GROUP MANAGEMENT REPORT 2012

OVERVIEW OF 2012

WE WANT TO PUT POWER IN MOTION IN OUR COMPANY

Weak global economic growth The situation in the world economy had already become gloomier in 2011 and the pace of growth continued to tail off in 2012. Global gross domestic product (GDP) rose by just 3.2 per cent owing to fears about growth in all regions. The German economy expanded at a moderate 0.9 per cent, the strongest rate of growth among the larger countries in the euro zone. Economic growth in China, an increasingly important international market for DEUTZ, slowed to 7.8 per cent.

Business performance below 2011 level owing to economic situation DEUTZ's business in 2012 was adversely affected by the weak performance of the economy in Europe and of the capital equipment sector in China, the sector most relevant to our business. Demand for our products declined over the course of the year, which meant we were unable to sustain the encouraging figures reported in 2011: revenue amounted to €1.3 billion, unit sales came to just under 179,000 engines and operating profit (EBIT) decreased to €38.5 million. This earnings trend is the result not only of the decline in volume but also of lower current profit contributions from our joint ventures, start-up costs for our growth projects and the production start-up of new engines.

Increased cost-saving measures In light of our weaker business performance, we took prompt action to cut costs and improve earnings. For example, we significantly scaled back the number of contract workers deployed. We have already achieved substantial savings on our overheads and we are currently in the process of critically examining all established structures. As a result, we decided in November to optimise our value chain by selling our pipe manufacturing operation to a supplier. Other steps to boost efficiency will begin to have an effect in 2013.

Level of funding improved By entering into a new funding arrangement in mid-2012, we were able to safeguard our Company's growth over the long term and significantly improve our flexibility while reducing our finance costs. In this context we were encouraged by our good key financials in 2012, which we achieved despite the challenging market conditions: free cash flow remained in positive figures at €12.6 million while net financial debt declined by some €20 million to below €50 million.

New major shareholder In September 2012, Swedish truck and construction equipment manufacturer AB Volvo became the largest individual shareholder in DEUTZ AG with a stake of just over 25 per cent. Already one of our long-standing business partners and shareholders, AB Volvo acquired approximately 22 million DEUTZ shares from SAME DEUTZ-FAHR, which had been our major shareholder until that point. SAME DEUTZ-FAHR continues to hold 8.4 per cent of DEUTZ AG shares and remains one of our Company's major strategic business partners and customers. We want to step up our alliance with AB Volvo in future.

Modular assembly line for production in Cologne The upcoming production start-up of the 2.9 and 3.6 engine series dominated production and logistics activities in the year under review. We also continued to work hard on further optimising our supply chain and implementing our campaign to improve productivity and quality. In Cologne, we brought a new modular assembly line on stream for our family of engines of less than four litres. The modular structure offers maximum flexibility and the ability to respond to changing market conditions.

Sales and service activities expanded In order to be able to be more responsive to our customers' needs, we stepped up our international sales and service activities during 2012. This included strengthening our Chinese sales and service company by hiring additional staff, expanding the dealer network and providing further training. We also established a new service centre in Madrid (Spain) and a new service company in Moscow (Russia) to give us better and faster market access.

GROUP STRUCTURE AND BUSINESS ACTIVITIES

OPERATING SEGMENTS AND PRODUCT RANGE

As an independent manufacturer of compact diesel engines with outputs of between 25kW and 520kW for both on-road and non-road applications, DEUTZ has been providing reliable drive units for mobile and separate stationary applications for almost 150 years. 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. A principal component of our service business is the supply of reconditioned exchange parts and engines marketed under the name 'DEUTZ Xchange' and offered within the DEUTZ Customised Solutions segment.

DEUTZ AG	
DEUTZ Compact Engines	**DEUTZ Customised Solutions**
· liquid-cooled engines up to 8 litres	· air-cooled engines · liquid-cooled engines > 8 litres

We also offer our customers advice and support on operating the machinery. Our modern products are complemented by a range of attractive services that we have carefully designed to meet the needs of our customers worldwide. We actively assist customers with the repair, maintenance and servicing of their vehicles and equipment fitted with DEUTZ engines. Our global service network, which comprises subsidiaries, service centres and authorised agents, ensures a reliable and speedy supply of spare parts.

LEGAL STRUCTURE AND PRODUCTION SITES

DEUTZ maintains a strong international presence in a globalised market. We offer our customers support almost everywhere and can respond very quickly thanks to our eleven sales companies, nine sales offices and more than 800 sales and service partners in over 130 countries. 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 the year under review, we continued to expand our presence in the emerging markets of China and Russia. Since early 2012, we have been represented by four companies in the Chinese market. Besides our existing joint ventures DEUTZ (Dalian) Engine Co., Ltd. (DDE) in Dalian (China) and WEIFANG WEICHAI-DEUTZ DIESEL ENGINE CO., LTD. in Weifang (China) and the sales company DEUTZ (Beijing) Engine Co., Ltd. in Beijing (China), we teamed up with Shandong Changlin Machinery Group in January 2012 to establish a production company, DEUTZ Engine (Shandong) Co., Ltd., which is based in Linyi (China). DEUTZ AG holds the majority of the voting rights in this company with a stake of 70 per cent. In Russia, we have been represented by an additional sales and service company, LLC DEUTZ Vostok, Moscow (Russia), since July 2012. Detailed information on the joint ventures can be found in the relevant section on page 24.

In addition to DEUTZ AG, six (31 December 2011: seven) German companies and 13 (31 December 2011: eleven) foreign companies were included in the consolidated financial statements as at 31 December 2012. Page 99 of the annex to the notes to the consolidated financial statements lists all the shareholdings of DEUTZ AG as at 31 December 2012.

MARKET AND COMPETITIVE ENVIRONMENT

DEUTZ manufactures diesel engines for professional applications used in countries with stringent emissions standards, in particular Stages II, III and IV. These technically sophisticated applications include construction equipment, agricultural machinery, lifting and material-handling equipment, pumps, gensets and medium-duty and heavy 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. In addition, our relevant market does not encompass diesel engines based on very outdated technology that are designed for applications used in countries or application segments with only very low requirements regarding product quality, emissions and fuel consumption.

The market for technically sophisticated diesel engines comprises the captive market, in which the equipment manufacturers produce their own engines (such manufacturers also having a presence as engine suppliers in the non-captive market in some cases), and the non-captive market, where equipment manufacturers predominantly do not produce their own engines and therefore obtain them 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. The engine providers that compete with us come from western Europe, North America and Asia. None of these competitors offers an identical product range to DEUTZ in terms of the power outputs and application segments that they cover. In various application segments, however, there are competitors whose products are technologically comparable with those offered by DEUTZ.

Main competitors

Application segment	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	Trucks Buses Rail vehicles	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 its medium-term corporate targets using selected key performance indicators (KPIs). We manage the Group using this internal system of KPIs in order to boost profitability and achieve sustained growth. The primary KPIs in this system are unit sales and revenue in conjunction with the EBIT margin; we also manage the capital tied up in the business using the working capital ratio[1] and the capital expenditure volume. In conjunction with working capital and EBIT optimisation, this in turn determines the return on capital employed[2]. In managing its liquidity, DEUTZ focuses on free cash flow[3] as a key performance indicator. We also specifically monitor net income and revenue growth as performance indicators in the context of our internal system of KPIs. 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.

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 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.

The KPIs stated below show a significant improvement in unit sales in 2011 and reflect the general uncertainty that plagued the markets in 2012, in particular owing to the European sovereign debt crisis:

		2012	2011	2010
Revenue	€ million	1,291.9	1,529.0	1,189.1
Unit sales	Units	178,774	230,598	167,680
EBIT margin before one-off items[4]	(%)	3.0	6.0	3.5
Net income from continuing operations	€ million	22.1	68.7	–15.9
Working capital ratio (as at 31 Dec)	(%)	11.0	9.3	9.5
Working capital ratio (average)	(%)	14.7	10.8	12.9
ROCE before one-off items	(%)	5.1	12.5	6.3
Free cash flow	€ million	12.6	4.8	–55.9
Growth	(%)	–15.5	28.6	37.7

CONTINUOUS OPTIMISATION OF THE CONTROL SYSTEM

The constant optimisation of its corporate management and control system is one of the DEUTZ Group's overriding objectives regardless of fluctuations in the economic cycle. This essentially involves the annual planning of all the performance indicators referred to above. 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 coordinated with the management strategy. Both the specific unit sales and revenue targets and the customer- and product-related targets (EBIT margins) are reviewed with the operating units each year taking into account Group-wide objectives and are thus available at the relevant hierarchical levels for use in the operational management of the business.

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.

[1] Working capital ratio: ratio of average working capital (inventories plus trade receivables minus trade payables) over four quarters to revenue for the last twelve months
[2] Return on capital employed (ROCE): ratio of EBIT to average capital employed. Capital employed: total assets minus 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 interest expense

[4] One-off item: In addition to the information required according to IFRS, the Deutz Group reports an EBIT before one-off items which it uses for internal purposes to gauge the profitability of its business. One-off items are defined as significant revenue/expenditure (if material) generated outside the normal business activities

We are pursuing long-term growth objectives. In order to secure the financial basis for these, we have centralised the management of capital expenditure, the main element in the management of capital tie-up. Clearly defined budgetary targets determine 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. Those responsible hold annual budget meetings at which they review individual projects, development expenditure and planned capital expenditure in the context of the Group-wide financial planning process and document the outcomes of the review. 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, profit and loss calculation, cost comparisons). A project with an appropriate budget is only approved if there is a clear positive outcome from this investment appraisal.

The liquidity-based performance indicator we use is the free cash flow. A positive figure shows that we can finance our growth and necessary capital expenditure from the net cash provided by our operational business.

BUSINESS PERFORMANCE IN THE DEUTZ GROUP

ECONOMIC ENVIRONMENT

Sovereign debt crisis in the euro zone impacts on global economy The world economy grew at a weak rate overall last year. Having already fallen to 3.9 per cent in 2011, global GDP growth slowed to 3.2 per cent in 2012 according to the International Monetary Fund (IMF)[1]. Fears about growth emanated from all regions.

Europe's weak economic performance continued over the course of 2012, weighed down by structural problems in the euro zone, sovereign debt in southern European countries and the growth-inhibiting effects of consolidation measures. However, the markets calmed down again to some extent at the end of the year following the European Central Bank's announcement of unlimited measures to support the euro. Nonetheless, the economy in the euro zone contracted by 0.4 per cent, albeit with large regional differences. Although its rate of growth tailed off, the German economy proved robust overall and expanded by 0.9 per cent, the strongest rate among the larger countries in the euro zone.

The United States saw a slight revival in its growth at 2.3 per cent. The real-estate market settled down and unemployment fell. However, the political conflict about raising the debt ceiling had a negative impact at the end of the year.

The emerging markets did not escape the weakness of the global economy either. Although the economy in China, an important international market for DEUTZ, expanded by 7.8 per cent (2011: 9.3 per cent), there were declines in capital equipment, some of which were significant.

Varying trends in DEUTZ's customer industries DEUTZ's main customer industries exhibited very different trends in 2012. Demand for construction equipment in western Europe and China fell by 3 per cent and 30 per cent respectively[2], while the construction equipment market in the United States recorded growth of 17 per cent.[3] According to its own estimates, the agricultural machinery sector in Europe registered a slight year-on-year growth increase in 2012. The German agricultural machinery sector grew by 8 per cent last year.[4] EU-wide production of medium-duty and heavy trucks decreased by 9 per cent.[5] In China too, the markets for medium-duty and heavy in China contracted by more than 20 per cent.[6]

IMPACT OF ECONOMIC CONDITIONS ON BUSINESS PERFORMANCE

DEUTZ affected by global fears about growth The worsening mood and fears about growth created a reluctance to invest last year, above all in Europe and China. Accordingly, DEUTZ's unit sales fell by 22.5 per cent and revenue by 15.5 per cent. Our main customer industries performed inconsistently, with some registering equally sharp declines.

The economy in the euro zone saw GDP contract by 0.4 per cent in the year under review. There were also downward trends in DEUTZ's main customer industries in this region: demand for construction equipment reduced by 3 per cent in Europe, while EU-wide production of medium-duty and heavy trucks decreased by 9 per cent. DEUTZ's revenue in our largest market, EMEA (Europe, Middle East and Africa), was also down by 19.7 per cent. Unit sales of engines were negatively affected by the noticeable slowdown in our European installation customers' export business in emerging markets. They were also hampered by the fact that European customers had purchased so-called advance production engines at the end of 2011 in the mobile machinery segment and, in particular, the agricultural machinery segment, which resulted in a lower volume of unit sales in 2012. American economic output went up by 2.3 per cent last year. Our business continued to expand in the Americas, where we sold 13.6 per cent more engines than in the previous year, above all owing to increased capital expenditure by American rental companies. The US construction machinery market also grew, gaining 17 per cent. The general slowdown in economic growth also hit growth in China, an important international market for us: although growth rates were lower than in previous years, with GDP growth of 7.8 per cent, they were still very high by international comparison. Moreover, there were

[1] Source: IMF World Economic Outlook Update, January 2013

[2] Source: Off-Highway Research, November 2012
[3] Source: ITR Trends Report, January 2013
[4] Source: German Engineering Federation (VDMA), December 2012
[5] Source: European Automobile Manufacturers' Association (ACEA), January 2013
[6] Source: China Automotive Information Net, December 2012

declines, some substantial, in the capital equipment sector that is critical to our business. For example, demand for construction equipment in China decreased by around 30 per cent, while the markets for medium-duty and heavy trucks in China contracted by more than 20 per cent. Against this backdrop, DEUTZ's revenue fell by 7.9 per cent and unit sales by 12.4 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, shrank by 10.2 per cent.

PROCUREMENT

Our centralised purchasing organisation at head office faced new challenges in 2012. Significant objectives were achieved, such as reducing overall costs, ensuring security of supply, improving quality, outsourcing, expanding procurement from China and implementing embedded material group strategies. We are continuously optimising our value chain while raising quality levels in order to boost our efficiency and secure the supply of materials over the long term. At the same time we are critically reviewing established structures and processes. This is illustrated by the sale of our pipe manufacturing operation to a supplier, the contract for which was signed in November 2012.

DEUTZ AG was again able to decrease its total procurement costs for production materials – which include all individual components used in engine manufacturing – and non-production materials. Significant factors in this success last year included ongoing negotiations with existing and new suppliers relating to purchasing for series production as well as close cooperation with other departments aimed at lowering costs. We are continually working on the technical optimisation and standardisation of existing parts from a cost perspective. This puts us in a stronger negotiating position and lays the foundations for further consolidation of suppliers. The supplier base for C parts has been further reduced over the past two years, resulting in more stable processes and lower costs.

As we are increasingly carrying out activities with joint ventures in China, we require a market-specific procurement strategy. Our activities in this area are supported by our purchasing office in Beijing, which allows us to establish relationships with new, competitive suppliers in China. At the same time, our purchasing office in Bangalore (India) is working hard to identify competitive suppliers in the Indian market and cooperating with the purchasing department at head office to ensure the quality of the materials we procure.

Commodities markets remain flat Prices for cast iron, aluminium, copper and nickel rose for a brief time at the start of 2012 but had fallen again by the end of the year. As a result, average prices for the year remained stable and were within the bandwidths that we had forecast.

In the reporting year, foundry products (particularly cylinder heads and engine blocks) continued to be our most important product category, followed by fuel injection equipment (predominantly pumps and valves) and measurement & control devices (for example mechanical and electronic regulators and sensors). The remaining purchasing volume was spread across the following product categories: generators, starters, exhaust-gas turbochargers, EAT components, EGR modules, turned parts, sheet metal parts, standard and DIN parts, and forged parts.

Further improvement in supplier quality We continued to sharpen the focus of our purchasing strategy on optimisation of supplier quality, which therefore improved considerably again. As a result, process costs for goods inward and the assembly line were far lower. This led to improved security of supply and reduced downtime costs. We succeeded in driving down the PPM figure (parts per million – the KPI for defective parts) by almost 50 per cent.

With the introduction of the new Tier 4 Interim and (from 2014) Tier 4 Final emissions standards, ensuring high standards of quality is a key success factor for DEUTZ and it was therefore one of the main areas of focus in 2012.

PRODUCTION AND LOGISTICS

In 2012, production and logistics were dominated by the upcoming production start-ups for new engines in the 2.9 and 3.6 series, an extensive range of activities to streamline our supply chain and our campaign focusing on productivity enhancement and quality.

Cologne plants In Cologne, we successfully brought a new modular assembly line on stream for our family of engines of less than four litres. All engine series of less than four litres will be assembled here in future. Based on cutting-edge technology, the modular assembly line offers maximum flexibility and the ability to respond to changing market conditions. Expansion of the assembly line allows production capacities to be increased and additional engine series to be included. Separation of basic engine assembly and final assembly into two separate sections ensures that our other production sites worldwide can be supplied with basic engines. This significant milestone is another step towards improving the efficiency of our processes.

Materials are supplied through our just-in-sequence assembly centre. All required parts are supplied on a just-in-sequence basis, apart from DIN and standard parts, which are made available using a 'supermarket' principle.

Particular attention was paid to user-friendliness when the new assembly concept was planned. For example, height-adjustable, revolving assembly equipment is used, which can be adjusted to the different body sizes of our employees. Process steps are made more efficient by deploying hoists, pivots and rotating equipment.

We are again undertaking a critical review of the extent of our vertical integration in mechanical fabrication. One aspect of this is the sale of our pipe manufacturing operation at the Cologne production facility to T.ERRE in 2013. We expect this step to increase our efficiency.

Around 163,000 engines were built at the Cologne site in 2012.

Ulm plant Just over 16,000 engines, including V engine series with a capacity of more than eight litres, were assembled at our site in Ulm in the year under review.

Last year, we steadfastly continued with kaizen activities aimed at boosting our competitiveness. Workshops for assembly, manufacturing, logistics and maintenance resulted in improvements to all key performance indicators: productivity, inventory, throughput time and machine availability. Parts from the manufacturing network are now delivered directly to the assembly lines, which reduces logistics costs.

The Tier 4 Final prototypes for the 12.0 and 16.0 model series were built directly on the series production assembly line in 2012 so as to allow assembly requirements to be incorporated into the development process at an early stage. It also allows problems to be identified and eliminated long before production start-up.

Zafra plant, Spain The plant at Zafra, Spain, is the DEUTZ Group's centre of excellence for the manufacturing of cylinder heads, connecting rods and gearwheels – and therefore one of the largest suppliers for the assembly plants in Cologne and Ulm. Modern, target-oriented and flexible cost management enabled fixed costs and the break-even threshold to be driven down further. The Zafra plant achieved its ambitious goals by closely following the kaizen approach used at DEUTZ and through intensive sharing of information. The Spanish subsidiary was renamed DEUTZ SPAIN, S.A. in January 2013.

Xchange plants at Übersee on Lake Chiemsee and at Pendergrass, Georgia, USA In 2012, the facilities at Übersee on Lake Chiemsee reconditioned around 3,600 exchange engines. A broad range of individual reconditioned components are built into the exchange engine or sold as exchange parts in the service network. We considerably expanded our product range in the year under review. For example, we now also recondition exhaust-gas turbochargers. In addition, we further shortened the average throughput time from order receipt to shipment.

The facilities at Pendergrass in Georgia, USA, produced more than 1,100 exchange engines. This plant allows us to deliver exchange engines to the American market with very short lead times. The focus in the year under review was on broadening the range of products.

Award for improved supply chain on the basis of the DEUTZ logistics platform DEUTZ AG won the 2012 eLogistics Award for the web-based DEUTZ logistics platform, which had been implemented in previous years. The 'Just-in-Time Working Group' handed out this accolade at its annual conference in Saarbrücken in recognition of an element of our supply chain that ensures deliveries to the assembly lines are synchronised with production, starting at source with the suppliers. More than 260 suppliers and freight forwarders worldwide now synchronise their logistics processes using our logistics platform. Every partner in the supply chain therefore has access to all the relevant information simultaneously.

Quality enshrined in our corporate principles In the world of engines, the DEUTZ name is synonymous with high quality standards and efforts are constantly devoted to further consolidating this key factor in the success of our business.

In 2011, the prestigious DQS GmbH certified our quality management system in accordance with ISO 9001 and our environmental management system in accordance with ISO 14001. DEUTZ successfully completed the monitoring audit in 2012. DQS, part of the DQS-UL Group, is the only large certification company to focus on inspecting and certifying management systems and processes in companies and organisations.

At DEUTZ, we use the Six Sigma methodology and are systematically expanding it. We are able to train employees in the methodology ourselves so that it becomes firmly rooted in the Company. The projects begun in 2012 will be completed in 2013. Managers at DEUTZ AG are also initiating and supporting further projects. We carried out a benchmarking workshop with one of our major customers, which confirmed to us that our strategy for securing our quality leadership is the right one and is well established in the Company.

The key performance indicators (KPIs) from our quality report again revealed a positive trend in 2012. We made particular improvements with regard to purchasing quality. Moreover, we have set ourselves ambitious goals for 2013 and will pay special attention to customer satisfaction.

International joint ventures Since 2007, DEUTZ has operated a joint venture with First Automotive Works Group, one of the leading vehicle manufacturers in China. The joint venture, which operates under the name DEUTZ (Dalian) Engine Co., Ltd. and is based in the Chinese city of Dalian, produces three to eight-litre diesel engines, primarily for the Chinese market. The unit sales figure for 2012 was just short of 89,000 engines. This brought in revenue equivalent to €246 million, down by 10.2 per cent year on year. Faced with challenging conditions, the markets for medium-duty and heavy trucks and construction equipment both contracted by more than 20 per cent, with declines of up to 40 per cent in some individual construction equipment applications. Owing to the market trends, DEUTZ (Dalian) made a loss: the pro-rata loss attributable to DEUTZ reduced DEUTZ's EBIT in 2012 by around €11 million. As far as the current year is concerned, we predict that DEUTZ (Dalian) will benefit from the incipient recovery of the markets, the introduction – scheduled for mid-2013 – of the Euro 4 emissions standard in the automotive sector, new truck models from our joint venture partner and, in particular, the measures already initiated to cut costs and boost efficiency. DEUTZ (Dalian) has also been applying the Six Sigma methodology since late 2012. An action programme to reduce working capital has also been drawn up.

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. This joint venture produces 226B series engines under licence for the agricultural machinery, genset, construction equipment, automotive and marine equipment segments. Its unit sales totalled around 33,000 engines in 2012 and it posted revenue of €93 million (2011: €103 million). The company made a small loss as a result of market conditions.

During 2012, we established DEUTZ Engine (Shandong) Co., Ltd. in Linyi (China) to assemble diesel engines of less than four litres. We hold a stake of 70 per cent in this production company, while our partner Shandong Changlin Machinery Group Co., Ltd. in Qingdao (China) holds 30 per cent. In future, the company will produce 2011 series engines, which are designed for use in industrial, construction and agricultural applications and have proven their worth a million times over.

DEUTZ AGCO Motores S.A. (DAMSA), our Argentinian joint venture with the AGCO Group, produces engines for the local market, primarily for installation in agricultural machinery, buses and industrial applications. In 2012, the company sold almost 1,900 engines against a backdrop of challenging market conditions. It generated revenue of €23 million, which was 17.7 per cent less than in 2011. Nonetheless, DAMSA was able to post a small profit.

In the year under review, we sold our 25 per cent equity investment in our joint venture Bosch Emission Systems GmbH & Co. KG, Stuttgart (BESG) to the main shareholder Robert BOSCH GmbH. The original partners have therefore restructured their alliance, which will continue in future in the form of an innovation partnership in the fields of exhaust aftertreatment, diesel injection technology and electronics. The aim of this partnership is to integrate the drive technology systems for mobile machinery more tightly. BESG will continue to supply DEUTZ with exhaust aftertreatment systems. This restructuring will not hamper our growth prospects relating to engine systems, especially as developing, certifying and selling these systems is our responsibility.

DEUTZ operations in China

	DEUTZ Engine (Shandong) Co., Ltd.	DEUTZ (Dalian) Engine Co., Ltd.	WEIFANG WEICHAI-DEUTZ DIESEL ENGINE CO., LTD.
City (Province)	Linyi (Shandong)	Dalian (Liaoning)	Weifang (Shandong)
Partner	Shandong Changlin Machinery Group	FAW Group	Weichai Holding
DEUTZ shareholding	70 %	50 %	50 %
Consolidation	Fully consolidated	Equity-accounted	Equity-accounted
Engine size	Under 4 litres	3–8 litres	4–8 litres
Main application segment	Mobile Machinery	Automotive	Various
Revenue in 2012 (€ million)	n/a	246	93

NEW ORDERS

DEUTZ Group: New orders

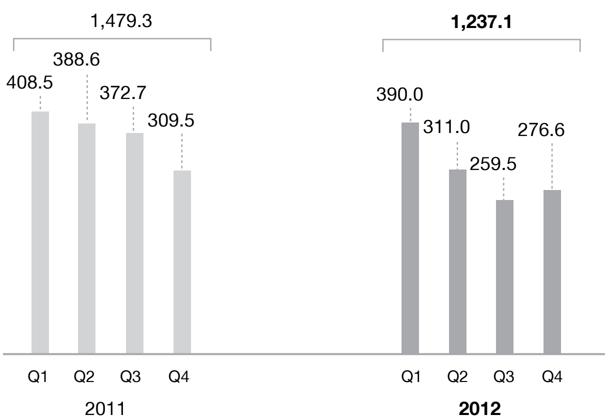
€ million

2012	**1,237.1**
2011	1,479.3
2010	1,315.0
2009	842.3
2008	1,363.5

Fewer orders than in 2011 DEUTZ AG won new orders worth €1,237.1 million in 2012, a decline of 16.4 per cent compared with the 2011 figure of €1,479.3 million. This decrease is attributable to continued general uncertainty in the markets and the weak economic performance of Europe and China. Following a strong first quarter with new orders exceeding €390.0 million, there was a downward trend during the two subsequent quarters. On a positive note, new orders received in the fourth quarter of 2012 amounted to €276.6 million, which was up on the value of new orders in the third quarter of €259.5 million.

DEUTZ Group: New orders by quarter[1)]

€ million



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

All application segments were affected by the decline in new orders. Only the service business saw an increase in new orders, which rose by 1.9 per cent to €249.4 million. By contrast, the Mobile Machinery application segment saw its new orders fall by 8.9 per cent. New orders in the Agricultural Machinery application segment were down by as much as 35.9 per cent year on year. Besides the economic slowdown, this was due to delays in production start-up at key customers and to advance production of engines that our European customers had already purchased by the end of 2011 in anticipation of the stricter emissions standards that came into force in 2012. The Automotive and Stationary Equipment application segments reported decreased of 5.3 per cent and 10.1 per cent respectively.

As at 31 December 2012, orders on hand stood at €173.0 million, 25.1 per cent lower than the high figure of €231.1 million as at 31 December 2011.

UNIT SALES

DEUTZ Group: Unit sales

units

2012	**178,774**
2011	230,598
2010	167,680
2009	117,961
2008	252,359

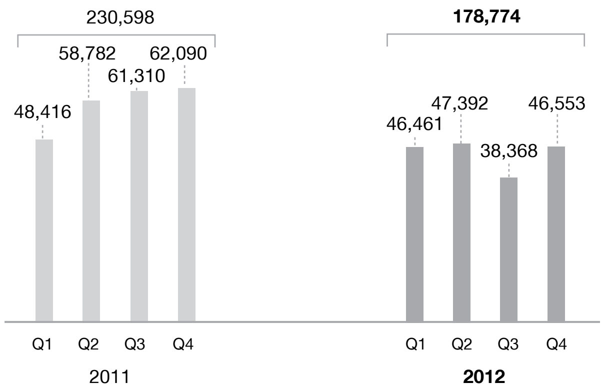
Deterioration in engine sales DEUTZ sold almost 179,000 engines last year, down by 22.5 per cent compared with 2011. Engines in lower power output categories outsold engines in higher categories during the reporting year. Overall, unit sales decreased in all application segments.

However, a regional analysis reveals an inconsistent picture. Our Americas business continued to grow, benefiting from increased capital expenditure by American rental companies. As a result, unit sales rose by 13.6 per cent to approximately 39,000 engines. By contrast, unit sales in our largest market, EMEA (Europe, Middle East and Africa), decreased by 29.7 per cent to around 130,000 engines. We also sold 12.4 per cent fewer engines in the Asia/Pacific region, where unit sales were just short of 9,500 engines.

Fairly steady trend over the year There were only very small fluctuations over the course of the year, with unit sales remaining relatively steady at around 47,000 engines in each quarter. Only the third quarter saw a drop in unit sales, when we sold just over 38,000 engines. This was because some of our customers had shut down production for the summer holidays. Unit sales in the fourth quarter of 2012 were therefore 21 per cent higher than in the third quarter but were down by a quarter compared with the fourth quarter of 2011, when we had reported very strong unit sales.

DEUTZ Group: Consolidated unit sales by quarter

units



RESULTS OF OPERATIONS

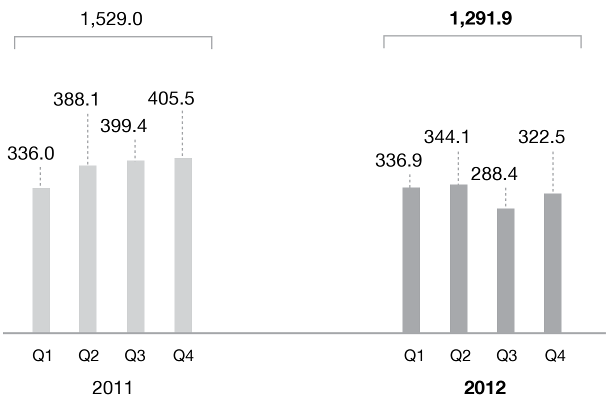
DEUTZ Group: Revenue

€ million

Year-on-year fall in revenue The DEUTZ Group's revenue decreased by 15.5 per cent to €1,291.9 million in 2012. However, the decline in revenue was low in relation to the fall in unit sales due to the greater value and complexity of the engines sold. This was because an increasing proportion of engines sold met the new emissions standards in Europe and North America – a trend that is expected to continue.

DEUTZ Group: Revenue by quarter

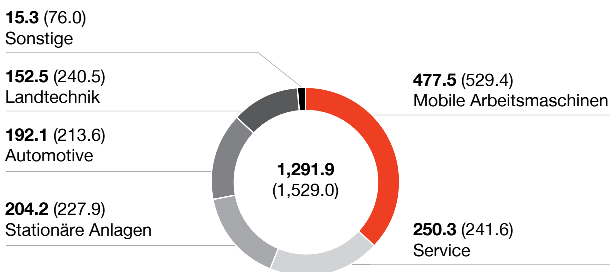
€ million



A look at the year as a whole shows that we generated the highest revenue in the second quarter. In the fourth quarter of 2012, revenue totalled €322.5 million, which was 11.8 per cent higher than in the third quarter of 2012 but down by 20.5 per cent compared with the impressive level of revenue generated in the fourth quarter of 2011. The revenue increase in the fourth quarter of 2011 had also reflected some benefit from the advance production of engines ordered early by European customers to avoid the new emissions standards applicable to diesel engines of between 56kW and 130kW from 2012 and the associated additional costs.

DEUTZ Group: Revenue by application segment

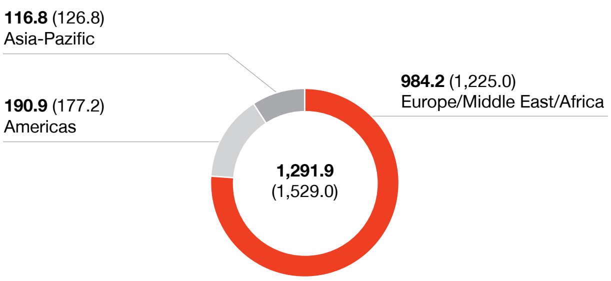
€ million (2011 figures)



Our largest application segment, Mobile Machinery, generated revenue of €477.5 million in 2012, which was 9.8 per cent less than in 2011. Although revenue from the construction equipment and material-handling equipment subsegments declined, there was an increase in revenue from ground support equipment and underground equipment, which are smaller subsegments. Revenue also declined in other application segments: Agricultural Machinery was down by 36.6 per cent, Stationary Equipment was down by 10.4 per cent and Automotive was down by 10.1 per cent. By contrast, revenue in the highly profitable service business grew by 3.6 per cent to €250.3 million. This once again constituted a record for service revenue and primarily reflected the success of various projects in the service business.

DEUTZ Group: Revenue by regions

€ million (2011 figures)



Revenue in the Americas region rose again in 2012, increasing to €190.9 million (7.7 per cent up on 2011). In contrast, revenue in the Asia/Pacific region went down by 7.9 per cent to €116.8 million. The region that accounts for the largest proportion of revenue, EMEA (Europe, Middle East and Africa), did not achieve as much revenue as in 2011 either, reporting a fall of 19.7 per cent to €984.2 million. Germany and the rest of Europe saw particularly substantial revenue decreases of 16.1 per cent and 22.3 per cent respectively.

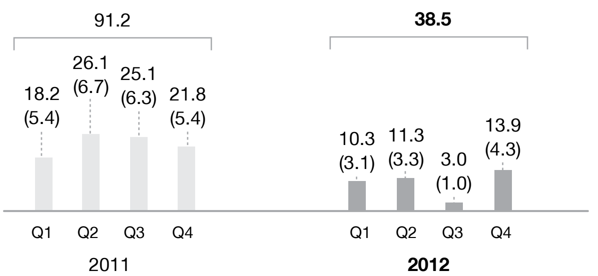
DEUTZ Group: Operating profit/EBIT margin before one-off items

€ million (EBIT margin in %)

[1] Since 2009 the interest cost of defined benefit pension obligations has been reported as part of staff costs. These expenses are no longer shown as part of net interest expense. The prior-year figures have been restated accordingly to improve comparability.

DEUTZ Group: Operating profit/EBIT margin by quarter

€ million (EBIT margin in %)



Earnings performance In 2012, we achieved an operating profit (EBIT) of €38.5 million, equating to a decline of €52.7 million compared with the previous year (2011: €91.2 million). Consequently, the EBIT margin decreased from 6.0 per cent in 2011 to 3.0 per cent in the year under review. Besides the smaller volume of business resulting from the weak economy, this trend was largely attributable to the negative contributions to earnings from our joint ventures, set-up costs for our growth projects and for the production start-up of new engines, and higher depreciation and amortisation charges.

Overview of the DEUTZ Group's results of operations

	2012	2011
€ million		
Revenue	**1,291.9**	**1,529.0**
Changes in inventories and other own work capitalised	37.0	44.7
Total output	**1,328.9**	**1,573.7**
Other operating income	52.5	37.5
Cost of materials	–862.9	–1,021.1
Staff costs	–268.0	–276.8
Depreciation and amortisation	–78.9	–69.1
Impairment	–5.7	–
Other operating expenses	–113.5	–154.5
Net investment income	–13.9	1.5
EBIT	**38.5**	**91.2**
Interest expenses, net	–10.6	–13.4
Other taxes	–1.4	–1.3
Income taxes	–4.4	–7.8
Net income on continuing operations	**22.1**	**68.7**
Net income	**21.0**	**75.5**
%		
EBIT margin	3.0	6.0
Cost of materials	64.9	64.9
Staff costs	20.2	17.6

Cost of materials As a percentage of total operating output, the cost of materials was unchanged year on year at 64.9 per cent. Despite the sharp rise in unit sales of engines for the European Union's III B emissions standard and the corresponding EPA Tier 4 Interim standard in the United States, which have a higher proportion of material costs, we were able to maintain the cost-of-materials ratio at a constant level.

Staff costs Owing to the reduction in the workforce compared with the previous year, staff costs fell by €8.8 million to €268.0 million in 2012 (2011: €276.8 million). However, the staff costs ratio (staff costs as a percentage of total operating output) rose by 2.6 percentage points to 20.2 per cent (2011: 17.6 per cent) as a result of the decrease in revenue. Including the costs for contract workers (reported under other operating expenses), the staff costs ratio went up by just 1.8 percentage points (2012: 21.0 per cent; 2011: 19,2 per cent).

Depreciation, amortisation and impairment Depreciation and amortisation came to €78.9 million in 2012, a year-on-year rise of €9.8 million (2011: €69.1 million). This was predominantly the result of depreciation and amortisation related to capitalised development expenditure resulting from the production start-up of our engines for the Stage III B emissions standard in the EU and the corresponding US EPA Tier 4 Interim standard in the second half of 2011 and in 2012. We also recognised an impairment loss of €5.7 million in respect of previously capitalised development expenditure as a result of changes that were made to the technical concept for a model series at the end of 2012.

Other operating income Other operating income was up by €15.0 million year on year to €52.5 million (2011: €37.5 million). The main reason for this was the disposal of our shareholding in Bosch Emission Systems GmbH & Co. KG (BESG) during the fourth quarter of 2012.

Other operating expenses Other operating expenses totalled €113.5 million in the reporting year, a year-on-year decrease of €41.0 million (2011: €154.5 million). This was predominantly due to lower costs for contract workers and smaller additions to general warranty provisions on the back of the reduced volume of business. Considerably scaled back consultancy services also contributed to this positive trend.

Investment income, net Net investment income decreased by €15.4 million year on year and amounted to a net expense of €13.9 million (2011: net income of €1.5 million). This substantial loss is largely attributable to our equity-accounted Chinese joint ventures DEUTZ (Dalian) Engine Co., Ltd. in Dalian (China) and WEIFANG WEICHAI-DEUTZ DIESEL ENGINE CO., LTD. in Weifang (China), which were affected by the general slowdown in growth in China, and to current profit contributions from Bosch Emission Systems GmbH & Co. KG until its disposal.

Interest expenses, net Owing to the new funding and efficient cash management, finance costs decreased by €2.8 million year on year to €11.6 million in 2012 (2011: €14.4 million). With interest income remaining almost constant at €1.0 million (2011: €1.0 million), net interest expense came to €10.6 million (2011: €–13.4 million) last year.

Income taxes Income taxes from continuing operations reduced from €7.8 million in 2011 to €4.4 million in 2012, a decrease of €3.4 million. The reduction is predominantly attributable to smaller additions to deferred tax liabilities. This trend was partly offset by higher current tax expenses incurred by our American subsidiary.

Net income The lower level of operating profit led to a sharp fall in net income to €21.0 million in 2012, compared with €75.5 million in 2011.

BUSINESS PERFORMANCE IN THE SEGMENTS

DEUTZ Group segments

	2012	2011
€ million		
New orders		
DEUTZ Compact Engines	960.6	1,174.2
DEUTZ Customised Solutions	276.5	305.1
Total	**1,237.1**	**1,479.3**
Unit sales (quantity)		
DEUTZ Compact Engines	161,899	204,161
DEUTZ Customised Solutions	16,875	26,437
Total	**178,774**	**230,598**
Revenue		
DEUTZ Compact Engines	1,005.0	1,199.1
DEUTZ Customised Solutions	286.9	329.9
Total	**1,291.9**	**1,529.0**
Operating profit (EBIT)		
DEUTZ Compact Engines	–15.6	47.2
DEUTZ Customised Solutions	46.6	46.5
Miscellaneous	7.5	–2.5
Total	**38.5**	**91.2**

BUSINESS PERFORMANCE IN THE DEUTZ COMPACT ENGINES (DCE) SEGMENT

New orders slightly lower than revenue The DEUTZ Compact Engines segment (DCE) took new orders amounting to €960.6 million in 2012, down by 18.2 per cent compared with 2011. All application segments reported a decline in new orders, except for the service business, where they rose by 6.7 per cent to €141.2 million. Overall, new orders were at a slightly lower level than revenue in the DCE segment. Orders on hand totalled €108.8 million as at 31 December 2012, equating to a year-on-year decrease of 30.0 per cent.

Fewer unit sales In the year under review, unit sales in the DCE segment fell by 20.7 per cent to around 162,000 engines. We had sold some 204,000 engines in the previous year. The Americas was the only region to increase its unit sales (by 34.2 per cent), while this figure fell by 28.8 per cent and 21.3 per cent respectively in the EMEA and Asia/Pacific regions. All application segments registered decreases in unit sales. The Mobile Machinery application segment saw a drop of 17.1 per cent. The reduction of as much as 45.6 per cent in the Agricultural Machinery application segment was due to the economic slowdown, to delays in production start-up at key customers and to advance production of engines that our European customers had already purchased by the end of 2011 in view of the stricter emissions standards that came into force in 2012.

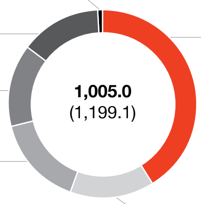
Smaller decrease in revenue than in unit sales At €1,005.0 million, revenue in the DCE segment was down by 16.2 per cent year on year (2011: €1,199.1 million). While revenue rose sharply in the Americas region (by 26.9 per cent), it fell by 20.6 per cent and 22.1 per cent respectively in the EMEA and Asia/Pacific regions. The only application segment to increase its revenue was the service business, which registered an encouraging gain of 8.0 per cent that was generated largely from the spare parts business. By contrast, revenue declined by 11.3 per cent in the Mobile Machinery application segment, while the Automotive and Agricultural Machinery application segments reported decreases of 7.1 per cent and 37.6 per cent respectively.

Fourth quarter better than third quarter The volume of new orders received by the DCE segment in the fourth quarter of 2012 came to €214.0 million, a year-on-year decrease of 9.7 per cent (Q4 2011: €236.9 million). However, this represented an increase of 8.2 per cent compared with the third quarter of 2012. Fourth-quarter unit sales were down by 22.0 per cent year on year to just under 43,000 engines but were up by a quarter in comparison with the third quarter of 2012. The trend in unit sales across the year was also reflected in revenue: in the fourth quarter, the segment generated revenue of €252.5 million, 16.0 per cent more than in the third quarter, but 20.9 per cent less than in the final quarter of 2011.

Operating profit/loss Operating profit in the DCE segment fell by a substantial €62.8 million year on year, resulting in an operating loss of €15.6 million. This trend was driven, above all, by the continued low level of demand in the European market and the negative contributions to earnings from our joint ventures as a result of the economic slowdown. Set-up costs for our growth projects and for the production start-up of new engines also had an adverse impact on operating profit for the segment, as did higher depreciation and amortisation charges.

DEUTZ Compact Engines: Revenue by application segment

€ million (2011 figures)



BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS (DCS) SEGMENT

Small year-on-year decrease in new orders In the year under review, the DEUTZ Customised Solutions (DCS) segment received new orders for products worth €276.5 million, 9.4 per cent lower than in the previous year. The Mobile Machinery and Automotive application segments took 3.1 per cent and 14.5 per cent more orders respectively. All other DCS application segments, including the service business, saw decreases in new orders. Overall, new orders were therefore at almost the same level as revenue in the DCS segment. As at the end of 2012, orders on hand stood at €64.2 million, down by 15.2 per cent on the figure reported a year earlier (31 December 2011: €75.7 million).

Fewer engines sold In the year under review, unit sales in the DCS segment fell by 36.2 per cent to around 17,000 engines. Although engine sales were up by 10.1 per cent in the Asia-Pacific region, they were down by 40.4 per cent and 45.2 per cent respectively in the EMEA and Americas regions. All application segments reported a decline in unit sales.

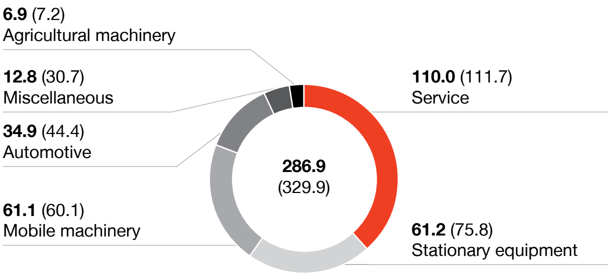
Reduction in revenue Revenue in the DCS segment amounted to €286.9 million last year, a year-on-year decline of 13.0 per cent. Nonetheless, revenue grew by 8.5 per cent in the Asia/Pacific region. However, the EMEA and Americas regions reported revenue decreases of 15.1 per cent and 26.3 per cent respectively.

All application segments saw their revenue fall with the exception of Mobile Machinery, which achieved a small rise in revenue of 1.7 per cent to €61.1 million.

Revenue and unit sales down in fourth quarter New orders in the fourth quarter of 2012 fell by 13.8 per cent to €62.6 million compared with the fourth quarter of 2011 but were at roughly the same level as in the third quarter of 2012. Fourth-quarter unit sales were down by almost a half compared with the same quarter of 2011, amounting to around 3,700 engines; they were also lower than they had been in the third quarter of 2012. Revenue in the fourth quarter of 2012 also fell compared with the fourth quarter of 2011, down by 18.8 per cent to €70.0 million, but remained at the same level as in the third quarter of 2012.

DEUTZ Customised Solutions: Revenue by application segment

€ million (2011 figures)



Operating profit at prior-year level Even though market conditions had worsened overall, we generated an operating profit of €46.6 million in the DCS segment, thereby managing to sustain the very good level reported for the previous year (2011: €46.5 million). This positive result was largely attributable to greater profitability.

BUSINESS PERFORMANCE IN THE OTHER SEGMENT

The successful disposal of our shareholding in Bosch Emission Systems GmbH & Co. KG (BESG) during the fourth quarter of last year was the main factor in the operating profit of €7.5 million earned in the Other segment. This equates to a rise of €10.0 million compared with 2011, when we reported an operating loss of €2.5 million.

FINANCIAL POSITION

BASIC PRINCIPLES AND OBJECTIVES OF FINANCIAL MANAGEMENT

Overview of the DEUTZ Group's financial position

	2012	2011
€ million		
Cash flow from operating activities[1]	104.9	120.0
Cash flow from investing activities	–81.4	–102.3
Cash flow from financing activities[1]	–22.2	–34.1
Change in cash and cash equivalents	1.3	–16.4
Free cash flow	12.6	4.8
Cash and cash equivalents at 31 December	52.1	51.6
Current and non-current interest-bearing financial liabilities at 31 December	100.7	121.2
Net financial position at 31 December	–48.6	–69.6

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

[1] Interest income, which amounted to €0.9 million (2011: €0.5 million), is now reported under cash flow from financing activities instead of under cash flow from operating activities so that both interest income and interest expense are now shown under financing activities. The prior-year figures have been restated accordingly to improve comparability.

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

Loan from European Investment Bank and syndicated bank loan ensure sufficient liquidity In mid-2012, a syndicate of five banks provided us with a €160 million working capital facility. It is a floating-rate, unsecured line and, as a revolving facility, can be drawn down as and when we need it until June 2017. DEUTZ can elect whether to utilise the cash line as a bilateral overdraft facility (up to €60 million) or to draw down amounts under the syndicated line with interest periods of three to six months.

In mid-2012, the European Investment Bank also granted us a €90 million loan. This loan, which is also unsecured, is repayable over a period of eight years, although no repayments are due in the first two years. DEUTZ has 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. As a result of this new funding, interest expenses will continue to fall in the next few years, while our range of options has expanded significantly.

In the first half of 2012, we had utilised the previous working capital facility, which was for €240 million. This line was fully repaid and replaced in mid-2012. The remaining outstanding amounts due to US noteholders, with a value equivalent to €15.7 million, were also repaid ahead of schedule.

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 was slightly lower in 2012 than in the previous year as a result of the business situation, the volume as at 31 December 2012 being around €125 million (31 December 2011: €138 million).

FREE CASH FLOW POSITIVE AGAIN

Although operating profit (EBIT) decreased substantially in 2012 owing to the weak economy, cash flow from operating activities declined by just €15.1 million to €104.9 million (2011: €120.0 million). The main reasons for this were the improvement in working capital compared with the previous year, higher depreciation and amortisation charges, and losses on equity-accounted investments that did not have an impact on cash flow.

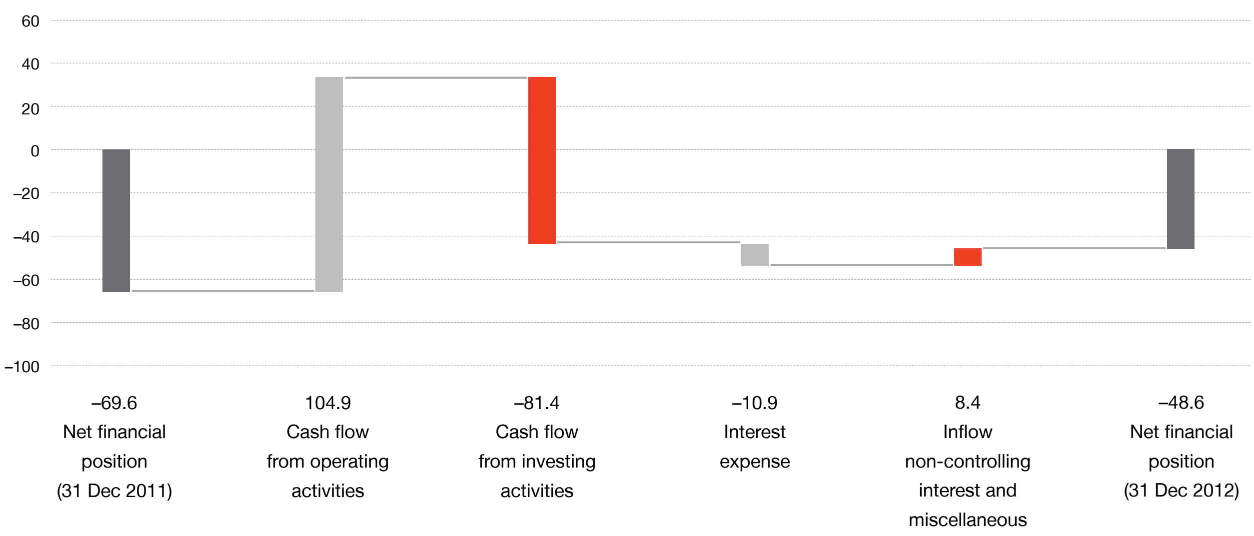
Cash flow from investing activities amounted to minus €81.4 million in 2012. This outflow of funds was primarily the result of capital expenditure on production facilities and tools for production start-ups of our new engine series that had taken place, or were due to take place, and the development of new engines and refinement of existing ones to meet new exhaust emissions standards. The net cash used for investing activities decreased by €20.9 million year on year (2011: €102.3 million), largely due to the disposal of our shareholding in Bosch Emission Systems GmbH & Co. KG (BESG) during the fourth quarter of last year.

The net cash remaining after capital expenditure was predominantly used to repay financial liabilities. At the end of 2012, cash flow from financing activities amounted to an outflow of €22.2 million (31 December 2011: outflow of €34.1 million[1]). Cash flow from financing activities was particularly affected by the restructuring of the funding in mid-2012, which involved paying back old loans and taking up new ones.

Despite the challenging economic conditions, we were able to increase our free cash flow slightly compared with the previous

DEUTZ Group: Change in net financial position

€ million



[1] Since the first quarter of 2012, interest income (2012: €0.9 million; 2011: €0.5 million) has been reported under cash flow from financing activities. The comparative figure for 2011 has been restated accordingly.

year. Free cash flow improved by €7.8 million year on year to €12.6 million at the end of 2012 (31 December 2011: €4.8 million). Factors in this uptrend included an inflow of cash from the disposal of our shareholding in Bosch Emission Systems GmbH & Co. KG (BESG) and the lower interest expense following the restructuring of the funding in mid-2012.

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

In 2012, our capital expenditure on property, plant and equipment and on intangible assets including investment grants totalled €110.6 million, which was slightly higher than in the previous year (2011: €102.7 million). This was broken down into €56.1 million on property, plant and equipment and €54.5 million on intangible assets. We invested €19.2 million more on property, plant and equipment than in the previous year (2011: €36.9 million) – predominantly on production equipment and tools in connection with the upcoming market launch of the new TCD 2.9 and TCD 3.6 engines and on a new development building. However, our capital expenditure on the development of new engines and refinement of existing ones in accordance with the new exhaust emissions standards, which accounts for the lion's share of capital spending on intangible assets, fell by €17.4 million to €44.2 million (2011: €61.6 million) as budgeted.

As in previous years, capital investment on property, plant and equipment and the development and refinement of products was higher than the depreciation and amortisation of these two groups of assets.

The bulk of the total capital expenditure including investment grants was invested in the DEUTZ Compact Engines segment (2012: €95.0 million; 2011: €92.9 million). Capital expenditure in DEUTZ Customised Solutions was €15.6 million (2011: €9.6 million). Investing activities in both segments focused on property, plant and equipment and on development expenditure.

NET ASSETS

Overview of the DEUTZ Group's assets

	31/12/2012	31/12/2011
€ million		
Non-current assets	639.2	640.3
Current assets	385.4	458.3
Assets classified as held for sale	1.8	0.4
Total assets	**1,026.4**	**1,099.0**
Equity	480.1	453.5
Non-current liabilities	274.8	304.3
Current liabilities	271.5	341.2
Total equity and liabilities	**1,026.4**	**1,099.0**
Working capital (in € million)	141.6	142.1
Working capital ratio at the balance sheet date (%)	11.0	9.3
Working capital ratio (average, %)	14.7	10.8
Equity ratio (%)	46.8	41.3

Working capital: inventories plus trade receivables minus trade payables

Equity ratio: ratio of equity to total equity and liabilities

Non-current assets Despite the sustained high level of capital expenditure on property, plant and equipment and on intangible assets, non-current assets had fallen slightly by the end of the year to €639.2 million, a decline of €1.1 million (31 December 2011: €640.3 million). The reduction in equity-accounted investments resulting from the disposal of our shareholding in Bosch Emission Systems GmbH & Co. KG (BESG) during the fourth quarter of 2012 and from negative contributions to earnings was largely offset by the capital expenditure on property, plant and equipment and on intangible assets.

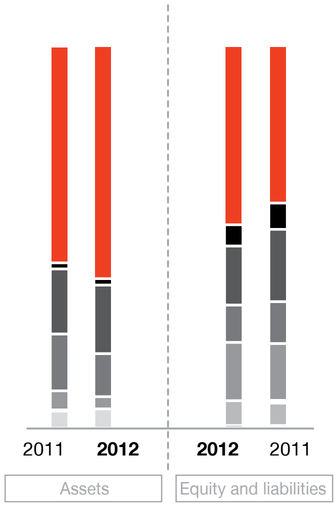
Current assets Current assets had decreased by €72.9 million to €385.4 million as at 31 December 2012 (31 December 2011: €458.3 million). The biggest factor in this trend was trade receivables, which were affected by the decline in business volume.

DEUTZ Group: Balance sheet structure

in % (2011 figures)

Assets

60.5	(56.7)	Non-current assets
1.7	(1.6)	Deferred taxes
18.0	(17.1)	Inventories
11.3	(14.9)	Trade receivables
3.2	(5.0)	Other receivables and assets
5.1	(4.7)	Cash and cash equivalents
0.2	(0.0)	Non-current assets classified as held for sale



Equity and liabilities

46.8	(41.3)	Equity
5.6	(6.9)	Other liabilities
15.5	(19.0)	Trade payables
9.8	(11.0)	Financial liabilities
15.3	(14.9)	Pension provisions
6.7	(6.6)	Other provisions
0.3	(0.3)	Deferred tax provisions

Working capital The ratio of working capital (inventories plus trade receivables minus trade payables) to revenue deteriorated owing to the lower volume of business compared with 2011. The working capital ratio[1)] had grown from the record 9.3 per cent achieved as at 31 December 2011 to 11.0 per cent as at 31 December 2012. The average working capital ratio (ratio of average working capital over four quarters to the revenue for twelve months) increased at an even higher rate, climbing from 10.8 per cent in 2011 to 14.7 per cent in 2012. The reason for this was the higher inventories to revenue ratio during the year under review. Overall, working capital remained roughly the same year on year at €141.6 million (31 December 2011: €142.1 million). However, while inventories were largely unchanged, trade receivables and trade payables both declined by a similar degree.

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 almost 150 years. DEUTZ also enjoys valuable long-standing relationships with customers; it has entered into long-term cooperation agreements, particularly with its key customers.

Further increase in the equity ratio Equity was €26.6 million higher than it had been at 31 December 2011. This was primarily due to the amount of net income generated in 2012 but was also the result of the capital contribution paid by the Shandong Changlin Machinery Group Co., Ltd. into DEUTZ (Shandong) Engine Co., Ltd., which belongs to the DEUTZ Group. The shares that Shandong Changlin Machinery Group Co., Ltd. holds in the joint venture are reported as non-controlling interests under Group equity. As at 31 December 2012, equity amounted to €480.1 million (31 December 2011: €453.5 million). Consequently, the equity ratio, which had already been very high the previous year, improved by a further 5.5 percentage points to 46.8 per cent (31 December 2011: 41.3 per cent).

Current and non-current liabilities Both current and non-current liabilities decreased year on year. The decline in current liabilities of €69.7 million was predominantly attributable to the reduction in trade payables resulting from the business situation. Non-current liabilities fell by €29.5 million, above all because we had drawn down less from bank loans and because, as expected, provisions for pensions and other post-retirement benefits were lower. As at 31 December 2012, current liabilities came to €271.5 million (31 December 2011: €341.2 million) and non-current liabilities to €274.8 million (31 December 2011: €304.3 million).

As a consequence of the decrease in current assets and liabilities, total assets had fallen by €72.6 million to €1,026.4 million as at 31 December 2012 (31 December 2011: €1,099.0 million).

[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 financial year to revenue for the last twelve months

OVERALL ASSESSMENT FOR 2012

Having had one of the best years in our almost 150-year history in 2011, we were unable to repeat this excellent performance in 2012. This was due above all to the generally weak level of economic growth in Europe and in the parts of the capital equipment sector in China that are relevant to us. The decline in demand for our products caused revenue to decrease by 15.5 per cent to €1.3 billion. Unit sales of 179,000 engines constituted a drop of 22.5 per cent, although we are seeing a growing proportion of higher-value engines for the new emissions standards. Operating profit fell sharply to €38.5 million; the EBIT margin therefore amounted to 3.0 per cent. Besides the reduction in business volume, this earnings trend is above all attributable to smaller contributions to earnings from the joint ventures, start-up costs for our growth projects and the production start-up of new engines. Income from the sale of Bosch Emission Systems GmbH & Co. KG had a countervailing effect. During the year under review, we therefore initiated further measures to cut costs, boost flexibility and improve earnings with the aim of further reinforcing our economic stability. It was encouraging to see that, despite the challenging market conditions, free cash flow remained in positive figures at €12.6 million and net financial debt declined by some €20 million to below €50 million. We are confident that, in the long term, DEUTZ AG is well positioned to take advantage of the improving economic situation thanks to our solid foundations, improved funding structure and increasingly strong presence in Asian growth markets.

EVENTS AFTER THE REPORTING PERIOD

With effect from 1 March 2013, Mr Michael Wellenzohn was appointed as an additional member of the Board of Management where, in a newly created position, he will be in charge of sales and marketing. Mr Wellenzohn was previously sales director at ThyssenKrupp Chassis.

RESEARCH AND DEVELOPMENT

Research and development expenditure (after deducting grants)

€ million (R&D ratio in %)

2012	**62.1**	**(4.8)**
2011	84.6	(5.5)
2010	71.8	(6.0)
2009	64.1	(7.4)
2008	56.4	(3.8)

RESEARCH AND DEVELOPMENT EXPENDITURE

We want to maintain our strong footing in our market and to grow profitably. To achieve this aim, it is critical that we remain one of the innovation leaders in our industry. Research and development lay the foundations for this.

Including grants, expenditure on research and development in 2012 amounted to €82.7 million (2011: €109.8 million). If the grants received from key customers and development partners are excluded, expenditure came to €62.1 million. This equates to a year-on-year decrease of €22.5 million or almost 27 per cent (2011: €84.6 million). The R&D ratio (including grants) – the ratio of net R&D expenditure to consolidated revenue – fell in the year under review to 4.8 per cent (2011: 5.5 per cent). As announced, we were therefore able to scale back expenditure on research and development owing to the advanced stage of the work on new products and the new exhaust emissions standards. In 2012, some 88 per cent (2011: 90 per cent) of all R&D expenditure was accounted for by new engine development and engine refinement, 10 per cent (2011: 8 per cent) by customer applications and support for existing engine series, and the remaining 2 per cent (2011: 2 per cent) by research and preliminary development.

Including grants, R&D expenditure came to €55.3 million (2011: €70.6 million) in the DEUTZ Compact Engines segment and €6.8 million (2011: €14.0 million) in the DEUTZ Customised Solutions segment.

The development work for the design of the basic engines to meet the EU Stage IV and US EPA Tier 4 Final emissions standards, which will apply from 2014, has already been largely included in the development work for EU Stage III B and US EPA Tier 4 Interim. Additional development work will cover combustion optimisation, adaptation of exhaust gas aftertreatment systems and mechatronics.

Development and refinement of our engines A number of products were introduced in 2012, which also saw a continuation of development work for the upcoming EU Stage IV and US EPA Tier 4 Final emissions standards for four to eight-litre engines, which are being launched in 2013 and will have an output of 130kW or higher. In the capacity category of less than four litres, the TCD 2.9 for Tier 4 Final is being developed for use in agricultural equipment and will be available to customers from the second quarter of 2014.

By developing the new TCD 2.9 and TCD 3.6 engines, DEUTZ aims to streamline its overall product range from seven engine series to five. It also wants to further strengthen its foothold in the segment of engines with an output of less than 90kW for agricultural applications by offering engine series tailored to customer requirements. With their current engine architecture, the TCD 2.9 and TCD 3.6 have the potential to be developed for further engine variants and future emissions standards.

The TCD 3.6 is a water-cooled, four-cylinder, in-line, turbocharged engine that meets the EU Stage III B and US EPA Tier 4 Interim emissions standards thanks to its powerful common-rail injection system and highly efficient internal combustion with cooled external exhaust gas recirculation. Achieving excellent values for torque and rated power, this engine series has penetrated a power category previously served only by engines with greater capacity. Different engine parameters, tailored to customer requirements, ensure low fuel consumption, increased engine power and improved engine response in a wide variety of applications.

At INTERMAT 2012, one of the biggest construction equipment and structural engineering trade fairs, we presented the entire range of DEUTZ engines with outputs of up to 390kW for the first time as well as DVERT® components for the EU Stage IV and US EPA Tier 4 emissions standards. This was a chance for us to demonstrate the future of engine technology.

Strategic partnerships In 2012, we entered into a strategic partnership with hydraulics suppliers to achieve all-round optimisation and systems integration of hydraulics components. The results of the strategic partnership will enable us to offer customers an engine that, as an integrated system including the hydraulics, has been optimised in terms of performance and installation.

DEUTZ and Bosch will intensify their future collaboration as part of an innovation partnership in the fields of exhaust aftertreatment, diesel injection technology and electronics. The aim of this partnership is to integrate the drive technology systems for mobile machinery more tightly.

New organisational structure Systems integration was strengthened in early 2012 when a new organisational unit was formed within the development division. In the context of the company's global operations, the development division will take on a leading role in the international development network. In the long term, this will involve setting up further local teams at the future international development sites.

Exhaust aftertreatment Internal modifications to engines to reduce untreated emissions – primarily measures to fine-tune the combustion process, optimise the design of the gas exchange cycle and introduce exhaust gas recirculation mechanisms – are complemented by optimised external exhaust aftertreatment systems.

DVERT® (DEUTZ Variable Emissions Reduction Technology) is a modular, slimline system of technical components compatible with different engine configurations. The various DVERT® elements are external exhaust gas aftertreatment technologies such as oxidising catalytic converters, open and sealed design particulate filters and selective catalytic reduction (SCR) systems. The systems can be combined as required in order to achieve the desired outcome in terms of engine performance, compliance with emissions limits and competitiveness. The solutions have been designed so that they can be upgraded to meet the future, even lower, emissions limits in the EU Stage IV and US EPA Tier 4 Final standards.

Research for the future Preliminary development focuses on the development of groundbreaking technologies and system designs for engines in the next generation but one. We continued with preliminary development on engine concepts to meet the future EPA Tier 5 emissions standard.

In 2012, a pioneering new preliminary development project was launched for a gas engine for use in agricultural applications. As part of the project, the potential for using methane-based fuels, in particular biomethane, is being assessed. Following the start of series production of an engine powered by rapeseed oil, DEUTZ continues to show a keen interest in engines powered by alternative fuels that help to reduce overall CO_2 emissions. A recent market analysis found that running agricultural machinery on biomethane brings economic benefits, while the practically neutral carbon footprint resulting from extremely low levels of pollutant emissions plays a key role in reducing the impact on the environment.

Intellectual property rights protect our expertise We use patents, patent applications and utility models to safeguard our expertise against unauthorised use by third parties. In the year under review, we submitted 20 new patent applications, of which eleven were in Germany. As a result, we now hold a total of 186 patent applications, patents and utility models registered in Germany and 219 registered elsewhere.

EMPLOYEES

Overview of the DEUTZ Group's workforce

	31/12/2012	31/12/2011
Headcount		
DEUTZ Group	**3,991**	**4,060**
Thereof		
In Germany	3,189	3,325
Outside Germany	802	735
Thereof		
Non-salaried employees	2,377	2,459
Salaried employees	1,460	1,440
Trainees	154	161
Thereof		
DEUTZ Compact Engines	3,223	3,242
DEUTZ Customised Solutions	768	818

Number of employees adjusted to decline in production A flattening out of demand and lower capacity utilisation in production meant we had to reduce the number of employees in 2012. The DEUTZ Group employed 3,991 people in total at the end of 2012, which was 69 fewer than at the end of 2011. This equates to a decline of 1.7 per cent in the workforce. As at 31 December 2012, we also had a further 152 people on temporary employment contracts, compared with 538 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 2012.

Approximately 80 per cent of our workforce is employed in Germany. In 2012, as in the past, most of these employees were based in Cologne – 2,489 as at 31 December 2012. At the end of the year, 413 employees were based at the Ulm facilities. Of the 802 employees outside Germany, 459 of them work for our DEUTZ SPAIN subsidiary in Zafra, Spain.

DEUTZ Group: breakdown of workforce by location

	31/12/2012	31/12/2011
Headcount		
Cologne	2,489	2,561
Ulm	413	471
Other	287	293
In Germany	**3,189**	**3,325**
Outside Germany	802	735
Total	**3,991**	**4,060**

When broken down by segment, DEUTZ Compact Engines employed 3,223 people as at 31 December 2012, which was almost the same number as it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 768, down by 6.1 per cent compared with the end of 2011.

Slightly fewer employees in R&D compared with 2011 DEUTZ is an innovation-driven, technology-based enterprise. Research and development is therefore of fundamental importance to us and critical to our long-term technological orientation. Nevertheless, we slightly decreased the number of R&D employees at 31 December 2012 to 520 (31 December 2011: 544) owing to the completion of projects.

A helping hand for a new generation DEUTZ gives young people an optimal start for the future by offering a well-grounded training programme. In the year under review, we provided training at our various plants for 154 young men and women in seven different technical and commercial occupations. The Cologne site employed 109 young people, while the DEUTZ plant in Ulm employed 27. Eleven young people are receiving vocational training from DEUTZ at the XChange plant in Übersee on Lake Chiemsee. DEUTZ employs a further seven trainees at its components plant at Herschbach im Westerwald.

We are especially pleased that another three women joined our Company to pursue technical training in the year under review. Women now account for around eleven per cent of all the apprentices and trainees at DEUTZ. In 2012, the overall domestic ratio of trainees to other employees was around 4,8 per cent (2011: 4.8 per cent). All apprentices and trainees passing their final examinations were then taken on as qualified employees for at least one year.

One of our top priorities is to encourage young people to take an interest in technology while they are still at school. That is why we took part in various training fairs and careers information events again last year. This allows us to make direct contact with young people, while they get to meet their future employer in person. We also provide this opportunity by regularly taking part in the Girls' Day and 'Erlebniswelt Maschinenbau' campaign days. As part of our corporate social responsibility, we have been working closely for more than 20 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 persons with learning and social difficulties. A total of 38 participants undergo basic metalwork training over a ten-month period at the DEUTZ training centre. This course provides the participants with a comprehensive range of skills that they will need to take up a career. Our efforts pay dividends: in the year under review, the placement rate for an apprenticeship in industry or the trades was 92 per cent (2011: 100 per cent).

As in 2011, the Cologne Chamber of Industry and Commerce (IHK) awarded our training centre in Cologne its 'Best performer' certificate in 2012 for the centre's outstanding contribution to introductory vocational training. The IHK also awarded certificates in recognition of the exemplary commitment demonstrated by the training departments in Ulm and Herschbach.

The DEUTZ Group is also involved in training activities outside Germany. Last year, DEUTZ Spain took part in a project to become one of the first companies in Spain to offer vocational training combined with studies at a vocational college. This is a new type of training project for Spanish industry and is based on the German vocational college system. A total of 15 trainees have started the programme.

We encourage our employees to submit suggested improvements with the payment of bonuses for ideas accepted through the suggestions management system. In this way, we receive a continuous feed of ideas for increasing profitability, refining health & safety or improving environmental protection. In 2012, DEUTZ employees submitted more than 1,100 suggestions, which led to savings of just under €0.5 million.

Personnel marketing activities expanded DEUTZ continued its successful participation in key university fairs held around the region in Cologne, Aachen and Bonn/Siegburg. Our presence at these three universities, which offer courses in engine-related subjects, enables us to make contact at an early stage with prospective graduate recruits and to provide them with information on the opportunities for work placements, dissertations and career starts at DEUTZ. In 2012, some 100 students on work placements in a wide variety of departments made the most of the opportunity to obtain an initial insight into day-to-day working life and to gain important practical experience. We also provided the opportunity for 51 students to complete their bachelor's or master's degree by preparing a practically relevant dissertation in cooperation with DEUTZ. A new programme was launched, under which particularly talented engineering students are offered a part-time job that allows them to learn about the work of engineers and to deepen and apply this knowledge. The objective of all these activities is to continue to be able to recruit highly qualified staff for DEUTZ.

DEUTZ also took part in the SinoJobs Career Days, a careers fair focusing on China. Attendees were especially interested in our joint ventures in China and the job opportunities there.

Continued talent management and succession planning We continued with the collaboration with Steinbeis University Berlin that we had begun in 2011. The aim is to enable selected young employees to gain a master of science degree in international management based on studies combined with practical experience. The purpose of this degree course is specifically to train the engineers and managers of tomorrow who will support and contribute to DEUTZ's increasing focus on activities at an international level.

In 2011, we had used structured HR development activities to create a pool of talent, which we were able to draw on in 2012 to fill vacant specialist and managerial positions with internal candidates. This is proof positive of the priority given to our own talented employees in terms of opportunities for continuing professional development in Germany and abroad. Based on the outcome of discussions about their potential, DEUTZ-specific training courses were developed on the themes of team-building and leadership that were then run for a number of groups. As the participants' feedback was highly positive, it is planned to continue these training activities in 2013.

Strategic HR activities taking shape As part of its qualitative HR planning activities, DEUTZ is addressing the issue of which skills, qualifications and job profiles it will need in the workforce to successfully implement our corporate strategy in the next few years. Initially, we focused on research and development, sales and assembly. One of the outcomes was that we started taking on trainees in the field of mechatronics for the first time in autumn 2012. This is in recognition of the fact that mechanics and electronics are becoming increasingly interlinked disciplines.

Health management activities stepped up In 2012, we again focused on important health issues in cooperation with the health insurance provider, the company medical service and the works council. The health insurance provider's health report shows that skeletal disorders are the most frequent cause of illness among employees. We carried out a pilot project with a manufacturer of safety shoes to bring about improvements in this area. In the next step, we plan to offer ergonomics advice on site so that employees can find out about correct and incorrect posture in the workplace. These measures have already proved very effective at our site in Ulm.

CORPORATE SOCIAL RESPONSIBILITY

DEUTZ AG's corporate philosophy is based on five principles: innovations, quality, success, trust and responsibility. The latter means that DEUTZ assumes responsibility for its decisions and actions, for its products and services, for its customers and lenders, for the environment and for the society in which we live. As a global company, we have been involved in corporate citizenship activities throughout Germany and beyond for many years, although they are predominantly focused in our home region in the area around Cologne.

Engine museum popular with visitors Last year, DEUTZ AG participated in the Expedition Colonia festival for the first time, during which Cologne-based companies opened their doors to the public. The festival on 23 April 2012 gave engineering enthusiasts the chance to learn about the history of how the internal combustion engine was developed by taking a guided tour of the DEUTZ engine museum. At the technology centre, which covers over 600 square metres, more than 50 exhibits offer a fascinating insight into the world of engine technology and highlight the ingenuity of the company's founder Nicolaus August Otto, who developed the world's first fully functioning four-stroke engine in 1876. This engine can be seen at the technology centre alongside engine no. 1, the first atmospheric gas-powered engine, which dates from 1867 and is also still in working order. As in 2011, we also took part in Heritage Day, which was held throughout Germany on 9 September 2012. Again, we offered free admission to our engine museum and ran guided tours.

Integration of people with disadvantages DEUTZ also sets an example for the integration of people with disabilities. For 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 creates employment in the regular labour market for 40 people with severe disabilities or who face other disadvantages in the job market. 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. The goods inward, packing and component manufacturing services provided by the two organisations are tightly integrated with DEUTZ AG's processes. We benefit from the high level of precision demonstrated by their employees. In addition, we are involved in the HauptschulPower initiative, which runs targeted programmes aimed at challenging and developing schoolchildren at less academic secondary schools (Hauptschulen), many of whom are disadvantaged, so that they can later undergo vocational training. Our global activities include the 'Learnership for disabled people' programme, which is organised by D. D. Power Holdings (Pty) Ltd. (DDP) in South Africa. Initiated by DDP's supervisory board in September 2011, the programme's objective is to integrate people with disabilities into work processes and improve their job prospects in the economy.

DEUTZ choir performs on the global stage For many years, cultural activities at DEUTZ have included a company choir. Based in Cologne, the DEUTZ choir has added a musical dimension to DEUTZ AG's outstanding international reputation for more than 65 years. The choir is a musical ambassador for the Company and the city of Cologne, bringing people and cultures together with highly respected concerts and tours throughout the world. Last year, for example, the choir sang in a joint concert with the Beijing Symphony Orchestra at the Cologne Philharmonic Hall as part of the 2012 Year of China. The concert celebrated the 25th anniversary of the twinning of Cologne and Beijing and also featured the internationally acclaimed trio, China's Three Tenors. Another highlight took place at the Cologne Philharmonic Hall in June 2012, when the choir took the audience on a musical journey from Berlin to Paris.

The members of the Board of Management and managers at DEUTZ AG are also 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

ENVIRONMENTAL MANAGEMENT SYSTEM

DEUTZ AG manufactures eco-friendly products that meet the latest emissions standards and therefore make a significant contribution to protecting the environment. Our production processes are also resource-efficient. 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, avoiding and disposing of waste, protecting against soil and water pollution and sustainably reducing energy consumption.

Each year, the performance of the environmental management system, which DEUTZ introduced voluntarily, is assessed and audited by the external certification organisation DQS. Our environmental management system meets the international standard ISO 14001, as was most recently confirmed in June 2012. This also satisfies a key requirement of our customers.

Besides the external audit conducted by DQS, DEUTZ has its own safety management department that regularly reviews compliance with applicable laws and regulations. Its tasks include evaluating new legal requirements and, if necessary, the related adjustments to our processes.

Air pollution prevention at the production testing centre in Cologne-Porz There were further reductions in emissions of nitrogen oxide, organic dust and benzene in 2012. This was primarily due to two reasons: firstly, a higher proportion of diesel engines with a capacity of less than four litres was tested and, secondly, the diesel engines are subject to increasingly stringent emissions requirements. Another significant factor in the decrease in emissions was the modern exhaust gas collection system used at the production testing centre in Cologne-Porz, whose cleaned gas now has a dust content of just 1.0 mg/m^3. In the year under review, around 1,600 tonnes of CO_2 emissions were released during engine tests at the test centre for engine production (2011: just over 2,000 tonnes). This reduction is particularly encouraging because this source of emissions is of great relevance to the Group's environmental footprint.

Waste disposal and handling of hazardous waste DEUTZ AG is aware of its responsibility when it comes to handling hazardous waste, which is why it set up a sealed collection point for such waste a number of decades ago. Hazardous waste includes scrap parts still contaminated with oil, waste oil, paint residues, solvents and (special) fuels. During the year under review, the existing collection point for hazardous waste was updated with the latest technology. Additional retractable covers and collection trays were also installed outside for the storage of dumper trucks containing steel scrap still contaminated with oil. Extensive training and new company regulations on handling hazardous waste will help to minimise the environmental risk still further.

Water pollution control The research and development unit has drawn up a multi-stage concept for improving water pollution control near engine testing centres. In 2012, around €200 thousand was spent on renovating the testing centre cellars in order to catch any service fluids that may escape during engine testing. These fluids, which include fuel, engine oil and antifreeze, are collected and transported to a waste processing facility, where the high water content is separated from the hazardous waste. The extracted water can then be used in a variety of auxiliary processes at DEUTZ. This significantly reduces the volume of water consumed in production and the cost of waste disposal. During the period under review, approximately 39m^3 of waste was treated, of which only a small proportion required subsequent disposal.

Energy savings In 2012, additional engine test rigs were equipped with generator brakes as part of a multi-stage concept for improving the development test rigs. The brakes convert the kinetic energy produced by diesel engines on the test rig into electrical energy and feed it into the electricity grid at DEUTZ AG. The use of generator brakes also allows us to buy fuel at special lower tax rates. Generator brakes, combined with the smaller amount of electricity purchased, enabled us to achieve savings of around €700 thousand in 2012.

HEALTH AND SAFETY PROMOTED BY SAFETY MANAGEMENT

Our safety management activities are based on partnership with the relevant managers of the statutory accident insurer and with the German government supervisory authorities for workplace health & safety and environmental protection. This helps to effectively reduce the risk of serious accidents, unsafe conditions and unplanned machinery downtime.

There was an encouraging year-on-year improvement in the KPIs 'notifiable accidents per thousand employees' (TMQ)[1] and 'accident frequency'[2] despite the level of risk not changing: TMQ fell to 29.8 (2011: 33.0) and accident frequency decreased to 23.1 (2011: 26.8). This proves the effectiveness of our internal concepts. The accident frequency KPI also indicates that this improvement was achieved irrespective of the volume of work or the number of employees.

Besides providing employees with extensive training on health and safety during inhouse and external courses, we also analysed our health and safety processes again and took steps to reduce accidents. In particular, these included regular testing of facilities, equipment and tools. This helps to ensure that our employees can use all tools safely and that all processes operate with an adequate level of safety.

RESULTS OF OPERATIONS FOR DEUTZ AG

Income statement for DEUTZ AG

	2012	2011
€ million		
Revenue	1,214.4	1,452.4
Profit/loss from ordinary activities	**58.0**	**21.2**
Net extraordinary expense	–2.3	–2.3
Income taxes	2.9	6.6
Other taxes	–0.4	–0.6
Net income	**58.2**	**24.9**
Loss	–115.8	–140.7
Accumulated loss	**–57.6**	**–115,8**

The annual financial statements of DEUTZ AG are prepared in accordance with the requirements of the German Commercial Code (HGB) and the German Stock Corporation Act (AktG). The revenue generated by DEUTZ AG in 2012 amounted to €1,214.4 million; a year-on-year fall of €238.0 million (2011: €1,452.4 million). By contrast, the profit from ordinary activities had risen to €58.0 million (2011: €21.2 million), largely on account of the reversal of an impairment loss on the carrying amount of the equity invested in our US subsidiary. After deduction of interest, tax and extraordinary items, the net income for the year was €58.2 million (2011: €24.9 million).

DISCLOSURES PURSUANT TO SECTION 315 (4) HGB

Composition of the issued capital There were no changes to the issued capital (share capital) of DEUTZ AG in 2012. As at 31 December 2012, 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 has been a shareholder in DEUTZ AG with a voting share of 25 per cent plus one share.

Restrictions affecting voting rights or the transfer of shares There are no longer any restrictions affecting voting rights or the transfer of DEUTZ AG shares as the restrictions (described in last year's annual report) on SAME DEUTZ-FAHR Group S.p.A. in the event that it sold, encumbered or otherwise disposed over the shares that it held in DEUTZ AG elapsed when it sold most of these shares to AB Volvo.

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

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

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

According to article 14 of the Statutes of DEUTZ AG:

"The Supervisory Board may change the wording but not the spirit of the Statutes." Sections 179, 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.

[1] Known as TMQ (Tausend-Mann-Quote) in German
[2] Accident frequency: number of accidents x 1 million / hours worked

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.

The Technology Project Agreement between DEUTZ and Volvo can be terminated by Volvo for good cause with immediate effect if DEUTZ AG is directly or indirectly acquired by a competitor of Volvo, merged with such a competitor or in any other way falls under the control of such a competitor.

In mid-2012, DEUTZ AG took up a syndicated loan for €160 million from a syndicate of banks and a loan for €90 million from the European Investment Bank. Also in mid-2012, we fully repaid and replaced the working capital facility, which was for €240 million and was still being used in the first half of 2012, and the remaining outstanding amounts due to noteholders, equivalent to €15.7 million. Under the terms of the new 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 employment contracts of the Board of Management members Dr Helmut Leube and Dr Margarete Haase stipulate the following provision in the event of a change of control: if their appointment is (1) revoked within nine months of the change of control or (2) ended within nine months of the change of control subject to certain other requirements following a change to the legal form of DEUTZ AG, they will receive 150 per cent of the severance cap pursuant to item 4.2.3 of the German Corporate Governance Code. Within the meaning of the employment contracts, a change of control is when one or more 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 management report and group management report pursuant to sections 289 (4) and 315 (4) HGB relate to arrangements that may be significant in the success of any public takeover bid for DEUTZ AG. It is the opinion of the Board of Management that these arrangements are normal for publicly traded companies comparable with DEUTZ AG.

BASIC PRINCIPLES OF THE REMUNERATION SYSTEM

REMUNERATION OF THE BOARD OF MANAGEMENT

The remuneration paid to the members of DEUTZ's Board of Management in 2012 consisted of fixed, variable and long-term performance-related components. The fixed component is paid monthly as basic salary. The performance-related variable component of remuneration is paid as an annual bonus, which is linked to changes in specific key performance indicators in the DEUTZ Group, such as the EBIT margin, free cash flow and the working capital ratio, and to personal targets related to the individual's areas of responsibility.

The members of the Board of Management also receive options – intended to have a long-term incentive effect – related to the increase in shareholder value. These incentives are virtual share options that are issued on the basis of a Long-term Incentive Plan (LTI Plan) to reward the sustained contribution of management to the success of the business. Before they receive virtual share options, those eligible must invest some of their own capital in DEUTZ shares. The virtual share options include the right to receive a cash payment at the end of a lock-up period of three or four years, providing the performance of DEUTZ shares meets the criteria specified in the LTI Plan. Under these criteria, the price of DEUTZ shares on the exercise date either must be 30 per cent above the defined reference price – the weighted average price of DEUTZ shares in the three months prior to the option grant date – or must have outperformed the Prime Industrial index by 30 per cent.

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.

The members of the Board of Management may defer some of their remuneration and add it to an occupational pension scheme. The Company does not grant the members of the Board of Management any pension entitlements.

Further information on the remuneration paid to the Board of Management can be found on page 96 of the Notes to the consolidated financial statements.

Changes were made to the remuneration system for the members of the Board of Management at the start of 2013. In order to take account of statutory changes which have been introduced by the Act on the Appropriateness of Executive Compensation, the system of variable compensation of the members of the Executive Board of DEUTZ AG has been changed. For DEUTZ AG an amendment or, respectively, extension of the Service Agreements of the respective Executive Board members was due in the year 2012. This has led to the implementation of the change of law already occurred in 2009.

The new compensation systems as resolved by the Supervisory Board provides that the variable compensation of an Executive Board member consists of two elements: on the one hand the Executive Board member receives a performance-based variable compensation ("Bonus"), the calculation of which is dependent on the achievement of certain key performance indicators. On the other hand, upon the beginning of his Service Agreement and thereafter at the beginning of each subsequent year of service, the Executive Board member receives for each full year of service a certain contractually determined Euro amount in the form of Virtual Performance Shares.

The calculation of the Bonus for a business year is dependent on the degree of the achievement of quantative key performance indicators for which the degree of goal achievement is measured on an annual basis ("Short-term KPI's"). Number, content and weight of the Short-Term KPI's is determined annually by the Supervisory Board exercising due discretion, and in each case after considering the view of the members of the Executive Board. The minimum goal achievement for the grant of a Bonus is 75 %; the maximum goal achievement which shall be considered for the achievement of a relevant KPI is 150 %. The maximum amount of a Bonus which would result from maximum goal achievement is determined in the respective Service Agreement. Only 60 % of the Bonus for a business year is paid out after the end of the respective business year. In case of the achievement of further mid-term key performances indicators ("Mid-term KPI's"), further 20 % portions of the Bonus are paid out one and, respectively, two years later, provided that the amount of the pay-out is dependent on the degree of achievement in relation to the respective Mid-term KPI's. Also in relation to these pay-outs the respective maximum amounts are determined in the Service Agreements. The goals for all pay-outs are already determined in the beginning of the business year, for which the Bonus is granted.

Details regarding the Virtual Performance Shares are set forth in a long-term incentive plan for the Executive Board ("LTI-Plan Executives") which is part of the Service Agreement with the Executive Board members. The number of Virtual Performance Shares alloted to an Executive Board member is equal to the annual Euro amount as determined by the Service Agreement, divided by a reference price. The reference price is the average closing price of the DEUTZ share in Xetra-trading (or an equivalent successor system) on the Frankfurt Stock Exchange during the 60 stock exchange trading days preceding the allotment date. Virtual Performance Shares represent an entitlement to payment of a cash amount in accordance with the provisions of the LTI-Plan Executives. The cash amount per Virtual Performance Share corresponds to the average closing price of the DEUTZ share in Xetra-trading (or an equivalent successor system) on the Frankfurt Stock Exchange during the last 60 stock exchange trading days prior to the expiry of a waiting period of four years as from the allotment, and is limited to a maximum of 1.5 times the reference price. The entitlement for the payment claim requires, however, that either the stock exchange price of the DEUTZ share must have increased by at least 30 % as compared to its reference price or the development of the DEUTZ share during the waiting period must have exceeded the development of the M-DAX (or a future index replacing the M-DAX) by at least 10 percentage points. It is further required that the Executive Board member makes a personal investment by holding one DEUTZ share for every 20 Virtual Performance Shares received.

The variable compensation is designed in a way that the greater part of variable compensation is measured against the development of several years. The total compensation structure is intended to support a sustainable business development.

REMUNERATION OF THE SUPERVISORY BOARD

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

The chairmanship and membership of Supervisory Board committees are remunerated separately in accordance with the guidelines set out in the German Corporate Governance Code. DEUTZ also pays each member of a committee a fee of €1,000 for each committee meeting they attend. The chairman of a committee is entitled to twice this sum, and 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.

Further information on the remuneration paid to the Supervisory Board can be found on page 97 of the Notes to the consolidated financial statements.

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 terms 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 therefore has an appropriate risk management system to ensure it can meet this requirement.

Such a system raises the awareness of employees and strengthens their sense of responsibility with regard to 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 in conjunction with the Risk Management Committee ensures that all major risks are documented and communicated, and that appropriate corrective action is taken and documented at an early stage.

Risk inventories normally take place four times a year – and this was also the case in 2012. 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. 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 risks that have already been identified and whether there is still a need for further action. The Risk Management Committee assesses the risks and makes proposals to the Board of Management, which then decides on appropriate measures to prevent or minimise the risk. To enable the Company to respond promptly at all times to any possible risks arising, risk officers and their employees are under an obligation to submit ad hoc reports on any new material risks or if there is an increase in the threat from known risks, such reports to be separate from the regular reporting requirements.

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 or the Risk Management Committee were speedily implemented by DEUTZ.

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 addition to the fundamental principles of separating functions and restricting access to data, DEUTZ AG issues written work instructions and, in particular, Group accounting guidelines that are regularly updated at head office and communicated throughout the Group in order to ensure that the consolidated financial statements are properly and consistently prepared. 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.

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 ICS is subject to regular reviews by the internal audit department, which reports directly to the Board of Management. 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. The findings allow us to eliminate any deficiencies that have been identified and ensure that the ICS undergoes continuous refinement.

RISK MANAGEMENT IN RELATION TO FINANCIAL INSTRUMENTS

As a corporate group operating at a global level, DEUTZ is exposed to various financial risks that may have a significant impact on its financial position and financial performance. The objective of the overarching risk management system is to eliminate these potentially negative effects or at least to minimise them.

We hedge financial risks in a number of different ways. 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 written principles for the Company's overarching risk management strategy as well as guidelines for certain areas, such as how to manage currency risk, interest-rate risk and credit risk and how to use derivative and non-derivative financial instruments. Derivative financial instruments are only used for hedging purposes, i.e. only in conjunction with corresponding hedged items from the Company'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 financial directive.

Further information on financial risk management can be found in Note 28 of the notes to the financial statements on page 82.

FINANCIAL RISKS

Risk from bad debts We protect ourselves against the risk from bad debts by means of constant IT-supported monitoring and regular analysis of 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, which arises as a result of transactions denominated in foreign currency with third parties (at DEUTZ, primarily US dollar transactions), 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 contractual 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 arrangements now in place provide the Company with the basis for future funding. 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.

OPERATIONAL AND OTHER RISKS

Market risk The industry in which we work is characterised by particular sensitivity to cyclical influences and this can negatively impact on the financial position and financial performance of the DEUTZ Group. We operate in very cyclical markets in our main application segments – above all 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. From a regional perspective, we will increase the proportion of revenue accounted for by the fast-growing Asian market.

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 Volvo and SAME DEUTZ-FAHR are of considerable importance in enabling us to achieve these sales targets. Our underlying strategy is to expand these long-term alliances with key customers.

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.

Procurement risk Procurement risks resulting from bottlenecks in the market and unforeseen price increases cannot be fully ruled out. As a result of the economic crisis in 2008 and 2009, our suppliers were forced to cut capacity. The subsequent economic recovery led to some bottlenecks in deliveries from our suppliers caused by the rise in demand. They are building up their capacities again only to a very limited degree owing to the ongoing uncertainty in the markets. Despite the renewed slowdown in the global economy and a resulting drop in the level of demand, there continues to be a risk that our suppliers may be unable to respond flexibly enough and this could cause procurement difficulties for DEUTZ. These potential risks arise specifically in connection with the procurement of parts, components and services from third parties. This could have a negative impact on DEUTZ's net income and on its capacity utilisation.

We seek to mitigate these risks by carrying out intensive supplier management and ongoing, increasingly global monitoring of the market. This is supported by the implementation of local purchasing offices in China, India and the USA, which use the infrastructure of DEUTZ subsidiaries abroad. These local offices allow the Group to ensure a high level of quality and supplier performance and, at the same time, to benefit from the low wage costs in these huge growth markets.

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

Even though the economic conditions have brought about an improvement in the financial position of our suppliers, we are continuing to carry out ongoing analyses to establish which suppliers could be susceptible to financial difficulties and liquidity problems. At the same time, DEUTZ is working on backup solutions to minimise the risk from supplier default. These solutions may involve a switch to inhouse production or a shift to other suppliers.

Production risk The level of dependency on the general economic situation leads to fluctuations in capacity utilisation in production, which in turn can have a negative impact on profitability.

In order to avoid mistakes in planning and capital expenditure, the necessary production capacity is 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.

Technological risks Increasingly stringent emissions standards represent a major technological challenge for the DEUTZ Group. In 2011, exhaust emissions standard III B in Europe and Tier 4 Interim in the USA came into force for mobile machinery engines with an output of 130kW or more. From 2012, the standards have also applied to smaller engines with outputs of 56kW to 130kW. Emissions limits will be lowered again from 2014 when the US EPA Tier 4 Final and EU Stage IV emissions standards come into effect. These new 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.

To mitigate these technological 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.

Quality risks The DEUTZ Group is exposed to liability and warranty risks. Potential warranty claims and claims for compensation could have a negative impact on the Company's 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 their production processes, take action to minimise the risk in series production start-ups and reduce warranty risks. A central quality management organisation ensures standardised processes and methods as well as carrying 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.

Provisions are recognised on the balance sheet to account for warranty risks.

IT risks Risks can arise in IT as a result of operating breakdowns in systems, leading to production stoppages and disruption of work processes.

Strategic business processes in the DEUTZ Group are handled using the SAP ECC 6.0 software. The IT service provider continues to operate the data processing centre on the basis of the principles in the current version of the de facto ITIL (IT Infrastructure Library) standard. The operation of systems by our outsourcing partner, Hewlett-Packard, does not currently pose any identifiable material risks. However, we are holding intensive discussions with HP with the aim of restructuring our technology for the future. We are also examining alternatives.

DEUTZ is continuing its strategy of consolidating its information and communication technology systems worldwide. In 2012, further international sites were successfully connected to the central SAP system.

Human resources risks Highly skilled employees are the basis for successful business in a technology-oriented international company like ours.

The risks in this regard arise from not being able to recruit additional personnel quickly enough to meet the requirements of growth in DEUTZ, both in Germany and abroad. In particular, not being able to appoint suitably qualified managers and specialist employees to relevant posts promptly could have a negative impact on the Company's development. We mitigate these human resources risks by systematically analysing the skills and qualifications of our young managerial talent and using this analysis to draw up appropriate measures targeting the development of individual managerial and functional capabilities. By combining this targeted personnel development with long-term succession planning, we are also well positioned from a human resources perspective to meet the challenges of demographic change. We continue to work closely with universities in order to present ourselves at an early stage as an appealing and innovative employer of choice for university graduates.

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 imminent legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and covered by an appropriate amount added to ongoing risk provisioning. DEUTZ's management can therefore take appropriate and timely action and recognise any necessary accounting provisions.

Risk also arises from the winding up of subsidiaries, which can have a negative impact on the Group's financial position and financial performance. This risk is monitored on an ongoing basis with the support of external consultants. Currently, it is not considered likely that this risk will materialise.

Group-wide standards such as the general terms and conditions of business, sample contracts for various uses and implementation provisions in the form of organisational guidelines are refined on an ongoing basis and reduce the level of new legal risks at DEUTZ. The Legal Affairs Department and, if necessary, 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.

Planning risks The preparation of the consolidated financial statements in accordance with IFRS requires significant estimates and assumptions, which have an impact, in particular, on the recognition and measurement of assets and liabilities, including the recognition of deferred tax assets relating to expected future tax reductions based on tax loss carryforwards. The estimates and assumptions are based on projections, which by their nature are subject to a degree of uncertainty. The possibility of routine adjustments to the estimates and assumptions and any associated negative impact on our financial position and financial performance can therefore not be entirely excluded.

Pension risks DEUTZ recognises significant provisions to cover its pension obligations. The amount of these pension obligations is subject to risks arising in connection with the change in life expectancy, the future amount of pension adjustments and the movement in interest rates on capital markets.

Tax risks One of the consequences of the globalisation of the DEUTZ Group's operating business is that the Company must observe a whole range of international and country-specific rules and regulations – most of which are statutory – as well as directives from national tax authorities. The Company faces tax risks if it fails to observe these laws and other regulations. In particular, tax audits and the findings from these audits can lead to additional expenses for the Group in the form of interest, penalties and retrospective tax payments. The Company recognises appropriate provisions when it becomes aware of such tax risks. The external tax audit started in Germany in 2009, covering the tax assessment periods 2006 to 2008, was completed at the end of 2012.

Compliance risks As an international company, DEUTZ is obliged to comply with the legal requirements in every country in which it operates. There is therefore a risk that the Company will not be able to comply with these obligations, resulting in legal and financial risk for DEUTZ, such as penalties and claims for damages. The material compliance risks take the form of corruption, breach of antitrust law, noncompliance with environmental, tax and health & safety laws etc.

To counter these risks, the DEUTZ Board of Management has set up a compliance organisation that systematically examines possible risks and counteracts them by clearly defining the responsibilities and processes for avoiding breaches of legal requirements. For more details on the compliance organisation in the DEUTZ Group, please refer to our corporate management declaration on page 109.

OVERALL ASSESSMENT OF THE RISK SITUATION

Material risks were 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 sufficiently probable risks that could jeopardise the continued existence of the enterprise as a going concern.

OUTLOOK

2013: MODEST GROWTH IN GLOBAL ECONOMY[1)]

The forecasts for the further growth of the global economy remain cautious. The International Monetary Fund (IMF) is predicting expansion of 3.5 per cent (2012: 3.2 per cent).

Growth of 1.4 per cent is expected for the industrialised countries in 2013. Economic growth in the euro zone is hampered by unresolved structural problems, the need for consolidation of government finances and companies' reluctance to invest. As a result, the euro zone's economy is anticipated to contract slightly again in the coming year, shrinking by 0.2 per cent. The German economy will also see only muted growth: gross domestic product (GDP) in Germany is expected to go up by 0.6 per cent in 2013. Experts reckon on growth of 2.0 per cent in the USA. Recently, the pace of growth has tailed off slightly in many emerging markets – a trend that is likely to continue. Nevertheless, China and India will remain the main growth drivers in the global economy. Chinese GDP is predicted to rise by 8.2 per cent and Indian GDP by 5.9 per cent.

Significant ongoing threats to growth are the still unresolved problems in the euro zone and the large budget deficit in the USA combined with the recurring discussions about raising the debt ceiling.

However, a noticeable improvement to the sentiment indicators sent out a positive signal at the start of 2013. The business climate index published by the ifo Institute of Economic Research in January 2013, an index that covers trade and industry in Germany, was up for the third month in succession, having fallen for seven consecutive months up to October 2012. In January of this year, the Indicator of Economic Sentiment for Germany issued by the

[1)] Sources: IMF, World Economic Outlook Update, January 2013
Deutsche Bank Research, Outlook 2013, January 2013
ifo Institute of Economic Research, Business Climate Germany, January 2013
ZEW, Indicator of Economic Sentiment, January 2013
ISM, Purchasing Managers' Index, January 2013

Centre for European Economic Research (ZEW) even attained its highest level since May 2010. Also in January, the ISM purchasing managers' index in the USA reached its highest level since April 2012. The improved mood was also reflected in the performance of the stock markets at the start of this year. If the general mood continues to brighten, growth forecasts could rise slightly.

DIESEL ENGINES MARKET[1)]

The diesel engines market essentially follows the applications and markets in which the engines are installed. We anticipate that the mobile machinery, agricultural machinery and automotive applications in Europe will remain flat in 2013. However, in view of the introduction of the EU Stage IV emissions standard for engines with an output of more than 130kW in 2014, we expect to see the effects of the advance production of engines for agricultural machinery and construction equipment, which should generate slight growth in unit sales in the European diesel engines market. In the USA, we predict tangible growth in construction equipment this year. Following the sharp contraction in the Chinese construction equipment and truck markets last year, we expect a recovery in these markets of at least 10 per cent in 2013.

Owing to the increasing proportion of higher-value engines to meet the new emissions standards in Europe and the Americas, the volume of the diesel engines market in euro terms will increase at a faster rate than its unit sales. On balance, we predict that the diesel engines market relevant to us will rise in euro terms by more than 10 per cent in 2013.

STRUCTURAL GROWTH PUSHES UP REVENUE

Building on the structural growth created by growth projects and on the increasing proportion of higher value engines sold to meet the new emissions standards, we expect to generate an encouraging rise in revenue in 2013 and subsequent years. At the same time, we anticipate that the growth projects and production ramp-up of new engines will still impact earnings in 2013. The priorities this year will be measures to cut costs and boost efficiency across the Company (including improving the profitability of our DEUTZ Dalian joint venture), the smooth production start-up for our new engines and improvements to their profitability, plus the successful implementation of various new customer projects. We will also focus on growth projects in China within the scope of our strategy. In addition, we are reviewing the extent of our vertical integration in mechanical fabrication.

NEW ORDERS, UNIT SALES, REVENUE

In view of the continuing macroeconomic risk and the still challenging economic situation in Europe, we predict demand for our engines in the DCE and DCS segments to remain flat or to rise slightly, while there will be further encouraging growth in our service business. From a regional perspective, we forecast that the strongest growth will be in Asia followed by North America, whereas demand in Europe will remain level or increase slightly. We anticipate a significant recovery in the Agricultural Machinery application segment.

Overall, we forecast a small rise in unit sales and revenue of at least €1.4 billion in 2013. Revenue will be supported by a higher proportion of engines meeting new emissions standards, which have a significantly greater value and, thus a higher price.

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.

OPERATING PROFIT (EBIT)

We expect the EBIT margin to be higher than in 2012, i.e. above 3.0 per cent. In view of the ongoing financial burdens, however, we anticipate a moderate increase. Earnings will be boosted by growth in revenue combined with economies of scale and measures to cut costs and boost efficiency at DEUTZ AG and the Chinese joint ventures. However, the set-up costs for growth projects in China will have a negative impact on earnings. Product start-ups will also affect earnings in 2013, although these engines have the potential to generate far better margins in subsequent years due to the higher proportion of common parts used. In addition, depreciation and amortisation related to capitalised development expenditure will rise noticeably. We expect our DCE and DCS segments to achieve similar levels of earnings growth.

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. Our objective is to drive down the cost level to a low double-digit million euro amount on a permanent basis. We aim to achieve this primarily by continuing to strictly implement our strategy of relocating the procurement of individual parts to low-cost countries and by making technical changes.

Given the increasing importance of technology-intensive Tier 4 Interim engines, there has been a noticeable shift in the distribution of purchasing volumes across the individual product categories in the DEUTZ Group. Injection systems, exhaust aftertreatment, control devices and electronic components are accounting for an increasing proportion of purchasing volume, whereas the proportion of purchasing volume attributable to forged and cast parts, turned parts, sheet metal parts, standard and DIN parts is generally falling.

Rising collectively agreed pay The current collective pay agreement will remain in force until 30 April 2013. We anticipate a moderate increase in collectively agreed pay.

[1)] Sources: Off-Highway Research, November 2012
ITR Trend Reports, January 2013

RESEARCH AND DEVELOPMENT EXPENDITURE

As the development of our engines for the new emissions standards is already well advanced and some projects have been completed, research and development expenditure will fall again in 2013. We forecast research and development expenditure of approximately €55 million after reimbursements.

CAPITAL EXPENDITURE

We forecast that our capital expenditure in 2013 (excluding capitalisation of research and development expenditure and after reimbursements) will amount to between €60 million and €70 million.

JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD

In the case of DEUTZ (Dalian) Engine Co., Ltd., we expect market conditions to improve in 2013 although they will remain volatile. Nevertheless, we are forecasting a noticeable improvement in earnings as a result of measures introduced to increase profitability.

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 that free cash flow will be stable or slightly positive in 2013.

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.

As a consequence of the new rules in the revised version of IAS 19 'Employee Benefits', we expect defined benefit obligations to rise as the corridor approach used in the measurement of these obligations is being eliminated. The obligations measured using the new method will be recognised in other comprehensive income after allowing for deferred taxes. We anticipate that equity will decrease by around €25 million in 2013 and that equity will be more volatile in future.

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 employment fluctuations. Our site-specific shift patterns also help us to increase or decrease capacity at short notice, where required.

Collective agreement on pre-retirement part-time employment As in 2012, we will again use the 'Collective agreement concerning the flexible transition into retirement' in 2013. This will give employees who meet the necessary requirements the opportunity – within the collectively agreed quotas – to retire early by switching to pre-retirement part-time employment.

STATUTORY REGULATIONS, EXHAUST EMISSIONS STANDARDS

On 1 January 2012, the exhaust emissions standard 97/68 Stage III B came into force in the European Union and the corresponding EPA Tier 4 Interim standard came into force in the USA. Both standards apply to diesel engines of between 56kW and 130kW used in non-road applications. Similar standards for smaller engines of between 37kW and 56kW in Europe, and between 19kW and 56kW in the USA, have applied since 1 January 2013 and even more stringent exhaust emissions limits will be introduced in 2014 to 2016. The regulations for these limits, which are the final ones currently planned, require nitrogen oxide (NO_X) emissions to be reduced by 95.7 per cent and soot particles by 96.5 per cent relative to the first limits, which were introduced in 1999.

OUTLOOK FOR 2014

We are expecting significant double-digit revenue growth in 2014. This is based on structural growth from the significantly higher value engines for the new emissions standards and from our business activities in China. However, growth projects and the start-up of engines for the Tier 4 emissions standard will still impact earnings. Overall, we forecast a moderate improvement to the EBIT margin compared with 2013. We expect our DCE and DCS segments to achieve a positive earnings trends.

Global megatrends, such as growth of the world's population, advancing industrialisation in the agricultural sector and urbanisation along with accompanying investment in infrastructure, are encouraging the further growth of the global engine market, especially in the emerging markets. This will open up significant 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.

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 warranty with regard to the forward-looking statements made in this management report.