ANNUAL REPORT 2017

A NEW DYNAMIC

The engine company. DEUTZ

DEUTZ GROUP: KEY FIGURES

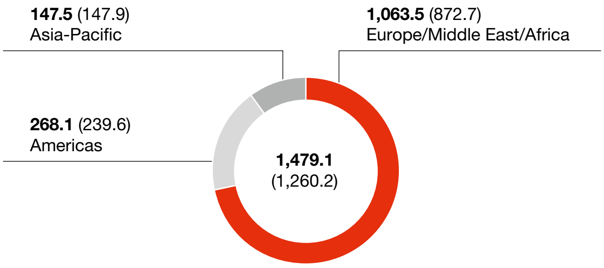
€ million

	2017	2016	Change (%)
New orders	1,556.5	1,261.4	23.4
Unit sales (units)	161,646	132,539	22.0
Revenue	1,479.1	1,260.2	17.4
EBITDA	240.0	114.2	110.2
EBITDA (before exceptional items)	135.9	114.2	19.0
EBIT	146.5	23.4	–
EBIT (before exceptional items)	42.4	23.4	81.2
EBIT margin (%)	9.9	1.9	+8.0%-age points
EBIT margin (before exceptional items, %)	2.9	1.9	+1.0%-age points
Net income	121.2	16.0	–
Earnings per share (€)	1.00	0.14	–
Dividend per share (€)	0.15	0.07	114.3
Total assets	1,213.1	1,059.7	14.5
Non-current assets	534.2	483.7	10.4
Equity	599.2	491.1	22.0
Equity ratio (%)	49.4	46.3	+3.1%-age points
Cash flow from operating activities	112.7	63.8	76.6
Free cash flow[1]	82.5	4.7	–
Net financial position[2]	98.2	31.6	210.8
Working capital[3]	222.2	204.3	8.8
Working capital ratio at the balance sheet date (average, %)[4]	13.4	17.9	–4.5%-age points
Capital expenditure (excluding capitalisation of R&D, after deducting grants)	54.7	52.9	3.4
Depreciation and amortisation	93.5	90.8	3.0
Research and development	67.0	50.4	32.9
thereof capitalised	17.5	9.1	92.3
Employees (31 December)	4,154	3,665	13.3

[1] Free cash flow: cash flow from operating and investing activities less net interest expense.
[2] Net financial position: cash and cash equivalents minus current and non-current interest-bearing financial liabilities.
[3] Working capital: inventories plus trade receivables minus trade payables.
[4] Working capital ratio (average, %): average working capital at the four quarterly reporting dates divided by revenue for the previous twelve months.

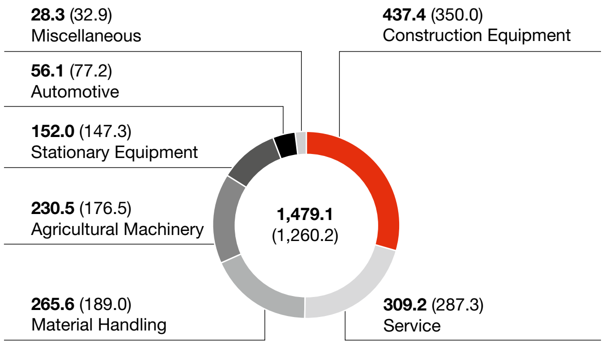
DEUTZ Group: Revenue by region

€ million (2016 figures)



DEUTZ Group: Revenue by application segment

€ million (2016 figures)



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INTERVIEW WITH THE CHAIRMAN OF THE BOARD OF MANAGEMENT

Dr Ing Frank Hiller, Chairman of the Board of Management of DEUTZ AG, on the past and the future of DEUTZ

Dr Ing Frank Hiller, Chairman of the Board of Management

“2017 has been a success. We have mapped out the strategic course we intend to follow and got people excited about the new era we are about to enter into.”

Dr Hiller, what is your view of the last financial year? What do you think have been the biggest successes of 2017?

Dr Ing Frank Hiller: 2017 has been a successful year for DEUTZ. We have made improvements to how we operate, mapped out the strategic course we intend to follow and got people excited about the new era we are about to enter into. I am thinking, in particular, of the new E-DEUTZ strategy, the acquisitions of electric engine specialist Torqeedo and Italian dealer IML Motori S.r.l., the expansion of our product portfolio through the partnership with Liebherr, and the EU Stage V certification, which we are the first engine manufacturer in the world to receive. Our financial results have greatly improved in 2017, and we have significantly increased important KPIs such as new orders, revenue and operating profit. The capital markets have recognised this – our share price rose by more than 40 per cent in 2017.

DEUTZ has a long and successful tradition. To what extent does this influence today's business?

Dr Ing Frank Hiller: Looking back, we can see that from the outset DEUTZ was a technology leader in the manufacture and supply of engines, and employed the best engineers of their time: Daimler, Maybach and Bugatti. Our ambition remains to attract the best engineers who can help us to develop the drive systems of the future. The discovery of the four-stroke principle marked the birth of the combustion engine and paved the way for the global motorisation we see on and off our roads today. DEUTZ and its engineers have always been at the vanguard of change, and DEUTZ will continue to produce innovative and technologically advanced solutions in the future.

“DEUTZ and its engineers have always been at the vanguard of change. The discovery of the four-stroke principle marked the birth of the combustion engine and paved the way for global motorisation – and DEUTZ will continue to produce innovative and technologically advanced solutions in the future.”

Diesel engines are a hot topic at the moment – what is your opinion on the matter and how do you assess the development in your markets in this regard?

Dr Ing Frank Hiller: One of the key demands in society today is to save energy and make engines cleaner and more environmentally friendly. A major discussion has evolved around diesel engines, but we firmly believe that diesel technology will continue to be the dominant type of drive in off-highway applications, such as agricultural machinery, for a long while yet. Nonetheless, the reality is that there has been a paradigm shift in the public acceptance of diesel engines. And we are addressing this. We want to actively promote change and benefit from it, and there is a good reason why we are the first engine manufacturer to be EU Stage V certified. But we want to do even more to meet the growing demand for efficient and more eco-friendly drive systems.

"There has been a paradigm shift in the public acceptance of diesel engines, and we are addressing this. We want to actively promote change and benefit from it."

What does that mean specifically? What is the strategy at DEUTZ?

Dr Ing Frank Hiller: We implemented a new strategy in 2017 with the ambition of becoming the leading manufacturer of innovative drive systems. We will continue to invest in clean diesel engines, as we still see good potential for DEUTZ in this segment. The new family of large engines we are developing in partnership with Liebherr will enable us to extend our product portfolio at the upper end of the power output range, for example. At the same time, we want to expand our technology portfolio. In the future, we will offer drive system solutions using alternative fuels – initially with liquefied petroleum gas and biogenic fuels. Through the E-DEUTZ strategy we aim to take the lead in the development of technically sophisticated and economical electrification solutions for off-highway applications. Our ambition is for electric drive systems to account for 5 to 10 per cent of our revenue in five years' time. What happens after that will depend on a variety of factors, including infrastructure, battery development and customer behaviour.

How are you approaching electrification? After all, your sector is still taking its first steps in this area.

Dr Ing Frank Hiller: As I mentioned earlier, in autumn last year we bought Torqeedo GmbH, the market leader in electric-powered boats with twelve years' experience and 70,000 systems in the field. The task now is to transfer this extensive knowledge to our own segments. We hope to present the first prototypes for electric and hybrid drives this year. The acquisition of Torqeedo gives DEUTZ access to expertise not only in battery management, electric motors and power electronics, but also in integrating these components into electric drive systems. In short, we are working on delivering a scalable product portfolio of hybrid and all-electric engines that meet our customers' specific requirements. By investing in technology, DEUTZ is helping to reduce fuel consumption and emissions, while bringing down overall costs for end customers over the lifecycle.

How large is the capital expenditure on electrification?

Dr Ing Frank Hiller: We currently have a budget of €100 million for the electrification of DEUTZ, including the acquisition of Torqeedo. The bulk of the capital investment was made in 2017. This demonstrates that we are taking the issue of electrification seriously. We have been able to finance this ourselves thanks to the sale of our former premises in Cologne-Deutz, which further bolstered our already healthy financial situation.

"We are working on delivering a scalable product portfolio of hybrid and all-electric engines that meet our customers' specific requirements. By investing in technology, DEUTZ is helping to reduce fuel consumption and emissions."

How is the acquisition of IML contributing to this?

Dr Ing Frank Hiller: The acquisition of IML Motori, our long-standing Italian sales and service partner, which is now trading as DEUTZ Italy, has strengthened us in a different way. It has allowed us to bolster our profitable service business in the Mediterranean, and it brings us closer to our customers. This too is an important part of our successful strategy.

“Our priority is the ongoing focus on customer satisfaction and superior product quality. As Chairman of the Board of Management, I want to work with all my colleagues to ensure that we continue to offer our customers the right solutions in the future.”

You have been the Chairman of the Board of Management of DEUTZ AG for over a year. How would you assess your time so far?

Dr Ing Frank Hiller: As I mentioned earlier, DEUTZ has seen positive developments in terms of strategy and operations over the course of 2017. Our priority is the ongoing focus on customer satisfaction and superior product quality. As Chairman of the Board of Management, I want to work with all my colleagues to ensure that we continue to offer our customers the right solutions in the future. We want to further strengthen our market position, reinforce our commercial success and thus make ourselves more attractive to our customers and the capital markets.

Following on from a very successful 2017, what do you expect for 2018 (and beyond)?

Dr Ing Frank Hiller: I think we are on the right track – now we just need to keep the momentum going. I am very optimistic that DEUTZ will continue its success in 2018 and that we will achieve our targets. Take profitability, for example. Our operating profit in 2016 was just under 2 per cent, which is unsatisfactory. In 2017, we improved that to almost 3 per cent. In the current year, we will again increase the EBIT margin significantly. In five years’ time, we aim to achieve an EBIT margin of 7 to 8 per cent.

Dr Hiller, thank you for talking to us.

BOARD OF MANAGEMENT

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

Dr Margarete Haase
Board of Management member (until 30 April 2018),
responsible for finance, human resources, procurement
and information services (until 31 March 2018)

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

Dr Andreas Strecker
Board of Management member (from 1 March 2018),
responsible for finance, human resources, procurement
and information services (from 1 April 2018)

DEUTZ SHARES

The global equity markets maintained their upward trajectory in 2017. Strong economic growth across the world, the passing of tax reforms in the US and the European Central Bank's decision to continue purchasing bonds were key factors in this positive market environment. Another factor was the ongoing low-interest-rate policy pursued by the major central banks, even though the Federal Reserve did begin to make small interest-rate hikes. On 29 December 2017, the DAX closed at 12,917.64 points, which was 12.5 per cent higher than at the end of 2016.

DEUTZ SHARES MAKE SUBSTANTIAL GAINS

The SDAX, in which DEUTZ shares are listed, rose in value by 24.9 per cent in 2017 and closed at 11,886.85 points (end of 2016: 9,519.43 points). The DAXsector Industrial, which comprises major German industrial companies, gained 16.3 per cent in the reporting year to close at 6,732.29 points (end of 2016: 5,788.57 points).

DEUTZ shares significantly outperformed all benchmarks. The share price reached its lowest level for the year of €5.31 back in January. After this, it gained significantly to reach a high for the year of €7.78 on 21 June 2017. In the second half of the year, the share price initially fell again – in part because of AB Volvo's decision to sell its 25 per cent holding in DEUTZ to institutional investors in July 2017 – before rebounding strongly towards the end of the year. The year-end closing price of €7.58 was 41.7 per cent higher than the price twelve months earlier of €5.35.

Market capitalisation stood at €916.1 million as at 29 December 2017, compared with €646.6 million at the end of 2016.

Key figures for DEUTZ shares

	2017	2016
Number of shares (31 Dec)	120,861,783	120,861,783
Average number of shares	120,861,783	120,861,783
Share price as at 31 Dec (€)	7.58	5.35
Share price high (€)	7.78	5.58
Share price low (€)	5.31	2.65
Market capitalisation as at 31 Dec (€ million)	916.1	646.6
Earnings per share (€)	1.00	0.14

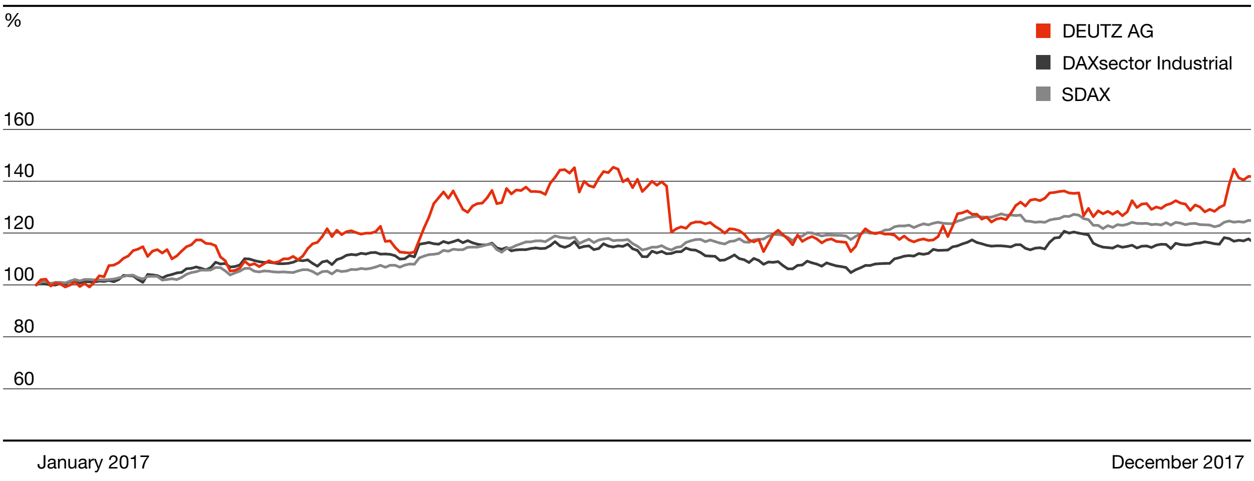
EARNINGS PER SHARE

Earnings per share is calculated by dividing the net income for the year attributable to the shareholders of DEUTZ AG by the weighted average number of shares in issue. In the year under review, the number of DEUTZ shares in issue was 120.9 million. Basic earnings per share was therefore €1.00, compared with €0.14 in 2016. This sharp increase was primarily attributable to the high level of extraordinary income resulting from the sale of a property.

Key data on stock market listing

ISIN	DE0006305006
WKN	630500
Reuters	DEZG.DE
Bloomberg	DEZ:GR
Market segment	Regulated Market/Prime Standard
Trading platforms	Xetra, Frankfurt/Main and all other German stock exchanges

DEUTZ share price performance in 2017



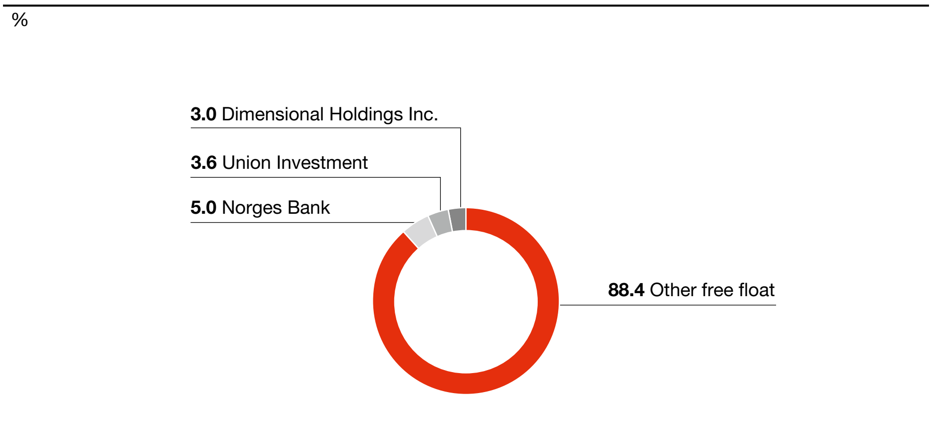
DIVIDEND ENABLES SHAREHOLDERS TO SHARE IN PROFITS

The Board of Management and Supervisory Board propose that a dividend of €0.15 be paid for 2017. With this substantial increase on the prior year (2016: dividend of €0.07), we intend to pass on to our shareholders some of the proceeds of our successful property sale. We plan to carry on enabling our shareholders to participate in the success of our Company in the form of a regular dividend. It is also our aim to pay a consistent dividend, although as previously mentioned, the dividend for 2017 is influenced by the sale of a property. At the same time, we intend to continue funding a significant proportion of our growth ourselves, that is to say from our own capital.

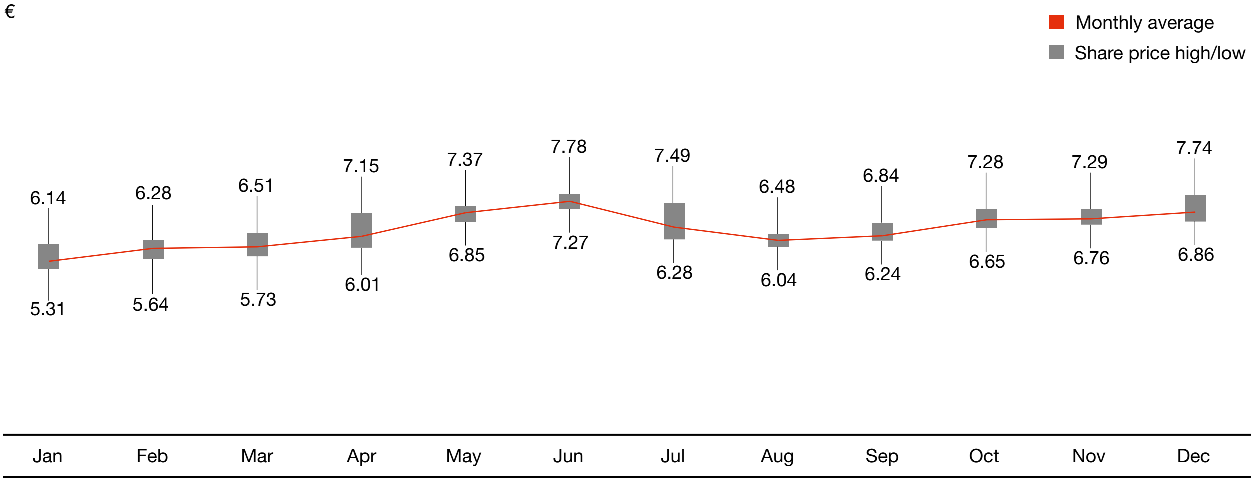
ALL DEUTZ SHARES IN FREE FLOAT

DEUTZ shares are held by a broadly diversified range of private and institutional shareholders both in Germany and abroad. As mentioned previously, AB Volvo sold all of its approximately 25 per cent shareholding in DEUTZ AG to institutional investors in July. Since that time, all DEUTZ AG shares have been in free float. Most of the private investors are in Germany. At the end of 2017, Norges Bank (Norway) held 5.0 per cent of our Company, while Union Investment (Germany) held 3.6 per cent and Dimensional Holdings Inc. (US) 3.0 per cent. These are also considered non-controlling shareholdings.

Shareholder structure as at 31 December 2017



DEUTZ share price high and low for 2017



INTENSIVE INVESTOR-RELATIONS WORK

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

At our annual results press conference and analysts' meeting on 16 March 2017, we presented the DEUTZ annual financial statements and our future strategic direction. We also held conference calls when we published our quarterly results.

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

NINE ANALYSTS MONITOR DEUTZ SHARES

As at the end of 2017, nine banks and securities houses were monitoring the performance of DEUTZ shares: Bankhaus Lampe, Commerzbank, DZ Bank, HSBC Trinkaus & Burkhardt, Kepler Cheuvreux, Metzler, M.M. Warburg, Quirin Privatbank and Solventis.

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

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

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A NEW DYNAMIC

STAGE V CERTIFIED

STAGE V certified®

ALTERNATIVE FUELS

Liquid gas (LPG)

Compressed natural gas (CNG)

Synthetic fuels

E-DEUTZ

Hybrid

Full electrification

INNOVATIVE DRIVE SYSTEMS

DEUTZ stands for a pioneering spirit, passion and a culture imbued with innovation. We are trailblazers when it comes to high-quality, environmentally friendly and efficient drive systems for use in industrial, agricultural and commercial vehicle applications. Our objective is to position DEUTZ as the market leader for innovative drive systems. We aim to offer our customers a comprehensive choice of modular technological building blocks for powering their machines. Challenging emissions standards make for greater complexity but we are able to support our customers through our well-established expertise in systems integration and exhaust aftertreatment. Our unbeatable range of services ensures maximum availability at all times anywhere in the world. With a view to continued growth, we are mainly investing in product innovation, aftersales support and internationalisation.

As mentioned above, we intend, in future, to broaden our technological base and to become the leading supplier of innovative drive systems. Our acquisition of Torqeedo GmbH in September 2017 provided the initial impetus for the E-DEUTZ strategy. Having made a start on electrifying our drive systems, we are now ahead of our competitors in off-highway applications. As regards application areas which produce economic benefits for our customers, we will, within two or three years, be adding hybrid engines and fully-electrified drive solutions to our product range.

In the off-highway segment, the diesel engine is still a long way from being pensioned off. The public debate about diesels is leading to potential customers no longer producing their own diesel engines. This presents us with an opportunity because DEUTZ is ideally placed to meet future emissions requirements and is the world's first engine manufacturer to have been awarded certification for the EU Stage V emissions standard, which will apply from 2019. Our faith in diesel is also demonstrated by the fact that from 2019 we will be expanding our product range in the lower and higher power output ranges.

In addition to fossil-based diesel, DEUTZ is widening its choice of fuels. From 2019, for example, our product range will be expanded to include gas engines (LPG) which offer emission advantages and allow simpler exhaust aftertreatment systems to be installed. DEUTZ has also approved alternative fuels (paraffinic diesel fuels and biodiesel) for use in the entire latest generation of its TCD diesel engine range. This will improve the carbon footprint of combustion engines. The approval also covers the prospective synthetic fuels which could be obtained from renewable energy, thus enabling the development of CO_2-neutral drive systems.

STAGE V CERTIFIED

"We made a promise in 2015 and now, with the world's first certificate, we have made good on that promise. It gives our customers flexibility when installing engines in their equipment and planning certainty when changing over to Stage V. We are particularly proud to receive the world's first Stage V certification and it underlines our technological lead in exhaust aftertreatment."

Michael Wellenzohn,
member of the DEUTZ AG Board of Management for Sales / Marketing and Service

TCD 3.6

- Cylinders: 4
- Capacity: 3.6 l
- Power output: 105 kW
- Emissions standards: EU V, EU IV, EU IIIB, US T4

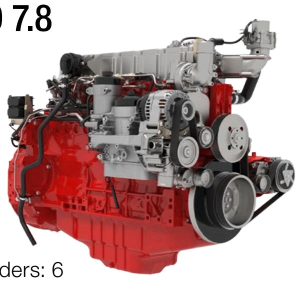
TCD 4.1

- Cylinders: 4
- Capacity: 4.1 l
- Power output: 115 kW
- Emissions standards: EU V, EU IV, US T4

TTCD 6.1

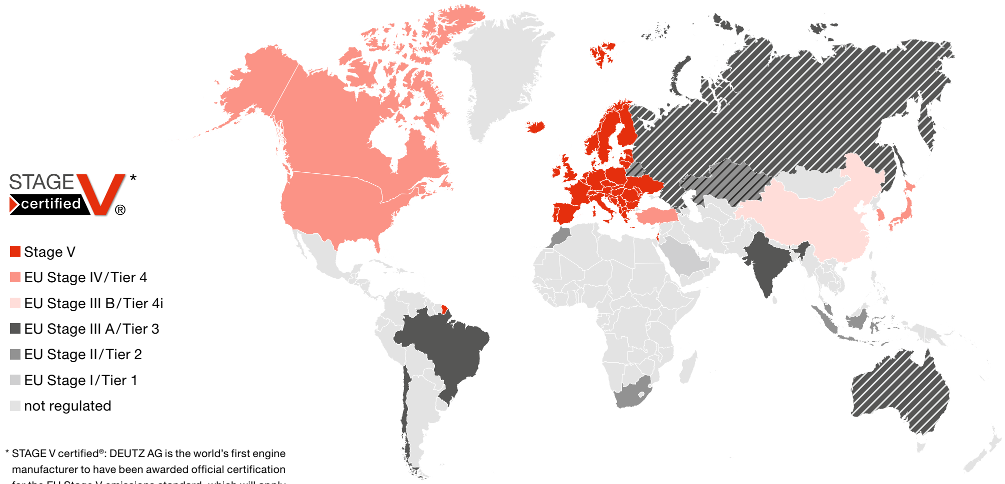
- Cylinders: 6
- Capacity: 6.1 l
- Power output: 211 kW
- Emissions standards: EU V, EU IV, US T4

TTCD 7.8



- Cylinders: 6
- Capacity: 7.8 l
- Power output: 291 kW
- Emissions standards: EU V, EU IV, US T4

EMISSIONS LEGISLATION FOR MOBILE MACHINERY IN 2020



* STAGE V certified®: DEUTZ AG is the world's first engine manufacturer to have been awarded official certification for the EU Stage V emissions standard, which will apply from January 2019.

Emissions occur whenever combustion engines are used. Soot particles, nitrogen oxides and other pollutants harm people and contaminate the environment. Ever more stringent emissions standards are intended to limit the harm these pollutants cause. The strictest emissions regulations currently apply in North America, Europe, South Korea and Japan. Emissions legislation in other countries is aligned to these standards and will also be tightened up in the medium term.

And there really are environmentally friendly diesel engines! The technology currently available, consisting of diesel oxidising catalytic converters (DOC), diesel particulate filters (DPF) and selective catalytic reduction (SCR), can almost completely eliminate nitrogen oxide emissions and soot particles through the use of the latest exhaust aftertreatment. As a result, the exhaust gas from diesel engines equipped with DPFs contains fewer particles than the ambient air in cities. Tests are being conducted to establish whether truck engines and off-road diesel engines comply with emissions standards over the entire mapping range. This means that exhaust aftertreatment is active under real operating conditions in all of the engine's power output ranges, enabling emissions to be actively reduced even when engines are subjected to high loads at high engine speeds.

On 6 September 2017, DEUTZ became the world's first engine manufacturer to be awarded a certificate by the Federal Motor Transport Authority for the EU Stage V emissions directive, which will apply from 2019. Most DEUTZ engines with cubic capacities of between 3.6 and 7.8 litres have since been certified. This quite clearly positions DEUTZ as the technology leader and as an ecologically oriented engine manufacturer. No additional installation space is needed for DEUTZ engines when changing over from the current EU Stage IV to Stage V, meaning that costly alterations to customers' machines will not be necessary. This is an advantage which should not be underestimated since customers will, as a result, incur no additional investment costs nor be obliged to undertake additional development work when implementing the new statutory requirement.

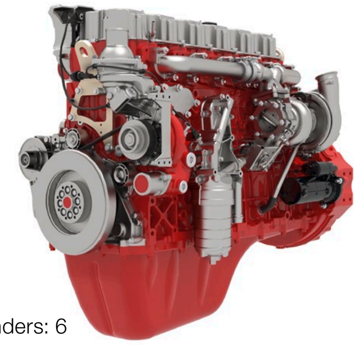
The imminent EU Stage V emissions standard will lower the particulate limit still further. From 2019, Europe will have the world's strictest exhaust emissions standards. For the first time, a limit will be placed on the number of particles as a solution to the problem of fine dust. This represents a major challenge to all engine manufacturers because, from 2019 onwards, a sealed diesel particulate filter will be required. An intelligent heat management system will be necessary in order to burn the particles collected by the filter. DEUTZ has, therefore, specifically developed a 'heat mode' to increase the exhaust temperature, ensuring that users can operate their machinery with confidence. In view of the huge variety in the load profiles of our customers' applications, employing a diesel particulate filter demands in-depth expertise. DEUTZ has over ten years' experience in the use of diesel particulate filter technology and already employs it as standard in its range of TCD engines.

OUR NEW HEAVY-DUTY ENGINES

TCD 9.0

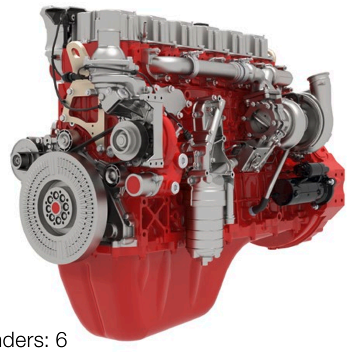
- Cylinders: 4
- Capacity: 9.0 l
- Power output: 200 to 300 kW
- Emissions standards: EU V, EU IV, US T4

TCD 12.0



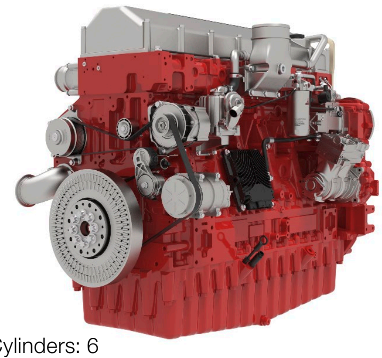
- Cylinders: 6
- Capacity: 12.0 l
- Power output: 280 to 400 kW
- Emissions standards: EU V, EU IV, US T4

TCD 13.5



- Cylinders: 6
- Capacity: 13.5 l
- Power output: 300 to 450 kW
- Emissions standards: EU V, EU IV, US T4

TCD 18.0



- Cylinders: 6
- Capacity: 18.0 l
- Power output: 565 to 620 kW
- Emissions standards: EU V, EU IV, US T4

“The new in-line engines complement our product range perfectly. They allow us to specifically cover further power output ranges and applications. Customers benefit from our comprehensive expertise in applications and in service.”

Dr Ing Frank Hiller,
Chairman of the DEUTZ AG Board of Management

More power and better performance in-line: DEUTZ is expanding its product range in the upper power output range by introducing no less than four new in-line engines: the four-cylinder TCD 9.0 and the six-cylinder TCD 12.0 / 13.5 and 18.0. These four power units will be introduced to the market in time for EU Stage V, providing customers with completely new options in the power output range between 200 and 620 kW. DEUTZ’s familiar V-engines, the TCD 12.0 V and 16.0 V, with six and eight cylinders respectively, will continue as part of our product portfolio. Due to their configuration, these engines are used in special applications such as push-back tractors at airports. We are the market leaders as regards the drive systems in these applications and our V-engines represent a technical benchmark.

These four new in-line engines are the result of the collaborative partnership agreed in August 2017 with Liebherr, the construction equipment manufacturer. DEUTZ has the global rights for marketing and after-sales support for various applications. These engines will be inserted seamlessly in every respect into DEUTZ’s familiar TCD product landscape, allowing DEUTZ to expand its engine portfolio cost-effectively rather than pursue inhouse developments. DEUTZ will contribute its global marketing and engine servicing network to the collaborative partnership, thus opening up additional sales potential. The proportion of common parts in the TCD 9.0 / 12.0 and 13.5 is approximately 65 per cent, making lean spare part inventories possible. These in-line engines also have a common customer interface and identical front and rear sides. This makes integrating and servicing the engines considerably simpler and reduces the cost of training service technicians. DEUTZ’s comprehensive application expertise will support customers when integrating engines into their particular machine.

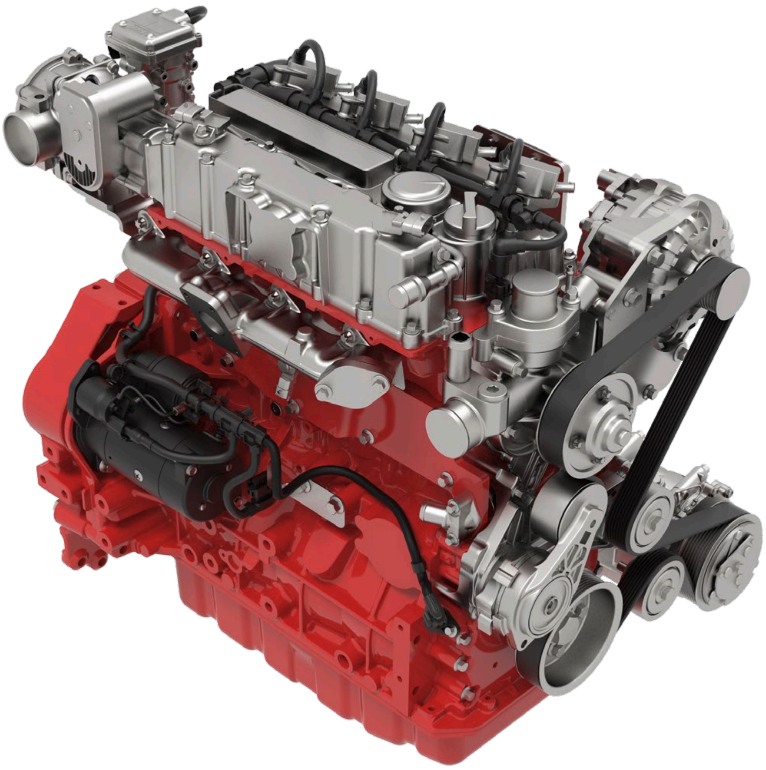
POWERFUL ALTERNATIVES

Gas engines do not represent a new departure for DEUTZ: the first DEUTZ engine, the atmospheric gas power machine of 1867, was based on the gas principle. And gas was also the fuel for the world's first four-stroke engine – the Ottomotor – developed in 1876 by the founder of DEUTZ, Nicolaus August Otto. In contrast, the present DEUTZ product portfolio for mobile applications consists largely of diesel engines.

In the compact segment, however, especially for material handling applications such as forklift trucks, gas engines are enjoying increasing popularity. To satisfy the growing demand, DEUTZ will be launching two LPG versions of the TCD 2.2 and TCD 2.9 diesel engines onto the market ready to meet the EU Stage V emissions standard from 2019. We have already gained a major customer in the KION Group, a technology leader in the field of forklift trucks. KION intends to equip the high-volume models of its premium brand, Linde, with the new DEUTZ gas engines. LPG stands for 'liquefied petroleum gas'. Gas engines are particularly well-suited for use in enclosed buildings because engines powered by LPG in conjunction with a three-way catalytic converter emit considerably lower emissions than diesel engines. There is, consequently, no need for a sophisticated exhaust aftertreatment system.

The new three-cylinder 2.2 litre cubic capacity engine shares significant characteristics and components with the successful and well-established four-cylinder TCD 2.9 engine, which is installed in large numbers in agricultural machinery, construction equipment and material handling equipment. These two engines will form a standard engine platform from which customers can choose between either a diesel or a gas engine version. This will result in extensive synergy benefits. Some changes are, however, inherently unavoidable. The LPG variants exhibit important differences in, for example, the cylinder head, the sensors, the exhaust aftertreatment system and the mixture formation method. There is also, of course, the most distinctive feature: although installed in the same position, the spark plug with its pencil-type ignition coil replaces the diesel-powered variant's fuel injector.

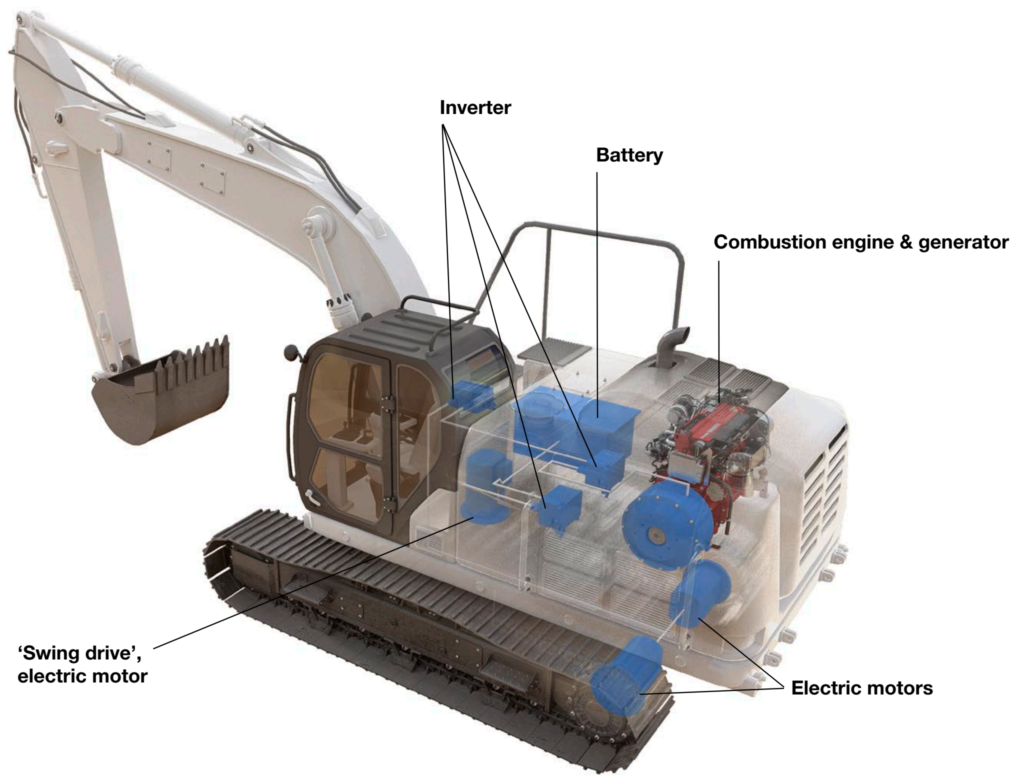
G 2.2



- Cylinders: 3
- Capacity: 2.2 l
- Power output: 42 kW
- Emissions standards: EU V, US EPA T4

"The DEUTZ G 2.2 LPG gas engine is the perfect addition to our drive portfolio. Our customers particularly like the fact that the exhaust aftertreatment is not only simple, with a three-way catalytic converter, but also lowers emissions."

Dr Ing Markus Schwaderlapp,
Head of Research & Development



Hybrid and all-electric drive systems are already in use in some transportation segments as long as the masses to be moved are relatively small and the corresponding infrastructure is available. However, these prerequisites are often not present in the off-highway segment. Heavy-duty agricultural machinery and construction equipment are mostly employed away from urban areas or are actually being used to put the infrastructure in place. By implementing the E-DEUTZ strategy – the electrification of our product range – we are making an early start on developing technically advanced, economic electrification solutions.

At the end of September 2017, DEUTZ acquired Torqeedo GmbH, a company based in the Munich area which now forms the nucleus of the E-DEUTZ strategy. This company, established twelve years ago, is a systems solution specialist with many years of experience of electromobility in marine applications – its know-how is well-suited for transferring to our current core markets. This acquisition gives us wide-ranging e-expertise as regards components, software and systems integration and can significantly accelerate the market launch of electrified drive solutions in the off-road segment. This is a decisive advantage in view of the very fast-moving competition.

“Our acquisition of Torqeedo means that we are now in a position to build up our e-expertise much more quickly and to electrify our product range wherever it makes technological and economic sense to do so.”

Dr Ing Frank Hiller,
Chairman of the DEUTZ AG Board of Management

DEUTZ supplies engines for a wide range of machinery with very different requirements. As to whether a hybrid drive or an all-electric drive is suitable will greatly depend on the use to which the machinery is put and on its load profile. In the first instance, we intend to develop electric products for applications in the low and medium power output range which have fluctuating power requirements or very low load profiles because there are excellent opportunities for employing these applications. As a component part of a hybrid drive, the electric motor in electric drive systems can assist the combustion engine by providing additional energy when peak power is required. When idling, the electric motor, which simultaneously acts as a generator, is able to re-charge the battery. In the low load range, for forklift trucks for example, we will also offer all-electric drives in future.

Other potential benefits offered by the E-DEUTZ strategy include the downsizing of combustion engines and, as a consequence, lower fuel consumption. This will noticeably reduce customers’ operating costs and, furthermore, it will make a positive contribution to the environment by considerably reducing CO_2 emissions. In urban areas, meanwhile, reducing both particle and nitrogen oxide emissions together with limiting noise pollution remains a topic of major concern.

INDICATIVE APPLICATIONS

ADVANTAGES

- Increased torque
- Engine downsizing (hybrid) – same interfaces
- CO_2 reduction
- TCO reduction (total cost of ownership)

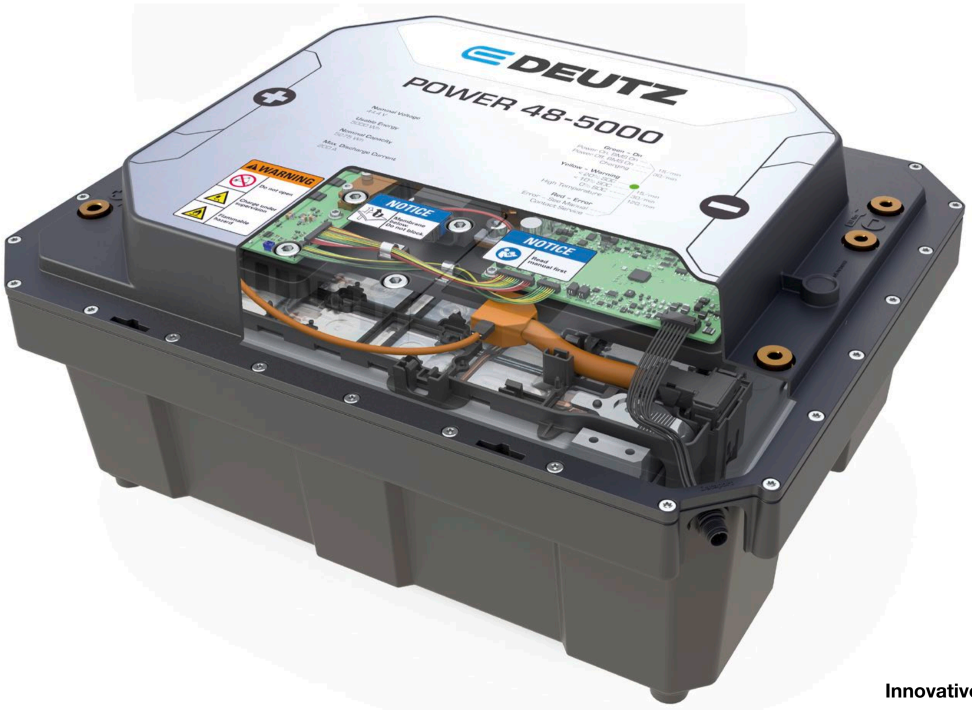
TORQEEDO KNOW-HOW TRANSFER

- System architecture for electric drives
- Expertise in regulations
- 48 and 400 volt know-how
- Battery expertise – lithium-ion technology
- Power electronics and battery management systems expertise
- Accelerated R&D process
- Earlier market launch

E-DEUTZ – ROADMAP

2017	ACQUISITION OF TORQEEDO
2018	BUILDING OF HYBRID AND FULLY ELECTRIC PROTOTYPES
2019	MODULAR PRODUCT SYSTEM E-DEUTZ
2020	MARKETABLE HYBRID AND ALL-ELECTRIC PRODUCTS
2021	START OF ROLLOUT, FIRST RELEVANT REVENUE
2022/2023	5–10% OF OUR REVENUE

As part of our E-DEUTZ strategy, we will be investing approximately €100 million in the period 2017 to 2019 including the acquisition of Torqeedo. We will build up additional e-technology resources at both DEUTZ and Torqeedo. We aim to introduce the first products from the E-DEUTZ strategy onto the market in around two years. We are assuming that in five years from now between 5 and 10 per cent of our revenue will come from hybrid or all-electric drive systems. Our E-DEUTZ strategy is based on the requests of those of our customers who want to install an electrified drive system. This is why, together with our partners, we will begin the series production development of the appropriate drive systems as soon as possible.



Innovative battery technology

HYBRID DRIVES

Essentially, hybrid drives, in which the combustion engine is combined with an electric motor, exhibit various degrees of hybridisation. In a full hybrid, the propulsive power is provided entirely by the electric motor. In a mild hybrid, the e-drive assists the combustion engine, resulting in greater efficiency. The underlying principle is simple: In order to supplement the combustion engine, DEUTZ installs a powerful e-drive which simultaneously acts as a generator. In the partial-load range, the diesel engine is constantly run within an efficient operating range and any excess power is used to generate electrical energy, which is stored in a lithium-ion battery. When high performance levels are demanded, the e-drive assists the combustion engine, making use of the energy stored earlier. The basic prerequisite is for the voltage of the vehicle's onboard electrical system to be raised to at least 48 V so that the energy can be safely transferred between the electric motor and the lithium-ion battery. In addition, a standard 12/24 V network for traditional consumer units, such as the motor's control electronics, is operated via a DC/DC converter. 'Mild' hybridisation of the compact DEUTZ four-cylinder engines is being undertaken so that customers' applications can achieve the same performance as they would with a correspondingly bigger combustion engine. The main effects of downsizing using hybrid technology are that fuel is saved and CO_2 emissions reduced. Initial simulation work shows that this can lower fuel consumption by up to 12 per cent while, at the same time, improving the engine's environmental footprint.

GOING IN NEW DIRECTIONS WITH TORQEEDO

Torqeedo is by some distance the world market leader in the growing segment for electric drive systems for boats. Since the company was established in 2005, Torqeedo, a pioneer in the sector concerned with electromobility for marine applications, has set many standards, confirming the lead enjoyed by its engines compared with every other solution on the market. Since it was established, Torqeedo has grown by an average of 30 to 40 per cent every year.

Superior technology and revolutionary benefits – every product which Torqeedo brings to market fulfils both these criteria. At present, Torqeedo supplies outboard and inboard engines, electric and hybrid drives with outputs from 0.5 to 50 kW; this will rise to more than 100 kW in future. These drives are complemented by any number of functional and innovative accessories, from lithium batteries and solar charging devices to smartphone apps.

All Torqeedo engines operate at unsurpassed levels of overall efficiency; this is the most important parameter for electric drives installed in boats because it determines what power output levels and ranges are possible with limited battery reserves. Their power output in relation to engine weight is also unique.

Every day, Torqeedo products, now available in more than 50 countries – and counting – are attracting a growing fan base. The current trend towards electromobility is being driven by fundamental developments which will not change in the immediate future: continuous world population growth and increasing prosperity in populous countries such as China and India, together with rising energy consumption and the demand for mobility.

FOUNDED IN

2005

32 ELECTRIC BOAT DRIVES

POWER OUTPUT RANGE OF

0.5–50 kW

Throughout the world, both east and west, in industrialised countries as much as in developing countries, people from all walks of life express the desire to preserve the natural environment for future generations. There is a corresponding interest worldwide in environmentally friendly solutions. This is reflected by the increasing acceptance by consumers of sustainable lifestyles and the growth in demand for all things related to electromobility.

In view of this and the huge progress made in the performance of electric drives, it is foreseeable that clean, electric drives will increasingly take up their place in the market. Torqeedo is leading this development in the marine application segment.

DEUTZ AG completed its acquisition of Torqeedo GmbH on 1 October 2017. As part of the DEUTZ Group, Torqeedo is to continue along its present path towards growth under its own independent 'Torqeedo' brand name and will move into further marine business segments. At the same time, the Torqeedo and DEUTZ development teams will push ahead together with the electrification of DEUTZ's range of off-highway products.

torqeedo

- Founded in 2005 in Starnberg, Germany
- International team comprising 130 employees
- Extensive development expertise and field experience in electric motors, power electronics, lithium-ion battery technology and battery management systems, hybrid technology and systems integration
- Drive systems with outputs from 0.5 to 50 kW, system voltages from 24 V to 400 V
- Company headquarters in Gilching, Starnberg (Germany).
  Sales outlets in Crystal Lake, IL (USA) and Bangkok (Thailand)
- More than 70,000 electric drive systems in the field
- Over 60 MWh of lithium-ion battery capacity in the field

We care. We support. We deliver.

DEUTZ SERVICE.

As far as DEUTZ is concerned, its business relationship with its customers does not end with the sale of an engine. The global DEUTZ Service network is fast, efficient and cost-effective. It is a reliable partner and expert problem-solver for all engine-related requirements. Our in-depth understanding of what is required throughout the engine life cycle, the technical know-how of our service experts and our broad range of products and services mean we are always in a position to offer our customers the best solution. Our service business has enjoyed sustained growth in recent years.

And excellent service is set to remain one of the key ways in which DEUTZ will stand out from the competition. We are investing in our service network and continuously expanding our range of products so as to strengthen this profitable area of business.

ACQUISITION OF IML MOTORI

By taking over IML Motori S.r.l., our long-term sales and service partner, with effect from 1 October 2017, including IML Motoare, the Romanian sales and service company, DEUTZ has continued to grow its service business and increase its focus on its customers around the Mediterranean. This long-term

“The acquisition of DEUTZ Italy – formerly known as IML Motori S.r.l. – is in line with our strategy of investing in our own service network at selected locations in order to achieve further growth in this profitable area of business. The increasing technical complexity of the engine business also requires close contact with our customers.”

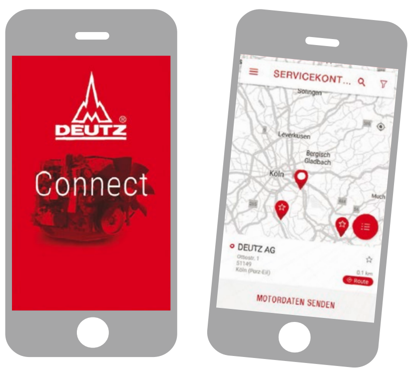
Michael Wellenzohn,
member of the DEUTZ AG Board of Management for Sales/Marketing and Service

distribution partner, which now operates under the name of DEUTZ Italy, sells DEUTZ diesel engines and spare parts to the Italian market. Its experienced management team will continue to support DEUTZ customers.

DIGITALISATION

Together with its dealers, DEUTZ has opened a service portal for workshops, end customers and equipment operators. At www.deutz-serviceportal.com, customers are now able to go online to quickly and securely purchase genuine DEUTZ spare parts and equipment for DEUTZ engines. The portal has a tremendous advantage over other shops in that it provides direct access to original documentation for the more than 1.6 million DEUTZ engines that are in the field, and therefore to information on the latest technical modifications. A search using the individual engine number ensures that the right part will always be found and will be guaranteed to fit. The DEUTZ service portal combines the advantages of the World Wide Web, i.e. unrestricted availability round the clock, with the benefits of qualified, local service: the provision of back-up assistance, service and delivery remain in the hands of the local DEUTZ partner close to the customer. Availability is increased, delivery times are reduced to a minimum and the customer knows they are getting the best possible support.

Our new DEUTZ Connect app for smartphones is a combined hardware/software solution that gives users direct access to live data from their engine. It gathers this data from a Bluetooth interface that is fitted to the engine, which DEUTZ can supply as an accessory for existing equipment in the field. The system enables all the relevant engine data to be accessed from the control unit and sent directly to the DEUTZ service partner via the internet. Dealers thus receive in advance all the information they need to carry out a rapid and precisely targeted repair, which minimises costs and downtime. And thanks to GPS positioning data, customers can easily determine the location of their nearest service dealer and order any spare parts they need from the service portal.



The DEUTZ Connect App helps customers to find their nearest dealer in the service network.

STRATEGIC HIGHLIGHTS

INNOVATIVE DRIVE SYSTEMS

Our objective is to position DEUTZ as the market leader for innovative drive systems in the off-highway segment. We aim to offer our customers a comprehensive choice of modular technological building blocks for powering their equipment. We have already mapped out the strategic course we intend to follow.

33

Stage V certified diesel engines

STAGE V CERTIFIED

DEUTZ is the first engine manufacturer in the world to be awarded a certificate for the EU Stage V emissions directive, which will apply from 2019. As the trailblazer for this technology, we are providing our customers with flexibility and planning certainty when integrating engines into their equipment in preparation for the forthcoming change in emissions standards.

NEW HEAVY-DUTY ENGINES

We intend to broaden our diesel engine portfolio in the upper power output range as part of a collaborative partnership. From 2019, four new heavy-duty engines will be available for our customers to buy. The cubic capacities of these power units range from 9.0 to 18.0 litres.

TCD

9.0 l 13.5 l

12.0 l 18.0 l

E-DEUTZ

The E-DEUTZ strategy has spurred on the talent for invention which has characterised DEUTZ since the day it was founded. We intend to electrify drive systems wherever it makes technical and economic sense to do so. Expanding our product range to include hybrid and fully electrified drive systems will open up further growth potential for DEUTZ.

5–10%

expected proportion of revenue in 5 years

SERVICE NETWORK

DEUTZ is investing in its own service network at selected sites so as to continue to grow in this profitable area of business. The increasing technical complexity of the engine business also requires close contact with our customers. Therefore, as part of our succession plans, we have grasped the opportunity of taking over our long-term dealer in Italy.

800

sales and service partners worldwide

TORQEEDO

The acquisition of Torqeedo, the electromobility specialists, gives DEUTZ the expertise which will speed up our E-DEUTZ strategy. As the market leader in the electric marine engine sector, Torqeedo will continue to grow under its own brand name.

DIGITALISATION

The continuing trend towards digitalisation has implications for business processes, value chains and production processes. Last year, we set up two important tools, the DEUTZ service portal and the DEUTZ service app, so that our customers' needs could be met with progressive, digital solutions.

2017 COMBINED MANAGEMENT REPORT FOR DEUTZ AG AND THE DEUTZ GROUP

OVERVIEW OF 2017

Significantly better key financials DEUTZ can look back on a very successful 2017. At €1,556.5 million, new orders were up by 23.4 per cent on the previous year. We sold 161,646 engines and increased our revenue by 17.4 per cent to €1,479.1 million. There was also a sharp rise in operating profit (EBIT before exceptional items), which climbed by €19.0 million to €42.4 million. This underlines the success of the steps that we have taken.

Acquisition of Torqeedo and IML Motori We completed two major acquisitions in 2017. At the end of September, we acquired Torqeedo GmbH, a systems solution specialist and market leader with many years of experience in electromobility for marine applications. It forms the nucleus of our E-DEUTZ strategy. And having acquired our long-standing sales and service partner IML Motori S.r.l. on 1 October 2017, we are also strengthening our high-margin service business. This acquisition brings us closer to our customers around the Mediterranean.

Steps to increase efficiency successfully completed We completed the comprehensive programme of optimisation at our sites in Germany during the year under review. The transfer of crankshaft and camshaft production from Cologne-Deutz to the new shaft centre in Cologne-Porz was finished in February 2017. The relocation of all functions from Übersee on Lake Chiemsee to Ulm was also completed. These steps are enabling us to make substantial efficiency gains every year, thanks in no small part to the new shaft centre and the relocation of Xchange assembly to Ulm.

Cologne-Deutz site sold Following the transfer of the Cologne-Deutz plant to Cologne-Porz, the land was sold to a project developer in May 2017. The site, which occupies an area of approximately 160,000 square metres, is to be redeveloped in the coming years to create a new city district with a high proportion of housing. DEUTZ received a sum of around €125 million as purchase consideration for the sale in 2017. We are also expecting a further, final instalment of the purchase consideration in the coming years that will be in the mid-double-digit million euros.

Expansion of the product range Our objective is to position DEUTZ as the market leader for innovative drive systems. To this end, we are mainly investing in product innovation, aftersales support and internationalisation. We intend to broaden our diesel engine portfolio in the upper power output range as part of a collaborative partnership entered into last year. As a result, four new heavy-duty engines with a cubic capacity in the range of 9.0 to 18.0 litres will be available for our customers from 2019. Moreover, DEUTZ was the first engine manufacturer in the world to be awarded a certificate for the EU Stage V emissions directive, which will apply from 2019. This gives our customers a high level of flexibility and a reliable basis for their planning.

New Chief Financial Officer Dr Andreas Strecker was appointed as a member of the DEUTZ AG Board of Management with effect from 1 March 2018. From 1 April 2018, he will assume responsibility for Finance, HR, Purchasing and Information Services. Dr Strecker takes over the role of Chief Financial Officer from Dr Margarete Haase, whose contract ends on 30 April 2018.

FUNDAMENTAL FEATURES OF THE GROUP

BUSINESS MODEL AND SEGMENTS

DEUTZ is one of the world's leading manufacturers of drive systems and was founded in 1864 by Nicolaus August Otto, developer of the four-stroke engine, and Eugen Langen. We are an independent producer of diesel and gas engines for on-highway and off-highway applications. The product range is currently being expanded to include new gas and diesel engines with a power output of between 19 and 620 kW as well as hybrid engines and all-electric drive systems. The DEUTZ Group's customers include manufacturers of construction equipment, agricultural machinery, lifting and material handling equipment and other equipment as well as the users of such machines. Operating activities are divided into three segments: DEUTZ Compact Engines, DEUTZ Customised Solutions and Other. The DEUTZ Compact Engines segment comprises liquid-cooled engines with capacities of up to 8 litres. The DEUTZ Customised Solutions segment specialises in air-cooled engines and large liquid-cooled engines with capacities of more than 8 litres. Operating under the name DEUTZ Xchange, the DEUTZ Customised Solutions segment also supplies reconditioned engines and parts. The Torqeedo subsidiary has been included in the Other segment since the fourth quarter of 2017. It manufactures electric drives for boats and has extensive expertise in the electrification of drive systems.

DEUTZ also offers its customers advice and support on installing and operating the drive systems. We actively assist customers with the repair, maintenance and servicing of their vehicles fitted with DEUTZ engines. The global DEUTZ service network, which comprises subsidiaries, service centres and authorised agents, guarantees a reliable and rapid supply of spare parts.

DEUTZ AG

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

MAIN SITES AND BASIS OF CONSOLIDATION

DEUTZ maintains a very strong presence in the global market. Following the acquisition of Torqeedo and DEUTZ Italy (formerly IML Motori S.r.l.), DEUTZ now has 19 sales companies, nine sales offices and over 800 sales and service partners in more than 130 countries. DEUTZ AG is the executive and operating parent company in the DEUTZ Group; it is headquartered in Cologne, Germany. It has various domestic and foreign subsidiaries, including several companies that perform sales and service functions plus a production facility in Spain. The equity-accounted joint venture DEUTZ Dalian in China produces diesel engines that are primarily destined for the Chinese market.

In addition to DEUTZ AG, eight German companies (31 December 2016: seven) and 17 foreign companies (31 December 2016: twelve) were included in the consolidated financial statements as at 31 December 2017. A complete list of DEUTZ AG shareholdings as at 31 December 2017 is given in the annex to the notes to the consolidated financial statements on page 139.

MARKET AND COMPETITIVE ENVIRONMENT

DEUTZ's market consists of drive solutions for construction equipment, agricultural machinery, lifting and material handling equipment, pumps, gensets, medium-duty trucks and buses. Its sales are concentrated in countries with stringent emissions standards and, currently, on diesel engines. The market for alternative fuels and electrified drives is expanding all the time. To reflect this evolution, DEUTZ is developing its engines so that they can run on gas, petroleum and biogenic and synthetic fuels. It is also broadening its product portfolio to include electric and hybrid drive systems. The overall market can be divided into the captive segment and the non-captive segment. The captive segment comprises equipment manufacturers who produce their own engines; some of these manufacturers are also active as engine suppliers in the market but also use third-party engines in their equipment. The non-captive segment is made up of equipment manufacturers who, for the most part, do not produce their own engines and therefore buy in engines from suppliers. DEUTZ is able to sell engines with outputs between 19 kW and 620 kW around the globe in both segments. We have attained a good position as one of the biggest suppliers in our relevant market. We face competition from rival engine suppliers in western Europe, North America and Asia, but none of these competitors can offer an identical product range to DEUTZ in terms of the power outputs and application segments that they cover.

Main competitors

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

INTERNAL CONTROL SYSTEM

RESPONSIBLE CORPORATE MANAGEMENT BASED ON TRANSPARENT PERFORMANCE INDICATORS

The DEUTZ Group defines its budget targets and medium-term corporate targets using selected key performance indicators (KPIs). In order to increase profitability and achieve sustained growth, we manage the Group on the basis of the following financial performance indicators:

		2017	2016
Revenue growth	%	17.4	1.0
EBIT margin (before exceptional items)	%	2.9	1.9
Working capital ratio [1] (average)	%	13.4	17.9
ROCE (before exceptional items) [1]	%	5.5	3.1
R&D ratio	%	4.5	4.0
Free cash flow [1]	€ million	82.5	4.7

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

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

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

EBIT margin (before exceptional items)

€ million

	2017
EBIT	146.5
Exceptional items	
Proceeds from the sale of the Cologne-Deutz site	–98.8
Proceeds from the sale of a building lease in Hamburg	–10.0
Transaction costs in relation to Torqeedo and IML	4.7
Total exceptional items	**–104.1**
EBIT (before exceptional items)	**42.4**
Revenue	**1,479.1**
EBIT margin (before exceptional items)	**2.9 %**

The exceptional items include a gain of €98.8 million, after deduction of transaction costs, resulting from the disposal of the land occupied by our former Cologne-Deutz site. There was also a €10.0 million gain relating to the disposal of the building lease of our subsidiary Ad. Strüver for a plot of land in Hamburg that was no longer being used for production purposes.

These positive exceptional items were partly offset by negative exceptional items of €4.7 million in the year under review. Legal and consultancy costs of €4.7 million arose in connection with the acquisition of Torqeedo GmbH, Gilching, and IML Motori S.r.l., Milan, Italy, which were completed in the fourth quarter of 2017.

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

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

ROCE

€ million

	2017	2016
Total assets	1,213.1	1,059.7
Cash and cash equivalents	–143.8	–91.8
Trade payables	–207.5	–162.3
Other current and non-current liabilities	–71.3	–57.3
Capital employed	**790.5**	**748.3**
Capital employed (average for the year)	**769.4**	**752.7**
EBIT (before exceptional items)	**42.4**	**23.4**
ROCE (before exceptional items)	**5.5 %**	**3.1 %**

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

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

Based on these performance indicators, DEUTZ has set up an early warning system in order to be proactive and respond promptly. At the same time, we operate a sound system of causal analysis to ensure that we minimise risks and make the most of opportunities. Three times a year we produce an annual forecast for all key performance indicators.

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

CONTINUOUS OPTIMISATION OF THE CONTROL SYSTEM

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

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

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

BUSINESS PERFORMANCE IN THE DEUTZ GROUP

ECONOMIC ENVIRONMENT

Global economic growth continues to accelerate The growth of the world's economy continued to pick up pace in 2017. Nearly all regions contributed to this expansion, with Europe and Asia particularly exceeding expectations. The latest forecasts factor in the anticipated impact of the US tax reforms that were recently approved. The International Monetary Fund (IMF)[1] is expecting global economic growth of 3.7 per cent for 2017 as a whole, compared with 3.2 per cent in 2016.

The economy of the eurozone grew by 2.4 per cent in 2017, which was considerably stronger than the increase of 1.8 per cent in 2016. Germany's economy stepped up the pace of growth significantly, expanding by 2.5 per cent year on year (2016: 1.9 per cent). Spain again reported strong growth with a rate of 3.1 per cent (2016: 3.3 per cent). France's growth rate was also up sharply on the previous year at 1.8 per cent (2016: 1.2 per cent), as was Italy's at 1.6 per cent (2016: 0.9 per cent).

The economic upturn continued in the USA, where the economy expanded by 2.3 per cent overall (2016: 1.5 per cent). Given the tax cuts and sustained fall in unemployment, this growth is set to continue. The growth of the Chinese economy was on a par with the previous year at 6.8 per cent (2016: 6.7 per cent). Russia's economy emerged from recession, achieving growth of 1.8 per cent. South America also appears to have turned the corner.

Positive trend in DEUTZ's customer industries In 2017, DEUTZ's main customer markets performed well in all regions. Demand for construction equipment rose by around 13 per cent[2] in Europe, by 5 per cent[2] in North America and by over 30 per cent[3] in China. Europe's material handling sector grew by 7 per cent[2]. In North America[3], the expansion of the material handling sector was comparable with that of the construction equipment sector. In China[3], the material handling market grew at a slightly slower rate than the construction equipment market. Europe's agricultural machinery sector grew by up to 5 per cent[3]. Unit sales of light and medium-duty trucks in China improved by up to 5 per cent[3], while the market for heavy-duty trucks saw very strong expansion.

[1] IMF World Economic Outlook Update, January 2018.
[2] According to Power Systems Research (PSR).
[3] Own estimate.

IMPACT OF ECONOMIC CONDITIONS ON BUSINESS PERFORMANCE

Much brighter market environment On the whole, economic conditions were far more positive in 2017 than in the year before. Prices for oil, commodities and agricultural goods rose in 2017, stimulating capital expenditure in all of the major application segments and in all regions. Moreover, by the end of 2016 DEUTZ's European customers had used up most of the stock of engines that they had built up ahead of the last change to emissions standards. This had led to reduced demand in previous years. These customers' ordering patterns have since normalised and, in 2017, were once again largely in line with their requirements. The market's revival and this depletion of customers' inventories resulted in a sharp rise in new orders at DEUTZ.

The global economy grew by 3.7 per cent in 2017. DEUTZ's revenue rose by 17.4 per cent in this period. The economy in the eurozone expanded by 2.4 per cent in the year under review. DEUTZ's main customer industries – construction equipment, material handling equipment and agricultural machinery – also fared well in this region. Our revenue in our largest market, EMEA (Europe, Middle East and Africa), climbed by 21.9 per cent in 2017.

The US economy remained on its growth trajectory, expanding by 2.3 per cent. Demand for construction equipment and material handling equipment also rose in North America. Our revenue in the Americas region advanced by 11.9 per cent. China, our key international market, generated economic growth of 6.8 per cent, which was on a par with 2016. Against this backdrop, the markets for construction equipment and for light and medium-duty trucks saw slight growth while the heavy-duty truck market expanded significantly. By contrast, DEUTZ's revenue in the Asia-Pacific region fell slightly, by 0.3 per cent, as the figure for the prior year had included licensing income.

DEUTZ thus outperformed the market in virtually all regions and application segments.

RESEARCH AND DEVELOPMENT

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

€ million (R&D ratio in %)

2017	**67.0**	**(4.5)**
2016	50.4	(4.0)
2015	40.8	(3.3)
2014	53.1	(3.5)
2013	52.6	(3.6)

[1)] Research and development expenditure after deducting grants from development partners and subsidies.

R&D spending stepped up significantly[1)] Expenditure on research and development in 2017 amounted to €70.9 million (2016: €53.5 million). After deducting grants received from development partners and subsidies, expenditure was €67.0 million (2016: €50.4 million), which was in line with the planning. The R&D ratio (after deducting grants), i.e. the ratio of net development expenditure to consolidated revenue, thus increased to 4.5 per cent (2016: 4.0 per cent). The rise in R&D expenditure compared to spending in the prior year was largely attributable to the expansion of our product range. In the year under review, 26.1 per cent of development expenditure after deducting grants was capitalised (2016: 18.1 per cent).

Spending by the DEUTZ Compact Engines segment after deducting grants came to €63.5 million (2016: €47.7 million) and that of the DEUTZ Customised Solutions segment came to €2.2 million (2016: €2.7 million). The Other segment's spending after deducting grants amounted to €1.3 million (2016: €0.0 million); this figure included Torqeedo's R&D expenditure from the fourth quarter of 2017.

Stage V certified In previous years, we had completely overhauled our engine portfolio due to the introduction of the EU Stage IV/US Tier 4 emissions standards. Our engines are also equipped to meet the next European emissions standard, EU Stage V[2)], which comes into effect in 2019. Most of our TCD engines in the 3.6 to 7.8 litre capacity range were certified for Stage V in 2017 – the first engines worldwide to obtain such certification. It is not yet known whether a further emissions standard will be introduced in the USA.

Ongoing enhancements to the product portfolio We are expanding our product range through new development, alliances and acquisitions. The D/TD/TCD 2.2, for example, is a three-cylinder engine that we are developing on the basis of the existing four-cylinder engine with a 2.9 litre capacity. In addition, we will offer smaller engines not only in a diesel variant but also in a liquefied petroleum gas (LPG) variant. The latter is a particularly interesting option for forklift trucks and other material handling applications. We are also planning to offer 'bi-fuel' engines, i.e. engines that can run on LPG and petroleum.

Our plans for our larger engines include the introduction of a four-cylinder engine with a 9 litre capacity and six-cylinder engines with capacities of 12.0, 13.5 and 18.0 litres in cooperation with Liebherr Machines Bulle S.A. These industrial engines with outputs between 200 and 620 kW represent an important extension to our upper power output range.

The diesel engine debate is driving the development of new technologies. Alternative drives will also play an important role in DEUTZ's core segments in future. DEUTZ is seizing the opportunities arising from the changing conditions by introducing the E-DEUTZ strategy to complement its innovative drive systems. The strategy focuses on the development and manufacture of

[1)] Research and development expenditure constitutes actual spending on R&D projects. It differs from the research and development costs recognised in the income statement in that development expenditure that can be capitalised is deducted and amortisation on completed development projects is added.

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

hybrid and all-electric drive systems for off-highway applications. The acquisition of Torqeedo, the market leader for electric drives for boats, is significantly accelerating and supporting the electrification of DEUTZ's drive units. Some of the greatest potential is to be found in the substantial reduction of fuel consumption and the lowering of operating costs.

Most of our medium-duty engines are now Stage V certified. Expected demand for these engines has increased as a result. In addition, the E-DEUTZ strategy is opening up new opportunities for our product portfolio. We have therefore decided to stop the complete redevelopment of the four-cylinder 5.0 engine that had been planned. Instead, we will meet customers' requirements from our existing product portfolio and by refining existing engines, which will involve significantly less capital expenditure. Details of the related impairment loss can be found in the 'Earnings performance' section on page 41.

We have also continued to concentrate on data transfer and analysis (Industry 4.0) so that we can offer our customers new services in the future. As a first step, we made our new DEUTZ Connect App available to customers in November 2017.

Preliminary development work intensified Exhaustive research and development will continue to form the basis for innovative products and services from DEUTZ in future. We have recently expanded our activity in the field of alternative fuels. As well as looking at natural gas, we are focusing on hydrogen and on fuels generated from renewable sources. The aforementioned projects under the E-DEUTZ strategy are still classified as preliminary development work at the moment.

PROCUREMENT

In 2017, the main areas of focus in terms of purchasing were ensuring continuity of supply and optimising quality. Due to economic growth worldwide, significant effort was required in many different industries and sectors to ensure that the entire supply chain was able to keep up with the increase in demand for engine components. Major bottlenecks were avoided by proactively managing capacity and ensuring the necessary collaboration between logistics and purchasing. In this context, capacity at suppliers that might potentially create supply bottlenecks was increased so that it will be possible to continue adapting to higher demand and faster changes in future.

Commodity prices rise for the second year in a row We have been seeing price increases in the primary markets since 2016. Overall, all the average prices for the year were slightly higher in 2017 than the ranges that had been forecast. The effects were only partly offset by savings initiatives and improvements to purchasing terms.

Measures to reduce costs stepped up In 2017, we intensified our efforts to lower costs, not only to ensure our competitiveness in respect of the next European emissions standard (EU Stage V) but also to offset the negative impact on costs of commodity prices and the procurement of materials. We focused on engine series of less than 4 litres and on the following material groups: exhaust aftertreatment, injection technology and controllers.

We again utilised potential for further savings by increasing the proportion of procurement from emerging markets. By starting work on localising the 2.9 engine series in our joint venture DEUTZ (Dalian) Engine Co., Ltd., China, we will further improve the cost situation so that we can tackle mounting competitive pressure.

Preparations for procuring new innovative products The procurement department has equipped itself to deal with the new challenges presented by the E-DEUTZ strategy and added innovative products in the areas of e-machinery, power electronics and batteries to its portfolio of material groups. The pace of development, both technical and commercial, accelerated significantly during the year under review.

PRODUCTION AND LOGISTICS

In production and logistics, the main areas of focus in 2017 were product quality, process quality and efficiency. We also initiated, and in some cases successfully completed, a number of measures as planned as part of efforts to optimise our network of sites.

The Cologne plants, Germany Following the consolidation of our sites in Cologne, which included closing the plant in Cologne-Deutz, we have brought the organisational units relating to production in Cologne under a single management team so as to further increase our efficiency. Our new shaft centre in Cologne-Porz was officially opened on 6 April 2017. Last year, we initiated various steps aimed at improving quality at our largest site, Cologne-Porz. This included optimising and renewing the painting robots and application equipment in the painting area as well as increasing the quality checks throughout the assembly process. New packaging equipment incorporating video documentation was implemented in the logistics processes in order to ensure the quality of goods on delivery. A DEUTZ production system learning factory was established to provide standardised skills training for our employees; training on specific topics is offered regularly using 'learning islands'. Preparations for handling the new gas engines and the 2.2 series in the assembly, test rig and logistics departments are well under way.

At our centre of excellence for add-on components in Herschbach, the central washing and preservation facility was completely renewed last year in order to comply with quality requirements.

The plants in Ulm and Übersee on Lake Chiemsee, Germany The relocation of the removal, inspection and reconditioning of Xchange engines from the plant in Übersee on Lake Chiemsee to the Ulm plant was completed on schedule in June 2017. Revenue and unit sales of the exchange engines increased, even during the relocation phase. Once everything had been relocated, the Übersee plant was decommissioned. This was the final step in optimising the network of sites in Germany.

In 2017, preparations were made at the Ulm plant for the creation of bespoke applications for the new heavy-duty engines under the alliance with Liebherr. This was the next step in the expansion of the Ulm site, which is evolving into the plant for small production runs, focusing on DCS products, project business, exchange engines and models that are soon to be discontinued.

The Zafra plant, Spain Our plant in Zafra produces the crankcases for engines of up to 4 litres in addition to the other major engine components already manufactured there, namely cylinder heads, conrods and gearwheels. Capacity was increased in 2017 – by 30 per cent for crankcases.

The Pendergrass plant, USA Due to the strong growth in the volume of Xchange business in the United States, we invested further in increasing productivity and output at our plant in Pendergrass, Georgia/USA.

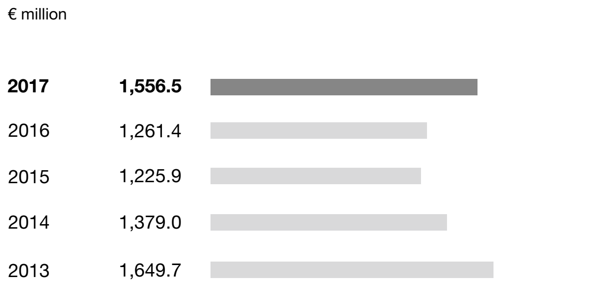
DEUTZ DALIAN JOINT VENTURE

We have been operating the DEUTZ Dalian joint venture – in which our Chinese production activities are concentrated – with the First Automotive Works Group, one of China's leading truck manufacturers, since 2007. In the joint venture, we produce 3 to 8 litre diesel engines, mainly for automotive and industrial applications for the local market. Local production ensures that we have the proximity to our customers that we need.

In 2017, unit sales in the DEUTZ Dalian joint venture fell by 5.6 per cent to around 64,000 engines. By contrast, revenue rose by 0.9 per cent to €305.6 million. Adjusted for exchange rate effects, the increase in revenue was 5.2 per cent. The company, accounted for under the equity method, contributed €1.9 million to earnings (2016: negative impact of €5.7 million).

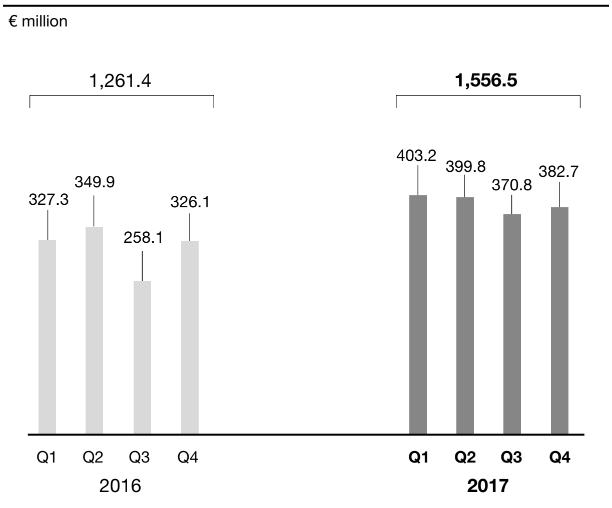
NEW ORDERS

DEUTZ Group: New orders



Sharp year-on-year rise in new orders The DEUTZ Group received new orders worth €1,556.5 million in 2017, which was 23.4 per cent above the figure of €1,261.4 million achieved in the previous year. New orders increased in all the main application segments: by 44.1 per cent in Material Handling, by 39.3 per cent in Agricultural Machinery, by 29.9 per cent in Construction Equipment and by 16.7 per cent in Stationary Equipment. The Automotive application segment's new orders declined by 19.9 per cent. Our truck and bus engine business is increasingly shifting to our Chinese DEUTZ Dalian joint venture, which is consolidated under the equity method and is therefore not included in the DEUTZ Group's sales figures. The service business maintained the strong performance seen in recent years with a rise of 9.6 per cent. New orders followed a positive trajectory over the course of the year, with year-on-year increases in every quarter. In the fourth quarter of 2017, we received new orders amounting to €382.7 million, which was 17.4 per cent more than in the fourth quarter of 2016. DEUTZ Italy (formerly IML Motori S.r.l.) and Torqeedo have been fully consolidated since the fourth quarter of 2017, so their new orders are included in the total for the final quarter of the year.

DEUTZ Group: New orders by quarter

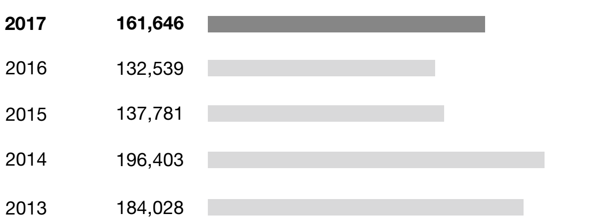


Orders on hand totalled €270.9 million as at 31 December 2017, a rise of 41.8 per cent compared with the figure of €191.0 million at the end of 2016.

UNIT SALES

DEUTZ Group: Unit sales

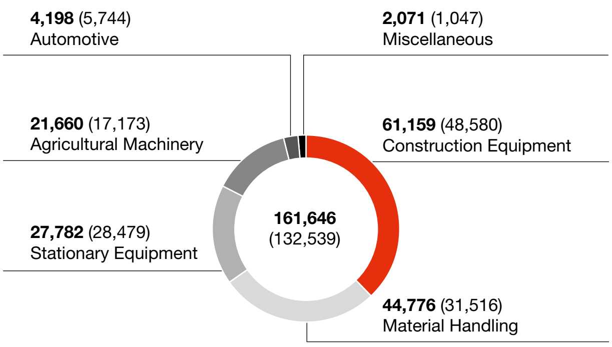
units



Significantly more engines sold DEUTZ sold 161,646 engines in 2017, which was 22.0 per cent more than in the prior year (2016: 132,539 engines). Unit sales were up significantly in the Material Handling (by 42.1 per cent), Agricultural Machinery (by 26.1 per cent) and Construction Equipment (by 25.9 per cent) application segments. However, the Automotive application segment sold 26.9 per cent fewer engines, while Stationary Equipment's engine sales were down by 2.4 per cent.

DEUTZ Group: Unit sales by application segment

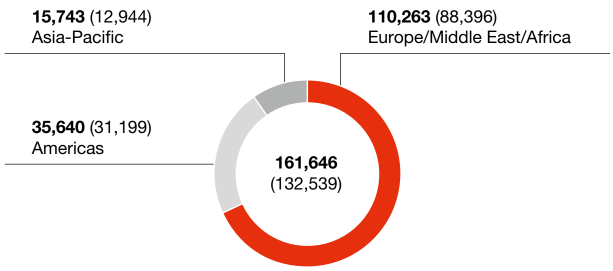
units (2016 figures)



All regions reported higher unit sales in the reporting year. Sales of engines in our largest market, EMEA (Europe, Middle East and Africa), increased by 24.7 per cent to 110,263. They were up by 14.2 per cent to 35,640 in the Americas and by 21.6 per cent to 15,743 in the Asia-Pacific region.

DEUTZ Group: Units sales by region

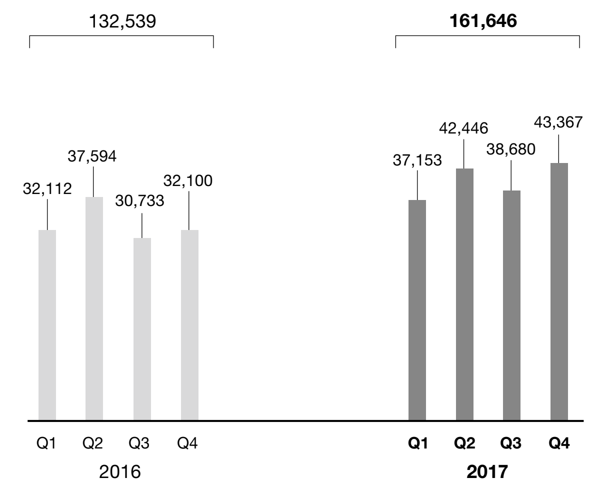
units (2016 figures)



Year-on-year increases were registered in all four quarters. In the final quarter of 2017, DEUTZ sold 43,367 engines, which was an increase of 35.1 per cent compared to the fourth quarter of 2016 and 12.1 per cent compared to the third quarter of 2017. The figure for the fourth quarter of 2017 also included the unit sales of Torqeedo for the first time, which sold 1,235 engines.

DEUTZ Group: Consolidated unit sales by quarter

units



RESULTS OF OPERATIONS

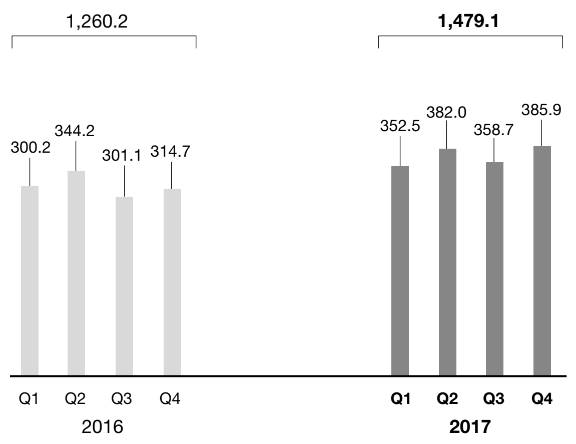
DEUTZ Group: Revenue

€ million

Strong revenue growth DEUTZ generated revenue of €1,479.1 million in 2017, an increase of 17.4 per cent on the previous year (2016: €1,260.2 million). We therefore fully achieved the forecast of a marked rise in revenue that we had published in our 2016 annual report. Contrary to our planning, the average price of the engines sold fell slightly because we sold a larger proportion of engines in the lower power output range.

DEUTZ Group: Revenue by quarter

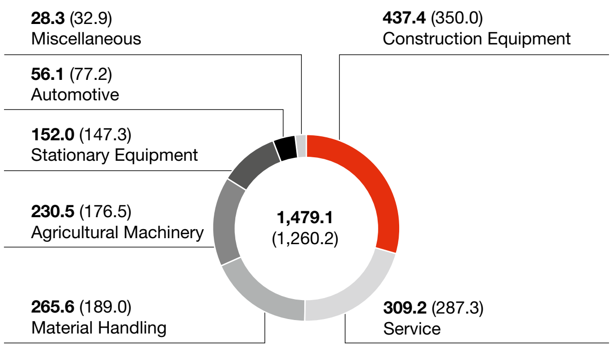
€ million



As with new orders, we saw year-on-year increases in all four quarters. Our revenue in the fourth quarter amounted to €385.9 million, which was 22.6 per cent more than in the fourth quarter of 2016 and 7.6 per cent more than in the third quarter of 2017. The final quarter of 2017 was thus the strongest of the reporting year.

DEUTZ Group: Revenue by application segment

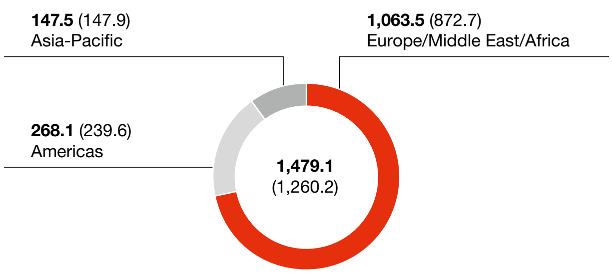
€ million (2016 figures)



The breakdown by application segment presents a slightly more disparate picture. The Material Handling, Agricultural Machinery and Construction Equipment application segments saw sharp rises of 40.5 per cent, 30.6 per cent and 25.0 per cent respectively. Revenue in the service business was up by 7.6 per cent and that of the Stationary Equipment application segment by 3.2 per cent. By contrast, revenue in the Automotive application segment fell by 27.3 per cent.

DEUTZ Group: Revenue by region

€ million (2016 figures)



Broken down by region, revenue in EMEA (Europe, Middle East and Africa) advanced by 21.9 per cent year on year to €1,063.5 million. Revenue in the Americas region increased by 11.9 per cent to €268.1 million. However, the Asia-Pacific region's revenue at €147.5 million was slightly lower, by 0.3 per cent, than in the previous year; the licensing income received in 2016 was not repeated in 2017.

Earnings performance Operating profit before depreciation and amortisation (EBITDA before exceptional items) came to €135.9 million in 2017, up by €21.7 million on the prior-year figure of €114.2 million. The EBITDA margin (before exceptional items) improved slightly to reach 9.2 per cent (2016: 9.1 per cent). However, the EBITDA margin in 2016 had been boosted by a licensing transaction that had contributed €5.5 million to profits.

Operating profit after depreciation and amortisation (EBIT before exceptional items) came to €42.4 million in 2017 (2016: €23.4 million). This significant increase of €19.0 million was attributable to the larger volume of business and the improvement in the share of profit (loss) of equity-accounted investments. Countervailing effects to these positive factors were the higher level of research and development costs (including an impairment loss in the fourth quarter of 2017), negative currency effects and a temporary increase in costs caused by the rapid ramping up of capacities due to the surge in demand last year, especially in logistics. The EBIT margin (before exceptional items) improved to 2.9 per cent in the reporting year (2016: 1.9 per cent). At the start of the year, we had expected a moderate increase in the EBIT margin before exceptional items. As the EBIT margin rose by 1 percentage point, we fully achieved our forecast.

In the fourth quarter of 2017, operating profit (before exceptional items) amounted to €14.6 million. It therefore increased significantly compared with the previous quarter (by €9.6 million; Q3 2017: €5.0 million) and with the fourth quarter of the previous year (by €10.9 million; Q4 2016: €3.7 million) due to the sharp rise in the volume of business. The EBIT margin (before exceptional items) for the fourth quarter of 2017 was 3.8 per cent (Q3 2017: 1.4 per cent; Q4 2016: 1.2 per cent).

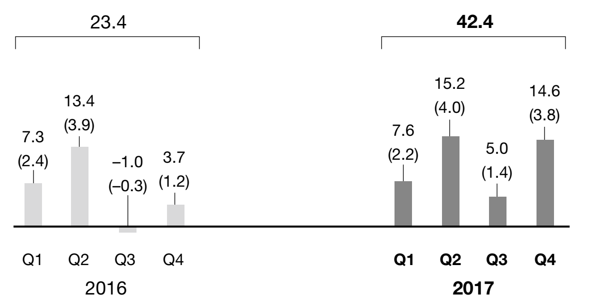
DEUTZ Group: Operating profit and EBIT margin (before exeptional items)

€ million (EBIT margin in %)

2017	**42.4**	**(2.9)**
2016	23.4	(1.9)
2015	4.9	(0.4)
2014	31.7	(2.1)
2013	47.5	(3.3)

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

€ million (EBIT margin in %)



The higher operating profit resulted in a substantially improved return on capital employed (ROCE before exceptional items)[1], our internal KPI, which rose from 3.1 per cent in 2016 to 5.5 per cent in the reporting year. At the start of the year, we had expected ROCE to rise slightly compared with 2016. We exceeded this forecast for the reasons outlined above.

Unlike in 2016, substantial positive exceptional items totalling €104.1 million arose in 2017. Operating profit (EBIT) after these exceptional items came to €146.5 million, a year-on-year rise of €123.1 million (2016: €23.4 million). The exceptional items included a gain of €98.8 million (after deduction of transaction costs and before the final instalment of the purchase consideration) resulting from the sale of the land at our former Cologne-Deutz site. There was also a €10.0 million gain relating to the disposal of the building lease of our subsidiary Ad. Strüver for a plot of land in Hamburg that was no longer being used for production purposes. These positive exceptional items were partly offset by negative exceptional items of €4.7 million in the year under review. Legal and consultancy costs of €4.7 million arose in connection with the acquisition of Torqeedo GmbH, Gilching, and IML Motori S.r.l., Milan, Italy, which were completed in the fourth quarter of 2017.

[1] Return on capital employed (ROCE): ratio of EBIT to average capital employed. Capital employed: total assets less cash and cash equivalents, trade payables and other current and non-current liabilities, based on average values from two balance sheet dates.

Combined management report

Overview of the DEUTZ Group's results of operations

€ million

	2017	2016
Revenue	**1,479.1**	**1,260.2**
Cost of sales	–1,222.9	–1,041.6
Research and development costs	–94.8	–77.5
Selling and administrative expenses	–120.3	–104.7
Other operating income	144.1	17.7
Other operating expenses	–42.1	–26.7
Profit/loss on equity-accounted investments	2.5	–5.1
Other financial income	0.9	1.1
Operating profit (EBIT)	**146.5**	**23.4**
Exceptional items	104.1	–
EBIT (before exceptional items)	**42.4**	**23.4**
Interest expenses, net	–2.4	–3.5
Income taxes	–22.9	–3.9
Net income	**121.2**	**16.0**

Cost of sales In 2017, the cost of sales amounted to €1,222.9 million (2016: €1,041.6 million). This year-on-year rise of €181.3 million was largely attributable to the much higher volume of business and the resultant increase in the cost of materials. The gross margin[1] of 17.3 per cent was at the same level as the previous year (2016: 17.3 per cent). Whereas the gross margin had been boosted by the contribution to earnings from the licensing transaction in 2016, it was squeezed by the capacity-related increase in logistics costs during the reporting year.

Research and development costs In the year under review, research and development costs totalled €94.8 million (2016: €77.5 million). They largely comprised staff costs, the cost of materials and amortisation on completed development projects, from which investment grants received and capitalised development costs were deducted. The rise of €17.3 million compared with 2016 was due not only to the increase in research and development activities but also to an impairment loss of €8.8 million recognised on an uncompleted development project. The much improved market outlook for the engine series in the 4 to 6 litre capacity range, which have already achieved Stage V certification, led to a sharp drop in the expected demand for the 5.0 series. Consequently the development project was written off in full for reasons of commercial viability. It will not be pursued further for the time being. The useful life of the 4.1 and 6.1 engine series was extended as a result. Please also refer to the notes on internally generated intangible assets on page 96 of the notes to the consolidated financial statements.

Selling expenses In 2017, selling expenses amounted to €78.8 million (2016: €68.0 million). The year-on-year increase of €10.8 million was mainly attributable to the intensification of sales activities and the accompanying growth in headcount. Furthermore, the selling expenses for the reporting year included the selling expenses incurred in the fourth quarter by Torqeedo and DEUTZ Italy (formerly IML S.r.l.), which were consolidated for the first time as at 1 October 2017.

Other operating income Other operating income totalled €144.1 million in the reporting year, equating to a rise of €126.4 million compared with the prior year (2016: €17.7 million). This was due, in particular, to the gains resulting from the sale of the land at our former Cologne-Deutz site (€114.6 million) and the disposal of the building lease of our subsidiary Ad. Strüver KG for a plot of land in Hamburg (€10.5 million). The gains on these two transactions were classified as exceptional items. If these exceptional items are excluded, there was a slight increase in other operating income that was mainly attributable to income from the charging on of costs.

Other operating expenses Other operating expenses totalled €42.1 million in the reporting year, a year-on-year rise of €15.4 million (2016: €26.7 million). This increase was primarily due to three exceptional items. Firstly, transaction costs totalling €13.5 million – mainly expenses for services provided by agents and consultants, plus real estate transfer tax – arose in connection with the sale of the land at our former Cologne-Deutz site. Secondly, the provision recognised in 2015 in connection with optimisation of the site network was increased by the costs of €2.3 million still expected for the clearance of the Cologne-Deutz site. Thirdly, legal and consultancy costs of €4.7 million arose in connection with the acquisition of Torqeedo GmbH and DEUTZ Italy (formerly IML Motori S.r.l.), which were completed in the fourth quarter of 2017. Excluding these exceptional items, other operating expenses fell by €5.6 million despite significantly higher foreign currency losses. This is primarily due to smaller additions to other provisions, provisions for pensions and other post-retirement benefits and impairment losses on receivables.

Profit/loss on equity-accounted investments In 2017, there was a profit on equity-accounted investments of €2.5 million, a significant improvement of €7.6 million compared with the previous year (2016: loss of €5.1 million). This change is attributable to the greatly improved contribution to earnings from our Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd. Further information can be found in the 'DEUTZ Dalian Joint Venture' section on page 38.

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

Net interest expense Net interest expense amounted to €2.4 million (2016: €3.5 million). This year-on-year improvement of €1.1 million was attributable to lower utilisation of credit lines, better terms and increased capitalisation of borrowing costs.

Income taxes The income tax expense amounted to €22.9 million in the year under review (2016: €3.9 million). Current tax expenses came to €23.3 million, a year-on-year rise of €14.0 million (2016: €9.3 million). This increase was mainly the result of improved earnings at DEUTZ AG. The current tax expenses were partly offset by deferred tax income of €0.4 million (2016: €5.4 million).

Earnings per share Net income advanced by €105.2 million to €121.2 million in the reporting period (2016: €16.0 million). This led to a significant improvement in earnings per share, which came to €1.00 (2016: €0.14).

BUSINESS PERFORMANCE IN THE SEGMENTS

DEUTZ Group: Segments

€ million

	2017	2016
New orders		
DEUTZ Compact Engines	1,290.4	1,011.6
DEUTZ Customised Solutions	261.3	249.8
Other	4.8	–
Total	**1,556.5**	**1,261.4**
Unit sales (units)		
DEUTZ Compact Engines	151,671	123,179
DEUTZ Customised Solutions	8,740	9,360
Other	1,235	–
Total	**161,646**	**132,539**
Revenue		
DEUTZ Compact Engines	1,227.5	1,000.8
DEUTZ Customised Solutions	247.9	259.4
Other	3.7	–
Total	**1,479.1**	**1,260.2**
EBIT		
DEUTZ Compact Engines	22.5	–6.1
DEUTZ Customised Solutions	24.5	32.7
Other	–4.6	–3.2
Total	**42.4**	**23.4**

BUSINESS PERFORMANCE IN THE DEUTZ COMPACT ENGINES (DCE) SEGMENT

Significantly more orders than in 2016 In the year under review, the DEUTZ Compact Engines (DCE) segment received new orders worth €1,290.4 million, which was 27.6 per cent up on 2016 when orders worth €1,011.6 million were received. All application segments except Automotive saw rises. Orders on hand amounted to €209.0 million at the end of the year, up by 43.6 per cent compared with the end of 2016.

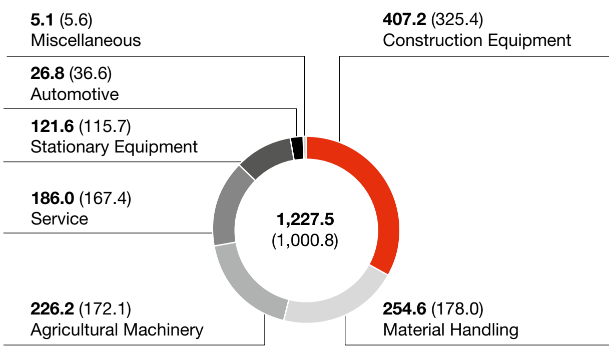
Unit sales up by 23.1 per cent The DCE segment's unit sales rose sharply to reach 151,671 engines, compared with 123,179 engines in 2016. In EMEA, our largest market, we sold 105,381 engines, which was 26.9 per cent more than in 2016. Unit sales climbed by 12.5 per cent in the Americas region and by 23.3 per cent in the Asia-Pacific region. All application segments except Automotive and Stationary Equipment saw increased unit sales.

Considerably higher revenue At €1,227.5 million, revenue in the DCE segment was up by 22.7 per cent year on year (2016: €1,000.8 million). The EMEA region's revenue advanced by 26.4 per cent to €911.7 million. Furthermore, revenue in the Americas region rose by 12.5 per cent to €225.5 million and in the Asia-Pacific region by 14.0 per cent to €90.3 million. The breakdown of revenue by application segment reveals a very positive picture, except in the case of Automotive. The strongest increases were reported in the Material Handling (43.0 per cent), Agricultural Machinery (31.4 per cent) and Construction Equipment (25.1 per cent) application segments. There were also rises in revenue, of 5.1 per cent and 11.1 per cent respectively, for the Stationary Equipment application segment and the service business. However, revenue in the Automotive application segment declined by 26.8 per cent.

Good final quarter In the DCE segment, new orders reached €321.1 million in the fourth quarter of 2017. This was 19.9 per cent more than in the fourth quarter of the previous year and 4.4 per cent up on the previous quarter. Unit sales rose by 33.0 per cent year on year to 39,724 engines and also exceeded the figure for the previous quarter by 8.9 per cent. Revenue in the final quarter of 2017 amounted to €319.9 million, which was 27.4 per cent more than in the fourth quarter of 2016 and 8.8 per cent more than in the third quarter of 2017.

DEUTZ Compact Engines: Revenue by application segment

€ million (2016 figures)



Strong improvement in DCE's operating profit The DEUTZ Compact Engines segment reported an operating profit (EBIT before exceptional items) of €22.5 million in 2017 (2016: operating loss of €6.1 million). This turnaround of €28.6 million was largely attributable to the larger volume of business and the improvement in the share of profit (loss) of equity-accounted investments. The main countervailing effects were higher research and development costs, negative currency effects and increased freight costs. Research and development costs included an impairment loss of €8.8 million recognised in respect of a development project.

BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS (DCS) SEGMENT

Slightly more new orders than in 2016 In the year under review, the DEUTZ Customised Solutions (DCS) segment received new orders worth €261.3 million, which was 4.6 per cent up on 2016 when orders worth €249.8 million were received. All application segments except Automotive and Material Handling saw rises. As at the end of 2017, orders on hand stood at €59.7 million, an increase of 31.2 per cent on the figure reported a year earlier.

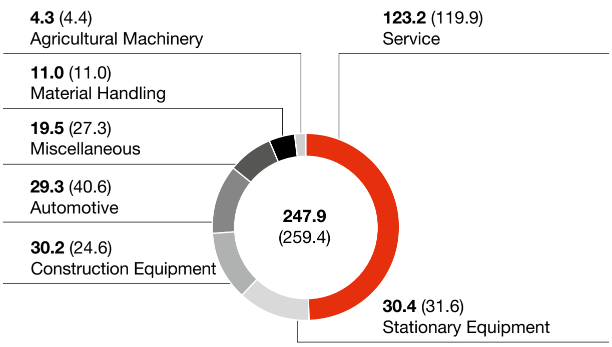
Slightly fewer engines sold Unit sales in the DCS segment declined by 6.6 per cent to 8,740 engines in 2017. Whereas the Americas and Asia-Pacific regions registered an increase, engine sales fell in the EMEA region.

Smaller drop in revenue than in unit sales In the reporting period, the DCS segment's revenue fell by 4.4 per cent to €247.9 million. In the EMEA region, revenue was on a par with the prior year. Revenue rose by 3.8 per cent in the Americas region but decreased by 17.5 per cent in the Asia-Pacific region, partly due to the recognition of licensing income in 2016. The situation in the application segments was very mixed. The Construction Equipment application segment saw strong growth of 22.8 per cent. Revenue from the service business increased by 2.8 per cent, while Material Handling's revenue was on a par with the previous year. By contrast, the Automotive and Stationary Equipment application segments reported decreases of 27.8 per cent and 3.8 per cent respectively.

Weaker fourth quarter except in terms of unit sales In the fourth quarter of 2017, new orders in the DCS segment totalled €56.8 million, down by 2.4 per cent year on year and down by 10.0 per cent on the previous quarter. The 2,408 engines sold in the final quarter exceeded the corresponding figure for the fourth quarter of 2016 by 7.9 per cent. Unit sales were also up by 8.7 per cent compared with the third quarter of 2017. The revenue attributable to the DCS segment in the final quarter amounted to €62.3 million and was down by 2.0 cent year on year and by 3.7 per cent compared with the previous quarter.

DEUTZ Customised Solutions: Revenue by application segment

€ million (2016 figures)



Lower operating profit for DCS than in 2016 The operating profit of the DEUTZ Customised Solutions segment for the reporting year was €24.5 million (2016: €32.7 million). This fall of €8.2 million primarily resulted from the prior-year period having been boosted by a contribution to profits of €5.5 million from a licensing transaction but also because of the contraction in the volume of business in the reporting year.

OTHER

New orders in the Other segment, in which Torqeedo has been included since 1 October 2017, amounted to €4.8 million. A total of 1,235 engines were sold in this period. Revenue in the Other segment came to €3.7 million.

The operating loss reported by the Other segment came to €4.6 million (2016: operating loss of €3.2 million), a deterioration of €1.4 million year on year. Due to the first-time consolidation of Torqeedo as at 1 October 2017, the segment's operating loss for 2017 also includes Torqeedo's operating loss in the fourth quarter of 2017 of €4.7 million. As Torqeedo's product range is primarily designed for marine applications, the fourth quarter is usually weaker due to seasonal factors.

FINANCIAL POSITION

BASIC PRINCIPLES AND OBJECTIVES OF FINANCIAL MANAGEMENT

Overview of the DEUTZ Group's financial position

€ million

	2017	2016
Cash flow from operating activities	112.7	63.8
Cash flow from investing activities	–27.3	–55.4
Cash flow from financing activities	–32.6	–26.8
Change in cash and cash equivalents	52.8	–18.4
Free cash flow from continuing operations	82.5	4.7
Cash and cash equivalents at 31 Dec	143.8	91.8
Current and non-current interest-bearing financial debt at 31 Dec	45.6	60.2
Net financial position at 31 Dec	98.2	31.6

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

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

FUNDING

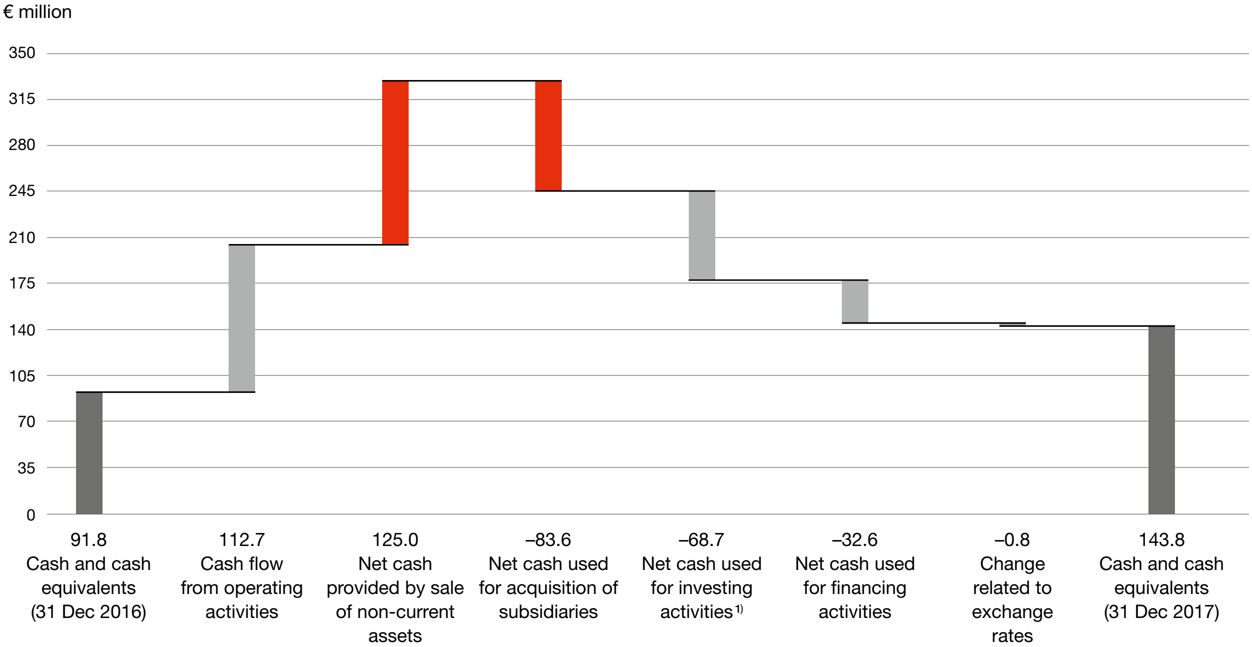
Syndicated credit line and loan from the European Investment Bank ensure sufficient liquidity In order to ensure sufficient liquidity, DEUTZ has at its disposal a syndicated, revolving working capital facility of €160 million provided by a consortium of banks. In 2017, we extended this facility on improved terms. It is a floating-rate, unsecured line and is due to mature in June 2022. DEUTZ can elect whether to utilise the cash line as a bilateral overdraft facility (up to €60 million) or to draw down amounts with interest periods of three to six months.

In addition, we have an amortising loan from the European Investment Bank with a remaining balance of €39.6 million at 31 December 2017. This loan, which is also unsecured, is repayable in instalments until July 2020. We have hedged the interest-rate risk arising from this loan.

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

Receivables management optimised by means of factoring The sale of receivables is an important way of optimising receivables management. Because the credit quality of our customer receivables is excellent, factoring is also a cost-effective way of improving working capital, especially as considerable cash resources are tied up by the preliminary financing of production and due to the payment terms that we have granted to our customers. The volume of sales of receivables on the balance sheet date was slightly higher than at the end of 2016 as a result of the business situation, the volume as at 31 December 2017 being around €117 million (31 December 2016: €111 million).

DEUTZ Group: Change in cash and cash equivalents



[1] Capital expenditure on intangible assets, investments, property, plant and equipment.

CASH FLOW

Cash flow from operating activities amounted to €112.7 million in 2017 (2016: €63.8 million). This year-on-year rise of €48.9 million was predominantly due to the larger operating profit and the decline in other receivables. There had been a fairly sharp rise in other receivables in 2016, but they were mostly settled in 2017. The change in working capital also contributed to the growth in cash flow from operating activities. Working capital had increased much more significantly in 2016.

The net cash used for investing activities came to €27.3 million in 2017. Besides increased capital expenditure on intangible assets owing to the purchase of distribution and service rights from Liebherr Machines Bulle S.A., the main influences on net cash used for investing activities were as follows. Firstly, we sold the land occupied by our former Cologne-Deutz site. Secondly, DEUTZ AG acquired 100 per cent of the voting shares in both Torqeedo GmbH, Gilching, and DEUTZ Italy S.r.l., Milan (formerly IML Motori S.r.l.).

Financing activities in 2017 resulted in a net cash outflow of €32.6 million (2016: €26.8 million). The net cash outflow in 2017 consisted mainly of the repayment of loans and a dividend payment to shareholders of €8.5 million.

Cash and cash equivalents as at 31 December 2017 had risen by €52.0 million to €143.8 million (31 December 2016: €91.8 million). The net financial position[1] as at 31 December 2017 was €98.2 million, an improvement compared with the same date a year earlier of €66.6 million (31 December 2016: €31.6 million).

Free cash flow[2] improved significantly year on year despite the acquisitions made, climbing by €77.8 million to €82.5 million (2016: €4.7 million) as a result of the aforementioned disposal of assets and the sharp rise in cash flow from operating activities. Consequently, we met our forecast made at the start of 2017 that free cash flow would be in the mid- to high-double-digit million euro range.

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

CAPITAL EXPENDITURE

After deducting investment grants, our capital expenditure on property, plant and equipment and on intangible assets totalled €72.2 million in 2017, which was €10.2 million more than in the previous year (2016: €62.0 million). This was broken down into €34.9 million (2016: €49.3 million) on property, plant and equipment and €37.3 million (2016: €12.7 million) on intangible assets. Additions to property, plant and equipment were mainly in connection with replacement investment in tools, equipment and machinery. The additions also related to the new TCD 2.2 engine series and the final measures to optimise our network of sites. In the first half of 2017, we also made the final capital investment in connection with stage two of the relocation of the exchange engine plant from Übersee to Ulm and with the construction of the shaft centre in Cologne-Porz.

Capital expenditure on intangible assets went mainly on the development of our new engines and the refinement of existing ones. Another major investing activity was the purchase of distribution and service rights as part of a cooperation agreement with Liebherr Machines Bulle S.A.

Before the capitalisation of development expenditure, capital investment amounted to €54.7 million (2016: €52.9 million). This was just over €15.0 million below our forecast of €70.0 million and was due, above all, to the postponement of capital expenditure in production and assembly areas. Moreover, capital expenditure in connection with the optimisation of the network of sites was lower than planned.

We exceeded our forecast of capitalised development expenditure of €15.0 million by just under €2.5 million. This was due to a higher capitalisation rate.

As in 2016, the bulk of the total capital expenditure after deducting investment grants was invested in the DEUTZ Compact Engines segment (€51.7 million in 2017 and €55.0 million in 2016). Capital expenditure in DEUTZ Customised Solutions was €20.1 million (2016: €7.0 million). The new heavy-duty engines under the Liebherr alliance are allocated to this segment. In the Other segment, capital expenditure amounted to €0.4 million (2016: €0.0 million) as a result of Torqeedo GmbH's capital expenditure in the fourth quarter of 2017.

The main areas of capital spending in the reporting year were property, plant and equipment, intangible assets and, notably, the acquisition of Torqeedo and DEUTZ Italy (formerly IML Motori S.r.l.). The capital expenditure of these two companies, which were included in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017, came to €73.9 million and €11.4 million respectively. For details of the individual assets and liabilities acquired in connection with the acquisitions, please refer to page 92 et seq. in the notes to the consolidated financial statements.

NET ASSETS

Overview of the DEUTZ Group's assets

€ million

	31 Dec 2017	31 Dec 2016	Change
Non-current assets	603.4	563.6	39.8
Current assets	609.3	495.7	113.6
Assets classified as held for sale	0.4	0.4	–
Total assets	**1,213.1**	**1,059.7**	**153.4**
Equity	599.2	491.1	108.1
Non-current liabilities	240.4	265.0	–24.6
Current liabilities	373.5	303.6	69.9
Total equity and liabilities	**1,213.1**	**1,059.7**	**153.4**
Working capital (€ million)	222.2	204.3	17.9
Working capital ratio (31 Dec, %)	15.0	16.2	–1.2
Working capital ratio (average, %)	13.4	17.9	–4.5
Equity ratio (%)	49.4	46.3	3.1

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

Non-current assets Non-current assets of the DEUTZ Group totalled €603.4 million as at 31 December 2017 (31 December 2016: €563.6 million). This growth of €39.8 million was largely attributable to the increase in intangible assets. Firstly, the acquisition of Torqeedo and DEUTZ Italy (formerly IML Motori S.r.l.) led to the recognition of goodwill in an amount of €48.0 million and to a rise in miscellaneous intangible assets of €24.2 million. Secondly, we acquired distribution and service rights as part of a cooperation agreement with Liebherr Machines Bulle S.A. By contrast, other non-current assets decreased in the reporting year.

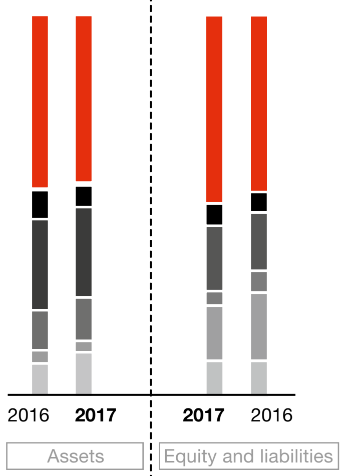
Current assets Current assets rose by €113.6 million year on year to €609.3 million (31 December 2016: €495.7 million). The main reason for this was the higher level of cash and cash equivalents. Inventories and trade receivables also went up significantly due to the larger volume of business and the first-time consolidation of Torqeedo and DEUTZ Italy (formerly IML Motori S.r.l.).

DEUTZ Group: Balance sheet structure

% (2016 figures)

Assets

44.0	(45.6)	Non-current assets
5.7	(7.6)	Deferred taxes
23.7	(23.9)	Inventories
11.8	(10.7)	Trade receivables
3.0	(3.5)	Other receivables and assets
11.8	(8.7)	Cash and cash equivalents



Equity and liabilities

49.4	(46.3)	Equity
5.9	(5.4)	Other liabilities
17.1	(15.3)	Trade payables
3.8	(5.7)	Financial liabilities
14.5	(17.9)	Pension provisions
9.3	(9.4)	Other provisions

Working capital Working capital had risen to €222.2 million as at 31 December 2017 (31 December 2016: €204.3 million). The main reason for this was the increase in inventories and trade receivables. Much of this increase was offset by the rise in trade payables, which was also attributable to the greater volume of business. Despite the higher level of working capital[1], the working capital ratio improved to 15.0 per cent as at 31 December 2017 (31 December 2016: 16.2 per cent) as a result of the sharp increase in revenue. The average working capital ratio[2] also decreased, reaching 13.4 per cent at the end of the reporting year (31 December 2016: 17.9 per cent). We therefore more than achieved our forecast that we would report a slightly better average working capital ratio than as at 31 December 2016. This was due to the very encouraging revenue growth.

Equity As at 31 December 2017, equity had risen substantially to €599.2 million (31 December 2016: €491.1 million). This sharp rise of €108.1 million was predominantly due to the high level of net income in the year under review.

The equity ratio therefore increased slightly to reach 49.4 per cent (31 December 2016: 46.3 per cent). It thus remains well above our target of above 40 per cent.

Non-current liabilities Non-current liabilities totalled €240.4 million as at 31 December 2017 (31 December 2016: €265.0 million). This fall of €24.6 million was largely attributable to the reduction in financial debt and provisions for pensions and other post-retirement benefits. Financial debt decreased as planned by €15.9 million to €28.1 million. The decline in provisions for pensions and other post-retirement benefits was mainly due to ongoing pension payments.

Current liabilities By contrast, current liabilities rose by €69.9 million to €373.5 million. Higher trade payables and provisions for income taxes were the main reason for this increase. The €45.2 million growth in trade payables is attributable, in particular, to the rise in the volume of raw materials and consumables ordered as a result of the growth in business and to the first-time inclusion of Torqeedo and DEUTZ Italy (formerly IML Motori S.r.l.) in the consolidated financial statements of DEUTZ AG. The increase in provisions for income taxes is primarily due to the high level of net income in 2017.

Total assets rose to €1,213.1 million as at 31 December 2017 (31 December 2016: €1,059.7 million).

OVERALL ASSESSMENT FOR 2017

DEUTZ can look back on a very successful year. Our business grew encouragingly and we were able to win new customers. DEUTZ diesel engines equipped with particulate filters already comply with the limits defined in the EU Stage V emissions standard, which comes into force in 2019. We were the world's first engine manufacturer to obtain certification for the new standard. In general, we are broadening our technology base as part of our efforts to become the leading provider of innovative drive systems. Our acquisition of Torqeedo marked the start of the E-DEUTZ strategy and thus the electrification of our product range. As part of an alliance, we will also add four new heavy-duty engines with cubic capacities of between 9 and 18 litres to our portfolio of diesel engines. This gives our customers a comprehensive choice of modular technological building blocks for powering their equipment.

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

[2] Working capital ratio (average, %): average working capital at the four quarterly reporting dates divided by revenue for the previous twelve months.

Overall, our business performance in the year under review was in line with our expectations. We fully met our forecasts for revenue and earnings, benefiting from the return to more favourable market conditions as we had predicted. With unit sales rising by 22.0 per cent, revenue advanced by 17.4 per cent year on year to €1,479.1 million. In the 2016 annual report, we had anticipated a marked rise in revenue. At €1,556.5 million, new orders were up by 23.4 per cent on the previous year. Operating profit (EBIT before exceptional items) increased from €23.4 million in 2016 to €42.4 million in 2017. The EBIT margin (before exceptional items) improved from 1.9 per cent to 2.9 per cent in the reporting year. We had forecast a moderate increase in the EBIT margin before exceptional items. Net income grew from €16.0 million to €121.2 million. This led to a significant improvement in earnings per share, which came to €1.00 (2016: €0.14). Free cash flow climbed from €4.7 million to €82.5 million, largely because of the disposal of assets and the increase in cash flow from operating activities.

EMPLOYEES

Overview of the DEUTZ Group's workforce

Headcount

	31 Dec 2017	31 Dec 2016
DEUTZ Group	**4,154**	**3,665**
Thereof		
In Germany	3,060	2,827
Outside Germany	1,094	838
Thereof		
Non-salaried employees	2,421	2,177
Salaried employees	1,657	1,403
Trainees	76	85
Thereof		
DEUTZ Compact Engines	3,333	2,989
DEUTZ Customised Solutions	688	676
Other/Torqeedo	133	–

Increase in headcount At the end of 2017, the DEUTZ Group employed a total of 4,154 people, 489 more than at the end of 2016 (a rise of 13.3 per cent). This was partly due to the acquisition of Torqeedo and DEUTZ Italy (formerly IML Motori S.r.l.). As at 31 December 2017, we also had a further 423 people on temporary employment contracts, compared with 182 a year earlier. By offering fixed-term contracts and employing temporary workers, DEUTZ can respond flexibly to any fluctuations in demand. Almost 16 per cent of all staff at DEUTZ had fixed-term or temporary contracts as at 31 December 2017.

Nearly 74 per cent of our workforce was employed in Germany as at the reporting date. Most of these employees were based in Cologne – 2,356 as at 31 December 2017. 450 employees were based in Ulm. Of the 1,094 employees outside Germany, 558 of them work at our DEUTZ Spain subsidiary.

From a segment perspective, DEUTZ Compact Engines employed 3,333 people as at 31 December 2017, 11.5 per cent more than it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 688, up by 1.8 per cent compared with the end of 2016. There were 133 employees in the Other segment at the reporting date; Torqeedo's employees have been included in this segment since the fourth quarter of 2017.

DEUTZ Group: Breakdown of workforce by location

Headcount

	31 Dec 2017	31 Dec 2016
Cologne	2,356	2,202
Ulm	450	411
Other	254	214
In Germany	**3,060**	**2,827**
Outside Germany	1,094	838
Total	**4,154**	**3,665**

DEUTZ AG

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

BASIC PRINCIPLES AND BUSINESS PERFORMANCE OF DEUTZ AG

DEUTZ AG is the parent company of the DEUTZ Group. At home and abroad, DEUTZ AG has various direct and indirect subsidiaries and equity investments. The subsidiaries include two production facilities in Spain and Germany as well as several companies that perform sales and service functions. On 1 October 2017, DEUTZ AG acquired 100 per cent of the voting shares in both Torqeedo GmbH, an electric drive specialist headquartered in Gilching, and IML Motori S.r.l., a long-standing sales and service partner based in Milan, Italy. IML Motori S.r.l. was renamed DEUTZ Italy S.r.l. on 31 December 2017. Torqeedo GmbH and DEUTZ Italy S.r.l. (formerly IML Motori S.r.l.) have equity investments in two further companies each – of 100 per cent for both of Torqeedo GmbH's equity investments and of 100 per cent and 75 per cent for DEUTZ Italy S.r.l.'s equity investments. In total, DEUTZ AG has a direct or indirect stake in 34 companies (2016: 28 companies). DEUTZ AG is also by far the largest production company of the DEUTZ Group and provides the head-office functions for the Group. For details of DEUTZ AG's equity investments, please see the list of shareholdings on page 139 of the annual report.

Because the business performance and financial situation of DEUTZ AG are essentially the same as for the DEUTZ Group, we make reference here to the 'Business performance in the DEUTZ Group' section on page 35 et seq. of this combined management report.

Because of the significance of DEUTZ AG within the Group, and its heavy interdependencies with other Group companies, the Group is managed at the level of DEUTZ AG. In addition to the key performance indicators used for management at Group level, the net income of DEUTZ AG, as the relevant variable in the payment of dividends, is also an element of the management system of the Company. The internal management system for the DEUTZ Group is described on page 33 et seq. of this combined management report. The DEUTZ Group's net income in accordance with IFRS is reconciled to DEUTZ AG's net income in accordance with the German Commercial Code (HGB):

DEUTZ AG: Reconciliation

€ million

DEUTZ Group net income (IFRS)	**121.2**
Consolidation of equity investments	–15.4
DEUTZ AG income (IFRS)	**105.8**
Material differences due to different financial reporting standards	
Recognition of development expenditure	33.5
Measurement of provisions for pensions and other post-retirement benefits	–4.3
Recognition of deferred taxes	–9.5
Capitalisation of acquisition-related costs	2.2
Other differences relating to the financial reporting standards	1.0
DEUTZ AG net income (HGB)	**128.7**

RESULTS OF OPERATIONS

Overview of DEUTZ AG's results of operations

€ million

	2017	2016
Revenue	**1,356.0**	**1,151.8**
Cost of sales	–1,171.5	–998.3
Research and development costs	–60.3	–45.0
Selling and administrative expenses	–74.5	–69.3
Other operating income	145.5	37.7
Other operating expenses	–55.4	–21.4
Net investment income	15.5	4.4
Write-downs of investments	–0.5	–
Operating profit (EBIT)	**154.8**	**59.9**
Interest expenses, net	–6.8	–5.7
Income taxes	–16.7	–8.6
Other taxes	–2.6	–0.5
Net income	**128.7**	**45.1**

Revenue In 2017, the revenue generated by DEUTZ AG came to €1,356.0 million, a sharp year-on-year rise of 17.7 per cent (2016: €1,151.8 million). This trend was primarily due to increased demand in the Construction Equipment, Material Handling and Agricultural Machinery application segments. In the Construction Equipment application segment, revenue rose by 23.3 per cent to €426.6 million (2016: €346.0 million). The increases were even higher in the Material Handling and Agricultural Machinery application segments, where revenue climbed by 44.5 per cent to €230.6 million (2016: €159.6 million) and by 30.5 per cent to €231.0 million (2016: €177.0 million) respectively.

The region with the strongest revenue growth was our largest region, EMEA (Europe, Middle East and Africa), where revenue advanced by 22.5 per cent to €1,023.3 million (2016: €835.2 million). In the Americas region, revenue rose by a substantial 10.5 per cent to €203.6 million (2016: €184.1 million). By contrast, revenue fell by 2.6 per cent to €129.1 million in the Asia-Pacific region (2016: €132.5 million).

Earnings performance In 2017, DEUTZ AG generated an operating profit (EBIT) of €154.8 million (2016: €59.9 million). This year-on-year rise of €94.9 million was due to the far greater volume of business and, in particular, to the disposal of the land occupied by our former Cologne-Deutz site. Moreover, net investment income improved significantly. Countervailing effects to these positive factors were the higher level of research and development expenditure, negative currency effects and a temporary increase in costs caused by the rapid ramping up of capacities due to the surge in demand last year, especially in logistics.

Cost of sales DEUTZ AG's cost of sales came to €1,171.5 million in 2017 (2016: €998.3 million). The year-on-year increase of €173.2 million was mainly attributable to the volume-related rise in the cost of materials and a capacity-related increase in logistics costs. The gross margin[1] improved from 13.3 per cent to 13.6 per cent.

Research and development costs In the year under review, research and development costs totalled €60.3 million (2016: €45.0 million). They largely comprised staff costs, the cost of materials and amortisation on completed development projects, after deduction of investment grants received and capitalised development costs. The rise of €15.3 million compared with 2016 was due to the increase in research and development activities and, above all, an impairment loss recognised on an uncompleted development project. The much improved market outlook for the engine series in the 4 to 6 litre capacity range, which have already achieved Stage V certification, led to a sharp drop in the expected demand for the 5.0 series. Consequently the development project was written off in full for reasons of commercial viability. It will not be pursued further for the time being.

Selling and administrative expenses In 2017, selling and administrative expenses totalled €74.5 million (2016: €69.3 million). The year-on-year increase of €5.2 million was mainly attributable to selling expenses resulting from the intensification of sales activities. When measured as a proportion of revenue, however, selling and administrative expenses fell from 6.0 per cent in 2016 to 5.5 per cent in 2017.

Other operating income Other operating income advanced by €107.8 million year on year to €145.5 million (2016: €37.7 million). The main reason for this increase was the income from the disposal of the land occupied by our former Cologne-Deutz site.

Other operating expenses Other operating expenses rose by €34.0 million year on year to €55.4 million (2016: €21.4 million). This was primarily attributable to expenses in connection with reversing the sale to DEUTZ-Mülheim Grundstücksgesellschaft mbH in 2001/2002 of the former Company premises at the Cologne-Deutz site. The rise in other operating expenses was also caused by higher losses on the translation of foreign currency positions.

Net investment income Net investment income was up on the previous year, rising by €11.1 million to €15.5 million (2016: €4.4 million). This was largely due to increases in the earnings of DEUTZ Asien Verwaltungs GmbH. The earnings of DEUTZ Asien Verwaltungs GmbH increased because of the equity investment in DEUTZ-Mülheim Grundstücksgesellschaft mbH and relates to the reversal of the sale of land to DEUTZ-Mülheim Grundstücksgesellschaft mbH in 2001/2002. Another reason for the increase was the distribution of a dividend by DEUTZ Corporation, Atlanta, USA.

Net interest expense Net interest expense in 2017 amounted to €6.8 million (2016: €5.7 million) The year-on-year deterioration of €1.1 million was mainly due to a decrease in interest income from loans to affiliated companies. Interest expense also decreased due to lower utilisation of credit lines.

Income taxes Income taxes came to €16.7 million in 2017 (2016: €8.6 million). Current tax expenses amounted to €18.1 million (2016: €6.1 million), mainly because of the improved results of operations. The current tax expenses were partly offset by deferred tax income of €1.4 million (2016: tax expense of €2.6 million). Of the total current tax expenses, an amount of €2.2 million related to previous years and arose following tax audits for previous years.

Other taxes Other taxes were much higher than in the previous year, advancing by €2.1 million to €2.6 million (2016: tax expense of €0.5 million). Real estate transfer tax of €2.2 million arose on the disposal of the land occupied by our former Cologne-Deutz site.

Net income Owing, in particular, to the much better level of operating profit, the net income for the reporting year increased significantly, rising by €83.6 million year on year to €128.7 million (2016: €45.1 million). However, the level of net income was pushed up by the gain on the disposal of the land occupied by our former Cologne-Deutz site. Excluding this one-off effect, net income would still have risen year on year – and thus exceeded the forecast – because of the strong growth in the volume of business.

In view of the positive level of net income, the Board of Management and Supervisory Board propose using €18.1 million of the accumulated income to pay a dividend of €0.15 per share.

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

FINANCIAL POSITION

Overview of DEUTZ AG's financial position

€ million

	2017	2016
Cash flow from operating activities	100.8	50.7
Cash flow from investing activities	–29.0	–44.5
Cash flow from financing activities	–24.6	–23.1
Change in cash and cash equivalents	47.2	–16.9
Free cash flow	70.1	6.0
Cash and cash equivalents at 31 Dec	128.0	80.8

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

Financial management in the DEUTZ Group is one of the core functions of the Group, and DEUTZ AG holds responsibility for this function. The basic principles and objectives of financial management at DEUTZ AG are therefore largely the same as those of the Group, as is the funding of DEUTZ AG. In this regard, please refer to the relevant sections on page 45 et seq. of this combined management report.

Liquidity Cash flow from operating activities amounted to €100.8 million last year (2016: €50.7 million). This rise of €48.6 million was predominantly due to the larger operating profit and the decline in other receivables. There had been a fairly sharp rise in other receivables in 2016, but they were mostly settled in 2017.

The cash flow from investing activities in 2017 was minus €29.0 million (2016: minus €44.5 million). Besides increased capital expenditure on intangible assets owing to the purchase of distribution and service rights from Liebherr Machines Bulle S.A., the main influences on net cash used for investing activities were as follows. Firstly, we sold the land occupied by our former Cologne-Deutz site. Secondly, DEUTZ AG acquired 100 per cent of the voting shares in both Torqeedo GmbH, Gilching, and DEUTZ Italy S.r.l., Milan (formerly IML Motori S.r.l.).

Cash flow used for financing activities in 2016 totalled €24.6 million (2016: €23.1 million). The net cash outflow in 2017 consisted mainly of the repayment of loans and a dividend payment to shareholders of €8.5 million.

Free cash flow increased year on year, rising by €64.1 million to €70.1 million (2016: €6.0 million). This was due, above all, to the significant rise in cash flow from operating activities.

Capital expenditure After deducting investment grants, DEUTZ AG's capital expenditure in 2017 amounted to a total of €160.0 million (2016: €52.1 million). The bulk of this spending (€90.5 million) went on investments (2016: €0.7 million). On 1 October 2017, 100 per cent of the voting shares were acquired in both Torqeedo GmbH, Gilching, and IML Motori S.r.l., Milan, Italy. Of the total capital expenditure (including acquisition-related costs), €79.0 million related to Torqeedo GmbH and €11.5 million to IML Motori S.r.l.

Capital expenditure on property, plant and equipment amounted to €32.6 million (2016: €41.2 million). Additions to these assets were mainly in connection with replacement investment in tools, equipment and machinery. The additions also related to the new TCD 2.2 engine series and the final measures to optimise our network of sites. In the first half of 2017, we also made the final capital investment in connection with stage two of the relocation of the exchange engine plant from Übersee to Ulm and with the construction of the shaft centre in Cologne-Porz.

Capital expenditure on intangible assets went mainly on the development of our new engines and the refinement of existing ones. Another major investing activity was the purchase of distribution and service rights as part of a cooperation agreement with Liebherr Machines Bulle S.A.

NET ASSETS

Overview of DEUTZ AG's net assets

€ million

	31 Dec 2017	31 Dec 2016
Non-current assets	572.6	494.4
Current assets	484.5	410.1
Prepaid expenses	1.4	1.6
Deferred tax assets	85.1	83.7
Total assets	**1,143.6**	**989.8**
Equity	629.0	508.8
Provisions	260.6	254.3
Liabilities	253.5	226.2
Deferred income	0.5	0.5
Total equity and liabilities	**1,143.6**	**989.8**
Working capital (€ million)	63.2	63.2
Working capital ratio (31 Dec, %)	4.7	5.5
Equity ratio (%)	55.0	51.4

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

Non-current assets Non-current assets as at 31 December 2017 amounted to €572.6 million (31 December 2016: €494.4 million). The year-on-year rise was due, above all, to the increase in investments attributable to the acquisition of Torqeedo GmbH and DEUTZ Italy (formerly IML Motori S.r.l.). This rise was partly offset by a decrease in loans to affiliated companies. Following the reversal of the sale to DEUTZ-Mülheim Grundstücksgesellschaft mbH of the Company's former premises at the Cologne-Deutz site, the related loans were derecognised. The level of intangible assets also went up significantly on the back of capital expenditure on the development of new engines, the refinement of existing ones and the purchase of distribution and service rights from Liebherr Machines Bulle S.A. By contrast, capital expenditure on property, plant and equipment was less than the level of depreciation, resulting in a decrease in such assets as at 31 December 2017.

Current assets As at 31 December 2017, current assets amounted to €484.5 million. This increase of €74.4 million compared with twelve months earlier (31 December 2016: €410.1 million) mostly resulted from the higher volume of cash and cash equivalents held. Furthermore, trade receivables and inventories increased due to the larger volume of business.

Working capital Working capital had risen to €63.2 million as at 31 December 2017 and was thus at the same level reported a year earlier (31 December 2016: €63.2 million). Although inventories and trade receivables increased due to the larger volume of business, the increase was offset by the rise in trade payables, which was also attributable to the greater volume of business. The significantly higher amount of revenue caused the working capital ratio[1] to decrease to 4.7 per cent as at the balance sheet date (31 December 2016: 5.5 per cent).

Deferred tax assets Deferred tax assets rose by €1.4 million year on year to €85.1 million (31 December 2016: €83.7 million). This increase was largely due to higher deferred taxes on loss carryforwards.

Equity ratio Owing to the positive level of net income, equity advanced by €120.2 million to €629.0 million (31 December 2016: €508.8 million). The rise was partly offset by the distribution of a dividend to the shareholders of DEUTZ AG of €8.5 million for 2016. The equity ratio increased to reach 55.0 per cent at the end of the year (31 December 2016: 51.4 per cent).

Provisions As at 31 December 2017, provisions stood at €260.6 million (31 December 2016: €254.3 million). The year-on-year increase of €6.3 million was mainly attributable to higher provisions for income taxes as a result of significantly improved earnings in the reporting year. The increase was mitigated to an extent by lower provisions for pensions and other post-retirement benefits. The decline in provisions for pensions and other post-retirement benefits was mainly due to ongoing pension payments.

Liabilities As at 31 December 2017, liabilities had risen by €27.3 million to €253.5 million (31 December 2016: €226.2 million). The main factor here was the volume-related increase in trade payables. A decrease in liabilities to banks, which were scaled back as planned, was the primary factor in the opposite direction.

EMPLOYEES

As at 31 December 2017, a total of 2,978 people were employed by DEUTZ AG. This meant that the number of employees had increased by 114 year on year (31 December 2016: 2,864 employees). We also had a further 366 people on temporary employment contracts as at 31 December 2017 (31 December 2016: 159 temporary workers). Employing temporary workers enables us to respond flexibly to any fluctuations in demand.

From a segment perspective, DEUTZ Compact Engines employed 2,534 people as at 31 December 2017, 151 more than it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 444, which was 37 fewer year on year.

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

OPPORTUNITY AND RISK REPORT

DEUTZ AG is integrated into the risk management system of the DEUTZ Group. As a head-office function, risk management for the Group is performed by DEUTZ AG. Information about the structuring and mechanics of the risk management system and of risk management with regard to financial instruments can be found in our notes on pages 59 to 60.

Because DEUTZ AG is closely integrated with the other Group companies, its risk and opportunities situation is essentially the same as that of the Group. Risks arising from subsidiaries may have an effect on DEUTZ AG because of the carrying amount of an equity investment, reduced dividend payments and the internal business relations. The risks and opportunities associated with the DEUTZ Group are described on pages 60 to 64 of this combined management report.

Information about DEUTZ AG's internal accounting-related control system can be found on pages 62 and 63 of this combined management report.

OUTLOOK

DEUTZ AG performs the head-office functions of the DEUTZ Group and is the biggest production company within the Group by some margin. Because of DEUTZ AG's wide-ranging relationships with other Group companies and because of its size within the Group, the expectations presented in the Group outlook for 2017 are essentially the same as those for DEUTZ AG. We therefore anticipate that the revenue of DEUTZ AG will develop largely in line with the statements made for the DEUTZ Group. As the one-off effect resulting from the sale of the land at our former Cologne-Deutz site will not be repeated, we expect net income in 2018 to be significantly lower than in 2017. Excluding the disposal of the land, however, we expect a sharp rise in net income for 2018. Further information can be found in the outlook for the DEUTZ Group on pages 64 to 65.

NON-FINANCIAL REPORT PURSUANT TO SECTIONS 289B AND 315B HGB

DEUTZ AG publishes a separate combined non-financial report for the DEUTZ Group and DEUTZ AG. We refer here to our remarks on page 67 et seq. of the annual report and to our website DEUTZ.com/NFR.

CORPORATE GOVERNANCE DECLARATION PURSUANT TO SECTION 289F HGB

The corporate governance declaration pursuant to section 289f HGB is an integral element of the combined management report. We refer here to our remarks on pages 153 to 156 of the annual report and to our website DEUTZ.com/CGD.

DISCLOSURES PURSUANT TO SECTIONS 289A (1) AND 315A (1) HGB

Composition of the issued capital There were no changes to the issued capital (share capital) of DEUTZ AG in 2017. As at 31 December 2017, the issued capital amounted to €308,978,241.98 and was divided into 120,861,783 no-par-value bearer shares.

Direct or indirect shareholdings representing more than 10 per cent of voting rights At the end of 2017, there were no direct or indirect shareholdings in DEUTZ AG representing more than 10 per cent of the voting rights.

Restrictions affecting voting rights or the transfer of shares We are not aware of any restrictions affecting voting rights or the transfer of shares.

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

"(1) The Board of Management shall comprise at least two members.
(2) The Supervisory Board shall determine the number of members of the Board of Management and the allocation of responsibilities. It may draw up and issue rules of procedure."

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

According to article 14 of the Statutes of DEUTZ AG:

"The Supervisory Board may change the wording but not the spirit of the Statutes." Sections 179 and 133 AktG also apply in the case of changes to the Statutes.

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

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

FURTHER DISCLOSURES

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

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

A consortium of banks has provided DEUTZ AG with a syndicated, revolving cash credit line of €160 million. DEUTZ AG also took out a loan with the European Investment Bank that has a remaining balance of €39.6 million. Under the terms of the loan agreements, the lenders can demand that the outstanding loan be repaid within a specified period in the event of a change of control, i.e. one or more people acting jointly acquire a direct or indirect shareholding of at least 50 per cent of all shares and/or voting rights in DEUTZ AG.

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

The cooperation agreement concluded between DEUTZ AG and Liebherr gives Liebherr the right to terminate the agreement if there is a change of control at DEUTZ AG. A change of control for these purposes shall be deemed to have occurred if a competitor of Liebherr directly or indirectly acquires a shareholding representing at least 30 per cent of the voting rights in DEUTZ AG or is able to exert direct or indirect influence by means of contracts.

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

The long-term incentive plans (LTI), under which the highest level of senior management in the DEUTZ Group (executives and managing directors of major subsidiaries) are granted virtual options that they can exercise after a vesting period and upon achievement of certain performance targets (see pages 133 et seq. of this annual report), contain the following provision in the event of an entity – either alone or acting jointly with an affiliated company – acquiring a minimum of 50 per cent of the shares in DEUTZ AG: provided one of the performance targets has been achieved, the LTI participants may exercise their options within a short time frame after the acquisition, even if the vesting period has not yet expired.

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

EXPLANATORY STATEMENT BY THE BOARD OF MANAGEMENT IN CONNECTION WITH SECTIONS 289A (1) AND 315A (1) HGB

The disclosures contained in the combined management report and management report pursuant to sections 289a (1) and 315a (1) HGB relate to arrangements that may be significant in the success of the purchase of shares in DEUTZ AG for the purpose of any public takeover bid. It is the opinion of the Board of Management that these arrangements are normal for publicly traded companies comparable with DEUTZ AG.

REMUNERATION REPORT

REMUNERATION OF THE BOARD OF MANAGEMENT

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

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

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

Benefits granted

€ thousand

	Dr Ing Frank Hiller **Chairman of the Board of Management** Took office on 1 January 2017				**Dr Margarete Haase**			
	2016	**2017**	2017 (min)	2017 (max)	2016	**2017**	2017 (min)	2017 (max)
Fixed remuneration		750	750	750	580	580	580	580
Additional benefits [1]		177	177	177	146	147	147	147
Total	**–**	**927**	**927**	**927**	**726**	**727**	**727**	**727**
One-year variable remuneration [2]		450	–	675	270	270	–	405
Multi-year variable remuneration								
2017–2018 deferral (2016 bonus)	–	–	–	–	180	–	–	–
2018–2019 deferral (2017 bonus)		300	–	450	–	180	–	270
LTI 2016–2020 [3]	–	–	–	–	155	–	–	–
LTI 2017–2021 [3]	–	223	–	300	–	167	–	225
Total	**–**	**973**	**–**	**1,425**	**605**	**617**	**–**	**900**
Other	–	–	–	–	–	–	–	–
Total remuneration	**–**	**1,900**	**927**	**2,352**	**1,331**	**1,344**	**727**	**1,627**

Instead of the target values for one-year variable remuneration and for deferrals from one-year variable remuneration required under the German Corporate Governance Code (DCGK), the figures in the table below for total remuneration indicate the remuneration figures that are required to be disclosed under the applicable accounting standards. For the one-year variable remuneration, these represent the provisions for the annual bonus for 2017, adjusted for any over- or under-allocation in the previous year. With regard to the deferrals from the one-year variable remuneration, the figures represent the amounts vested and recognised in provisions in 2017.

	2016	**2017**	2017 (min)	2017 (max)	2016	**2017**	2017 (min)	2017 (max)
One-year variable remuneration	–	629			242	377		
Multi-year variable remuneration								
2015–2016 deferral (2014 bonus)	–	–			18	–		
2016–2017 deferral (2015 bonus)	–	–			–	–		
2017–2018 deferral (2016 bonus)	–	–			–	108		
2018–2019 deferral (2017 bonus)	–	416			–	250		
Total remuneration	**–**	**2,195**			**1,141**	**1,629**		

[1] Includes payment into a life insurance policy.
[2] The figures given for one-year variable remuneration and for deferrals from one-year variable remuneration represent the amount granted for full achievement of targets.
[3] Share-based remuneration represents the fair value of the options on the date of grant. Please refer to Note 32 in the consolidated financial statements for a description of the structure of the share-based remuneration agreements. General contractual conditions are identical for all members of the Board of Management.

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

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

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

The service contracts of the Board of Management members stipulate a special provision in the event of a change of control. Further details can be found in the section 'Disclosures pursuant to sections 289a (1) and 315a (1) HGB on page 54 et seq.

The table below presents the total remuneration of the Board of Management in accordance with the recommendation in the German Corporate Governance Code dated 7 February 2017. In line with this recommendation, the benefits granted in 2017 and those actually paid are reported separately.

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

	Michael Wellenzohn				**Dr Ing Helmut Leube** **Chairman of the Board of Management** Retired on 31 December 2016			
	2016	**2017**	2017 (min)	2017 (max)	2016	**2017**	2017 (min)	2017 (max)
	520	520	520	520	725			
	109	107	107	107	173			
	629	**627**	**627**	**627**	**898**			
	255	255	–	383	360			
	170	–	–	–	240			
	–	170	–	255	–			
	160	–	–	–	207			
	–	173	–	233	–			
	585	**598**	**–**	**870**	**807**			
	–	–	–	–	–			
	1,214	**1,225**	**627**	**1,497**	**1,705**			
	188	356	–	–	–	–		
	14	–	–	–	–	–		
	–	–	–	–	–	–		
	–	102	–	–	–	–		
	–	236	–	–	–	–		
	991	**1,494**	**–**	**–**	**1,105**	**–**		

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

Benefits paid

€ thousand

	Dr Ing Frank Hiller Chairman of the Board of Management Took office on 1 January 2017		**Dr Margarete Haase**		**Michael Wellenzohn**		**Dr Ing Helmut Leube Chairman of the Board of Management** Retired on 31 December 2017	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Fixed remuneration	750	–	580	580	520	520	–	725
Additional benefits	177	–	147	146	107	109	–	173
Total	**927**	**–**	**727**	**726**	**627**	**629**	**–**	**898**
One-year variable remuneration	–	–	240	–	227	–	–	–
Multi-year variable remuneration								
2014–2015 deferral (2013 bonus)	–	–	–	21	–	13	–	28
2015–2016 deferral (2014 bonus)	–	–	18	17	14	14	24	23
LTI 2013-2017	–	–	219	–	185	–	292	–
Other	–	–	–	–	–	–	–	–
Total	**–**	**–**	**477**	**38**	**426**	**27**	**316**	**51**
Total remuneration	**927**	**–**	**1,204**	**764**	**1,053**	**656**	**316**	**949**

The total expense for share-based payments recognised in the reporting year amounted to €75 thousand for Dr Hiller (2016: €0 thousand), €32 thousand for Dr Haase (2016: €275 thousand) and €74 thousand for Mr Wellenzohn (2016: €242 thousand). In connection with the share-based payments for Dr Leube, income recognised from the reversal of provisions amounted to €32 thousand in the reporting year (2016: expense of €367 thousand).

REMUNERATION OF THE SUPERVISORY BOARD

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

In addition, each member of a Supervisory Board committee receives an attendance fee of €2,500 for each committee meeting attended. The chairman of a committee is entitled to twice this sum, his deputy to one-and-a-half times the amount.

In addition, DEUTZ reimburses the members of the Supervisory Board for any VAT they incur in connection with the performance of their mandate.

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

€	Fixed remuneration	Attendance fees	**Total**
Hans-Georg Härter Chairman	45,000	75,000	**120,000**
Werner Scherer Deputy Chairman	33,750	60,000	**93,750**
Sabine Beutert	22,500	25,000	**47,500**
Hans-Peter Finken	22,500	15,000	**37,500**
Gisela Füssel	22,500	15,000	**37,500**
Dr Ing Hermann Garbers	22,500	15,000	**37,500**
Gerhard Gehweiler (from 1 June 2017)	13,192	12,500	**25,692**
Göran Gummeson	22,500	17,500	**40,000**
Leif Peter Karlsten	22,500	15,000	**37,500**
Herbert Kauffmann	22,500	52,500	**75,000**
Alois Ludwig	22,500	15,000	**37,500**
Dr Witich Roßmann	22,500	12,500	**35,000**
Dr Herbert Vossel (until 31 May 2017)	9,308	–	**9,308**
Total	**303,750**	**330,000**	**633,750**

RISK REPORT

RISK MANAGEMENT SYSTEM

To ensure their long-term survival, companies must act quickly – and react even faster – in a world in which economic conditions and the individual markets are constantly in a state of rapid change. Against the background of increasingly complex corporate structures and growing internationalisation, systematic risk management therefore forms an important basis for long-term business success.

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

Our objective is to generate profits on a sustained basis and to increase these profits significantly over the medium and long term in order to develop the Company and secure its future. It is therefore critically important to identify and assess business risks at an early stage and take corrective action where required. DEUTZ has an appropriate risk management system to ensure it can meet this requirement.

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

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

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

Each year, the Group internal audit department and the independent auditors carry out an audit of DEUTZ AG's system for the early identification of risks pursuant to section 91 (2) AktG to assess whether the system is functioning efficiently. Suggestions for improvements proposed by the internal audit department, the Risk Management Committee or the auditors are promptly implemented by DEUTZ.

RISK MANAGEMENT WITH REGARD TO FINANCIAL INSTRUMENTS

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

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

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

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

The objective of risk management is to mitigate fluctuations in profits and cash flows caused by volatility in commodity, interest-rate and foreign-exchange markets. Derivative financial instruments are used only for hedging purposes, i.e. only in connection with corresponding underlying transactions arising from the Group's ordinary business activities or financial transactions that have a countervailing risk profile to that of the hedging transaction. The nature and scope of the hedged items are specified in a binding financing directive.

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

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

We manage the financial risk as follows:

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

Currency risk arising from operating activities Currency risk, primarily in US dollars, which arises as a result of transactions with third parties denominated in foreign currency, is monitored by means of a central currency management system and mitigated by the use of derivative financial instruments. The DEUTZ Group's net currency exposure is normally hedged by forwards equivalent to 50 to 80 per cent of open items. DEUTZ is also taking specific action to increase the volume of purchasing in US dollars; this enables the Company to counteract exchange-rate risks from sales invoiced in US dollars by way of natural hedging.

Interest-rate risk arising from funding arrangements The DEUTZ Group is exposed to risk from interest-rate changes, above all in relation to floating-rate loans and other loans that it has taken up. We hedged the interest-rate risk arising from the funding arranged in mid-2012 with the European Investment Bank.

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

Further information on risk management with regard to financial instruments can be found in Note 27 on page 120 et seq.

RISK ASSESSMENT

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

DEUTZ Group: Risk assessment

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

Impact

RISK

As with the internal risk report, the following presentation of the current risk situation is focused on the risk factors that are important for the DEUTZ Group. Consequently, risks that are referred to were categorised at least as 'low' before measures to counter the risk were taken into account. In contrast to the internal risk management, the risks in the following description are more strongly aggregated and are listed by risk category. Unless otherwise stated, the risks refer to 2018 and relate to the DCE, DCS and Other segments.

Market risk We operate in sales markets that are characterised by particular sensitivity to cyclical influences. This can have a negative impact on the financial position and financial performance of the DEUTZ Group. As well as having a direct effect on unit sales and revenue, this may also impact negatively on the value of the assets on our balance sheet. We operate in very cyclical markets in our main application segments, Construction Equipment and Material Handling, and in our principal sales regions of Germany, western Europe and North America. Our objective is to continue to reduce this cyclicality from a regional and application segment perspective.

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

We are very well diversified and well positioned for the future in terms of the geographical and sectoral distribution of our customers. We supply the market-leading manufacturers in the various application segments. Despite the countermeasures that are in place, we cannot completely control the external risks. In view of the measures in place, we categorise the market risk as 'low' in respect of the achievement of our corporate targets for 2018 because the economic situation in our main sales markets is continuing to improve. Still factoring in these measures, we assume a 'medium' level of risk in the medium term, however.

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

STRATEGIC RISK

Based on our objective of broadening our customer and product base, our new strategy focuses not only on continued globalisation but also on the electrification of our existing product range. Under our E-DEUTZ strategy, we will add electric and hybrid drive systems to the existing technology portfolio. This strategy presents the DEUTZ Group with numerous opportunities but is, of course, also associated with risks. Target markets might not grow as anticipated, while new product developments may not be as well received by customers as predicted or may not be able to compete with rival products.

We attempt to mitigate these risks by precisely analysing trends in our markets and by taking into account external market research. In September 2017, we acquired the electric drive specialist Torqeedo in order to accelerate the implementation of the E-DEUTZ strategy. We also enter into close alliances with our major customers in the target markets. Finally, we closely monitor our strategic projects so that we are able to respond immediately to changes.

In view of the measures in place, we categorise the strategic risks with regard to the attainment of our financial targets as 'low' in 2018 and as 'moderate' in the medium term.

OPERATIONAL RISK

Procurement risk Demand-related supply shortages at our suppliers – e.g. as a result of the sustained economic upturn – may lead to production downtime and delays in our own deliveries if there are no alternative sources of supply. This would adversely affect our earnings. These potential risks arise specifically in connection with the procurement of components and input materials from third parties. This could have a negative impact on DEUTZ's net income and on its capacity utilisation.

We seek to mitigate these risks by carrying out intensive supplier management and ongoing monitoring of the market.

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

In view of the measures in place, we categorise the procurement risks with regard to the attainment of our financial targets as 'low' in 2018.

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

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

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

OTHER RISKS

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

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

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

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

Groupwide standards such as the general terms and conditions of business, sample contracts for various uses and implementation provisions in the form of organisational guidelines are refined on an ongoing basis and reduce the level of new legal risks at DEUTZ. The legal affairs department and external lawyers are also regularly consulted about projects and the finalisation of contracts that fall outside the scope of the standards developed for day-to-day business. Based on the current status of ongoing cases and in view of the measures that have been taken either to avoid or minimise risk, we continue to categorise the legal risk as ‘low’.

OVERALL ASSESSMENT OF THE RISK SITUATION

We identify and evaluate material risks on an ongoing basis using our risk management system. Appropriate action is taken to manage these risks and, as far as possible, bring them under control. Changes in material risks are monitored regularly at Group level. Currently, the DEUTZ Group has not identified any risks that either individually or in their totality could jeopardise the continued existence of the enterprise as a going concern. Unlike in 2017, quality issues do not represent a major risk factor for 2018, which is why we have not reported separately on quality risk here. Furthermore, we now categorise market risk as ‘low’, whereas we regarded it as ‘medium’ last year. By contrast, procurement risk is defined as significant to achieving the financial targets for 2018, which is why we have included it in this year’s report again. Other risk factors changed only marginally year on year.

Compared with the previous year, there is a greater focus on procurement in the overall assessment of the risk situation. However, the overall risk level remains essentially the same as in 2017. Because of the precautions that have been taken and our position in the market, we are confident in our ability to successfully manage the existing risks and overcome the resulting challenges.

ACCOUNTING-RELATED INTERNAL CONTROL SYSTEM

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

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

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

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

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

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

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

OPPORTUNITIES REPORT

In the fast-paced, dynamic markets in which the DEUTZ Group operates, there are, in addition to the aforementioned risk factors that can negatively impact on the attainment of the business objectives, also opportunities that can have a positive effect on the business objectives of the Group for 2018 and beyond. Identifying and harnessing these opportunities is the responsibility of the individual operating segments of the Group. Unlike risks, opportunities are not collated and assessed centrally.

Unless otherwise stated, the opportunities described below refer to 2018 and relate to the DCE and DCS segments.

Economic situation in relevant markets Developments in the global economy have a major effect on the financial position and financial performance of the DEUTZ Group. If our expectations regarding the macroeconomic situation in our most important markets of Europe, the USA and Asia and regarding the propensity to invest in our most important end markets (construction equipment, material handling and agricultural machinery) are exceeded, we may perform significantly better than we predicted in these regions/application segments.

Research and development Increasingly stringent emissions standards and general technological progress are placing huge demands on our entire industry. We are one of the innovation leaders and have a very strong competitive position thanks to our proven expertise, our many years of experience and our efficient processes in the research and development of innovative drive systems. We will continue to reinforce our strong competitive position by developing gas engines with a capacity of up to 4 litres, expanding our portfolio of products with a capacity of over 4 litres and developing hybrid and all-electric drives.

New trends Diesel technology is currently the subject of much debate. We firmly believe that diesel technology will continue to be the dominant type of drive in off-highway applications for a long while yet. However, the discussion is making potential customers who, until now, have invested in their own diesel development work, more willing to collaborate with us instead. This creates a tremendous opportunity for us. Although we continue to have faith in diesel, we are also investing in other innovative technologies and the debate about diesel is opening up good opportunities to pursue new and innovative approaches – which is what our E-DEUTZ strategy is all about. This includes the possibility of tapping into new markets and customer groups by offering innovative solutions on a much bigger scale than we expect in the medium term.

Torqeedo The company is the global market leader for electric drives for boats and, in recent years, has seen its revenue increase at rates of between 30 and 40 per cent. As well as contributing its expertise to the E-DEUTZ strategy, Torqeedo aims to continue generating substantial growth in the marine business under its own brand in the years ahead. The company is not only strategically important to the DEUTZ Group but could also have a significant effect on the financial position and financial performance of the DEUTZ Group as a whole and on the Other segment, to which Torqeedo is assigned.

Services and digitalisation We intend to significantly expand our high-margin service business. Potential for growth may stem from offering new service products, broadening our service network, acquiring dealers and having a very good understanding of price elasticities. Opportunities are also presented by new sales channels, such as online shops, and digitalisation. Our DEUTZ Connect App, which we brought out in 2017 and will continue to add to, gives users access to engine diagnostics. This creates greater customer loyalty and satisfaction and has the potential to increase efficiency.

OUTLOOK

ACCELERATING ECONOMIC GROWTH

The International Monetary Fund (IMF)[1] has raised its forecasts for the next few years. It now expects the global economy to expand by 3.9 per cent in both 2018 and 2019, following growth of 3.7 per cent in 2017. This improved outlook is based on the acceleration of overall growth and on the expected impact of the tax reforms in the United States.

The eurozone economy is expected to expand by 2.2 per cent in 2018 and by 2.0 per cent in 2019, compared with 2.4 per cent in 2017. Growth rates of 2.3 per cent in 2018 and 2.0 per cent in 2019 are anticipated for Germany. The US economy will benefit from the aforementioned effects and is expected to grow at a rate of 2.7 per cent in 2018 and 2.5 per cent in 2019. The IMF anticipates slightly slower growth rates for China than in 2017: gross domestic product (GDP) is predicted to rise by 6.6 per cent in 2018 and 6.4 per cent in 2019.

The business climate index published by the ifo Institute of Economic Research, which covers trade and industry in Germany[2], rose from 117.2 points to a record high of 117.6 points in January 2018. Companies view the current situation much more positively but have lowered their expectations slightly for the coming months. The ISM purchasing managers' index[3] in the USA stood at 59.1 points on 1 February 2018 and had thus fallen slightly. However, it is still at a high level overall.

DIESEL ENGINES MARKET

For the construction equipment market in 2018, we anticipate that unit sales in Europe and North America will each grow within a range of 5 to 10 per cent while the Chinese market will expand by up to 20 per cent. We anticipate the same rates for the material handling market. For the agricultural machinery market, we predict slight expansion of up to 5 per cent in Europe and North America and stagnation or a small contraction of the Chinese market (between 0 per cent and a decline of 5 per cent). We also expect the light and medium-duty truck sector in China to generate a low level of growth of up to 5 per cent.

On 1 January 2019, the Stage V emissions standard comes into force in the European Union for engines of less than 56 kW and engines of more than 130 kW. It will apply to engines between 56 and 130 kW from 1 January 2020. Experience shows that, in the run-up to a new emissions standard, installation customers significantly increase their inventories and therefore buy fewer engines in subsequent periods.

UNIT SALES, REVENUE

DEUTZ's engine business will benefit from the robust global economy and positive unit sales trends in key application segments. The start of 2018 has been characterised by a significantly better level of orders on hand and strong momentum in terms of new orders. We expect our European customers to bring forward their spending this year ahead of the switch to the new emissions standard in the European Union on 1 January 2019 (EU Stage V). This is likely to have a positive influence on our unit sales in the current year, which we predict will rise by a low five-digit number of engines. Consequently, a tailing off of new orders at the end of 2018 is realistic. However, many new customer projects will get under way in 2019 due to the introduction of the new emissions standard.

We believe the service business's revenue will continue to go up thanks to various service initiatives and the integration of the service business in Italy.

We therefore anticipate a marked rise in revenue overall. The increase in revenue will be fuelled by the DCE segment, whereas we expect the DCS segment's revenue to hold steady. From a low base, revenue in the Other segment, in which Torqeedo has been included since the fourth quarter of 2017, will increase significantly.

Our forecasts are of course subject to great uncertainty. The flexibility of our business and a competitive cost structure therefore remain key factors in our competitiveness.

EARNINGS

We expect to see a moderate increase in the EBIT margin before exceptional items. The improvement to the EBIT margin will be mainly due to greater capacity utilisation. We also anticipate lower R&D costs, savings on the cost of materials as a result of using new suppliers and improved efficiency compared with 2017. Conversely, collectively agreed pay increases, higher commodity prices and exchange rate movements will squeeze earnings. We believe the improvement in earnings will come mainly from the DCE segment, whereas the DCS segment's operating profit will be on a par with 2017. The consolidation of Torqeedo is expected to have a negative impact on the Other segment's earnings in the high-single-digit millions of euros.

[1] IMF World Economic Outlook Update, January 2018.
[2] ifo Institute of Economic Research, January 2018.
[3] ISM Institute for Supply Management, February 2018.

The final instalment of the purchase consideration from the disposal of the Cologne-DEUTZ site could provide a positive exceptional item. After the development plan for the site has been approved, we will receivable a variable payment in the region of around €50 million. The amount and timing of this payment depends on this approval and is therefore not yet certain. From a current perspective, we assume that the payment will be made in 2019 but it could be as early as this year if the plans progress very well.

As a result of the anticipated increase in operating profit, we believe that the return on capital employed (ROCE) before exceptional items will see a further improvement towards the double-digit percentage level in 2018.

COMMODITIES, COLLECTIVE PAY AGREEMENTS

Commodity prices Given the growth of the global economy and strong demand in the manufacturing sector, we anticipate that prices will continue to rise in the primary markets this year.

Collective pay bargaining at the start of the year The current collective pay agreement for the metalworking and electrical engineering industry in Germany expired on 31 December 2017. Following extensive negotiations, the parties signed a new collective pay agreement that runs until 31 March 2020. The main features of the new agreement are a pay rise of 4.3 per cent in 2018, one-off payments for employees in 2019 and the flexibility to choose working hours of between 28 and 40 hours per week.

RESEARCH AND DEVELOPMENT EXPENDITURE[1)]

We predict that research and development spending will rise to between approximately €70 million and €75 million, of which €20 million to €25 million will be capitalised. This is because of new engine projects and activities relating to the E-DEUTZ strategy that will lead to the expansion of our engine portfolio.

CAPITAL EXPENDITURE

We forecast that our capital expenditure in 2018 (excluding capitalisation of research and development expenditure) will be in the range of €60 million to €70 million.

JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD

We expect the revenue and earnings of our joint venture DEUTZ (Dalian) Engine Co., Ltd. to improve slightly. Its earnings will depend heavily on its capacity utilisation and thus on market conditions.

WORKING CAPITAL RATIO, FREE CASH FLOW AND EQUITY RATIO

We predict that the working capital ratio, measured as the quarter-end average, will rise to just under 16 per cent, following the very low value achieved in 2017. The level of free cash flow will depend to a significant extent on working capital. As working capital is budgeted to rise sharply, we expect free cash flow to only be around neutral.

We intend to maintain our equity ratio, which is currently 49.4 per cent, at well above 40 per cent. The good level of equity reduces our dependency on capital markets in a volatile market environment.

EMPLOYEES

Flexible headcount adjustment In view of the planned increase in production, we anticipate that we will continue to need additional workers. We intend to further increase the proportion of flexible contracts, whether fixed-term or temporary, while complying with the provisions of the German Labour Leasing Act (AÜG). As we operate in a cyclical industry, this is the best way that we can respond to fluctuations in our demand for employees.

Disclaimer This management report includes certain statements about future events and developments, together with disclosures and estimates provided by the Company. Such forward-looking statements include known and unknown risks, uncertainties and other factors that may mean that the actual performances, developments and results in the Company or those in sectors important to the Company are significantly different (especially from a negative point of view) from those expressly or implicitly assumed in these statements. The Board of Management cannot therefore make any guarantees with regard to the forward-looking statements made in this management report.

1) Research and development expenditure constitutes actual spending on R&D projects. It differs from the research and development costs recognised in the income statement in that development expenditure that can be capitalised is deducted and amortisation on completed development projects is added.

SEPARATE COMBINED NON-FINANCIAL REPORT

ABOUT THIS NON-FINANCIAL REPORT

In accordance with section 315b et seq. and section 289b et seq. of the German Commercial Code (HGB), DEUTZ will publish a separate combined non-financial report ('non-financial report') for each financial year from 2017. The content of this report covers both the DEUTZ Group and the parent company DEUTZ AG and is issued as a separate report. Unless otherwise indicated, all disclosures pertain to the Group ('DEUTZ') as a whole. Disclosures that relate only to DEUTZ AG are labelled accordingly. The non-financial report summarises the key issues pertaining to the following areas of focus: environmental matters, treatment of employees, social responsibility and measures to combat corruption and bribery. Corporate social responsibility at DEUTZ AG is not subject to reporting requirements according to the materiality assessment. However, it is also reported on in this non-financial report so as to provide a more rounded picture of the Company. Human rights are not reported on as they are not relevant to the Company's situation and the resultant risks are not deemed to be material. Reference is made at the relevant points to further information contained in other parts of this annual report. References to disclosures outside the scope of the combined group management report or consolidated financial statements do not form part of the non-financial report.

This non-financial report has been produced with reference to the framework provided by the German Sustainability Code (DNK). It covers criteria 1, 3 and 6 of the DNK.

The non-financial report has been voluntarily submitted for a review with limited assurance pursuant to ISAE 3000 (Revised).

Using the net method, we identified no material risks in relation to our own business activity or to our business relationships, products and services pursuant to sections 289c (3) nos. 3 and 4 HGB. All other information on opportunities and risks are presented in the opportunity and risk report on page 59 et seq. of the combined management report.

BUSINESS MODEL

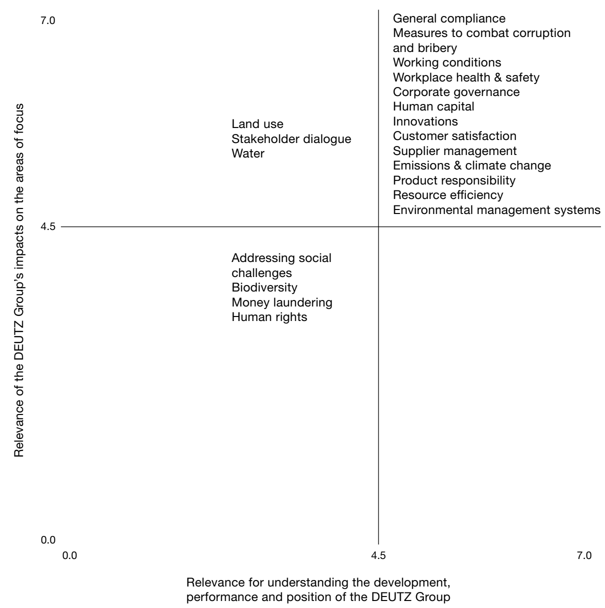
DEUTZ is one of the world's leading engine manufacturers. We are an independent producer of diesel and gas engines in the power output range of 19 kW to 620 kW for on-highway and off-highway applications. For further information on the business model, see page 32 et seq. in the combined management report of this annual report.

MATERIALITY ASSESSMENT

Last year, in preparation for the non-financial report, we set up an internal process to identify the key topics under the Corporate Social Responsibility Directive Implementation Act (CSR-RUG) pursuant to sections 315b et seq. and 289b et seq HGB. First, we drew up a comprehensive list of potential key topics based on research into competitors, frameworks and sustainability ratings. This list was then analysed. We declared those topics to be material that were particularly relevant both in terms of their impact on the aforementioned areas of focus and in understanding DEUTZ's development, performance and position. To get to this stage, we first conducted a survey among internal contacts. The results of this survey were then discussed in a workshop before undergoing a final assessment by the Board of Management.

The materiality matrix encompasses the dimensions 'Relevance of the DEUTZ Group's impacts on the areas of focus' and 'Relevance for understanding the development, performance and position of the DEUTZ Group'.

DEUTZ Group: Materiality matrix



The following key issues were identified for each area of focus:

- Environmental matters: environmental management systems, resource efficiency, air and climate
- Treatment of employees: working conditions, health, safety and human capital
- Social responsibility: product responsibility
- Compliance: general compliance, measures to combat corruption and bribery, corporate governance
- Overarching topics: customer satisfaction, innovation, supplier management

In the following section, we report on the 13 key topics on the basis of the criteria specified under CSR-RUG.

The materiality assessment revealed that the subject of human rights has little relevance in terms of impacts on the areas of focus and in terms of understanding the development, performance and position of our Company because our compliance with applicable domestic and international laws and collectively agreed working conditions means that human rights infringements can essentially be ruled out. Furthermore, it emerged that there were no material risks with regard to our business activities, to our business relationships, products and services, and to the non-financial areas.

ENVIRONMENTAL MATTERS

Key environmental concerns for DEUTZ are environmental management systems, resource efficiency and climate. These are explained below:

Environmental matters form part of the integrated management system DEUTZ AG's integrated management system, which covers environmental protection, energy and quality, meets the requirements of the DIN EN ISO 14001, 50001 and 9001 (version 2015) standards that are currently applicable. This conformity was reviewed and confirmed by the external auditors from TÜV Rheinland Cert GmbH.

The continuous improvement process, which was introduced together with the integrated management system, helps DEUTZ AG to continually review the targets that it has set itself. This is done as part of the management review conducted by the Company's most senior level of management (Chairman of the Board of Management).

The senior management team is involved in the processes through the environmental management system. It assesses the measures as part of the management review and decides on further activities.

Continuous reduction of emissions The DEUTZ Group has set itself the target of reducing CO_2 emissions per manufactured engine by at least 2 per cent every year. Data is also collected on the pollutants dust, nitrogen oxide and benzene; here too we are striving to continually reduce the level of these emissions per unit of production.

Regular audits of energy use and environmental impact DEUTZ AG has set up a working group to review its compliance with important product-related laws and regulations. The group conducts investigations into the supply chain, part of which includes auditing suppliers. In addition, internal environmental and energy audits take place five or six times a year as set out in the integrated management handbook. These are carried out in accordance with a fixed schedule and help to ensure that the examined processes comply with statutory norms and customer specifications. Most of the work is done by an external service provider that specialises in environmental and energy matters. The aim is to provide an assurance of legal conformity and to reduce commercial risk.

Reducing energy consumption In early 2017, DEUTZ AG's energy management system was recertified under ISO 50001 without any nonconformities. We continue to work on further developing this system in a continuous improvement process at strategic and operational level.

Ongoing training for trainees/apprentices and production staff as well as optimisation of the measurement systems form the basis for identifying and successfully implementing measures to improve energy-related performance.

DEUTZ AG has adopted a variety of measures aimed at reducing primary and secondary energy consumption. It has achieved most energy savings by optimising its network of sites.

Despite a sharp rise in production volume, the amount of energy used throughout the DEUTZ Group was reduced in 2017, by nearly 50 per cent in the case of district heating. Electricity consumption rose slightly for production-related reasons. Consumption of LPG was also higher due to production-related reasons, as this is being used to test the new gas engine.

DEUTZ Group: Energy consumption in our plants[1]

MWh

	2017	2016
Electricity	84,605	79,837
Natural gas	35,277	35,795
District heating	12,223	23,017
Heating oil[2]	3,653	4,440
Diesel fuel[3]	19,218	20,144
LPG[4]	421	310
Total	**155,397**	**163,543**

[1] Plants in the DEUTZ Group, excluding joint ventures.
[2] At 10.5 kWh/litre (mean).
[3] At 9.85 kWh/litre (mean).
[4] At 12.8 kWh/kg (mean).

Minimising CO_2 emissions through engineering A number of different measures are in place to achieve the aim of reducing CO_2 emissions. At DEUTZ itself, emissions are primarily produced by the engine test bays used in development and production. The state-of-the-art, high-performance exhaust gas aftertreatment system used in the production test bays at the German sites ensures that DEUTZ remains within permitted limits and, in some cases, is well below them. DEUTZ AG is also introducing cold testing, a system in which comprehensive pre-start diagnostics are run on the engine functions. Some engines will therefore not have to undergo test runs for minutes at a time. This will conserve fuel and substantially reduce engine emissions. The test method, which offers compelling economic and ecological advantages, was purchased in the reporting year. The project will commence in the second half of 2018. Plans for the forthcoming optimisation of material flows for engine series with capacities of less than 4 litres include ramping up the proportion of cold tests of sub 4 litre engines at the Porz plant to more than 50 per cent by 2020. The cold testing has the potential to dramatically reduce factory-related emissions, which at DEUTZ AG are mainly released from the consumption of fossil fuels in test bays.

Reducing CO_2 emissions through sustainability The optimisation of our network of sites, which was completed last year, is also playing a key role in resource efficiency. The clearing of the Cologne-Deutz premises at the beginning of 2017, with the site being sold and a new shaft centre built in Cologne-Porz, has freed up around 160,000 square metres of industrial space in a central location in Cologne. The area can be used for housing, commercial premises, schools and parks. As the Company's utilisation of space is now much more efficient and old infrastructure has been disposed of, the energy efficiency of the network of sites has improved and the emissions they produce have been markedly reduced. And in mid-2017, the relocation of production from the Übersee plant on Lake Chiemsee to the Ulm plant was successfully completed – and it has had a positive impact in terms of both resource efficiency and emissions.

When designing its workspaces, DEUTZ AG takes sustainability aspects into account as soon as planning starts. In our new shaft centre at the Porz plant, the supply of coolant has been centralised and the flow of materials optimised from an economic and ecological perspective. This has reduced the throughput time of camshafts by around 75 per cent and of crankshafts by more than 50 per cent.

Reducing CO_2 emissions through technology and innovative products DEUTZ is further minimising emissions by introducing more stringent emissions standards for diesel engines and by optimising its products. In 2017, DEUTZ became the world's first engine manufacturer to be given a certificate for the Stage V emissions standard, which comes into effect in the EU in 2019. Numerous engine models in the 3.6 litre to 7.8 litre power output range have now been certified. The Company has therefore met what will be the world's strictest emissions standards ahead of time and is actively contributing to climate protection and improvements in air quality. DEUTZ engines offer high performance, a small installation space and, at the same time, reduced fuel consumption. This is to the benefit both of our customers and of the environment as CO_2 emissions are directly related to fuel consumption.

In recent years, Torqeedo has won multiple accolades for its innovative products and environmental credentials. For example, it received the Top Product 2016 award from US magazine Boating Industry for its Cruise 10.0 R outboard motor as a "green and quiet alternative for commercial and recreational users".

DEUTZ's Xchange product programme also plays its part in improving sustainability as having used engines professionally refurbished gives them an extended lease of life.

Significant reduction in CO_2 emissions The DEUTZ Group's primary environmental target is to reduce CO_2 emissions per engine manufactured by at least 2 per cent every year, and it did significantly better than this in 2017, cutting emissions by 18.5 per cent. This is mainly attributable to the optimisation of the number of sites in Germany, the construction of a state-of-the-art, energy-efficient shaft centre at the Cologne-Porz plant, the savings in diesel fuels in development and the greatly expanded production programme. The overall impact will soon be greatly enhanced by the introduction of cold testing, which reduces some of the test runs that engines have to undergo.

The reduction in nitrogen oxide, dust and benzene emissions was mainly achieved by cutting fuel consumption in production areas at the Cologne-Porz plant[5].

[5] Not checked by the external auditor.

DEUTZ Group: Annual CO_2e emissions in our plants [1]

Tonnes

	2017	2016 [2]
CO_2e emissions (Scope 1)	13,239	13,748
CO_2e emissions (Scope 2)	38,012	39,325
CO_2e emissions (Scope 3)	9,217	7,722
CO_2e emissions (total)	**60,469**	**60,795**

Scope 1: CO_2e emissions from diesel, natural gas, LPG and heating oil caused by combustion in our own facilities.
Scope 2: CO_2e emissions relating to purchased energy (e.g. electricity, district heating).
Scope 3: CO_2e emissions from air miles and CO_2e emissions produced by the treatment of purchased water.

[1] CO_2e = carbon dioxide equivalents.
CO_2e emissions in plants in the DEUTZ Group, excluding joint ventures.
CO_2e figures are reported in accordance with the Greenhouse Gas Protocol and are determined by multiplying the energy consumed by the relevant emissions factor.
Prior-year figures have been adjusted in line with the new calculation method.
[2] CO_2e figures for 2016 have not been checked by the external auditor.

DEUTZ Group: Emissions per engine in our plants [1, 2]

Emissions per engine

	2017	2016
CO_2e (kg)	353	433
Nitrogen oxide (kg)	0.18	0.22
Dust (g)	2.25	2.70
Benzene (mg)	76.8	84.8

[1] CO_2e = carbon dioxide equivalents.
CO_2e emissions in plants in the DEUTZ Group, excluding joint ventures. The other data relates only to German plants.
CO_2e figures are reported in accordance with the Greenhouse Gas Protocol.
Prior-year figures have been adjusted in line with the new calculation method. The ‘emissions per engine’ figure is calculated by dividing total emissions by the number of engines made. CO_2e reporting includes all scopes.
[2] CO_2e figures for 2016 and all figures for dust, nitrogen oxide and benzene have not been checked by the external auditor.

TREATMENT OF EMPLOYEES

Because of the materiality of DEUTZ AG as the executive parent company, there is currently no overarching system that monitors the treatment of employees in the Group as a whole. Our reporting therefore focuses on the treatment of employees at DEUTZ AG. The subsidiaries are managed on an individual basis on account of different local circumstances. The local senior management teams regularly report on relevant matters to DEUTZ AG’s management.

HUMAN CAPITAL

DEUTZ AG has formulated the following goals in this area:

- Provide foundation training for specific specialist positions
- Fill vacancies for specialist/management roles with qualified internal candidates
- Develop the workforce at all levels

Due to the specific labour market situation in Extremadura, DEUTZ Spain is planning to open its own business school in 2018 so that it can fundamentally improve the skills of its employees.

Strong focus on training and development Measures in place at DEUTZ AG include individual development plans, training in technical and IT professions, career guidance for young people, student programmes, support for part-time education (e.g. technical training and master’s degrees), inhouse training courses and training courses run in collaboration with external providers.

DEUTZ AG has long been committed to providing vocational training in professions recognised by the Chambers of Industry and Commerce (IHK). In Germany, our apprentices can train in careers ranging from electronics, mechatronics and metalworking to warehouse logistics and business administration. Last year, 29 young men and women began a vocational apprenticeship at our Company; as at the end of 2017, a total of 51 trainees were employed at our Cologne site, 19 at the DEUTZ plant in Ulm and six at the components plant in Herschbach. Our training centre in Cologne also provides vocational training, on a part-time and full-time basis, for apprentices from 21 other companies.

In 2017, a total of 206 interns were employed at DEUTZ AG, of whom 35 wrote their bachelor or master’s dissertations while at the Company. A total of 34 students spent a practical semester with us.

Our management trainees followed a special management training programme (six participants in 2017). Our professional development programme comprised 362 seminars (inhouse training and one-off external courses), attended by 1,897 participants. A further 29 specialist employees participated in skills training provided by the employers’ liability insurance association. The existing collaboration with the training provider macils.management-centrum GmbH for the implementation of specific workshops was successfully continued.

Some employees also took part in a cross-mentoring programme for female management trainees. We offer career days for young people and encourage women to enter industrial/technical occupations.

In 2017, the HR management system at DEUTZ Spain underwent thorough analysis, with 300 employees taking part in SWOT workshops in order to examine the strengths and weaknesses of the current set-up. Workspaces were assessed and an employee appraisal system was developed. An HR programme for 2017 to 2021 was defined that highlights the cause-and-effect relationships of the various approaches in HR management. These were used to create an HR dashboard featuring a hierarchical system of KPIs that gauge the efficiency of the various measures.

DEUTZ Business School in Spain The more technology progresses towards Industry 4.0, the more highly skilled employees will have to be. Because of this and because of the specific labour market situation in Extremadura, approval was given in 2017 for a project that will culminate in the opening of the DEUTZ Business School® with its four areas of focus: strengthening dual vocational training, offering university courses in lean management, running language courses with official certification and providing ongoing training in the form of conferences and seminars.

At each site, approval processes ensure that the senior management team is closely involved in all proposed measures.

DEUTZ AG evaluates its service providers and trainers by conducting satisfaction surveys among the participants.

At DEUTZ Spain, procedures are in place for the structuring of internships (students undergoing practical training, dual vocational training and HR programme). In addition, the training process is monitored by both the company committee and the quality management system.

DEUTZ trainees and training score highly The achievements of trainees and the DEUTZ training centre in Cologne are regularly recognised, and 2017 was no exception. Indeed last year, DEUTZ's training was right up there with the very best in Germany, with the Association of German Chambers of Industry and Commerce (DIHK) presenting an award to a DEUTZ trainee in December 2017 in Berlin for achieving the best result in the metal technology specialist exam. And for the seventh year in a row, the DEUTZ training centre was recognised by the Chambers of Industry and Commerce for its outstanding achievements in vocational training. Further DEUTZ apprentices were awarded 'best performer' certificates at national, regional and federal state level.

DEUTZ AG takes on apprentices after they have completed their training and recruits graduates who worked at DEUTZ while they were studying. Technical and *meister* grade positions are generally filled by internal candidates. We have also improved skills training for employees, widened the reach of the 'employees train employees' scheme and extended the training courses offered by DEUTZ AG.

At DEUTZ AG, the ratio of trainees to total employees stood at 2.5 per cent in 2017. All apprentices and trainees who passed the final examination were given a permanent employment contract. Currently, around 5 per cent of apprentices at DEUTZ are female.

The high-potential programme at DEUTZ Spain has proven to be a success, with 75 per cent of participants having now been taken on. Its success prompted the launch of a second programme in September 2017.

WORKING CONDITIONS

Compliance with laws and agreements DEUTZ acts in accordance with the collective pay agreements, tax laws, social insurance guidelines and rules on variable remuneration that are currently applicable. Our corporate culture is built on respect for different cultural values and supports equal opportunities for all employees, regardless of gender, age, ethnicity, sexual orientation or disability. Our management culture helps managers and employees to work together efficiently and from a position of trust. DEUTZ strives for fair and appropriate remuneration for all employees.

DEUTZ Spain specified comparable targets for working conditions in its HR strategy plan 2017–2021 and was the first company in Spain to introduce a compliance system with consequences under criminal law. Certification to the UNE19601 standard ensures that the statutory working conditions are also being complied with.

Employee communications and consultation At all locations, the senior management team is closely involved in the implementation of measures. DEUTZ AG and DEUTZ Spain also follow the principle of codetermination, which gives workers a voice in company decisions. All employees in Germany are subject to the collective pay agreement of the metalworking and electrical engineering industry. Employees are represented by a works council at each site. There is also a General Works Council with responsibility for matters concerning multiple sites. An elected Senior Staff Committee represents the interests of senior managers at DEUTZ AG. Both the works council and senior managers appoint representatives to the Company's Supervisory Board. Employee rights are safeguarded by adherence to the Company's own corporate and management principles, collective bargaining agreements and the corresponding agreements with the employee representative bodies. The myDEUTZ staff magazine, noticeboards and ad-hoc announcements keep employees up to date with what is going on in the Company. Moreover, any employee can attend one of the local works meetings and have their voice heard if they feel this is necessary.

Appropriate measures are in place to reintegrate members of staff at DEUTZ AG who have been on long-term sick leave.

Childcare facilities Employees of DEUTZ AG in Cologne can have children under the age of three looked after at the 'DEUTZlinge' day care centre, which makes it easier for them to return to their day-to-day work after parental leave. We also offer tailored or flexible working hours for employees who provide care or assistance to an elderly or disabled family member. In addition, all employees covered by collective pay agreements receive a share of the Company's profits in accordance with a system agreed with the works council.

Promoting equality DEUTZ Corporation closely monitors best practice in the US and builds on this to generate improvements and recommendations. The subsidiary has implemented an affirmative action plan in line with the regulations of the U.S. Equal Employment Opportunity Commission (EEOC). This sets out how discrimination on the grounds of skin colour, gender and other factors can be avoided when recruiting and promoting staff and in the general working environment.

Codetermination in action On the basis of the applicable collective pay agreements and laws, the employee representatives at DEUTZ AG and DEUTZ Spain are closely involved in the processes and in any action taken that concerns the treatment of employees (recruitment, remuneration, reassignment, development, dismissal).

At DEUTZ Spain, there are job profiles and salary bands that comply with the collective pay agreements. A compliance system safeguards equal opportunities in the selection of personnel.

DEUTZ Corporation makes efforts to ensure that its pay is fair and appropriate. Regular audits are carried out to check that this is the case. Mechanisms have been put in place for employees to report workplace bullying and inappropriate behaviour. A handbook describes relevant countermeasures. An equal opportunities audit is carried out once a year and the results are reported to the regulatory authority (EEOC).

Key figures bear out the effectiveness of measures Average staff turnover at DEUTZ AG is very low, at 1 per cent.

In 2017, three children were looked after at the new day care centre at the Cologne-Porz site. In an employee survey, 89 per cent were in favour of company childcare provision.

More than 70 new fathers at DEUTZ AG made use of the option to take parental leave.

HEALTH AND SAFETY

Reducing accident frequency A groupwide accident frequency rate of less than 10 is a target specified by DEUTZ AG in the area of health and safety. Accident frequency is defined as the number of reportable accidents in relation to hours worked.

Various measures helping to achieve this target At DEUTZ AG, these include ergonomic improvements, flu vaccinations, medical check-ups, sports events, accident analyses, health and safety training, and campaigns run in conjunction with health insurance schemes. Managers in production, development and assembly also followed a multi-part training programme in health-oriented leadership.

At DEUTZ Spain, medical check-ups are offered and workspaces are ergonomically optimised. Noise, vibrations and levels of chemical pollutants are also measured and risk assessments carried out.

At DEUTZ Corporation, all aspects of workplace safety management (accident analysis, prevention, etc.) have been outsourced to an external service provider.

At all locations, the senior management team is closely involved in the implementation of health and safety measures through management reviews. Stakeholders such as external service providers and health insurance schemes are also involved.

Alignment with overarching standards In order to assess safety and the protection of its employees' health, DEUTZ AG and DEUTZ Spain have put in place a system for checking workspaces. IMS (Integrated Management System) has been introduced in Germany and OHSAS in Spain. The primary areas of focus are health, safety and the environment. The frequency with which these internal inspections take place depends on the extent and type of the risk presented by the machinery or workspace. Teams made up of experts from various disciplines carry out these workplace safety inspections in areas such as assembly and production. Any issues that are identified are documented in action plans that specify a timeframe for remedial measures to be taken.

To minimise safety risks, DEUTZ AG has introduced an internal approval process for hazardous substances and for the procurement of plant, machinery and equipment. The service providers that we engage are given detailed information about site-specific risks.

The accident frequency rate at the DEUTZ Group was 13.9[1] in the year under review. Despite the improvement that can be seen in all plants, DEUTZ AG fell short of its target of an accident frequency rate of below 10 (2017: 15.1; 2016: 22.2[2]).

[1] Plants in the DEUTZ Group, excluding joint ventures.
[2] Prior-year figures not checked by the external auditor.

SOCIAL RESPONSIBILITY

Product responsibility is a cornerstone of our commitment to act as a good corporate citizen.

PRODUCT RESPONSIBILITY

Because of the materiality of DEUTZ AG as the executive parent and production company, there is currently no overarching system that monitors product responsibility in the Group as a whole. Our reporting therefore focuses on product responsibility at DEUTZ AG. The local senior management teams regularly report on relevant matters to DEUTZ AG's management.

Product-related KPIs at DEUTZ AG relate to the following metrics:

- Targets concerning durability
- Targets concerning delivery quality (zero-hour defects)
- Targets concerning field quality (field defects)
- Targets concerning the speed at which defects are fixed
- Delivery reliability of engines
- Full compliance with machinery directives such as RoHS and REACH
- Certification to EU Stage V, the latest exhaust emissions standard

DEUTZ AG carries out audits on the basis of ISO 9001, ISO 14001, ISO 50001, VDA 6.3, the German Occupational Safety Act and REACH. DEUTZ Spain carries out audits in line with ISO 9001 and IATF 16949 and Torqeedo to ISO 9001.

Foundation laid for high quality At DEUTZ AG, consistent high quality is maintained by means of certification to ISO 9001. A weekly quality report featuring KPIs keeps the senior management team up to date with the current status of target attainment. Where shortfalls are identified, an action plan is drawn up at quality meetings and subsequently implemented within the Company in order to meet the targets.

Product-related targets, with a particular focus on durability and field quality, are taken into account early on in the product development process when the product specifications are defined.

Initial successes documented DEUTZ AG plans to further raise the level of customer satisfaction by reducing zero-hour defects. It has also increased the speed at which field problems are resolved and successfully commenced certification of its product range in accordance with EU Stage V.

Every year, Torqeedo launches new products with the aim of continually improving its market position.

For information on Torqeedo's new products, patents and awards, see the Innovations section on page 76 et seq.

COMPLIANCE

General compliance, corporate governance and the fight against corruption and bribery play an important role in compliance. As measures to combat bribery and corruption form an integral part of the general compliance management system, these key issues are explained together.

GENERAL COMPLIANCE AND MEASURES TO COMBAT BRIBERY AND CORRUPTION

The prime objective of the groupwide compliance management system is to prevent violations of applicable laws and internal policies. To this end, employees are given help in familiarising themselves with the relevant laws and policies as well as guidance on how to apply them correctly. The Board of Management strives to act in accordance with ethical principles. It is unreservedly committed to compliance and declines to be involved in any transactions that are inconsistent with these values. It is also fully committed to compliance with competition law and does not tolerate any form of corruption.

Compliance organisation in place A Compliance Officer appointed by the Board of Management coordinates compliance activities within the Group. The individual business units and subsidiaries have their own compliance coordinators, who are responsible for compliance in their organisations and present structured written reports twice a year to the Compliance Officer. The Compliance Officer in turn reports to the Board of Management and Audit Committee. As well as information on compliance activities and changes to the legal situation or compliance organisation, the reports also detail possible future risks and countermeasures. The basic principles of the compliance organisation are described in rules of procedure. The duties of the relevant employees are set out in job descriptions.

Code of conduct forms the basis Compliance with these principles is set out in the code of conduct, which provides a mandatory framework for ensuring that behaviour towards business partners and employees is fair and in compliance with the law. The code of conduct forms the basis of a structured system of policy management that is continually updated. Other policies, such as the zero tolerance policy, the gifts and entertainment policy, the policy on the engagement of external distributors, the anti-money laundering policy and the insider trading policy, provide employees with binding rules on specific issues relevant to their day-to-day work.

Training is intended to ensure that employees are aware of the relevant laws and corporate policies, and that they comply with them at all times in their day-to-day work. Salaried staff in the head office sales, procurement, research and development and administration units, as well as in the subsidiaries, generally receive annual training sessions that are specifically tailored to their areas of activity. In the production plants, compliance training takes place in conjunction with the regular safety training.

Whistleblowing system introduced Employees can supply information or direct questions to line managers, compliance coordinators, the Compliance Officer or the managers responsible for the legal affairs or internal audit units. Furthermore, since the beginning of 2017, the DEUTZ AG website has featured a whistleblowing system that can also be accessed by non-employees. Any information supplied is rigorously followed up. Any necessary investigations are carried out by internal audit, with external support if required.

Regular meetings are held to develop, discuss and coordinate compliance initiatives. These activities focus on preventing corruption, tackling money laundering and complying with export regulations (including export controls). They also ensure safety in the workplace, IT & data security, corporate security and product safety. A further aim is to prevent breaches of environmental, antitrust and insider trading laws.

As and when needed, the Board of Management and the Compliance Officer take legal advice as part of their efforts to continuously improve the compliance management system. The internal audit department advises on all activities. The compliance management system is also reviewed by internal audit or by external consultants, and is monitored by the Audit Committee on behalf of the Supervisory Board.

Training stepped up Compliance activities at DEUTZ AG during the year under review again centred on the continuation and intensification of regular staff training, including for staff at subsidiaries outside Germany. The primary focus was on the code of conduct, money laundering, gifts, commission, export checks, antitrust/competition law and contract law. In 2017, around 1,100 employees took part in the various classroom-based training courses. In the production plants, compliance training takes place in conjunction with the annual safety training measures. Around 1,800 employees worldwide successfully completed the e-learning programme.

At DEUTZ Corporation USA, additional classroom-based training was provided on compliance with the International Traffic in Arms Regulations (ITAR). An e-learning programme specifically for the US was launched in 2017. From 2018, this will be mandatory for all DEUTZ Corporation employees.

OVERARCHING TOPICS

Customer satisfaction, innovations and supplier management are important overarching topics.

Because of the materiality of DEUTZ AG as the executive parent company, there is currently no system that monitors overarching topics in the Group as a whole. Our reporting therefore focuses on DEUTZ AG. The local senior management teams regularly report on relevant matters to DEUTZ AG's management.

CUSTOMER SATISFACTION

DEUTZ AG has adopted a zero-error strategy. Our main aim in pursuing this quality assurance programme is to ensure that we always meet our customers' expectations. The idea is to detect errors before they actually occur. And where errors do occur, we have to learn from them quickly in order not to make the same mistakes again. A further objective concerns delivery performance: A high standard of delivery performance means delivering engines and parts at the right time and in the right quantity and thus enhancing customer satisfaction. The aim is for customer satisfaction to be as high as possible, which is why it is regularly measured using various means.

Comprehensive measures under the zero-defect strategy DEUTZ AG is lowering its defect rate using a range of measures that, depending on their scope, are defined by the responsible departments or in conjunction with the Board of Management. The senior management team also plays its part by receiving regular reports and making important decisions. In all parts of the Company, action is being taken to improve quality. In 2016, we developed a concept to implement our quality assurance programme, designating certain employees as 'multipliers' and providing them with the necessary training to run workshops. This system was further refined in 2017. At two half-day sessions, managers and employees were given intensive training on topics such as customer satisfaction, quality of work and constructive approaches to dealing with errors.

A survey carried out in collaboration with the Laboratory for Machine Tools and Production Engineering (WZL) revealed that the culture of quality assurance among middle-management employees at DEUTZ AG was very strong on average in terms of external customer focus.

We regularly gauge the levels of satisfaction among DEUTZ AG customers in order to identify areas where we could improve. The customer feedback is used to create action plans that are designed to improve aspects such as customer communication, the availability of contact persons and the transparency of pricing.

The senior management team is closely involved in the implementation of measures.

Quality assurance begins with suppliers DEUTZ AG works together with its suppliers to systematically apply the advanced product quality planning (APQP) process, with the aim of safeguarding and continually improving the quality of delivered parts. This ensures that supplier parts are procured in accordance with the product development process and are of the required quality before volume production begins. Suppliers' delivery reliability and quality performance are also regularly evaluated.

An external service provider works with the Business Intelligence unit to analyse the results of the customer satisfaction survey. In addition, a monthly report on all quality- and customer-relevant KPIs as well as a weekly status report on the most important problems is sent to the unit heads and the Board of Management to ensure a rapid response time where targets are not being met.

Regular reviews At DEUTZ AG, a monthly report on defects reported by customers is presented to the Board of Management and the relevant departments, based on which rapid remedial measures are defined. The proportion of employees trained as part of the quality drive stands at 55 per cent and is increasing all the time. An annual management review examines the financial and non-financial quality KPIs. Here too, the measures taken on the basis of previous reviews are analysed to see how effective they have been. The 2016 survey revealed that customer satisfaction had increased overall compared with 2013, with an increase in scores recorded in most categories.

INNOVATIONS

Our aim is to position DEUTZ as a leading manufacturer of innovative drive systems.

Innovations at DEUTZ AG are primarily in one of the three following areas:

1) Alternative fuels: As well as looking at liquefied petroleum gas (LPG), we are focusing on natural gas, hydrogen and fuels generated from renewable sources.

2) Hybrid drive systems: A key pillar of our development work is the combination of internal combustion engines and electric motors (hybridisation).

3) Digitalisation: There is a particular focus on innovative digital solutions that offer our customers new services (connectivity, smart services for engines).

Centralised research and development At DEUTZ AG, most innovations originate from the central R&D department in Cologne-Porz. Our DEUTZ Corporation and Torqeedo subsidiaries are involved at an early stage in product planning so that they can actively contribute their market-specific requirements to the development and innovation process. DEUTZ Corporation focuses in particular on US emissions legislation (EPA, CARB). Torqeedo is most closely involved in the innovation process when it comes to hybridisation and electrification.

Within DEUTZ AG, the product management department is responsible for monitoring the market and for the product requirements that result from this. Members of the Board of Management are among those that attend its quarterly 'Product Boards', at which market trends and preliminary development work are discussed and other development activities are initiated and prioritised. New developments are brought on and assessed with the aid of the well-established product development process (PEP). Internal and external development work is carried out in order to achieve the Company's targets. In the case of external development work, we collaborate closely with development partners that include suppliers, universities and research institutes.

Torqeedo provides innovation boost In 2017, we acquired Torqeedo GmbH. The company serves as the nucleus for the E-DEUTZ strategy, under which we aim to develop hybrid and all-electric drives for off-highway applications. Torqeedo's expertise in electric-powered drive systems is providing a huge boost to innovation at DEUTZ.

Every year, Torqeedo brings new products to market that consolidate and extend its competitive edge in the market for electric drives for boats.

As previously mentioned, the DEUTZ AG senior management team is closely involved in innovation activities via the 'Product Boards'. At these meetings, which are attended by representatives from product planning, sales and service, the Board of Management discusses the status of preliminary development and approves suitable projects for the next stage of development. Subsidised projects are discussed by a committee below the level of the senior management team. An innovation process is currently being worked on in this area.

DEUTZ broadens its technology portfolio Last year, we presented a number of pioneering new developments that stemmed from our innovation activities. At Agritechnica, the world's biggest agricultural machinery fair, we unveiled our Stage V-certified engine range, our new in-line engines with capacities from 9 to 18 litres, and the E-DEUTZ strategy for hybrid and all-electric drives. We are also committed to investing in the digitalisation of our service products. As well as the DEUTZ Connect app, a tool for remote engine diagnostics, we have a new web shop that has brought the DEUTZ service network online.

DEUTZ AG uses a bonus-driven ideas management scheme to harness the creativity of its employees. Last year, the ideas that they submitted (an average of 24.1 per 100 employees) generated a benefit of more than €200 thousand.

Multitude of patents and awards We use patents, patent applications and utility models to safeguard our expertise against unauthorised use by third parties. In 2017, DEUTZ AG submitted 20 new patent applications, six of which were in Germany. DEUTZ AG now holds a total of 125 patents registered in Germany and 189 registered elsewhere.

Torqeedo has brought a multitude of new products to market in recent years. It has also received numerous awards for these, including the Pittman Innovation Award from Sail Magazine in the US for its Cruise FP Rudder Drive, and the NMMA Innovation Award 2017 from the US National Marine Manufacturers Association for its Cruise F.

SUPPLIER MANAGEMENT

DEUTZ AG's overarching supplier management system[1] is designed to continually improve quality, lead times, commercial conditions and general communication with our suppliers. There is a clear focus on supplier development. As part of this quality improvement process, target defect rates are defined for each product group, communicated to the suppliers and regularly monitored, with remedial measures initiated where necessary. Our overarching objective is to have zero defects. All new suppliers need to be approved by DEUTZ based on self-declarations, feasibility studies, and supplementary documents and criteria. This process usually includes a site audit. The DEUTZ Group uses only certified original equipment suppliers (certified to ISO 9001:2015 as a minimum). Purchasing at the subsidiaries, particularly DEUTZ Corporation and DEUTZ Spain, is modelled on the supplier management system in use at DEUTZ AG.

Performance measurement tool DEUTZ AG manages its suppliers using a 'supplier cockpit'. We use this to monitor suppliers' performance from purchasing, delivery and quality perspectives and, in the case of development partners, with regard to their research and development capabilities and their ability to innovate. Before being included in the cockpit, suppliers must first be categorised accordingly. Their results for the individual KPIs and how these change over time are used to initiate remedial measures and improve performance.

For further information, please see the Compliance and Customer Satisfaction chapters on pages 74 and 75 et seq.

On a monthly basis, the senior management team at DEUTZ AG is provided with information about the procurement budget and other KPIs in the balanced scorecard. This monthly procurement management report contains key figures for the Board of Management, including key financials and KPIs related to quality. The underlying targets were confirmed by the Board of Management.

Supplier due diligence process being set up to ensure compliance DEUTZ AG assesses its suppliers using self-declarations and audits, including preventive audits where necessary. As previously mentioned, the Company also uses a 'supplier cockpit', a piece of supplier management software that can be used to categorise suppliers and track their performance. A supplier due diligence process is currently being set up to ensure compliance. The first global surveys are currently being evaluated. The TSD (Total Supplier Development) steering committee meets every two weeks to discuss data from the supplier cockpit and determine what action needs to be taken. A system of risk management for suppliers is also in place, covering risks such as insolvency, corruption, natural disasters and local developments.

Regular review of KPIs DEUTZ AG compares the current and target figures in regard to cost savings, supplier performance and quality KPIs. The degree of target attainment is also checked. In 2017, we visited and audited a large number of suppliers. The defect rate (ppm) for deliveries was lower than ever before last year.

[1] The statements relate to direct suppliers that have a contractual relationship with DEUTZ.

CORPORATE SOCIAL RESPONSIBILITY [1)]

Corporate social responsibility is a well-established tradition at DEUTZ. As a company with operations around the world, we of course shoulder our responsibilities as a corporate citizen. This includes responsibility for our decisions and our actions, for our products and services, for our customers and lenders, for the environment and for society. We have been involved in corporate citizenship projects for many years, not only in our home region in the area around Cologne but also throughout Germany and beyond.

Nurturing enthusiasm for technology The DEUTZ engine museum, which includes exhibits on the origins and history of global motorisation and shows original machines from the early days of the engine, opens to the public free of charge and continues to attract a good number of visitors. Our history began more than 150 years ago with the founding of N.A. Otto & Cie., the predecessor of today's DEUTZ AG. The Company's history department, which is run on a voluntary basis, and the Friends of DEUTZ's Engine Collection, whose patron is Professor Andreas Pinkwart, Minister for Economic Affairs in the State of North Rhine-Westphalia, again initiated joint projects with the Rhineland Regional Association, the Knowledge Foundation of the Sparkasse savings bank in Cologne/Bonn and the Luxembourg Science Center in 2017.

DEUTZ also promotes a continual dialogue of ideas in order to nurture enthusiasm for technology among the general public, particularly young people. As part of the redevelopment of the former DEUTZ site in Cologne-Mülheim, for example, the Company is helping to preserve historical features in partnership with investors and the City of Cologne.

Helping young people and the unemployed into work For more than 26 years, we have been working with IN VIA – an association under the auspices of the German Caritas organisation – and the German Federal Employment Agency to provide career preparation courses for young people with learning and social difficulties. In 2016/17, a total of 28 participants underwent basic metalwork training over a ten-month period at the DEUTZ training centre. In 2017, 74 per cent of those who completed this training then enrolled on a vocational apprenticeship scheme, which is a relatively high proportion.

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

Playing our part in the community We support community projects in the region with our 'DEUTZ fulfils your wish' Christmas initiative. In 2017, around 90 youngsters from Kalker Kindermittagstisch wrote down their wishes on 'wish notes' and hung them on the Christmas tree in the foyer at our head office in Cologne-Porz so that DEUTZ employees could make their wishes come true. Employees at the Cologne-Kalk and Cologne-Porz sites also organised a donations drive as part of this community project. Kalker Kindermittagstisch serves a hot meal to up to 120 children every day and supervises them while they do their homework.

In spring 2017, apprentices at our Ulm site got involved with 'Guter Hirte', a local organisation that looks after young single parents with small children, young people in need and child refugees without parents.

Dr Hiller becomes patron of the DEUTZ choir In January 2017, the new Chairman of DEUTZ AG's Board of Management, Dr Ing Frank Hiller, became patron of the DEUTZ choir. This sends a strong signal, both internally and externally, of the choir's significance for the Company.

The ensemble regularly creates positive publicity for the DEUTZ name through its concerts and other appearances, which range from performances for staff and customers and local concerts at the Cologne Philharmonic Hall and Cologne-Gürzenich events centre to tours to churches and concert halls in Germany and abroad. Last year, almost 10,000 people were able to enjoy the choir's singing.

[1)] Not checked by the external auditor.

The choir also supports good causes. In 2017, donations collected from concert-goers totalling €7,200 were distributed to, among other organisations, the 'Good deeds' charity of the Kölner Stadtanzeiger newspaper, the 'Kölnische Rundschau für das Hilfswerk (Rundschau-Altenhilfe: Die gute Tat e.V.)' of the Kölnische Rundschau newspaper and the Cologne hospice service for children and young people.

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

2017 CONSOLIDATED FINANCIAL STATEMENTS

2017 consolidated financial statements

Notes to the consolidated financial statements

Annual financial statements in accordance with the German Commercial Code (HGB)

Miscellaneous

INCOME STATEMENT FOR THE DEUTZ GROUP

€ million

	Note	2017	2016
Revenue	1	**1,479.1**	**1,260.2**
Cost of sales	2	–1,222.9	–1,041.6
Research and development costs	3	–94.8	–77.5
Selling expenses	4	–78.8	–68.0
General and administrative expenses	4	–41.5	–36.7
Other operating income	5	144.1	17.7
Other operating expenses	6	–42.1	–26.7
Profit/loss on equity-accounted investments	7	2.5	–5.1
Other financial income	7	0.9	1.1
EBIT		**146.5**	**23.4**
thereof exceptional items	8	104.1	–
thereof operating profit (EBIT before exceptional items)		42.4	23.4
Interest expenses, net	9	–2.4	–3.5
thereof finance costs	9	–3.1	–3.8
Net income before income taxes		**144.1**	**19.9**
Income taxes	10	–22.9	–3.9
Net income		**121.2**	**16.0**
thereof attributable to shareholders of DEUTZ AG		121.2	16.6
thereof attributable to non-controlling interests		–	–0.6
Earnings per share (basic/diluted, €)	11	**1.00**	**0.14**

STATEMENT OF COMPREHENSIVE INCOME FOR THE DEUTZ GROUP

€ million

	Note	2017	2016
Net income		**121.2**	**16.0**
Amounts that will not be reclassified to the income statement in the future	12	**1.8**	**–9.1**
Remeasurements of defined benefit plans		1.8	–9.1
Amounts that will be reclassified to the income statement in the future if specific conditions are met	12	**–5.3**	**–1.4**
Currency translation differences		–8.0	0.2
thereof profit/loss on equity-accounted investments		*–3.0*	*–1.1*
Effective portion of change in fair value from cash flow hedges		2.7	–1.6
Change in fair value of available-for-sale financial instruments		–	–
Other comprehensive income, net of tax	12	**–3.5**	**–10.5**
Comprehensive income		**117.7**	**5.5**
thereof attributable to shareholders of DEUTZ AG		117.7	6.3
thereof attributable to non-controlling interests		–	–0.8

BALANCE SHEET FOR THE DEUTZ GROUP

€ million

Assets	Note	31 Dec 2017	31 Dec 2016
Property, plant and equipment	13	273.4	286.0
Intangible assets	14	213.2	148.5
Equity-accounted investments	15	40.8	41.7
Other financial assets	16	6.8	7.5
Non-current assets (before deferred tax assets)		534.2	483.7
Deferred tax assets	17	69.2	79.9
Non-current assets		**603.4**	**563.6**
Inventories	18	287.0	253.1
Trade receivables	19	142.7	113.5
Other receivables and assets	19	35.8	37.3
Cash and cash equivalents	20	143.8	91.8
Current assets		**609.3**	**495.7**
Non-current assets classified as held for sale	21	0.4	0.4
Total assets		**1,213.1**	**1,059.7**

Equity and liabilities	Note	31 Dec 2017	31 Dec 2016
Issued capital		309.0	309.0
Additional paid-in capital		28.8	28.8
Other reserves		11.8	17.1
Retained earnings and accumulated income		249.4	136.2
Equity attributable to shareholders of DEUTZ AG		**599.0**	**491.1**
Non-controlling interests		0.2	–
Equity	22	**599.2**	**491.1**
Provisions for pensions and other post-retirement benefits	23	162.9	175.9
Deferred tax liabilities	17	0.2	0.4
Other provisions	24	36.2	38.4
Financial debt	25	28.1	44.0
Other liabilities	26	13.0	6.3
Non-current liabilities		**240.4**	**265.0**
Provisions for pensions and other post-retirement benefits	23	13.5	14.1
Provision for current income taxes		18.3	4.1
Other provisions	24	58.4	55.9
Financial debt	25	17.5	16.2
Trade payables	26	207.5	162.3
Other liabilities	26	58.3	51.0
Current liabilities		**373.5**	**303.6**
Total equity and liabilities		**1,213.1**	**1,059.7**

STATEMENT OF CHANGES IN EQUITY FOR THE DEUTZ GROUP

€ million

	Issued capital[3]	Additional paid-in capital[3]	Retained earnings and accumulated income[3]	Fair value reserve[1),2)]	Currency translation reserve[1]	Equity attributable to share-holders of DEUTZ AG	Non-controlling interests[3]	**Total[3]**
Balance at 1 Jan 2016	**309.0**	**28.8**	**134.3**	**–0.4**	**18.7**	**490.4**	**5.2**	**495.6**
Dividend payments to shareholders			–8.5			–8.5		–8.5
Net income			16.6			16.6	–0.6	16.0
Other comprehensive income			–9.1	–1.6	0.4	–10.3	–0.2	–10.5
Comprehensive income			7.5	–1.6	0.4	6.3	–0.8	5.5
Changes to basis of consolidation			2.9			2.9	–4.4	–1.5
Balance at 31 Dec 2016	**309.0**	**28.8**	**136.2**	**–2.0**	**19.1**	**491.1**	**–**	**491.1**
Balance at 1 Jan 2017	**309.0**	**28.8**	**136.2**	**–2.0**	**19.1**	**491.1**	**–**	**491.1**
Dividend payments to shareholders			–8.5			–8.5		–8.5
Net income			121.2			121.2	–	121.2
Other comprehensive income			1.8	2.7	–8.0	–3.5	–	–3.5
Comprehensive income			123.0	2.7	–8.0	117.7	–	117.7
Changes to basis of consolidation			–			–	0.2	0.2
Other changes			–1.3			–1.3		–1.3
Balance at 31 Dec 2017	**309.0**	**28.8**	**249.4**	**0.7**	**11.1**	**599.0**	**0.2**	**599.2**

1) On the balance sheet these items are aggregated under 'Other reserves'.
2) Reserves from the measurement of cash flow hedges and reserves from the measurement of available-for-sale financial assets.
3) The items of equity are explained in Note 22 of the notes to the consolidated financial statements.

CASH FLOW STATEMENT FOR THE DEUTZ GROUP

€ million

	Note	2017	2016
EBIT		**146.5**	**23.4**
Income taxes paid		–9.6	–9.2
Depreciation, amortisation and impairment of non-current assets		93.5	90.8
Gains/losses on the sale of non-current assets		–114.6	–0.3
Profit on equity-accounted investments		–1.6	5.6
Other non-cash income and expenses		–	0.4
Change in working capital		–7.7	–18.7
Change in inventories		–27.6	1.6
Change in trade receivables		–24.0	–11.1
Change in trade payables		43.9	–9.2
Change in other receivables and other current assets		14.8	–8.4
Change in provisions and other liabilities (excluding financial liabilities)		–8.6	–19.8
Cash flow from operating activities		**112.7**	**63.8**
Capital expenditure on intangible assets, property, plant and equipment		–68.3	–57.8
Capital expenditure on investments		–0.4	–0.2
Acquisition of subsidiaries		–83.6	–
Proceeds from the sale of non-current assets		125.0	2.6
Cash flow from investing activities		**–27.3**	**–55.4**
Dividend payments to shareholders	22	–8.5	–8.5
Interest income		0.4	0.2
Interest expense		–3.3	–3.9
Repayment of capital contributions to non-controlling interests		–1.3	–
Cash receipts from borrowings		–	–
Repayments of loans	25	–19.9	–14.6
Cash flow from financing activities		**–32.6**	**–26.8**
Cash flow from operating activities		112.7	63.8
Cash flow from investing activities		–27.3	–55.4
Cash flow from financing activities		–32.6	–26.8
Change in cash and cash equivalents		**52.8**	**–18.4**
Cash and cash equivalents at 1 Jan		**91.8**	**112.5**
Change in cash and cash equivalents		52.8	–18.4
Change in cash and cash equivalents related to exchange rates		–0.8	0.2
Change in cash and cash equivalents related to the basis of consolidation		–	–2.5
Cash and cash equivalents at 31 Dec	20	**143.8**	**91.8**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

BASIS OF PRESENTATION

PARENT COMPANY

The parent company of the DEUTZ Group is DEUTZ AG. Its registered office is located at Ottostrasse 1, 51149 Cologne, Germany, and the Company is entered under no. HRB 281 in the commercial register at the local court in Cologne. The Board of Management approved these consolidated financial statements for publication by adoption of a resolution dated 19 February 2018.

DEUTZ AG shares are listed in the Deutsche Börse SDAX segment and are publicly traded on the Xetra electronic trading platform and on all German stock exchanges.

DEUTZ is one of the world's leading manufacturers of drive systems. We are an independent producer of diesel and gas engines for on-highway and off-highway applications. The business is broken down into the main application segments of Construction Equipment, Material Handling, Agricultural Machinery, Automotive, and Stationary Equipment. Comprehensive aftersales service rounds off the product range offered. The Group's activities are divided into three operating segments: DEUTZ Compact Engines, DEUTZ Customised Solutions and Other. The DEUTZ Compact Engines segment comprises liquid-cooled engines with capacities of up to 8 litres. The DEUTZ Customised Solutions segment specialises in air-cooled engines and large liquid-cooled engines with capacities of more than 8 litres. The Torqeedo subsidiary has been included in the Other segment since the fourth quarter of 2017. It manufactures electric drives for boats and has extensive expertise in the electrification of drive systems. In its operating segments, DEUTZ focuses on value creation processes involving the development, design, production and sales of liquid-cooled and air-cooled engines, hybrid engines and electrified drive systems.

BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The DEUTZ Group's consolidated financial statements prepared for the parent company DEUTZ AG are based on uniform accounting policies. The consolidated financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) and their interpretations as adopted by the European Union (EU) and are consistent with the statutory obligations applicable to publicly traded parent companies subject to disclosure requirements pursuant to section 315e (1) of the German Commercial Code (HGB) in conjunction with Article 4 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council dated 19 July 2002 concerning the application of international accounting standards, as amended (IAS Regulation).

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

APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

1) Amendments to accounting policies

The accounting policies on which the consolidated financial statements are based are fundamentally the same as the policies applied in 2016 with the exceptions set out below.

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

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

Collective standard amending various IFRSs (2014–2016) The amendments published by the IASB in December 2016 primarily serve to clarify ambiguous provisions in standards. The amendments relating to IFRS 12 came into force for financial years commencing on or after 1 January 2017. Initial application of these amendments has not had any impact on the consolidated financial statements. Other amendments – relating to IFRS 1 and IAS 28 – are only required to be applied from 1 January 2018.

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

The International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC) have published the following standards and amendments to standards that have already become part of EU law via the comitology procedure. However, the application of these standards was not yet mandatory in 2017 and DEUTZ has not opted to apply these interpretations or amendments to standards before the mandatory application date.

IFRS 9 'Financial Instruments' Following completion of the final phase of the project to replace IAS 39 'Financial Instruments: Recognition and Measurement', the IASB published the final version of IFRS 9 in July 2014. IFRS 9 introduces new requirements for the classification and measurement of financial assets. The standard defines the basis for this as the contractual cash flow characteristics and the objective of the business model under which the assets are being managed. These changes result in a new system for categorising financial instruments. Essentially, a distinction has to be made between financial assets recognised at amortised cost and financial assets measured at fair value. Depending on the subcategory, measurement at fair value is through profit or loss for the current period or in other comprehensive income.

IFRS 9 also sets out a new three-level impairment model based on expected losses, in which financial assets are assigned to one of three risk levels depending on their credit risk. Upon acquisition or if the credit risk is not expected to have risen significantly since initial recognition, all financial instruments are assigned to level 1. An impairment loss resulting from expected default events in the next twelve months has to be recognised on a portfolio of instruments of the same type. If the credit risk increases significantly, the financial instruments are assigned to level 2 and an impairment loss resulting from default events over the life of the financial instruments has to be recognised. If there is additional objective evidence of impairment, individual financial instruments are transferred to level 3 and a specific impairment loss has to be recognised. If the financial instruments are trade receivables, lease receivables or contract assets pursuant to IFRS 15, a simplified impairment loss approach should be used. Under this approach, the entire life of the financial instruments is taken as the basis for determining the losses (as is the case for level 2).

The standard also includes new requirements for hedge accounting, with the specific aim of linking hedge accounting more closely to the risk management of entities and thus improving the transparency of the accounting treatment of hedges. For the time being, the DEUTZ Group will continue to make use of the option pursuant to IFRS 9.7.2.21, thereby continuing to account for hedges in accordance with the rules in IAS 39. The new standard comes into force for financial years beginning on or after 1 January 2018; early adoption is permitted. DEUTZ is applying IFRS 9 for the first time for the financial year beginning 1 January 2018.

Based on the analysis carried out as at 31 December 2017, the new categorisation system for financial assets particularly affects trade receivables. Those trade receivables that the Company intends to sell under factoring agreements will have to be measured at fair value, with the changes in fair value recognised in the income statement. In view of the relatively small proportion of receivables that the Company intends to sell and in view of the very short period of time before the receivables are actually sold, this will not give rise to any significant measurement effects.

Trade receivables will also be particularly affected by implementation of the new future-oriented impairment model. The analysis carried out as at 31 December 2017 resulted in an only insignificantly higher impairment loss of well below 1 per cent of the recognised trade receivables.

DEUTZ will recognise the transition effects in its retained earnings as at 1 January 2018 resulting from initial application of the new classification and measurement rules and the new impairment model. However, the prior-year figures will not be restated to reflect the new rules.

IFRS 15 'Revenue from Contracts with Customers' The IASB published IFRS 15 in May 2014. This new standard replaces IAS 11 'Construction Contracts', IAS 18 'Revenue' and the interpretations relating to them. One of the objectives of the new standard was to amalgamate the numerous requirements previously included in several standards and interpretations and to establish consistent underlying principles to be used for all categories of revenue-related transaction across all sectors. According to IFRS 15, the amount recognised as revenue is the amount expected in return for providing goods or services to customers. The point at which control over the goods or services is transferred to the customer determines the point in time at which or the period of time over which revenue is recognised. Full control can be transferred at a certain point in time or gradually over a period. In an amendment in September 2015, the IASB changed the original initial application date from 1 January 2017 to financial years beginning on or after 1 January 2018; early adoption is permitted. In April 2016, the IASB published clarifications regarding the identification of performance obligations, principal versus agent considerations and licensing as well as transition relief for modified and completed contracts. The amendments also come into force on 1 January 2018. The Company is applying IFRS 15 for the first time for the financial year beginning 1 January 2018 taking the modified retrospective approach. Under this modified approach, the cumulative effect of applying IFRS 15 for the first time is recognised as an adjustment to the opening balance of retained earnings as at the date of initial application.

As part of a groupwide project to implement IFRS 15, existing customer contracts were examined to ascertain whether they would be affected. Services such as the Xchange business and the granting of extended warranties were also specifically analysed. Finally, the delivery terms and conditions in use were examined with regard to their time of realisation and whether they contained multiple performance obligations. As had been expected in view of the business model, the analysis of existing customer contracts and the examination of the Xchange services and the granting of extended warranties did not result in transition effects. However, the examination of the delivery terms and conditions in use showed that, in addition to the delivery obligation, there could be distinct ancillary performance obligations (such as transport or insurance) for which the revenue would be recognised at a different time, particularly in the case of sea freight. In individual cases, the time of realisation of delivery obligations may occur in a later reporting period. Based on the quantitative check as at 31 December 2017, the distinct ancillary performance obligations resulting in the revenue being recognised in the subsequent reporting period make up only a very insignificant proportion. The possible non-recurring transition effect resulting from delivery obligations being realised at a later time is less than 0.1 per cent of the total revenue for 2017. This possible non-recurring transition effect on revenue is expected to have a corresponding transition effect on trade receivables and inventories. The Group also anticipates additional qualitative and quantitative disclosures in the notes to the financial statements.

IFRS 16 'Leases' The IASB published IFRS 16 in January 2016. This new standard replaces IAS 17 'Leases' and the interpretations relating to them (IFRIC 4, SIC 15 and SIC 27). IFRS 16 governs the recognition, measurement, presentation and disclosure of leases with the aim of ensuring that lessees and lessors provide relevant information about the impact of leases. As a result of this model, lessees must recognise assets and liabilities for all leases on the balance sheet, unless the lease term is twelve months or less or the underlying asset has a low value. The new standard comes into force for financial years beginning on or after 1 January 2019; early adoption is permitted if IFRS 15 has already been applied. DEUTZ will apply the new standard for the first time with effect from 1 January 2019 taking the modified retrospective approach. Under the modified retrospective approach, the prior-year comparative figures are not restated; instead, all adjustments may be recognised in the opening balance of retained earnings for the year of initial application. The preliminary groupwide inventory of the existing leases shows that, as at the transition date of 1 January 2019, the balance sheet is expected to increase by up to 1 per cent due to the recognition of the usage rights and corresponding lease liabilities. The transition effect is primarily attributable to the recognition of usage rights attaching to leased property. The impact of the new standard on the consolidated financial statements was still being investigated as at 31 December 2017.

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

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

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

IFRIC 23 'Uncertainty over Income Tax Treatments' The publication of IFRIC 23 in June 2017 eliminated uncertainties surrounding the income tax treatment of profits, losses, tax bases, tax credits and tax rates. An entity has to use its judgement to determine whether each tax treatment should be considered independently or together. It has to decide on a particular tax treatment after considering whether the tax authority will accept such treatment. The entity has to assume that a tax authority will have knowledge of all relevant information when it examines the amounts reported to it. If facts and circumstances change, the entity has to reassess its judgements and estimates. This interpretation applies to financial years commencing on or after 1 January 2019. It is not expected to have any material impact on the DEUTZ Group's consolidated financial statements.

'Plan Amendment, Curtailment or Settlement' (Amendments to IAS 19) The amendments to IAS 19 'Employee Benefits' were published in February 2018. If a defined benefit pension plan amendment, curtailment or settlement occurs, it will be mandatory in future for the current service cost and the net interest for the remainder of the financial year to be newly determined using the actuarial assumptions used for the required remeasurement of the net liability (asset). In addition, amendments have been included to clarify the effect of a plan amendment, curtailment or settlement on the requirements regarding the asset ceiling.

'Long-term Interests in Associates and Joint Ventures' (Amendments to IAS 28) Published in October 2017, these amendments aim to clarify that IFRS 9 has to be applied to long-term interests in an associate or joint venture that form part of the net investment in this associate or joint venture but to which the equity method is not applied. The amendments come into force for reporting periods commencing on or after 1 January 2019. The initial application of these amendments is not expected to have any impact on the Group's consolidated financial statements because the Group does not have such interests.

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

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

'Prepayment Features with Negative Compensation' (Amendments to IFRS 9) In October 2017, the IASB amended IFRS 9 so that financial assets with symmetric termination rights are measured at amortised cost or at fair value through other comprehensive income. The IASB also clarified that, if a financial liability is not derecognised after being modified, the carrying amount of the liability has to be adjusted and recognised in profit or loss after the modification. The amendments apply to financial years beginning on or after 1 January 2019. The initial application of these amendments is not expected to have a material impact on the Group's consolidated financial statements.

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

Collective standard amending various IFRSs (2014–2016) The amendments published by the IASB in December 2016 primarily serve to clarify ambiguous provisions in standards. The amendments relating to IFRS 1 and IAS 28 come into force for financial years commencing on or after 1 January 2018. The initial application of these amendments is not expected to have a material impact on the Group's consolidated financial statements. The amendments to IFRS 12 have had to be applied since 1 January 2017.

Collective standard amending various IFRSs (2015–2017) The amendments published by the IASB in December 2017 primarily serve to clarify ambiguous provisions in standards. The amendments come into force for financial years commencing on or after 1 January 2019. The initial application of these amendments is not expected to have a material impact on the Group's consolidated financial statements.

Significant estimates and assumptions

To a certain extent, the preparation of the consolidated financial statements in accordance with IFRS requires estimates and assumptions that have an impact on the recognition, measurement and reporting of assets and liabilities, the disclosure of contingent liabilities at the balance sheet date and the reporting of income and expenses. Estimates and assumptions giving rise to a material risk in the form of adjustments to the carrying amounts of assets or liabilities over the next financial year are explained below. Adjustments to estimates are recognised in income when better knowledge becomes available.

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

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

As at 31 December 2017, the carrying amount of deferred tax assets recognised in respect of tax loss carryforwards amounted to €66.8 million (31 December 2016: €66.9 million). Further details can be found in Note 17 on page 109 et seq.

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

Because of changes in economic and market conditions, the costs and liabilities actually incurred may differ significantly from the estimates made on the basis of actuarial assumptions. The rate of pension and salary increases, the longevity of those entitled to pension benefits and the discount rate used can have a material impact on the amount of the defined benefit obligation and, consequently, on future pension costs.

Development expenditure is capitalised in accordance with the accounting policies described below. Management makes assumptions about the amount of future cash flows expected to be generated from the development projects, the discount rates to be applied and the period over which the cash is expected to flow into the Company. As at 31 December 2017, the carrying amount of capitalised development expenditure was €114.9 million (31 December 2016: €139.8 million).

Pending or potential legal disputes DEUTZ AG and other companies in the DEUTZ Group are subject to a variety of regulations under tax, competition and patent law as well as to other legal and statutory requirements. Existing and potential legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and an appropriate amount is recognised in the risk provisions in the accounts. At present, it is not possible to predict the outcome of pending cases with any degree of certainty beyond the provisions already recognised. We do not expect them to have a significantly adverse impact on the DEUTZ Group's financial position or financial performance. The overall position as regards the legal risks facing the DEUTZ Group is explained in more detail in Note 29 on page 131.

Business combinations When acquirees are consolidated for the first time, the identifiable assets and liabilities (including contingent liabilities) are recognised at their fair value as at the date of acquisition. The measurement of intangible assets is particularly subject to uncertainties. They are measured using accepted valuation methods on the basis of estimates of future cash flows, expected growth rates and exchange rates, discount rates and useful lives.

BASIS OF CONSOLIDATION

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

Subsidiaries are all entities directly or indirectly controlled by DEUTZ AG. Subsidiaries are consolidated from the point at which the parent company acquires control. Consolidation ends when the parent company no longer has control. In addition to DEUTZ AG, the consolidated financial statements include eight German subsidiaries (2016: seven) and 14 foreign subsidiaries (2016: nine). Details of the acquisitions during the reporting year and the related impact on the Group's financial position and financial performance can be found in the 'Acquisitions' section on page 92 et seq. of these notes to the financial statements.

Torqeedo GmbH, Gilching, was included in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017. DEUTZ AG holds 100 per cent of the voting shares in Torqeedo GmbH, which in turn holds 100 per cent of the shares in the subsidiaries Torqeedo Inc., Crystal Lake, USA, and Torqeedo Asia-Pacific Ltd., Bangkok, Thailand.

The newly acquired subsidiary DEUTZ Italy S.r.l., Milan, Italy, (formerly IML Motori S.r.l.) was also included in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017. DEUTZ AG holds 100 per cent of the shares in DEUTZ Italy S.r.l., including the investments in its subsidiaries IML Service (subsequently renamed Service Center Milan S.r.l.) and IML Motoare S.r.l. However, DEUTZ AG has only an indirect investment of 75 per cent in IML Motoare S.r.l. The effects on financial position and financial performance are shown on pages 92 et seq.

Joint ventures are companies over which control is exercised jointly by DEUTZ and other entities on the basis of a contractual agreement. Associates are entities over whose business and financial policies DEUTZ AG is able to exert a significant influence but are neither subsidiaries nor joint ventures. Associates and joint ventures are both accounted for in the consolidated financial statements using the equity method. In the year under review, as had also been the case in 2016, the consolidated financial statements included two foreign joint ventures and one foreign entity in accordance with the rules governing associates.

Page 139 of the annex to the notes to the financial statements lists the shareholdings of DEUTZ AG as at 31 December 2017.

PRINCIPLES OF CONSOLIDATION

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

The acquisition method has been used to account for business combinations since 1 January 2010. The acquisition cost is measured at the fair value of the assets transferred, the liabilities incurred or assumed (including conditional liabilities) and of the equity instruments issued at the acquisition date, irrespective of the amount of any non-controlling interests. The determined acquisition cost is then allocated to the identifiable assets and liabilities (including contingent liabilities) that were measured at their fair value as at the date of acquisition in accordance with the rules of IFRS 3. The excess of the cost of acquisition over the value of net assets, after deduction of any non-controlling interests in acquirees, is recognised as goodwill. Negative goodwill is recognised in profit or loss in the period in which the business combination takes place. For each business combination, the Group decides whether to measure the non-controlling interest in the acquiree at fair value (full goodwill method) or at the proportionate fair value of the assets acquired and the liabilities assumed. The option to measure non-controlling interests at fair value is currently not exercised. Non-controlling interests are thus recognised at their proportionate share of the net assets, disregarding the goodwill. Acquisition-related costs arising in connection with business combinations are expensed as incurred.

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

Non-controlling interests are the share of net profit/loss and net assets not attributable to the DEUTZ Group. The non-controlling interests reported as at 31 December 2017 relate to Mr Glavan's holding of 25 per cent of the voting shares in IML Motoare S.r.l., of which Mr Glavan is CEO and which was included in the consolidated financial statements for the first time as at 1 October 2017. No non-controlling interests had been reported as at 31 December 2016.

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

JOINT VENTURES AND ASSOCIATES

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

ACQUISITIONS

Torqeedo

DEUTZ AG acquired 100 per cent of the voting shares in Torqeedo GmbH, Gilching, on 27 September 2017. On 1 October 2017, the acquisition was completed and Torqeedo GmbH and its subsidiaries Torqeedo Inc., Crystal Lake, USA, and Torqeedo Asia-Pacific Ltd., Bangkok, Thailand, were included in the consolidated financial statements of DEUTZ AG for the first time. Torqeedo GmbH holds a 100 per cent stake in both of these subsidiaries.

Torqeedo was founded twelve years ago and currently operates in more than 50 countries on five continents. The company has significant expertise in components, software and systems integration for electric drives. It is a global market leader and systems solution specialist for electromobility for marine applications. The company develops and manufactures electric and hybrid drives from 0.5 kW to 100 kW for leisure and commercial applications. The acquisition, which was financed from available cash, complements DEUTZ AG's existing technology portfolio. As a result of acquiring Torqeedo, DEUTZ is building up its expertise in electric drive technologies very quickly and is aiming to be the market leader for innovative drive systems in the off-highway sector.

The acquisition of Torqeedo impacted on the DEUTZ Group's net assets as follows:

€ million	Fair values as at the acquisition date
Dealer network	2.3
Brand	7.0
Technology	13.4
Development projects	1.3
Miscellaneous intangible assets	0.6
Property, plant and equipment	2.6
Non-current assets	**27.2**
Inventories	11.3
Trade receivables	2.2
Cash and cash equivalents	0.5
Miscellaneous current assets	5.1
Current assets	**19.1**
Total assets	**46.3**
Provisions	2.4
Deferred tax liabilities	8.2
Non-current liabilities	**10.6**
Trade payables	4.5
Other current liabilities	5.0
Current liabilities	**9.5**
Total liabilities	**20.1**
Net assets acquired	**26.2**
thereof attributable to DEUTZ AG	26.2
Consideration transferred (cash payment)	**73.9**
Goodwill of DEUTZ AG	47.7

The goodwill acquired represents the company's predicted earnings performance. The acquisition is also expected to result in strategic synergies for development, such as the faster electrification of drive units at DEUTZ AG. This goodwill is currently not tax-deductible. As the purchase price allocation was only carried out on 1 October 2017, the allocation of the resulting goodwill of €47.7 million to the relevant CGUs has not yet been finalised.

The consideration transferred in cash amounted to €73.9 million. The transaction costs of €4.5 million relating to the business combination were recognised under other operating expenses in the income statement. The gross amount of the acquired trade receivables was €2.3 million. At the date of acquisition, there were assumed to be uncollectible receivables amounting to €0.1 million. The business combination caused consolidated revenue to rise by €3.7 million and net income to fall by €4.3 million. If the acquisition of Torqeedo had taken place with effect from 1 January 2017, there would have been additional consolidated revenue of €22.2 million and a reduction in net income of €9.7 million.

A net cash outflow (after deduction of the cash acquired with Torqeedo) of €73.4 million has been recognised for the acquisition of Torqeedo in the 'Acquisition of subsidiaries' line item in the cash flow statement.

IML Motori

Also in September 2017, DEUTZ AG acquired 100 per cent of the voting shares in DEUTZ Italy S.r.l., Milan, Italy (formerly IML Motori S.r.l.). Upon completion of the acquisition on 1 October 2017, DEUTZ Italy S.r.l. and its subsidiaries Service Center Milan S.r.l., Milan, Italy, (formerly IML Service S.r.l.) and IML Motoare S.r.l., Galati, Romania, were included in the consolidated financial statements of DEUTZ AG for the first time. DEUTZ Italy S.r.l. holds 100 per cent of the voting shares in Service Center Milan S.r.l. and 75 per cent of the voting shares in IML Motoare S.r.l. The remaining 25 per cent of the voting shares are held by the company's CEO, Mr Glavan. DEUTZ Italy is a long-standing sales and service partner of DEUTZ AG. Since its establishment in 1904, IML Motori has been meeting the demand for DEUTZ engines and spare parts in the Italian market and customising them according to customers' individual requirements. Service Center Milan and IML Motoare provide services in Italy and Romania respectively. This acquisition is helping to step up DEUTZ AG's international service business and gives the DEUTZ brand a stronger presence in Italy.

The acquisition of DEUTZ Italy impacted on the DEUTZ Group's net assets as follows:

€ million	Fair values as at the acquisition date
Customer relationships	2.6
Miscellaneous intangible assets	0.2
Miscellaneous property, plant and equipment	0.7
Non-current assets	**3.5**
Inventories	4.9
Trade receivables	14.5
Cash and cash equivalents	1.2
Miscellaneous current assets	3.8
Current assets	**24.4**
Total assets	**27.9**
Provisions for pensions and other post-retirement benefits	1.0
Deferred tax liabilities	0.7
Other non-current liabilities	0.4
Non-current liabilities	**2.1**
Current financial liabilities	4.9
Trade payables	7.6
Other current liabilities	2.0
Current liabilities	**14.5**
Total liabilities	**16.6**
Net assets acquired	**11.3**
thereof attributable to DEUTZ AG	11.1
thereof attributable to non-controlling interests	0.2
Consideration transferred (cash payment)	**11.4**
Goodwill of DEUTZ AG	0.3

The goodwill resulting from the acquisition is derived from the strengthening of DEUTZ AG's service business and the expected revenue-related synergies. This goodwill is currently not tax-deductible.

As the purchase price allocation was only carried out on 1 October 2017, the allocation of the resulting goodwill of €0.3 million to the relevant CGUs has not yet been finalised.

The consideration transferred in cash amounted to €11.4 million. The transaction costs of €0.2 million relating to the business combination were expensed in the current period and recognised under other operating expenses in the income statement. The gross amount of the acquired trade receivables equated to €14.7 million. At the date of acquisition, there were assumed to be uncollectible receivables amounting to €0.2 million. The business combination caused consolidated revenue to rise by €4.7 million and net income to improve by €0.6 million. If the acquisition of DEUTZ Italy had taken place with effect from 1 January 2017, there would have been additional consolidated revenue of €9.6 million and an increase in net income of €1.8 million.

A net cash outflow (after deduction of the cash acquired with DEUTZ Italy) of €10.2 million has been recognised for the acquisition of DEUTZ Italy in the 'Acquisition of subsidiaries' line item in the cash flow statement.

CURRENCY TRANSLATION

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

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

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

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

		Average rates		Closing rates at 31 Dec	
		2017	2016	**2017**	2016
USA	USD	1.14	1.10	1.20	1.05
UK	GBP	0.88	0.82	0.89	0.86
China	CNY	7.66	7.34	7.80	7.32
Australia	AUD	1.48	1.49	1.53	1.46
Morocco	MAD	10.98	10.84	11.22	10.65
Russia	RUB	66.18	73.31	69.39	64.30

ACCOUNTING POLICIES

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

REVENUE RECOGNITION

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

Revenue and other income is recognised as follows:

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

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

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

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

BORROWING COSTS

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

ADDITIONAL DISCLOSURES

In addition to the information required by IFRS, the DEUTZ Group reports a figure for EBIT adjusted for exceptional items, which it uses for internal purposes to gauge the profitability of its business. Such exceptional items are defined as significant income generated or expenses incurred outside the scope of the Company's ordinary business activities that are unlikely to recur. We use this KPI internally so that we can compare the Company's operating performance over time.

PROPERTY, PLANT AND EQUIPMENT

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

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

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

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

Straight-line depreciation is based on the following useful lives for the main asset categories:

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

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

An item of property, plant or equipment is derecognised either on disposal or if no further economic benefit is expected from further use or sale of the asset. Gains or losses arising from the derecognition of the asset are calculated as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement in the period in which the asset is derecognised.

INTANGIBLE ASSETS

Goodwill

Goodwill is the difference between the cost of an acquisition and the fair value of the net assets acquired less any non-controlling interests. As goodwill has an indefinite useful life, it is not amortised. However, it must be tested for impairment at least once a year in accordance with the provisions of IAS 36. It must also be tested for impairment on an ad-hoc basis if there are any indications of impairment. Goodwill is tested for impairment at the level of the cash-generating units (CGUs). A CGU is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or other CGUs. Goodwill has to be allocated at the lowest level within the entity that is monitored for goodwill for internal management purposes. The CGUs defined in this way must not be bigger than an operating segment.

In an impairment test, the carrying amount of the goodwill is compared with the recoverable amount (higher of the net realisable value and the value in use) of the CGU in question. The recoverable amount of a CGU is calculated by determining the value in use according to the discounted cash flow (DCF) method. Value in use is calculated by discounting estimated future cash flows to their present value. The calculation uses a discount rate that reflects current market expectations in respect of the time value of money and the risks inherent in the CGU. The cash flows used in the calculation are derived and extrapolated from operational planning (five-year period).

As the purchase price allocation for the acquisition of Torqeedo GmbH and DEUTZ Italy S.r.l. was only carried out on 1 October 2017, the allocation of the resulting total goodwill of €48.0 million to the relevant CGUs has not yet been finalised.

Miscellaneous intangible assets

Miscellaneous intangible assets are measured at cost. The cost of purchase or conversion includes directly attributable costs. The cost of conversion also includes a proportion of overheads and borrowing costs for long-term projects provided the recognition criteria are met. In subsequent periods, intangible assets are reported at cost less amortisation on a straight-line basis and any additional impairment losses. Investment grants from customers are deducted from cost. The useful lives of both purchased and internally generated intangible assets are limited. The amortisation expense and impairment losses are reported in the income statement accordingly.

The following principles are applied:

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

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

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

As at 31 December 2017, the material, completed development projects had the following remaining useful lives:

Engine series 12.0/16.0	2 years
Engine series 7.8	8 years
Engine series 6.1	8 years
Engine series 4.1	8 years
Engine series 3.6	3 years
Engine series 2.9	4.5 years

The useful lives and amortisation methods for completed development projects are reviewed at every year-end, if not more frequently. If any changes in their useful lives are required, they are treated as changes in accounting estimates. Following successful certification for Stage V, changes to the product strategy and the cessation of development work on potential successor models in December 2017, the production cycle for the 4.1 and 6.1 engine series is now expected to be considerably longer. Consequently, the useful life of the 4.1 series was extended from the original nine years to 14 years and the useful life of the 6.1 series was extended from the original nine years to 15 years as at 31 December 2017. At the same time, the amortisation method for the two series was adjusted for 2018 onwards, from the straight-line method to the declining-balance method, to reflect its expected usefulness over the remaining product lifecycle. The revised estimates for the two series will have the following overall impact on amortisation over the entire residual life:

Financial year	(–) Decrease/ (+) increase in amortisation	(–) Decrease/ (+) increase in deferred tax income	(–) Decrease/ (+) increase in net income
	€ million	€ million	€ million
2018	–7.1	–2.2	4.9
2019	–8.2	–2.6	5.6
2020	0.2	0.1	–0.1
2021	5.1	1.6	–3.5
2022	4.0	1.3	–2.7
2023	3.0	0.9	–2.1
2024	2.0	0.6	–1.4
2025	1.0	0.3	–0.7

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

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

IMPAIRMENT OF NON-FINANCIAL ASSETS

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

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

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

In 2017, lower unit sales forecasts gave rise to indications of impairment ('trigger events') on some property, plant and equipment and some completed internally generated intangible assets. Subsequent impairment tests identified a need to recognise impairment losses on the development project that was still at the development stage. The very positive feedback from our customers on the engine series in the 4 to 6 litre capacity range, which have already achieved Stage V certification, led to a sharp drop in the expected demand for the 5.0 series. Consequently the development project was written off in full for reasons of commercial viability. The project will not be pursued further for the time being. For further details, see Note 14 in these notes to the consolidated financial statements.

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

GOVERNMENT GRANTS

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

INCOME TAXES

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

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

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

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

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

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

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

INVENTORIES

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

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

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

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

NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE

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

FINANCIAL ASSETS

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

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

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

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

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

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

Derivatives, including separately recognised embedded derivatives, are classified as held for trading unless they are derivatives designated as hedging instruments and are determined to be effective. Gains and losses on financial assets held for trading are recognised in the income statement. At the time the DEUTZ Group first becomes a party to a contract, it determines whether an embedded derivative needs to be accounted for separately from the host contract. This decision is only reassessed if there is a substantial amendment to the terms of the contract and this amendment results in a significant change to the cash flows that would otherwise have been derived from the contract.

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

Available-for-sale financial assets Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified in one of the other categories stipulated in IAS 39. After initial measurement, available-for-sale financial assets are measured at fair value. Financial assets whose fair value cannot be determined either using generally accepted measurement methods (e.g. discounted cash flow) or from their market prices are recognised at amortised cost. Unrealised gains and losses are recognised in other comprehensive income. If a financial asset in this category is derecognised or written down, any cumulative gains or losses previously recognised in other comprehensive income are reclassified to the income statement.

IMPAIRMENT OF FINANCIAL ASSETS

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

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

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

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

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

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

CASH AND CASH EQUIVALENTS

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

FINANCIAL LIABILITIES

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

- financial liabilities at fair value through profit or loss, or
- other financial liabilities.

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

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

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

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

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

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

DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGES

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

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

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

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

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

The market values of derivatives designated as cash flow hedges are stated in Note 25. Changes in the cash flow hedge reserve are reported under a separate item in other comprehensive income (fair value reserve).

PROVISIONS FOR PENSIONS AND OTHER POST-RETIREMENT BENEFITS

The occupational pension scheme offered by the DEUTZ Group takes account of the relevant legislation in various countries and the benefits that each company provides for its staff.

Occupational pensions take the form of defined benefit pension plans, which are funded by the recognition of pension provisions. Besides entitlements to an employer-funded pension, employees in Germany can build up an employee-funded pension by participating in a deferred compensation plan. In the UK (branch of DEUTZ AG), there is an employer-funded pension plan and the option of building up an employee-funded pension by participating in a deferred compensation plan. There are also employer-funded pension plans at DEUTZ Corporation, Atlanta, USA, at DEUTZ FRANCE S.A.S., Gennevilliers, France, at DEUTZ Italy S.r.l. (acquired on 1 October 2017, formerly IML Motori S.r.l.) and at Service Center Milan S.r.l. (formerly IML Service S.r.l.).

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

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

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

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

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

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

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

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

OTHER PROVISIONS

Other provisions are recognised if there are legal or constructive obligations towards third parties that arise from past events and are likely to result in cash outflows. Furthermore, it must be possible to estimate the obligation reliably. Provisions are recognised at their settlement value calculated at the balance sheet date and take account of projected cost increases. Non-current provisions are discounted. Provisions for warranty obligations are recognised when products are sold or when new warranties are initiated. The measurement of potential warranty liabilities is based primarily on historical experience.

CONTINGENT LIABILITIES

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

NOTES TO THE INCOME STATEMENT

1. REVENUE

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

€ million	2017	2016
Engines	1,169.9	972.9
Service	309.2	287.3
Total	**1,479.1**	**1,260.2**

The breakdown of revenue by segment and region is shown in the notes on segment reporting on page 119 et seq.

2. COST OF SALES

The cost of sales comprises the following cost items:

€ million	2017	2016
Cost of materials	857.7	712.0
Staff costs	175.7	165.0
Depreciation on property, plant and equipment	40.9	46.4
Other cost of sales items	148.6	118.2
Total	**1,222.9**	**1,041.6**

3. RESEARCH AND DEVELOPMENT COSTS

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

€ million	2017	2016
Cost of materials	17.4	10.1
Staff costs	34.1	29.8
Depreciation, amortisation and impairment	48.0	39.9
Own work capitalised and reimbursements	–13.7	–8.8
Other research and development costs	9.0	6.5
Total	**94.8**	**77.5**

The figure for depreciation, amortisation and impairment in the reporting year includes impairment losses recognised on capitalised development expenditure of €8.8 million. The very positive feedback from our customers on the engine series in the 4 to 6 litre capacity range, which have already achieved Stage V certification, led to a sharp drop in the expected demand for the 5.0 series, which is still in the development phase. Consequently the development project was written off in full for reasons of commercial viability. There had been no impairment losses in 2016.

4. SELLING EXPENSES AND GENERAL AND ADMINISTRATIVE EXPENSES

Selling expenses amounted to €78.8 million in the year under review (2016: €68.0 million). General and administrative expenses came to €41.5 million (2016: €36.7 million). Both the selling expenses and the general and administrative expenses predominantly consisted of staff costs. The respective amounts were €55.5 million and €32.3 million (2016: €47.5 million and €29.5 million).

5. OTHER OPERATING INCOME

€ million	2017	2016
Income from the disposal of non-current assets	114.7	0.6
Income from recharged costs and services	8.4	5.3
Foreign currency gains	4.8	7.1
Income from the reversal of provisions	2.1	0.8
Income from the measurement of derivatives	1.1	0.4
Income from the derecognition of liabilities	0.2	0.9
Sundry other income	12.8	2.6
Total	**144.1**	**17.7**

The income from the disposal of non-current assets consisted of the proceeds of €114.6 million from the disposal of the land occupied by our former Cologne-Deutz site. The increase in sundry other income mainly resulted from the €10.5 million gain relating to the disposal of the building lease of our subsidiary Ad. Strüver KG for a plot of land in Hamburg. The gains on these two transactions, which totalled €125.1 million, were classified as exceptional items.

6. OTHER OPERATING EXPENSES

€ million	2017	2016
Expenses in connection with the disposal of non-current assets	15.8	–
Foreign currency losses	11.4	3.8
Transaction costs resulting from the acquisition of companies	4.7	–
Expenses for pensions and other post-employment benefits	3.8	6.6
Other expenses from the adjustment of provisions	1.2	5.4
Other cost of fees, contributions and advice	2.7	2.5
Expenses in connection with the measurement of derivatives	0.6	0.8
Rental and lease expenses	0.8	0.9
Sundry other expenses	1.1	6.7
Total	**42.1**	**26.7**

The expenses in connection with the disposal of non-current assets mainly consisted of expenses for services provided by agents and consultants and related to the disposal of the land at our former Cologne-Deutz site. The transaction costs resulting from the acquisition of companies related to the acquisitions of the subsidiaries Torqeedo GmbH, Gilching, and DEUTZ Italy S.r.l., Milan, Italy, (formerly IML Motori S.r.l.) and mainly consisted of legal and consultancy costs.

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

€ million	2017	2016
Profit/loss on equity-accounted investments		
Income from equity-accounted investments	2.5	0.6
Expenses relating to equity-accounted investments	–	–5.7
Total	**2.5**	**–5.1**
Other investment income	**0.9**	**1.1**
Total	**3.4**	**–4.0**

Income from equity-accounted investments consisted of DEUTZ AG's shares in the profits of its associate D.D. Power Holdings (Pty), South Africa, and the joint venture DEUTZ (Dalian) Engine Co., Ltd., Dalian, China.

Other net investment income essentially related to profits transferred by DEUTZ Sicherheit GmbH, Cologne.

8. EXCEPTIONAL ITEMS

In 2017, there were positive exceptional items of €104.1 million. This sum included a gain of €98.8 million resulting from the disposal of the land occupied by our former Cologne-Deutz site. There was also a €10.0 million gain relating to the disposal of the building lease of our subsidiary Ad. Strüver for a plot of land in Hamburg that was no longer being used for production purposes. These positive exceptional items were partly offset by negative exceptional items of €4.7 million. Legal and consultancy costs of €4.7 million arose in connection with the acquisition of Torqeedo GmbH, Gilching, and DEUTZ Italy S.r.l, Milan, Italy (formerly IML Motori S.r.l.). There had been no exceptional items in 2016.

9. INTEREST EXPENSES, NET

€ million	2017	2016
Interest income on credit balances with banks	0.1	–
Other interest income	0.6	0.3
Interest income	**0.7**	**0.3**
Interest paid on liabilities to banks	–1.9	–2.5
Interest paid on sales of receivables	–0.8	–0.7
Other interest expense and similar charges	–0.4	–0.6
Interest expense and similar charges (finance costs)	**–3.1**	**–3.8**
Interest expenses, net	**–2.4**	**–3.5**

In 2017, borrowing costs of €0.5 million were capitalised (2016: €0.1 million).

10. TAXES

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

€ million	2017	2016
Current tax expense	23.3	9.3
thereof unrelated to the reporting period	2.2	–0.3
Deferred tax income	–0.4	–5.4
thereof from temporary differences	0.8	–8.1
thereof from loss carryforwards	–1.2	2.7
Total tax expense	**22.9**	**3.9**

The current income tax expenses of €23.3 million predominantly related to additions to provisions for anticipated tax payments on current income generated by Group companies in 2017 and to additions to provisions for prior-year tax payments.

The deferred tax income included expenses of €0.8 million arising from temporary differences (2016: tax income of €8.1 million). These arose mainly due to the following effects. Firstly, tax income of €7.8 million resulted from the reduction of deferred tax liabilities in connection with the capitalisation of development expenditure under IFRS. However, this was offset by the reversal of deferred tax assets owing to the disposal of the land at the former Cologne-Deutz site, which led to a tax expense of €7.5 million. Secondly, the consolidation of intercompany profits and losses led to a tax expense of €1.1 million, mainly due to the lowering of tax rates in the USA.

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

The tax reconciliation table shows the reconciliation from anticipated income taxes to effective taxes as shown in the income statement. Effective income taxes include current and deferred taxes. The applicable tax rate is 31.65 per cent (2016: 31.6 per cent) comprising corporation tax at 15 per cent, the solidarity surcharge (5.50 per cent of the corporation tax) and trade tax at 15.82 per cent based on an average assessment rate.

€ million	**2017**	2016
Net income before income taxes	**144.1**	**19.9**
Anticipated tax expense (+)/income (–)	45.6	6.3
Effect from trade tax add-backs and deductions	0.2	0.2
Differing tax rates	0.8	0.3
Changes arising from the recognition of deferred taxes on loss carryforwards and on temporary differences and the utilisation of loss carryforwards	–24.8	–6.8
Effect of non-deductible expenses	1.0	0.4
Effect of consolidation adjustments	2.0	2.6
Effect of partnership's supplementary tax accounts	–0.4	1.3
Share of profit (loss) of equity-accounted investments	–0.5	1.8
Effect of tax-exempt income	–0.7	–0.7
Effect of potential dividend distributions	0.2	–
Effects not related to the reporting period		
Prior-year tax payments	2.2	–0.2
Deferred taxes resulting from prior-year adjustments	–2.7	–1.2
Other	–	–0.1
Effective tax expense (+)/income (–)	**22.9**	**3.9**
Effective tax rate (%)	15.9	19.6

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

11. EARNINGS PER SHARE

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

There were no dilutive effects in 2017 or 2016 because there are no exercisable options to convert financial instruments with equity components.

	2017	2016
Net income attributable to shareholders of DEUTZ AG (€ million)	121.2	16.6
Weighted average number of shares outstanding (thousands)	120,862	120,862
Earnings per share (€)	**1.00**	**0.14**

NOTES TO THE STATEMENT OF COMPREHENSIVE INCOME

12. OTHER COMPREHENSIVE INCOME

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

€ million	**2017**			2016		
	Before taxes	**Taxes**	**After taxes**	Before taxes	Taxes	After taxes
Amounts that will not be reclassified to the income statement in the future	**2.6**	**–0.8**	**1.8**	**–13.3**	**4.2**	**–9.1**
Remeasurements of defined benefit plans	2.6	–0.8	1.8	–13.3	4.2	–9.1
Amounts that will be reclassified to the income statement in the future if specific conditions are met	**–4.0**	**–1.3**	**–5.3**	**–2.1**	**0.7**	**–1.4**
Currency translation differences	–8.0	–	–8.0	0.2	–	0.2
thereof profit/loss on equity-accounted investments	–2.5	–	–2.5	–1.1	–	–1.1
Effective portion of change in fair value from cash flow hedges	4.0	–1.3	2.7	–2.3	0.7	–1.6
Change in fair value of available-for-sale financial instruments	–	–	–	–	–	–
Other comprehensive income	**–1.4**	**–2.1**	**–3.5**	**–15.4**	**4.9**	**–10.5**

In 2017, gains of €0.5 million on cash flow hedges (2016: losses of €32 thousand) recognised in other comprehensive income during the year (prior to the inclusion of deferred taxes) were reclassified to other operating expenses or other operating income in the consolidated income statement.

NOTES TO THE BALANCE SHEET

13. PROPERTY, PLANT AND EQUIPMENT

Gross figures Cost of purchase/conversion	Land, leasehold rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Advances paid and construction in progress	Total
€ million					
Balance at 1 Jan 2017	**218.6**	**521.9**	**248.2**	**9.1**	**997.8**
Currency translation differences	–0.2	–0.9	–0.5	–0.1	–1.7
Additions	2.8	8.9	15.4	10.9	38.0
Investment grants	–	–3.1	–	–	–3.1
Disposals	–5.7	–22.8	–8.1	–0.1	–36.7
Changes to basis of consolidation	0.4	1.6	1.2	0.1	3.3
Reclassifications	–	6.2	0.1	–6.3	–
Balance at 31 Dec 2017	**215.9**	**511.8**	**256.3**	**13.6**	**997.6**

Gross figures Depreciation and impairment	Land, leasehold rights and buildings	Technical equipment and machines	Other equipment, furniture and fixtures	Advances paid and construction in progress	Total
€ million					
Balance at 1 Jan 2017	**94.1**	**419.2**	**198.5**	**–**	**711.8**
Currency translation differences	–0.1	–0.6	–0.4	–	–1.1
Depreciation	5.3	22.5	17.7	–	45.5
Impairment	–	–	–	–	–
Disposals	–1.6	–22.5	–7.9	–	–32.0
Reclassifications	–	–	–	–	–
Balance at 31 Dec 2017	**97.7**	**418.6**	**207.9**	**–**	**724.2**
Net carrying amount at 31 Dec 2017	**118.2**	**93.2**	**48.4**	**13.6**	**273.4**

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

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

Additions to property, plant and equipment were mainly in connection with replacement investment in tools, equipment and machinery. The additions also related to the new TCD 2.2 engine series and the final measures to optimise our network of sites. In the first half of 2017, we also made the final capital investment in connection with stage two of the relocation of the exchange engine plant from Übersee to Ulm and with the construction of the shaft centre in Cologne-Porz.

The changes over the course of the year resulting from changes to the basis of consolidation related to the inclusion of Torqeedo and DEUTZ Italy in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017.

Government grants at our Spanish subsidiary were deducted from the cost of purchasing the property, plant and equipment. In 2017, additional subsidies of €3.1 million were granted in connection with capital expenditure on property, plant and equipment. Total government grants recognised as at 31 December 2017 amounted to €4.0 million (31 December 2016: €1.4 million). In 2017, grants of €0.5 million (2016: €0.5 million) were reclassified to the income statement (as a reduction of the depreciation expense).

Purchase commitments for property, plant and equipment are described on page 131.

14. INTANGIBLE ASSETS

Gross figures Cost of purchase/conversion	Goodwill	Internally generated intangible assets, completed	Internally generated intangible assets, in development	Other intangible assets	Total
€ million					
Balance at 1 Jan 2017	**–**	**411.7**	**13.1**	**123.6**	**548.4**
Currency translation differences	–	–	–	–0.7	–0.7
Additions	–	–	17.5	19.8	37.3
Investment grants	–	–	–	–	–
Disposals	–	–	–4.9	–0.5	–5.4
Changes to basis of consolidation	48.0	–	–	27.4	75.4
Reclassifications	–	–	–	–	–
Balance at 31 Dec 2017	**48.0**	**411.7**	**25.7**	**169.6**	**655.0**

Notes

Gross figures Amortisation and impairment	Goodwill	Internally generated intangible assets, completed	Internally generated intangible assets, in development	Other intangible assets	Total
€ million					
Balance at 1 Jan 2017	**–**	**280.1**	**4.9**	**114.9**	**399.9**
Currency translation differences	–	–	–	–0.7	–0.7
Amortisation	–	33.6	–	5.6	39.2
Impairment	–	–	8.8	–	8.8
Disposals	–	–	–4.9	–0.5	–5.4
Reclassifications	–	–	–	–	–
Balance at 31 Dec 2017	**–**	**313.7**	**8.8**	**119.3**	**441.8**
Net carrying amount at 31 Dec 2017	**48.0**	**98.0**	**16.9**	**50.3**	**213.2**

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

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

Other intangible assets mainly comprise grants for tool costs, licences, purchased development services and software. The additions to other intangible assets mainly resulted from the purchase of distribution and service rights under a cooperation agreement with Liebherr Machines Bulle S.A. The additions relating to changes to the basis of consolidation resulted from the inclusion of Torqeedo and DEUTZ Italy in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017. Details of the assets acquired in connection with the business combinations can be found in the 'Business acquisitions' section on page 92 of these notes to the financial statements.

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

The impairment of intangible assets in development in 2017 related to the development expenditure on the 5.0 engine series. The very positive feedback from our customers on the engine series in the 4 to 6 litre capacity range, which have already achieved Stage V certification, led to a sharp drop in the expected demand for this series. The impairment testing of this development project was carried out at the level of a cash-generating unit that represents this engine series. The recoverable amount of this cash-generating unit, which was calculated on the basis of the value in use, stood at €0.0 million at the end of the year. The impairment loss recognised amounted to €8.8 million in 2017. The discount rate underlying the calculation before tax was 6.0 per cent. The 5.0 engine series is allocated to the DEUTZ Compact Engines (DCE) segment.

15. EQUITY-ACCOUNTED INVESTMENTS

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

€ million	2017	2016
1 Jan	**41.7**	**48.5**
Additions	–	–
Pro-rata profit/loss on equity-accounted investments	2.5	–5.1
Disposals	–	–
Impairment	–	–
Other changes arising from measurement using the equity method	–3.4	–1.7
31 Dec	**40.8**	**41.7**

A summary of further financial information about associates and joint ventures is provided in Note 28 ‘Interests in other entities’.

16. OTHER FINANCIAL ASSETS (NON-CURRENT)

€ million	31 Dec 2017	31 Dec 2016
Equity investments	2.0	2.3
Non-current securities	3.1	3.2
Cost of borrowing	1.2	0.9
Other	0.5	1.1
Total	**6.8**	**7.5**

Equity investments
This item mainly related to the carrying amounts of the investments in DEUTZ Engine (Shandong) Co., Ltd., which is not operational, and DEUTZ Engines (India) Private Limited, Pune, India. For reasons of materiality, these companies are not consolidated.

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

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

17. DEFERRED TAXES, CURRENT TAX ASSETS AND LIABILITIES

At the balance sheet date, DEUTZ AG had unutilised tax-losses carried forward of €832.0 million for corporation tax (2016: €908.2 million) and €947.6 million for trade tax (2016: €1,024.5 million). The figures disclosed in 2016 for tax loss carryforwards (corporation tax: €921.9 million; trade tax: €1,039.3 million) were restated as a result of tax audits for previous years.

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

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

€ million	31 Dec 2017	31 Dec 2016
Non-current		
Deferred tax assets	69.2	79.9
Deferred tax liabilities	0.2	0.4
Current		
Current tax assets	1.5	0.8
Provision for income taxes	18.3	4.1
Income tax liabilities	0.6	0.5

In 2017, the deferred tax assets net of deferred tax liabilities amounted to €69.2 million. They were largely the result of capitalising deferred tax assets on tax losses carried forward and of temporary differences, particularly those between the carrying amount of provisions for pensions and other post-retirement benefits in the consolidated balance sheet and their tax base in the financial statements of DEUTZ AG. Deferred tax assets from items recognised in other comprehensive income amounted to €21.1 million for provisions for pensions and other post-retirement benefits, minus €8.5 million for consolidation-related changes and minus €0.3 million for measurement of cash flow hedges and interest rate derivatives.

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

€ million	31 Dec 2017		31 Dec 2016	
	Assets	**Liabilities**	Assets	Liabilities
Intangible assets	–	44.9	–	44.2
Property, plant and equipment	2.0	2.3	10.0	3.3
Equity-accounted investments and financial assets	–	–	0.5	1.8
Inventories	10.3	–	11.3	0.1
Receivables and other assets	3.8	–	4.9	–
Pensions	23.2	–	26.0	–
Other liabilities	10.9	0.8	9.5	0.2
Tax loss carryforwards	66.8	–	66.9	–
Deferred taxes (gross)	**117.0**	**48.0**	**129.1**	**49.6**
Netting	47.8	47.8	49.2	49.2
Deferred taxes (net)	**69.2**	**0.2**	**79.9**	**0.4**

The tax asset in excess of deferred tax liabilities – for which tax planning indicates sufficient taxable profit will be available in future – amounted to €69.2 million (31 December 2016: €79.9 million).

The decrease in deferred taxes in respect of temporary differences, which was recognised in other comprehensive income, was €11.1 million at 31 December 2017 (31 December 2016: increase of €5.0 million) and largely resulted from changes to the basis of consolidation and changes in provisions for pensions.

As at 31 December 2017, the DEUTZ Group had not recognised any deferred tax liabilities on temporary differences of €16.6 million (31 December 2016: €15.5 million) in respect of taxes on untransferred profits from subsidiaries, associates or joint ventures because the timing of the reversal of the differences can be controlled or the sums are mostly tax exempt and no material impact on taxes is expected in the near future.

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

Loss carryforwards on which deferred taxes have not been recognised

€ million	**31 Dec 2017**	31 Dec 2016
Corporation tax/solidarity surcharge	684.3	719.4
Trade tax	792.1	825.4

Thereof: expiry periods for German and international loss carryforwards

€ million	**31 Dec 2017**	31 Dec 2016
Up to 5 years	–	–
6 to 9 years	–	–
Indefinite		
Corporation tax/solidarity surcharge	684.3	719.4
Trade tax	792.1	825.4

The figures disclosed in 2016 for loss carryforwards on which deferred taxes had not been recognised in full (corporation tax: €733.2 million, trade tax: €840.2 million) were restated, mainly as a result of changes owing to tax audits for previous years.

18. INVENTORIES

€ million	**31 Dec 2017**	31 Dec 2016
Raw materials, consumables, bought-in parts and spare parts	143.5	124.5
Work in progress	42.2	42.1
Finished goods	101.3	86.5
Total	**287.0**	**253.1**

Write-downs on raw materials, bought-in parts and spare parts totalled €2.8 million in the reporting year (2016: €1.4 million). As at 31 December 2017, the carrying amount of inventories written down to net realisable value was €83.0 million (31 December 2016: €82.1 million).

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

€ million	**2017**	2016
1 Jan	**37.0**	**30.4**
Changes	2.4	6.6
31 Dec	**39.4**	**37.0**

19. RECEIVABLES AND OTHER ASSETS

€ million	31 Dec 2017	31 Dec 2016
Trade receivables	146.4	118.0
Less write-downs	–3.7	–4.5
Trade receivables (net)	**142.7**	**113.5**
Other receivables and assets		
Receivables arising from other taxes	9.9	5.6
Receivables remaining after sale of receivables	3.1	6.5
Receivables arising from investment grants	2.7	–
Receivables due from investments	1.8	3.1
thereof trade receivables	1.8	3.1
thereof other receivables	–	–
Receivables arising from income tax assets	1.5	0.8
Derivative financial instruments	1.3	–
Advances paid	0.3	0.2
Sundry other receivables	13.4	21.1
Total	**35.8**	**37.3**

As at 31 December 2017, the volume of receivables sold under factoring agreements was €117.5 million (31 December 2016: €111.4 million). Essentially, all the opportunities and risks connected with title to the receivables that were sold were transferred to the factor. While the entire credit risk was transferred, a risk of late payment remains, but it is not material so the receivables were not reported in the consolidated financial statements of DEUTZ AG. The remaining exposure in respect of the receivables that have been assigned is largely limited to the administration and collection of these receivables. As at 31 December 2017, the Group had access to factoring lines totalling €170.0 million (31 December 2016: €160.0 million). They are revolving lines. In 2017, interest expense of €0.8 million (2016: €0.7 million) was recognised in connection with the sale of receivables.

As at 31 December 2017, the receivables sold were offset by receivables amounting to €3.1 million due from one factor (31 December 2016: €6.5 million). The fair value of these receivables was also €3.1 million (31 December 2016: €6.5 million). The risk arising from the factoring transaction was the credit risk of the factor, which was lower than the credit risk of the original debtors. The maximum downside risk as at 31 December 2017 was limited to the amount receivable of €3.1 million (31 December 2016: €6.5 million).

Trade receivables with a principal amount of €4.4 million were written down as at 31 December 2017 (31 December 2016: €4.7 million). The following table shows the change in the valuation allowance account:

€ million	31 Dec 2017	31 Dec 2016
Balance at 1 Jan	**4.5**	**2.4**
Changes to basis of consolidation	0.3	–
Additions	0.2	2.9
Utilised	–0.7	–0.1
Reversals	–0.6	–0.7
Balance at 31 Dec	**3.7**	**4.5**

If other receivables or assets are found to be impaired, a direct write-down is applied to the relevant carrying amounts. Total impairment losses of €18.0 million were recognised on other receivables and assets as at 31 December 2017 (31 December 2016: €17.6 million).

20. CASH AND CASH EQUIVALENTS

As at 31 December 2017, cash and cash equivalents including cash on hand, short-term deposits and credit balances with banks amounted to €143.8 million (31 December 2016: €91.8 million). There were no access restrictions, as had also been the case in the previous year.

21. NON-CURRENT ASSETS CLASSIFIED AS HELD FOR SALE

The non-current assets classified as held for sale as at 31 December 2017 related to the parts of the land and buildings at our former Cologne-Deutz site that had not yet been sold. These assets are allocated to the DEUTZ Compact Engines segment.

22. EQUITY

€ million	31 Dec 2017	31 Dec 2016
Issued capital	309.0	309.0
Additional paid-in capital	28.8	28.8
Other reserves	11.8	17.1
Retained earnings and accumulated income	249.4	136.2
Equity attributable to the shareholders of the parent	599.0	491.1
Non-controlling interests	0.2	–
Total	**599.2**	**491.1**

Issued capital
At the end of 2017, the issued capital (share capital) of DEUTZ AG amounted to €308,978,241.98 (unchanged on the end of 2016) and was divided into 120,861,783 no-par-value bearer shares (also unchanged).

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

No such compound financial instruments were in issue, either in 2017 or in 2016.

Other reserves
Currency translation Translation differences allocated to the shareholders of DEUTZ AG arising from the translation of equity at historical rates and the translation of the net income or loss at average rates for the year are reported under accumulated other comprehensive income/loss. In the year under review, this item reduced other comprehensive income by €8.0 million (2016: increase of €0.4 million). The cumulative gain on translation differences recognised in other reserves amounted to €11.1 million at the end of 2017 (31 December 2016: gain of €19.1 million recognised). Total differences arising from currency translation amounted to a gain of €8.0 million (2016: gain of €0.2 million), none of which was attributable to non-controlling interests (2016: loss of €0.2 million).

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

Retained earnings and accumulated income
This item includes DEUTZ AG's legal reserve of €4.5 million (31 December 2016: €4.5 million).

Non-controlling interests
The non-controlling interests relate to Mr Glavan's 25 per cent stake in the subsidiary IML Motoare S.r.l., Galati, Romania, which was included in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017. DEUTZ AG has an indirect interest in this company through DEUTZ Italy S.r.l.

Dividend
According to the German Stock Corporation Act (AktG), the dividend is paid from the accumulated income reported in the annual financial statements of DEUTZ AG prepared in accordance with the German Commercial Code (HGB). In 2017, DEUTZ AG distributed a dividend of €8.5 million to its shareholders (€0.07 per share) from the accumulated income reported as at 31 December 2016.

The Board of Management proposes using €18.1 million of the accumulated income reported by DEUTZ AG as at 31 December 2017 to pay a dividend of €0.15 per no-par-value share.

23. PROVISIONS FOR PENSIONS AND OTHER POST-RETIREMENT BENEFITS

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

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

The employer's contribution to the German statutory pension insurance scheme in 2017 came to €16.1 million (2016: €15.3 million). In addition, a further €2.1 million (2016: €2.2 million) was paid for pension and direct insurance policies in connection with deferred compensation.

Defined benefit plans
The DEUTZ Group maintains several defined benefit pension plans in Germany and abroad. The largest pension plans are in Germany and the UK. Together, they accounted for more than 95 per cent of defined benefit obligations and just under 99 per cent of plan assets, as was the case in 2016.

In all, there are four defined benefit pension plans in Germany. While three of the plans are employer funded, the fourth is a deferred compensation plan. As a rule, the employer-funded pension plans comprise a general employee retirement pension for life, a disability pension and a surviving dependants' pension. The level of the monthly pension paid under the employer-funded pension plans is based on earned income and years of service in the DEUTZ Group. Since the pension plans were frozen in 1995, employees can no longer acquire any further employer-funded pension entitlements. In the case of the deferred compensation plan, the Company has taken out a reinsurance policy with a life insurance company based on the amount of salary contribution and undertakes to pay a pension based on the guaranteed capital that has been underwritten. In Germany, occupational pension schemes are governed by the Occupational Pensions Act (BetrAVG), according to which the DEUTZ Group has sole responsibility for meeting the requirements of defined benefit pension plans. The normal retirement age is 67.

The existing defined benefit plan in the UK entitles pension beneficiaries to a pension which depends on the level of their basic salary and the number of eligible years of service. However, since the pension plans were frozen in 2016, no employees can now acquire any further employer-funded pension entitlements. The retirement age is between 62 and 65. The annual pension paid is between 1/55 and 1/60 of the highest basic salary received in the final five years of service for each eligible year of service. The pension plan is primarily funded by converting pension beneficiaries' basic salary and employer contributions into plan assets. The DEUTZ Group undertakes to compensate for any shortfall in the scheme. Every year, the amount for which the Company is liable is determined with reference to a report by an independent pensions actuary.

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

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

Funded status of pension plans

€ million	**2017**	2016
Pension plans in Germany		
Present value of defined benefit obligation	170.1	183.1
Fair value of plan assets	5.0	5.0
Deficit (net liability)	**165.1**	**178.1**
Pension plans in the UK		
Present value of defined benefit obligation	28.6	28.7
Fair value of plan assets	23.8	22.8
Deficit (net liability)	**4.8**	**5.9**
Other pension plans		
Present value of defined benefit obligation	6.9	6.0
Fair value of plan assets	0.4	–
Deficit (net liability)	**6.5**	**6.0**
Total		
Present value of defined benefit obligation	205.6	217.8
Fair value of plan assets	29.2	27.8
Deficit (net liability)	**176.4**	**190.0**

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

Breakdown of defined benefit obligation by beneficiary

€ million	**2017**	2016
Pension plans in Germany		
Active members	10.4	11.6
Deferred members	8.3	10.9
Pensioners	151.4	160.6
Present value of defined benefit obligation	**170.1**	**183.1**
Pension plans in the UK		
Active members	–	–
Deferred members	15.5	15.4
Pensioners	13.1	13.3
Present value of defined benefit obligation	**28.6**	**28.7**

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

Change in the net liability for defined benefit pension plans

€ million	2017	2016
Net liability as at 1 Jan	**190.0**	**186.6**
Changes to basis of consolidation	0.9	0.9
Amounts recognised in the income statement	3.0	4.0
Amounts recognised in other comprehensive income	–2.7	13.3
Employer contributions	–0.4	–0.5
Pension benefits paid	–13.5	–13.8
Effects of changes in foreign exchange rates	–0.9	–0.5
Net liability as at 31 Dec	**176.4**	**190.0**

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

Change in present value of defined benefit obligation

€ million	2017	2016
Defined benefit obligation as at 1 Jan	**217.8**	**214.4**
Changes to basis of consolidation	1.3	0.9
Service cost	–	0.2
Employee contributions	0.1	0.1
Interest expense	3.6	4.6
Remeasurements	–1.1	16.2
thereof: experience adjustments	–2.3	1.6
thereof: actuarial (gains)/losses arising from changes in biometric assumptions	0.5	–0.3
thereof: actuarial (gains)/losses arising from changes in financial assumptions	0.7	14.9
Effects of changes in foreign exchange rates	–1.7	–3.9
Pension benefits paid	**–14.4**	**–14.7**
Defined benefit obligation as at 31 Dec	**205.6**	**217.8**

At 31 December 2017, the weighted average life of the bulk of the defined benefit obligation was 9.6 years (31 December 2016: 9.8 years).

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

Change in fair value of plan assets

€ million	2017	2016
Fair value of plan assets at 1 Jan	**27.8**	**27.8**
Employer contributions	0.4	0.5
Employee contributions	0.1	0.1
Interest income	0.6	0.8
Return on (+)/expenses (–) from plan assets (excl. interest income)	1.6	2.9
Pensions paid from plan assets	–0.9	–0.9
Currency translation differences	–0.8	–3.4
Other	0.4	
Fair value of plan assets at 31 Dec	**29.2**	**27.8**

Breakdown of plan assets

€ million	31 Dec 2017	31 Dec 2016
Cash and cash equivalents	–	–
Equity instruments (by region)		
UK	3.6	3.5
Europe (excl. UK)	2.1	2.1
North America	2.6	2.5
Japan	1.1	1.0
Asia-Pacific	1.1	1.0
Other	1.4	1.4
	11.9	11.4
Debt instruments		
Government bonds	4.0	3.9
Corporate bonds	7.9	7.5
	11.9	11.4
Reinsurance policies	5.4	5.0
Total	**29.2**	**27.8**

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

The breakdown of the portions of the net pension cost recognised in current income and expense for 2017 and 2016 is as follows:

Net pension cost

€ million	2017	2016
Current service cost	–	0.2
Net interest cost	3.0	3.8
	3.0	**4.0**

The actual return on plan assets in 2017 was €2.1 million (2016: €3.7 million).

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

Actuarial assumptions

%	2017	2016
Discount rate		
Germany	1.29	1.54
UK	2.50	2.70
Rate of pension increase		
Germany	1.75	2.00
UK	2.00	2.20

Mortality tables

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

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

Sensitivity analysis

2017	Impact on defined benefit obligation of:	
€ million		
	0.50% rise	0.50% fall
in discount rate		
Germany	–7.4	8.1
UK	–2.7	2.7
in rate of pension increase		
Germany	7.9	–7.4
UK	2.3	–2.0

Sensitivity analysis

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

Furthermore, we also believe it is possible that the life expectancy of eligible DEUTZ employees will change. If the life expectancy of eligible DEUTZ employees had increased by one year, the increases in the defined benefit obligation arising from the pension plans in Germany and the UK as at 31 December 2017 would have been €15.7 million and €0.8 million respectively (31 December 2016: €16.5 million and €0.8 million respectively).

The sensitivity calculations are based on the average duration of the pension obligations calculated as at 30 November 2017. In order to highlight the impact on the present value of the defined benefit obligations calculated as at 31 December 2017 separately, the calculations were carried out for each of the actuarial parameters deemed to be material and capable of changing.

Future cash flows

For 2018, the DEUTZ Group forecasts that its payments into pension plans will amount to €0.4 million (2017: €0.4 million).

Expected benefit payments

€ million	31 Dec 2017
2018	14.1
2019	13.7
2020	13.1
2021	12.4
2022	11.9
2023–2027	51.3

Expected benefit payments

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

24. OTHER PROVISIONS

The following table gives a breakdown of other provisions:

€ million	2017			2016		
	Total	**Residual term of up to 1 year**	**Residual term of more than 1 year**	Total	Residual term of up to 1 year	Residual term of more than 1 year
Warranties	55.0	33.4	21.6	61.6	36.2	25.4
Obligations to employees	21.5	12.2	9.3	15.8	6.5	9.3
Restructuring	3.9	1.1	2.8	7.8	6.9	0.9
Onerous contracts	4.1	4.1	–	3.5	3.5	–
Other	10.1	7.6	2.5	5.6	2.8	2.8
Total	**94.6**	**58.4**	**36.2**	**94.3**	**55.9**	**38.4**

Other provisions are recognised at their settlement value calculated as at the balance sheet date and take account of projected cost increases. Non-current provisions are discounted at a rate of 2.5 per cent (31 December 2016: 2.5 per cent).

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

The following table shows the changes to other provisions in 2017:

€ million	Warranties	Obligations to employees	Restructuring	Onerous contracts	Other	**Total**
1 Jan 2017	**61.6**	**15.8**	**7.8**	**3.5**	**5.6**	**94.3**
Additions	5.1	16.3	2.4	0.6	6.3	30.7
Currency translation differences	–0.3	–0.1	–	–	–0.2	–0.6
Amounts utilised	–3.8	–11.2	–5.8	–	–1.1	–21.9
Reversals	–8.9	–0.3	–0.5	–	–1.0	–10.7
Basis of consolidation	0.9	1.0	–	–	0.5	2.4
Accrued interest/effect of changes in interest rates	0.4	–	–	–	–	0.4
31 Dec 2017	**55.0**	**21.5**	**3.9**	**4.1**	**10.1**	**94.6**

The additions relating to changes to the basis of consolidation were due to the business combinations during 2017. Details can be found in the 'Business acquisitions' section on page 92 of these notes to the financial statements.

25. FINANCIAL DEBT

	31 Dec 2017				31 Dec 2016			
€ million								
	Total	**Residual term up to 1 year**	**Residual term 1–5 years**	**Residual term > 5 years**	Total	Residual term up to 1 year	Residual term 1–5 years	Residual term > 5 years
Liabilities to banks	44.1	17.3	26.2	0.6	58.5	16.0	41.9	0.6
Other financial debt	1.5	0.2	0.9	0.4	1.7	0.2	0.8	0.7
Total	**45.6**	**17.5**	**27.1**	**1.0**	**60.2**	**16.2**	**42.7**	**1.3**

Liabilities to banks

Liabilities to banks include a loan from the European Investment Bank with a remaining balance of €39.6 million. This unsecured loan is repayable in instalments until July 2020.

The syndicated working capital facility had not been drawn down as at 31 December 2017. This revolving line of credit for a total of €160 million provided by a consortium of banks is a floating-rate facility and is also unsecured. In 2017, its term was extended to May 2022.

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

Banco Bilbao Vizcaya Argentaria has also granted two loans via our Spanish subsidiary; they have a total remaining balance of €2.3 million. The interest rate on the loans is 1.78 per cent. Because the loans have been used for capital expenditure in Spain, finance costs up to an interest rate of 3.0 per cent are reimbursed by the Spanish government as part of a subsidy programme.

In addition, a financial liability of MAD 12.4 million (Moroccan dirhams) existed as at 31 December 2017 through our subsidiary Nlle Ste MAGIDEUTZ S.A., Casablanca, Morocco, in respect of a property leasing agreement with the leasing company WAFABAIL. Translated into the reporting currency, this financial debt amounted to €1.0 million.

Other financial debt

Other financial debt comprises an interest-free government loan.

The fair value of financial debt is described in Note 26 on page 120 et seq.

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

%	**31 Dec 2017**	31 Dec 2016
Liabilities to banks	2.83	2.78
Other financial debt	–	–

As in 2016, all current financial debt was denominated in euros. Of the non-current financial debt, €1.0 million was denominated in Moroccan dirhams and the remainder in euros.

The level of financial debt changed as follows over the course of 2017:

€ million	1 Jan 2017	Cash changes	Non-cash changes: Acquisition of companies	Exchange rate effects	Fair value changes	Other changes	31 Dec 2017
Non-current financial debt							
Liabilities to banks	42.5	–0.6		–0.1		–15.0	26.8
Other financial debt	1.5	–				–0.2	1.3
Total non-current financial debt	**44.0**	**–0.6**	**–**	**–0.1**	**–**	**–15.2**	**28.1**
Current financial debt							
Liabilities to banks	16.0	–19.2	4.9			15.6	17.3
Other financial debt	0.2	–0.2	–			0.2	0.2
Total current financial debt	**16.2**	**–19.4**	**4.9**	**–**	**–**	**15.8**	**17.5**
Total financial debt	**60.2**	**–20.0**	**4.9**	**–0.1**	**–**	**0.6**	**45.6**

26. TRADE PAYABLES AND OTHER LIABILITIES

€ million	31 Dec 2017	31 Dec 2016
Trade payables	**207.5**	**162.3**
Other liabilities		
Personnel-related liabilities	14.9	12.3
Price reduction liabilities	12.4	13.0
Advances received	7.8	1.9
Liabilities to investments	3.1	3.0
Liabilities arising from other taxes	3.0	3.1
Liabilities arising from income taxes	0.6	0.5
Derivative financial instruments	0.3	3.6
Sundry other liabilities	29.2	19.9
Total	**71.3**	**57.3**

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

The sundry other liabilities include interest benefits of €0.8 million (31 December 2016: €1.0 million) derived from a loan from the European Investment Bank and of €0.1 million (31 December 2016: €0.1 million) derived from an interest-free government loan. The loans were initially recognised at fair value and are reported as non-current and current financial debt.

NOTES TO THE CASH FLOW STATEMENT

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

Dividend income of €0.9 million was included in cash flow from operating activities (2016: €0.6 million).

The net cash used for investing activities included net cash payments (after deduction of the cash acquired with the companies) of €73.4 million and €10.2 million respectively for the acquisition of 100 per cent of the voting shares in both Torqeedo GmbH, Gilching, and DEUTZ Italy S.r.l., Milan, Italy, (formerly IML Motori S.r.l.).

The cash flow from financing activities included the dividend paid to the shareholders of DEUTZ AG for 2016, amounting to €8.5 million.

Cash and cash equivalents had risen by €52.0 million to €143.8 million at the end of 2017 (31 December 2016: €91.8 million).

SEGMENT REPORTING

The following table provides an overview of the segments in the DEUTZ Group for 2017 and 2016.

2017	DEUTZ Compact Engines	DEUTZ Customised Solutions	Other	**Total segments**	Recon-ciliation	**DEUTZ Group**
€ million						
External revenue	1,227.5	247.9	3.7	1,479.1	–	1,479.1
Intersegment revenue	–	–	–	–	–	–
Total revenue	**1,227.5**	**247.9**	**3.7**	**1,479.1**	**–**	**1,479.1**
Depreciation and amortisation	74.3	9.7	0.7	84.7	–	84.7
Impairment	8.8	–	–	8.8	–	8.8
Profit/loss on equity-accounted investments	2.5	–	–	2.5	–	2.5
Income from the reversal of provisions	1.0	1.1	–	2.1	–	2.1
Operating profit/loss (EBIT before exceptional items)	22.5	24.5	–4.6	42.4	–	42.4

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

Reconciliation from overall profit of the segments to net income

€ million	**2017**	2016
Overall profit of the segments	**42.4**	**23.4**
Reconciliation	–	–
Operating profit (EBIT before exceptional items)	**42.4**	**23.4**
Exceptional items	104.1	–
EBIT	**146.5**	**23.4**
Financial income, net	–2.4	–3.5
Net income before income taxes	**144.1**	**19.9**
Income taxes	–22.9	–3.9
Net income	**121.2**	**16.0**

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

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

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

Other Since the inclusion of Torqeedo in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017, this segment has included business with electric and hybrid drive systems for marine applications, which is operated under the Torqeedo brand. As in 2016, this segment also contains Group activities that are not allocated to any of the segments.

Reconciliation Where relevant, the reconciliation table also shows the elimination of intercompany relationships between the segments. There were no such eliminations in the reporting year or in 2016.

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

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

Information about products and services

€ million	2017	2016
Engines	1,041.5	833.4
Service	186.0	167.4
DEUTZ Compact Engines	**1,227.5**	**1,000.8**
Engines	124.7	139.5
Service	123.2	119.9
DEUTZ Customised Solutions	**247.9**	**259.4**
Engines	3.7	–
Other	**3.7**	**–**
Total	**1,479.1**	**1,260.2**

Geographical information about external revenue

€ million	2017	2016
Germany	**284.3**	**221.8**
Outside Germany	**1,194.8**	**1,038.4**
Rest of Europe	725.5	588.6
Middle East	18.7	18.5
Africa	35.0	43.8
Americas	268.1	239.6
Asia-Pacific	147.5	147.9
Total	**1,479.1**	**1,260.2**

Of the European countries outside Germany, Switzerland accounted for €176.9 million in the reporting year (2016: €148.6 million), Sweden for €117.9 million (2016: €116.2 million) and France for €95.1 million (2016: €74.1 million).

The above information is presented according to customer location. Two customers accounted for at least 10 per cent of our total revenue in both 2017 and 2016. The revenue from these customers amounted to €270.6 million (2016: €242.7 million) and €155.5 million (2016: €132.1 million) respectively and was reported predominantly in the DEUTZ Compact Engines segment.

Geographical information about non-current assets

€ million	31 Dec 2017	31 Dec 2016
Germany	447.3	394.8
Outside Germany	80.1	81.4
Total	**527.4**	**476.2**

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

OTHER INFORMATION

27. FINANCIAL RISK MANAGEMENT AND ADDITIONAL INFORMATION ON CAPITAL MANAGEMENT

Owing to its global business operations, the DEUTZ Group is exposed to various financial risks that can arise from adverse movements and trends in the international sales, procurement, interest-rate and foreign-exchange markets. Information about the principles of risk management with regard to financial instruments can be found in the risk report on pages 59 to 60 of the DEUTZ Group’s combined management report.

Liquidity risk

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

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

In order to ensure sufficient liquidity, DEUTZ has at its disposal a syndicated, revolving cash credit line amounting to €160 million that runs until June 2022 and two long-term amortising loans with a total remaining balance of €39.6 million. These are being repaid in equal instalments between July 2014 and July 2020. As part of the loan agreements, the Company is required to comply with certain covenants.

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

31 Dec 2017	2018 cash payments	2019–2022 cash payments	>2022 cash payments	**Total**
€ million				
Primary financial instruments	**–283.4**	**–13.9**	**–**	**–297.3**
Derivative financial instruments	**–0.3**	**–0.3**	**–**	**–0.6**
Currency derivatives				
thereof settled gross: cash payments	–	–	–	–
thereof settled gross: cash receipts	–	–	–	–
Interest rate derivatives				
Presentation of net cash flow	–0.3	–0.3	–	–0.6

31 Dec 2016	2017 cash payments	2018–2021 cash payments	>2021 cash payments	**Total**
€ million				
Primary financial instruments	**–230.2**	**–49.9**	**–**	**–280.1**
Derivative financial instruments	**–4**	**–0.4**	**–**	**–4.4**
Currency derivatives				
thereof settled gross: cash payments	–64	–	–	–64.0
thereof settled gross: cash receipts	60.3	–	–	60.3
Interest rate derivatives				
Presentation of net cash flow	–0.3	–0.4	–	–0.7

Credit risk

The overview of written-down financial assets and of the age structure of past due financial assets that have not been written down does not include cash and cash equivalents of €143.8 million (31 December 2016: €91.8 million) or available-for-sale financial assets of €5.1 million (31 December 2016: €5.5 million).

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

As regards trade receivables and other receivables and assets that were neither past due nor written down as at the balance sheet date, there were no indications that the customers concerned would be unable to meet their payment obligations. The bulk of the DEUTZ Group's trade receivables are insured with the EULER HERMES Group. There is usually an obligation to the trade credit insurance association (WKV) or, where applicable, the German government's export credit guarantee scheme (APG) to meet defaults on the receivables unless they are secured by letters of credit confirmed by a bank or similar instruments. DEUTZ does not produce any standardised credit rating for its customers itself but usually sets the maximum customer exposure in accordance with the level of cover provided by the credit insurance agency. In addition, we have received collateral in the form of payment guarantees amounting to €0.1 million (31 December 2016: payment guarantees and comfort letters amounting to €0.6 million) for foreign trade receivables.

31 Dec 2017			**thereof written down at the balance sheet date**		**thereof past due at the balance sheet date but not written down**			
€ million	**Carrying amount**	thereof neither past due nor written down at the balance sheet date	Gross amount before write down	Write down	up to 90 days	91 to 180 days	181 to 360 days	over 360 days
Non-current financial assets	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Current financial assets	**163.4**	**129.6**	**25.0**	**–21.7**	**30.3**	**0.5**	**–0.3**	**–**
Trade receivables	142.7	110.7	5.2	–3.7	30.3	0.5	–0.3	–
Other receivables and assets	20.7	18.9	19.8	–18.0	–	–	–	–

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

Currency risk

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

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

Currency sensitivity analysis

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

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

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

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

Euro rises by 10 per cent

€ million **2017**	Notional amounts	Impact on net income	Notional amounts	Impact on equity
USD	78.5	–6.3	31.6	2.8
MAD	9.0	–0.8	–	–
CNY	8.2	–0.7	–	–

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

Euro falls by 10 per cent

€ million **2017**	Notional amounts	Impact on net income	Notional amounts	Impact on equity
USD	78.5	7.7	31.6	–3.4
MAD	9.0	1.0	–	–
CNY	8.2	0.9	–	–

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

Interest-rate risk and sensitivity analysis

The DEUTZ Group is exposed to risk from interest-rate changes, primarily in relation to floating-rate loans and other debt. As at 31 December 2017, there were no material loans or other debt exposed to interest-rate risk. The floating-rate loan from the European Investment Bank outstanding on the balance sheet date, which had a remaining balance of €19.8 million, was hedged using interest-rate swaps that form part of an effective cash flow hedge. Because hedging transactions are measured at fair value, changes in interest rates have an impact on the hedging reserve in other comprehensive income. The following tables show the impact of the interest-rate swaps on other comprehensive income if market interest rates rise or fall by 100 basis points.

Interest rates rise by 100 basis points

€ million **2017**	Notional amounts	Impact on equity
	19.8	0.2

€ million 2016	Notional amounts	Impact on equity
	27.0	0.5

Interest rates fall by 100 basis points

€ million **2017**	Notional amounts	Impact on equity
	19.8	–0.2

€ million 2016	Notional amounts	Impact on equity
	27.0	–0.5

Capital management

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

DEUTZ is not subject to capital requirements under its Statutes. However, it is under an obligation towards the banks from which it has obtained loans to ensure that its ratio of net financial debt to equity does not exceed a certain level. This external requirement has been integrated into capital management and was met at all times.

As at the balance sheet date, the net financial position (cash and cash equivalents less interest-bearing financial debt) was €98.2 million, which equated to a substantial year-on-year improvement of €66.6 million (31 December 2016: €31.6 million). In addition to the net financial position, free cash flow (defined as cash flow from operating activities and investing activities less interest payments) is an essential part of active capital management and is used as a key figure to show changes in the liquidity situation. The free cash flow from continuing operations was €82.5 million in 2017 (2016: €4.7 million). The year-on-year increases in the net financial position and free cash flow were mainly due to the disposal of the land occupied by our former Cologne-Deutz site and growth in the volume of business.

The equity ratio is another indicator used by the DEUTZ Group to monitor its capital. This indicator reflects the ratio of total assets to Group equity as reported on the consolidated balance sheet. As at 31 December 2017, the equity ratio for the DEUTZ Group was 49.4 per cent (31 December 2016: 46.3 per cent) and therefore remained at a high level and met all internal targets in full.

Financial instruments

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

Financial instruments (assets)

31 Dec 2017	Measured at amortised cost		Measured at fair value			Assets not within the scope of IAS 39	
€ million	Loans and receivables	Available-for-sale financial assets	Available-for-sale financial assets	Derivatives designated as hedging instruments (recognised as other comprehensive income/loss)	Held-for-trading financial assets	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial assets	**–**	**0.3**	**4.8**	**–**	**–**	**1.7**	**6.8**
Current financial assets	**307.2**	**–**	**–**	**1.2**	**0.1**	**13.8**	**322.3**
Trade receivables	142.7	–	–	–	–	–	142.7
Other receivables and assets	18.0	–	–	1.2	0.1	16.5	35.8
Cash and cash equivalents	143.8	–	–	–	–	–	143.8

Financial instruments (assets)

31 Dec 2016	Measured at amortised cost		Measured at fair value			Assets not within the scope of IAS 39	
€ million	Loans and receivables	Available-for-sale financial assets	Available-for-sale financial assets	Derivatives designated as hedging instruments (recognised as other comprehensive income/loss)	Held-for-trading financial assets	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial assets	**0.5**	**0.3**	**5.2**	**–**	**–**	**1.5**	**7.5**
Current financial assets	**234.4**	**–**	**–**	**–**	**–**	**8.2**	**242.6**
Trade receivables	113.5	–	–	–	–	–	113.5
Other receivables and assets	29.1	–	–	–	–	8.2	37.3
Cash and cash equivalents	91.8	–	–	–	–	–	91.8

Financial instruments (liabilities)

31 Dec 2017	**Measured at amortised cost**	**Measured at fair value**		**Liabilities not within the scope of IAS 39**	
€ million	Financial liabilities	Derivatives designated as hedging instruments (recognised as other comprehensive income/loss)	Held-for-trading financial liabilities	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial liabilities	**38.8**	**0.3**	**–**	**2.0**	**41.1**
Financial debt	27.1	–	–	1.0	28.1
Other liabilities	11.7	0.3	–	1.0	13.0
Current financial liabilities	**268.6**	**–**	**–**	**14.7**	**283.3**
Financial debt	17.5	–	–	–	17.5
Trade payables	207.5	–	–	–	207.5
Other liabilities	43.6	–	–	14.7	58.3

Financial instruments (liabilities)

31 Dec 2016	**Measured at amortised cost**	**Measured at fair value**		**Liabilities not within the scope of IAS 39**	
€ million	Financial liabilities	Derivatives designated as hedging instruments (recognised as other comprehensive income/loss)	Held-for-trading financial liabilities	Carrying amount	**Carrying amount on the balance sheet**
Non-current financial liabilities	**47.0**	**0.9**	**–**	**2.4**	**50.3**
Financial debt	42.9	–	–	1.1	44.0
Other liabilities	4.1	0.9	–	1.3	6.3
Current financial liabilities	**219.9**	**2.4**	**0.3**	**6.9**	**229.5**
Financial debt	16.2	–	–	–	16.2
Trade payables	162.3	–	–	–	162.3
Other liabilities	41.4	2.4	0.3	6.9	51.0

The following table shows the carrying amounts and fair values of all financial instruments included in the consolidated financial statements that fall within the scope of IFRS 7 'Financial Instruments: Disclosures' and that are not reported at fair value.

€ million	31 Dec 2017		31 Dec 2016	
	Carrying amount	**Fair value**	Carrying amount	Fair value
Financial assets	**304.8**	**304.5**	**235.2**	**234.9**
Available-for-sale financial assets measured at cost	0.3	–	0.3	–
Trade receivables	142.7	142.7	113.5	113.5
Other receivables and assets	18.0	18.0	29.6	29.6
Cash and cash equivalents	143.8	143.8	91.8	91.8
Financial liabilities	**308.4**	**310.4**	**268.0**	**269.8**
Financial debt – liabilities to banks	45.6	47.6	60.2	62.0
Trade payables	207.5	207.5	162.3	162.3
Other liabilities	55.3	55.3	45.5	45.5

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

The available-for-sale financial assets with a carrying amount of €0.3 million (31 December 2016: €0.3 million) are investments. They are measured at amortised cost because their fair value cannot be reliably determined due to their not being listed on a market and due to a lack of market data for comparable instruments. There was no intention to dispose of these instruments as at 31 December 2017.

The fair value of non-current financial assets and liabilities is computed by discounting estimated future cash flows using arm's length discount rates and taking into account our own credit risk and that of our counterparties based on credit ratings and exchange rates on the balance sheet date.

The following table shows the classification in the IFRS 13 measurement hierarchy of the fair values as at the balance sheet date of financial assets and liabilities that were measured at fair value in the consolidated financial statements, or for which a fair value was disclosed in the notes to the financial statements:

31 Dec 2017

€ million	**Carrying amount**	**Fair value**	Level 1	Level 2	Level 3
Financial assets					
Securities	3.1	3.1	3.1	–	–
Currency forwards	1.3	1.3	–	1.3	–
Available-for-sale financial assets measured at fair value	1.7	1.7	–	–	1.7
Financial liabilities					
Interest-rate swaps	0.3	0.3	–	0.3	–
Financial debt	45.6	47.6	–	–	47.6

31 Dec 2016

€ million	**Carrying amount**	**Fair value**	Level 1	Level 2	Level 3
Financial assets					
Securities	3.2	3.2	3.2	–	–
Available-for-sale financial assets measured at fair value	2.0	2.0	–	–	2.0
Financial liabilities					
Currency forwards	2.9	2.9	–	2.9	–
Interest-rate swaps	0.7	0.7	–	0.7	–
Financial debt	60.2	62.0	–	–	62.0

Level 1: Measurement is based on the price of identical assets or liabilities in active markets.
Level 2: Measurement is based on the price of a similar instrument in active markets/measurement using a method in which all the critical input factors are based on observable market data.
Level 3: Measurement using a method in which critical input factors are not based on observable market data.

The fair value of securities is derived from prices in active markets.

The available-for-sale financial assets measured at fair value relate to the equity investment in DEUTZ Engine (Shandong) Co., Ltd., Linyi, China. As this company is no longer operational and is currently being wound up, the fair value of the equity investment was determined on the basis of the company's net asset value as at 31 December 2017. There was no intention to dispose of these financial assets as at 31 December 2017.

The fair value of derivative financial instruments (currency forwards and interest-rate swaps) is calculated over the remaining term of the instrument using current exchange rates, market interest rates and yield curves and taking into account our own credit risk and that of our counterparties. The disclosures are based on valuations by banks.

Net gains and losses on financial instruments

Net gains or losses recognised in the income statement are broken down by measurement category in IAS 39 as follows:

2017	Loans and receivables	**Derivatives designated as hedging instruments**	Held-for-trading financial assets	Financial liabilities measured at amortised cost	Held-for-trading financial liabilities
€ million					
Net gains/losses	–6.6	0.2	–	–1.6	–

2016	Loans and receivables	**Derivatives designated as hedging instruments**	Held-for-trading financial assets	Financial liabilities measured at amortised cost	Held-for-trading financial liabilities
€ million					
Net gains/losses	0.8	–0.4	–	–2.6	–0.3

The net gains or losses for each measurement category primarily comprise gains and losses recognised in profit or loss resulting from the measurement of financial instruments at fair value, currency translation of financial instrument carrying amounts, impairment losses and/or reversal of impairment losses on financial instruments and interest income and expense.

In the year under review and in 2016, no unrealised losses or gains on available-for-sale financial assets were recognised in other comprehensive income. As had been the case in 2016, no realised gains or losses were reclassified from other comprehensive income to the income statement in 2017.

Total interest income and interest expense

In 2017, interest income of €0.7 million (2016: €0.3 million) and interest expense of €1.9 million (2016: €2.5 million) were attributable to financial assets and financial liabilities that were not measured at fair value through profit or loss.

Hedging

Cash flow hedging As at 31 December 2017, there were currency futures and interest-rate swaps which were classified as hedging instruments. Interest-rate swaps are used to hedge the interest-rate risk associated with floating-rate loans. Currency futures are used to hedge the currency risk arising from forecast transactions in foreign currencies.

Unrealised gains of €4.0 million on cash flow hedges were recognised in other comprehensive income in 2017 (2016: losses of €2.3 million), taking into account deferred tax liabilities of €1.3 million (2016: deferred tax assets of €0.7 million). These changes in fair value represent the effective portion of the hedge. In 2017, prior to the inclusion of deferred taxes, gains of €0.5 million (2016: losses of €32 thousand) recognised in other comprehensive income during the year were reclassified to other operating income or expenses in the consolidated income statement. There was no hedging ineffectiveness requiring reclassification from the reserve for cash flow hedges to the income statement in the year under review. Hedges relating to foreign-currency transactions in the operating business are expected to be unwound within the next twelve months and those relating to future interest-rate risks are expected to be unwound after a period of two and a half years. The associated gains that have been recognised in other comprehensive income will be reclassified to the income statement.

Derivative financial instruments

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

€ million	**Notional amounts 2017**	Notional amounts 2016	**Fair value 2017**	Fair value 2016
Currency forwards				
not used as hedges	4.8	6.9	0.1	–0.3
used as cash flow hedges	31.6	58.8	1.2	–2.6
Interest-rate swaps				
used as cash flow hedges	19.8	27.0	–0.4	–0.7

Netting

Netting agreements with financial institutions covering derivatives exist within the DEUTZ Group. In accordance with these master agreements, amounts in the same currency relating to outstanding transactions owed by each counterparty on a specific settlement date are aggregated into a net amount.

As at 31 December 2017, there were also netting agreements with customers that permit the DEUTZ Group to net receivables and liabilities with each other that are in the same currency.

The following table shows the financial assets and liabilities that are subject to netting agreements:

31 Dec 2017	Gross amounts	Figures netted on the balance sheet	Net amounts reported on the balance sheet	Related amounts not netted on the balance sheet	Potential net amounts
€ million					
Financial liabilities					
Other liabilities	1.5	0.8	0.7	–	0.7
Derivative financial instruments	0.1	–	0.1	–	0.1

31 Dec 2016	Gross amounts	Figures netted on the balance sheet	Net amounts reported on the balance sheet	Related amounts not netted on the balance sheet	Potential net amounts
€ million					
Financial liabilities					
Other liabilities	2.2	1.2	1.0	–	1.0
Derivative financial instruments	0.1	–	0.1	–	0.1

28. INTERESTS IN OTHER ENTITIES

As well as the parent company DEUTZ AG, the consolidated financial statements for 2017 included 22 subsidiaries, two joint ventures and one associate.

Subsidiaries and non-controlling interests

As a result of DEUTZ Italy S.r.l., Milan, Italy (formerly IML Motori S.r.l.) and its investment IML Motoare S.r.l., Galati, Romania, being included in the consolidated financial statements of DEUTZ AG for the first time as at 1 October 2017, the 25 per cent of the voting shares in IML Motoare S.r.l. attributable to Mr Glavan (CEO of IML Motoare S.r.l.) are shown as non-controlling interests. These amounted to €0.2 million as at 31 December 2017 and are therefore regarded as not material.

Joint ventures

DEUTZ (Dalian) Engine Co., Ltd., Dalian, China, is an unlisted joint arrangement in which the Group shares joint control and has an ownership interest of 50 per cent. The company, which is structured as a separate vehicle, was established jointly with the First Automotive Works Group (China), Dalian, China. It is a strategic partnership for the production and distribution of diesel engines with a capacity of between 3 and 8 litres for the Chinese market. The interest is classified as a joint venture and accounted for in the consolidated financial statements using the equity method.

A summary of financial information for DEUTZ (Dalian) Engine Co., Ltd. based on its annual financial statements prepared in accordance with IFRS is shown in the following table.

€ million	**2017**	2016
Revenue	305.6	303.0
Depreciation and amortisation	–11.3	–22.3
Interest expenses, net	–7.2	–9.6
Income taxes	–	–
Profit (loss) from continuing operations	–	–15.4
Net income	**–**	**–15.4**
Current assets	236.6	210.4
thereof cash and cash equivalents	10.6	2.3
Non-current assets	263.3	292.6
Current liabilities	376.8	236.0
thereof current financial liabilities	229.1	95.3
Non-current liabilities	38.6	176.9
thereof non-current financial liabilities	37.1	175.2
Net assets	**84.5**	**90.1**
Group's share of net assets at 1 Jan	45.1	54.7
Share of net income	–	–7.7
Dividends received in 2017	–	–
Effect of currency translation	–2.8	–1.9
Group's share of net assets at 31 Dec	42.3	45.1
Elimination	–3.9	–6.2
Impairment	–	–
Carrying amount using the equity method at 31 Dec	**38.4**	**38.9**

Non-material joint ventures

Financial information is shown below for the Group's interest in DEUTZ AGCO Motores S.A., Haedo, Argentina, which is classified as a non-material joint venture.

€ million	**2017**	2016
Carrying amount of interests	**–** [1]	**–** [1]
Group's share of:		
Loss from continuing operations	–0.3	–0.2
Other comprehensive income	–	–
Net income	**–0.3**	**–0.2**

[1] As the carrying amount of the interests was zero, total losses of €–0.5 million (2016: €0.2 million) were not recognised under the equity method.

Non-material associates

A summary of financial information is shown below for the Group's interest in D. D. Power Holdings (Pty) Ltd., Elandsfontein, South Africa, which is classified as a non-material associate. The company has a different financial year (ending on 30 November). Annual financial statements for the year ended 31 December have not been prepared for reasons of materiality.

€ million	2017	2016
Carrying amount of interests	**2.4**	**2.8**
Group's share of:		
Profit from continuing operations	0.6	0.6
Other comprehensive income	–	–
Net income	**0.6**	**0.6**

29. CONTINGENT LIABILITIES

Contingent liabilities

The DEUTZ Group's contingent liabilities as at the balance sheet date were as follows:

€ million	31 Dec 2017	31 Dec 2016
Guarantee liabilities	0.1	0.1
Warranty liabilities	1.1	0.3
Total	**1.2**	**0.4**

The increase in warranty liabilities is essentially due to the inclusion of DEUTZ Italy S.r.l. (formerly IML Motori S.r.l.) in the consolidated financial statements of DEUTZ AG for the first time.

Other financial obligations

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

€ million	31 Dec 2017	31 Dec 2016
due in less than 1 year	11.8	8.6
due in 1 to 5 years	20.3	17.2
due in more than 5 years	0.3	–
Total	**32.4**	**25.8**

The above obligations largely relate to rental agreements and leases on real estate, movable assets and financial obligations in connection with IT services. Obligations under rental agreements and leases were partly offset by receivables of €5 thousand (2016: €18 thousand) from sub-leases. In 2017, the cost of rentals and leases for real estate and movable assets totalled €9.7 million (2016: €9.8 million).

Commitments to purchase property, plant and equipment and intangible assets amounted to €34.7 million as at 31 December 2017 (31 December 2016: €36.6 million) and commitments to purchase inventories amounted to €112.7 million (31 December 2016: €80.5 million).

Legal disputes

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

Financial provision has been made to cover litigation risks facing the respective Group companies if the event in question occurred before the balance sheet date, an obligation is probable and the amount of the obligation can be determined with a sufficient degree of reliability.

Claims for compensation have been made in respect of isolated product liability cases in the USA although the extent of these is as yet unknown. Due to the low probability of losses occurring, no provisions have been recognised on the balance sheet. The outcome of these legal disputes cannot be predicted with any degree of certainty. It is therefore possible that they might have a negative impact on the financial position or financial performance. However, the level of existing insurance cover means that if the outcome is negative, this impact will only be a maximum of €1.5 million.

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

30. RELATED PARTY DISCLOSURES

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

These include the business relationships between the DEUTZ Group and **entities in which it holds significant investments** and the relationship with AB Volvo (publ), Gothenburg, Sweden (including its subsidiaries), which as a **shareholder** in DEUTZ AG had been able to exert a significant influence. On 7 July 2017, AB Volvo sold its entire stake in DEUTZ AG and thus ceased to be a related party.

Related parties also include the **Supervisory Board** and the **Board of Management**.

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

€ million	Goods and services provided		Other expenses for services received		Receivables 31 Dec		Payables 31 Dec	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Associates	–	–	–	–	–	–	–	–
Joint ventures	7.5	7.8	–	–	1.4	2.9	–	–
Other investments	0.6	0.5	4.7	4.7	0.1	0.2	3.1	3.0
Total	**8.1**	**8.3**	**4.7**	**4.7**	**1.5**	**3.1**	**3.1**	**3.0**

The goods supplied and services rendered to joint ventures are largely attributable to goods supplied to our Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd.

Receivables due from joint ventures amounting to €3.8 million (31 December 2016: €3.7 million) had been written off in full as at 31 December 2017; the expense in 2017 amounted to €0.1 million (2016: €0.3 million). As at 31 December 2017, impairment losses of €14.3 million (31 December 2016: €13.9 million) had been recognised on €14.4 million (31 December 2016: €14.0 million) of the Company's receivables due from other investments. The resulting expense came to €0.8 million in 2017 (2016: €0.1 million).

Of these receivables, €6.8 million related to loans granted by DEUTZ (31 December 2016: €6.8 million) on which impairment losses of €6.8 million had been recognised (31 December 2016: €6.8 million). Taken together, neither the interest and similar income nor the interest expense and similar charges arising from the interest paid on these loans are material.

The following table gives a breakdown of the significant business relationships between the DEUTZ Group and AB Volvo (including its subsidiaries):

€ million	Volvo Group	
	1 Jan–7 Jul 2017	1 Jan–31 Dec 2016
Engines & spare parts supplied	134.7	242.7
Services	0.4	1.7
Receivables as at 31 Dec	–	7.1

AB Volvo (including its subsidiaries) ceased to be a related party when it sold its shares in DEUTZ AG on 7 July 2017. Consequently, the business relationships with AB Volvo are only disclosed up to this date. Any receivables due from AB Volvo as at 31 December 2017 were no longer classified as receivables due from related parties.

All transactions were concluded at arm's-length market rates. DEUTZ has an agreement with the Volvo Group that grants Volvo companies extended credit periods in return for payment of a fee.

The following payments were made to the Supervisory Board and the Board of Management as related parties of the DEUTZ Group.

€ million	Supervisory Board		Board of Management	
	2017	2016	**2017**	2016
Short-term remuneration [1]	1.2	1.0	3.8	2.7
Other long-term benefits	–	–	1.0	–
Termination benefits	–	–	–	1.9
Share-based remuneration [2]	0.2	0.1	0.1	0.9

[1] The current remuneration for members of the Supervisory Board includes both remuneration for their work as Supervisory Board members and the regular salaries of the salaried employee representatives.
[2] The disclosure of share-based remuneration corresponds with the expense (+) or income (–) recognised in the operating profit in 2017 from the changes in provisions made for distributed virtual share options.

The DEUTZ Group did not maintain material business relationships with any other related parties.

31. EVENTS AFTER THE REPORTING PERIOD

No events occurred after 31 December 2017 that had a material impact on the financial position or financial performance of the DEUTZ Group.

32. SHARE-BASED REMUNERATION PROGRAMMES

Between 2007 and 2017, DEUTZ AG launched long-term incentive plans as long-term components of remuneration. Under these long-term incentive plans, virtual stock options are issued to reward management for its sustained contribution to the Company's success.

General description of the incentive plans of DEUTZ AG

Under DEUTZ AG's incentive plans, virtual options are issued on shares in DEUTZ AG. The Company decides at its discretion who is eligible to participate in the plans. However, only members of the DEUTZ Group's senior management and members of the Supervisory Board of DEUTZ AG may be considered for inclusion. It is at the discretion of the Company to decide how many options are granted.

By the balance sheet date, the following long-term incentive plans (LTI) that were still in existence, with the number of options shown, had been granted free of charge:

Incentive plan	Date of grant	Number of options
LTI no. IV	1 July 2010	330,000
LTI no. V	1 June 2011	280,000
LTI no. VI	1 August 2012	270,000
LTI no. VII	1 July 2013	260,000
LTI BoM 2014	1 January 2014	72,389
LTI no. VIII	1 September 2014	320,000
LTI BoM 2015	1 January 2015	125,657
LTI no. IX	1 June 2015	320,000
LTI BoM 2016	1 January 2016	147,577
LTI no. X	1 September 2016	340,000
LTI BoM 2017	1 January 2017	102,926
LTI no. XI	1 September 2017	320,000

A total of 585,291 of these options had been granted to current and former members of the DEUTZ AG Board of Management.

Information on the exercise of options

One of the fundamental requirements for exercising options is that the option holders themselves invest in the Company at a ratio of one share per ten options, or one share per 20 options in the case of the LTI BoM 2014 to 2017. The absolute earliest that options can be exercised is four years after the date of grant (vesting period) and then only within four years from the end of the vesting period and only within ten days from the date of publication of quarterly financial statements. However, options under the LTI BoM 2014 to 2017 are exercised automatically four years after the date of grant. The Company may delay the start of the exercise window for the options or accelerate the exercise and vesting periods, but cannot change the exercise or vesting periods of the options relating to the LTI BoM 2014 to 2017.

Furthermore, options may only be exercised:

- if the market price of DEUTZ AG shares has risen by at least 30 per cent relative to the reference price (dividend distributions by DEUTZ AG must be taken into consideration, i.e. for the purposes of calculating the performance target, the total gross dividend distribution up to the exercise date must be added to the DEUTZ AG share price), or
- if, in the period starting from the grant date of the option and ending on the date of exercise, DEUTZ AG shares outperform the Prime Industrial Performance Index – or any future index that replaces the Prime Industrial Performance Index – by at least 30 per cent, or
- in the case of the LTI BoM 2014 to 2017, if, in the period starting from the grant date of the option and ending on the date of exercise, DEUTZ AG shares outperform the MDAX – or any future index that replaces the MDAX – by at least 10 percentage points.

A request to exercise options must be submitted to the Company in writing.

The following specific terms and conditions apply to the incentive plans still in existence:

Incentive plan	Earliest or automatic exercise date	Reference price
LTI no. IV	1 July 2014	€4.39
LTI no. V	1 June 2015	€6.10
LTI no. VI	1 August 2016	€3.89
LTI no. VII	1 July 2017	€4.45
LTI BoM 2014	1 January 2018	€6.63
LTI no. VIII	1 September 2018	€5.37
LTI BoM 2015	1 January 2019	€3.82
LTI no. IX	1 June 2019	€4.40
LTI BoM 2016	1 January 2020	€3.42
LTI no. X	1 September 2020	€3.94
LTI BoM 2017	1 January 2021	€4.91
LTI no. XI	1 September 2021	€6.66

When an option is exercised, the beneficiary receives a cash payment in the amount of the difference between the DEUTZ AG share price on the exercise date and the reference price at the time the option was granted. Under the LTI BoM 2014 to 2017, however, beneficiaries receive a cash payment equivalent to the average closing price of DEUTZ AG shares on the 60 trading days prior to the end of the vesting period up to a maximum of 1.5 times the reference price. No beneficiary receives shares in the Company.

The following table shows the changes to the number of outstanding options in 2017:

Incentive plan	Outstanding options at 1 Jan	Options granted	Options exercised	Options expired	Outstanding options at 31 Dec
LTI no. IV	230,000	–	–170,000	–10,000	50,000
LTI no. V	240,000	–	–	–10,000	230,000
LTI no. VI	240,000	–	–135,000	–20,000	85,000
LTI BoM 2013	136,742	–	–136,742	–	–
LTI no. VII	250,000	–	–98,000	–20,000	132,000
LTI BoM 2014	72,389	–	–	–	72,389
LTI no. VIII	280,000	–	–	–40,000	240,000
LTI BoM 2015	125,657	–	–	–	125,657
LTI no. IX	300,000	–	–	–40,000	260,000
LTI BoM 2016	147,577	–	–	–	147,577
LTI no. X	340,000	–	–	–40,000	300,000
LTI BoM 2017	–	102,926	–	–	102,926
LTI no. XI	–	320,000	–	–	320,000
	2,362,365	**422,926**	**–539,742**	**–180,000**	**2,065,549**

Notes on the fair value of options

Because the virtual options are cash-based instruments rather than equity-based instruments, the Company is obliged to recognise a provision, the amount of which is derived from the fair value of the virtual options at the grant date and apportioned over the vesting period pro rata temporis.

An option pricing model using the Black-Scholes formula was used to ascertain the fair value. The model factors in the aforementioned exercise prices, the term and the value of the underlying asset (DEUTZ AG shares).

LTI no. IV

The risk-free interest rate (2.50 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2010. The assumed volatility (48.87 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.10 on 1 July 2010. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI no. V

The risk-free interest rate (3.25 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2011. The assumed volatility (51.35 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €6.82 on 1 June 2011. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI no. VI

The risk-free interest rate (1.75 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2012. The assumed volatility (57.30 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €3.07 on 1 August 2012. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI no. VII

The risk-free interest rate (1.75 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in mid-2013. The assumed volatility (54.18 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.77 on 1 July 2013. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2014

The risk-free interest rate (0.625 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes with terms of two to five years issued at the start of 2014. The assumed volatility (50.44 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2014. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €6.49 on 1 January 2014. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. VIII

The risk-free interest rate (0.63 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in the second half of 2014. The assumed volatility (57.72 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.52 on 1 September 2014. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2015

The risk-free interest rate (0.1 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes issued at the start of 2015. The assumed volatility (45.34 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2015. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.24 on 1 January 2015. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. IX

The risk-free interest rate (0.63 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in the second half of 2015. The assumed volatility (58.58 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €5.24 on 1 June 2015. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2016

The risk-free interest rate (0.1 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes issued at the start of 2016. The assumed volatility (49.71 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2016. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €3.535 on 1 January 2016. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. X

The risk-free interest rate (0.0 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in the second half of 2016. The assumed volatility (44.30 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €4.00 on 1 September 2016. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

LTI BoM 2017

The risk-free interest rate (0.1 per cent) used in the calculation is based on German Federal notes and German Federal Treasury notes issued at the start of 2017. The assumed volatility (41.39 per cent) is based on the average value for call options on DEUTZ AG shares available on the market as at 1 January 2017. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €5.473 on 1 January 2017. As the options are automatically exercised at the end of the vesting period, the provision for the options that are not yet vested was calculated on the basis of the vesting period.

LTI no. XI

The risk-free interest rate (0.0 per cent) used in the calculation is based on German government bonds with terms of up to ten years issued in the second half of 2017. The assumed volatility (39.50 per cent) is based on the average value for call options on DEUTZ AG shares available on the market at the end of the year. It is assumed that no option holders leave the Company.

The calculation on the grant date was based on the DEUTZ AG share price of €6.51 on 1 September 2017. It was also assumed that employees would tend to exercise options at the earliest possible date. Consequently, the provisions were calculated on the basis of the vesting period.

In accordance with the requirement for the fair value of options to be recalculated on each balance sheet date, a calculation was carried out on the basis of the DEUTZ AG share price of €7.58 on 31 December 2017 (31 December 2016: €5.35), which resulted in an expense of €2,019 thousand in 2017 (2016: €2,373 thousand). A total provision of €4,988 thousand was recognised at the end of 2017 (31 December 2016: €3,836 thousand). The amount is broken down as follows:

Incentive plan	**31 Dec 2017 € thousand**	31 Dec 2016 € thousand
LTI no. IV	164	407
LTI no. V	604	375
LTI no. VI	377	674
LTI BoM 2013	–	692
LTI no. VII	570	284
LTI BoM 2014	549	290
LTI no. VIII	525	256
LTI BoM 2015	540	336
LTI no. IX	619	267
LTI BoM 2016	379	189
LTI no. X	402	66
LTI BoM 2017	190	–
LTI no. XI	69	–
	4,988	**3,836**

Of the total expenses in 2017 and the total provisions as at 31 December 2017, the sum attributable to members of the Board of Management and Supervisory Board of DEUTZ AG was €363 thousand (2016: €1,003 thousand) and €2,383 thousand (31 December 2016: €1,693 thousand) respectively.

The options granted had the following intrinsic values, provided the vesting conditions were met:

Incentive plan	**Intrinsic value per option, provided the vesting conditions are met (€)**	
	31 Dec 2017	**31 Dec 2016**
LTI no. IV	3.19	–
LTI no. V	–	–
LTI no. VI	3.69	1.46
LTI no. VII	3.13	–
LTI BoM 2014	7.58	–
LTI no. VIII	2.21	–
LTI BoM 2015	5.73	5.35
LTI no. IX	3.18	–
LTI BoM 2016	5.13	5.13
LTI no. X	3.64	1.41
LTI BoM 2017	7.37	–
LTI no. XI	–	–

33. STAFF COSTS

€ million	**2017**	2016
Wages	116.5	108.0
Salaries	131.7	119.1
Social security contributions	46.4	43.0
Net interest cost for provisions for pensions and other post-retirement benefits	3.0	3.8
Cost of post-employment benefits and other long-term benefits	1.6	1.6
Cost of severance payments/personnel restructuring	2.2	2.9
Total	**301.4**	**278.4**

The following table shows the breakdown of staff costs by functional area:

€ million	**2017**	2016
Cost of sales	175.7	165.0
Research and development costs	34.1	29.8
Selling expenses	55.5	47.5
Administrative expenses	32.3	29.5
Other operating expenses	3.8	6.6
Total	**301.4**	**278.4**

The average number of employees during the year is given in the section about disclosures under German accounting standards on page 137.

DISCLOSURES UNDER GERMAN ACCOUNTING STANDARDS

34. AVERAGE NUMBER OF EMPLOYEES DURING THE YEAR (PURSUANT TO SECTION 314 (1) NO. 4 HGB)

	2017	2016
Non-salaried employees	2,298	2,216
Salaried employees	1,492	1,390
	3,790	**3,606**
Trainees	70	86
Total	**3,860**	**3,692**

35. CORPORATE GOVERNANCE

In September 2017, the Board of Management and the Supervisory Board of DEUTZ AG issued a declaration of conformity with the recommendations of the German Corporate Governance Code government commission pursuant to section 161 AktG and made this declaration permanently and publicly available on the Company's website (https://www.deutz.com/en/investor-relations/corporate-governance/declaration-of-conformity/).

36. AUDITORS' FEES

The total fees reported for auditing the consolidated financial statements for 2016 and 2017 are broken down as follows:

€ thousand	2017	2016
Auditing	541	455
Other attestation services	53	15
Total	**594**	**470**

The fees for auditing services essentially consisted of the fees for the audit of the consolidated financial statements, the review of the interim financial statements for the six months to 30 June and the audit of DEUTZ AG's annual financial statements. The fees for other attestation services primarily related to the audit of the declaration of completeness in respect of sales packaging pursuant to section 10 of the German Packaging Ordinance (VerpackV), the audit of the non-financial report and the audit of compliance with key financials.

The content of the reporting categories has changed as a result of applying the amended Accounting Principle of the Institute of Public Auditors in Germany (IDW AcP HFA 36, new). The comparative figures for 2016 have been restated accordingly.

37. TOTAL REMUNERATION FOR THE BOARD OF MANAGEMENT, FORMER BOARD OF MANAGEMENT MEMBERS AND THE SUPERVISORY BOARD

Board of Management

The total remuneration for the Board of Management of DEUTZ AG in 2017 was €5,318 thousand (2016: €3,238 thousand). This consisted of short-term employee benefits of €3,746 thousand (2016: €2,716 thousand), other long-term benefits of €1,009 thousand (2016: €0 thousand) and share-based long-term benefits as part of the long-term incentive plans amounting to €563 thousand (2016: €522 thousand).

Further details about the remuneration system for members of the Board of Management and details of individual remuneration can be found in the 'Remuneration report' section of the 2017 combined management report.

Remuneration for former members of the Board of Management or their surviving dependants amounted to €1,431 thousand (2016: €3,340 thousand) for DEUTZ AG and the Group. In 2016, it had included payments of €1,893 thousand in connection with the premature termination of the Board of Management contract of Dr Leube with effect from 31 December 2016. Provisions of €13,855 thousand (31 December 2016: €15,293 thousand) have been recognised to cover pension obligations to former members of the Board of Management.

Supervisory Board

The total remuneration for the Supervisory Board of DEUTZ AG in 2017 was €634 thousand (2016: €629 thousand). In addition, the employee representatives on the Supervisory Board who are also employees of the DEUTZ Group received normal salaries in line with their employment contracts. The level of their salaries represented appropriate remuneration for corresponding functions and tasks in the Group.

Further details about the Supervisory Board remuneration system and details of individual remuneration can be found in the 'Remuneration report' section of the 2017 combined management report.

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

As at 31 December 2017, there were no outstanding advances or loans to any members of the Board of Management or the Supervisory Board, nor had any guarantees or other warranties been issued in favour of any such persons.

38. DISCLOSURES UNDER THE GERMAN SECURITIES TRADING ACT (WPHG)

The German Securities Trading Act (WpHG) obliges investors whose share of voting rights in listed companies reaches certain thresholds to notify the company accordingly. DEUTZ AG received the following voting right notifications in 2017:

On 10 May 2017, pursuant to section 21 (1) WpHG, Assenagon S.A., Senningerberg, Luxembourg, notified us that its voting share in our Company had exceeded the 3 per cent threshold on 9 May 2017 and amounted to 3.47 per cent (4,193,477 voting rights) on that date. Pursuant to section 22 (1) sentence 1 no. 1 WpHG, 3.47 per cent (4,193,477 voting rights) are attributable to it. The voting rights attributable to it are held by the following company under its control, whose voting share in DEUTZ AG is 3 per cent or more: Source Markets PLC, Dublin, Ireland.

On 10 May 2017, pursuant to section 21 (1) WpHG, Source Markets PLC, Dublin, Ireland, notified us that its voting share in our Company had exceeded the 3 per cent threshold on 9 May 2017 and amounted to 3.47 per cent (4,193,477 voting rights) on that date.

On 12 May 2017, pursuant to section 21 (1) WpHG, Assenagon S.A., Senningerberg, Luxembourg, notified us that its voting share in our Company had fallen below the 3 per cent threshold on 10 May 2017 and amounted to 0 per cent (0 voting rights) on that date.

On 12 May 2017, pursuant to section 21 (1) WpHG, Source Markets PLC, Dublin, Ireland, notified us that its voting share in our Company had fallen below the 3 per cent threshold on 10 May 2017 and amounted to 0 per cent (0 voting rights) on that date.

On 7 July 2017, pursuant to section 21 (1) WpHG, AB Volvo, Gothenburg, Sweden, notified us that its voting share in our Company had fallen below the 3 per cent threshold on 7 July 2017 and amounted to 0 per cent (0 voting rights) on that date.

On 10 July 2017, pursuant to section 21 (1) WpHG, the Ministry of Finance on behalf of the State of Norway, Oslo, Norway, notified us that its voting share in our Company had exceeded the 5 per cent threshold on 7 July 2017 and amounted to 5.4 per cent (6,532,485 voting rights) on that date. Pursuant to section 22 WpHG, 5.4 per cent (6,532,485 voting rights) are attributable to it. The voting rights attributable to it are held by the following company under its control, whose voting share in DEUTZ AG is 3 per cent or more: Norges Bank (the Central Bank of Norway).

On 5 December 2017, pursuant to section 21 (1) WpHG, the Ministry of Finance on behalf of the State of Norway, Oslo, Norway, notified us that its voting share in our Company had fallen below the 5 per cent threshold on 4 December 2017 and amounted to 4.96 per cent (5,993,088 voting rights) on that date. Pursuant to section 22 WpHG, 4.96 per cent (5,993,088 voting rights) are attributable to it. The voting rights attributable to it are held by the following company under its control, whose voting share in DEUTZ AG is 3 per cent or more: Norges Bank (the Central Bank of Norway).

On 20 December 2017, pursuant to section 21 (1) WpHG, Union Investment Privatfonds GmbH, Frankfurt am Main, Germany, notified us that its voting share in our Company had exceeded the 3 per cent threshold on 20 December 2017 and amounted to 3.57 per cent (4,316,034 voting rights) on that date. Pursuant to section 22 WpHG, 3.57 per cent (4,316,034 voting rights) are attributable to it.

39. SUPERVISORY BOARD AND BOARD OF MANAGEMENT

Information on the members of the Supervisory Board and the Board of Management, including non-executive directorships held at other companies, is given in a separate list on page 140 et seq.

Cologne, 19 February 2018

DEUTZ Aktiengesellschaft
The Board of Management

Dr Ing Frank Hiller

Dr Margarete Haase

Michael Wellenzohn

SHAREHOLDINGS OF DEUTZ AG

As at 31 December 2017

Ref. no.	Name and registered office of the company	Held via	Holding (%)	Equity (€ thousand)	Net income (€ thousand)
1	DEUTZ AG, Cologne			628,981	128,618
	Consolidated companies in Germany				
2	Ad. Strüver KG (GmbH & Co.), Hamburg[1]	6	94.0	–2,886	8,094
3	DEUTZ Abgastechnik GmbH i.L., Cologne[1]	1	100.0	24	–1
4	DEUTZ Amerika Holding GmbH[1), 2)]	1	100.0	92,274	–
5	DEUTZ Asien Verwaltungs GmbH, Cologne[1), 2)]	1	100.0	16,125	–
6	DEUTZ Beteiligung GmbH, Cologne[1]	1	100.0	–1,880	–1,972
7	Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf[1]	5	100.0	–5,102	16,490
8	Torqeedo GmbH, Gilching[8]	1	100.0	34,208	–3,680
9	Unterstützungsgesellschaft mbH der DEUTZ Aktiengesellschaft, Cologne[1]	1	100.0	–1,984	85
	Consolidated companies outside Germany				
10	DEUTZ ASIA-PACIFIC (PTE.) LTD., Singapore (Singapore)[1]	1	100.0	8,665	2,169
11	Deutz Australia (Pty) Ltd., Braeside (Australia)[1]	1	100.0	6,593	408
12	DEUTZ (Beijing) Engine Co., Ltd., Beijing (China)[1]	1	100.0	4,977	323
13	Deutz Corporation, Atlanta (USA)[1]	4	100.0	27,699	923
14	DEUTZ FRANCE S.A.S., Gennevilliers (France)[1]	1	100.0	10,684	1,509
15	DEUTZ Italy S.r.l., Milan (Italy) (formerly IML Motori S.r.l.)[8]	1	100.0	11,040	556
16	DEUTZ (SHANGHAI) INTERNATIONAL TRADE Co., Ltd., Shanghai (China)	1	100.0	641	–
17	DEUTZ Spain S.A., Zafra (Spain)[1]	1	100.0	30,242	1,572
18	IML Motoare S.r.l., Galati (Romania)[8]	15	75.0	860	24
19	Nlle Ste MAGIDEUTZ S.A., Casablanca (Morocco)[1]	14	100.0	4,533	445
20	OOO DEUTZ Vostok, Moscow (Russia)[1]	1	100.0	2,217	1,588
21	Service Center Milan S.r.l., Milan (Italy) (formerly IML Service S.r.l.)[8]	15	100.0	579	1
22	Torqeedo Asia-Pacific Ltd., Bangkok (Thailand)[8]	8	100.0	45	–56
23	Torqeedo Inc., Crystal Lake (USA)[8]	8	100.0	–4,831	–611
24	D. D. Power Holdings (Pty) Ltd., Elandsfontein (South Africa)[3), 4)]	1	30.0	10,078	1,963
25	DEUTZ AGCO MOTORES S.A., Haedo (Argentina)[3]	1	50.0	854	–598
26	DEUTZ (Dalian) Engine Co., Ltd., Dalian (China)[3]	1	50.0	76,835	3,939
	Unconsolidated companies in Germany				
27	DEUTZ Sicherheit Gesellschaft für Industrieservice mbH, Cologne[2]	1	100.0	26	–
28	Feld & Hahn GmbH i. L., Cologne[2]	1	100.0	455	–
	Unconsolidated companies outside Germany				
29	AROTRIOS S.A., Nea Filadelfia (Greece)	1	100.0	–	–
30	DEUTZ DO BRASIL LTDA., São Paulo (Brazil)	1	100.0	461	61
31	DEUTZ Engine (Shandong) Co. Ltd., Linyi (China) (in liquidation)[5]	5	70.0	5,033	–1,865
32	DEUTZ ENGINEERING druzba za projektiraje, proizvodnjo in trgovino d.o.o., Maribor (Slovenia)	1	100.0	103	90
33	DEUTZ Engines (India) Private Limited, Pune (India)[6]	1	100.0	357	43
34	DEUTZ UK LTD, Cannock (UK)	1	100.0	172	15
35	OOO DEUTZ, Moscow (Russia)[7]	1	100.0	–	–

1) Equity and net income in accordance with the annual financial statements prepared for consolidation purposes.
2) Profit-and-loss transfer agreement with DEUTZ AG.
3) Consolidated using the equity method.
4) Figures as at 30 November 2017.
5) Figures as at 31 December 2016.
6) Figures as at 31 March 2017 measured using exchange rate as at 31 December 2017.
7) Closed on 26 May 2017.
8) Proportion of net income for the year since the acquisition on 1 October 2017.

SUPERVISORY BOARD

Hans-Georg Härter
Chairman
Proprietor of HGH-Consulting

a) Knorr-Bremse AG, Munich, Germany

b) Unterfränkische Überlandzentrale Lülsfeld eG, Lülsfeld, Germany
Klingelnberg AG, Zurich, Switzerland
Faurecia S.A., Paris, France
Bain Capital L.P., Boston, USA

Werner Scherer[1)]
Deputy Chairman
Chairman of the Cologne Works Council and of the General Works Council of DEUTZ AG, Cologne, Germany

Sabine Beutert[1)]
Trade Union Secretary, IG Metall Administrative Office, Cologne-Leverkusen, Cologne, Germany

Gisela Füssel[1)]
Member of DEUTZ AG Works Council

Hans-Peter Finken[1)]
Member of DEUTZ AG Works Council

Dr Ing Hermann Garbers
Management consultant

Gerhard Gehweiler[1)]
(since 1 June 2017)
Senior manager representative, DEUTZ AG, Cologne, Germany
Head of Purchasing at DEUTZ AG, Cologne, Germany

Göran Gummeson
Senior management consultant

b) European Furniture Group AB, Tranås, Sweden
Nimbus Boats AB, Gothenburg, Sweden
Clean Oil Technology AB, Anderstorp, Sweden
German-Swedish Chamber of Commerce, Stockholm, Sweden

Leif Peter Karlsten
CEO of Confiar AB, Gothenburg, Sweden

b) Bulten AB, Gothenburg, Sweden
Prevas AB, Vasteras, Sweden
Alelion Energy System AB, Gothenburg, Sweden
Holmbergs Safety Systems AB, Halmstad, Sweden
ReFinance AB, Sweden

Herbert Kauffmann
Management consultant

a) adidas AG, Herzogenaurach, Germany

Alois Ludwig
Management consultant

b) CARAT Systementwicklung- und Marketing GmbH & Co. KG, Mannheim, Germany

Dr Witich Roßmann[1)]
Chief Executive of IG Metall Cologne-Leverkusen, Cologne, Germany (until 30 September 2017)

Dr Herbert Vossel[1)]
(until 31 May 2017)
Senior manager representative, DEUTZ AG, Cologne, Germany
Head of Legal at DEUTZ AG, Cologne, Germany

[1)] Employee representative on the Supervisory Board.
a) Membership of statutory German supervisory boards within the meaning of section 125 AktG.
b) Membership of comparable German or international supervisory bodies within the meaning of section 125 AktG.

SUPERVISORY BOARD COMMITTEES

HUMAN RESOURCES COMMITTEE

Hans-Georg Härter, Chairman
Werner Scherer, Deputy Chairman
Herbert Kauffmann

AUDIT COMMITTEE

Herbert Kauffmann, Chairman
Werner Scherer, Deputy Chairman
Sabine Beutert
Hans-Georg Härter

ARBITRATION COMMITTEE (SECTION 27 (3) OF THE GERMAN CODETERMINATION ACT (MITBESTG))

Hans-Georg Härter, Chairman
Gisela Füssel
Herbert Kauffmann
Werner Scherer

NOMINATIONS COMMITTEE

Hans-Georg Härter, Chairman
Göran Gummeson
Herbert Kauffmann

BOARD OF MANAGEMENT

Dr Ing Frank Hiller (51)
Chairman
Technical and head-office functions

b) DEUTZ Corporation, Atlanta, USA, Chairman
DEUTZ (Dalian) Engine Co., Ltd., Dalian, China, Deputy Chairman

Dr Margarete Haase (64)
Finance, human resources, purchasing and information services

a) Fraport AG, Frankfurt am Main, Germany
ZF Friedrichshafen AG, Friedrichshafen, Germany
ING Groep N.V., ING Bank N.V., Amsterdam, Netherlands (elected April 2017, will take up her post in 2018)

b) DEUTZ (Dalian) Engine Co. Ltd., Dalian, China
DEUTZ Engine (Shandong) Co., Ltd., Linyi, China, Chairwoman

Michael Wellenzohn (51)
Sales, marketing and service

b) DEUTZ ASIA PACIFIC (PTE) LTD., Singapore, Singapore
DEUTZ Corporation, Atlanta, USA
DEUTZ (Dalian) Engine Co., Ltd., Dalian, China

a) Membership of statutory German supervisory boards within the meaning of section 125 AktG.
b) Membership of comparable German or international supervisory bodies within the meaning of section 125 AktG.

ANNUAL FINANCIAL STATEMENTS IN ACCORDANCE WITH THE GERMAN COMMERCIAL CODE (HGB)

BALANCE SHEET OF DEUTZ AG

€ million

Assets	**31 Dec 2017**	31 Dec 2016
Intangible assets	39.8	16.3
Property, plant and equipment	238.0	243.2
Investments	294.8	234.9
Non-current assets	**572.6**	**494.4**
Inventories	169.6	153.3
Receivables and other assets	186.9	176.0
Cash and cash equivalents	128.0	80.8
Current assets	**484.5**	**410.1**
Prepaid expenses	1.4	1.6
Deferred tax assets	85.1	83.7
Total assets	**1,143.6**	**989.8**

Equity and liabilities		
Issued capital	309.0	309.0
Additional paid-in capital	26.8	26.8
Retained earnings		
Legal reserve	4.5	4.5
Other retained earnings	216.9	152.9
Accumulated income	71.8	15.6
Equity	**629.0**	**508.8**
Provisions	260.6	254.3
Other liabilities	253.5	226.2
Deferred income	0.5	0.5
Total equity and liabilities	**1,143.6**	**989.8**

INCOME STATEMENT OF DEUTZ AG

€ million

	2017	2016
Revenue	**1,356.0**	**1,151.8**
Cost of sales	–1,171.5	–998.3
Gross profit	**184.5**	**153.5**
Research and development costs	–60.3	–45.0
Selling expenses	–44.9	–41.3
General and administrative expenses	–29.6	–28.0
Other operating income	145.5	37.7
Other operating expenses	–55.4	–21.4
thereof expenses pursuant to art. 67 (1) and (2) of the Introductory Act to the HGB (EGHGB)	*–2.3*	*–2.3*
Net investment income	15.5	4.4
Interest expenses, net	–6.8	–5.7
Write-downs of investments	–0.5	–
Income taxes	–16.7	–8.6
Profit after income taxes	**131.3**	**45.6**
Other taxes	–2.6	–0.5
Net income	**128.7**	**45.1**
Profit carried forward	15.6	9.0
Dividend payments to shareholders	–8.5	–8.5
Additions to other retained earnings	–64.0	–30.0
Accumulated income	**71.8**	**15.6**

RESPONSIBILITY STATEMENT

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

Cologne, 19 February 2018

DEUTZ Aktiengesellschaft
The Board of Management

Dr Ing Frank Hiller

Dr Margarete Haase

Michael Wellenzohn

INDEPENDENT AUDITOR'S REPORT

To DEUTZ Aktiengesellschaft, Cologne

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS AND OF THE GROUP MANAGEMENT REPORT

AUDIT OPINIONS

We have audited the consolidated financial statements of DEUTZ Aktiengesellschaft, Cologne, and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated statement of comprehensive income, consolidated statement of profit or loss, consolidated statement of changes in equity and consolidated statement of cash flows for the financial year from 1 January to 31 December 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of DEUTZ Aktiengesellschaft, Cologne, which is combined with the Company's management report, for the financial year from 1 January to 31 December 2017. We have not audited the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § [Article] 315e Abs. [paragraph] 1 HGB [Handelsgesetzbuch: German Commercial Code] and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as at 31 December 2017, and of its financial performance for the financial year from 1 January to 31 December 2017, and

- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the group management report does not cover the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

Pursuant to § 322 Abs. 3 Satz [sentence] 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

BASIS FOR THE AUDIT OPINIONS

We conducted our audit of the consolidated financial statements and of the group management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the consolidated financial statements and on the group management report.

KEY AUDIT MATTERS IN THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January to 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matters of most significance in our audit were as follows:

1) Accounting treatment of internally generated intangible assets

2) Sale of properties in Cologne-Deutz

3) Company acquisitions

Our presentation of these key audit matters has been structured in each case as follows:

1) Matter and issue

2) Audit approach and findings

3) Reference to further information

Hereinafter we present the key audit matters:

1) ACCOUNTING TREATMENT OF INTERNALLY GENERATED INTANGIBLE ASSETS

1) In the consolidated financial statements of the Company expenses for the development of new technologies – in particular the development of new engine series – amounting to EUR 114.9 million (9.5% of consolidated total assets) are reported under the "Intangible assets" balance sheet item. Development costs are capitalized based on milestones within the development process that are defined by the Company. The assets are generally subject to amortization on a straight-line basis over the expected production cycle of eight to ten years.

At each balance sheet date a test is performed to determine whether there are indications that an asset may be impaired. An impairment test is carried out at least once a year for intangible assets that are not yet available for use. Impairments are calculated by comparing the carrying amount against the recoverable amount. The recoverable amount of an asset is either the fair value of an asset or a cash-generating unit, less costs to sell, and the value in use, whichever is higher. For the purposes of the impairment test, assets are grouped, at the lowest level that makes sense, into cash-generating units for which cash inflows can be identified largely independently. In order to calculate the value in use, the expected future cash flows are discounted to their present values using a discount rate that reflects the current market expectations regarding the interest rate effect and the specific risks associated with the asset or cash-generating unit.

The valuations are based on model calculations that take into account the projections, with a finite planning period, and the corresponding carrying amounts as of 31 December 2017. These projections were also used to prepare the Group's medium-term plan prepared by the executive directors and adopted by the Supervisory Board. The financial surpluses are discounted using the weighted cost of capital of the respective asset or the respective cash-generating unit.

The impairment test identified impairment losses that had to be recognized on series 5.0 in the amount of EUR 8.8 million in total.

The outcome of this valuation is dependent to a large extent on the estimates made by the executive directors with respect to the future cash inflows from the respective assets or cash-generating units, the discount rate used, and other assumptions, and is therefore subject to considerable uncertainty. Against this background and due to the complexity of the valuation, this matter was of particular significance in the context of our audit.

2) For the purposes of our audit, we first of all asked for the development process to be explained to us and assessed adherence to the requirements for capitalizing development costs based on milestones that had been reached.

We also evaluated the procedures for identifying and assessing issues and developments, which could result in an impairment of the intangible assets, including the controls established. In a further step, we assessed, among other things, the method used for performing impairment tests and assessed the assumptions and parameters used to determine whether they form an appropriate basis for impairment testing on internally generated intangible assets performed by the Company's executive directors on the whole. After matching the future cash inflows used for the calculation against the model calculations and the adopted medium-term business plan of the Group, we assessed the appropriateness of the calculation, in particular by reconciling it with general and sector-specific market expectations.

In the knowledge that even relatively small changes in the discount rate applied can have a material impact on the value calculated using this method, we focused our testing in particular on the parameters used to determine the discount rate applied, and evaluated the measurement model. We performed sensitivity analyses on an ad hoc basis in order to reflect the uncertainty inherent in the projections. Overall, the measurement parameters and assumptions used by the executive directors are in line with our expectations and are also within the ranges considered by us to be reasonable.

3) The Company's disclosures on the internally generated intangible assets are contained in sections "Accounting policies" and "Notes to the balance sheet" in the notes to the consolidated financial statements.

2) SALE OF PROPERTIES IN COLOGNE-DEUTZ

1) In financial year 2017, DEUTZ Aktiengesellschaft, Cologne, entered into a notarized purchase agreement with GERCHGROUP AG, Düsseldorf, dated 3 May 2017 on various properties in Cologne-DEUTZ that were previously used for operational purposes. GERCHGROUP AG acquired these properties via 21 project companies. The benefits and encumbrances pass to the buyer on the day following full payment of the first two purchase price installments (fixed installments). The purchase price is split into fixed installments and a variable installment that depends on the actual development plan for the affected properties. The variable installment was not included in the calculation of the consideration, because its amount could not be determined reliably. Disposal gains of EUR 114.6 million were realized in the consolidated financial statements as of 31 December 2017 within this context and are reported under other operating income.

In our view, this matter was of particular significance during our audit due to the complexity of the underlying purchase agreement regarding the realization of the disposal gains and the overall material impact of the sale in terms of its amount on the net assets, financial position and results of operations of the Group.

2) For the purposes of our audit and in order to evaluate the proper accounting treatment of the sale, we first of all acquired an understanding of the provisions of the underlying notarized purchase agreement and its impact on the consolidated financial statements. We also examined and assessed the realization of the disposal gains and the presentation of the transaction in the Company's financial accounts. Within this context, we also assessed the disposal entries made by the Company against its property, plant and equipment. We were able to satisfy ourselves that the sale of the properties was appropriately reported in the balance sheet.

3) The Company's disclosures on the sale of the properties are contained in section "Notes to the income statement" in the notes to the consolidated financial statements.

3) COMPANY ACQUISITIONS

1) During the financial year, DEUTZ Aktiengesellschaft, Cologne, acquired all of the shares in Torqeedo GmbH, Gilching and its subsidiaries Torqeedo Inc., Crystal Lake/USA and Torqeedo Asia-Pacific Ltd., Bangkok/Thailand. It also acquired all of the shares in IML Motori S.r.l., Milan/Italy and its subsidiary IML Service S.r.l., Milan/Italy, as well as 75% of the shares in IML Motoare, Galati/Romania. The purchase price for the company acquisitions came to EUR 73.9 million and EUR 11.4 million respectively. The acquired assets and liabilities are generally recognized at fair value as of the acquisition date. After taking into account the share of the net assets acquired attributable to DEUTZ AG of EUR 26.2 million and EUR 11.1 million respectively, the resulting purchased goodwill amounts to EUR 47.7 million and EUR 0.3 million respectively. In view of the material impact of the overall amounts involved in the acquisitions on the net assets, financial position and results of operations of the DEUTZ Group, and given the complexity of measuring the acquisitions, they were of particular importance in the context of our audit.

2) In reviewing the accounting treatment of the company acquisitions we initially inspected and reviewed the respective contractual agreements underlying the company acquisitions and reconciled the purchase prices paid as consideration for the shares received with the supporting payment documentation provided to us. We assessed the opening balance sheets underlying the aforementioned company acquisitions. We assessed fair values that were measured centrally (e.g., fair values of customer relationships) by reconciling quantity analyses with the original financial accounting records and the parameters used. We also used checklists to establish whether the requirements set out in IFRS 3 for disclosures in the notes to the financial statements had been complied with in full. Based on the procedures performed and the information available, we were able to satisfy ourselves that the acquisition of the respective shares is properly presented.

3) The Company's disclosures on the company acquisitions are contained in section "Company acquisitions" of the notes to the consolidated financial statements.

OTHER INFORMATION

The executive directors are responsible for the other information. The other information comprises the following non-audited parts of the group management report:

- the statement on corporate governance pursuant to § 289f HGB and § 315d HGB included in the group management report
- the corporate governance report pursuant to No. 3.10 of the German Corporate Governance Code
- the separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB

The other information comprises further the remaining parts of the annual report – excluding cross-references to external information – with the exception of the audited consolidated financial statements, the audited group management report and our auditor's report.

Our audit opinions on the consolidated financial statements and on the group management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or

- otherwise appears to be materially misstated.

RESPONSIBILITIES OF THE EXECUTIVE DIRECTORS AND THE SUPERVISORY BOARD FOR THE CONSOLIDATED FINANCIAL STATEMENTS AND THE GROUP MANAGEMENT REPORT

The executive directors are responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS AND OF THE GROUP MANAGEMENT REPORT

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems.

- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.

- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on 4 May 2017. We were engaged by the supervisory board on 2 November 2017. We have been the group auditor of the DEUTZ Aktiengesellschaft, Cologne, without interruption since the financial year 2014.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Bernd Boritzki.

Cologne, 8 March 2018

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Bernd Boritzki
Wirtschaftsprüfer

ppa. Gerd Tolls
Wirtschaftsprüfer

REPORT OF THE SUPERVISORY BOARD

CLOSE COOPERATION BETWEEN SUPERVISORY BOARD AND BOARD OF MANAGEMENT

In 2017, the Supervisory Board of DEUTZ AG continued its ongoing monitoring of the management of the business in accordance with the requirements of the German Stock Corporation Act (AktG) and the German Corporate Governance Code and provided advice to the Board of Management on key decisions. The Supervisory Board was directly involved in all material decisions taken by the Board of Management. In particular, the Board of Management coordinated closely with the Supervisory Board on the Company's corporate strategy.

Four ordinary and two extraordinary meetings of the Supervisory Board were held in 2017. Apologies for absence were received from one member for the meetings on 9 March 2017 and 26 July 2017; all members of the Supervisory Board participated in all the other meetings in 2017.

At each of the ordinary meetings of the Supervisory Board, the Board of Management reported on the general economic, market and competitive environment for the DEUTZ Group, presented a business update and sales report that included detailed information on the actual performance of the business over the immediately preceding period, submitted an up-to-date risk report, provided information on key operational issues and offered an overview of the results forecast for the year as a whole. These reports were made on the basis of the key performance indicators that were already familiar to the Supervisory Board members from the Company's written monthly reports. These key performance indicators included new orders, orders on hand, revenue, unit sales, EBIT, research and development expenditure, capital expenditure, working capital, quality data and headcount data, in each case compared against the prior-year figures and budget. Reports from the Human Resources and Audit Committees presented by their chairperson were also a regular item on the agenda of the Supervisory Board meetings.

FOCUS OF SUPERVISORY BOARD DELIBERATIONS

The deliberations and discussions of the Supervisory Board in the year under review focused on the current business position and risk situation of the DEUTZ Group as well as on the operational and strategic development of the business. Particular attention was paid to the acquisition of Torqeedo GmbH, the alliance with Liebherr, the development of new business and the steps to bring about lasting quality improvements.

Other key decisions concerned the 2018 budget, the medium-term planning up to 2022 and the approval of capital expenditure and development projects. As is the case every year, the Supervisory Board also adopted resolutions concerning the achievement of targets by the Board of Management – and consequently its variable remuneration for the previous year – as well as the setting of its targets for the current year and its medium-term targets.

The Board of Management ensured that it provided the Supervisory Board with comprehensive, regular and timely information at all times. Between meetings, the Board of Management informed the members of the Supervisory Board in writing about all important events. In addition, the chairman of the Supervisory Board and the chairman of the Board of Management remained in close and regular contact to discuss all important transactions, imminent decisions and optimisation measures. All the decisions that the Supervisory Board was required to take in accordance with the law and Statutes were taken on the basis of the reports and draft resolutions submitted by the Board of Management and, where necessary, following preparation by the relevant committees of the Supervisory Board.

COMPOSITION OF THE BOARD OF MANAGEMENT

On 22 September 2016, the Supervisory Board had appointed Dr Frank Hiller as a member and the Chairman of the Board of Management with effect from 1 January 2017 for a term of five years up to 31 December 2021. At the Supervisory Board meeting on 8 December 2017, following preparatory work by the Human Resources Committee, the Supervisory Board appointed Dr Andreas Strecker as a member of the Board of Management and as the Company's Human Resources Director for the period from 1 March 2018 to 28 February 2021. He succeeds Dr Margarete Haase, whose term of appointment continues until 30 April 2018. The Supervisory Board would like to thank Dr Haase for her very successful work. By means of a resolution dated 31 January 2018, following preparatory work by the Human Resources Committee, the Supervisory Board extended Mr Wellenzohn's appointment by five years for the period from 1 January 2019 to 31 December 2023.

CORPORATE GOVERNANCE: DECLARATION OF CONFORMITY WITH FOUR EXCEPTIONS

At its meeting on 21 September 2017, the Supervisory Board also held in-depth discussions on the German Corporate Governance Code as amended on 7 February 2017 and, together with the Board of Management, issued a declaration of conformity pursuant to section 161 AktG. This declaration includes just four variances from the Code and since 22 September 2017 has been available in the 'Investor Relations/ Corporate Governance' section of the Company's website at www.deutz.com, where it can be downloaded.

Hans-Georg Härter
Chairman of the Supervisory Board

MATTERS HANDLED EFFICIENTLY BY FOUR COMMITTEES

The Supervisory Board has created four committees to enable it to perform its duties effectively. These committees prepare various topics and resolutions for the full Supervisory Board. Details of all members of the Supervisory Board and its committees, as well as other directorships held by its members, are shown separately on pages 140 to 141 of this annual report.

The Human Resources Committee makes preparations for all Supervisory Board decisions concerning the appointment of members of the Board of Management and their contracts of employment, including the remuneration specified therein, and all issues arising in this connection. The committee met on six occasions in 2017. Among the main matters addressed were the preparation of the resolutions to be adopted by the full Supervisory Board in relation to Dr Strecker succeeding Dr Haase on the Board of Management, to the achievement of the Board of Management's targets for 2016 and to the setting of Board of Management targets, including medium-term targets, for 2017.

The work of the Audit Committee in the year under review focused on monitoring the financial accounting process, on assessing the annual and consolidated financial statements and the combined management report of DEUTZ AG and the Group for 2016 and the corresponding auditors' reports, the condensed consolidated financial statements for the six months to 30 June 2017 and their review by the auditors, the interim management statements for the periods ended 31 March and 30 September 2017, and the discussion of the audit engagement for the year ended 31 December 2017, including a review of auditor quality and independence. Other matters addressed by the committee included risk management, compliance, the internal control system, internal audit, strategic planning, key performance indicators as well as the non-financial report that had to be produced for the 2017 financial year for the first time and other obligations resulting from implementation of the CSR directive (2014/95/EU). In 2017, the Audit Committee held four meetings, three of which were also attended by the external auditors.

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

The Nominations Committee is tasked with proposing to the Supervisory Board suitable candidates as shareholder representatives on the Supervisory Board. The Nominations Committee met once in 2017, during which it focused on preparations for the Supervisory Board election to be held in 2018.

The entire Supervisory Board was informed of the outcome of all discussions in the committees and gave its approval to the recommendations for board resolutions submitted by the committees.

ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS AUDITED IN DETAIL AND APPROVED

The annual financial statements of DEUTZ AG prepared by the Board of Management in accordance with the German Commercial Code (HGB), the consolidated financial statements prepared in accordance with International Financial Reporting Standards (IFRS) and the combined management report for DEUTZ AG and the DEUTZ Group, in each case for the year ended 31 December 2017, were audited by PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Cologne, Germany, the auditors appointed by the Annual General Meeting on 4 May 2017. The auditors issued unqualified opinions.

The annual financial statements of DEUTZ AG, the consolidated financial statements, the combined management report, the Board of Management's proposal for the appropriation of profit and the auditors' reports were made available to all members of the Supervisory Board and were examined by the Supervisory Board. The auditors explained their audit findings in detail to the Audit Committee meeting held on 27 February 2018 and to the Supervisory Board meeting held on 8 March 2018 and answered any supplementary questions raised.

The Supervisory Board approved the findings of the auditors' reports on DEUTZ AG and the DEUTZ Group. The conclusive findings of the Supervisory Board's own audit have not led to any reservations about either the annual financial statements or the consolidated financial statements, and the Supervisory Board has therefore approved them. The annual financial statements have thus been adopted. Finally, the Supervisory Board audited the separate combined non-financial report. This was the first time that it was required to fulfil this obligation pursuant to section 171 (1) sentence 4 AktG. It did not identify any issues.

The Supervisory Board also approved the Board of Management's proposal to use the accumulated income reported as at December 31, 2017 to pay a dividend of €0.15 per dividend-bearing share.

COMPOSITION OF THE SUPERVISORY BOARD AND ITS COMMITTEES

The changes in the composition of the Supervisory Board in 2017 are described below.

At the request of the Board of Management, the local court in Cologne on 19 May 2017 appointed Mr Gerhard Gehweiler as an employee representative on the Supervisory Board of DEUTZ AG with effect from 1 June 2017 for the remaining term of the current Supervisory Board membership cycle. The appointment became necessary when Dr Herbert Vossel stepped down from his post with effect from 31 May 2017. The Supervisory Board would like to thank Dr Vossel for his work and valuable contribution.

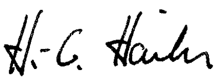
At its meeting on 9 March 2017, the Supervisory Board elected Ms Füssel to succeed Mr Paust as a member of the Arbitration Committee.

CONFLICTS OF INTEREST / INDEPENDENCE OF SUPERVISORY BOARD MEMBERS / THANKS

No conflicts of interest between members of the Supervisory Board and DEUTZ AG arose in the year under review. The current members of the Supervisory Board of DEUTZ AG are all considered independent within the meaning of article 5.4.2 sentence 2 of the German Corporate Governance Code.

The Supervisory Board would like to express its thanks and appreciation to all employees of DEUTZ AG in Germany and abroad, to the elected employee representatives and to the Board of Management for their valuable efforts and the considerable dedication they showed in 2017.

Cologne, March 2018
The Supervisory Board



Hans-Georg Härter
Chairman

CORPORATE GOVERNANCE DECLARATION AND CORPORATE GOVERNANCE REPORT

For DEUTZ, a responsible approach to management that meets the standards of good corporate governance forms the basis for enhancing shareholder value over the long term. This is one of the main reasons why we attach great importance to the implementation of the German Corporate Governance Code (DCGK) and ensure quality and transparency in all key decisions and processes in our Company.

CORPORATE GOVERNANCE DECLARATION PURSUANT TO SECTION 289F HGB

Declaration of conformity with some exceptions

In 2017, the Board of Management and the Supervisory Board once again carefully considered to what extent it was proper and consistent with the Company's objectives for DEUTZ to apply all the guidelines and recommendations of the DCGK. As a result, DEUTZ AG complies with the recommendations of the Code, as amended on 7 February 2017, with the following exceptions:

1. The D&O insurance taken out by DEUTZ AG for the members of the Supervisory Board does not provide for any excess, contrary to article 3.8 (2) and (3) DCGK. In the case of Supervisory Board members, an excess of this type is, as before, not considered an appropriate means of control.

2. There is no age limit at DEUTZ AG for members of either the Board of Management or Supervisory Board, contrary to articles 5.1.2 (2) sentence 3 and 5.4.1 (2) sentence 1 DCGK.

3. Furthermore, there is no general limit on length of membership of the Supervisory Board, contrary to article 5.4.1 (2) sentence 1 DCGK. These exceptions enable DEUTZ AG to retain the option of benefiting from the experience brought to the Company by older members of the Board of Management and Supervisory Board and by long-standing members of the Supervisory Board.

4. DEUTZ AG does not yet have a skills profile for the Supervisory Board, contrary to article 5.4.1 (2) sentence 1 DCGK. The DEUTZ AG Supervisory Board is currently drawing up a skills profile ahead of the Supervisory Board election to be held in 2018.

The current declaration of conformity in accordance with section 161 of the German Stock Corporation Act (AktG), which the Board of Management and Supervisory Board submitted on 21 September 2017, can be accessed in the 'Investor Relations/ Corporate Governance' section of the Company's website at www.deutz.com. Declarations of conformity from previous years can also be viewed and downloaded there.

Composition of the Board of Management and Supervisory Board; composition and operating procedures of Supervisory Board committees

At the time this annual report was published, the Company's Board of Management comprised four members: Dr Frank Hiller (Chairman, technical and head-office functions), Dr Margarete Haase (finance, human resources, purchasing and information services until 31 March 2018; no areas of responsibilities in the subsequent period up to 30 April 2018), Mr Michael Wellenzohn (sales, service and marketing) and Dr Andreas Strecker (no areas of responsibility initially; responsible for finance, human resources, purchasing and information services from 1 April 2018).

At the Supervisory Board meeting on 8 December 2017, following preparatory work by the Human Resources Committee, the Supervisory Board appointed Dr Andreas Strecker as a member of the Board of Management and as the Company's Human Resources Director for the period from 1 March 2018 to 28 February 2021. He succeeds Dr Margarete Haase, whose term of appointment continues until 30 April 2018. The Supervisory Board would like to thank Dr Haase for her very successful work.

By means of a resolution dated 31 January 2018, following preparatory work by the Human Resources Committee, the Supervisory Board extended Mr Wellenzohn's appointment by five years for the period from 1 January 2019 to 31 December 2023.

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

The changes in the composition of the Supervisory Board in 2017 are as follows:

At the request of the Board of Management, the local court in Cologne on 19 May 2017 appointed Mr Gerhard Gehweiler as an employee representative on the Supervisory Board of DEUTZ AG with effect from 1 June 2017 for the remaining term of the current Supervisory Board membership cycle. The appointment became necessary when Dr Herbert Vossel stepped down from his post with effect from 31 May 2017.

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

The Human Resources Committee makes preparations for all Supervisory Board decisions concerning the appointment of members of the Board of Management and their contracts of employment, including the remuneration specified therein, and all issues arising in this connection. The committee met on six occasions in 2017. Among the main matters addressed were the preparation of the resolutions to be adopted by the full Supervisory Board in relation to Dr Strecker succeeding Dr Haase on the Board of Management, to the achievement of the Board of Management's targets for 2016 and to the setting of Board of Management targets, including medium-term targets, for 2017.

The work of the Audit Committee in the year under review focused on monitoring the financial accounting process, on assessing the annual and consolidated financial statements and the combined management report of DEUTZ AG and the Group for 2016 and the corresponding auditors' reports, the condensed consolidated financial statements for the six months to 30 June 2017 and their review by the auditors and the interim management statements for the periods ended 31 March and 30 September 2017, and on discussing the audit engagement for the year ended 31 December 2017, including a review of auditor quality and independence. Other matters addressed by the committee included risk management, compliance, the internal control system, internal audit, strategic planning, key performance indicators as well as the non-financial report that had to be produced for the 2017 financial year for the first time and other obligations resulting from implementation of the CSR directive (2014/95/EU). In 2017, the Audit Committee held four meetings, three of which were also attended by the external auditors.

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

The Nominations Committee is tasked with proposing to the Supervisory Board suitable candidates as shareholder representatives on the Supervisory Board. The Nominations Committee met once in 2017, during which it focused on preparations for the Supervisory Board election to be held in 2018.

The entire Supervisory Board was informed of the outcome of all discussions in the committees and gave its approval to the recommendations for board resolutions submitted by the committees.

The composition of the Supervisory Board committees changed as follows in 2017: at its meeting on 9 March 2017, the Supervisory Board elected Ms Füssel to succeed Mr Paust as a member of the Arbitration Committee.

Details of all members of the Supervisory Board and its committees, as well as other directorships held by its members, are shown separately on pages 140 and 141.

Targets and timeframes in accordance with sections 76 (4), 111 (5) AktG

On 21 August 2017, the Board of Management of DEUTZ AG set certain targets and timeframes in accordance with section 76 (4) AktG. The proportion of women employed by DEUTZ AG at the top level of senior management below the Board of Management is to be increased to 13 per cent by 30 June 2022. The proportion of women at the second level of senior management below the Board of Management is to be increased to 7 per cent over the same period. The top level of senior management below the Board of Management encompasses all managers in Germany who report directly to a member of the Board of Management. The second level of senior management below the Board of Management comprises all managers in Germany who report directly to a manager in the top level of senior management.

To ensure that women are taken into consideration for vacant managerial positions, DEUTZ AG has adopted a staff development programme. When positions in the top and second levels of senior management below the Board of Management become available, the Board of Management and the HR department are striving to ensure that at least one woman is always shortlisted for the post (article 4.1.5 DCGK). This means that external recruitment must focus on female managers.

At the time of publication, the proportion of women in the top level of senior management below the Board of Management is 5.9 per cent and in the second level of senior management below the Board of Management 8.2 per cent. DEUTZ AG thus attained the aforementioned target for the second level of senior management. It did not achieve the target for the first level of senior management because only very few management positions have been newly filled since the Board of Management set the targets on 21 August 2017. Furthermore, it remains the case that women continue to be under-represented in the scientific and technical degree courses that are of particular relevance to DEUTZ AG.

At its meeting on 21 September 2017, the Supervisory Board of DEUTZ AG set the following target in accordance with section 111 (5) AktG: on 30 June 2022, the members of the Board of Management of DEUTZ AG should still include at least one woman.

Disclosures regarding compliance with the statutory quotas for women and men on the Supervisory Board

In accordance with the Law for the equal participation of women and men in managerial positions in the private and public sectors (law on the quota for women), the Supervisory Board of DEUTZ AG must have at least four female members and four male members after the elections scheduled for 2018, if not before.

At the time this law came into effect on 1 January 2016, the Supervisory Board of DEUTZ AG comprised eleven men and one woman. Since 1 June 2016, following the appointment of Ms Füssel to succeed Mr Paust, it has had ten male members and two female members.

As both women are employee representatives, and the Supervisory Board decided that the minimum quota has to be met separately for shareholder and employee representatives, the employee representatives are already in compliance with the statutory quota.

This is not currently the case for the shareholder representatives, as it has not been necessary to appoint new shareholder representatives to the Supervisory Board since the law on the quota for women came into effect.

Description of the diversity concept for the composition of the Board of Management and Supervisory Board

DEUTZ AG currently does not have a diversity concept in place for the composition of its Board of Management and Supervisory Board beyond those targets outlined in this declaration and in the corporate governance report. Discussions are taking place about whether a detailed diversity concept should be drawn up.

Disclosures relevant to corporate management practices: compliance management system, environmental and quality management, energy management

DEUTZ AG has a compliance management system that is firmly anchored in the Company's organisational structure. The system is continually enhanced in order to meet changing requirements. Dr Hiller is the member of the Board of Management responsible for compliance.

The overriding objective of the compliance management system is to use preventive measures to ensure that the business practices of DEUTZ AG and the internal regulations and policies are known across the Group. This is primarily achieved through a structured policy management system in which existing policies are reviewed on an ongoing basis to see if they need updating and new policies are published. The policy management system is based on the code of conduct, which provides a framework for ensuring that behaviour towards business partners and employees is fair and in compliance with the law. Employees can access the code of conduct via the internal communications platform. Third parties can view the code of conduct on the DEUTZ AG website. The guidelines set out in the code of conduct are formalised in specific policies, including a zero-tolerance policy, a policy on gifts and entertainment, a policy on engaging external sales service providers, an anti-money laundering policy and an insider trading policy, that help to ensure that employees are aware of the relevant laws and policies and are able to apply them correctly.

The Board of Management supports and promotes ethical conduct. It is unreservedly committed to corporate compliance and declines to be involved in any transactions that are inconsistent with these values. The Board of Management does not tolerate any form of corruption and is fully committed to compliance with competition law and to incorporating the notion of sustainability into the Company's activities.

Training is intended to ensure that employees are aware of the relevant laws and corporate policies, and that they comply with them at all times in their day-to-day work. Salaried staff in the head-office sales, purchasing, research and development and administration units, as well as in the subsidiaries, generally receive annual training sessions that are specifically tailored to their areas of activity. In the production plants, compliance training takes place in conjunction with the regular safety training.

A Compliance Officer appointed by the Board of Management coordinates compliance activities at DEUTZ AG. The individual business units and subsidiaries have their own compliance coordinators, who are responsible for compliance in their organisations and submit regular structured reports in writing to the Compliance Officer, who in turn reports to the Board of Management and Audit Committee. The basic principles of the compliance organisation are described in rules of procedure. The duties of the relevant employees are set out in job descriptions.

Employees can supply information or direct questions to line managers, compliance coordinators, the Compliance Officer or the managers responsible for the legal affairs or internal audit units. Furthermore, since the beginning of 2017, the DEUTZ AG website has featured a whistleblowing system that can also be accessed by non-employees. Any information supplied is rigorously followed up. Any necessary investigations are carried out by internal audit, with external support if required.

Regular meetings are held to develop, discuss and coordinate compliance initiatives. These activities focus on preventing corruption, tackling money laundering and complying with export regulations (including export controls). They also ensure safety in the workplace, IT & data security, corporate security and product safety. A further aim is to prevent breaches of environmental, antitrust and insider trading laws.

As and when needed, the Board of Management and the Compliance Officer take legal advice on establishing and continuously improving the compliance management system. In 2017, the compliance system was reviewed with assistance from an external consultancy in order to gather information for the system's future refinement. The internal audit department reviews the activities, and the Audit Committee monitors them on behalf of the Supervisory Board.

Compliance activities during the year under review again centred on the continuation and stepping up of regular staff training (including for staff at affiliated companies abroad), focusing on the code of conduct, money laundering, gifts, commission, export controls, competition law and contract law. A further focus was the delivery of training courses via a web-based e-learning programme, which featured modules on antitrust law, data security and prevention of corruption.

In 2017, almost 1,100 employees took part in classroom-based training and around 1,800 employees successfully completed all or individual modules of the e-learning programme.

As part of the ongoing review of our organisational policies, we revised the policy on inhouse continuing professional development and the policy on conformity rules for engines destined for the EU or US market.

Another essential element of corporate management at DEUTZ AG is rigorous environmental, quality and energy management. In the year under review, DEUTZ AG continued to satisfy the quality management requirements in accordance with ISO 9001, the environmental management requirements in accordance with ISO 14001 and the energy management requirements in accordance with ISO 50001. The relevant certificates from TÜV Rheinland can be found on the DEUTZ website.

All standards set by the Deutsches Institut für Normung e.V., Berlin (DIN) can be inspected free of charge at DIN standards repositories.

CORPORATE GOVERNANCE REPORT

Basic principles and objectives of the composition of the Supervisory Board; particularly, conflicts of interest/ independence of Supervisory Board members and the consideration of women

The Supervisory Board re-drafted the specific objectives regarding its composition in accordance with articles 5.4.1 (1) and (2), 5.4.2 DCGK at its meeting held on 24 September 2015. The new version is as follows:

"The Supervisory Board must be composed in such a way that its members as a group possess the knowledge, ability and expert experience required to properly complete its tasks. In particular, the following applies:

a) Internationality

To reflect the international nature of the Company's activities, at least two Supervisory Board members shall have several years' experience of international business – preferably acquired abroad.

b) Potential conflicts of interest

The composition of the Supervisory Board shall also take account of potential conflicts of interest of its members.

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

Supervisory Board members shall not be directors of major competitors of DEUTZ AG.

c) Number of independent Supervisory Board members

The Supervisory Board is limiting its target concerning this aspect to the shareholder representatives. It considers this group to have an adequate number of independent members if the number of independent members equals the number of members who are not independent, i.e. at least three.

d) Standard age limit

At DEUTZ AG, there is no age limit for Supervisory Board members or for Board of Management members. Nor is there a standard limit on length of membership of the Supervisory Board. This is because DEUTZ AG wants to retain the option of benefiting from the experience brought to the Company by older members of the Board of Management and Supervisory Board and/or long-serving members of the Supervisory Board.

e) Diversity/proportion of women on the Supervisory Board

The Supervisory Board shall primarily take the appropriate skills of its members, and also its diversity, into consideration when deciding on its composition. The Supervisory Board welcomes the fact that the law for the equal participation of women and men in managerial positions in the private and public sectors has now come into force and that, as a consequence, the Supervisory Board will have at least four women members after the elections marking the start of the next membership cycle in 2018, if not before."

Except for the target relating to female representation, the Supervisory Board has continuously met these objectives since 2012. It has even exceeded them in cases such as the international experience available on the Supervisory Board and the number of independent members. The current members of the Supervisory Board are all considered independent within the meaning of article 5.4.2 sentence 2 DCGK. No conflicts of interest between members of the Supervisory Board and DEUTZ AG arose in the year under review.

Consideration of women when making appointments to the Board of Management

At the time this annual report was published, the Board of Management of DEUTZ AG had four members, one of whom is female. This equates to a ratio of 25 per cent.

Responsible risk management

A forward-looking, prudent and responsible approach to corporate risks is a core aspect of good corporate governance and forms the basis for the risk management system at DEUTZ. The Board of Management regularly notifies the Supervisory Board of any existing or anticipated risks. Details of the DEUTZ Group's risk management systems can be found in the risk report on pages 59 to 63.

Comprehensive transparency and active investor relations

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

We achieve this objective by using various media. DEUTZ AG reports on the performance and development of its business and on significant changes and events four times a year in its interim management statements, half-year report and annual report. The interim management statements and half-year reports are published within 45 days of the end of a reporting period; the annual report is published within 90 days of the end of the financial year. The Company maintains constant contact with investors and analysts through its regular investor relations activities. In addition to the annual analysts' meeting held when the Company's consolidated financial statements are published, conference calls for analysts and institutional investors also take place when the interim management statements and half-year report are published. The Annual General Meeting is usually held in the first five months of the year; shareholders who do not attend the AGM in person can instruct proxies to vote on their behalf.

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

Accounting and auditing

DEUTZ AG's consolidated financial statements are prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The consolidated financial statements are prepared by the Board of Management and reviewed by the auditors.

The auditors have agreed to inform the chairman of the Supervisory Board or the chairman of the Audit Committee without delay if grounds for disqualification or release of the auditors, or any misrepresentations in the declaration of conformity, come to light during the audit. The auditors inform the chairman of the Supervisory Board without delay of any issues or incidents relevant to the role of the Supervisory Board that arise during the audit of financial statements.

Conflicts of interest and consultancy agreements

Information about conflicts of interests in relation to Supervisory Board members can be found under 'Basic principles and objectives of the composition of the Supervisory Board' at the start of this corporate governance report.

The Company does not have any consultancy agreements with members of the Supervisory Board.

The members of the Board of Management must disclose any conflicts of interest to the Supervisory Board. The Supervisory Board then reports these cases, along with any conflicts of interest relating to its own members, to the Annual General Meeting.

Remuneration report

The remuneration of the Board of Management complies with the German Act on the Appropriateness of Management Board Remuneration (VorstAG) and DCGK recommendations.

A description of the main features of the remuneration systems for the Board of Management and Supervisory Board, along with details of the remuneration for each member, can be found in the remuneration report on pages 55 to 58 of the combined management report.

Dealings subject to reporting requirements

Section 15a of the German Securities Trading Act (WpHG) and (since mid-2016) article 19 of the Market Abuse Regulation (MAR) state that persons with executive functions or persons with whom they are closely associated must notify both the company and the German Federal Financial Supervisory Authority (BaFin) of their own dealings in shares of the company or in financial instruments of the company based on such shares.

In 2017, Dr Hiller and Mr Wellenzohn disclosed the purchase of DEUTZ shares in accordance with section 15a WpHG. No other persons required to make such a disclosure did so before the adoption of the 2017 annual financial statements. Transactions disclosed in previous years are published on the DEUTZ AG website.

GLOSSARY

Benchmark The performance of a particular index that provides a basis of comparison for the performance of a fund.

Biogenic fuel Liquid or gaseous fuel produced from biomass.

Captive market/segment Market segment in which original equipment and commercial vehicle manufacturers have their own engine production facilities to meet their engine needs. Consequently, the captive market is not generally accessible to independent engine manufacturers.

Cash flow statement Shows the Group's inflows and outflows of cash over the financial year. It distinguishes between cash flow from operating activities, cash flow from investing activities and cash flow from financing activities. It also shows the change in cash and cash equivalents.

Compliance Denotes the entirety of measures taken by a company to comply with laws, regulations and directives and also to comply with contractual obligations and self-imposed obligations. Compliance is a key element of corporate governance.

Compressed natural gas (CNG) Unlike liquefied natural gas (LNG), this natural gas is always gaseous.

Corporate citizenship Denotes a company's corporate social responsibility activities.

Corporate governance Responsible management and control of a company with a view to long-term value creation and increasing shareholder value.

DC-to-DC converter A power converter, also known as a DC-to-DC converter, steps up, steps down or inverts an input voltage.

Deferred taxes Differences between the calculation of profit under tax law and under IAS result in differing tax calculations. These differences in the amount of tax are recognised on the balance sheet as deferred tax assets or liabilities.

DIN EN ISO 9001 (Deutsches Institut für Normung – European Norm – International Organization for Standardization – 9001) A German, European and international industrial standard for environmental management.

Diversity Acceptance of the differences between individual employees, which – when embedded in a tolerant corporate culture – can be utilised to boost the success of a company. Employees should not suffer discrimination due to ethnic origin, gender, age, religion, sexual orientation, disability, etc. They should all have equal opportunities.

Downsizing Reduction of technical dimensions (such as weight and capacity) but delivering the same or similar power output.

Earnings per share A key figure calculated by dividing the net income attributable to the shareholders of DEUTZ AG by the average number of shares in issue.

EBIT (earnings before interest and tax) Income from operating activities (before interest and tax).

EU Stage I, II, III A, III B, IV, V Exhaust emissions standard laid down by the European Union for off-road applications. Sets limits for pollutants such as nitrogen oxide, hydrocarbons and soot particulates in exhaust gas.

Exhaust aftertreatment Ensures compliance with statutory emissions limits for pollutants such as nitrogen oxides (NOx) and soot particles through the cleansing of combustion exhaust gases. In vehicles, exhaust aftertreatment is achieved by the use of catalytic converters and diesel particulate filters.

Forward Individually structured, non-exchange-traded forward transaction.

Four-stroke principle The way in which a gasoline engine works. The German word for gasoline engine, Ottomotor, is named after its inventor, Nicolaus August Otto. All four strokes (first stroke: intake; second stroke: compression; third stroke: power; fourth stroke: exhaust) take place in two crankshaft rotations.

Free float The proportion of shares in a public limited company (Aktiengesellschaft) not held by a major shareholder. According to the Deutsche Börse AG definition, shareholdings of less than 5 per cent are classified as free float.

Hedging Countering interest-rate, currency, price or similar risks through the use of derivative financial instruments that limit the risk associated with the underlying transactions.

IMS (integrated management system) Standardised structure bringing together methods and tools for ensuring compliance with requirements in various areas (e.g. quality, environment, health and safety), thereby contributing to corporate governance (i.e. the management and monitoring of a company).

ITAR (International Traffic in Arms Regulations) US rules that conflict with the German General Equal Treatment Act (AGG). The provisions of ITAR are strict and also impact on the recipients of US goods outside the United States.

Liquefied petroleum gas (LPG) A liquefied variable mixture, mainly of butane and propane, that can be used in internal combustion engines.

Long-term incentive (LTI) plan A form of incentive-based remuneration offered to members of the Board of Management and selected senior managers; its purpose is to enable these executives to benefit from the company's long-term success, thereby encouraging them to stay with the company.

Material handling Equipment for moving goods within contained areas, such as airports or factories. Examples include forklift trucks, telehandlers, lifting platforms and ground support equipment.

Non-captive market/segment Market segment in which original equipment and commercial vehicle manufacturers purchase engines from third-party manufacturers to meet their engine needs. The non-captive market is accessible to independent engine manufacturers.

Off-highway applications (off-road) Engine-powered applications whose use on roads is subject to restrictions, e.g. trains, ships, agricultural vehicles and construction vehicles.

OHSAS (Occupational Health and Safety Assessment Series) A standard based very closely on ISO 9001 and ISO 14001. OHSAS 18001 was defined as a UK standard in 2007. It has also become a national standard in Poland. Used in more than 80 countries worldwide, OHSAS 18001 is one of the best known and most important standards for occupational health and safety management systems. Certification for this standard can be obtained.

Onboard voltage Voltage of a vehicle's onboard electrical system. The onboard electrical system comprises all of the electrical components of a vehicle, such as a car, aeroplane, ship or rail vehicle.

Option Contract that, until the expiry date, gives the holder the right to buy – and the writer the obligation to sell – an underlying instrument (a security or a product/commodity) at an exercise price that has been fixed in advance.

Outboards and inboards (outboard and inboard motors) An inboard motor is the main propulsion system on a boat or ship and is installed inside the hull. An outboard motor is a propulsion system for boats consisting of a self-contained unit that includes the engine, power transmission, gearbox and propeller.

Paraffinic diesel fuel A diesel fuel produced through hydrotreatment, i.e. the raw material is chemically converted using hydrogen. It is added to a conventional fuel or replaces it entirely.

Prime Standard The minimum standard set by Deutsche Börse AG for companies looking to raise capital from international investors. These companies have to meet stringent international disclosure requirements. Admission to the Prime Standard is a prerequisite for inclusion in the DAX, MDAX, TecDAX and SDAX indices.

Pushback tractor Tug used to push back aeroplanes.

Rating Used to assess the creditworthiness of a company. It gauges the extent to which the company will be able to repay the principal and interest on its outstanding liabilities at the agreed date.

REACH European Union regulation concerning the registration, evaluation, authorisation and restriction of chemicals.

Return on capital employed (ROCE) Ratio of EBIT to average capital employed. Capital employed: total assets less cash and cash equivalents, trade payables and other current and non-current liabilities, based on average values from two balance sheet dates.

RoHS Directive 2011/65/EU; restricts the use of certain hazardous substances in electrical and electronic equipment.

Soot and particulate filters Devices for reducing the particulates contained in the exhaust gases of diesel engines.

Synthetic fuel Fuel that is produced in a different way to conventional fuels (e.g. diesel, petroleum, kerosene) and is sourced from a raw material other than, for example, crude oil.

US EPA TIER 1, 2, 3, 4 US emissions standard for off-road applications. Sets limits for pollutants such as nitrogen oxide, hydrocarbons and soot particulates in exhaust gas.

Working capital Inventories and trade receivables less trade payables.

Working capital ratio Ratio of working capital (inventories plus trade receivables less trade payables) at the end of the reporting period to revenue for the preceding twelve months.

Xetra Stands for 'Exchange Electronic Trading' and is the name given to the electronic dealing system run by Deutsche Börse AG (also known as screen-based trading).

DEUTZ GROUP: MULTI-YEAR OVERVIEW

€ million

	Continuing operations 2013	Continuing operations 2014	Continuing operations 2015	Continuing operations 2016	**Continuing operations 2017**
New orders	1,649.7	1,379.0	1,225.9	1,261.4	1,556.5
Unit sales (units)	184,028	196,403	137,781	132,539	161,646
DEUTZ Compact Engines	167,964	183,125	125,214	123,179	151,671
DEUTZ Customised Solutions	16,064	13,278	12,567	9,360	8,740
Other					1,235
Revenue	1,453.2	1,530.2	1,247.4	1,260.2	1,479.1
DEUTZ Compact Engines	1,188.8	1,279.9	967.2	1,000.8	1,227.5
DEUTZ Customised Solutions	264.4	250.3	280.2	259.4	247.9
Other					3.7
EBITDA	142.0	120.3	112.2	114.2	240.0
EBITDA (before exceptional items)	142.0	137.4	112.2	114.2	135.9
EBIT	47.5	12.8	4.9	23.4	146.5
EBIT (before exceptional items)	47.5	31.7	4.9	23.4	42.4
EBIT margin (%)	3.3	0.8	0.4	1.9	9.9
EBIT margin (before exceptional items, %)	3.3	2.1	0.4	1.9	2.9
Net income	36.0	19.5	3.5	16.0	121.2
thereof from continuing operations	36.0	19.5	3.5	16.0	121.2
Earnings per share (basic/diluted, €)	0.30	0.18	0.04	0.14	1.00
thereof from continuing operations	0.30	0.18	0.04	0.14	1.00
Dividend per share (€)	0.07	0.07	0.07	0.07	0.15
Total assets	1,121.0	1,149.2	1,088.1	1,059.7	1,213.1
Non-current assets	596.6	563.6	520.5	483.7	534.2
Equity	504.7	511.0	495.6	491.1	599.2
Equity ratio (%)	45.0	44.5	45.5	46.3	49.4
Cash flow from operating activities	105.0	114.1	103.3	63.8	112.7
Free cash flow	13.8	52.0	35.0	4.7	82.5
Net financial position [1]	–31.7	13.7	39.0	31.6	98.2
Working capital [2]	172.3	196.2	183.6	204.3	222.2
Working capital ratio (average, %)	12.0	13.3	17.6	17.9	13.4
Capital expenditure (excl. capitalisation of R&D, after deducting grants)	42.5	40.3	56.2	52.9	54.7
Depreciation and amortisation	94.5	107.5	107.3	90.8	93.5
Research and development (after deducting grants)	52.6	53.1	40.8	50.4	67.0
thereof capitalised	33.8	26.3	13.0	9.1	17.5
Employees (31 Dec)	3,952	3,916	3,730	3,665	4,154

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

	Continuing operations 2013	Continuing operations 2014	Continuing operations 2015	Continuing operations 2016	**Continuing operations 2017**
Revenue by region € million	1,453.2	1,530.2	1,247.4	1,260.2	1,479.1
Europe/Middle East/Africa	1,155.4	1,166.2	844.5	872.7	1,063.5
Americas	190.6	256.6	275.3	239.6	268.1
Asia-Pacific	107.2	107.4	127.6	147.9	147.5
Revenue by application segment € million	1,453.2	1,530.2	1,247.4	1,260.2	1,479.1
Construction Machinery	325.1	429.0	334.7	350.0	437.4
Material Handling	156.5	286.3	188.5	189.0	265.6
Stationary Equipment	173.7	179.2	178.1	147.3	152.0
Agricultural Machinery	325.6	257.5	159.3	176.5	230.5
Automotive	188.5	82.0	87.9	77.2	56.1
Service	253.7	259.3	278.4	287.3	309.2
Miscellaneous	30.1	36.9	20.5	32.9	28.3
Key figures for DEUTZ shares					
Number of shares (31 Dec)	120,861,783	120,861,783	120,861,783	120,861,783	120,861,783
Number of shares (average)	120,861,783	120,861,783	120,861,783	120,861,783	120,861,783
Share price (31 Dec, €)	6.49	4.00	3.69	5.35	7.58
Share price high (€)	7.45	7.94	5.59	5.58	7.78
Share price low (€)	3.71	3.35	2.86	2.65	5.31
Market capitalisation (31 Dec, € million)	784.4	483.4	446.0	646.6	916.1
Earnings per share (basic/diluted, €)	0.30	0.18	0.04	0.14	1.00
thereof from continuing operations	0.30	0.18	0.04	0.14	1.00
thereof from discontinued operations	–	–	–	–	–

FINANCIAL CALENDAR

2018	
26 April 2018	Annual General Meeting in Cologne
2 May 2018	Interim management statement for the first quarter of 2018 Conference call with analysts and investors
2 August 2018	Interim report for the first half of 2018 Conference call with analysts and investors
8 November 2018	Interim management statement for the first to third quarter of 2018 Conference call with analysts and investors

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