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DEUTZ AG

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- Convenience Translation -

Report of the Board of Management pursuant to sections 203 (1), 203 (2) and 186 (4) sentence 2 AktG concerning agenda items 9 and 10

The Statutes of DEUTZ AG do not currently make any provision for the granting of authorisations for corporate actions relating to the issued capital. The Company needs options that allow it to respond to the markets in a manner that protects its share price. It also needs to be able to carry out capital increases in return for both cash and non-cash contributions. To this end, the management of the Company requires the creation of appropriate new authorisations for the longest legally permissible period of five years that enable it to increase the issued capital of the Company through the issue of new no-par-value bearer shares.

Overall, it plans to create a new authorised capital I and authorised capital II with a combined total of up to €154,489,117.16. Authorised capital I authorises the Board of Management, subject to the consent of the Supervisory Board, to increase the issued capital of the Company on one or more occasions through the issue of new no-par-value bearer shares for cash by up to a total amount of €92,693,470.30. Authorised capital II authorises the Board of Management, subject to the consent of the Supervisory Board, to increase the issued capital of the Company on one or more occasions through the issue of new no-par-value bearer shares for cash and/or non-cash contributions by up to a total amount of €61,795,646.86. The management is requesting that the authorisations be granted for the longest period permissible under the law (up to 25 April 2023).

The proposed authorisations for the issue of new shares under authorised capital I and II are also intended to allow the Company to respond at short notice to any funding requirements that may arise.

Existing shareholders will generally have statutory pre-emption rights when the proposed authorised capital I or II is utilised. In addition to a direct issue of the new shares to the shareholders, it will also be possible under authorised capital I and II to offer the new shares to the shareholders in such a way that they will firstly be transferred to banks or companies equivalent to banks under section 186 (5) sentence 1 AktG, which undertake to offer them to the shareholders. The sole reason for the interposition of banks or companies equivalent to banks under section 186 (5) sentence 1 AktG is to make the process of selling the shares easier from a technical perspective. It does not lead to a de facto disapplication of shareholders' pre-emption rights, in accordance with the legislator's assessment of section 186 (5) sentence 1 AktG.

In the case of authorised capital I, however, the plan provides for the disapplication of pre-emption rights for fractional amounts. This is intended to facilitate the processing of an issue in which existing shareholders generally have a pre-emption right. Fractional amounts may arise as a result of the issue volume and the need for a manageable ratio in the pre-emption rights calculation. The value of these fractional amounts is normally minimal as far as the individual shareholder is concerned, whereas the effort required to carry out an issue without a disapplication of rights of this kind is significantly greater than otherwise would be the case. Furthermore, any dilutive effect owing to the restriction of fractional amounts is negligible. The shares arising from the fractional amounts and made available as a consequence of the disapplication of the pre-emption rights of existing shareholders are sold to generate the best possible benefit for the Company. The disapplication of pre-emption rights is therefore practical and facilitates the implementation of an issue.

In the case of authorised capital II, the Board of Management is to be further authorised to disapply the pre-emption rights of shareholders also for fractional amounts (see above) as well as in the following cases:

(a) for capital increases against non-cash contributions,

(b) for cash contributions up to a maximum of 10 per cent of the issued capital at the time this authorisation takes effect or – if lower – the issued capital at the time this authorisation is utilised, if the issue price of the shares is not significantly below the market price of the existing publicly listed shares in the Company on the date the final issue price is fixed, and

(c) in order to grant holders or creditors of bonds with option or conversion rights to shares of the Company or with option or conversion obligations (where such bonds are issued or are to be issued in future by the Company or by one of its direct or indirect majority shareholdings) a pre-emption right to the same amount of new shares in the Company that they would be entitled to as a shareholder following the exercise of their option or conversion rights or after fulfilling option or conversion obligations.

Re (a) Disapplication of pre-emption rights in the event of non-cash capital increases

In the event of a capital increase against non-cash contributions utilising the authorised capital II, the Board of Management is to be authorised, subject to the consent of the Supervisory Board, to disapply the pre-emption rights of the shareholders. This will enable the Board of Management, without recourse to the capital markets, to use the Company's shares in suitable individual cases as consideration for non-cash contributions, particularly in connection with mergers or the acquisition of entities, parts of entities or equity investments in entities, or of other assets, such as receivables or industrial property rights, or rights to acquire such other assets. The Company operates in a competitive environment. It therefore needs to be able to act swiftly and flexibly at all times in rapidly changing markets. This includes being able to acquire entities, parts of entities or equity investments in entities, as well as other assets. Experience shows that a high price often has to be paid for the acquisition of entities, parts of entities or equity investments in entities, as well as other assets. In many cases, this price cannot or should not be paid in cash. This may be because the seller demands shares in the acquirer as consideration, or it may be in the interests of the Company to offer shares in the Company, particularly to know-how owners, as a means of securing long-term loyalty to the Company. This applies in particular if the entity being acquired is not the owner of all industrial property rights or intellectual property rights associated with its business. In such and similar cases DEUTZ AG must be in a position to acquire assets associated with the intended acquisition and to grant shares in return – whether to protect liquidity or because the seller demands them – provided that the assets concerned are eligible as capital contributions. The proposed authorisation gives the Company the necessary latitude to quickly and flexibly exploit any opportunities to acquire entities, parts of entities or equity investments in entities, and other assets. Granting the shareholders' pre-emption rights would require a subscription offer and could substantially delay a planned transaction. Furthermore, it may not be possible to guarantee the confidentiality or transaction security stipulated by the sellers as a condition, and the transaction could fail for these reasons.

There are currently no specific plans to utilise this authorisation. If specific acquisition opportunities present themselves, the Board of Management will carefully review them and will use the authorisation granted to it only in the best interests of the Company. Only if these conditions are met will the Supervisory Board grant its consent.

By analogy with section 255 (2) AktG, the value of the acquired entity, part of an entity, equity investment or other assets must not be unreasonably low in relation to the value of the shares to be issued, as determined by an overall assessment to be carried out by the Board of Management and Supervisory Board, so that there is no risk of any impairment of the shareholders' assets. The shares to be granted in the Company and the asset to be acquired will generally be valued at market price or, if no market price can be determined, on the basis of a valuation by an impartial expert e.g. an auditing firm and/or investment bank, in order to avoid the exercising of the authorisation leading to any erosion of the Company's share value.

For the first time, the authorisation to disapply pre-emption rights against non-cash contributions also explicitly permits the issuance of shares for the purposes of a scrip dividend. The scrip dividend involves offering shareholders the option of exchanging all or part of their dividend entitlement – acquired by way of the profit appropriation resolution of the AGM – for new shares in the Company.

A scrip dividend may be implemented as a genuine rights issue, specifically in compliance with the provisions of section 186 (1) AktG (minimum two-week subscription period) and section 186 (2) AktG (announcement of the issue price at least three days before the expiry of the subscription period). The shareholders will only be offered whole shares. In respect of any portion of the dividend entitlement that is below the subscription price for a whole share, shareholders are referred to the subscription of the cash dividend and are unable to subscribe to shares for this amount. No offer of partial rights is envisaged, nor is the establishment of any trade in pre-emption rights. Because the shareholders receive a cash dividend in lieu of the right to subscribe new shares, this is generally regarded as fair and reasonable.

Depending on the capital market situation, it may be preferable in an individual case to structure the scrip dividend in such a way that the Board of Management offers new shares to all shareholders eligible for dividends (while complying with the principle of equal treatment (section 53a AktG)) in exchange for their dividend entitlement, thus granting the shareholders a pre-emption right in economic terms, but at the same time excluding the pre-emption right of the shareholders to new shares in legal terms. Such disapplication of the pre-emption right enables the scrip dividend to be implemented without having to comply with the requirements of section 186 (1) and (2) AktG, i.e. on more flexible terms. Furthermore, the scrip dividend could generally be implemented more easily and at lower cost. In view of the fact that all shareholders are offered the new shares and surplus dividend amounts are settled through payment of a cash dividend, a disapplication of pre-emption rights would fundamentally appear to be fair and reasonable in this case, too.

Re (b) Disapplication of pre-emption rights in the event of cash capital increases

The pre-emption right may also be disapplied for authorised capital II pursuant to section 186 (3) sentence 4 AktG in the event of a capital increase against cash contributions. The purpose of this authorisation is to make use of the simplified disapplication of pre-emption rights pursuant to section 186 (3) sentence 4 AktG. The statutory disapplication of pre-emption rights provided for in section 186 (3) sentence 4 AktG puts the Company in a position where it can quickly, flexibly and at low cost make use of the opportunities afforded by stock market conditions at any given time. This will enable the Company to strengthen its capital in the best interests of the Company and all its shareholders. Relieved of the time-consuming and costly processing of pre-emption rights, the Company can rapidly cover any equity capital requirement. It can also attract new groups of shareholders in Germany and abroad. Having this option available is also important to the Company because it needs to be able to make use of opportunities arising in its markets quickly and flexibly, and therefore needs to be able to meet any need for capital, sometimes at very short notice. Pursuant to section 186 (3) sentence 4 AktG, the authorisation is limited to a maximum of 10 per cent of the issued capital at the time this authorisation takes effect or – if lower – the issued capital at the time the authorisation is utilised. This 10 per cent limit includes shares that are acquired on the basis of an authorisation granted by the Annual General Meeting and sold during the period of this authorisation pursuant to section 71 (1) no. 8 sentence AktG in conjunction with section 186 (3) sentence 4 or issued on the basis of another authorisation to disapply pre-emption rights pursuant to section 186 (3) sentence 4 AktG during the term of this authorisation. Specifically, it includes shares that have been or are to be issued in order to service bonds with conversion or option rights or conversion or option obligations in so far as these bonds were issued during the term of this authorisation with the disapplication of pre-emption rights in application mutatis mutandis of section 186 (3) sentence 4 AktG.

These shares are not included, however, if the other exercised authorisation is renewed. In this case, the offsetting rule will lapse to the extent that the renewed authorisation permits the issue of shares with disapplication of pre-emption rights in direct application or application mutatis mutandis of section 186 (3) sentence 4 AktG. If, for example, in addition to the authorised capital, the Company is also authorised to sell treasury shares, a sale of shares amounting to 10 per cent of the issued capital with the disapplication of pre-emption rights pursuant to section 186 (3) sentence 4 AktG would be applied to the authorisation first, with the result that no more shares would be able to be issued with the disapplication of pre-emption rights under the authorisation. If the Annual General Meeting subsequently renews the authorisation to sell treasury shares and thereby grants another authorisation to disapply pre-emption rights pursuant to section 186 (3) sentence 4 AktG for 10 per cent of the issued capital, the limit in respect of the authorised capital that had previously been applied would no longer apply. The Company would subsequently be able to issue shares, disapplying pre-emption rights, on the basis of the authorised capital up to a limit of 10 per cent of the issued capital.

This protects the interests of the shareholders as it ensures that utilisation of the authorisation does not result in any dilution of their shareholding that cannot be compensated through a subsequent purchase of shares via the stock market. This accords with the intention of the legislators as expressed in section 186 (3) sentence 4 AktG.

The authorisation is also subject to the proviso that the issue price for the new shares is not significantly below the market price of the existing publicly listed shares in the Company on the date the final issue price is fixed. The issue price for the new shares will therefore be based on the market price of the already traded shares and will not be substantially below the relevant market price (generally no more than 3 per cent lower, never more than 5 per cent lower), so that the shareholders need not fear a significant dilution of their shareholdings.

Re (c) Disapplication of pre-emption rights in favour of bond holders

The management should also be able to exclude pre-emption rights, where necessary, in order to grant holders or creditors of bonds with option or conversion rights or option or conversion obligations (where such bonds are issued or are to be issued in future by the Company or by one of its direct or indirect majority shareholdings) a pre-emption right to

the same amount of new shares in the Company that they would be entitled to as a shareholder following the exercise of their option or conversion rights or after fulfilling option or conversion obligations.

Bond conditions such as these are frequently provided for as an anti-dilution mechanism for bond holders or creditors, in order to facilitate the placement of bonds on the capital market. Pre-emption rights to new shares – equal to those pre-emption rights granted to existing shareholders – are granted to the holders or creditors of the aforementioned bonds in lieu of a discounted option or conversion price. This puts the bond holders or creditors in the same position they would have been in if they were already shareholders. Mechanisms to disapply the pre-emption rights of the existing shareholders to these shares must be available in order to allow the terms of the bonds to include dilution protection of this nature. The advantage of this approach over dilution protection trough a reduction of the option or conversion price is that the Company can achieve a higher issue price for the shares to be issued when the option or conversion right or obligation is exercised.

Final assessment of the Board of Management

In the opinion of the Board of Management, taking into account all circumstances presently known, the proposed authorisations to disapply pre-emption rights thus serve legitimate purposes, are in the Company's interest, and appear to be suitable and necessary for achieving these purposes. The possibilities for disapplying pre-emption rights are also proportionate with regard to the shareholders' interests, as they take account of the interests of the Company in disapplying pre-emption rights in the specific circumstances referred to, while at the same time taking appropriate account of the interests of the shareholders.

To protect shareholders, the authorisation of the Board of Management to disapply shareholders' pre-emption rights in the event of a share issue against cash and non-cash contribution – with the exception of the disapplication of pre-emption rights for fractional amounts – is capped at 20 per cent of the present issued capital, equal to 24,172,356 shares with the pro rata amount of the issued capital of €61,795,646.86 or – if lower – at 20 per cent of the issued capital at the time this authorisation is exercised. This restriction is considerably below the legally permitted limit of 50 per cent of issued capital for which an authorisation to disapply pre-emption rights can be granted. This means that a substantial dilution of the shareholdings of existing shareholders is prevented from the outset.

The 20 per cent limit includes shares that are sold or issued during the term of this authorisation on the basis of all other authorisations under disapplication of pre-emption rights. An issue of shares in this sense also includes the issue or creation of option or conversion rights or obligations in respect of the Company's shares for bonds issued by the Company or by its direct or indirect majority shareholdings, if the option or conversion rights or obligations are issued on the basis of an authorisation disapplying pre-emption rights during the term of this authorisation.

This disapplication limit clause will ensure that the Board of Management's ability to disapply pre-emption rights cumulatively – i.e. taking account of other authorisations granted to it – will not result in shareholdings being diluted by more than the 20 per cent limit.

The aforementioned provisions concerning the disapplication of pre-emption rights, where a limit applied in respect of a previous authorisation no longer applies to a subsequent authorisation, apply mutatis mutandis to this limit.

There are currently no specific plans to utilise the authorisations.

The Board of Management will utilise the requested authorisations with the disapplication of pre-emption rights only if, in the specific instances, this is suitable, necessary and – in view of the impaired shareholders interests – proportionate to achieve a legitimate objective in the Company's interest. Only if these conditions are met will the Supervisory Board grant its consent. The Board of Management will report on the disapplication of pre-emption rights to the next Annual General Meeting following the utilisation of the authorisation to disapply pre-emption rights.

Cologne, 6 March 2018

The Board of Management of DEUTZ AG

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Dr. Frank Hiller	Dr. Margarete Haase
_____	_____
Michael Wellenzohn	Dr. Andreas Strecker