

DEUTZ AG	
<b>DEUTZ Compact Engines</b>	<b>DEUTZ Customised Solutions</b>
<ul style="list-style-type: none"> <li>Liquid-cooled engines of up to 8 litres cubic capacity</li> </ul>	<ul style="list-style-type: none"> <li>Air-cooled engines</li> <li>Liquid-cooled engines of more than 8 litres cubic capacity</li> </ul>

## 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 Engines that rely on outdated technology and that are intended for use in applications in countries or application segments with only very low requirements in terms of product quality,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)
<b>Mobile Machinery</b>	Construction equipment Ground support equipment Material handling equipment Mining equipment	Cummins, USA Kubota, Japan Perkins, UK Yanmar, Japan
<b>Agricultural Machinery</b>	Tractors Harvesters	Deere, USA Kubota, Japan Perkins, UK Yanmar, Japan
<b>Stationary Equipment</b>	Gensets Compressors Pumps	Deere, USA Kubota, Japan Perkins, UK Yanmar, Japan
<b>Automotive</b>	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 <sup>1)</sup> (average)	(%)	13.3	12.0
ROCE before one-off items <sup>2)</sup>	(%)	3.9	6.0
R&D ratio	(%)	3.5	3.6
Free cash flow <sup>3)</sup>	€ million	52.0	13.8

<sup>1)</sup> 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.

<sup>2)</sup> 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.

<sup>3)</sup> 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<sup>1)</sup> 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.

<sup>1)</sup> Source: IMF World Economic Outlook, January 2015.