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.