2014 COMBINED MANAGEMENT REPORT FOR DEUTZ AG AND THE DEUTZ GROUP

OVERVIEW OF 2014

Global growth at previous year's level Despite a good start to the year, the global economic growth rate of 3.3 per cent in 2014 again merely matched that of 2013. Germany's growth rate of 1.5 per cent was the best among the larger countries in the eurozone once more, while the US economy grew strongly at a rate of 2.4 per cent. By contrast, growth in China, another particularly important market for DEUTZ, slowed to 7.4 per cent. Trends in DEUTZ's customer industries varied from region to region and sector to sector.

Year-on-year rise in revenue In 2014, we particularly benefited from customers buying more engines than they needed in anticipation of the change to the emissions standard for engines under 130kW in the EU that came into effect on 1 October 2014. As a result, our revenue was up by 5.3 per cent to €1,530.2 million. Unit sales rose at an even faster rate than revenue, increasing by 6.7 per cent to 196,403 engines sold. However, operating profit (EBIT before one-off items), which had declined to €31.7 million, was significantly affected by exceptional items.

DEUTZ celebrates its 150th anniversary In 2014, DEUTZ AG celebrated 150 years of existence as a company. N.A. Otto & Compagnie, which would go on to become DEUTZ AG, was founded by Nicolaus August Otto and Eugen Langen in 1864. As the world's first engine factory, it ushered in an era of motorisation that endures to this day. As well as other events, we celebrated this special anniversary with our friends and partners at an official celebration in Koelnmesse exhibition centre in Cologne on 9 May 2014.

Decision to optimise sites in Germany Our objective is long-term efficiency enhancement. With this in mind, we took the decision in 2014 to carry out a comprehensive optimisation of our network of sites. Firstly, this includes the consolidation of our facilities in Cologne where we will move out of our Cologne-Deutz site within two years and build a new shaft centre for the production of camshafts and crankshafts at our largest site in Cologne-Porz. This will provide long-term security for at least 140 permanent positions. Secondly, we will close our exchange engine plant in Übersee on Lake Chiemsee and integrate it into the plant in Ulm. We have also initiated further measures as part of our 'operational excellence' efficiency and quality programme.

New products also attract new customers Last year, we completed the introduction of engines that comply with the latest EU Stage IV/US EPA Tier 4[1)] emissions standard. The engines feature an extremely compact design, exhaust gas aftertreatment systems tailored to customers' individual needs and low lifecycle costs, showing that in terms of technology, we remain at the leading edge of the market. It was additionally encouraging that our new products not only impressed our existing customers, but also attracted new customers for us across all regions and sectors.

[1)] The Tier 4 Interim/Tier 4 final emissions standard is mentioned at various points in the annual report. This refers both to the EPA Tier 4 Interim and EPA Tier 4 standards for diesel engines in the United States and to the 97/68 Stage III B and Stage IV exhaust emissions standards in the European Union, but for the sake of simplicity the latter is not always explicitly mentioned.

FUNDAMENTAL FEATURES OF THE GROUP

BUSINESS SEGMENTS AND PRODUCT RANGE

For over 150 years, DEUTZ has been supplying reliable drive systems for mobile and standalone static applications – as an independent manufacturer of compact diesel engines in the 25kW to 520kW power range for both on and off-road use. We develop, design, produce and sell diesel engines that are cooled by water, oil or air. The operating activities of the DEUTZ Group are divided between the DEUTZ Compact Engines segment and the DEUTZ Customised Solutions segment: the DEUTZ Compact Engines segment comprises liquid-cooled engines with capacities of up to eight litres, while the DEUTZ Customised Solutions segment specialises in air-cooled engines and large liquid-cooled engines with capacities of more than eight litres. Operating under the name DEUTZ Xchange, the DEUTZ Customised Solutions segment also supplies reconditioned parts and engines as the main element of our service business.

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

LEGAL STRUCTURE AND PRODUCTION SITES

DEUTZ maintains a comprehensive international presence in a globalised market: with thirteen sales companies, seven sales offices and over 800 sales and service partners in more than 130 countries, we can offer our customers service and support virtually anywhere with very short response times. DEUTZ AG is the executive and operating parent company in the DEUTZ Group; it is headquartered in Cologne, Germany, and has various domestic and foreign subsidiaries. The subsidiaries include a production facility in Spain and several companies that perform sales and service functions.

In addition to DEUTZ AG, six German companies (31 December 2013: six) and 14 foreign companies (31 December 2013: 14) were included in the consolidated financial statements as at 31 December 2014. A complete list of DEUTZ AG shareholdings as at 31 December 2014 is given in the annex to the notes to the consolidated financial statements on page 117.

DEUTZ AG

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

MARKET AND COMPETITIVE ENVIRONMENT

DEUTZ manufactures diesel engines for professional applications used in countries with stringent emissions standards, in particular Stages III and IV. These technically sophisticated applications include construction equipment, agricultural machinery, lifting and material-handling equipment, pumps, gensets, medium and heavy-duty trucks and buses. The market for DEUTZ engines is therefore separate from the market segments for diesel engines used in passenger cars and small commercial vehicles up to a permissible gross weight of around 3.5 tonnes. Engines that rely on outdated technology and that are intended for use in applications in countries or application segments with only very low requirements in terms of product quality, emissions and fuel consumption also do not feature in our target market.

The market for technically sophisticated diesel engines divides into what are known as the captive and non-captive areas. The captive area comprises equipment manufacturers who produce their own engines, some of whom are also active as engine suppliers in the market. The non-captive area is made up of equipment manufacturers who for the most part do not produce their own engines and who, therefore, buy in engines from other suppliers. It is in this non-captive market that DEUTZ sells its high-quality engines with outputs between 25kW and 520kW around the globe.

In recent years, we have attained an outstanding position as one of the biggest suppliers in the non-captive market. We face competition from other 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)
Mobile Machinery	Construction equipment Ground support equipment Material handling equipment Mining equipment	Cummins, USA Kubota, Japan Perkins, UK Yanmar, Japan
Agricultural Machinery	Tractors Harvesters	Deere, USA Kubota, Japan Perkins, UK Yanmar, Japan
Stationary Equipment	Gensets Compressors Pumps	Deere, USA Kubota, Japan Perkins, UK Yanmar, Japan
Automotive	Special vehicles Rolling stock 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 using the following financial performance indicators:

		2014	2013
Revenue growth	(%)	**5.3**	12.5
EBIT margin before one-off items	(%)	**2.1**	3.3
Working capital ratio[1] (average)	(%)	**13.3**	12.0
ROCE before one-off items[2]	(%)	**3.9**	6.0
R&D ratio	(%)	**3.5**	3.6
Free cash flow[3]	€ million	**52.0**	13.8

[1] Working capital ratio (average): ratio of working capital (inventories plus trade receivables minus trade payables), as an average of the four quarters, to revenue for the preceding twelve months.

[2] 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.

[3] Free cash flow: cash flow from operating and investing activities minus net interest expense.

Our internal control system focuses, on the one hand, on revenue growth and the EBIT margin before one-off items, while on the other hand, we manage tied-up capital via the average working capital ratio. In conjunction with working capital and EBIT optimisation, this in turn determines the return on capital employed. In managing its liquidity, DEUTZ focuses on free cash flow as a key performance indicator. Also, as a technology-oriented company, we consider the R&D ratio, which represents the ratio of research and development expenditure (less reimbursements) to revenue, to be a key management variable as part of our internal performance indicator system. On the basis of these KPIs, the Group's financial flexibility is subject to constant analysis in the form of a comparison between budget and actual so that we can take swift, appropriate action in the event of significant variances. One-off items are defined as material income and expenses that are exceptional and unlikely to recur.

In order to enable us to be proactive and respond promptly, DEUTZ has set up an early warning system based on the performance indicators. A monthly/quarterly reporting process enables the Board of Management to track changes in the performance indicators. This approach ensures that we can respond immediately to the latest business developments. At the same time, we operate a sound system of causal analysis to ensure that we minimise risks and make the most of opportunities. Three times a year we produce an annual forecast for all key performance indicators. In this way, we ensure optimum transparency in our business performance, benefiting both the Group and all stakeholders.

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

CONTINUOUS OPTIMISATION OF THE CONTROL SYSTEM

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

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 economy growing at previous year's level Following an encouraging start to the year, sentiment regarding future global economic growth deteriorated again in the autumn of 2014. The focus returned more sharply to geopolitical crises, particularly the Russia/Ukraine conflict and the clashes in the Middle East. The International Monetary Fund (IMF) is reporting worldwide growth of 3.3 per cent for 2014[1] as a whole, which is the same level as in 2013.

The economy in the eurozone only grew by around 0.8 per cent in 2014, but this does mean that the eurozone has recovered from the recession of 2013. Growth rates continued to vary greatly among the European countries. Germany remained the eurozone's growth driver with an expansion rate of 1.5 per cent, despite the pace of growth slowing in the second half of the year. Spain has made good progress in overcoming the financial crisis and its economy has picked up, growing by 1.4 per cent. By contrast, Italy remained in recession and even France only managed minimal growth with scarcely any improvement on 2013. The revival of growth in the UK, where the economy grew by 2.6 per cent, is of particular note.

In 2014, the US economy was one of the major drivers of global economic growth. It expanded by 2.4 per cent (2013: 2.2 per cent), a higher rate than recently forecast, confirming hopes of a sustained economic recovery in the US. The US is also expected to provide strong growth stimulus in the year ahead.

The Chinese economy grew by 7.4 per cent, having slowed from growth of 7.8 per cent in the previous year. Conditions remained difficult in the truck and construction equipment sector, which is a core market for DEUTZ. The Russian economy experienced a massive downturn as a result of the crisis and sanctions, even though the IMF is still forecasting slight growth. Nor is the growth engine running smoothly in South America.

[1] Source: IMF World Economic Outlook, January 2015.

Varying trends in DEUTZ customer industries depending on region and sector Demand in DEUTZ's main customer markets varied once again in 2014. According to preliminary figures, demand for construction equipment rose by 7 per cent in Europe and by 8 per cent in North America[1], while it fell by 8 per cent in China[2]. According to DEUTZ's own estimates, the agricultural machinery sector in Europe contracted by 8 per cent in the year under review. The market for medium and heavy-duty trucks shrank by 8 per cent[3] in Europe and by 9 per cent in China[4].

IMPACT OF ECONOMIC CONDITIONS ON BUSINESS PERFORMANCE

DEUTZ just ahead of global trends While the global economy grew by 3.3 per cent in 2014, DEUTZ increased its revenue by 5.3 per cent and its unit sales by 6.7 per cent. Unit sales outstripped revenue because a shift in the product mix towards engines with a low power output had a greater impact on revenue per unit than the rising proportion of higher-value engines. Growth across our key customer sectors has been varied and, in some cases, even negative. DEUTZ has generally been able to insulate itself from the trends in the various sectors. In 2014, DEUTZ achieved the strongest growth by application segment in Mobile Machinery, where unit sales were up by around 40 per cent, significantly outperforming the market. In view of the introduction of the EU Stage IV emissions standard for power categories below 130kW on 1 October 2014, DEUTZ sold a particularly large number of engines with capacities of less than four litres.

The economy in the eurozone experienced slight growth of 0.8 per cent in the year under review. Some of DEUTZ's key customer sectors in this region also performed poorly. Although demand in Europe for construction equipment rose by 7 per cent according to preliminary estimates, volumes in the agricultural machinery sector declined by 8 per cent and registrations of medium and heavy-duty trucks also decreased by 8 per cent. While DEUTZ's revenue in our biggest market – EMEA (Europe, Middle East and Africa) – remained at the same level as the previous year, unit sales were up by 3.8 per cent in 2014. US economic output grew by a relatively strong 2.4 per cent in 2014, and the North American construction equipment market grew by 8 per cent. Our unit sales in the Americas region rose by 15.4 per cent, and revenue actually increased by 34.6 per cent. China, our key international market, experienced another difficult year, with its growth rate of 7.4 per cent below that of 2013. In this environment, the markets for construction equipment and medium and heavy-duty trucks declined by 8 per cent and 9 per cent respectively. By contrast, DEUTZ's revenue remained flat, and unit sales rose by 16.7 per cent in the Asia-Pacific region. The revenue generated by our largest equity investment in China, DEUTZ (Dalian) Engine Co., Ltd., which is not included in consolidated revenue, grew by 12.8 per cent year on year.

[1] Off-Highway Research, October 2014.
[2] China Construction Machinery Association, January 2015 and own estimates.
[3] Source: ACEA – European Automobile Manufacturers' Association, January 2015.
[4] China Automotive Information Net, January 2015.

RESEARCH AND DEVELOPMENT

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

€ million (R&D ratio in %)

2014	**53.1**	**(3.5)**
2013	52.6	(3.6)
2012	62.1	(4.8)
2011	84.6	(5.5)
2010	71.8	(6.0)

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

R&D expenditure at prior-year level Expenditure on research and development in 2014 amounted to €68.7 million (2013: €71.1 million). After deducting grants received from major customers and development partners, expenditure was €53.1 million (2013: €52.6 million), meaning that development expenditure after deducting grants was on a par with 2013. The R&D ratio (after deducting grants), i.e. the ratio of net development expenditure to consolidated revenue, fell marginally as planned to 3.5 per cent (2013: 3.6 per cent). In the year under review, 50 per cent of development expenditure after deducting grants was capitalised (2013: 64 per cent).

Spending by the DEUTZ Compact Engines segment after deducting grants came to €48.1 million (2013: €48.8 million), that of the DEUTZ Customised Solutions segment came to €5.0 million (2013: €3.8 million).

Successful launch of EU Stage IV/US Tier 4 products In 2014, we gave series production approval to all of our engines that are designed to meet the latest EU Stage IV/US Tier 4 emissions standard and that had still been awaiting approval. During the previous years, DEUTZ carried out a complete revision of its entire engine portfolio in order to meet this emissions standard. This has resulted in very compact engines, featuring low lifecycle costs and exhaust aftertreatment designs tailored to customer needs. To some extent, it was this emissions standard that made it essential for exhaust aftertreatment systems to be installed in the engines. We do not expect to be faced with such a complex challenge again in future; instead, we expect to be able to market these engines well into the next decade.

Stage V ready We aim to continue pursuing technologically leading designs with our engines. Our engines in the 2.9 to 7.8 litre cubic capacity range that are equipped with diesel particulate filters already meet the next European emissions standard, EU Stage V, which is expected in 2019[5]. Certification will follow as soon as possible. There are currently no plans for a further emissions standard in the USA. Going forward, we intend to continue improving engine performance for the same engine size and thus actively accelerate the trend towards downsizing. Our exhaust aftertreatment concept – DVERT or DEUTZ Variable Emissions

[5] EU Commission's proposal for EU Stage V published on 25 September 2014.

Reduction Technology – offers our customers exhaust aftertreatment design modules tailored to their needs. Our portfolio already includes a diesel particulate filter for all the above-mentioned engines.

Preliminary development work expanded Exhaustive research and development will continue to provide the bedrock for DEUTZ's position at the forefront of innovation within the sector. However, following the successful introduction of the latest emissions standard, there is now a possibility that spending on development can be slightly reduced. We will therefore reduce the number of employees in R&D this year. The main focus of attention is also shifting from the development of new engines and the refinement of existing models to support for existing engine series and preliminary development. Development of new engines and the refinement of existing models accounted for some 77 per cent (2013: 86 per cent) of all R&D expenditure (after deducting grants); support for existing engine series including customer applications took up 14 per cent (2013: 10 per cent) and 9 per cent (2013: 4 per cent) was spent on preliminary development work.

Further development of specific functionalities We intend to add further new developments to our product range. For example, the production launch of the TCD 3.6 High Torque with an output of less than 56kW (EU Stage IV/US Tier 4) is planned for this year. This engine, with its torque curve optimised in the low to medium engine speed range, gives customers the same performance (torque) as engines of the same design but with a higher output. This plus point is achieved through a more compact, less complicated exhaust gas aftertreatment system. The considerable practical advantages of this design can be seen in applications with limited installation space, tractors for example.

New technical designs We are constantly developing new, innovative approaches and have recently expanded our activity in this area. Last year, for example, together with TEREX Fuchs and supported by the Federal Ministry for Economic Affairs and Energy, we fitted a hybrid system to a material handler and ran it as a prototype. Whereas hybrid systems are now firm fixtures in the automotive industry's product range, they are still only found as prototypes or potentially as small-scale production runs in the construction equipment sector. The special characteristics of the hybrid system we developed are the dynamic reduction in the diesel engine's engine speed, energy recuperation and a start-stop function. During the testing carried out so far, fuel savings and reductions in CO_2 emissions of over 40 per cent have been achieved; the test driver was also highly enthusiastic about the system's performance.

Continuous process optimisation Because of the constantly growing complexity of the systems under development, we are systematically and continuously improving our processes. These new high-grade systems can, as a result, be developed at an acceptable cost and to the existing high quality standards. The volume of data to be stored in the electronic control system has multiplied greatly, precisely because of the demands imposed by the management and regulation of the combustion engine and the subsequent exhaust aftertreatment system. We have developed and implemented a new dataset development process including integral validation to cope with this increase.

Intellectual property rights safeguard our know-how We protect our know-how from unauthorised outside use by means of patents, patent applications and utility models. In 2014, we submitted 19 new patent applications, seven of which were in Germany. We now hold a total of 168 patents registered in Germany and 261 registered elsewhere.

PROCUREMENT

In 2014, purchasing focused on further improving DEUTZ's competitiveness by reducing material costs. There was also a need to implement the more tightly drawn requirements for security of supply and supplier performance. Our global supplier base was put under the spotlight so as to identify any critical areas in the supply chain, quality or strategic positioning.

Raw material markets present a mixed picture The price of cast-iron scrap – the most significant raw material for us – fell slightly in 2014. In contrast, the price of aluminium and nickel rose substantially while the copper price flatlined. Platinum has fallen slightly in price whereas the price of palladium increased significantly compared with 2013. This meant that, except for aluminium, average annual values lay within the range we had forecast. However, the increased cost of aluminium did not have any significant effect on the Company's material costs.

The product categories of foundry products, fuel injection equipment and measurement & control devices made up the bulk of the overall volume of materials purchased.

Procurement from China stepped up The proportion of procurement from emerging markets continued to increase. This was particularly true of China, where DEUTZ has been buying individual parts and components for many years. Sourcing projects were again implemented successfully, and new potential savings identified.

Security of supply ensured Security of supplies for engines of up to four litres proved a challenge in 2014 because our requirements had increased significantly compared with 2013. However, much closer collaboration between strategic purchasing and logistics managed early on to reduce supply bottlenecks and delivery delays to a minimum.

Supplier management and material group strategies As part of our supplier management, we stepped up the structured support we gave to problematic suppliers in 2014. Our aim is to reduce the negative effects of insolvencies and to achieve a sustained improvement in supplier performance. By the end of the year, we were able, for the first time, to achieve a figure of 94 per cent in the performance of these problematic suppliers. In future, this figure needs to be maintained and improved still further in order, in the long term, to minimise or avoid extra costs caused by short-term under-supply and delays. This is essential in order to further increase customer satisfaction.

Enduring improvement in supplier quality Our parts per million (ppm) rate as a performance indicator for defective parts is at an historical low. For the third time in succession it was better than the strategic objective which, for 2014, had been tightened still further. This success is due to the consistent and sustained support and assistance provided to those suppliers with the poorest supplier quality.

PRODUCTION AND LOGISTICS

The main areas of activity for production and logistics in 2014 were the start of production of the new 2.9 and 3.6 engine models, our productivity enhancement and quality offensive and action to further optimise our logistics chain.

The Cologne plants, Germany In 2014, the main focus at Cologne-Porz, our largest assembly site for production engines, was ensuring quality and delivery reliability for the start of series production of the 2.9 and 3.6 engine models. Customers had also bought significant numbers of advance production engines of these models and this required us to put special measures into effect throughout the entire supply chain. We introduced a new employee information system for these models so that quality-related matters and the precise details of the work involved could be clearly displayed. We are continuing to work at meeting our objectives through strict cost management.

Audit reports are helping us to improve health and safety at work, tidiness, cleanliness and quality. As planned, we have also extended shop floor management to all assembly lines. This comprehensive, overarching management concept is preparing the way for zero-error production. A range of kaizen measures on the assembly lines concentrated on ergonomics and workstation design.

Component manufacture As part of the plan for optimising our sites, the Cologne-Deutz plant will be closed by 2016 and engine component production will be relocated to other plants. Together with the works council, we have agreed a plan for the future of the Cologne sites, including job security; this will result in a lasting increase in flexibility and cost benefits. The central feature of the relocation plan will be the construction of a new shaft centre at our Cologne-Porz site which will be responsible for crankshaft and camshaft manufacture from 2016. The land that is freed up at the old Cologne-Deutz site is to be sold in the next few years. The manufacture of crankcases for engine models up to four litres will be relocated to our Spanish plant in Zafra. The production line in Cologne-Kalk for four to eight-litre crankcases will be further optimised and expanded to meet the increased quality requirements for the Tier 4 engines. The Herschbach component plant has continued to develop into a centre of excellence for complex attached parts.

The Ulm plant, Germany As part of site optimisation, the Ulm plant will be expanded to become the plant for small production runs, focusing on DEUTZ Customised Solutions products, project business, exchange engines and models which are becoming obsolete. Productivity can be increased and fixed costs reduced by relocating the exchange engine work from Übersee to Ulm. Synergies will largely be created from the use of the Ulm plant's infrastructure and from shared overheads. Kaizen activity over recent years has freed up the space needed for integrating exchange engine production.

The Zafra plant, Spain In future, our Spanish plant in Zafra is to produce the crankcases for engines of up to four litres in addition to the main cylinder head, conrod and gearwheels components. In addition to the 2011 crankcase, the 2.9 crankcase will also be produced there. Crankcase production will start in the second half of 2015. The space needed for the new components was generated in this plant, too, by kaizen activity.

The Xchange plant in Übersee am Chiemsee, Germany As part of our site optimisation programme, we have decided to close the Übersee plant by 2017 in two stages and to relocate exchange engine production to Ulm. A reconciliation of interests, as required by German law, and a social plan were drawn up in the fourth quarter of 2014 for the 157 employees affected. They were signed at the start of this year. In addition to offers of compensation and of moving to an interim employment company, the employees were given the alternative option of working in Ulm. For those employees willing to move, working time models tailored to the situation have been worked out and financial compensation for additional costs agreed with the works council.

Plants in Georgia/USA At our site in Norcross, Georgia, USA, we are producing system solutions in increasing quantities to satisfy specific customer or segment needs. These solutions help our customers when it comes to installing our engines in their equipment. Our plant in Pendergrass, Georgia, USA produces exchange engines for the American market. Local production makes for short delivery times.

Logistics During 2014, we concentrated on gradually expanding our demand and capacity management system. Additional capacity-critical suppliers were brought within the scope of this management system which, at the end of 2014, covered some 89 per cent of the total purchasing volume. This has improved the early identification of emerging capacity constraints, allowing us to simulate situations and create various scenarios involving capacity limits. In order to be able to produce a clear logistical picture of the continuously increasing volume of exhaust aftertreatment systems, another external service provider helped us to integrate storage, packaging and dispatch into DEUTZ's IT systems.

Quality is firmly embedded in our corporate principles The DEUTZ name has always stood for high quality standards in engines. We intend to continue to live up to this reputation.

An international benchmarking project undertaken by St. Gallen University placed DEUTZ AG among the five leading industrial concerns, an achievement which was marked by the Award for Global Quality Excellence presented to us on 4 December 2014 in Zurich.

This award proves that DEUTZ AG focuses strongly on quality and employs the correct methods.

In 2014, we again met the ISO 9001 quality management, the ISO 14001 environmental management and the ISO 50001 energy management requirements; our current certificates have been renewed. At present, DEUTZ AG is getting ready to meet the changes to the requirements set out in the ISO updates 9001:2015 and 14001:2015.

Quality management is a continuous process. For example, there was a rise in the number of warranty claims on engines from the DEUTZ Compact Engines segment, primarily relating to engines manufactured in 2011. We ensured that no faulty parts are used in production by changing our processes and implementing quality-assurance measures. Provisions were recognised on the balance sheet to cover all future charges that can be anticipated to arise from this matter.

INTERNATIONAL JOINT VENTURES

China has been a very challenging market for some time. Growth forecasts have been revised down, and there is considerable capacity in the engine production sector. Although we continue to have every faith in the potential of the Chinese market, we made a decision after the balance sheet date to consolidate our Chinese operations and sites. Our intention is to focus our production operations in China on our established and successful joint venture DEUTZ (Dalian) Engine Co., Ltd. in Dalian, China, which has plenty of capacity at present.

DEUTZ has been operating the DEUTZ Dalian joint venture with the First Automotive Works Group, one of China's leading vehicle manufacturers, since 2007. Here, we produce three to eight litre diesel engines, mainly for automotive applications for the Chinese market. The unit sales figure for 2014 was just short of 106,000 engines. An improved product mix brought in revenue equivalent to roughly €360 million, up by 12.8 per cent year on year, as a result of which the business significantly outperformed the market, as it did the previous year. The company, accounted for under the equity method, contributed around €3.5 million to the DEUTZ Group's operating profit (2013: €1.3 million). For the current year, we are assuming that the company will continue to grow strongly in the Chinese market and will benefit from the China IV (similar to Euro 4) automotive emissions standard being introduced across the country from 1 January 2015 and from our continuing initiatives to reduce costs and increase efficiency.

In February 2015, together with our partner AB Volvo, we took a joint decision – because of the significantly downgraded growth forecasts – to wind up our DEUTZ Engine (China) Co., Ltd. joint venture in Linyi, China that had been established at the end of 2013. We have a 65 per cent shareholding in the company. It was originally intended to produce medium-duty diesel engines primarily for mobile machinery in the Asian market and the joint venture has not made any substantial investments to date. Going forward, we aim to continue satisfying local demand from our partners and other target customers using local Chinese production operations.

It was in 2012 that we established the DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China, in order to assemble diesel engines of up to four litres cubic capacity. We have a 70 per cent shareholding in this production company, which has not yet begun to operate commercially. Due to the market situation, we have put on hold any further implementation work and capital expenditure for the time being.

Another joint venture, WEIFANG WEICHAI-DEUTZ DIESEL ENGINE CO., LTD. based in Weifang, China, has been run by DEUTZ for many years in collaboration with Chinese engine manufacturer Weichai Power. It produces 226B series engines under licence. Because the joint venture is no longer considered strategically important, we are in talks with our partner Weichai Power about its future.

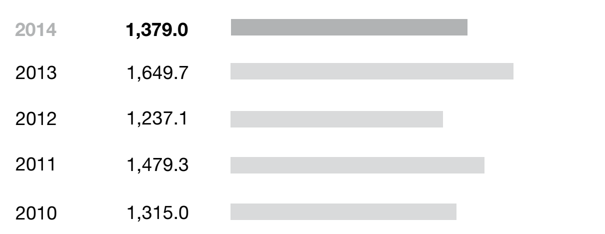
DEUTZ AGCO MOTORES S.A. (DAMSA), our Argentinian joint venture with the AGCO Group, produces engines for the local market, with a particular focus on agricultural machinery, buses and industrial applications. In 2014, the company sold around 1,400 engines in very challenging market conditions. It generated revenue of around €16 million, which was about a quarter less than in 2013, and the company made a loss of almost €1 million.

We hold a stake of 30 per cent in D.D. Power Holdings (Pty) Ltd., our South African joint venture. This sales and service company is active in the local market, focusing on sectors such as the local mining business. In the year under review, the company achieved revenue of around €17 million and a profit of approximately €2 million, with both figures at the same level as last year.

NEW ORDERS

DEUTZ Group: New orders

€ million

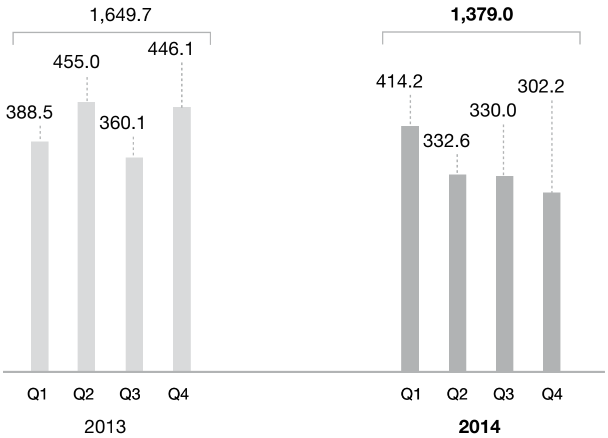


Year-on-year decrease in new orders The DEUTZ Group received new orders worth €1,379.0 million in 2014, which was 16.4 per cent below the figure of €1,649.7 million achieved in the previous year. The Mobile Machinery and Stationary Equipment application segments managed to increase their volumes of new orders by 10.5 per cent and 4.5 per cent respectively. The service business achieved a small gain of 2.8 per cent, whereas the volume of new orders received in the Automotive and Agricultural Machinery application segments slumped by 53.3 per cent and 59.2 per cent respectively. The fall in new orders in the Automotive application segment had been anticipated, because the Euro 6 emissions standard was introduced at the start of 2014 and DEUTZ does not offer compliant engines. The decrease in Agricultural Machinery was largely due to the very high level of orders received in 2013 and the current weakness of the market. However, the fact that we acquired new customers across all regions and applications was very encouraging.

While the level of new orders received in the first quarter of 2014 was 6.6 per cent higher than in the same period of 2013 due to the advance production of engines ahead of the introduction of the latest EU exhaust emissions standard, the remaining three quarters failed to match their prior-year level. The first quarter, when orders worth €414.2 million were received, was also the strongest quarter. The volume of new orders received in the fourth quarter was €302.2 million, a year-on-year fall of 32.3 per cent and a quarter-on-quarter fall of 8.4 per cent.

DEUTZ Group: New orders by quarter[1)]

€ million



[1)] These and subsequent quarterly figures are based on the published quarterly financial statements and have not been audited.

As at 31 December 2014, orders on hand stood at €219.7 million, 40 per cent lower than the figure of €366.1 million as at 31 December 2013.

UNIT SALES

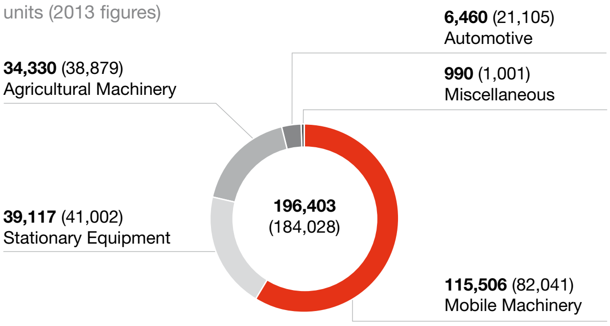
DEUTZ Group: Unit sales

units

Unit sales up on 2013 In 2014, DEUTZ sold 196,403 engines, which was a rise of 6.7 per cent on the number sold the previous year (184,028 engines). This was largely attributable to the Mobile Machinery application segment, where 40.8 per cent more engines were sold than in the previous year. Unit sales decreased in all the other application segments. In view of the introduction of the EU Stage IV emissions standard for power categories below 130kW in the European Union with effect from 1 October 2014, DEUTZ sold a particularly large number of engines with capacities of less than four litres in the first nine months of 2014.

DEUTZ Group: Unit sales by application segments

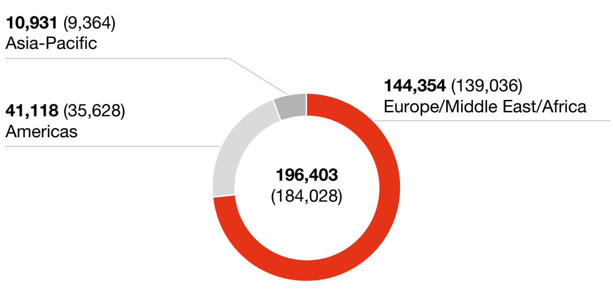
units (2013 figures)



Unit sales increased in all regions. In our largest market – EMEA – we increased our sales figures by 3.8 per cent to 144,354 engines. Within this region, there was a sharp rise in unit sales in Germany, which were up by 31.9 per cent; however, sales were down by 4.6 per cent in the rest of Europe. Sales of engines rose by 15.4 per cent to 41,118 units sold in the Americas and increased by 16.7 per cent to 10,931 engines in the Asia-Pacific region.

DEUTZ Group: Units sales by region

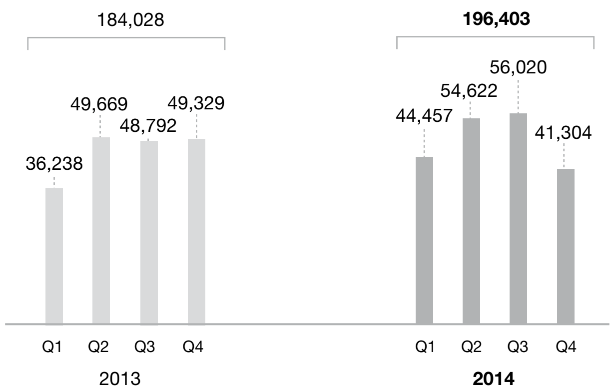
units (2013 figures)



During the year, unit sales were ahead of the comparative period of 2013 in each of the first three quarters, by 22.7 per cent, 10.0 per cent and 14.8 per cent respectively. However, unit sales slowed in the fourth quarter and stood at 41,304 engines, 16.3 per cent below the figure for the fourth quarter of 2013. The strongest quarter in terms of unit sales was the third quarter when 56,020 engines were sold.

DEUTZ Group: Consolidated unit sales by quarter

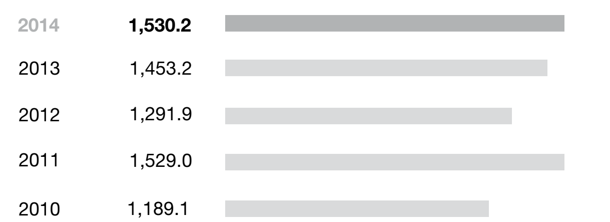
units



RESULTS OF OPERATIONS

DEUTZ Group: Revenue

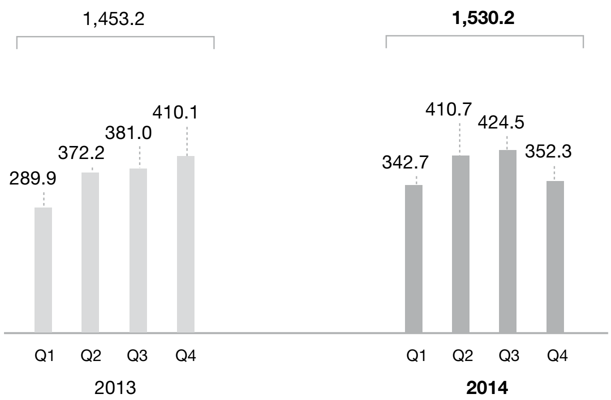
€ million



Revenue also up In 2014, DEUTZ generated revenue of €1,530.2 million, 5.3 per cent more than in the previous year when revenue amounted to €1,453.2 million. Although we did not meet the target of low double-digit revenue growth that we set at the beginning of the year, we did achieve our revised forecast of around €1.5 billion that was set in November 2014. Revenue growth was 1.4 percentage points lower than our growth in unit sales. Although the proportion of higher value engines rose once more in the year under review, this positive effect was more than offset by a shift in the product mix towards engines with a lower power output. The change in the emissions standard for engines under 130kW in the EU resulted in a distortion in demand for this power range. In anticipation of this change, which came into effect on 1 October 2014, European customers purchased more engines than they needed in the first nine months of the year, which reduced demand accordingly in the fourth quarter of 2014 and will continue to do so in the quarters ahead.

DEUTZ Group: Revenue by quarter

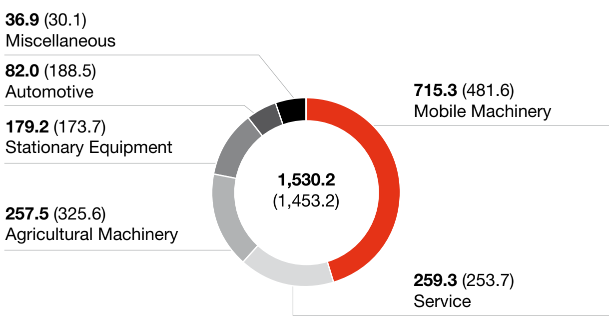
€ million



Consequently, revenue followed an upward trend over the course of the year, with the exception of the fourth quarter. Revenue of €342.7 million in the first quarter was followed by €410.7 million in the second and €424.5 million in the third. The final quarter was ultimately the weakest with revenue of €352.3 million, which represented a year-on-year fall of 14.1 per cent. In addition to the impact of the advance production of engines mentioned above, this was also attributable to an economic downturn towards the end of the year.

DEUTZ Group: Revenue by application segment

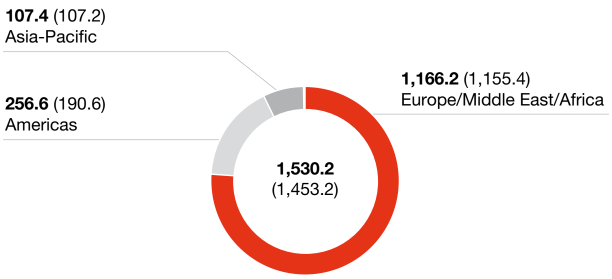
€ million (2013 figures)



Revenue generated by Mobile Machinery, our biggest application segment, increased to €715.3 million, a sharp rise of 48.5 per cent. The service business and the Stationary Equipment application segment also managed modest increases of 2.2 per cent and 3.2 per cent respectively. By contrast, Agricultural Machinery generated 20.9 per cent less revenue. Revenue in the Automotive application segment more than halved because DEUTZ has not introduced the Euro 6 emissions standard, as mentioned above. Our automotive business is shifting strongly towards Asia, particularly to our DEUTZ (Dalian) Engine Co., Ltd. joint venture (DEUTZ Dalian). However, this joint venture, in which we have a 50 per cent stake, is only consolidated under the equity method, so its revenue is not included in our consolidated revenue.

DEUTZ Group: Revenue by regions

€ million (2013 figures)



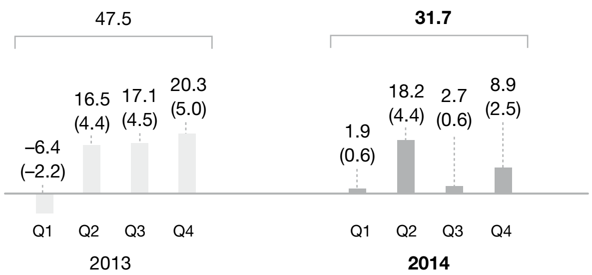
In terms of regions, our revenue in the Americas region was up significantly, rising by 34.6 per cent to €256.6 million. Revenue in the EMEA region (Europe, Middle East and Africa) amounting to €1,166.2 million remained at roughly prior-year level, as did the revenue of €107.4 million generated in the Asia-Pacific region. However, using a pro-forma calculation including revenue from the equity-accounted DEUTZ Dalian joint venture, revenue in the Asia-Pacific region would have gone up to €467.1 million, increasing the proportion of total revenue accounted for by this region to 24.7 per cent.

DEUTZ Group: Operating profit/EBIT margin before one-off items

€ million (EBIT margin in %)

DEUTZ Group: Operating profit/EBIT margin by quarter

€ million (EBIT margin in %)



Earnings performance Adjusted for one-off items, operating profit before depreciation and amortisation (EBITDA before one-off items) stood at €137.4 million in 2014 (2013: €142.0 million). Despite the positive trend in the volume of business, EBITDA before one-off items was down by €4.6 million year on year. This decrease was largely due to the increase in warranty costs. As already announced in October 2014, we made an unexpected addition to provisions for warranty costs in the third quarter of the year, which reduced earnings by €20.4 million after deduction of insurance claims.

Operating profit after depreciation and amortisation (EBIT before one-off items) amounted to €31.7 million in 2014 and was therefore €15.8 million lower than earnings for the previous year (2013: €47.5 million). Consequently, the EBIT margin before one-off items had fallen to 2.1 per cent in 2014 (2013: 3.3 per cent), which means that we failed to achieve the target of above 4.0 per cent that we had forecast at the beginning of 2014. This was largely attributable to the unexpected addition to provisions for warranty costs in the third quarter of 2014 and the non-achievement of business-volume targets. However, we did meet the revised target of 2.0 per cent in the revised November forecast. Without the unexpected addition to provisions and other exceptional effects, the EBIT margin before one-off items would have been 3.4 per cent. Depreciation and amortisation on property, plant and equipment and intangible assets before one-off items rose by €11.2 million to €105.7 million in the year under review. Firstly, depreciation and amortisation rose again slightly due to the production launch of all engines that comply with the latest emissions standard and secondly, due to changes in market forecasts, impairment losses of €9.5 million were recognised on property, plant and equipment and intangible assets, primarily capitalised development expenditure, at the end of 2014.

In the fourth quarter of 2014, the EBIT margin before one-off items stood at 2.5 per cent. Operating profit (EBIT before one-off items) was characterised by numerous other effects in this quarter, although they largely offset each other. The positive contribution to earnings from the sale of engine licences to an Algerian company as part of that country's industrialisation programme, amounting to €14.3 million, was offset by the following charges: in addition to the impairment losses of €9.5 million on property, plant and equipment and intangible assets mentioned above, impairment losses on equity-accounted investments of €1.8 million and on other receivables of €2.0 million (€2.5 million for the year as a whole) were recognised in relation to the shareholding in our Argentinian joint venture DEUTZ AGCO Motores S.A.

After one-off items, operating profit (EBIT) for 2014 amounted to €12.8 million (2013: €47.5 million). The one-off items totalling minus €18.9 million mainly related to expenses of €17.1 million in connection with measures to optimise our German sites, impairment losses recognised on the property, plant and equipment of our Chinese subsidiary DEUTZ Engine (Shandong) Co., Ltd. following weaker market forecasts and the associated change in our strategy for the subsidiary (€1.8 million). Overall, the one-off items were attributable to both the DEUTZ Compact Engines (DCE) segment and the DEUTZ Customised Solutions (DCS) segment. Consequently, the EBIT margin narrowed to 0.8 per cent overall (2013: 3.3 per cent).

Owing to the exceptional items in 2014 and the lower than expected volume of business, return on capital employed (ROCE before one-off items)[1], our internal KPI, fell from 6.0 per cent in the previous year to 3.9 per cent. We were thus unable to achieve our target, set at the start of the year, of above 6.0 per cent.

Cost of sales In 2014, the cost of sales totalled €1,327.6 million (2013: €1,257.4 million). This year-on-year increase of 5.6 per cent was mainly due to higher expenses for materials, staff and contract workers associated with the larger business volume and the unexpected addition to provisions for warranty costs. The ratio of cost of sales to revenue was 86.8 per cent, the same level as the previous year (2013: 86.5 per cent).

Overview of the DEUTZ Group's results of operations

€ million	2014	2013
Revenue	1,530.2	1,453.2
Cost of sales	–1,327.6	–1,257.4
Research and development costs	–74.3	–58.7
Sales and administrative expenses	–100.0	–96.1
Other operating income	22.9	17.0
Other operating expenses	–41.4	–13.9
Net investment income	3.0	3.4
EBIT	12.8	47.5
thereof one-off items	–18.9	–
EBIT before one-off items	31.7	47.5
Interest expenses, net	–6.1	–6.0
Income taxes	12.8	–5.5
Net income	19.5	36.0

Research and development costs In the year under review, research and development costs amounted to €74.3 million (2013: €58.7 million). They largely comprised amortisation on completed development projects, staff costs and cost of materials, from which investment grants received and capitalised development costs were deducted. The year-on-year increase was primarily attributable to impairment losses of €9.2 million recognised on completed development projects due to changes in predicted demand. Amortisation on completed development projects was also higher following the production start-up of new engines.

Selling and administrative expenses Selling and administrative expenses in 2014 came to €100.0 million, an increase of €3.9 million compared with 2013 (€96.1 million). On the other hand, when measured as a proportion of revenue, selling and administrative expenses actually declined slightly, from 6.6 per cent in 2013 to 6.5 per cent in 2014, owing to the greater volume of business.

Other operating income Other operating income was up by €5.9 million year on year to €22.9 million (2013: €17.0 million). This was mainly attributable to positive effects arising on the translation of foreign currency positions. However, the year-on-year increase in foreign currency gains was offset by a rise in foreign currency losses in the same period. Foreign currency losses are reported in other operating expenses.

Other operating expenses Other operating expenses totalled €41.4 million in the reporting year, an increase of €27.5 million compared with 2013 (€13.9 million). In addition to the rise in foreign exchange losses, this trend was primarily the result of recognising provisions for restructuring following the decision to optimise our network of sites.

Profit/loss on equity-accounted investments The profit on equity-accounted investments rose by €0.3 million on 2013 and amounted to €1.9 million (2013: €1.6 million). This year-on-year change was largely characterised by two countervailing factors. While the contribution to earnings from our Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd. rose sharply, by €2.2 million to €3.5 million, as the result of volume and efficiency gains, adverse market conditions in South America prompted us to recognise an impairment loss on the equity-accounted value of our Argentinian joint venture DEUTZ AGCO MOTORES S.A.

Other financial income The decline in other financial income largely resulted from the sale of our shareholding in DEUTZ Versicherungsvermittlung GmbH, Cologne in 2013.

Net interest expense Net interest expense in 2014 remained virtually unchanged on the previous year (2014: €6.1 million; 2013: €6.0 million). Both finance costs and interest income declined to a comparable extent due to the fall in interest rates.

[1] Return on capital employed (ROCE before one-off items): ratio of EBIT before one-off items 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.

Income taxes In 2014, there was overall tax income of €12.8 million, whereas income taxes of €5.5 million were incurred in the previous year. The current tax expense of €9.1 million was down slightly year on year, by €1.6 million (2013: €10.7 million). Current tax expenses were offset by deferred tax income of €21.9 million (2013: €5.2 million). This resulted from the reversal of deferred tax liabilities arising in connection with the capitalisation of development expenditure under IFRS and from increased deferred tax assets due to the findings of the tax audit carried out at DEUTZ AG for 2009 to 2011, which led to restatement of the tax accounts for DEUTZ AG as at 31 December 2014.

Earnings per share Based on the decline in the operating profit performance and the one-off charge in connection with site optimisation, net income fell to €19.5 million in 2014, a year-on-year decrease of €16.5 million (2013: €36.0 million). This resulted in earnings per share of €0.18 (2013: €0.30).

BUSINESS PERFORMANCE IN THE SEGMENTS

DEUTZ Group: Segments

	2014	2013
€ million		
New orders		
DEUTZ Compact Engines	1,115.0	1,385.5
DEUTZ Customised Solutions	264.0	264.2
Total	**1,379.0**	**1,649.7**
Unit sales (units)		
DEUTZ Compact Engines	183,125	167,964
DEUTZ Customised Solutions	13,278	16,064
Total	**196,403**	**184,028**
Revenue		
DEUTZ Compact Engines	1,279.9	1,188.8
DEUTZ Customised Solutions	250.3	264.4
Total	**1,530.2**	**1,453.2**
EBIT before one-off items		
DEUTZ Compact Engines	15.2	8.7
DEUTZ Customised Solutions	18.8	39.0
Other	–2.3	–0.2
Total	**31.7**	**47.5**

BUSINESS PERFORMANCE IN THE DEUTZ COMPACT ENGINES (DCE) SEGMENT

New orders down on 2013 In 2014, the Compact Engines (DCE) segment received new orders worth €1,115.0 million, 19.5 per cent down on 2013 when orders worth €1,385.5 million were received. As was the case for the Group as a whole, the Mobile Machinery and Stationary Equipment application segments increased their volumes of new orders, by 10.8 per cent and 7.5 per cent respectively. On the other hand, new orders received by the Automotive and Agricultural Equipment application segments were sharply down by 69.1 per cent and 59.9 per cent respectively. Orders on hand at the end of the year stood at €141.5 million, virtually half the figure for the end of 2013.

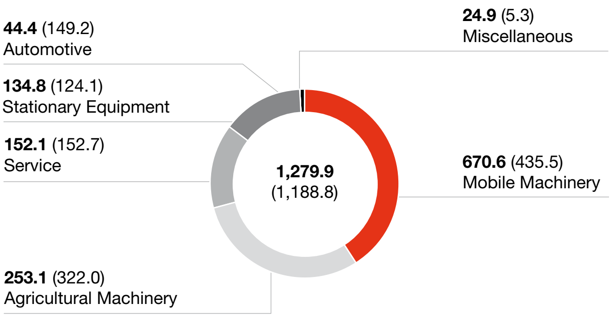
More engines sold A total of 183,125 engines were sold in the DCE segment in 2014, 9.0 per cent more than the 167,964 engines sold in 2013. In the EMEA region, our largest market, the number of engines sold climbed to 137,416 units, an increase of 5.7 per cent. Unit sales were also up in the Americas and Asia-Pacific regions (by 18.7 per cent and 28.5 per cent respectively). The main factor in the uptrend was the successful performance of the Mobile Machinery application segment, where unit sales were up by 43.5 per cent. In contrast, all the other application segments suffered a drop in unit sales.

Revenue also up At €1,279.9 million, revenue in the DCE segment was up by 7.7 per cent year on year (2013: €1,188.8 million). The biggest increase in revenue (42.9 per cent) was in the Americas region – driven by an encouraging expansion in business with our customers and strong economic growth. The Asia-Pacific region also reported significant revenue growth of 18.7 per cent, but revenue generated in the EMEA region was only up by 2.0 per cent. The performance of the Mobile Machinery application segment was encouraging, with a 54.0 per cent rise in revenue. The revenue attributable to the Stationary Equipment application segment rose by 8.6 per cent, service business revenue remained flat but Agricultural Machinery generated 21.4 per cent less revenue. Automotive reported a 70.2 per cent fall in revenue. Like the Group as a whole, the segment was impacted by the introduction of the Euro 6 emissions standard in Europe at the beginning of the year, for which DEUTZ does not offer compliant engines.

Fourth quarter down year on year In the DCE segment, new orders in the fourth quarter of 2014 reached €232.5 million, down by 39.1 per cent on the final quarter of 2013 and by 14.0 per cent on the third quarter of 2014. Unit sales declined by 16.7 per cent year on year to 36,601 engines and were well below the strong previous quarter when 53,589 engines were sold. The revenue of €277.1 million generated in the fourth quarter was 15.4 per cent below that of the same quarter in 2013 and 24.7 per cent down on the strong third quarter of 2014.

DEUTZ Compact Engines: Revenue by application segment

€ million (2013 figures)



Improvement in DCE operating profit In 2014, we generated operating profit (EBIT before one-off items) of €15.2 million for the segment, outstripping the profit of €8.7 million for 2013 by €6.5 million. The rise is due, in particular, to the increase in the volume of business in the reporting year and to the positive contribution to earnings from the sale of engine licences to an Algerian company. Moreover, the increased earnings of our Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd. also played a part in the rise. There was a negative impact on operating profit for the segment from the aforementioned addition to provisions for warranty costs.

BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS (DCS) SEGMENT

New orders in line with 2013 In the year under review, the DEUTZ Customised Solutions (DCS) segment received new orders worth €264.0 million, the same amount as in the previous year. The level of new orders rose in the Mobile Machinery and Agricultural Machinery application segments, as did the service business. At 31 December 2014, the order book stood at €78.2 million, 23.0 per cent higher than at the end of 2013.

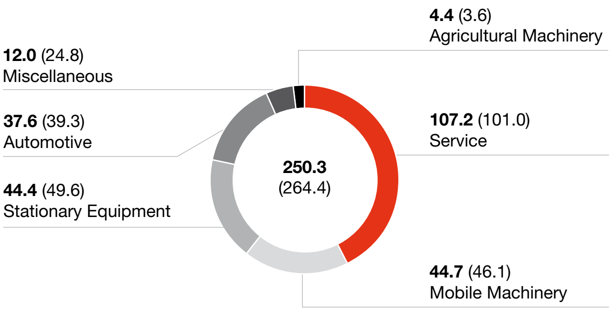
Fewer engines sold Unit sales in the DCS segment fell by 17.3 per cent to 13,278 engines in 2014. All regions and application segments reported lower unit sales.

Revenue down on 2013 In the year under review, the DCS segment generated revenue of €250.3 million, a decline of 5.3 per cent, although the Americas region managed to increase its revenue by 5.7 per cent. By contrast, revenue was down by 5.6 per cent and 11.8 per cent respectively in the EMEA and Asia-Pacific regions. The Agricultural Machinery application segment posted an increase of 22.2 per cent in revenue and service business revenue was also up, by 6.1 per cent. By contrast, the revenue attributable to the Mobile Machinery, Automotive and Stationary Equipment application segments declined by 3.0 per cent, 4.3 per cent and 10.5 per cent respectively.

Healthy level of new orders in the fourth quarter In the fourth quarter of 2014, the DCS segment achieved new orders worth €69.7 million, exceeding the equivalent figure in the fourth quarter of 2013 by 8.6 per cent. New orders were also up by 16.9 per cent compared with the third quarter of 2014. Unit sales in the final quarter of 2014 declined by 12.4 per cent compared with the corresponding quarter of 2013 but rose significantly (by 93.5 per cent) in comparison with the previous quarter, which had been adversely affected by supply shortages relating to one supplier. The revenue attributable to the DCS segment in the final quarter was down by 9.1 per cent year on year and amounted to €75.2 million, but nonetheless was around a third higher than the figure for the third quarter of 2014.

DEUTZ Customised Solutions: Revenue by application segment

€ million (2013 figures)

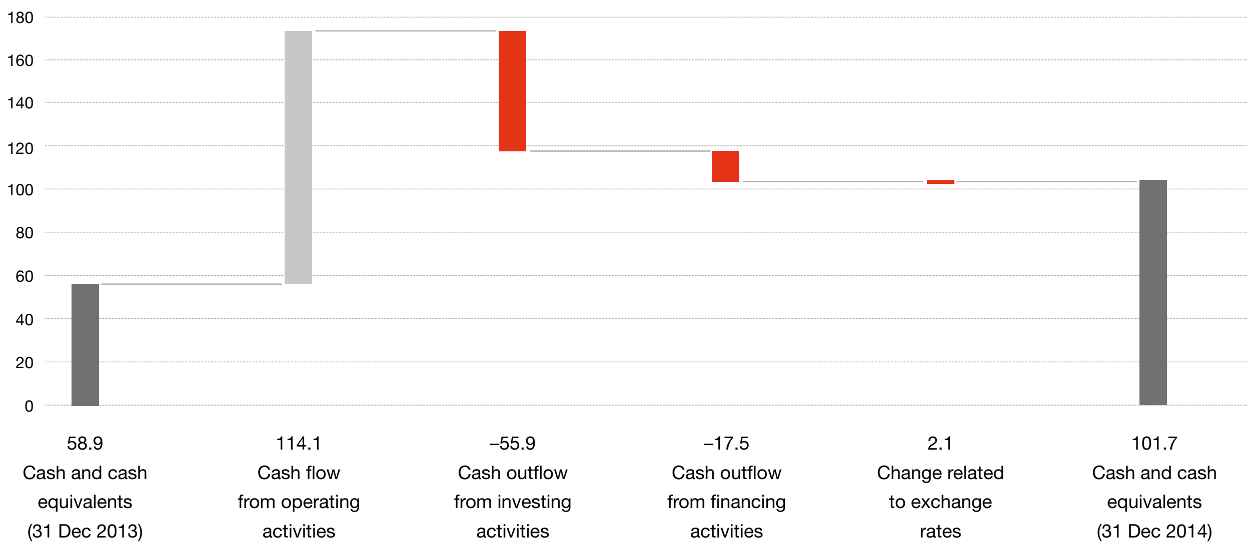


DCS operating profit In the DEUTZ Customised Solutions segment, earnings (EBIT before one-off items) fell by €20.2 million year on year to €18.8 million (2013: €39.0 million). In addition to the fall in the volume of business, this decline largely related to impairment losses totalling €9.5 million recognised on property, plant and equipment and intangible assets and to the adjustment of the equity-accounted value of our Argentinian joint venture DEUTZ AGCO MOTORES S.A., which equated to a decrease of €1.8 million.

Other The operating loss of the Other segment amounted to €2.3 million (2013: loss of €0.2 million) and was particularly affected by the write-off of a loan to our joint venture DEUTZ AGCO MOTORES S.A. Because the segment structure of the DEUTZ Group at the time the loan was granted was not comparable with the current segment structure, the amount receivable for the loan was not assigned to either the DCE or the DCS segment.

DEUTZ Group: Change in cash and cash equivalents

€ million



FINANCIAL POSITION

BASIC PRINCIPLES AND OBJECTIVES OF FINANCIAL MANAGEMENT

Overview of the DEUTZ Group's financial position

	2014	2013
€ million		
Cash flow from operating activities	114.1	105.0
Cash flow from investing activities	–55.9	–84.6
Cash flow from financing activities	–17.5	–13.2
Change in cash and cash equivalents	40.7	7.2
Free cash flow from continuing operations	52.0	13.8
Cash and cash equivalents at 31 December	101.7	58.9
Current and non-current interest-bearing financial liabilities at 31 December	88.0	90.6
Net financial position at 31 December	13.7	–31.7

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

Net financial position: cash and cash equivalents minus current and non-current interest-bearing financial liabilities.

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

FUNDING

Syndicated credit line and loan from the European Investment Bank ensure sufficient liquidity In order to ensure sufficient liquidity, DEUTZ has at its disposal a syndicated, revolving working capital facility of €160 million provided by a consortium of banks. It is a floating-rate, unsecured line. In 2014, the term of the facility was extended to May 2019. 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 €82.8 million at 31 December 2014. 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 medium to long term.

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 required to cover the period from the preliminary financing of production to receipt of payment from the customer. The volume of factoring on the balance sheet date was lower than at the end of 2013 as a result of the business situation, the volume as at 31 December 2014 being around €107 million (31 December 2013: €175 million).

FREE CASH FLOW

At the end of 2014, cash flow from operating activities amounted to €114.1 million, which was €9.1 million higher than at the end of the previous year (31 December 2013: €105.0 million). Due to the level of orders, there was a greater increase in working capital in 2013 than in 2014.

The cash flow from investing activities in the reporting period fell sharply from minus €84.6 million in 2013 to minus €55.9 million. The primary factor accounting for the decline of €28.7 million were the lower payments associated with capital spending on property, plant and equipment and intangible assets. The sale of our shareholding in DEUTZ Versicherungsvermittlung GmbH at the end of 2013 contributed to this decline because the transaction did not affect cash flow until the first quarter of 2014.

Financing activities in 2014 resulted in a net cash outflow of €17.5 million (2013: €13.2 million). This year-on-year change was largely attributable to the 2013 dividend payment amounting to €8.5 million but it was partly offset by lower borrowing costs in terms of payments of interest and principal.

Cash and cash equivalents as at 31 December 2014 had risen by €42.8 million and stood at €101.7 million (31 December 2013: €58.9 million). The net financial position[1] improved significantly, having risen by €45.4 million since the end of 2013 to €13.7 million at 31 December 2014, the first time it had returned to positive territory since 2009.

Primarily due to the lower amount of net cash used for investing activities, the free cash flow[2] was almost four times higher than in 2013 (€13.8 million), having risen by €38.2 million to €52.0 million and significantly exceeded our forecast at the beginning of the year.

CAPITAL EXPENDITURE ON PROPERTY, PLANT AND EQUIPMENT AND ON INTANGIBLE ASSETS

After deducting investment grants, capital expenditure on property, plant and equipment and intangible assets in 2014 totalled €66.6 million, which was €9.7 million less than in 2013 (€76.3 million). Of this total expenditure, €37.0 million was accounted for by property, plant and equipment (2013: €35.5 million) and €29.6 million (2013: €40.8 million) by intangible assets. The capital expenditure on property, plant and equipment focused on production facilities and tools for engines that meet new emissions standards. Capital expenditure on intangible assets was mainly spent on the refinement of existing engines to meet new exhaust emissions standards. Before the capitalisation of development expenditure, €40.3 million was spent on capital investment, a similar level to the previous year (2013: €42.5 million). Because demand in the Chinese market is not following the anticipated trend, virtually all growth-related capital expenditure in China is now on hold, with the result that capital spending is much lower than envisaged in our forecast at the beginning of the year.

The bulk of the total capital expenditure after deducting investment grants – €57.8 million – was invested in the DEUTZ Compact Engines segment (2013: €69.2 million). Capital expenditure in DEUTZ Customised Solutions was €8.8 million (2013: €7.1 million). As was the case in 2013, investing activities in both segments focused on property, plant and equipment and on development expenditure.

NET ASSETS

Overview of the DEUTZ Group's assets

	31 Dec 2014	31 Dec 2013	Change
€ million			
Non-current assets	625.8	627.4	–1.6
Current assets	523.0	493.2	29.8
Assets classified as held for sale	0.4	0.4	–
Total assets	**1,149.2**	**1,121.0**	**28.2**
Equity	511.0	504.7	6.3
Non-current liabilities	322.7	292.5	30.2
Current liabilities	315.5	323.8	8.3
Total equity and liabilities	**1,149.2**	**1,121.0**	**28.2**
Working capital (€ million)	196.2	172.3	23.9
Working capital ratio at the balance sheet date (%)	12.8	11.9	0.9
Working capital ratio (average, %)	13.3	12.0	1.3
Equity ratio (%)	44.5	45.0	–0.5

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

Non-current assets Non-current assets of the DEUTZ Group totalled €625.8 million as at 31 December 2014 (31 December 2013: €627.4 million). This slight decrease was primarily attributable to the change in property, plant and equipment and intangible assets. Because the production launch of the new engines for the EU Stage IV/US Tier 4 emissions standards had been completed, we reduced our investing activities in this area as planned. The additions to property, plant and equipment amounting to €37.0 million and to intangible assets amounting to €29.6 million were offset by higher depreciation charges of €51.6 million and higher amortisation charges of €55.9 million. In addition to higher depreciation and

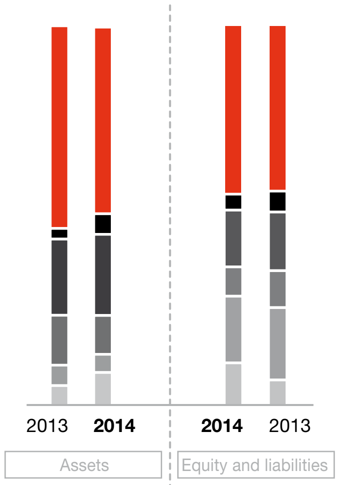
[1] Net financial position: cash and cash equivalents less current and non-current interest-bearing financial liabilities.
[2] Free cash flow: cash flow from operating and investing activities minus net interest expense.

DEUTZ Group: Balance sheet structure

in % (2013 figures)

Assets

49.0	(53.2)	Non-current assets
5.4	(2.8)	Deferred taxes
21.3	(20.0)	Inventories
10.6	(13.3)	Trade receivables
4.8	(5.4)	Other receivables and assets
8.9	(5.3)	Cash and cash equivalents



Equity and liabilities

44.5	(45.0)	Equity
4.2	(4.8)	Other liabilities
14.9	(18.0)	Trade payables
7.7	(8.1)	Financial liabilities
17.5	(16.4)	Pension provisions
11.2	(7.7)	Other provisions

amortisation expenses, changes in market forecasts and adverse economic developments in key markets made it necessary to recognise impairment losses on property, plant and equipment (€2.1 million) and intangible assets (€9.2 million).

Current assets Current assets were also higher than at the end of 2013, having risen by €29.8 million to €523.0 million (31 December 2013: €493.2 million). This year-on-year change was mainly attributable to higher cash and cash equivalents at the year end.

Working capital Working capital as at 31 December 2014 amounted to €196.2 million (31 December 2013: €172.3 million). The year-on-year increase of €23.9 million was mainly caused by higher levels of inventories and lower trade payables, while trade receivables were also lower. In association with this change in working capital, there was also an increase in the working capital ratio, i.e. the ratio of working capital (inventories plus trade receivables less trade payables) to revenue. As at the balance sheet date, this ratio was 12.8 per cent compared with 11.9 per cent as at 31 December 2013. The average working capital ratio, i.e. the ratio of average working capital at the four quarterly reporting dates to the revenue for twelve months, had also deteriorated year on year. It was 12.0 per cent in 2013 but 13.3 per cent in 2014, although this was a slight improvement on the 14.0 per cent that we had expected at the beginning of the year. This rise was related to the changes to the emissions standard in Europe and the United States.

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

Equity ratio As at 31 December 2014, equity stood at €511.0 million (31 December 2013: €504.7 million). The main reasons for the increase of €6.3 million were the level of net income in the reporting year and positive effects of translating our subsidiaries' financial statements that are prepared in foreign currencies. However, these effects were partly offset by expenses resulting from lower discount rates used in the measurement of pension liabilities and the payment of the dividend for 2013. At the end of 2014, the equity ratio was 44.5 per cent (31 December 2013: 45.0 per cent) and matched the target specified at the start of the year of above 40.0 per cent).

Non-current liabilities Non-current liabilities at 31 December 2014 had risen to €322.7 million (31 December 2013: €292.5 million). The increase of €30.2 million was largely attributable to higher provisions for pensions and other post-retirement benefits due to the fall in discount rates, the unexpected rise in provisions for warranty costs and the recognition of restructuring provisions relating to our decision to optimise our network of sites. The decline in financial liabilities partly offset this increase. Loan repayments due in the coming months were reclassified from non-current to current.

Current liabilities In contrast, current liabilities declined by €8.3 million to €315.5 million (31 December 2013: €323.8 million). A sharp fall in trade payables was the main reason for this decrease, but it was partly offset by the unexpected increase in provisions for warranty costs.

As at 31 December 2014, total assets amounted to €1,149.2 million, a year-on-year increase of €28.2 million (31 December 2013: €1,121.0 million).

OVERALL ASSESSMENT FOR 2014

The Company's performance in 2014 – a year in which we celebrated our 150th anniversary – was influenced by several exceptional items and the deterioration of market conditions over the course of the year, with the result that we failed to meet all the targets that we had set at the beginning of the year. However, it was encouraging that our new products were very well received by customers across all sectors all over the world. Revenue was up by 5.3 per cent to €1,530.2 million and sales of 196,403 engines represented a year-on-year rise of 6.7 per cent. The planned decline in business in the Automotive segment was fully offset by growth in other areas. The Mobile Machinery application was particularly successful. Our unit sales and revenue benefited from the advance production of engines, but demand from our customers will be lower in 2015. As a result, the level of new orders had already fallen by 16.4 per cent in 2014, compared with the record figure of €1,379.0 million in 2013. Operating profit (EBIT before one-off items) of €31.7 million was down on the previous year. The EBIT margin (before one-off items) stood at 2.1 per cent. Free cash flow amounted to €52.0 million, almost four times higher than at the end of 2013. Firstly, this is because all of our new products have now been launched on the market and the associated capital expenditure is being amortised, and secondly because the development costs and capital expenditure that had been increased in recent years could be scaled back. Our net financial position improved significantly, rising by €45.4 million to €13.7 million and returning to positive territory for the first time since 2009. In the year under review, we added 'operational excellence' to our growth programme in order to further improve the quality and efficiency of our Company. The introduction of a major optimisation of our sites in Germany was a key decision in this context. In view of the challenges currently presented by the market, we also carried out a critical review of our presence in China and we came to a decision after the balance sheet date that our sites in China also need to be consolidated.

The uncertainty prevailing in our markets has prompted us to increase our flexibility still further, which is how we intend to prepare the DEUTZ Group for a successful future.

EVENTS AFTER THE REPORTING PERIOD

In February 2015, we reached agreement with our partner AB Volvo not to set up the planned joint venture DEUTZ Engine (China) Co., Ltd., Linyi, China. Having completed a thorough and comprehensive review, we have now agreed to wind up this production company given the weak prevailing market situation in China.

EMPLOYEES

Overview of the DEUTZ Group's workforce

	31 Dec 2014	31 Dec 2013
Headcount		
DEUTZ Group	**3,916**	**3,952**
Thereof		
In Germany	3,093	3,095
Outside Germany	823	857
Thereof		
Non-salaried employees	2,338	2,356
Salaried employees	1,455	1,460
Trainees	123	136
Thereof		
DEUTZ Compact Engines	3,202	3,207
DEUTZ Customised Solutions	714	745

Slight adjustment in the number of employees At the end of 2014 the DEUTZ Group employed a total of 3,916 people, 36 fewer than at the end of 2013 (a fall of 0.9 per cent). As at 31 December 2014, we also had a further 288 people on temporary employment contracts, compared with 456 a year earlier. By offering fixed-term contracts and employing temporary workers, DEUTZ can respond flexibly to any fluctuations in demand. Around 10 per cent of all staff at DEUTZ had fixed-term or temporary contracts as at 31 December 2014.

79 per cent of our workforce is employed in Germany. Most of these employees are based in Cologne – 2,422 as at 31 December 2014. 387 employees are based at the Ulm facilities. Of the 823 employees outside Germany, 438 of them work at our DEUTZ SPAIN subsidiary.

DEUTZ Group: Breakdown of workforce by location

	31 Dec 2014	31 Dec 2013
Headcount		
Cologne	2,422	2,403
Ulm	387	408
Other	284	284
In Germany	**3,093**	**3,095**
Outside Germany	823	857
Total	**3,916**	**3,952**

Looking at it by segment, DEUTZ Compact Engines employed 3,202 people as at 31 December 2014, which was almost the same number as it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 714, down by 4.2 per cent compared with the end of 2013.

Further awards for DEUTZ training and trainees We offer young people a solid foundation for their future careers through our established training programme. In 2014, we provided training at our plants in Germany for 123 young men and women in various technical and commercial occupations. The Cologne site employed 83 young people, while the DEUTZ plant in Ulm employed nineteen. We employed 13 young people at the Xchange plant in Übersee, Bavaria, and a further seven apprentices are learning their trade at DEUTZ's components plant in Herschbach (Westerwald). We offer apprenticeships in the following technical and engineering occupations: skilled metal worker, mechatronics fitter, industrial electronics technician, milling machine operator, production mechanic, industrial mechanic, materials tester and warehouse operator. Our training centre also provides vocational training, on a part-time and full-time basis, for apprentices from ten other large and medium-sized companies.

In 2014 in Germany, our overall ratio of trainees to other employees was 4.0 per cent (2013: 4.4 per cent). All apprentices and trainees passing the final examination were given a permanent employment contract.

There was a special honour for two of our trainee industrial and production mechanics in Cologne, who were presented with Best Performer awards by the city's Chamber of Industry and Commerce (IHK).

In 2014, North Rhine-Westphalia's best trainee production mechanic also came from Cologne: as in the previous year, a top-performing apprentice from the DEUTZ training centre beat off competition from his peers to receive this coveted accolade from the Chamber of Industry and Commerce in Dortmund.

In 2014, for the fourth year in succession, the DEUTZ training centre received the Best Performer accolade from the Cologne IHK in recognition of its outstanding contribution to introductory vocational training. In an online public vote organised by the IHK, a DEUTZ trainer was named 'vocational trainer of the year', an honour that provides further evidence of the quality of the Company's training.

The dual vocational training initiative being run at our Spanish plant in Zafra entered its third year in 2014 with an intake of ten trainees. As planned, the three best graduates from the previous course visited Cologne for a week and gained valuable insights into the German vocational training system, our plants in Cologne and the city itself.

Initiatives to further the advancement of women continued
For a number of years now, we have been pushing to get young women interested in engineering careers before they have even left school by taking part in the nationwide Girls' Day initiative. Local schoolgirls are invited to our training centre, where they do hands-on exercises that give them an insight into technical occupations. The aim is to broaden their career choices. Currently around 7 per cent of apprentices learning technical and commercial trades at DEUTZ are female. In 2014, another young woman started a vocational apprenticeship with us in an engineering occupation.

The cross-mentoring initiative for the advancement of women, launched in 2013 by the city of Cologne, continued last year. The idea of the project, in which we have two mentees and two mentors, is to increase the proportion of women in management positions at the participating companies in the medium term. It once again focused on intensive meetings between mentees and mentors on a wide range of subjects, such as the work situation and careers of the mentees and how the mentors can help them in their daily lives. The programme was accompanied by various events, including a gender seminar and a range of personal coaching courses. Presentations were also given at the participating companies. At a workshop to draw preliminary conclusions, all those involved gave a positive verdict.

In addition, DEUTZ participated in the 'STEM role model' project initiated by the Association of German Engineers (VDI). STEM stands for Science, Technology, Engineering and Mathematics. The project aims to inspire young women to study science and engineering and to pursue careers in those areas. Using female role models, it seeks to dispel false preconceptions of STEM subjects and careers and thereby encourage women graduates to take up careers in industry and in science and research. Female engineers and scientists, and female students on STEM courses give presentations and organise workshops and information events where they talk to younger STEM students about their careers, their motivation and their experiences. One of DEUTZ's heads of department from the R&D division was an enthusiastic STEM role model between 2009 and 2014.

Continuation of recruitment activities In 2014, we again exhibited at two of the most prestigious university fairs in North Rhine-Westphalia, building on our success from previous years with a new stand. At meet@fhköln in Cologne and 'bonding' in Aachen, we made contact with students and graduates and presented our attractive career opportunities in Germany and abroad. These young engineering talents were also given an insight into DEUTZ engine technology. After all, we continue to be an attractive prospect for students: in 2014, our company employed a total of 249 students on work placements, of which 38 wrote their bachelor dissertation with us, 17 wrote their master's dissertation with us and four wrote their thesis with us. The best of these will be made available to all employees via the DEUTZ intranet. We also maintained our links with professors in 2014 so that we could exchange information about the latest research in vehicle technology.

Another of our priorities is to make young people with an interest in technology aware of our company's attractive training programmes while they are still at school. That is why we took part in various training fairs and careers information events again last year. We also offer our employees the opportunity to get involved with DEUTZ training activities in person, for example by taking part in initiatives such as the 'Erlebniswelt Maschinenbau' open day, when we open up our training centre to visitors and are available to answer questions.

Creative ideas are rewarded Through our bonus-based ideas management system we once again gathered creative suggestions for improvement from our employees. Last year, 733 ideas were submitted by DEUTZ employees – creativity that delivers.

Investing in people In 2014, we pressed ahead with our talent programme, the purpose of which is to ensure our company remains an attractive option for young, talented employees and to develop strong candidates internally through structured career planning. In conjunction with the current succession planning, this enables us to fill vacant managerial positions with people from within our own ranks. The numbers validate this approach: eleven managerial positions have been filled by graduates of the talent programme since 2011.

In 2014, we held numerous internal seminars and training courses focused on 'social and methodological skills' and on 'leadership' for employees and managers from various parts of the Company. These include the DEUTZ 'management driving licence', a modular management training course that has now been completed by 39 people. To upgrade the skills of our shopfloor staff, we worked with a training provider specialised in production management and lean management. As part of the Excellence development programme, a number of workshops were held with managers in which measures were devised for optimising the four key areas of structure, processes, employees and leadership.

Health promotion initiatives extended The 'Ergonomics in the workplace' pilot project has been running very successfully since 2013. Our aim is to firmly establish this initiative at DEUTZ because it will only begin to yield positive results after rigorous implementation over a period of years (see section on safety management, page 44 et seq.). Further preventive measures are being discussed in our working group on health and are scheduled for 2015. In Ulm there was a focus on providing training to managers. The aim is for them to be able to identify the first warning signs of various conditions so that they can take appropriate action at an early stage.

For the fourth year in a row, we took part in the HRS Business Run. The number of DEUTZ employees on the starting line rose again, to 294, building on the high turnout of the previous year. Our runners represented all different parts of the Company at all levels of seniority, from apprentices to members of the board. We once again finished in fourth place out of more than 550 companies. In addition to the sporting aspect, the annual HRS Business Run provides a great opportunity for people from across the Company to talk to each other and network.

Minimum-impact site optimisation agreed In June 2014, the social plan/reconciliation of interests required by German law was agreed for the closure of our Cologne-Deutz site. As part of the agreement, a new shaft centre is to be built at Cologne-Porz, giving a boost to the existing DEUTZ site and creating 140 jobs. The employees affected by the closure are being deployed in other functions in Cologne – in Porz or Kalk – and given appropriate training. They have also been given the option of terminating their employment contract with DEUTZ AG by mutual agreement and receiving a severance package. An interim employment company has also been set up to help the former employees find new jobs. In December, the Company and the local works council came to a mutual agreement on a reconciliation of interests and social plan for the planned relocation of all activities at the Übersee site on Lake Chiemsee. The relocation will take place in two phases, in 2015 and 2017. All employees will be offered a position in Ulm as well an attractive relocation package. Alternatively, they can transfer to an interim employment company or reach a severance agreement.

Short-time working in assembly and logistics Last year, because of stricter emissions standards coming into force on 1 October 2014, European customers built up a stock of advance-production engines that has resulted in reduced demand while these inventories are being used up. Because of this situation and a generally weak economic climate, short-time working was introduced in assembly and logistics from December 2014. A three-week shutdown of these two areas was also agreed so that additional short-time working could be avoided. Based on the current level of orders on hand, short-time working is expected to end by no later than the fourth quarter of 2015.

CORPORATE SOCIAL RESPONSIBILITY

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

Engine museum still popular with visitors The number of visitors to our DEUTZ engine museum rose again. More and more people from in and around Cologne, and from other parts of Germany and around the world, are taking the opportunity to discover the origins and history of global motorisation and original machines from the early days of the engine. This all started more than 150 years ago with the founding of N.A. Otto & Cie., the predecessor of today's DEUTZ AG.

Protected as a cultural asset of the Federal Republic of Germany, the engine collection on display at the technology centre in Cologne-Porz was given a fantastic new exhibit last year, dating from the time of Germany's post-war economic miracle: the 'see-through engine', equivalent to the F12L614 model, a twelve-cylinder drive unit producing 184kW (250HP), was unveiled to the world for the first time in 1955 at the Frankfurt International Motor Show as an exhibition piece. This 'see-through engine' was built by our trainees in Ulm. The air-cooled engine powered the Magirus Deutz Uranus, the most powerful German truck of its day.

Getting young people and the unemployed into careers As part of our corporate social responsibility, we have been working closely for more than 23 years 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 2014, a total of 36 participants underwent basic metalwork training over a ten-month period at the DEUTZ training centre, which equipped them with the skills they will need to take up a career. We also teamed up with the Spanish government to launch a programme at our plant in Zafra which will train people with no formal vocational education as machine operators. Graduates of the programme are given an official certificate that will improve their career prospects.

Integration of disabled and disadvantaged people For more than 25 years, DEUTZ AG has worked with Nostra GmbH, one of the largest and oldest organisations for the integration of disabled and disadvantaged people in Germany. The project finds employment in the regular labour market for 40 people who have severe disabilities or are socially disadvantaged. All participants are accommodated in special integration groups, in which disabled and non-disabled people work together in a spirit of inclusivity. This integration of the skills of disabled, socially disadvantaged and non-disabled people is proving particularly successful in the project at the DEUTZ AG site, and is clearly apparent on a day-to-day basis in the interactions with the staff there. DEUTZ has also worked in partnership with GWK, a not-for-profit organisation based in Cologne promoting the integration of people with disabilities, for more than 40 years. In 2014, more than 100 people at GWK were involved in work for DEUTZ. The goods inward, packaging and component manufacturing services provided by Nostra and GWK are closely integrated with DEUTZ AG's processes. We benefit from the high level of precision demonstrated by their employees, which is backed up by comprehensive investment by both organisations in the training of staff and in their machinery and equipment.

Company choir a highlight at DEUTZ's 150th anniversary celebration The performance given by the DEUTZ choir at the anniversary celebration on 9 May 2014 at the Koelnmesse exhibition centre was the most important and the most enduring in its almost 70-year history. Accompanied by Danish soprano Lisa Tjalve and led by artistic director Heinz Walter Florin, the choir sang themselves into the hearts of the international audience with a multilingual programme. Another highlight last year was the series of summer concerts at Cologne Philharmonic Hall.

DEUTZ has long been committed to diversity management: we value the diversity of our individual employees around the world – in terms of gender, origin, age, religion and disability – and we try to harness this for the success of the Company. For example, we have a clear target to increase the number of management positions within the DEUTZ Group that are occupied by women. We talk about our efforts to support young people, to help women advance in the workplace (cross-mentoring) and other diversity-focused activities in the 'Employees' section on pages 40 et seqq. of this annual report.

The members of the Board of Management and managers at DEUTZ are fully aware of their responsibility to set an example. For many years, they have been personally involved in various charitable associations, trade associations, committees, trusts and other forums.

ENVIRONMENT

Protection of the environment and the prevention of climate change are key corporate objectives for DEUTZ. We manufacture environmentally responsible products that meet the latest emissions standards and even future emissions standards and therefore make a vital contribution to protecting the environment. Our production processes are also resource-efficient. More than ten years ago, DEUTZ decided to implement an environmental management system as a way of contributing effectively to environmental protection. The system keeps track of aspects that are highly relevant to the environment, such as keeping the air clean, the avoidance and correct disposal of waste, protecting against soil and water pollution and sustainably reducing energy consumption.

ENERGY MANAGEMENT SYSTEM

Our energy management system at the Cologne-Deutz site was successfully certified back in November 2013. In April 2014, as part of the annual quality and environmental audit, the certification body DNV GL once again accredited the system without any nonconformities. As planned, the ISO-50001 certificate was then extended to all German sites.

The energy monitoring scheme was also expanded in 2014. The installation of additional energy meters and the centralised recording of the energy data provided by these gives the Company a transparent overview of energy flows. This information can then be analysed to find ways to deliver further efficiency gains or to monitor the performance of completed projects. The initiatives implemented in previous years remain effective. Additional potential was leveraged in 2014 through the implementation of various technological and organisational measures. The resulting annual cost savings amount to 750 MWh of electricity and 515 MWh of heat.

However, the potential for further savings is far from exhausted: additional efficiency measures and the final phase in the expansion of the monitoring system are already being planned for 2015.

DEUTZ Group: Energy consumption in European plants[1)]

	2014	2013
MWh		
Electricity	90,611	93,714
Natural gas	33,616	43,681
District heating	22,596	27,270
Heating oil	3,456	4,501
Diesel fuel[2)]	32,313	33,062

[1)] Deutz, Kalk, Porz, Herschbach, Ulm, Übersee, Zafra (SP).
[2)] At 9.85 kWh/litre (mean).

ENVIRONMENTAL MANAGEMENT SYSTEM

In March 2014, the certification body DNV confirmed that the DEUTZ AG environmental management system conforms to the international norm DIN EN ISO 14001. The audit that preceded this verdict was carried out over several days by a team put together by DNV to assess the Company's management systems for quality, environmental aspects and energy.

In 2014, all departments initiated measures to create an 'Integrated DEUTZ Management System' from the aforementioned management systems. This will generate synergies that result from similarities in how the management systems are structured.

DEUTZ Group: Emissions per engine in European plants

	2014	2013
CO_2 emissions (kg)	360	416
Nitrogen oxide (kg)	0.140	0.142
Dust (g)	2.7	2.9
Benzene (mg)	48.6	49.7

Further improved figures for air purity In 2014, we made significant reductions in the main types of emission generated by our production processes, including nitrogen oxide, carbon dioxide and benzene. This is a result of the ongoing improvements to the DEUTZ exhaust aftertreatment systems.[1)]

Reducing the length of time that diesel engines spend in testing has also played a key role in lowering emissions. Leaner test programmes, rigorous standardisation of test rig technology and changes to processes in the preparation of engine tests have cut the testing time for diesel engines with capacities of less than four litres by around four minutes and for diesel engines with capacities of above four litres by around 1.5 minutes compared with 2013. The ongoing reduction of test times is especially important for DEUTZ because the regulated test areas in Cologne account for the highest proportion of emissions in the Company. This approach is also particularly effective from an economic and environmental perspective as it not only lowers emissions but also saves resources.

In 2014, for example, 563,000 litres of fuel were used to test compact engines in the test area at the Cologne-Porz production site (2013: 689,000 litres). This equates to a fuel saving of 18 per cent, even though the number of engines tested rose in comparison with 2013.

By introducing the energy management system and by optimising operating times, which was mainly done in the fourth quarter due to the production programme, we were able to reduce carbon dioxide emissions resulting from product-manufacturing processes by 13.5 per cent on the previous year (2014: 360kg/engine; 2013: 416kg/engine). The significant drop in CO_2 emissions in comparison with 2013 was primarily due to the production sites in Germany and Spain lowering their consumption of district heating, natural gas and electricity.

[1)] Average values from the mix of all products.

Focus on water protection measures In a research and development initiative, the equipment at the testing centre that has to meet water pollution regulations was brought up to date with the latest technology. In the final phase, completed in 2014, the areas subject to the provisions of the German Water Resources Act were upgraded and the pipes used to transport and collect waste materials were replaced. Just under €0.2 million was invested in these measures. In addition, an independent expert conducted an extensive check of all underground pipes of tank facilities at the site in Cologne. No defects were found. On this basis, we do not currently expect any disruptions that would affect the availability of the facilities and which in a worst-case scenario could lead to contamination of the soil and groundwater.

Waste disposal and handling of hazardous waste A successful waste disposal system begins with the avoidance of non-reusable packaging. Because making an engine requires such a large number of components to be supplied by such a large number of providers, we need to conduct regular checks to ensure that reusable packaging is being used in preference to non-reusable packaging in the production cycle. Such packaging can only be used if our high quality standards and transport methods allow it. In 2014, DEUTZ invested €1.1 million in the sourcing of reusable packaging. Hazardous and non-hazardous waste from production and manufacturing is only disposed of by companies that are certified to do so under the requirements set out in the Ordinance on Specialised Waste Management Companies (EfbV). The DEUTZ AG safety department carries out spot checks on the companies contracted by us to remove and transport waste. No cases of non-compliance with the statutory norms have thus far been found.

SAFETY MANAGEMENT

In the area of workplace health and safety, the Board of Management of DEUTZ AG has set itself the most ambitious target imaginable: reducing the number of accidents to zero. In order to achieve this, measures are necessary that go well beyond the requirements imposed by law and by the employers' liability insurance association.

Accident frequency[2)] (AF), the number of notifiable workplace accidents in relation to the number of hours worked, fell again in 2014 to reach 20.8 (2013: 21.3). This highlights the continuing impact of DEUTZ's health and safety at work measures.

In 2014, the number of notifiable accidents per thousand employees[3)] rose slightly on the previous year to reach 26.1 (2013: 24.3). The increase was due to the fact that in 2014 there were, on average, fewer employees dealing with a busier production programme.

To ensure that the safety of our workers is continually being improved, all accidents – regardless of their severity – are reported and evaluated by the team so that action can be taken to prevent a repeat.

[2)] Accident frequency: number of accidents per 1 million hours worked (as defined by the employers' liability insurance association).
[3)] Known as TMQ (Tausend-Mann-Quote) in German.

In 2014, the health management department of DEUTZ AG joined forces with the Pronova health insurance scheme to launch a programme aimed at improving health and safety – and specifically ergonomics – at workstations in manufacturing and production. As part of this initiative, trained physiotherapists were brought in to talk to employees at their workstations and give them tips and advice on ergonomic matters. DEUTZ sees these training sessions as an opportunity to take early preventive action to counteract some of the problems related to demographic change in society. In the year under review, Pronova made a financial contribution to the running of an ergonomics programme. This sort of training can only succeed if it has long-term backing, so we intend to continue our support.

DEUTZ AG

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

BASIC PRINCIPLES AND BUSINESS PERFORMANCE OF DEUTZ AG

DEUTZ AG is the parent company of the DEUTZ Group. At home and abroad, DEUTZ AG has various direct and indirect subsidiaries and equity investments. The subsidiaries include a production facility in Spain, two production companies in China and several companies that perform sales and service functions. DEUTZ AG has a direct or indirect stake in a total of 29 companies. It is also by far the largest production company of the DEUTZ Group and provides the head-office functions for the Group.

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 pages 26 et seqq. 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 pages 25 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:

DEUTZ AG: Reconciliation

€ million	
DEUTZ Group net income (IFRS)	**19.5**
Consolidation of equity investments	–11.5
DEUTZ AG income (IFRS)	**8.0**
Material differences due to different financial reporting standards	
Recognition of development expenditure	21.5
Measurement of provisions for pensions and other post-retirement benefits	–7.6
Other differences relating to the financial reporting standards	2.5
DEUTZ AG net income (HGB)	**24.4**

RESULTS OF OPERATIONS

Overview of DEUTZ AG's results of operations

	2014	2013
€ million		
Revenue	**1,437.8**	**1,366.6**
Cost of sales	–1,280.6	–1,229.2
Research and development costs	–54.0	–53.9
Selling and administrative expenses	–68.8	–68.6
Other operating income	31.1	22.1
Other operating expenses	–15.9	–9.2
Net investment income	–7.3	21.9
Write-downs of investments	–0.7	–
Operating profit (EBIT)	**41.6**	**49.7**
Interest expenses, net	–11.6	–12.0
Profit from ordinary activities	**30.0**	**37.7**
Net extraordinary expense	–19.4	–2.3
Income taxes	15.0	4.4
Other taxes	–1.2	–0.6
Net income	**24.4**	**39.2**

Revenue In 2014, the revenue generated by DEUTZ AG increased by 5.2 per cent to €1,437.8 million (2013: €1,366.6 million), largely driven by higher demand in our largest application segment, Mobile Machinery. Our revenue in this segment grew substantially to €677.8 million, a rise of 46.7 per cent (2013: €462.0 million). The service business and the Stationary Equipment application segment managed modest increases of 3.1 per cent and 3.4 per cent respectively, but Agricultural Machinery generated 19.0 per cent less revenue. Revenue in the Automotive application segment more than halved because, as already mentioned above, DEUTZ has not introduced the Euro 6 emissions standard. Our automotive business is shifting strongly towards Asia, particularly to our DEUTZ (Dalian) Engine Co., Ltd. joint venture.

In terms of regions, our revenue in the Americas region was up significantly, rising by 42.7 per cent to €209.7 million. In the EMEA region (Europe, Middle East and Africa) revenue amounted to €1,135.9 million, roughly at its prior-year level, while the revenue generated in the Asia-Pacific region declined by 2.0 per cent to €92.2 million.

Earnings performance In 2014, DEUTZ AG generated operating profit (EBIT) of €41.6 million (2013: €49.7 million), a year-on-year fall of €8.1 million that was primarily attributable to the sharp decline in net investment income. Because of declining demand in the Chinese market and a resultant change in our strategy, the carrying amounts for our shareholdings in DEUTZ Engine (Shandong) Co., Ltd. and DEUTZ Engine (China) Co., Ltd. were reduced at the level of our holding companies DEUTZ Asien Verwaltungs GmbH and DEUTZ Engine (China) GmbH. The profits distributed by our subsidiaries DEUTZ Corporation and DEUTZ Spain S.A. were also lower than in 2013. The unexpected addition to provisions for warranty costs also had a negative impact on operating profit.

Earnings before interest, tax, depreciation and amortisation (EBITDA) at DEUTZ AG amounted to €90.0 million in 2014 compared with €96.9 million in 2013.

Cost of sales DEUTZ AG's cost of sales in 2014 amounted to €1,280.6 million (2013: €1,229.2 million). The year-on-year increase of €51.4 million was mainly attributable to the volume-related rise in the costs of materials, staff and contract workers, but an unexpected addition to provisions for warranty costs also played a part. As a percentage of revenue, the cost of sales improved year on year from 89.9 per cent to 89.1 per cent.

Research and development costs Research and development costs remained virtually unchanged on the previous year, rising by €0.1 million to €54.0 million (2013: €53.9 million). Research and development costs largely comprised staff costs and cost of materials. Any investment grants received were deducted from this expenditure. Unlike the development expenditure in the DEUTZ Group, which is recognised in accordance with IFRS requirements, the development expenditure in DEUTZ AG is recognised in accordance with the provisions of the German Commercial Code (HGB) and is not capitalised on the basis that the projects started before the initial application of the requirements of the German Accounting Law Modernisation Act (BilMoG).

Selling and administrative expenses Selling and administrative expenses in 2014 came to €68.8 million, an increase of €0.2 million compared with 2013 (€68.6 million). On the other hand, when measured as a proportion of revenue, selling and administrative expenses declined slightly, from 5.0 per cent in 2013 to 4.8 per cent in 2014, owing to the higher volume of business.

Other operating income There was a sharp rise in other operating income in 2014, which was €9.0 million higher at €31.1 million (2013: €22.1 million). This was primarily attributable to positive effects arising on the translation of foreign currency positions. However, the year-on-year increase in foreign currency gains was offset by a rise in foreign currency losses in the same period. Foreign currency losses are reported in other operating expenses.

We also recognised a higher value for our shareholding in our subsidiary DEUTZ Australia (Pty), Ltd. due to its improved earnings prospects.

Other operating expenses Other operating expenses were also up year on year, rising by €6.7 million to €15.9 million (2013: €9.2 million). This rise was mainly the result of an addition to provisions for pensions and other post-retirement benefits because of changes in measurement parameters. It was also attributable to the impairment loss recognised on other receivables due from our DEUTZ AGCO MOTORES S.A. joint venture owing to the company's poorer earnings prospects. Finally, higher expenses resulting from foreign-currency transaction also contributed to the change.

Net investment income Net investment income was significantly down on the previous year, declining by €29.2 million to minus €7.3 million (2013: €21.9 million). This was primarily the result of the transfer of losses from the DEUTZ Asien Verwaltungs GmbH and DEUTZ Engine (China) GmbH holding companies. Because of the revised assessment of the Chinese market, we reviewed our strategy regarding our Chinese equity investments DEUTZ Engine (Shandong) Co., Ltd. and DEUTZ Engine (China) Co., Ltd. As a consequence, the carrying amounts for these two companies were reduced at holding-company level. In the case of DEUTZ Engine (China) GmbH, the negative impact of currency translation also accounted for a large proportion of the loss. Furthermore, the profits distributed by our subsidiaries DEUTZ Corporation and DEUTZ Spain S.A. were lower than in 2013.

Impairment of investments In 2014, we adjusted the carrying amount of our equity investment in our Argentinian joint venture DEUTZ AGCO MOTORES S.A. due to adverse market conditions in South America.

Net interest expense Net interest expense in 2014 amounted to €11.6 million (2013: net expense of €12.0 million) representing a small year-on-year improvement of €0.4 million.

Extraordinary items In 2014, extraordinary items amounting to minus €19.4 million largely comprised expenses in connection with the optimisation of our sites. As in 2013, an addition was also made to the provisions for pensions and other post-retirement benefits of the difference arising under the initial application of BilMoG. This difference came about as a result of the remeasurement of the provisions for pensions and other post-retirement benefits on 1 January 2010.

Income taxes The income tax income of €15.0 million arose from the recognition of higher provisions under HGB compared with the tax accounts and partly from increased deferred tax assets due to the findings of the tax audit carried out for 2009 to 2011. These findings led to restatement of the tax accounts as at 31 December 2014. Furthermore, deferred tax assets related to the possible utilisation of loss carryforwards in the future have been recognised.

Net income Owing to the negative extraordinary item, the net income for the reporting year fell by €14.8 million year on year to €24.4 million (2013: €39.2 million).

At the Annual General Meeting, the Board of Management, in agreement with the Supervisory Board, will propose using €8.5 million of the accumulated income to pay a dividend of €0.07 per share.

FINANCIAL POSITION

Overview of DEUTZ AG's financial position

	2014	2013
€ million		
Cash flow from operating activities	85.2	63.0
Cash flow from investing activities	–23.0	–49.9
Cash flow from financing activities	–19.1	–14.3
Change in cash and cash equivalents	43.1	–1.2
Free cash flow	58.8	8.8
Cash and cash equivalents at 31 December	73.9	30.8

Free cash flow: cash flow from operating and investing activities minus 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 37 of this combined management report.

Liquidity In 2014, cash flow from operating activities amounted to €85.2 million. The year-on-year increase of €22.2 million was attributable, above all, to an encouraging operating performance before the addition to provisions for warranty costs and restructuring.

The cash flow from investing activities in 2014 was minus €23.0 million (2013: minus €49.9 million). The cash outflows were largely in connection with capital expenditure on production facilities and tools for the engines for the new exhaust emissions standards.

Cash flow used for financing activities in 2014 totalled €19.1 million (2013: €14.3 million). This year-on-year increase was largely attributable to the dividend payment for 2013 amounting to €8.5 million.

Free cash flow shot up compared with 2013 and amounted to €58.8 million for the year, an increase of €50.0 million (2013: €8.8 million).

Capital expenditure After deducting investment grants, DEUTZ AG's capital expenditure in 2014 amounted to a total of €32.9 million (2013: €51.0 million). Spending largely related to property, plant and equipment, and the amount of €30.0 million (after deducting grants) spent on these assets was level with that of the previous year (2013: €28.4 million). As was also the case in 2013, the bulk of the expenditure went on production facilities and tools for engines that meet the new exhaust emissions standards. By contrast, the decline of €18.1 million in overall investing activities largely related to investments. While in 2013, capital was injected into DEUTZ Engine China GmbH, Cologne, in connection with the establishment of DEUTZ Engine (China) Co., Ltd., Linyi, China, and a loan was made to our Spanish subsidiary DEUTZ Spain S.A., Zafra, Spain, there was no capital expenditure on investments in 2014.

NET ASSETS

Overview of DEUTZ AG's net assets

	31 Dec 2014	31 Dec 2013
€ million		
Non-current assets	502.0	518.8
Current assets	404.5	382.9
Prepaid expenses	2.0	2.5
Deferred tax assets	85.3	66.6
Total assets	**993.8**	**970.8**
Equity	453.9	438.0
Provisions	284.0	242.6
Liabilities	255.3	289.6
Deferred income	0.6	0.6
Total equity and liabilities	**993.8**	**970.8**
Working capital (€ million)	80.6	73.5
Working capital ratio at the balance sheet date (%)	5.6	5.4
Equity ratio (%)	45.7	45.1

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

Non-current assets Non-current assets at 31 December 2014 amounted to €502.0 million (31 December 2013: €518.8 million). The year-on-year decrease of €16.8 million was mainly due to the lower figure for property, plant and equipment because depreciation charges were higher than new capital expenditure during the year.

Current assets As at 31 December 2014, current assets amounted to €404.5 million. This increase of €21.6 million compared with current assets as at 31 December 2013 (€382.9 million) largely resulted from the higher volume of cash and cash equivalents held on 31 December 2014, although it was partly offset by a decline in trade receivables.

Working capital Working capital as at 31 December 2014 amounted to €80.6 million (31 December 2013: €73.5 million), up by €7.1 million year on year. While inventories remained virtually the same, this increase in working capital was principally attributable to a fall in trade payables. Trade receivables were also down, which counteracted much of the impact. As a consequence, there was also a slight increase in the working capital ratio, i.e. the ratio of working capital (inventories plus trade receivables less trade payables) to revenue. As at the balance sheet date[1], this ratio was 5.6 per cent compared with 5.4 per cent as at 31 December 2013.

Deferred tax assets The rise in deferred tax assets arose from the recognition of higher provisions under HGB compared with the tax accounts and partly from increased deferred tax assets due to the findings of the tax audit carried out for 2009 to 2011. These findings led to restatement of the tax accounts as at 31 December 2014. Furthermore, deferred tax assets related to the possible utilisation of loss carryforwards in the future have been recognised.

Equity ratio Owing to the positive level of net income, equity advanced by €15.9 million to €453.9 million (31 December 2013: €438.0 million). The equity ratio increased slightly to reach 45.7 per cent as at 31 December 2014 (31 December 2013: 45.1 per cent).

Provisions At 31 December 2014, provisions stood at €284.0 million (31 December 2013: €242.6 million). The significant increase of €41.4 million compared with the end of 2013 was largely attributable to higher provisions for potential warranty claims in the future and the recognition of restructuring provisions relating to our decision to optimise our network of sites.

Liabilities As at 31 December 2014, liabilities had fallen by €34.3 million to €255.3 million (31 December 2013: €289.6 million), primarily due to the decline in trade payables, partly resulting from the lower production volume at the end of the year under review.

EVENTS AFTER THE REPORTING PERIOD

In February 2015, we reached agreement with our partner AB Volvo not to set up the planned joint venture DEUTZ Engine (China) Co., Ltd., Linyi, China. Having completed a thorough and comprehensive review, we have now agreed to wind up this production company given the weak prevailing market situation in China.

EMPLOYEES

As at 31 December 2014, 3,125 people were employed by DEUTZ AG[2]. The number of employees was therefore at the same level as the previous year (31 December 2013: 3,126 employees). We also had a further 252 people on temporary employment contracts as at 31 December 2014, compared with 436 a year earlier. Employing temporary workers enables us to respond flexibly to any fluctuations in demand.

Looking at it by segment, DEUTZ Compact Engines employed 2,607 people as at 31 December 2014, which was 21 more than it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 518, down by 22 on the previous year.

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 53 to 54.

Because DEUTZ AG is closely integrated with the other Group companies, its risk 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 earnings and dividend payments and the internal business relations. The risks associated with the DEUTZ Group can be found on pages 54 to 56 of this combined management report.

Information about DEUTZ AG's internal accounting-related control system can be found on pages 56 et seq. of this combined management report.

OUTLOOK

DEUTZ AG performs the head-office functions of the DEUTZ Group and is the biggest production company within the Group by some margin. Because of DEUTZ AG's wide-ranging relationships with other Group companies and because of its size within the Group, the expectations presented in the Group outlook for 2015 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. Overall, we believe that net income for 2015 will be slightly up on 2014.

CORPORATE GOVERNANCE DECLARATION PURSUANT TO SECTION 289A HGB

The corporate governance declaration pursuant to section 289a of the German Commercial Code (HGB) is an integral element of the combined management report. We refer here to our remarks on pages 127 to 130 of the annual report.

[1] Working capital ratio as at the balance sheet date: ratio of working capital (inventories plus trade receivables minus trade payables) at the end of the reporting period to revenue for the preceding twelve months.
[2] Number of employees incl. apprentices and trainees.

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

Composition of the issued capital There were no changes to the issued capital (share capital) of DEUTZ AG in 2014. As at 31 December 2014, the issued capital amounted to €308,978,241.98 and was divided into 120,861,783 no-par-value bearer shares.

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

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

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

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

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

According to article 14 of the Statutes of DEUTZ AG:

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

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

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 €82.8 million. Under the terms of the loan agreements, the lenders can demand that the outstanding loan be repaid within a specified period in the event of a change of control, i.e. one or more people acting jointly acquire a direct or indirect shareholding of at least 50 per cent of all shares and/or voting rights in DEUTZ AG.

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

The service contracts of the Board of Management members Dr Ing Helmut Leube and Dr Margarete Haase stipulate the following provision in the event of a change of control: if their appointment (1) is revoked within nine months of the change of control or (2) ends within nine months of a change to the legal form of DEUTZ AG and subject to certain other requirements, they will receive 150 per cent of the severance cap pursuant to item 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 German Securities Acquisition and Takeover Act (WpÜG) acquire 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 the current major shareholder, AB Volvo, or the former major shareholder, the SAME DEUTZ-FAHR GROUP, acquires more than 30 per cent of the voting rights in the Company.

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

Explanatory statement by the Board of Management in connection with sections 289 (4) and 315 (4) HGB The disclosures contained in the combined management report and management report pursuant to sections 289 (4) and 315 (4) HGB relate to arrangements that may be significant in the success of any public takeover bid for DEUTZ AG. It is the opinion of the Board of Management that these arrangements are normal for publicly traded companies comparable with DEUTZ AG.

REMUNERATION REPORT

REMUNERATION OF THE BOARD OF MANAGEMENT

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

The calculation of the annual bonus is based on the degree of attainment of annual performance targets (short-term targets). The number, content and weighting of the short-term targets are set annually by the Supervisory Board at its due discretion after consulting with the respective Board of Management member. The minimum level of target attainment for the payment of a bonus is 75 per cent; the maximum level of target attainment relevant to the payment of the bonus is 150 per cent. The highest amount that can be paid as a bonus in the case of maximum target attainment is determined by the respective service contract. Only 60 per cent of the annual bonus is paid out at the end of the year. The remaining 40 per cent of the bonus is paid out in two equal instalments, 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	**Dr Ing Helmut Leube Chairman of the Board of Management**			
	2013	**2014**	2014 (min)	2014 (max)
€ thousand				
Fixed remuneration	725	725	725	725
Additional benefits[1]	173	174	174	174
Total	**898**	**899**	**899**	**899**
One-year variable remuneration[2]	583	360	–	540
Multi-year variable remuneration				
2014–2015 deferral[2]	240	–	–	–
2015–2016 deferral[2]	–	240	–	360
2013–2017 LTI[3]	224	–	–	–
2014–2018 LTI[3]	–	196	–	300
Total	**1,047**	**796**	**–**	**1,200**
Total remuneration	**1,945**	**1,695**	**899**	**2,099**

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 2014, 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 2014.

One-year variable remuneration	352	7		
2014–2015 deferral	–	51		
2015–2016 deferral	–	–		
Total remuneration	**1,474**	**1,153**		

[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 29 to 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, reimbursement of travel expenses 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 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 pay, 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 clause 4.2.3 of the German Corporate Governance Code).

The service contracts of the Board of Management members Dr Ing Helmut Leube and Dr Margarete Haase stipulate the following provision in the event of a change of control: if their appointment (1) is revoked within nine months of the change of control or (2) ends within nine months of a change to the legal form of DEUTZ AG and subject to certain other requirements, they will receive 150 per cent of the severance cap pursuant to item 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 German Securities Acquisition and Takeover Act (WpÜG) acquire 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 the current major shareholder, AB Volvo, or the former major shareholder, the SAME DEUTZ-FAHR Group, acquires more than 30 per cent of the voting rights in the Company.

The table below presents the total remuneration of the Board of Management in accordance with the recommendation in the German Corporate Governance Code dated 25 June 2014. In line with this recommendation, the benefits granted in 2014 and those actually paid are reported separately.

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

	Dr Margarete Haase				**Michael Wellenzohn Joined 1 March 2013**			
	2013	**2014**	2014 (min)	2014 (max)	2013	**2014**	2014 (min)	2014 (max)
	550	573	573	573	350	420	420	420
	147	148	148	148	101	107	107	107
	697	**721**	**721**	**721**	**451**	**527**	**527**	**527**
	270	270	–	405	175	210	–	315
	180	–	–	–	117	–	–	–
	–	180	–	270	–	140	–	210
	168	–	–	–	144	–	–	–
	–	147	–	225	–	127	–	195
	618	**597**	**–**	**900**	**436**	**477**	**–**	**720**
	1,315	**1,318**	**721**	**1,621**	**887**	**1,004**	**527**	**1,247**
	191	1			124	1		
	–	38			–	25		
	–	–			–	–		
	1,056	**907**			**719**	**680**		

Combined management report

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

Benefits paid	Dr Ing Helmut Leube Chairman of the Board of Management		Dr Margarete Haase		Michael Wellenzohn Joined 1 March 2013	
	2014	2013	**2014**	2013	**2014**	2013
€						
Fixed remuneration	725	725	573	550	420	350
Additional benefits	174	173	148	147	107	101
Total	**899**	**898**	**721**	**697**	**527**	**451**
One-year variable remuneration	359	413	192	165	125	–
Multi-year variable remuneration						–
2009–2013 LTI	–	–	–	232	–	–
Total	**359**	**413**	**192**	**397**	**125**	**–**
Total remuneration	**1,258**	**1,311**	**913**	**1,094**	**652**	**451**

REMUNERATION OF THE SUPERVISORY BOARD

The remuneration paid to the Supervisory Board is specified in paragraph 15 of the Company's Statutes. This stipulates that the members of the Supervisory Board of DEUTZ AG receive a fixed annual remuneration of €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**
€			
Lars-Göran Moberg Chairman	45,000	65,000	110,000
Werner Scherer Deputy Chairman	33,750	45,000	78,750
Sabine Beutert	22,500	25,000	47,500
Göran Gummeson	22,500	12,500	35,000
Hans-Georg Härter	22,500	20,000	42,500
Michael Haupt	22,500	52,500	75,000
Herbert Kaufmann (since 7 January 2014)	22,130	12,500	34,630
Dietmar Paust	22,500	12,500	35,000
Eva Persson	22,500	12,500	35,000
Dr Witich Roßmann	22,500	12,500	35,000
Dr Herbert Vossel	22,500	12,500	35,000
Egbert Zieher	22,500	12,500	35,000
Total	**303,380**	**295,000**	**598,380**

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 a large number of opportunities, but also gives rise to business-specific risks.

Our objective is to generate profits on a sustained basis and to increase these profits significantly over the medium and long 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. As in prior years, suggestions for improvements proposed by the internal audit department, Risk Management Committee or the auditors were promptly implemented by DEUTZ.

RISK MANAGEMENT IN RELATION TO FINANCIAL INSTRUMENTS

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

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

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

The Finance Committee, which meets every two to three months, 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, including through electronic means, and by regularly analysing receivables and their breakdown. The Company takes out credit insurance to cover a large proportion of its receivables unless payment is made in advance or by letter of credit.

Currency risk 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 70 per cent of open items, or 100 per cent in the case of selected project-based firm commitments. DEUTZ is also taking specific action to increase the volume of purchasing in US dollars; this enables the Company to counteract exchange-rate risks from sales invoiced in US dollars by way of natural hedging.

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

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

Further information on financial risk management can be found in Note 24 a on page 95.

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 probability of occurrence for the risks is 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 the financial position or 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 the financial position or 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 2015 and relate to both the DCE and DCS segments.

EXTERNAL RISK

Regulatory risk Increasingly stringent emissions standards represent major technological challenges for the DEUTZ Group that could have a negative impact on its financial position and financial performance. Specifically, emissions limits for engines in mobile machinery and agricultural applications have been made significantly tougher since 2011. The EU Stage IV emissions standard came into force in Europe during 2014. In the USA the comparable US Tier 4 emissions standard for engines with power outputs of between 130kW and 560kW has applied since early 2014. Restrictions for smaller engines with power outputs from 56kW to 130kW will follow in 2015. These tougher standards will require additional optimisation of engines, engine management systems and exhaust aftertreatment systems to achieve both lower fuel consumption and increased engine power, with the result that overall systems will become much more complex. Both the complexity of the technology and the tight timescales in which to comply with the new emissions standards represent a challenge for the Group. Delays in the development of our products with regard to the new emissions legislation could, for example, lead to higher than planned start-up costs, which would have a negative impact on earnings.

To mitigate these regulatory risks, DEUTZ has defined a detailed product development process and implemented it as the standard process for all projects in which new engines are developed or existing ones refined. Mandatory standards and procedures apply at each phase of a product's development, thereby ensuring that projects remain within budget and on schedule. The product development process also includes systematic cooperation with our suppliers and close collaboration with our customers in order to optimally incorporate customer requirements into products and minimise technological risks throughout the value chain. In addition, DEUTZ invests in research and preliminary development as well as carrying out pioneering work with universities and research institutes to develop technology concepts that meet the requirements of the future.

In view of the measures that have been implemented, we categorise the regulatory risks with regard to the financial position and financial performance of the Group as 'low'.

Political and social risk Because of our global presence we are exposed to dangers that may result from the political and social situation in our target markets – particularly in the emerging markets. Certain events could, for example, lead to us not being able to continue business activities at our sites or use our established sales channels. Conceivably this could also have a negative impact on relations with our partners and their willingness to make capital investments.

We have taken precautions within the Group to minimise these risks as far as possible. As well as reviewing alternative business strategies we also believe it is essential to maintain contact with the appropriate authorities.

In view of the precautionary measures that are in place, we categorise the political and social risks for the attainment of our financial targets as 'low'.

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

In the medium and long term, we seek to mitigate regional and application-related sales risks by aligning our development activities with our product strategy and by entering into alliances. Close alliances with key customers such as AB Volvo, AGCO and SAME DEUTZ-FAHR are of considerable importance in enabling us to achieve these sales targets.

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. We therefore continue to categorise the market risk as 'moderate'. In particular, the very uncertain economic outlook for 2015 could have a negative impact on the attainment of our financial targets.

STRATEGIC RISK

Our business strategy is focused on expanding our customer and product base and on further globalisation and internationalisation. This strategy presents the DEUTZ Group with numerous opportunities but is, of course, also associated with risks. For example, our expectations for the Asian market, which we see as critical to the attainment of our strategic goals, may not be fully realised (or may not be realised in the time we anticipated) as a result of political intervention in the markets or periods of general economic weakness.

We attempt to mitigate these risks by precisely analysing trends in our markets and by taking into account external market research. 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 in the coming year as 'moderate'.

OPERATIONAL RISK

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

We have set up local quality departments to ensure quality in all plants and relevant areas of the Group. These departments systematically analyse sources of errors and defects, optimise production processes, take action to minimise the risk in series production start-ups and reduce warranty risks. A central quality management organisation ensures that standardised processes and methods are in place and carries out regular audits. In addition, DEUTZ has defined uniform standards for the selection of suppliers and, in close cooperation with the suppliers, continuously improves the quality of supplied parts. Regular certification audits and additional quality initiatives enable us to handle the significant technical complexity of engines and to satisfy the steadily increasing quality requirements of our customers.

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

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

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

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

OTHER RISKS

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

We have put a series of measures in place to protect confidential information. As well as IT security training, 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 categorise the data security risk 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. In view of the measures that have been taken either to avoid or minimise risk, we categorise the legal risk as 'low'.

OVERALL ASSESSMENT OF THE RISK SITUATION

Material risks have been identified and evaluated 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. Individual risk factors have changed only slightly from the previous year, meaning the overall risk situation is largely the same. 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 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 2015. 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 2015 and relate to the DCE and DCS segments.

Economic situation in relevant markets Developments in the global economy have a major effect on the financial position and financial performance of the DEUTZ Group. If our expectations regarding the macroeconomic situation in our most important markets of Europe, the USA and Asia are exceeded, this can lead to us performing better than we predicted.

Research and development Increasingly stringent emissions standards and general technological progress are placing huge demands on our entire industry. We are one of the innovation leaders and have a very strong competitive position thanks to our proven expertise, our many years of experience and our efficient processes in the research and development of diesel engines and other drive systems. This competitive advantage can have a positive impact on our financial targets, for example through an increase in our market share.

Optimisation of the sales organisation The realignment of the sales organisation towards customer segments is aimed at improving focus and sales performance. This should also lead to an improvement in how market and sales activities are coordinated internationally.

OUTLOOK

ECONOMIC FORECASTS CAUTIOUSLY OPTIMISTIC

The International Monetary Fund (IMF)[1] expects the pace of growth in the global economy to increase slightly: following an increase of 3.3 per cent in 2014 it is on course to expand by 3.5 per cent in 2015 and by 3.7 per cent in 2016.

Growth predictions for the eurozone and for key countries such as China, Russia and Japan have recently been revised downwards. In the latest forecasts, only the expectations for the USA have been revised upwards. For the industrialised nations, the IMF predicts growth of 2.4 per cent in 2015 (2014: 1.8 per cent). The eurozone economy is set to continue its recovery with a growth rate of 1.2 per cent in 2015, following 0.8 per cent in 2014. A further slight increase, to 1.4 per cent, is anticipated for 2016. The regional differences will remain, however. The German economy is expected to grow by 1.3 per cent in 2015, down slightly from 1.5 per cent in 2014. For the US, the predictions are for strong growth of 3.6 per cent in the current year and 3.3 per cent next year. In China the pace of growth will slow again, falling to 6.8 per cent in 2015 and to 6.3 per cent in 2016.

The business climate index[2] published by the ifo Institute of Economic Research was up for the third time in succession in January 2015. This index, which covers trade and industry in Germany, stood at 106.7 points compared with 105.5 points in the previous month. The ISM purchasing managers' index in the US stood at 53.50 in January 2015[3], a slight decline but still an indicator of expansion in economy activity.

DIESEL ENGINES MARKET

For construction equipment in 2015, we anticipate a flattening of the market in Europe and China and growth of between 0 and 10 per cent in North America. For agricultural machinery, we predict that the market in Europe will either remain at its current level or contract by up to 10 per cent. We also expect the Chinese automotive sector to remain static.

As a rule, the diesel engines market largely follows the applications and markets of the machinery and equipment in which the engines are installed. In 2014 our European customers bought advance-production engines ahead of the introduction of new emissions standards, so we are expecting demand from them to fall this year.

NEW ORDERS, UNIT SALES, REVENUE

Because of the effects of these advance-production engines, we are expecting a decline in engine sales this year that it will not be possible for our thriving business with new customers to offset. In the service business we are planning for slight growth. From a regional perspective, we forecast growth in North America and Asia but a decline in Europe.

Owing to the increasing proportion of higher-value engines to meet the new emissions standards in Europe and America, the value of the diesel engines market will increase at a faster rate than its unit sales. Furthermore, an especially large number of small engines with an output of less than 130kW were sold in 2014 due to the effect of advance-production engines mentioned above, which will also lead to a higher average unit price in 2015 compared with 2014.

Overall, we expect revenue to fall by around 10 per cent. In terms of segments, we expect a significant decline for DCE and moderate growth for DCS. Given the current environment, our forecasts are of course subject to great uncertainty. The flexibility of our business therefore remains a key factor in our competitiveness. Although we have significantly improved our flexibility over the last few years, we will continue to work hard on increasing it still further.

EARNINGS

The focus this year – in addition to the production start-up of new engines, the successful implementation of new customer projects and the site optimisation process – is primarily on measures designed to increase efficiency and profitability.

We expect the EBIT margin before one-off items to rise to around 3.0 per cent, a moderate improvement on the previous year. Earnings will be boosted by the absence of exceptional items and the measures to reduce costs and raise efficiency in the DEUTZ Group. We believe there is potential to reduce warranty costs, while the first positive effects from site optimisation in Germany will not be seen until 2016. We are likely to benefit from the current movements in the US dollar exchange rate. However, the expected decline in revenue and the subsequent lack of economies of scale will have an adverse effect. We expect both our DCE segment and our DCS segment to achieve earnings growth.

As a result of the anticipated increase in earnings, we believe there will be a small year-on-year increase in return on capital employed (ROCE) in 2015.

[1] IMF World Economic Outlook, January 2015.
[2] ifo Institute of Economic Research, January 2015.
[3] ISM Institute for Supply Management, January 2015.

COMMODITIES, COLLECTIVE PAY AGREEMENTS

Commodity prices We expect to see primary markets remain flat during the year ahead, although there may be some slight upward movements in prices.

New collective pay agreement expected The collective pay agreement for Germany expired on 31 December 2014. We expect the negotiating parties to reach an agreement in the first quarter of 2015 that will be appropriate for the current economic climate in the metalworking and electrical engineering industries.

RESEARCH AND DEVELOPMENT EXPENDITURE

We expect expenditure on research and development to be slightly lower than in 2014. We expect the R&D ratio to be slightly lower than in 2014.

CAPITAL EXPENDITURE

We forecast that our capital expenditure in 2015 (excluding capitalisation of research and development expenditure) will be around €50 million. This includes capital expenditure on site optimisation.

JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD

We anticipate that the Chinese market will remain challenging and volatile in 2015. For our joint venture DEUTZ (Dalian) Engine Co., Ltd., we are expecting further growth in revenue and a slight increase in operating profit.

WORKING CAPITAL RATIO, FREE CASH FLOW AND EQUITY RATIO

Our objective is to achieve a working capital ratio of around 14 per cent as the quarter-end average. We forecast a positive free cash flow in 2015 in the low to mid-double-digit million euro range.

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

EMPLOYEES

Flexible headcount adjustment We will continue to take on temporary employees and staff on employment contracts with a flexible term so that we can respond quickly and flexibly to future fluctuations in demand. In addition, our site-specific shift patterns and employees' individual working time accounts help us to increase or decrease capacity at short notice, where required.

Collective agreement on pre-retirement part-time employment
As in 2014, we will again use the 'Collective agreement concerning the flexible transition into retirement' in 2015. This gives employees who meet the necessary conditions the opportunity – within the collectively agreed quotas – to retire early by switching to pre-retirement part-time employment.

STATUTORY REGULATIONS, EXHAUST EMISSIONS STANDARDS

The most stringent exhaust emissions standards yet for diesel engines have now been introduced in all power output categories in the European Union, in the form of 97/68 Stage IV, and in the USA, with EPA Tier 4. Our TCD engines in the 2.9 to 7.8 litre cubic capacity range with a diesel particulate filter already meet Stage V, which is scheduled to come into effect in the EU in 2019[1)]. No further tightening of exhaust emissions limits in the USA is on the horizon at the time of the writing.

OUTLOOK FOR THE YEARS AHEAD

Following the decline in demand expected in the current year because of advance production of engines in 2014, we expect demand to normalise in 2016. In addition, we are expecting new customer business to provide a boost. We are also likely to experience further benefits from the price/mix ratio.

For 2016 we therefore expect revenue growth of more than 10 per cent as well as a sharp increase in the EBIT margin before one-off items, particularly in the DCE segment.

Global megatrends, such as increases in the world's population, advancing industrialisation in the agricultural sector and urbanisation, along with accompanying investment in infrastructure, are driving the further expansion of the global engine market. This will open up good opportunities for the continued advancement of the DEUTZ Group in the years to come. We plan to seize these opportunities in order to generate profitable growth.

[1)] EU Commission's proposal for EU Stage V published on 25 September 2014.

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.