for identifiable risks of this type. The maximum credit risk theoretically possible corresponds to the carrying amount in each case.

In the reporting period, total write-downs of €20.9 million (2006: €18.9 million) were applied to receivables due from investments.

Re [1)] Measured at amortised cost.

Re [2)] The derivative financial instruments essentially consist of foreign-currency derivatives embedded in purchase agreements.

Re [3)] Sundry other receivables include unavailable deposits of €19.5 million from the disposal of DEUTZ Power Systems. These are used for trade tax expenses incurred in connection with the disposal.

21. CASH AND CASH EQUIVALENTS

This item comprises cash on hand and credit balances held with banks. As a result of the disposal of DEUTZ Power Systems, cash and cash equivalents increased by €261.7 million to €311.1 million.

22. EQUITY

Summary

	2007	2006
€ million		
Issued capital	307.0	292.3
Additional paid-in capital	28.1	24.1
Other reserves	–5.3	–1.8
Retained earnings	79.1	0.4
Accumulated income	148.2	43.5
Equity attributable to the shareholders of the parent enterprise	**557.1**	**358.5**
Total	**557.1**	**358.5**

Issued capital

At the end of 2007, the issued capital (share capital) of DEUTZ AG amounted to €306,992,504.46 (2006: €292,270,841.53) and was divided into 120,085,030 no-par-value bearer shares (2006: 114,326,416).

In 2007, 5,758,434 (2006: 9,339,625) convertible bonds and 18 (2006: 998,317) profit-sharing rights were converted into a total of 5,758,614 (2006: 19,322,795) no-par-value shares in DEUTZ AG.

Disclosures under the German Securities Trading Act (WpHG)

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

AB Volvo (publ), SE-40508 Gothenburg, Sweden, notified pursuant to sections 21 (1) and 24 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 thresholds of 5 per cent and 10 per cent on 21 November 2003; on 21 November 2003, this share amounted to 14.47 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 21 November 2003 also exceeded the thresholds of 5 per cent and 10 per cent; on 21 November 2003, this share amounted to 14.47 per cent and is now 38.88 per cent.

We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you, pursuant to sections 21 et seq. 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, each at V. le Cassani, 14, 24047 Treviglio (BG), Italy, and
(iii) INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, on 21 November 2003 exceeded the thresholds of 5 per cent and 10 per cent, with the share on 21 November 2003 amounting to 14.47 per cent; the share is now 38.88 per cent. These voting rights are fully attributable to the companies and natural persons specified under (i) to (iii) above pursuant to section 22 (1) sentence 1 number 1, and section 22 (3) WpHG."

In a further 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 sections 21 et seq. WpHG, in our own name and in the name of, and on the behalf of, the company and natural persons 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, each at 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 in DEUTZ AG on 2 July 2004, with the share on 2 July 2004 amounting to 29.90 per cent and now standing at 38.88 per cent. These voting rights are fully attributable to the companies and natural persons specified under (i) to (iii) above pursuant to section 22 (1) sentence 1 number 1, and section 22 (3) 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 sections 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 sections 21 et seq. WpHG:

"We, Belfort S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you, pursuant to sections 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."

The parent company (DEUTZ AG) received no further notifications concerning the above shareholdings in 2007.

In 2007, the parent company (DEUTZ AG) received the following further new notifications.

JPMorgan Chase & Co., 270 Park Avenue, New York, NY 10017, USA, notified, pursuant to section 21 (1) WpHG, that the share of voting rights held by JPMorgan Chase & Co. in DEUTZ AG on 27 February 2007, exceeded the threshold of 3 per cent and now amounts to 3.02 per cent. The voting rights are attributable to JPMorgan Asset Management Holdings Inc. pursuant to section 22 (1) sentence 1 numbers 1 and 6 in conjunction with sentence 2 WpHG.

JPMorgan Asset Management Holding Inc., 270 Park Avenue, New York, NY 10017, USA, notified, pursuant to section 21 (1) WpHG, that the share of voting rights held by JPMorgan Asset Management Holding Inc. in DEUTZ AG on 27 February 2007, exceeded the threshold of 3.00 per cent and now amounts to 3.00 per cent. These voting rights are attributable to JPMorgan Asset Management Holdings Inc. pursuant to section 22 (1) sentence 1 numbers 1 and 6 in conjunction with sentence 2 WpHG.

JPMorgan, 270 Park Avenue, New York, NY 10017, USA, notified, pursuant to section 21 (1) WpHG, that the share of voting rights held by JPMorgan Chase & Co in DEUTZ AG on 19 April 2007, fell below the threshold of 3 per cent and amounts to 2.92 per cent. These voting rights are attributable to JPMorgan Asset Management Holdings Inc. pursuant to section 22 (1) sentence 1 numbers 1 to 6 in conjunction with sentence 2 WpHG.

JPMorgan Asset Management Holding Inc., 270 Park Avenue, New York, NY 10017, USA, notified, pursuant to section 21 (1) WpHG, that the share of voting rights held by JPMorgan Asset Management Holding Inc. in DEUTZ AG fell below the threshold of 3 per cent on 19 April 2007, and now amounts to 2.90 per cent. These voting rights are attributable to JPMorgan Asset Management Holdings Inc. pursuant to section 22 (1) sentence 1 numbers 1 and 6 WpHG in conjunction with sentence 2.

Fidelity Investments International Limited, Kingswood Fields, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RB, UK, notified the following in its letter dated 14 May 2007, pursuant to sections 21 (1) and 22 (1) WpHG: Pursuant to section 21 (1) of the German Securities Trading Act (WpHG), we hereby notify you that the share of voting rights held by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, in DEUTZ AG fell below the 5 per cent threshold on 11 May 2007, and now amounts to 4.93 per cent. This share of the voting rights was attributable to Fidelity Management & Research Company pursuant to section 22 (1) number 2 in conjunction with section 22 (1) sentence 2 in conjunction with section 22 (1) sentence 1 number 6 WpHG."

In a letter dated 14 May 2007, Fidelity International Limited, Kingswood Fields, Millfield Lane, Lower Kingswood, Tadworth, Surrey KT20 6RB, UK, corrected its notification of 14 May 2007 as follows:

"Pursuant to section 21 (1) of the German Securities Trading Act (WpHG), we hereby notify you that the share of the voting rights held by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, in DEUTZ AG exceeded the threshold of 5 per cent on 4 May 2007, and now amounts to 5.05 per cent. This share of the voting rights was attributable to Fidelity Management & Research Company pursuant to section 22 (1) number 2 in conjunction with section 22 (1) sentence 2 in conjunction with section 22 (1) sentence 1 number 6 WpHG."

In a letter dated 17 July 2007, Fidelity International Limited, Kingswood Fields, Millfield Lane, Lower Kingswood, Tadworth, Surrey KT20 6RB, UK, notified the following pursuant to sections 21 (1) and 22 (1) WpHG:

"Pursuant to section 21 (1) of the German Securities Trading Act (WpHG), we hereby notify you that the share of the voting rights held by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, in DEUTZ AG fell below the threshold of 3 per cent on 16 July 2007, and now amounts to 2.98 per cent. This share of the voting rights was attributable to Fidelity Management & Research Company pursuant to section 22 (1) number 2 in conjunction with section 22 (1) sentence 2 in conjunction with section 22 (1) sentence 1 number 6 WpHG."

In a letter dated 25 July 2007, Fidelity International Limited, Kingswood Fields, Millfield Lane, Lower Kingswood, Tadworth, Surrey KT20 6RB, UK, corrected its notification of 17 July 2007 as follows:

"Pursuant to section 21 (1) of the German Securities Trading Act (WpHG), we hereby notify you that the share of the voting rights held by FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, in DEUTZ AG fell below the threshold of 3 per cent on 16 July 2007, and now amounts to 2.92 per cent. This share of the voting rights was attributable to Fidelity Management & Research Company pursuant to section 22 (1) number 2 in conjunction with section 22 (1) sentence 2 in conjunction with section 22 (1) sentence 1 number 6 WpHG."

Authorised capital

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

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

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

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

Conditional capital

Convertible profit-sharing rights The Annual General Meeting voted on 29 June 1995, to increase the Company's conditional share capital by DM 50,000,000, by issuing 10,000,000 bearer shares with a par value of DM 5. The increase in conditional capital was to be used to grant conversion rights to the holders of profit-sharing rights issued by the Company at the end of August 1995.

The conditional capital will only be increased to the extent that the holders of profit-sharing rights utilise their conversion rights.

Convertible bonds The Annual General Meeting voted on 28 June 2001, to increase the Company's conditional share capital by up to €16,600,000. The conditional capital will only be increased to the extent that

a) the holders or creditors of conversion rights or warrants attached to the convertible bonds or bonds with warrants issued by DEUTZ AG, or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding, on or before 27 June 2006, utilise their conversion rights or option rights, or
b) the holders or creditors of the convertible bonds issued on or before 27 June 2006 by DEUTZ AG, or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding who are obliged to exercise their conversion rights, fulfil their conversion obligations.

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

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

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

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

Additional paid-in capital

The additional paid-in capital contains premiums and contributions from shareholders as well as the equity component of compound financial instruments, such as non-interest-bearing profit-sharing rights and low-interest-bearing convertible bonds.

Retained earnings

Retained earnings contains the statutory reserve of DEUTZ AG of €4.5 million plus an addition to other retained earnings of €74.6 million.

Other reserves

Currency translation Translation differences arising from the translation of equity at historical rates and the translation of the net income or loss at average rates for the year are reported under accumulated other comprehensive income/loss. In 2007, a loss of €6.6 million (2006: loss of €5.7 million) was reported. The cumulative loss from exchange differences recognised in other reserves amounted to €9.4 million at the end of 2007 (2006: €2.8 million).

Fair value reserve The reserve for cash flow hedges and the revaluation reserve are both reported in the fair value reserve in the statement of changes in equity.

The net gains or losses on the effective portion of the changes in the fair value of derivative financial instruments designated as cash flow hedges are added to the reserve for cash flow hedges. A total of €3.5 million was added in 2007 (2006: €1.9 million). Cumulative gains from cash flow hedges totalling €4.1 million (2006: 1.0 million) were recognised in reserves at the end of 2007.

In 2007, there was no hedging ineffectiveness requiring reclassification from the reserve for cash flow hedges to income.

The cumulative gain or loss on cash flow hedges allocated to reserves is reclassified to the income statement if the hedged transaction also affects the net income. In 2007, gains of €1.2 million, before taking deferred taxes into account, were reclassified to other operating income on the face of the income statement.

There were no reserves from the remeasurement of financial instruments in the available-for-sale category at the end of 2007 (2006: €0.4 million).

In 2007, gains of €0.9 million, before taking deferred taxes into account, were reclassified to other operating income on the face of the income statement.

Net income

The following table gives a breakdown of the net income:

	2007	2006
€ million		
EBIT from continuing activities	**95.5**	**66.6**
Interest expenses, net	–18.1	–19.2
Other taxes	–1.3	–1.5
Income before income taxes on continuing operations	**76.1**	**45.9**
Income taxes	–16.7	–7.4
Net income on continuing operations	**59.4**	**38.5**
Net income on discontinued operations	**123.9**	**23.0**
Net income	**183.3**	**61.5**
thereof minority interest	–	–
thereof attributable to the shareholders of the parent enterprise	183.3	61.5

Dividend proposal

The Management Board and the Supervisory Board propose to the Annual General Meeting the distribution of a dividend of €0.20 per share for 2007, from the accumulated income of DEUTZ AG calculated in accordance with the principles of the German Commercial Code. The Management Board is also proposing payment of a further special dividend, also of €0.20 per share, from the gain on the disposal of DEUTZ Power Systems. The Management Board is, therefore, proposing a total dividend of €0.40 per share. On this basis, an amount of €48.0 million will be distributed from the accumulated income for 2007.

23. PROVISIONS (CURRENT AND NON-CURRENT)

Summary

	31 Dec. 2007	31 Dec. 2006
€ million		
Provisions for pensions and other post-retirement benefits	193.4	297.7
Deferred tax provisions	–	0.5
Provision for current income taxes	11.3	6.5
Other provisions	110.2	96.7
Total	**314.9**	**401.4**

Provisions for pensions and other post-retirement benefits

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

1) Defined-contribution plans

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

The employer's contribution to the German statutory pension insurance scheme in 2007 came to €17.3 million (2006: €14.9 million). In addition, a further €1.9 million (2006: €1.9 million) were passed on to pension insurers under employees' direct retirement insurance agreements as contributions from their salary.

2) Defined-benefit plans

Defined benefit obligation for pensions and other post-retirement benefits

	31 Dec. 2007	31 Dec. 2006
€ million		
Unfunded	195.5	319.1
Funded	17.1	18.5
Total	**212.6**	**337.6**

The pension obligations of DEUTZ AG and its German subsidiaries are measured under the projected unit credit method, as required by IAS 19, and take account of future salary and pension increases, as well as adjustments to other benefits.

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

The measurement of pension obligations is based on actuaries' reports using the following actuarial assumptions:

Actuarial assumptions: Germany

	2007	2006
in %		
Discount rate	5.41	4.58
Anticipated return on plan assets	n. a.	n. a.
Rate of pension increase – pensions of the Essener Verband pension association	1.5	1.5
Rate of pension increase – other pensions	2.0	1.5
Rate of salary increase	n. a.	n. a.

Outside Germany

	2007			2006		
in %	USA	UK	Weighted	USA	UK	Weighted
Discount rate	6.75	5.7	5.79	8.5	5.1	5.4
Anticipated return on plan assets	n. a.	5.75	5.75	n. a.	5.5	5.5
Rate of salary increase	4.0	2.75	2.85	4.0	4.1	4.1
Rate of pension increase	3.0	3.25	3.23	3.0	2.5	2.54

The following table shows the reconciliation of the defined benefit obligation and plan financing analysis to the carrying amount of provisions:

Reconciliation of the defined benefit obligation

	31 Dec. 2007	31 Dec. 2006
€ million		
Defined benefit obligation for pensions and other post-employment benefits	212.6	337.6
External fair value plan assets	–13.7	–14.3
Actuarial gain (+)/loss (–)	–5.5	–25.6
Pension provisions reported on the face of the balance sheet	**193.4**	**297.7**

The following table shows the reconciliation of the defined benefit obligation:

	2007	2006
€ million		
DBO at 1 January	**337.6**	**355.6**
Change in the basis of consolidation	–6.2	n.a.
Service cost	0.3	0.7
Employee contributions	0.4	0.2
Interest	12.1	14.1
Unrecognised past service cost	n.a.	–1.3
Gain (–)/loss (+)	–28.8	–6.1
Exchange differences	–1.6	0.3
Pensions paid	–21.4	–25.9
Reclassifications	n.a.	n.a.
Compensation for vested company pension rights	–79.8	n.a.
DBO at 31 December	**212.6**	**337.6**

In 2007, DEUTZ AG offered – where permitted by law – to pay compensation to its pensioners and those with pension entitlements in the form of a one-off payment for their vested company pension rights. A total amount of €79.8 million was paid out.

The new actuarial gains were mainly the result of the one-off settlement of vested company pension rights and of the change in discount rate in the German plans.

Change in plan assets

	2007	2006
€ million		
Market value of the plan assets at the beginning of the financial year	14.3	13.0
Anticipated return on plan assets	0.8	0.7
Gains (+)/losses (–) on plan assets	–0.1	0.3
Exchange differences	–1.2	0.3
Employer contributions	0.3	0.4
Employee contributions	0.1	0.2
Pensions paid from plan assets	–0.5	–0.6
External fair value plan assets	**13.7**	**14.3**

Total pension obligation expenses after utilisation of provisions were broken down as follows:

	2007	2006
€ million		
Service cost	0.3	0.7
Interest cost	12.1	14.1
Anticipated return on plan assets	–0.8	–0.7
Amortisation of actuarial gains/losses	–	–
Amortisation of unrecognised past service cost	–	–1.3
Total	**11.6**	**12.8**

Interest cost and return on plan assets are reported under interest expenses, net. The actual return on plan assets in 2007 amounted to €0.6 million (2006: €1.0 million).

Plan assets breakdown

	2007	2006
in %		
Shares	59	61
Debt instruments	40	38
Other assets	1	1

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

Funding status and adjustments based on past experience

	2007	2006	2005
€ million			
Defined benefit obligation for pensions and other post-employment benefits	212.6	337.6	355.6
External fair value plan assets	–13.7	–14.3	–13.0
Plan funding surplus/shortfall	198.9	323.3	342.6
Gains/losses based on historical experience			
from obligations	1.1	6.4	–0.1
from plan assets	–0.1	0.3	1.3

Other provisions

The following table gives a breakdown of other provisions:

	31 Dec. 2007			31 Dec. 2006		
€ million	Total	With a residual term of up to one year	With a residual term of more than one year	Total	With a residual term of up to one year	With a residual term of more than one year
Warranties	18.8	10.2	8.6	23.5	13.2	10.3
Imminent losses on pending transactions	11.8	4.6	7.2	5.4	3.5	1.9
Personnel	28.7	5.8	22.9	29.4	7.5	21.9
Restructuring	–	–	–	3.3	3.3	–
Other	50.9	43.1	7.8	35.1	17.2	17.9
Total	**110.2**	**63.7**	**46.5**	**96.7**	**44.7**	**52.0**

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

Other provisions cover all identifiable risks and other contingent liabilities. The main items covered are the cost of warranties and potential risks, discounts and price reductions, contractual risks, onerous contracts and provisions for obligations to employees, such as pre-retirement part-time working, early retirement and collective pay agreements. The provisions also cover commitments relating to the disposal of the DEUTZ Power Systems segment. Restructuring provisions are only recognised to cover the costs directly attributable to the restructuring.

The following table shows the changes to other provisions in 2007:

	Warranties	**Imminent losses on pending transactions**	**Obligations to personnel**	**Restructuring**	**Other**	**Total**
€ million						
1 Jan. 2007	**23.5**	**5.4**	**29.4**	**3.3**	**35.1**	**96.7**
Amounts added	4.0	6.2	10.6	–	51.2	72.0
Exchange differences	−0.1	–	−0.1	–	−0.4	−0.6
Amounts utilised	−1.4	−1.2	−4.2	−1.5	−5.8	−14.1
Amounts reversed	−0.1	−0.3	–	−0.3	−7.9	−8.6
Changes in the basis of consolidation	−6.6	1.7	−7.0	−1.5	−21.6	−35.0
Accrued interest/ effect of changes in interest rates	−0.2	–	–	–	–	−0.2
Reclassifications	−0.3	–	–	–	0.3	–
31 Dec. 2007	**18.8**	**11.8**	**28.7**	**–**	**50.9**	**110.2**

Provisions for taxes

Provisions for taxes are discussed under Note 17.

24. FINANCIAL LIABILITIES, TRADE PAYABLES AND OTHER LIABILITIES

Summary

€ million	31 Dec. 2007				31 Dec. 2006			
	Total	With a residual term of up to 1 year	With a residual term of 1–5 years	With a residual term of more than 5 years	Total	With a residual term of up to 1 year	With a residual term of 1–5 years	With a residual term of more than 5 years
Financial liabilities								
Profit-sharing rights	–[1]		–	–	–		–	–
Convertible bonds	2.7	2.7	–	–	20.8		20.8	
Bond (USPP)	190.1	–	39.3	150.8	–	–	–	–
Liabilities to banks	28.5	5.2	18.9	4.4	60.2	13.8	41.0	5.4
Liabilities under finance leases	0.1	0.1	–	–	2.4	0.1	0.5	1.8
Total	**221.4**	**8.0**	**58.2**	**155.2**	**83.4**	**13.9**	**62.3**	**7.2**
Trade payables	**206.1**	**206.1**	**–**	**–**	**236.4**	**236.4**	**–**	**–**
Other liabilities	**79.1**	**69.1**	**10.0**	**–**	**83.2**	**80.4**	**2.8**	**–**
Total	**506.6**	**283.2**	**68.2**	**155.2**	**403.0**	**330.7**	**65.1**	**7.2**

[1] €30 thousand

Profit-sharing rights

The Annual General Meeting on 29 June 1995 voted to authorise the Management Board, with the consent of the Supervisory Board, to issue registered profit-sharing rights with transfer restrictions with a total par value of up to DM 50,000,000, on or before 31 December 1996.

In August 1995, the Management Board decided, with the consent of the Supervisory Board, to utilise this authorisation and to issue profit-sharing rights with a total par value of DM 50,000,000. The 1,000,000 registered profit-sharing rights with transfer restrictions were issued in the ratio of one for 59 against cash contributions at the issue price of DM 100 for each profit-sharing right with a par value of DM 50.

The profit-sharing rights entitle the holder to an annual dividend payment equal to the dividend paid on shares of the same par value, and to a share of the liquidation proceeds up to the amount of the issue price. If the profit-sharing rights fall due for repayment before this date, only the par value is paid. The holder does not participate in any losses.

The profit-sharing rights do not entitle the holder to attend the Company's Annual General Meeting nor to any voting rights, options on new shares or new profit-sharing rights.

The company or the holders of profit-sharing rights can terminate the profit-sharing rights with effect from the day after any Annual General Meeting by giving six months' notice; however, the earliest effective termination date is the day after the Annual General Meeting at which the annual financial statements for the financial year ending on 31 December 2006 are presented.

In accordance with Article 7 (1) of the terms & conditions governing its profit-sharing rights, DEUTZ Aktiengesellschaft gave due notice of cancellation of the convertible profit-sharing rights it had previously issued with effect from midnight on the day immediately following the Annual General Meeting at which the adopted annual financial statements for the period ended 31 December 2007 are presented. The announcement of the routine termination of profit-sharing rights was published in the electronic Federal Gazette on 19 November 2007.

The profit-sharing rights can be exchanged for shares of DEUTZ AG in the ratio of one to ten. In 2007, 18 profit-sharing rights were converted into 180 no-par-value shares in DEUTZ AG.

The benefit accruing from the non-interest-bearing nature of profit-sharing rights has been allocated as an equity instrument to additional paid-in capital. Interest is accrued on the debt capital portion of profit-sharing rights at the historical market rate of 9 per cent under the effective interest method. The profit-sharing rights outstanding at the end of 2007 totalled €30 thousand (2006: €31 thousand).

Convertible bonds

In July 2004, the Board of Management of DEUTZ AG issued a convertible bond for €67.3 million with the consent of the Supervisory Board. This convertible bond pays an annual coupon of 3.95 per cent on its par value of €3.40, has a maturity of five years and falls due for repayment on 22 July 2009. The subscription price was €3.40. Each bond can be converted into one no-par-value share of DEUTZ AG and the bondholder can exercise the conversion right at any time on or before 10 July 2009.

The capital market interest rate appropriate to the bond's maturity and risk profile was found to be 6.5 per cent at the date of issue on 22 July 2004. The difference between this comparable capital market interest rate and the bond's coupon constitutes the value of the conversion right. This value of €7.2 million – minus the transaction costs payable on the equity component (€0.3 million) – was allocated to additional paid-in capital at the date of issue. The liability resulted from the bond's par value recognised at the date of issue, minus the value of the conversion right allocated to additional paid-in capital and the transaction costs payable on the debt capital portion (€1.6 million). Interest is accrued on the repayment amount over the bond's maturity under the effective interest method and recognised in income.

A total of 5,758,434 of these bonds were converted into shares in 2007.

The convertible bond incurred the following interest expense and similar charges:

	2007	**2006**
€ million		
Coupon	0.5	1.4
Accrued interest	0.4	1.0
Total	**0.9**	**2.4**

The Management Board of DEUTZ AG, Cologne, with the consent of the Supervisory Board, cancelled the convertible bond issued in 2004 on 6 February 2008, with effect from 7 March 2008. At 31 December 2007, 839,263 convertible bonds were still outstanding, which equates to 4.2 per cent of the original issue volume. On redemption, bondholders will receive the par value of €3.40 plus accrued interest. Until 3 March 2008, however, bondholders had the option of converting each bond into one DEUTZ share. Of the outstanding 839,263 bonds, 729,321 had been converted into DEUTZ shares by 29 February 2008.

Bonds (US private placement)

DEUTZ AG issued bonds worth US$ 274 million (€203 million) as part of a private placement in the United States, and recognised them at cost in accordance with IAS 39. 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$ (US$ 216.1 million) hedged in euros. The bonds carry maturities of five, seven and ten years and have coupons of between 5.22 and 6.08 per cent.

Liabilities to banks, payables due to subsidiaries and associates, and liabilities under finance leases

The following table shows the effective interest rates paid on current liabilities to banks in each currency:

	2007	2006
in %	€	€
Short-term interest rate	5.59	4.47
Long-term interest rate (up to five years)	5.64	4.71
Long-term interest rate (over five years)	5.86	4.71

The fair value of financial liabilities is explained in section 25 “Financial instruments and financial risk management”.

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

Exchange differences	2007	2006
€ million		
€	74.3	83.4
US$	147.1	–
Total	**221.4**	**83.4**

Liabilities under finance leases

There are no liabilities under finance leases in 2007, following the deconsolidation of Ad. Strüver KG (GmbH & Co.), Hamburg.

Trade payables and other liabilities

	31 Dec. 2007	31 Dec. 2006
€ million		
Trade payables	**206.1**	**236.4**
Other liabilities		
Derivatives	8.7	–
Liabilities to investments	4.9	4.7
Liabilities arising from other taxes	1.4	5.2
Personnel-related liabilities	13.8	17.1
Sales and marketing liabilities	25.5	30.0
Advances received	2.2	12.3
Other liabilities and deferred income	22.6	13.9
Total	**79.1**	**83.2**

Personnel-related liabilities include social insurance premiums and outstanding annual holiday entitlements. Other liabilities include accruals of €39.6 million (2006: €47.3 million).

25. ADDITIONAL NOTES ON FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

This section provides additional information on financial instruments pursuant to IFRS 7 and financial risk management.

The following table provides a breakdown of all categories of financial assets and liabilities.

	31 Dec. 2007					
	At amortised cost			At fair value		
Balance sheet item (= category)	Cash and cash equivalents	Loans and receivables	Available-for-sale financial assets (at cost)	Available-for-sale financial assets	Hedging derivatives pursuant to IAS 39	Held-for-trading financial assets
€ million						
Assets						
Non-current financial assets	–	1.3	5.8	1.4	–	–
Current financial assets	311.1	264.6	–	–	1.4	5.8
Trade receivables	–	188.8	–	–	–	–
Other receivables and assets	–	75.8	–	–	1.4	5.8
Cash and cash equivalents	311.1	–	–	–	–	–
	31 Dec. 2006					
Non-current financial assets	–	3.4	5.9	1.5	0.6	–
Current financial assets	49.4	285.4	–	–	0.8	5.2
Trade receivables	–	222.0	–	–	–	–
Other receivables and assets	–	63.4	–	–	0.8	5.2
Cash and cash equivalents	49.4	–	–	–	–	–

Balance sheet item (= category)	At amortised cost	At fair value		
	Financial liabilities	Hedging derivatives pursuant to IAS 39	Held-for-trading financial liabilities	Liabilities under finance lease
€ million	**31 Dec. 2007**			
Equity and liabilities				
Non-current financial liabilities	218.0	7.9	–	0.1
Financial liabilities	215.9	–	–	0.1
Other liabilities	2.1	7.9	–	–
Current financial liabilities	273.0	–	0.8	–
Financial liabilities	5.4	–	–	–
Trade payables	206.1	–	–	–
Other liabilities	61.5	–	0.8	–
	31 Dec. 2006			
Non-current financial liabilities	72.8	–	–	2.3
Financial liabilities	70.0	–	–	2.3
Other liabilities	2.8	–	–	–
Current financial liabilities	309.1	–	–	–
Financial liabilities	13.8	–	–	0.1
Trade payables	236.4	–	–	–
Other liabilities	58.9	–	–	–

Financial risk management

The financial risk management systems used by the DEUTZ Group are explained below.

Financial risk factors

Owing to its global business operations, the DEUTZ Group is exposed to various financial risks that can arise from adverse movements and trends in the international interest rate, foreign exchange, sales and procurement markets. The overarching risk management strategy used is designed to mitigate potentially negative effects on the DEUTZ Group's financial position. In order to manage financial risk, financial planning is carried out annually with monthly analysis of variances during the course of the year.

DEUTZ works with leading banks to ensure the availability of loan financing. The Group has sufficient credit lines and, following a US private placement of US$ 275 million with maturity tranches of five, seven and ten years, a secure source of long-term borrowing. The US$ liabilities for interest and capital repayment are hedged in euros by means of cross-currency swaps, eliminating any exchange-rate risk for DEUTZ.

The head office Treasury department manages the lines of credit in accordance with the Group's financing principles. If required, these lines of credit are made available to subsidiaries and secured by guarantees from DEUTZ AG.

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

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

Liquidity risk

Prudent liquidity management includes holding a sufficient reserve of cash and cash equivalents, the possibility to obtain funding through an adequate amount of bank loans and the ability to issue short- and long-term capital market instruments. Because the business environment in which the DEUTZ Group operates is constantly changing, the Treasury department aims to maintain the necessary degree of flexibility in its funding at all times by ensuring that it has sufficient unused credit lines at its disposal. The high level of liquidity resulting from the sale of DEUTZ Power Systems, combined with the borrowing capacity of DEUTZ over and above the existing credit lines, gives the Group substantial latitude for major capital expenditure.

The following table provides an overview of the contractually agreed, undiscounted, gross payments of interest and capital in connection with financial liabilities.

Liquidity analysis

	31 Dec. 2007			
€ million	2008 cash outflow	2009–2012 cash outflow	Post-2012 cash outflow	Total
Primary financial instruments	–295.8	–106.6	–199.7	–602.0
Derivative financial instruments	–1.6	–0.2	–11.1	–12.9
Currency derivatives				
thereof fulfilled gross: payments	–15.1	–	–	–15.1
thereof fulfilled gross: receipts	14.3	–	–	14.3
Interest rate derivatives				
Presentation of net cash flows	0.3	–0.1	–11.1	–10.9
Commodity derivatives				
Presentation of net cash flows	1.0	–0.1	–	–1.1
	31 Dec. 2006			
€ million	2007 cash outflow	2008–2011 cash outflow	Post-2011 cash outflow	Total
Primary financial instruments	–332.2	–27.2	–7.2	–366.7
Derivative financial instruments	–0.1	–	–	–0.1
Currency derivatives				
thereof fulfilled gross: payments	–4.8	–	–	–4.8
thereof fulfilled gross: receipts	4.7	–	–	4.7

Credit risk

There are no significant concentrations of potential credit risk in the DEUTZ Group. The risk from bad debts is restricted by constant monitoring and regular analysis of receivables and their breakdown. Receivables are, to a large extent, covered by credit insurance. Further measures, such as guarantees and creditworthiness checks, are used to protect against credit risk. The Group has also put in place procedures and guidelines to ensure that products and services are only sold to customers who have a satisfactory payment record. Appropriate write-downs are applied to allow for the credit risk attaching to financial assets.

Agreements on derivative financial instruments and financial transactions are only concluded with financial institutions of impeccable credit standing. They are reported at net values on the face of the balance sheet.

The following table provides an overview of written-down receivables and of the age structure of overdue receivables that have not been written down. The table does not include cash and cash equivalents of €311.1 million (2006: €49.4 million), held only with banks of impeccable credit standing, or available-for-sale financial assets of €1.4 million (2006: €1.5 million).

Balance sheet item (category)

			thereof written down at the balance sheet date		thereof overdue at the balance sheet date but not written down			
	Carrying amount	thereof neither overdue nor written down at the balance sheet date	Gross amount before write-down	Write-down	up to 90 days	91 to 180 days	181 to 360 days	more than 360 days
€ thousand								
31 Dec. 2007								
Non-current financial assets	1,307	1,255	848	–795	–	–	–	–
Current financial assets	291,030	251,445	35,488	–26,158	27,349	1,857	411	639
Trade receivables	188,776	155,892	7,956	–5,327	27,349	1,857	411	639
Other receivables and assets	102,254	95,553	27,532	–20,831	–	–	–	–
31 Dec. 2006[1)]								
Non-current financial assets	1,312	1,072	6,636	–6,395	–	–	–	–
Current financial assets	208,461	176,085	30,749	–24,082	23,155	1,590	141	823
Trade receivables	131,702	103,558	7,816	–5,381	23,155	1,590	141	823
Other receivables and assets	76,759	72,527	22,933	–18,701	–	–	–	–

[1)] Prior-year figures apply to continuing operations only.

Write-downs are charged directly to the relevant balance sheet items. Financial assets are recognised on the settlement date. Derivative financial instruments are recognised on the trade date.

Trade receivables relate, primarily, to DEUTZ AG and are insured with EULER HERMES Kreditversicherungs-AG. DEUTZ AG has an obligation to the trade credit insurance association (WKV) or, where applicable, the German government's export credit guarantee scheme (APG) to meet defaults on the receivables unless they are secured against letters of credit confirmed by a bank. DEUTZ does not produce any standardised credit rating for its customers itself, but sets the maximum customer exposure in accordance with the level of cover provided by the credit insurance agency. In addition, guarantees of €0.8 million (2006: €0.6 million) have been provided for foreign trade receivables. In 2007, no guarantees were provided for overdue or written-down foreign trade receivables (2006: €0.2 million). New terms were negotiated for €1.6 million (2006: €0) of overdue receivables.

Exchange-rate risk

Exchange-rate risks are monitored under a centralised currency management system and reduced by the use of hedging transactions. DEUTZ is also taking specific action to increase the volume of purchasing in US$; this enables the Company to counteract exchange-rate risks from sales invoiced in US$ by way of "natural hedging".

Risks arising from the translation of financial statements of subsidiaries drawn up in currencies other than the euro are not hedged.

Market risk

The DEUTZ Group operates internationally and, consequently, is exposed to currency risk arising from exchange rate movements in various foreign currencies, principally the US$.

The Group's Finance Department uses futures contracts, options and option combinations to hedge currency risks emanating from the net position on forecast transactions and recognised assets, and liabilities in any foreign currency.

Between 50 per cent and 70 per cent of the net positions budgeted for the following year are usually hedged, as are 100 per cent of project-based firm commitments.

Currency sensitivity analysis

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

The following table illustrates the sensitivity – from a Group perspective – to a 10 per cent rise or fall in the euro against each of the above currencies. The sensitivity analysis only takes into account outstanding monetary positions denominated in foreign currency and adjusts the translation of those amounts as at the year end, in line with a 10 per cent change in the respective exchange rates.

The amounts below show the impact on net income and on equity if the euro rises by 10 per cent against the respective currency. A 10 per cent fall in the euro relative to the respective currency would have an approximately equal but opposite impact on net income and equity.

€ million	2007			
Exchange differences	**Notional amounts**	**Net income**	**Notional amounts**	**Equity**
US$	64.18	0.49	23.82	2.17
AUD	2.23	0.53	4.18	0.37
GBP	9.88	–1.76	10.21	–0.93
	2006			
US$	119.73	4.79	55.73	3.31
AUD	3.79	–0.38	–4.79	0.44
GBP	9.41	–0.94	–	–

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

Interest rate sensitivity analysis

The sensitivity analyses shown below are based on interest rate risk exposures of derivative and non-derivative instruments at the balance sheet date. Due to the high level of liquidity at the end of 2007, an increase in the interest rate would have a positive effect on net income and also a positive effect on equity via the interest rate derivatives recognised under hedge accounting rules.

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

- net income for the financial year ended 31 December 2007 would have risen by €2.21 million (2006: decrease of €0.4 million) and
- Group equity would have risen by €10.6 million (2006: increase of €0.7 million).

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

Commodities sensitivity

DEUTZ hedges part of its commodities risk by way of an aluminium swap agreement. A 10 per cent change in the price of aluminium (expressed in US$, assuming a constant US$/EUR exchange rate), would have a €590 thousand impact on the derivative transaction.

Fair value of financial instruments

The following table provides a comparison of the carrying amounts and fair values of financial instruments in the various categories:

	31 Dec. 2007		31 Dec. 2006	
€ million	Carrying amount	Fair value	Carrying amount	Fair value
Loans and receivables	**576.956**	**576.956**	**338.150**	**338.150**
Non-current financial assets	1.307	1.307	3.407	3.407
Loans to other affiliated companies				
Other loans	1.307	1.307	3.407	3.407
Current financial assets	575.649	575.649	334.743	334.743
Trade receivables	188.776	188.776	221.982	221.982
Other receivables and assets	75.820	75.820	63.401	63.401
Cash and cash equivalents	311.053	311.053	49.360	49.360
Financial liabilities	**488.963**	**495.242**	**378.748**	**379.937**
Non-current financial liabilities	220.700	226.979	76.989	78.178
Liabilities to banks	27.843	27.832	53.769	53.738
US private placement, bonds and profit-sharing rights	192.775	199.065	20.831	22.051
Finance lease and other liabilities	0.082	0.082	2.389	2.389
Current financial liabilities	268.263	268.263	301.759	301.759
Financial liabilities	0.610	0.610	6.415	6.415
Trade payables	206.104	206.104	236.445	236.445
Other liabilities	61.549	61.549	58.899	58.899

The swap curve was used to ascertain the fair value of euro-denominated loans. The US Treasury curve was used for measurement of the US$-denominated loans. The relevant spread was added in each case.

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

Non-current trade payables and receivables are discounted to their present value; consequently their carrying amounts are also essentially identical to the fair values.

In the case of other financial assets and liabilities, either market prices were used or the fair value was ascertained using the discounted cash flow method. The measurement model was based on the interest rate curves and exchange rates prevailing on the balance sheet date. Bank measurements were used, where available.

Net income from financial instruments

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

	Loans and receivables	Held-for-trading financial assets	Financial liabilities at amortised cost	Held-for-trading financial liabilities
	2007			
€ million				
Currency gains/losses	–2.5	0.7	1.2	–
Impairment losses	–1.6	–	–	–0.8
Reversals of impairment losses	2.0	–	–	–
Net gains/losses	–2.1	0.7	1.2	–0.8
	2006			
Currency gains/losses	–2.8	4.4	0.5	–
Impairment losses	–1.2	–	–	–
Reversals of impairment losses	1.6	–	–	–
Net gains/losses	–2.2	4.4	0.5	–

The net income for each measurement category primarily comprises gains and losses recognised in income resulting from the measurement of fair value, currency translation and the disposal of financial instruments.

26. DERIVATIVE FINANCIAL INSTRUMENTS

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

	Notional amounts 2007	Notional amounts 2006	Market values 2007	Market values 2006
€ million				
Currency forwards	57.0	32.3	1.9	0.8
Currency options	–	62.1	–	0.6
Interest rate swaps	–	26.2	–	0.6
Cross-currency swap	160.2	–	–7.8	–
Commodities	7.0	–	–0.8	–
Embedded derivatives	–	–	5.9	4.7

Bank measurements were used, where available, to ascertain fair value. At the balance sheet date, the DEUTZ Group held US$-denominated currency forwards with a notional amount of €35.2 million (2006: €27.5 million) and no US$-denominated currency options (2006: €62.1 million) as a hedge against currency risk. Where available, bank measurements were used to ascertain fair value.

Of the derivative financial instruments in place at the balance sheet date, transactions with a notional amount of €193.7 million (2006: €87.8 million) and a market value of minus €6.5 million (2006: €1.4 million) were designated as cash flow hedges. There was no hedging ineffectiveness requiring reclassification from the reserve for cash flow hedges to income under other operating expenses.

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

27. CONTINGENT LIABILITIES AND OTHER FINANCIAL OBLIGATIONS

Contingent liabilities

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

	31 Dec. 2007	31 Dec. 2006
€ million		
Liabilities on endorsed bills of exchange	2.5	2.9
Liabilities on guarantees	10.0	12.8
Warranty liabilities	11.3	1.6
Total	**23.8**	**17.3**

Contingent liabilities at 31 December 2007 amounted to €23.8 million, an increase of €6.5 million on the figure reported as at 31 December 2006. The increase is due to guarantees provided by DEUTZ AG to DEUTZ Power Systems, which are reported as part of deconsolidation. The buyer of DEUTZ Power Systems has assumed the liability for these guarantees towards DEUTZ AG.

Other financial obligations

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

	31 Dec. 2007	31 Dec. 2006
€ million		
Lease obligations		
due in less than 1 year	8.4	9.4
due in 1–5 years	23.9	26.9
due in more than 5 years	2.6	3.5
Total	**34.9**	**39.8**

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

Commitments to purchase property, plant and equipment and intangible assets amounted to €39.8 at 31 December 2007 (2006: €36.8 million); commitments to purchase inventories amounted to €45.5 million.

Obligations under leases are partly offset by receivables of €0.3 million (2006: €1.0 million) from subleases.

28. LEGAL DISPUTES

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

Risks from litigation were substantially reduced in 2007. The claim by the Greek tax authorities against a Greek subsidiary of DEUTZ AG for supplementary tax payments and penalties totalling about €35 million is still pending, as are the actions brought by private persons against more than 100 companies, including one American subsidiary of DEUTZ AG, for alleged damage to health caused by asbestos.

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

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

29. RELATED-PARTY DISCLOSURES

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

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

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

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

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

	Products and services provided for		Products and services received		Receivables at 31 Dec		Liabilities at 31 Dec	
	2007	2006	2007	2006	2007	2006	2007	2006
€ million								
Other investments	7.5	11.0	3.8	3.7	6.7	5.8	4.9	4.7
Total	**7.5**	**11.0**	**3.8**	**3.7**	**6.7**	**5.8**	**4.9**	**4.7**

A total of €20.5 million (2006: €18.9 million) of the receivables due from subsidiaries and associates had been written down at 31 December 2007; this incurred an expense of €0.3 million in 2007 (2006: €0.3 million).

The following table gives a breakdown of the business relationships between the DEUTZ Group and its shareholders, including their subsidiaries:

	SAME DEUTZ-FAHR Group		Volvo Group	
	2007	**2006**	**2007**	**2006**
€ million				
Engines & spare parts supplied	44.5	67.0	408.4	219.6
Services	4.2	4.3	17.0	15.0
Receivables as at 31 December	22.4	36.7	57.6	45.8

All business was conducted at arm's-length market rates.

The following services were provided for the Supervisory Board, the Management Board and other members of the management team as related parties of the DEUTZ Group.

	Supervisory Board		Management Board		Other members of management	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**
€ million						
Current remuneration	0.4	0.3	3.4	2.5	2.0	2.8

The DEUTZ Group did not maintain material business relationships with any other related parties.

NOTES TO THE CASH FLOW STATEMENT

30. CASH FLOW STATEMENT

The presentation of the DEUTZ Group's cash flow statement is consistent with IAS 7 and is broken down into sources of cash flow. For greater transparency, the presentation of operating cash flow has been changed from last year such that the impact of changes in working capital on cash flow is more immediately apparent. The comparative figures for 2006 have been restated accordingly.

Cash flow from operating activities includes dividend income of €0.8 million from continuing activities for 2007 (2006: €0.3 million).

Cash and cash equivalents increased by €261.7 million to €311.1 million and correspond to the cash and cash equivalents reported on the face of the balance sheet. This substantial increase is mainly due to the sale of DEUTZ Power Systems.

NOTES TO THE SEGMENT REPORTING

31. SEGMENT REPORTING

Notes to the segment reporting
The presentation of the DEUTZ Group's segment reporting is consistent with IAS 14; its primary format is broken down by business segment and its secondary format by region.

Business segments
The primary reporting format is broken down into the following business segments and takes account of the DEUTZ Group's structural organisation and internal reporting systems, its products and services and its risk/return profile:

Continuing operations
Compact Engines This segment comprises new business and the servicing of air-, water- and oil-cooled diesel engines with a capacity of 4 to 8 litres and an output of between 9 kW and 500 kW.

DEUTZ Customised Solutions This segment comprises new business with air-cooled diesel engines with a capacity of 4 to 8 litres and water-cooled diesel engines with a capacity of more than 8 litres, both with an output of between 9 kW and 500 kW. It also includes customer-specific solutions (gensets) and service.

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

Discontinued operations
DEUTZ Power Systems This segment includes project-related systems business, the servicing of gas engines and diesel engines with an output of between 180 kW and 4,000 kW and systems used to convert fossil and non-fossil fuels. This segment was sold by DEUTZ AG with effect from 30 September 2007, and was consequently reclassified as a discontinued operation in accordance with IFRS 5. Segment earnings, therefore, includes the net gain on disposal.

Reconciliation of segment data to Group figures
The presentation of the reconciliation is consistent with IAS 14.67, and contains the effects of consolidation as well as the amounts arising from the differences in definition of the content of individual segment items compared with the corresponding Group items. Transfers between segments are reported at fair value.

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

The following text describes the breakdown of segment data. External revenue shows the revenue received by segments from external customers. Revenue generated between segments is shown as intersegment sales.

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

Segment earnings before one-off items constitutes the IFRS definition of segment earnings plus profit/loss from equity-accounted investments, other investment income and gains or losses on the disposal of financial assets.

Segment earnings in accordance with IFRS is defined as segment revenue less segment expenses. Gains or losses on the disposal of financial assets, share of profit/loss from equity-accounted investments, other investment income, interest and similar income, interest expense and similar charges, and taxes are not included.

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

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

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

Non-cash expenses include additions to other provisions.

OTHER INFORMATION

32. EVENTS AFTER THE BALANCE SHEET DATE

In mid-February, DEUTZ received notification of the threat of legal proceedings by an American customer claiming damages of more than US$ 40 million. The action, which has only been justified in general terms, is without substance in the opinion of DEUTZ AG, 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. On 22 February 2008, the American subsidiary of DEUTZ AG was also notified of a new action to be brought against the Company for the recovery of damages of an unspecified amount for alleged damage to health caused by asbestos. This action is being brought by two private persons against a total of more than 100 companies.

No further material events occurred after the balance sheet date.

33. REMUNERATION PROGRAMMES

In 2007, the Company launched a long-term incentive plan for the Management Board and the top level of senior management. Under this plan, virtual stock options are issued to senior executives to reward them for their sustained contribution to the Company's success.

General description of the incentive plan of DEUTZ AG

Virtual options on DEUTZ AG shares form the basis of the incentive plan. It is at the discretion of the Company to decide who is eligible to participate in the plan, but only members of the DEUTZ Group's senior management and members of the Supervisory Board of DEUTZ AG may be considered for inclusion in the plan.

The options were granted on 1 July 2007 with no payment. It is at the discretion of the Company to decide how many options are granted.

A total of 380,000 options had been granted at the balance sheet date, of which a total of 60,000 had been granted to members of the Management Board or Supervisory Board of DEUTZ AG.

All of these options remained outstanding at the end of the 2007 financial year.

Information on the exercising of options

In order to exercise options, option holders must themselves invest in the Company at a ratio of one share per ten options.

There is a three-year vesting period from the date on which options are granted, i.e. options cannot be exercised before 1 July 2010, at the earliest. Options must be exercised within a period of four years from the end of the vesting period, i.e. by 30 June 2014, and only within ten days from the date of publication of quarterly financial statements.

The Company may change the start date of the exercise window and may accelerate the exercise and vesting periods of the options. The request to exercise options must be submitted to the Company in writing.

The reference price for all options issued on 1 July 2007 is €10.68. The reference price for a total of 40,000 options issued at a later date is €8.51.

Options may only be exercised if

- the price of DEUTZ AG shares has risen by at least 30 per cent relative to the reference price. Dividend distributions by DEUTZ AG are to be taken into consideration, i.e. for the purposes of calculating the performance target, the total gross dividend distribution up to the exercise date are to be added to the share price; or if
- in the period starting from the grant date of the option and ending on the date of exercise, DEUTZ AG shares outperform the Prime Industrial Performance Index – or any future index that replaces the Prime Industrial Performance Index – by at least 30 per cent.

When an option is exercised, the beneficiary receives a cash payment in the amount of the difference between the DEUTZ AG share price on the exercise date and the reference price at the time the option was granted. The beneficiary does not receive shares in the Company.

No options were exercised in 2007.

Notes on the fair value of options

Because virtual options are cash-based rather than equity-based, the Company is obliged to recognise a provision, the amount of which is derived from the fair value of the virtual options at the time of granting and apportioned over the vesting period pro rata temporis.

An option pricing model using the Black-Scholes formula was used to ascertain the fair value. The model takes into consideration the aforementioned exercise prices, the term and the value of the underlying asset (DEUTZ AG shares). The risk-free interest rate (4.25 per cent) used in the calculation is based on German federal government bonds with terms of four to ten years, issued in mid-2007. The assumed volatility (50.88 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. Fluctuation was assumed to be 0 per cent.

The calculation on the grant date was based on the DEUTZ AG share price (€9.68) on 2 July 2007 (the first trading day after the options were granted). It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provision was calculated on the basis of the vesting period.

In accordance with the requirement for the fair value of options to be recalculated on each balance sheet date, a calculation was carried out on the basis of the DEUTZ AG share price of €6.95 at the end of the 2007 financial year (price on 28 December 2007, the last trading day of the year). As a result of this, a provision of €95,541 was recognised at the end of 2007.

STATEMENTS UNDER GERMAN ACCOUNTING STANDARDS

Average number of employees during the year (pursuant to section 314 (1) no. 4 HGB)

	2007	2006
Non-salaried employees	3,005	2,627
Salaried employees	1,586	1,530
Apprentices	161	147
Continuing operations	4,752	4,304
Discontinued operations[1)]	685	1,001
Total	**5,437**	**5,305**

[1)] Until 30 September 2007.

Corporate governance

In December 2007, the Management Board and the Supervisory Board of DEUTZ AG issued a declaration of compliance with the recommendations of the German Corporate Governance Code government commission in the versions dated 12 June 2006 and 14 June 2007, pursuant to section 161 AktG, and made this declaration permanently available to shareholders on the Company's website (www.deutz.com).

Auditors' fees

The following expenses were incurred in 2007:

	2007
€ thousand	
Auditing	305
Other advisory and attestation services	119
Total	**424**

34. MISCELLANEOUS

Dividend proposal

The Management Board and the Supervisory Board propose to the Annual General Meeting the distribution of a dividend of €0.20 per dividend-bearing share for 2007, from the accumulated income of DEUTZ AG calculated in accordance with the principles of the German Commercial Code, plus a special dividend of €0.20 per dividend-bearing share. The total dividend payout amounts to €48.0 million. Payment of the dividend requires the consent of the Annual General Meeting on 21 May 2008.

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

Management Board

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

	Fixed remuneration	Variable bonus	Other[1)]	Total	Share options
€ thousand					no. of options
Gordon Riske (up to 30 September 2007)	408	548	125	1,081	–
Gino M. Biondi (since 1 September 2007)	150	60	50	260	–
Karl Huebser	450	300	433	1,183	–
Helmut Meyer	418	305	152	875	60,000
Total	**1,426**	**1,213**	**760**	**3,399**	**60,000**

1) Including payment of life insurance premiums.

The share options of Helmut Meyer have a fair value of €203,504.23 on the initial grant date.

The remuneration paid to former members of the Management Board or their surviving dependants came to €1.438 million at DEUTZ AG and in the Group; a provision of €13.437 million 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 remuneration	Variable remuneration	Meeting attendance fee	Total
Dr Giuseppe Vita Chairman	25,000	46,587	40,000	111,587
Werner Scherer Deputy Chairman	18,750	34,940	33,000	86,690
Gino M. Biondi (former member)	417	766	1,000	2,183
Dr Massimo Bordi	11,910	22,208	9,000	43,118
Professor Klaus-Otto Fruhner	12,500	23,293	11,000	46,793
Reinhold Götz	12,500	23,293	11,000	46,793
Michael Haupt	12,500	23,293	24,000	59,793
Dr Helmut Lerchner	12,500	23,293	11,000	46,793
Helmut Müller	12,500	23,293	11,000	46,793
Karl-Heinz Müller	12,500	23,293	13,000	48,793
Dr Witich Roßmann	12,500	23,293	11,000	46,793
Peter Schwab (former member)	9,375	17,422	10,000	36,797
Professor Dr Marco Vitale	12,500	23,293	6,000	41,793
Egbert Zieher	3,125	4,914	1,000	9,039
Total	**168,577**	**313,181**	**192,000**	**673,758**

Advances and loans to members of the Board of Management and the Supervisory Board
On 31 December 2007, there were no outstanding advances or loans to any members of the Management Board or the Supervisory Board, nor had any guarantees or other warranties been issued in favour of any such persons.

Supervisory Board and Board of Management

Information on the members of the Supervisory Board and the Management Board, including non-executive directorships held at other companies, is given in a separate list from page 149.

Cologne, 29 February 2008

DEUTZ Aktiengesellschaft
Management Board

Dr Helmut Leube | Karl Huebser

Gino Mario Biondi | Helmut Meyer

SHAREHOLDINGS OF THE DEUTZ GROUP

As at 31 December 2007

Ref. no.	Name and registered office of the company	Holding (%)	Equity (€ thousand)	Net income/loss (€ thousand)
1	DEUTZ AG	–	494,538	153,207
Consolidated subsidiaries				
Germany				
2	Unterstützungsgesellschaft mbH der DEUTZ Aktiengesellschaft, Cologne	100.0	–26	–
3	Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf	19.6	–3,032	–160
4	DEUTZ Beteiligung GmbH, Cologne	100.0	21	–9
Outside Germany				
Europe/Africa				
5	DEUTZ DITER S.A., Zafra/Spain	100.0	–2,619	1,462
6	DEUTZ DITER COMPONENTES S.A., Zafra/Spain	100.0	18,505	688
7	DEUTZ FRANCE S.A., Gennevilliers/France	100.0	13,571	2,336
8	DEUTZ UK Ltd., Cannock/UK	100.0	3,648	11,503
9	Nlle Ste MAGIDEUTZ S.A., Casablanca/Morocco	100.0	1,331	–87
Americas				
10	Deutz Corporation, Atlanta/USA	100.0	34,731	–320
Asia-Pacific				
11	DEUTZ Asia-Pacific (Pte) Ltd., Singapore/Singapore	100.0	3,037	623
12	Deutz Australia (Pty) Ltd., Braeside/Australia	100.0	5,307	903
Associates				
Outside Germany				
13	D. D. Power Holdings (Pty) Ltd., Elandsfontein/South Africa	30.0	7,773	3,827
14	DEUTZ AGCO MOTORES S.A., Haedo/Argentina[1)]	50.0	5,370	1,094
15	DEUTZ (Dalian) Engine Co., Ltd., Dalian/China	50.0	105,215	–6,933

[1)] Joint venture measured in accordance with IAS 31.38.

Annual financial statements
in accordance with the German Commercial Code (HGB)

BALANCE SHEET OF DEUTZ AG

Assets

	31 Dec. 2007	31 Dec. 2006
€ million		
Expenses for the expansion of operations	**20.8**	**31.1**
Intangible assets	29.6	29.1
Property, plant and equipment	280.1	303.7
Investments	181.9	164.6
Fixed assets	**491.6**	**497.4**
Inventories	149.3	109.2
Receivables and other assets	271.6	229.5
Cash and cash equivalents	298.1	36.7
Current assets	**719.0**	**375.4**
Prepaid expenses	3.7	2.4
Total assets	**1,235.1**	**906.3**

Equity and liabilities

Issued capital	307.0	292.3
Additional paid-in capital	26.2	21.9
Retained earnings		
Legal reserve	4.5	0.4
Other retained earnings	74.6	–
Accumulated income	82.2	7.7
Equity	**494.5**	**322.3**
Profit-sharing rights	–	–
Provisions	320.9	339.3
Other liabilities	419.7	244.7
Total equity and liabilities	**1,235.1**	**906.3**

INCOME STATEMENT OF DEUTZ AG

€ million	2007	2006
Revenue	1,443.1	1,103.0
Change in inventories	13.1	9.1
Other own work capitalised	0.4	0.2
Total output	**1,456.6**	**1,112.3**
Other operating income	78.9	74.2
Cost of materials	–1,043.2	–771.2
Staff costs	–237.0	–211.4
Depreciation	–63.5	–56.0
Other operating expenses	–138.6	–120.9
Net investment income	13.4	10.0
Net interest expense	–14.3	–16.4
Profit from ordinary activities	**52.3**	**20.6**
Net extraordinary income	119.5	12.0
Income taxes	–18.0	–2.2
Other taxes	–0.6	–0.7
Net income	**153.2**	**29.7**
Profit/loss carried forward	7.7	–21.6
Additions to legal reserve	–4.1	–0.4
Additions to other retained earnings	–74.6	–
Accumulated income	**82.2**	**7.7**

SUPERVISORY BOARD

Dr Giuseppe Vita
Chairman
Chairman of the Supervisory Board of Axel Springer AG, Berlin

a) HUGO BOSS AG, Metzingen, Chairman
Axel Springer AG, Berlin, Chairman
Vattenfall Europe AG, Berlin

b) Allianz S.p.A (formerly R.A.S. S.p.A), Milan/Italy, Chairman
Gruppo Banca Leonardo, Milan/Italy, Chairman
Barilla S.p.A., Parma/Italy
Humanitas S.p.A., Milan/Italy

Werner Scherer [1)]
Deputy Chairman
Chairman of the Group Works Council of DEUTZ AG, Cologne

Gino M. Biondi
(until 12 January 2007)
Former CEO of SAME DEUTZ-FAHR DEUTSCHLAND GmbH, Lauingen

Dr Massimo Bordi
(from 18 January 2007)
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

Professor Klaus-Otto Fruhner
CEO K.O.F.-Projektberatung GmbH, Cologne

Reinhold Götz [1)]
Deputy Chief Executive of IG Metall Administrative Office Mannheim, Mannheim

a) MVV-Energie AG, Mannheim

b) Stadt Mannheim Beteiligungsgesellschaft mbH, Mannheim
Sparkasse Rhein-Neckar-Nord, Mannheim

Michael Haupt
Former member of the Group Board of AB SKF, Gothenburg/Sweden, Schweinfurt

[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 pursuant to section 125 AktG.

Dr Helmut Lerchner
Management consultant, Aichtal-Rudolfshöhe

a) ElringKlinger AG, Dettingen/Erms, Chairman

Helmut Müller[1)]
Chairman of the Senior Staff Committee of DEUTZ AG, Cologne

Karl-Heinz Müller[1)]
Deputy Chairman of the Group 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

Peter Schwab[1)]
(until 30 September 2007)
Chairman of the Works Council of DEUTZ Power Systems GmbH & Co. KG, Mannheim

b) DEUTZ Power Systems GmbH & Co. KG, Mannheim

Professor Dr Marco Vitale
President of Vitale-Novello & Co SRL, Milan/Italy

b) SAME DEUTZ-FAHR DEUTSCHLAND GmbH, Lauingen
SAME DEUTZ-FAHR ITALIA S.p.A., Treviglio/Italy, Chairman
SAME DEUTZ-FAHR POLSKA SP.Z.O.O., Melgiew/Poland
SAME DEUTZ-FAHR KOMBAJNI d.d., Zupanja/Croatia
BANCA POPOLARE DI MILANO, Milan/Italy
C. BORGOMEO & CO. SRL, Rome/Italy
CONNECT SUD SRL, Palermo/Italy
PICTET INTERNATIONAL CAPITAL MANAGEMENT, Luxembourg/Luxembourg
PICTET & C. SIM S.p.A., Turin/Italy
VINCENZO ZUCCHI S.p.A., Milan/Italy

Egbert Zieher[1)]
(since 16 October 2007)
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 pursuant to section 125 AktG.

SUPERVISORY BOARD COMMITTEES

Human Resources Committee

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

Audit Committee

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

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

Dr Giuseppe Vita, Chairman
Michael Haupt
Werner Scherer
Peter Schwab (until 30 September 2007)
Karl-Heinz Müller

Nominations Committee

Dr Giuseppe Vita, Chairman
Michael Haupt
Dr Massimo Bordi

MANAGEMENT BOARD

Dr.-Ing. Helmut Leube (54), Cologne
(since 1 February 2008)
Chairman
Markets

a) KUKA AG, Augsburg

Gordon Riske (50), Cologne
(until 30 September 2007)
Chairman
Markets

a) Dräger AG, Lübeck

Gino M. Biondi (48), Brombach
(since 1 September 2007)
Procurement, Logistics

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

Karl Huebser (62), Overath
Technology

b) DEUTZ DITER S.A., Zafra/Spain, Chairman
DEUTZ DITER COMPONENTES S.A., Zafra/Spain, Chairman
DEUTZ (Dalian) Engine Co., Ltd., Dalian/China
WEIFANG WEICHAI DEUTZ DIESEL ENGINE LTD., Weifang/China

Helmut Meyer (58), Düsseldorf
Finance, Personnel

b) DEUTZ Corporation, Atlanta/USA, Chairman
DEUTZ Asia-Pacific (Pte) Ltd., Singapore/Singapore, Chairman
DEUTZ (Dalian) Engine Co., Ltd., Dalian/China
DEUTZ UK Ltd., Cannock/UK

[a] Membership of statutory German supervisory boards within the meaning of section 125 AktG
[b] Membership of comparable German or international supervisory bodies pursuant to section 125 AktG

Miscellaneous

RESPONSIBILITY STATEMENT

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

Cologne, 29 February 2008

DEUTZ Aktiengesellschaft
Management Board

Dr.-Ing. Helmut Leube

Karl Huebser

Gino Mario Biondi

Helmut Meyer

INDEPENDENT AUDITOR'S REPORT

We have audited the consolidated financial statements – comprising the balance sheet, the income statement, the statement of changes in equity, the cash flow statement, the segment reporting and the notes to the consolidated financial statements – and the Group management report prepared by DEUTZ Aktiengesellschaft, Cologne, Germany, for the financial year from 1 January to 31 December 2007. The preparation of the consolidated financial statements and the Group management report, in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, and the additional requirements of German commercial law pursuant to section 315a (1) of the German Commercial Code (HGB), are the responsibility of the Parent Company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the Group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with section 317 HGB and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW – German Institute of Auditors). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements, in accordance with the applicable financial reporting framework and in the Group management report, are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the internal control system relating to the accounting system and the evidence supporting the disclosures in the consolidated financial statements and the Group management report are examined, primarily, on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the management, as well as evaluating the overall presentation of the consolidated financial statements and the Group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements of DEUTZ Aktiengesellschaft comply with IFRS, as adopted by the European Union, and the additional requirements of German commercial law pursuant to section 315a (1) HGB, and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The Group management report is consistent with the consolidated financial statements and, as a whole, provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Düsseldorf, 19 March 2008

Deloitte & Touche GmbH
Wirtschaftsprüfungsgesellschaft

Signed: Crampton	Signed: Lammers
Wirtschaftsprüfer	Wirtschaftsprüferin
(German Public Auditor)	(German Public Auditor)

GLOSSARY

4-valve technology The cylinder heads of internal combustion engines of this type have two inlet valves for supplying fresh air and two exhaust-gas outlet valves. Compared with 2-valve technology, the enlarged valve orifice area improves cylinder filling, thus achieving greater performance from the same cubic capacity, although the benefits are only apparent at higher engine speeds. The central location of the injection nozzle also enhances combustion.

Asset management Asset management is used to reduce the amount of assets that companies hold on their balance sheets to the optimum level. Effective asset management increases a firm's economic value added and frees up capital for new investment.

Captive market, captive segment Market segment comprising equipment and vehicle manufacturers that produce engines in-house.

Cash flow A key performance indicator that provides information on a company's financial strength and earnings power. The cash flow indicates to what extent the revenue generated within a particular accounting period provides the company with liquid funds.

Cash pooling The smoothing of intra-group liquidity differentials by a centralised financial management system, which provides loans to entities within the group to cover liquidity shortages. It is a form of cash management. The excess liquidity generated by all the group's entities replenishes the cash pool.

Catalyst A substance that, without itself undergoing any permanent chemical change, increases the rate of a chemical reaction.

Common rail Injection system for diesel engines in which a common fuel rail (or pipe) mounted behind the injection pump is used to serve all the cylinders as a reserve of pressure and to control the injection pressure, independently of the speed at which the engine is turning over.

Corporate compliance Companies' adherence to legislation, guidelines and voluntary codes; by ensuring compliance and monitoring the observance of rules, companies can supplement their organisational measures.

Corporate governance The German Corporate Governance Code contains the rules and recommendations valid in Germany for the management and supervision of publicly traded companies with Aktiengesellschaft status.

Covenants Contractual assurances given by a borrower over the term of a loan agreement; these additional undertakings specify certain rules of conduct that must be adhered to. If the covenants are broken, the loan agreement may be terminated.

Credit rating Credit ratings are used to assess a company's creditworthiness. They gauge to what extent the company will be able to repay the principal and interest on its outstanding liabilities at the agreed date.

Cross-currency swap An agreement between two parties to exchange various specified interest payments in different currencies over a period stipulated in the agreement.

DAX A share index comprising Germany's 30 largest companies on the Frankfurt Stock Exchange in terms of market capitalisation and liquidity. They are listed in the Prime Standard.

Declaration of compliance Section 161 of the German Stock Corporation Act (AktG) states that the management board and supervisory board of publicly traded German companies must submit an annual declaration of compliance, detailing to what extent they have implemented the recommendations of the German Corporate Governance Code.

De-facto ITIL standard The IT Infrastructure Library (ITIL) is a collection of publications that describes best practice in IT service management and is now widely recognised as the de-facto standard in this field.

Dependency report A report submitted by a company's management board in compliance with section 312 of the German Stock Corporation Act (AktG), detailing the company's relations with affiliated companies and subsidiaries.

DEUTZ Common Rail Common rail injection system, in which the rail is supplied with fuel via two high-pressure pump elements.

DIN EN ISO 14001 Deutsches Institut für Normung, European Norm, International Organisation for Standardisation – 14001; an international, European and German industrial standard for environmental management.

DNV certification Det Norske Veritas (DNV) is an independent foundation that was set up to safeguard life, property and the environment. Its DNV Certification division certifies management systems, conducts audits and assessments and provides services in the fields of environmental protection, business excellence and corporate social responsibility.

D&O insurance Stands for "directors' and officers' insurance"; a liability insurance policy that a company takes out to indemnify its directors and senior managers against claims for damages.

DVERT® DEUTZ Variable Emission Reduction Technology A combination of systems, components and procedures that are used as modules to create technically optimised and, at the same time, cost-effective solutions for reducing exhaust and noise emissions.

EBIT Earnings before interest and tax.

EBITDA Earnings before interest, taxes, depreciation and amortisation.

Emissions legislation Sets limits for certain exhaust-gas constituents in engine-powered vehicles and equipment. Also specifies test procedures, implementation schedules and, in certain cases, transitional periods.

EPA TIER 1, 2, 3, 4 US emissions standards for non-road applications. Set limits for pollutants such as nitrogen oxides, hydrocarbons and particulates (diesel) in exhaust gas.

Equity ratio The ratio of a company's equity to its total assets.

EU I, II, III A, III B, IV Exhaust standard laid down by the European Union for mobile machinery. Sets limits for pollutants such as nitrogen oxide, hydrocarbons and particulates (diesel) in exhaust gas.

Euro 1, 2, 3, 4, 5 Emissions standards laid down by the European Union. Set limits for pollutants such as nitrogen oxides, hydrocarbons and particulates (diesel) in exhaust gas.

Exhaust-gas aftertreatment Process for purifying combustion gases, by either mechanical or chemical means, once they have left the combustion space or combustion chamber. Typical examples include catalytic converters and particulate filters.

Exhaust-gas recirculation (EGR) Process for reducing the nitrogen oxides (NO_x) produced during the combustion of fuel in diesel engines, gasoline engines, gas turbines, heating boilers, etc. The process feeds part of the exhaust gas back for re-combustion. The effect is to reduce the likelihood of nitrogen and oxygen being able to react with one another by reducing the proportion of oxygen (O_2) in the intake air. In cooled EGR systems, the combustion temperature is lowered which brings about a further reduction in NO_x emissions.

Factoring A financial service that is used to provide short-term finance for a company's business; the sale of receivables in the form of factoring provides companies with immediate liquidity.

Forward hedging Hedging in this context means protecting against risk.

Free cash flow Operating cash flow minus capital expenditure plus divestments; companies can use the funds available from their free cash flow to pay dividends or repurchase shares. The free cash flow indicates how much money is actually left over for a company's shareholders.

Free float as defined by Deutsche Börse AG Irrespective of the size of shareholding, the free float includes all shares held as short-term investments by asset managers, trust companies, unit trusts, pension funds, venture capitalists, fund managers and foreign investment companies.

International Accounting Standards (IAS) International accounting standards created by the International Accounting Standards Committee (IASC), which was set up in London in 1973. The IASC was replaced by the International Accounting Standards Board (IASB) in 2001.

International Financial Reporting Standards (IFRS) International accounting standards for publicly traded companies; EU Regulation 1606/2002 of 19 July 2002 ("IAS Regulation") states that these companies must prepare their consolidated financial statements in accordance with IFRS as from 2005. IFRS accounting is designed to improve the comparability of financial statements prepared by publicly traded companies, subject to disclosure requirements worldwide.

Investment-grade bonds Bonds of high credit quality (i.e. with good credit ratings).

Investor relations The relationship between a publicly traded company and its shareholders.

ISIN International Security Identification Number; a ten-digit number prefixed by a country code (DE = Germany, CH = Switzerland, etc.) that is used to identify international securities.

Long-term incentive (LTI) plan A form of remuneration offered to selected senior managers; its purpose is to enable these executives to benefit from the company's long-term success, thereby encouraging them to stay with the company.

Market capitalisation The market value of a publicly traded company; it is calculated by multiplying the share price by the total number of shares in issue.

MDAX An index selected by Deutsche Börse AG comprising 50 medium-sized companies (mid-caps) which come immediately below DAX shares in terms of market capitalisation and liquidity. The MDAX only contains the shares of companies from traditional sectors. These can be either German or international companies.

Non-captive market In the context of this Annual Report, this term refers to independent engine manufacturers which are not part of a company that itself manufactures vehicles or equipment.

Non-road applications In the context of this Annual Report, this term refers to engine-powered equipment that is not licensed for use on public roads but which is subject to the provisions of emissions legislation.

Net present value (NPV) The present value (or net present value) provides a method of calculating the profitability of an investment over time. By discounting cash flows to their present value at the beginning of the investment project, investors can directly compare payments that arise at any point in the future.

On-road applications In the context of this Annual Report, this term refers to engine-powered commercial vehicles and buses which are subject to the provisions of emissions legislation.

Prime Industrial A sectoral index published by Deutsche Börse AG that includes all traditional industrial companies in the Prime Standard.

Prime Standard The standard set by Deutsche Börse AG for companies looking to raise capital from international investors. These companies have to meet stringent international disclosure requirements. Admission to the Prime Standard is a prerequisite for inclusion in the DAX, MDAX, TecDAX and SDAX indices.

Private placement A private placement involves the private, non-public sale of assets.

Roadshow A period or event during which a company's senior executives conduct intensive face-to-face meetings with investors and analysts. Roadshows are usually held at international financial centres such as London, New York or Frankfurt.

ROCE The return on the capital employed by a company.

SAS 70 The Statement on Auditing Standard 70 (SAS 70) was issued by the American Institute of Certified Public Accountants (AICPA) and is applied by auditors. The Standard relates to the internal control systems in place at companies and to the proper operation of outsourced services, such as data processing centres.

Securities Trading Act The German Securities Trading Act (WpHG) came into force in the wake of the Third Financial Markets Act, with the main aim of protecting investors.

Selective Catalytic Reduction (SCR) Catalytic reduction of nitrogen oxides in the exhaust gas of combustion engines whereby the reducing agent urea is injected into the exhaust gas. In the hot exhaust gas, the urea disintegrates to form ammonia, which converts the nitrogen oxide into harmless molecular nitrogen.

Soot and particulate filters Devices for reducing the particulates contained in the exhaust gases of diesel engines. There are two types of filter, which work in very different ways: wall-flow filters (surface-type filters), in which the exhaust gas penetrates a porous wall; and flow filters (deep-bed filters), in which the exhaust gas flows through the filter itself.

Stakeholder A party that is affected by a company's activities; the relationship is often reciprocal, so that the relevant party can influence the company as well. Typical stakeholder groups are shareholders, customers and staff.

Working capital The sum of inventories and trade receivables less trade payables.

Xetra This stands for "Exchange Electronic Trading" and is the name given to the electronic dealing system run by Deutsche Börse AG (also known as screen-based trading).

Financial Calendar

Dates 2008	Event	Location
27 March	Annual Results press conference Publication Annual Report 2007	DEUTZ AG, Cologne
28 March	Analysts' meeting	Frankfurt/Main
30 April	Publication Report 1st Quarter 2008 Conference call with analysts and investors	
21 May	Annual General Meeting 2008	Koelnmesse, Cologne
13 August	Publication Report 1st Half-year 2008 Press conference Conference call with analysts and investors	Cologne
7 November	Publication Report 1st to 3rd Quarter 2008 Conference call with analysts and investors	

Dates 2009		
30 April	Annual General Meeting 2009	Koelnmesse, Cologne

Imprint

Published by
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Concept and layout
Kirchhoff Consult AG, Munich

Photographer
Michael Dannenmann

Lithography and print
Bacht, Grafische Betriebe und Verlag GmbH, Essen

This is a complete translation of the original German version of the Annual Report.

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