2016 COMBINED MANAGEMENT REPORT FOR DEUTZ AG AND THE DEUTZ GROUP

OVERVIEW OF 2016

Revenue and EBIT higher than in previous year Despite the market environment remaining difficult and companies still being reluctant to invest, we were able to expand our volume of business in the reporting year. Revenue rose by a moderate 1.0 per cent to €1,260.2 million. Unit sales fell by 3.8 per cent to 132,539 engines. There was a big increase in operating profit (EBIT), which climbed by €18.5 million to €23.4 million. This underlines the effectiveness of our measures aimed at increasing profitability.

Reporting changes We have divided our former Mobile Machinery application segment into two parts. From the 2016 financial year, information is provided for the Construction Equipment and Material Handling application segments. We are thus increasing transparency and reflecting the significance of various customer industries.

Steps to increase efficiency on schedule The measures aimed at comprehensively optimising our network of sites in Germany are now either complete or well advanced. The transfer of crankshaft and camshaft production from Cologne-Deutz to the new shaft centre in Cologne-Porz was finished in February 2017. Assembly and order management have already been relocated to Ulm from Übersee on Lake Chiemsee, and all other functions will move during the course of 2017.

Positive market response to products Our TCD engines equipped with a diesel particulate filter in the 2.9 to 7.8 litre cubic capacity range already meet EU Stage V, the next European emissions standard, which comes into effect in 2019. This benefits our customers, for whom we again launched many new products last year. The engines that we unveiled in 2016 to expand our portfolio at the upper and lower end of the power output range, including a new TCD 5.0 engine, gas variants and a DEUTZ powerpack, were well received.

New Chairman of the Board of Management appointed Dr Frank Hiller was appointed as a member of the Board of Management of DEUTZ AG and its Chairman with effect from 1 January 2017. He succeeds Dr Helmut Leube, who retired on 31 December 2016.

FUNDAMENTAL FEATURES OF THE GROUP

BUSINESS MODEL AND SEGMENTS

DEUTZ is one of the world's leading engine manufacturers and was founded in 1864 by Nicolaus August Otto, developer of the four-stroke engine, and Eugen Langen. Since then, DEUTZ has been supplying reliable drive systems for mobile and standalone static applications. We are an independent producer of diesel and gas engines with a power output of 25 kW up to 520 kW for on-road and off-road use. The DEUTZ Group's customers include manufacturers of construction equipment, forklift trucks, tractors and other equipment as well as the buyers of such machines. Operating activities are divided into two segments: DEUTZ Compact Engines and DEUTZ Customised Solutions. The DEUTZ Compact Engines segment comprises liquid-cooled engines with capacities of up to 8 litres. The DEUTZ Customised Solutions segment specialises in air-cooled engines and large liquid-cooled engines with capacities of more than 8 litres. Operating under the name DEUTZ Xchange, the DEUTZ Customised Solutions segment also supplies reconditioned engines and parts.

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

MAIN SITES AND SCOPE OF CONSOLIDATION

DEUTZ maintains a comprehensive presence in the global market: with 13 sales companies, seven sales offices and over 800 sales and service partners in more than 130 countries, we can offer our customers service and support virtually anywhere with very short response times. DEUTZ AG is the executive and operating parent company in the DEUTZ Group; it is headquartered in Cologne, Germany, and has various domestic and foreign subsidiaries. The subsidiaries include several companies that perform sales and service functions plus a production facility in Spain. The equity-accounted joint venture DEUTZ Dalian in China produces diesel engines that are primarily destined for the Chinese market.

In addition to DEUTZ AG, seven German companies (31 December 2015: six) and 12 foreign companies (31 December 2015: twelve) were included in the consolidated financial statements as at 31 December 2016. A complete list of DEUTZ AG shareholdings as at 31 December 2016 is given in the annex to the notes to the consolidated financial statements on page 119.

DEUTZ AG

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

MARKET AND COMPETITIVE ENVIRONMENT

DEUTZ manufactures diesel engines for professional applications used in countries with stringent emissions standards, in particular EU Stage III A, III B and IV (as well as the equivalents in the US and other countries). These technically sophisticated applications include construction equipment, agricultural machinery, lifting and material handling equipment, pumps, gensets, medium-duty trucks and buses. The market for DEUTZ engines is therefore separate from the market segments for diesel engines used in passenger cars and small commercial vehicles up to a permissible gross weight of 3.5 tonnes. Engines that rely on outdated technology and that are intended for use in applications in countries or application segments with only very low requirements in terms of product quality, emissions and fuel consumption also do not feature in our target market. The market for technically sophisticated diesel engines can be divided into the captive segment and the non-captive segment. The captive segment comprises equipment manufacturers who produce their own engines; some of these manufacturers are also active as engine suppliers in the market. The non-captive segment is made up of equipment manufacturers who for the most part do not produce their own engines and who, therefore, buy in engines from suppliers. It is in this non-captive market that DEUTZ sells high-value engines with outputs between 25 kW and 520 kW around the globe.

We have attained a good position as one of the biggest suppliers in the non-captive market. We face competition from rival engine suppliers in western Europe, North America and Asia, but none of these competitors can offer an identical product range to DEUTZ in terms of the power outputs and application segments that they cover.

Main competitors

Application segments	Applications	Main competitors (in alphabetical order)
Construction Equipment	Excavators Wheel loaders Pavers Mining equipment	Cummins, USA Isuzu, Japan Weichai, China Yanmar, Japan
Material Handling	Forklift trucks Telehandlers Lifting platforms Ground support equipment	Cummins, USA VW, Germany Yanmar, Japan Zhejang Xinchai, China
Agricultural Machinery	Tractors Harvesters	Deere, USA Kubota, Japan Perkins, UK Yanmar, Japan
Stationary Equipment	Gensets Pumps Compressors	Cummins, USA Kubota, Japan Perkins, UK Yanmar, Japan
Automotive	Rolling stock Special vehicles Trucks Buses	Cummins, USA Fiat Powertrain, Italy MAN, Germany Mercedes, Germany

INTERNAL CONTROL SYSTEM

RESPONSIBLE CORPORATE MANAGEMENT BASED ON TRANSPARENT PERFORMANCE INDICATORS

The DEUTZ Group defines its budget targets and medium-term corporate targets using selected key performance indicators (KPIs). In order to increase profitability and achieve sustained growth, we manage the Group on the basis of the following financial performance indicators:

		2016	2015
Revenue growth	%	1.0	–18.5
EBIT margin (before exceptional items)	%	1.9	0.4
Working capital ratio [1] (average)	%	17.9	17.6
ROCE (before exceptional items) [1]	%	3.1	0.6
R&D ratio	%	4.0	3.3
Free cash flow [1]	€ million	4.7	35.0

[1] These KPIs are alternative performance measures that are not defined in the International Financial Reporting Standards (IFRS). A reconciliation of these KPIs to the amounts recognised in the financial statements is provided below.

Revenue growth Steadily increasing revenue is the basis for the profitable growth of the Company. The level and growth of revenue is determined on a monthly basis, broken down by product group, application segment and region. This data is provided to senior management promptly so that it can react quickly to changes as they materialise.

EBIT margin (before exceptional items) The main key performance indicator that we use to manage the Company's operating performance is the EBIT margin before exceptional items. This is based on the Group's earnings before interest and tax (EBIT). The EBIT figure is then adjusted for exceptional items and calculated as a percentage of revenue. We define exceptional items as significant income generated or expenses incurred outside the scope of the Company's ordinary business activities that are unlikely to recur. There were no exceptional items in 2016 or 2015. Adjusting for exceptional items enables a more accurate comparison of the Company's operating performance over time. The EBIT margin before exceptional items is, like revenue growth, calculated monthly and presented to senior management as part of internal reporting.

Working capital ratio (average) We manage the Company's tied-up capital using the average working capital ratio. This is the ratio of average working capital over the past four quarters to revenue for the preceding twelve months. Working capital comprises inventories plus trade receivables less trade payables. Along with revenue growth and the EBIT margin, this key figure is calculated monthly and presented to senior management.

ROCE (before exceptional items) The return on the capital employed in the Group is measured and managed on an annual basis using the key figure ROCE (before exceptional items). This is calculated as follows:

ROCE

€ million

	2016	2015
Total assets	1,059.7	1,088.1
Cash and cash equivalents	–91.8	–112.5
Trade payables	–162.3	–169.5
Other current and non-current liabilities	–57.3	–49.0
Capital employed	**748.3**	**757.1**
Capital employed (average for the year)	**752.7**	**792.7**
EBIT (before exceptional items)	**23.4**	**4.9**
ROCE (before exceptional items)	**3.1%**	**0.6%**

R&D ratio As a technology-focused company, we consider the R&D ratio to be one of the most significant performance indicators in our internal management system. It is the ratio of research and development expenditure (after reimbursements) to revenue in the period in question. The R&D ratio is calculated at least once a quarter and is reported to senior management.

Free cash flow The DEUTZ Group uses free cash flow as its main performance indicator for managing liquidity. It comprises net cash provided by, and used for, the operating activities and investing activities of the Group during the period in question less interest payments in connection with financing activities. We can thus show what cash flow generated in the relevant year is available to the Company, e.g. for repaying liabilities or paying a possible divided to shareholders. Free cash flow is reported to senior management at least once a quarter.

Based on these performance indicators, DEUTZ has set up an early warning system in order to be proactive and respond promptly. 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 with regard to our business performance, benefiting both the Group and all our stakeholders.

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

CONTINUOUS OPTIMISATION OF THE CONTROL SYSTEM

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

We specify working capital targets for the individual companies in the DEUTZ Group in order to optimise the capital tied up in the business. These overall figures are then broken down and specific targets for inventories, trade receivables and trade payables are allocated to the relevant individual employees.

We are pursuing long-term growth objectives. In order to secure the financial basis for this, we have made the management of capital expenditure a central element in the management of tied-up capital: clearly specified budget figures set out the framework for the level of capital expenditure and development expenditure; actual requirements are derived from the medium-term planning of unit sales and the resulting requirements in terms of capacity and technologies. Annual budget meetings are held to coordinate individual projects, development expenditure and planned capital expenditure with the groupwide financial planning process and to record the outcomes. An additional detailed review is carried out before projects are actually approved. To this end, we use standard investment appraisal methods (internal rate of return, amortisation period, net present value, the impact on the income statement and cost comparisons). A project with an appropriate budget is only approved if there is a clear positive outcome from this investment appraisal.

BUSINESS PERFORMANCE IN THE DEUTZ GROUP

ECONOMIC ENVIRONMENT

Global growth rate at prior-year level Worldwide economic growth remained at a moderate level last year. The International Monetary Fund (IMF)[1] is expecting global economic growth of 3.1 per cent for 2016 as a whole, compared with 3.2 per cent in 2015.

The economy of the eurozone grew by 1.7 per cent in 2016, which was slightly weaker than the increase of 2.0 per cent in 2015. Germany's economy stepped up the pace of growth slightly, expanding by 1.7 per cent year on year (2015: growth of 1.5 per cent). The Spanish economy again performed very encouragingly with a growth rate of 3.2 per cent, which was the same as in 2015. France was also on a par with the previous year with growth of 1.3 per cent. Italy's growth increased slightly from 0.7 per cent in 2015 to 0.9 per cent in 2016.

The US economy expanded by 1.6 per cent (2015: 2.6 per cent). This slowdown in the pace of growth was due to declining levels of capital investment. The economy in China held steady over the course of the year thanks to more expansionary economic policy. Gross domestic product (GDP) rose by 6.7 per cent over 2016 as a whole, compared with 6.9 per cent in 2015. The Russian economy remains in recession; South America's performance was weaker than originally anticipated.

Overall, the economic environment was characterised by a variety of risks and uncertainties in 2016, such as the vote for Brexit in the United Kingdom, and these will continue to have an impact this year. China is in a state of transition with a lower growth rate than in previous years and a shift away from the strong export model. The economic effects of the outcome of the US election cannot yet be gauged.

Mixed picture in DEUTZ's customer industries The situation varied significantly across DEUTZ's main customer markets in 2016. According to DEUTZ's own estimates, demand for construction equipment rose by around 5 per cent in both Europe and China. However, unit sales of construction equipment fell by approximately 5 per cent in North America. The European agricultural machinery sector contracted again, with demand declining by 5 per cent in 2016.[2] Unit sales of light and medium-duty trucks in China improved by around 7 per cent according to DEUTZ's own estimates.

IMPACT OF ECONOMIC CONDITIONS ON BUSINESS PERFORMANCE

Uncertainties hold back investment activity Overall, the economic environment was characterised by a variety of risks and uncertainties in 2016 that will continue to have an impact this year. The tendency is therefore for a wait-and-see stance as far as investment activity is concerned. Moreover, prices for oil, commodities and agricultural goods were again at a very low level in 2016, although they did rise over the course of the year. However, higher prices would encourage investment in the relevant areas – and thus would benefit business at DEUTZ.

While the global economy grew by 3.1 per cent in 2016, revenue at DEUTZ rose by 1.0 per cent. The economy in the eurozone expanded by 1.7 per cent in the year under review. Against this backdrop, the situation varied significantly across DEUTZ's main customer markets in Europe. Whereas demand for construction equipment rose, there was a decline in the agricultural equipment sector. Nevertheless, DEUTZ was able to increase its unit sales of engines for agricultural equipment applications because demand in the previous year had been very low due to customers using up their inventories. In 2014, they had purchased significant volumes of engines ahead of a new emissions standard. DEUTZ's revenue in its largest market, EMEA (Europe, Middle East and Africa), rose by 3.3 per cent in 2016.

Economic growth in the United States slowed to 1.6 per cent in the reporting year (2015: 2.6 per cent). DEUTZ's revenue in North America fell by 13.0 per cent. This was largely caused by declining unit sales of engines for construction equipment in North America and by rental companies' reluctance to invest.

Momentum in China, our key international market, slowed again, with economic growth of 6.7 per cent (2015: 6.9 per cent). However, the markets for construction equipment and for light and

[1] IMF World Economic Outlook Update, January 2017.

[2] Konjunkturbulletin of the German Engineering Federation (VDMA), February 2017.

medium-duty trucks stabilised following sharp decreases in previous years. DEUTZ's revenue in the Asia-Pacific region rose by 15.9 per cent thanks to the positive impact of new customer projects.

RESEARCH AND DEVELOPMENT

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

€ million (R&D ratio in %)

2016	**50.4**	**(4.0)**
2015	40.8	(3.3)
2014	53.1	(3.5)
2013	52.6	(3.6)
2012	62.1	(4.8)

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

R&D spending stepped up as planned Expenditure on research and development in 2016 amounted to €53.5 million (2015: €49.5 million). After deducting grants received from major customers and development partners, expenditure was €50.4 million (2015: €40.8 million). The R&D ratio (after deducting grants), i.e. the ratio of net development expenditure to consolidated revenue, increased as planned to 4.0 per cent (2015: 3.3 per cent). The rise in R&D expenditure compared to the low level of spending in the prior year was largely attributable to the expansion of our product range and the continuous improvements to current engine series. In the year under review, 18.1 per cent of development expenditure after deducting grants was capitalised (2015: 31.9 per cent).

R&D spending by the DEUTZ Compact Engines segment after deducting grants came to €47.7 million (2015: €38.2 million) and that of the DEUTZ Customised Solutions segment came to €2.7 million (2015: €2.6 million).

Stage V ready In previous years, we had completely overhauled our engine portfolio in connection with the introduction of the EU Stage IV/US Tier 4 emissions standards. Our latest 'Stage V ready' TCD engines in the 2.9 to 16.0 litre capacity range are already equipped to meet the next European emissions standard, EU Stage V[1], which comes into effect in 2019. The diesel particulate filters needed to ensure compliance are now available as standard or as an option for engines with a capacity up to 7.8 litres. A diesel particulate filter meeting the new emissions standard will be introduced for all the other engines that will not require much additional space for installation. It is not yet known whether a further emissions standard will be introduced in the USA.

Expansion of the product portfolio We plan to enhance our product range with further developments. One of these is the D/TD/TCD 2.2, a three-cylinder engine that we are developing on the basis of the existing four-cylinder engine with a 2.9 litre capacity. In addition, we will offer smaller engines not only in a diesel variant but also in a liquefied petroleum gas (LPG) variant. The latter is a particularly interesting option for forklift trucks and other material handling applications. We are also currently developing a completely new 5 litre engine with four cylinders. The TCD 5.0 will supplement the DEUTZ product range in the 100 to 150 kW power range and is, at the same time, the first step in renewing our medium-duty engine series. The design of the engine's underlying technology features minimum pipework, fewer components, strict separation between the hot and cold sides to avoid the need for heat protection measures and a reduction in performance losses from the oil and water circuits. Another feature is its overhead camshaft.

Preliminary development work at a high level Exhaustive research and development will continue to form the basis for innovative products and services from DEUTZ in future. We have recently expanded our activity in the field of alternative fuels. As well as looking at natural gas, we are also focusing on hydrogen and fuels that are generated from renewable sources, and we have taken steps to expand our work with universities and other research institutes. A key focus of our preliminary development work is the combination of internal combustion engines and electric motors (hybridisation). We have also continued to concentrate on data transfer and analysis (Industry 4.0) so that we can offer our customers new services in the future.

Intellectual property rights safeguard our know-how We protect our know-how from unauthorised outside use by means of patents, patent applications and utility models. In 2016, we submitted 14 new patent applications, eight of which were in Germany. We now hold a total of 147 patents registered in Germany and 178 registered elsewhere.

PROCUREMENT

Last year was characterised by an overall recovery in the commodities markets. Key purchasing objectives were achieved, such as reducing costs, ensuring continuity of supply, optimising quality and implementing embedded material group strategies.

Commodity prices rising While prices had continued to fall in the primary markets in 2015, the trend was reversed in 2016. Overall, all the average prices for the year were slightly higher than the ranges that had been forecast. However, commodity prices have only a limited influence on the price at which DEUTZ procures parts from suppliers because there is a very high element of value added.

[1] Regulation (EU) 2016/1628 of the European Parliament and of the Council dated 14 September 2016.

Measures implemented to reduce costs With regard to the material groups, we primarily focused on exhaust after-treatment, exhaust gas recirculation and filtration last year and were able to reduce costs in the overall system. We see potential for achieving further savings by increasing the proportion of procurement from emerging markets. This applies, above all, to China because of the competitive environment, particularly as quality standards in the supplier industry are continuing to improve there. We have concluded a purchasing agreement with our joint venture DEUTZ (Dalian) Engine Co., Ltd., China, in order to coordinate procurement potential in the Chinese market.

Supply chain and supplier performance We have been able to further optimise supplier performance in the supply chain, with the overall trend continuing to improve.

PRODUCTION

In production and logistics, the areas of focus in 2016 were workplace safety and ergonomics, product and process quality, and efficiency. We also implemented a number of measures as planned as part of efforts to optimise our network of sites.

The Cologne plants, Germany Last year, we initiated various steps aimed at improving quality and safeguarding the assembly processes in Cologne-Porz, our largest assembly site for production engines. This included optimising and renewing the cleaning and drying sections of the painting area and the automated adjustment of valve clearance. We also held kaizen workshops to further refine processes and procedures. Numerous tasks were consolidated in connection with vacating the Cologne-Deutz site, such as the management of empties. We also expanded shop floor management.

Component manufacture The process of vacating the Cologne-Deutz site began at the start of 2016. In May, the two transfer lines for the processing of crankcase housing for the 2011 and 91x engine series were moved to our plants in Zafra, Spain and Ulm, Germany. The relocation of shaft production from Cologne-Deutz to the newly built shaft centre in Cologne-Porz got under way in April without production being disrupted and was completed in February 2017. A total of 130 pieces of machinery and equipment were removed and then brought back on stream.

The plants in Ulm and Übersee on Lake Chiemsee, Germany We continued with our expansion of the Ulm plant in 2016. This site is evolving into the plant for small production runs, focusing on DCS products, project business, exchange engines and models that are soon to be discontinued. The Xchange assembly activities, which had been relocated in 2015, were optimised, costs were lowered and throughput times were shortened. In addition, the necessary preparations for integrating all of the other functions from the Übersee plant were carried out. The relocation of the remaining functions in connection with the closure of the Übersee site will take place in 2017. In mechanical fabrication, all transfer lines were replaced with production machines; mechanical component production has thus been attuned to the flexibility that is required in small production runs.

The Zafra plant, Spain Our plant in Zafra, Spain produces the crankcases for engines of up to 4 litres in addition to the other major engine components already manufactured there, namely cylinder heads, conrods and gearwheels. Relocation of the production of crankcases for the 2011 engine series, which were previously built inhouse in Cologne-Deutz, was completed in 2016. Manufacturing of crankcases for the 2.9 engine series was also ramped up in 2016.

The Pendergrass plant, USA In the year under review, we extended our plant in Pendergrass, Georgia/USA, to cover the additional volume resulting from the growth of the exchange engine business. This included expanding capacity for removal and final assembly activities and increasing the number of production employees. There is now capacity for roughly 2,400 engines in one-shift operation.

QUALITY

Quality is part of our corporate culture The DEUTZ name has always been synonymous with high-quality engines. We intend to continue to live up to this reputation.

For this reason, we introduced our zero-error strategy. Our main aim in pursuing this quality assurance programme is to ensure that we always meet our customers' expectations. The idea is to detect errors before they actually occur. And where errors do occur, we have to learn from them quickly in order not to make the same mistakes again.

In 2016, we developed a concept to implement our quality assurance programme and provided multipliers with the necessary training to run workshops. A large number of employees, from both production and administrative areas, took part in these workshops. Managers and employees were given intensive training on topics such as customer satisfaction, quality of work and the constructive handling of errors during two half-day sessions.

In addition, we conducted a study on quality focus in collaboration with the Laboratory for Machine Tools and Production Engineering (WZL). The objective was to assess the quality focus of employees in middle management. The study showed that the quality culture at DEUTZ was very strong on average in terms of external customer focus. In departments with a well-developed culture of quality, there is greater satisfaction among the employees and they value the quality performance of their team more highly.

Certification attests to high quality standards Last year, DEUTZ was again certified in accordance with ISO 9001 (quality management), ISO 14001 (environmental management) and ISO 50001 (energy management). In 2016, we successfully completed our second monitoring audit.

The more wide-ranging requirements resulting from the revised ISO 9001:2015 and 14001:2015 standards are currently being integrated into the DEUTZ management system. This is expected to be completed in time for re-certification in 2017.

INTERNATIONAL JOINT VENTURES

Conditions in the Chinese market for capital equipment have been very challenging for a number of years. Growth forecasts have been revised down significantly, and there is considerable capacity in the engineering sector.

We have been operating the DEUTZ Dalian joint venture – in which our Chinese production activities are concentrated – with the First Automotive Works Group, one of China's leading vehicle manufacturers, since 2007. Here, we produce 3 to 8-litre diesel engines, mainly for automotive and industrial applications for the Chinese market. We will expand DEUTZ Dalian's product range from 2019, which is when the China IV emissions legislation comes into force. Local production ensures that we have the proximity to our customers that we need and enables us to seize market opportunities in various off-road applications.

In 2016, unit sales in the DEUTZ Dalian joint venture fell by 8.7 per cent to around 68,000 engines. Revenue declined by 10.8 per cent to €303.0 million. Adjusted for exchange rate effects, the decrease was 5.7 per cent. The company, accounted for under the equity method, had a negative impact of around €5.7 million (2015: €7.0 million) on the DEUTZ Group's operating profit.

DEUTZ AGCO MOTORES S.A. (DAMSA) is our joint venture with the AGCO Group and is located in Argentina. It builds engines for the local market, mainly for agricultural machinery, buses and industrial applications. In 2016, DAMSA sold almost 1,000 engines. Revenue dropped by 24.9 per cent to €14.5 million as a result of negative exchange rate effects. However, measured in the local currency, revenue increased by 19.1 per cent. The company's operating profit came to €0.2 million (2015: €0.7 million).

We hold a stake of 30 per cent in D.D. Power Holdings (Pty) Ltd., our South African joint venture. This sales and service company is active in the local market, focusing on sectors such as the local mining business. In the year under review, the company reported revenue of €14.6 million (2015: €20.2 million) and a profit of €1.9 million (2015: €2.5 million).

NEW ORDERS

DEUTZ Group: New orders

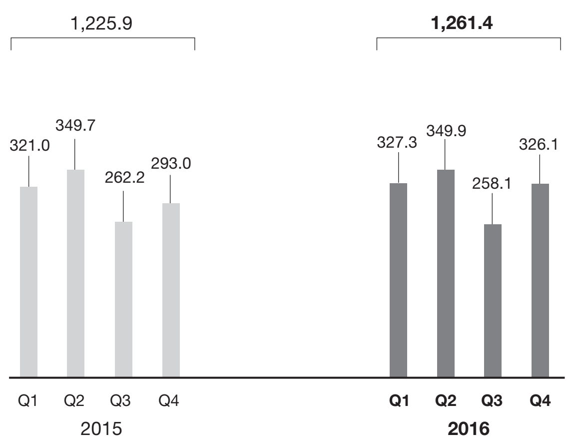
€ million

Year-on-year increase in new orders The DEUTZ Group received new orders worth €1,261.4 million in 2016, which was 2.9 per cent above the figure of €1,225.9 million achieved in the previous year. The former Mobile Machinery application segment has been divided into the Construction Equipment and Material Handling application segments in order to provide greater transparency in terms of the significance of various customer industries. In 2016, new orders increased by 9.6 per cent in the Construction Equipment application segment, by 6.9 per cent in Material Handling and by 6.4 per cent in Agricultural Machinery. The Automotive and Stationary Equipment application segments saw their new orders decline by 14.4 per cent and 16.7 per cent respectively. The service business maintained its positive trajectory with an increase of 2.2 per cent.

The level of new orders varied over the course of the year. New orders were up slightly year on year in the first quarter, unchanged year on year in the second quarter and down slightly year on year in the third quarter. In the fourth quarter, the volume of new orders increased by 11.3 per cent compared with the prior-year quarter to reach €326.1 million.

DEUTZ Group: New orders by quarter

€ million



Orders on hand totalled €191.0 million as at 31 December 2016, a decline of 5.0 per cent compared with €201.0 million at the end of 2015.

UNIT SALES

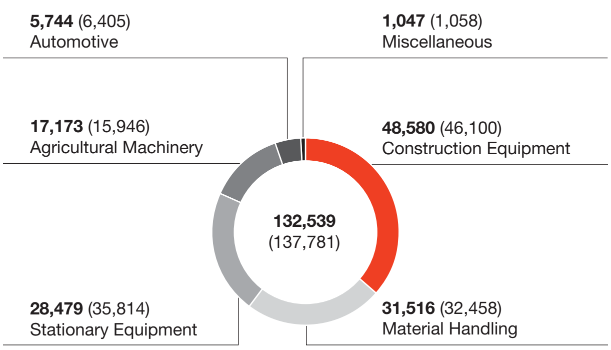
DEUTZ Group: Unit sales

units

Fewer engines sold DEUTZ sold 132,539 engines in the reporting year, which was 3.8 per cent fewer than in the prior year (2015: 137,781 engines). The decreases in the Stationary Equipment and Automotive application segments were particularly substantial at 20.5 per cent and 10.3 per cent respectively.

DEUTZ Group: Unit sales by application segment

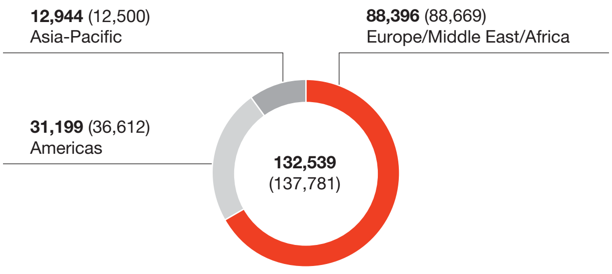
units (2015 figures)



The regional analysis shows a very mixed picture. Unit sales in our biggest market – EMEA (Europe, Middle East and Africa) – were on a par with 2015 at 88,396 engines. They were down by 14.8 per cent to 31,199 engines in the Americas. By contrast, unit sales in the Asia-Pacific region rose by 3.6 per cent to 12,944 engines.

DEUTZ Group: Units sales by region

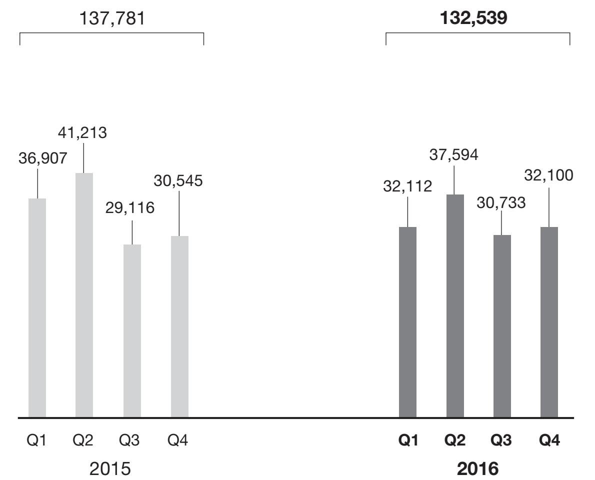
units (2015 figures)



In the first two quarters, unit sales were lower than in the corresponding periods of 2015. However, third-quarter and fourth-quarter unit sales were both up year on year. In the final quarter of 2016, DEUTZ sold 32,100 engines, which was an increase of 5.1 per cent compared to the fourth quarter of 2015 and a rise of 4.4 per cent on the third quarter of 2016.

DEUTZ Group: Consolidated unit sales by quarter

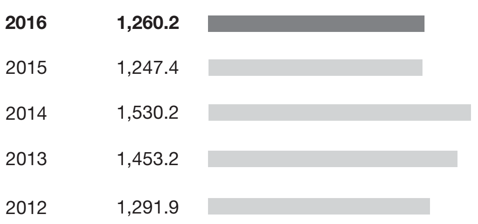
units



RESULTS OF OPERATIONS

DEUTZ Group: Revenue

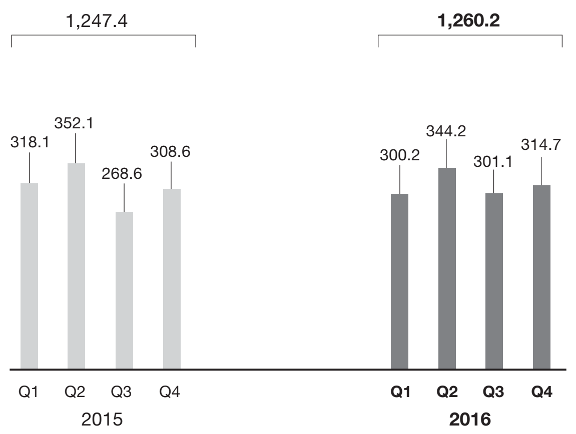
€ million



Revenue up slightly compared with prior year DEUTZ earned revenue of €1,260.2 million in 2016, an increase of 1.0 per cent on the previous year (2015: €1,247.4 million). We therefore met the forecast published in our 2015 annual report that revenue would stagnate or, at best, rise slightly. The average price of the engines sold went up again.

DEUTZ Group: Revenue by quarter

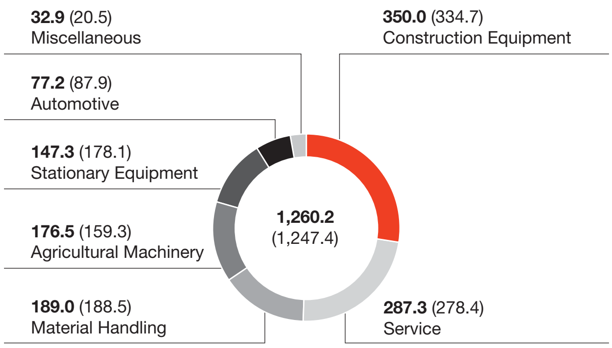
€ million



Revenue levels varied throughout the year. While revenue was down year on year in the first and second quarters, it was significantly higher year on year in the third quarter. In the fourth quarter, we generated revenue of €314.7 million, which was 2.0 per cent more than in the prior-year period and 4.5 per cent more than in the previous quarter. The second quarter, when revenue totalled €344.2 million, was the strongest quarter of 2016, as had been the case in 2015.

DEUTZ Group: Revenue by application segment

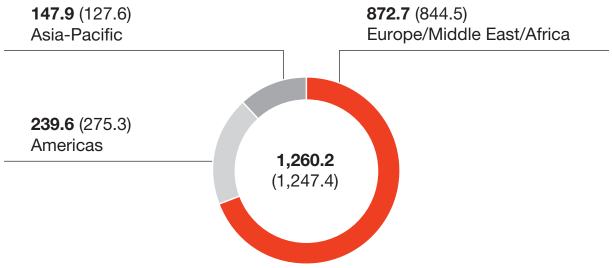
€ million (2015 figures)



The application segments presented a disparate picture. The Construction Equipment and Material Handling application segments, which were previously grouped together as Mobile Machinery, increased their revenue by 4.6 per cent and 0.3 per cent respectively. There were also rises in revenue, of 10.8 per cent and 3.2 per cent respectively, for Agricultural Machinery and the service business. By contrast, the Automotive and Stationary Equipment application segments reported decreases of 12.2 per cent and 17.3 per cent respectively.

DEUTZ Group: Revenue by region

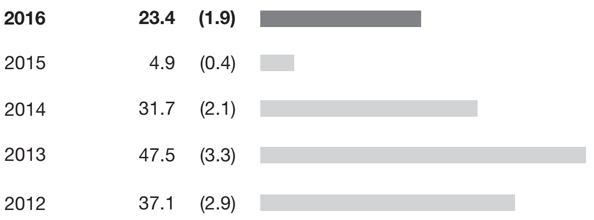
€ million (2015 figures)



Broken down by region, revenue in EMEA (Europe, Middle East and Africa) advanced by 3.3 per cent year on year to €872.7 million. In the Americas region, however, revenue was down by 13.0 per cent to €239.6 million. Thanks to new customer projects, the Asia-Pacific region again generated double-digit growth, with revenue climbing by 15.9 per cent to €147.9 million.

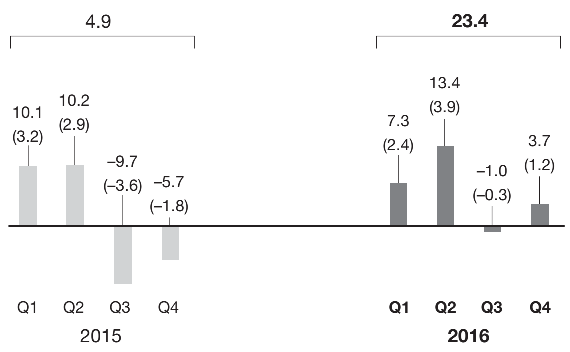
DEUTZ Group: Operating profit and EBIT margin (before exeptional items)

€ million (EBIT margin in %)



DEUTZ Group: Operating profit (EBIT) by quarter (before exeptional items)

€ million (EBIT margin in %)



Earnings performance Operating profit before depreciation and amortisation (EBITDA) came to €114.2 million in 2016, a year-on-year increase of €2.0 million (2015: €112.2 million). The EBITDA margin improved slightly to reach 9.1 per cent (2015: 9.0 per cent).

In the fourth quarter of 2016, EBITDA came to €26.3 million and was thus at the same level as the prior-year period (Q4 2015: €26.6 million). Compared with the third quarter of 2016, EBITDA rose by €5.3 million (Q3 2016: €21.0 million). The main reason for this increase was the larger volume of business.

Operating profit after depreciation and amortisation (EBIT) came to €23.4 million in 2016 The year-on-year increase was mainly attributable to lower production costs, far smaller impairment losses (2016: €1.5 million; 2015: €9.7 million) and a licensing transaction in the first quarter of 2016. The contribution to profits from the licensing transaction amounted to €5.5 million. The growth in service business and the first effects of the measures to optimise our network of sites also had a positive impact. The EBIT margin for 2016 was 1.9 per cent (2015: 0.4 per cent). At the start of the year, we had expected a moderate increase in the EBIT margin, so we met our forecast.

In the fourth quarter of 2016, operating profit amounted to €3.7 million (Q3 2016: loss of €1.0 million; Q4 2015: loss of €5.7 million), giving an EBIT margin of 1.2 per cent (Q3 2016: minus 0.3 per cent; Q4 2015: minus 1.8 per cent).

The higher operating profit resulted in a substantially improved return on capital employed (ROCE)[1)], our internal KPI, which rose from 0.6 per cent in 2015 to 3.1 per cent in the reporting year. At the start of the year, we had expected ROCE to rise slightly compared with 2015. We exceeded this forecast for the reasons outlined above.

Overview of the DEUTZ Group's results of operations

€ million

	2016	2015
Revenue	**1,260.2**	**1,247.4**
Cost of sales	–1,041.6	–1,054.8
Research and development costs	–77.5	–76.3
Selling and administrative expenses	–104.7	–104.8
Other operating income	17.7	29.3
Other operating expenses	–26.7	–30.6
Profit/loss on equity-accounted investments	–5.1	–6.3
Other financial income	1.1	1.0
Operating profit (EBIT)	**23.4**	**4.9**
Interest expenses, net	–3.5	–4.0
Income taxes	–3.9	2.6
Net income	**16.0**	**3.5**

[1)] Return on capital employed (ROCE): ratio of EBIT to average capital employed. Capital employed: total assets less cash and cash equivalents, trade payables and other current and non-current liabilities, based on average values from two balance sheet dates.

Cost of sales In 2016, the cost of sales amounted to €1,041.6 million (2015: €1,054.8 million), a year-on-year decrease of €13.2 million or 1.3 per cent. This was mainly due to the lower cost of materials resulting from the reduction in the volume of unit sales as well as increased cost efficiency. The gross margin[1] improved from 15.4 per cent in 2015 to 17.3 per cent in the reporting period.

Research and development costs In the year under review, research and development costs totalled €77.5 million (2015: €76.3 million). They largely comprised staff costs, the cost of materials and amortisation on completed development projects, from which investment grants received and capitalised development costs were deducted. Whereas lower amortisation on completed development projects helped to reduce R&D costs, the smaller volume of investment grants and the sharp drop in the capitalisation rate meant that, overall, there was a small year-on-year rise in R&D costs of €1.2 million.

Other operating income Other operating income totalled €17.7 million in the reporting year, equating to a decline of €11.6 million compared with the prior year (2015: €29.3 million). This change was largely due to lower foreign currency gains, although foreign currency losses (recognised under other operating expenses) also fell sharply. Moreover, the 2015 figure had included income from the disposal of the shares in WEIFANG WEICHAI DEUTZ DIESEL ENGINE CO., LTD., Weifang, China, and income from the deconsolidation of DEUTZ Engine (China) Co., Ltd. Linyi, China.

Other operating expenses Otheroperating expenses totalled €26.7 million in the reporting year, a year-on-year decrease of €3.9 million (2015: €30.6 million). This was mainly attributable to substantially smaller foreign currency losses. The main countervailing effect came from higher additions to other provisions. Other operating expenses also included a loss of €1.4 million arising from the deconsolidation of the subsidiary DEUTZ Engine (Shandong) Co., Ltd., Linyi, China.

Profit/loss on equity-accounted investments In 2016, there was a loss on equity-accounted investments of €5.1 million, a small improvement of €1.2 million compared with the previous year (2015: loss of €6.3 million). This change is primarily attributable to the contribution to earnings from our Chinese joint venture DEUTZ (Dalian) Engine Co., Ltd. Further information can be found in the 'International joint ventures' section on page 32.

[1] Gross margin: ratio of revenue less cost of sales to revenue (excluding amortisation relating to development expenditure).

Net interest expense Net interest expense amounted to €3.5 million (2015: €4.0 million). This year-on-year improvement of €0.5 million was attributable to lower utilisation of credit lines.

Income taxes The income tax expense amounted to €3.9 million in the year under review, whereas there had been tax income of €2.6 million in 2015. Current tax expenses came to €9.3 million, a year-on-year rise of €3.6 million (2015: €5.7 million). This was mainly the result of improved earnings at DEUTZ AG. The current tax expenses were partly offset by deferred tax income of €5.4 million (2015: €8.3 million). This mainly resulted from the reversal of deferred tax liabilities arising in connection with the capitalisation of development expenditure under IFRS.

Earnings per share Due to the higher operating profit, net income increased by €12.5 million to €16.0 million in the reporting period (2015: €3.5 million). This led to a significant improvement in earnings per share, which came to €0.14 (2015: €0.04).

BUSINESS PERFORMANCE IN THE SEGMENTS

DEUTZ Group: Segments

€ million	2016	2015
New orders		
DEUTZ Compact Engines	1,011.6	958.4
DEUTZ Customised Solutions	249.8	267.5
Total	**1,261.4**	**1,225.9**
Unit sales (units)		
DEUTZ Compact Engines	123,179	125,214
DEUTZ Customised Solutions	9,360	12,567
Total	**132,539**	**137,781**
Revenue		
DEUTZ Compact Engines	1,000.8	967.2
DEUTZ Customised Solutions	259.4	280.2
Total	**1,260.2**	**1,247.4**
EBIT		
DEUTZ Compact Engines	–6.1	–31.9
DEUTZ Customised Solutions	32.7	31.3
Other	–3.2	5.5
Total	**23.4**	**4.9**

BUSINESS PERFORMANCE IN THE DEUTZ COMPACT ENGINES (DCE) SEGMENT

More orders than in 2015 In the year under review, the DEUTZ Compact Engines (DCE) segment received new orders worth €1,011.6 million, which was 5.6 per cent up on 2015 when orders worth €958.4 million were received. At 13.8 per cent, Construction Equipment recorded the highest growth among the application segments. Material Handling, Agricultural Machinery and the service business also saw increases of 7.8 per cent, 7.1 per cent and 6.7 per cent respectively. However, new orders fell in the Stationary Equipment and Automotive application segments by 17.9 per cent and 3.9 per cent respectively. Orders on hand amounted to €145.5 million at the end of the year, up by 6.0 per cent compared with the end of 2015.

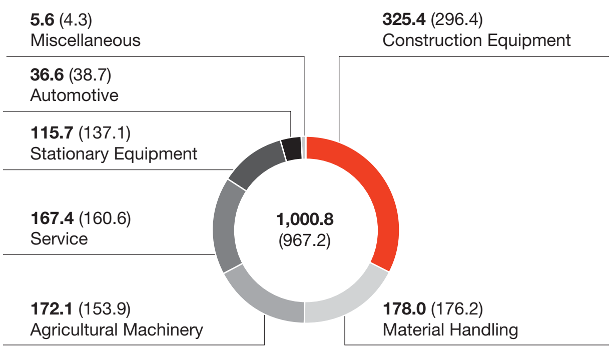
Slight year-on-year fall in unit sales The DCE segment's unit sales dropped by 1.6 per cent to 123,179 engines. The number sold in the previous year was 125,214 engines. In EMEA, our largest market, we sold 83,017 engines, which was 2.0 per cent more than in 2015. Unit sales went down by 13.1 per cent in the Americas region but rose by 9.8 per cent in the Asia-Pacific region. There were increases in the Construction Equipment, Agricultural Machinery and Miscellaneous application segments, while all other application segments sold fewer engines.

Higher revenue At €1,000.8 million, revenue in the DCE segment was up by 3.5 per cent year on year (2015: €967.2 million). As was the case at Group level, revenue thus increased despite the small decrease in unit sales. The EMEA region's revenue advanced by 5.5 per cent to €721.2 million. However, that of the Americas region dropped by 12.1 per cent to €200.4 million. The Asia-Pacific region's revenue climbed by a considerable 43.0 per cent to €79.2 million. Revenue rose by 11.8 per cent in the Agricultural Machinery application segment, by 9.8 per cent in the Construction Equipment application segment, by 4.2 per cent in the service business and by 1.0 per cent in the Material Handling application segment. By contrast, Stationary Equipment and Automotive revenue was down by 15.6 per cent and 5.4 per cent respectively.

Q4 2016 better than comparison periods In the DCE segment, new orders reached €267.9 million in the fourth quarter of 2016. This was 14.3 per cent more than in the fourth quarter of the previous year and 34.5 per cent up on the previous quarter. Unit sales rose by 8.2 per cent year on year to 29,869 engines and also exceeded the figure for the previous quarter by 4.8 per cent. Revenue in the final quarter of 2016 amounted to €251.1 million, which was 5.9 per cent more than in both the fourth quarter of 2015 and the third quarter of 2016.

DEUTZ Compact Engines: Revenue by application segment

€ million (2015 figures)



DCE's operating profit improved The DEUTZ Compact Engines segment reported an operating loss of €6.1 million in 2016 (2015: operating loss of €31.9 million). This substantial improvement of €25.8 million is mainly the result of savings on the cost of materials and the higher volume of business. A positive shift in the product mix that benefited our new engine series also contributed to this improved result for the segment. Moreover, the operating profit for the segment in the prior year had been adversely affected by impairment losses totalling €7.1 million on intangible assets and on property, plant and equipment. Impairment losses of €1.5 million were recognised in the reporting year, mainly on property, plant and equipment of our subsidiary DEUTZ Engine (Shandong) Co., Ltd.

BUSINESS PERFORMANCE IN THE DEUTZ CUSTOMISED SOLUTIONS (DCS) SEGMENT

New orders fall year on year In 2016, the DEUTZ Customised Solutions (DCS) segment received new orders worth €249.8 million, which is 6.6 per cent less than in 2015 when orders worth €267.5 million were received. There were year-on-year decreases in all application segments. As at the end of 2016, orders on hand stood at €45.5 million, a decrease of 28.7 per cent on the figure reported a year earlier (31 December 2015: €63.8 million).

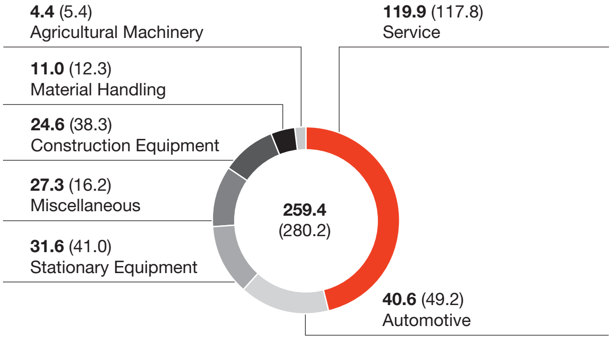
Engine sales down by a quarter Unit sales in the DCS segment declined by 25.5 per cent to 9,360 engines in 2016. This trend was repeated across all regions and, apart from Agricultural Machinery, across all application segments.

Far smaller drop in revenue than in unit sales In the reporting period, the DCS segment's revenue fell by 7.4 per cent to €259.4 million. All regions registered decreases in revenue: by 5.8 per cent in the EMEA region, by 16.9 per cent in the Americas and by 4.8 per cent in the Asia-Pacific region. Revenue also went down in all application segments; only the service business generated a further increase of 1.8 per cent to reach €119.9 million.

Weaker fourth quarter In the fourth quarter of 2016, new orders in the DCS segment totalled €58.2 million, down by 0.7 per cent year on year and down by 1.2 per cent on the previous quarter. A total of 2,231 engines were sold in the final quarter, which constituted a substantial year-on-year decrease of 23.8 per cent but was on a par with the third quarter of 2016. At €63.6 million, the DCS segment's revenue dropped by 11.0 per cent compared with the fourth quarter of 2015 and by 0.5 per cent compared with the previous quarter.

DEUTZ Customised Solutions: Revenue by application segment

€ million (2015 figures)



DCS's operating profit holds steady at a high level The operating profit of the DEUTZ Customised Solutions segment for the reporting year was €32.7 million (2015: €31.3 million). With the volume of business having reduced, this increase of €1.4 million is mainly attributable to a contribution to profits from the licensing transaction of €5.5 million at the start of the financial year. The operating profit for the segment in 2015 had been adversely affected by impairment losses totalling €2.6 million on intangible assets and on property, plant and equipment.

Other The operating loss reported by the Other segment came to €3.2 million (2015: operating profit of €5.5 million). In 2015, operating profit had been boosted by the sale of the shares in WEIFANG WEICHAI DEUTZ DIESEL ENGINE CO., LTD., Weifang, China. The figure for 2016 includes a loss of €1.4 million arising from the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd., Linyi, China. This company is currently being wound up and no longer has any operational or strategic significance to the DEUTZ Group, so it has been deconsolidated for reasons of materiality.

FINANCIAL POSITION

BASIC PRINCIPLES AND OBJECTIVES OF FINANCIAL MANAGEMENT

Overview of the DEUTZ Group's financial position

€ million

	2016	2015
Cash flow from operating activities	63.8	103.3
Cash flow from investing activities	–55.4	–64.4
Cash flow from financing activities	–26.8	–29.8
Change in cash and cash equivalents	–18.4	9.1
Free cash flow from continuing operations	4.7	35.0
Cash and cash equivalents at 31 Dec	91.8	112.5
Current and non-current interest-bearing financial debt at 31 Dec	60.2	73.5
Net financial position at 31 Dec	31.6	39.0

Free cash flow: cash flow from operating and investing activities less net expense.
Net financial position: cash and cash equivalents less current and non-current interest-bearing financial debt.

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

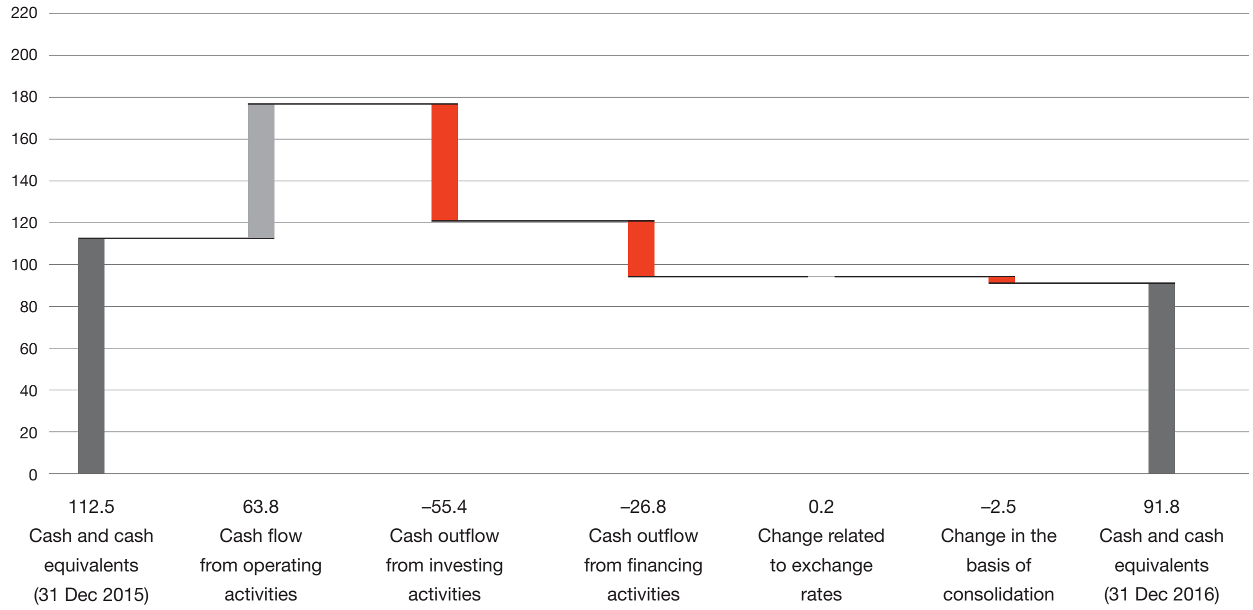
FUNDING

Syndicated credit line and loan from the European Investment Bank ensure sufficient liquidity In order to ensure sufficient liquidity, DEUTZ has at its disposal a syndicated, revolving working capital facility of €160 million provided by a consortium of banks. It is a floating-rate, unsecured line and is due to mature in May 2020. DEUTZ can elect whether to utilise the cash line as a bilateral overdraft facility (up to €60 million) or to draw down amounts with interest periods of three to six months.

In addition, we have an amortising loan from the European Investment Bank with a remaining balance of €54 million at 31 December 2016. This loan, which is also unsecured, is repayable in instalments until July 2020. We have hedged the interest-rate risk arising from this loan.

DEUTZ Group: Change in cash and cash equivalents

€ million



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 coming years.

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 tied up by the preliminary financing of production and due to the payment terms that we have granted to our customers. The volume of sales of receivables on the balance sheet date was higher than at the end of 2015 as a result of the business situation, the volume as at 31 December 2016 being around €111 million (31 December 2015: €99 million).

FREE CASH FLOW

Cash flow from operating activities amounted to €63.8 million in 2016 (2015: €103.3 million). This year-on-year fall of €39.5 million was mainly due to the change in working capital. Whereas there had been a marked decrease in working capital in 2015, the level of working capital rose significantly in the reporting period. This change was primarily due to the reporting date-related increase in trade receivables and the simultaneous reduction in trade payables caused by a drop in orders of raw materials and consumables at the end of the reporting year.

Cash outflow from investing activities came to €55.4 million in 2016. This represented a year-on-year decrease of €9.0 million that was caused, in particular, by lower cash payments in connection with development activities (2015: €64.4 million).

Financing activities in 2016 resulted in a net cash outflow of €26.8 million (2015: €29.8 million). As in the previous year, cash flow used for financing activities included a dividend payment to shareholders of €8.5 million.

Cash and cash equivalents as at 31 December 2016 had fallen by €20.7 million to €91.8 million (31 December 2015: €112.5 million). Of this decrease, €2.5 million was attributable to the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China. The net financial position[1] as at 31 December 2016 was €31.6 million, a decrease compared with the same date a year earlier of €7.4 million (31 December 2015: €39.0 million).

Free cash flow[2] decreased year on year, falling by €30.3 million to €4.7 million (2015: €35.0 million). This was due, above all, to the significant reduction in cash flow from operating activities. Consequently, we did not meet our forecast made at the start of 2016 that free cash flow would be in the low to mid-double-digit million euro range. This was primarily because of the aforementioned change in working capital.

CAPITAL EXPENDITURE

After deducting investment grants, capital expenditure on property, plant and equipment and on intangible assets totalled €62.0 million in 2016, which was €7.2 million less than in the previous year (2015: €69.2 million). As in 2015, the bulk of this spending (€49.3 million) went on property, plant and equipment (2015: €50.9 million). Capital expenditure on intangible assets accounted for €12.7 million (2015: €18.3 million). The investing activities relating to property, plant and equipment focused on the construction of the shaft centre in Cologne-Porz, where production was progressively ramped up from mid-2016 onward. There were also additions in connection with replacement investments in machinery and tools. Capital expenditure on intangible assets went mainly on the development of the new TCD 2.2 and TCD 5.0 engine series.

Before the capitalisation of development expenditure, capital investment amounted to €52.9 million (2015: €56.2 million). Capital investment was therefore slightly lower than we had predicted (forecast: €55.0 million). Including the capitalisation of development expenditure, our spending was almost €13.0 million less than the forecast amount of €75.0 million. This was mainly due to a far lower capitalisation rate as a result of the reprioritisation of the timing of development projects.

As in 2015, the bulk of the total capital expenditure after deducting investment grants was invested in the DEUTZ Compact Engines segment (€55.0 million in 2016 and €61.7 million in 2015). Capital expenditure in DEUTZ Customised Solutions was €7.0 million (2015: €7.5 million).

[1] Net financial position: cash and cash equivalents less current and non-current interest-bearing financial debt.

[2] Free cash flow: cash flow from operating and investing activities less interest expense.

NET ASSETS

Overview of the DEUTZ Group's assets

€ million

	31 Dec 2016	31 Dec 2015	Change
Non-current assets	563.6	589.6	–26.0
Current assets	495.7	498.1	–2.4
Assets classified as held for sale	0.4	0.4	–
Total assets	**1,059.7**	**1,088.1**	**–28.4**
Equity	491.1	495.6	–4.5
Non-current liabilities	265.0	280.8	–15.8
Current liabilities	303.6	311.7	–8.1
Total equity and liabilities	**1,059.7**	**1,088.1**	**–28.4**
Working capital (€ million)	204.3	183.6	20.7
Working capital ratio (31 Dec, %)	16.2	14.7	1.5
Working capital ratio (average, %)	17.9	17.6	0.3
Equity ratio (%)	46.3	45.5	0.8

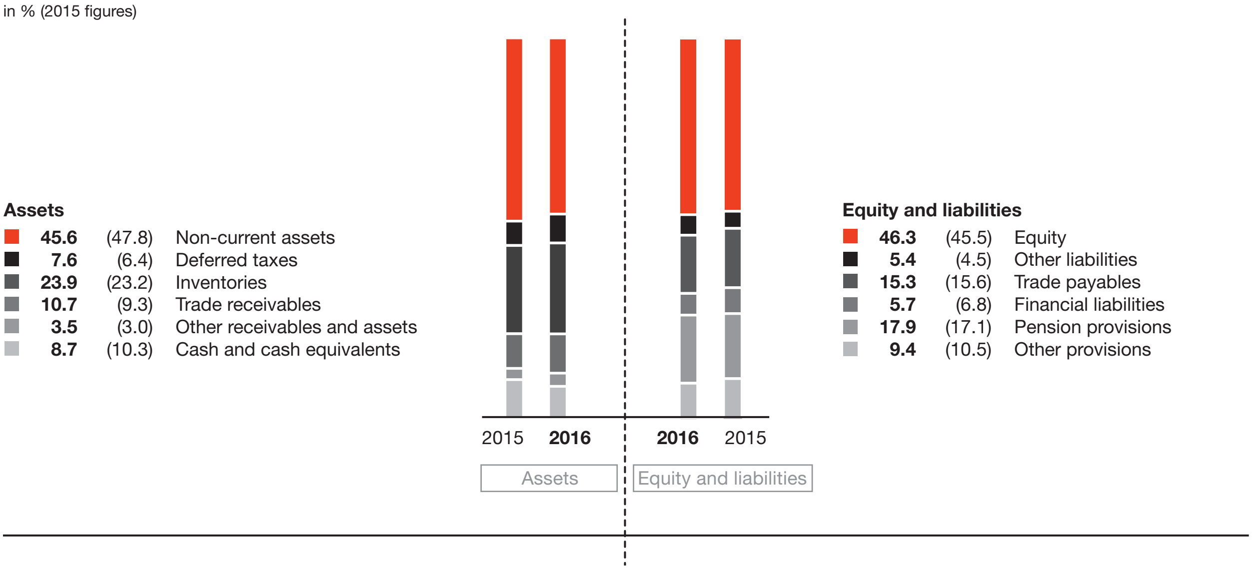
Working capital: inventories plus trade receivables less trade payables.
Equity ratio: equity / total equity and liabilities.

Non-current assets Non-current assets of the DEUTZ Group totalled €563.6 million as at 31 December 2016 (31 December 2015: €589.6 million). The decline of €26.0 million was largely due to the reduction in intangible assets. In particular, additions to capitalised development expenditure were much lower than amortisation charges relating to capitalised development expenditure.

Current assets Current assets were only a little lower than at the end of 2015, falling by €2.4 million to €495.7 million (31 December 2015: €498.1 million). This was mainly attributable to the reduction in cash and cash equivalents and in tax receivables, although the reduction was partly offset by a reporting date-related increase in trade receivables and other receivables and assets.

DEUTZ Group: Balance sheet structure

in % (2015 figures)



Working capital Working capital had risen to €204.3 million as at 31 December 2016 (31 December 2015: €183.6 million). The main reason for this was the reporting date-related increase in trade receivables. Moreover, there was a year-on-year decrease in trade payables as at the balance sheet date due to a reduction in orders of raw materials and consumables. By contrast, there was only a slight rise in inventories. The decline in raw materials and consumables was offset by an increase in finished goods. Due to the higher level of working capital, the working capital ratio rose to 16.2 per cent as at 31 December 2016 (31 December 2015: 14.7 per cent). The average working capital ratio[1] went up slightly, reaching 17.9 per cent on the reporting date (31 December 2015: 17.6 per cent). Consequently, we did not quite achieve our forecast for an average working capital ratio of approximately 17 per cent, due mainly to the higher level of trade receivables and inventories.

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

Equity As at 31 December 2016, equity had decreased to €491.1 million (31 December 2015: €495.6 million). This reduction of €4.5 million was predominantly attributable to the changes to non-controlling interests as a result of the deconsolidation of DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China. This company is currently being wound up and no longer has any operational or strategic significance to the DEUTZ Group. It was deconsolidated for reasons of materiality on 31 December 2016. However, there was a small increase in the Group equity attributable to the shareholders of DEUTZ AG due, above all, to the level of net income.

Despite the decrease in equity, the equity ratio rose slightly to 46.3 per cent (31 December 2015: 45.5 per cent) and thus continued to be within the range that we had forecast at the start of the reporting year of well above 40 per cent.

Non-current liabilities Non-current liabilities totalled €265.0 million as at 31 December 2016 (31 December 2015: €280.8 million). This fall of €15.8 million was largely attributable to the reduction in financial debt, which decreased as planned by €14.6 million to €44.0 million. Furthermore, there was a reduction in other provisions, mainly in connection with the changes to restructuring provisions. In view of their expected use, the bulk of the non-current restructuring provisions were reclassified as current.

[1] Working capital (inventories plus trade receivables less trade payables) as at the balance sheet date divided by revenue for the previous twelve months.

Current liabilities There was also a decline in current liabilities from €311.7 million as at 31 December 2015 to €303.6 million as at 31 December 2016. This drop of €8.1 million was mainly attributable to the lower level of trade payables.

Total assets fell to €1,059.7 million as at 31 December 2016 (31 December 2015: €1,088.1 million).

OVERALL ASSESSMENT FOR 2016

Last year, DEUTZ was able to offer new and existing customers a comprehensive and compelling product portfolio. DEUTZ diesel engines equipped with particulate filters already comply with the limits defined in the EU Stage V emissions standard, which comes into force in 2019. At bauma 2016, we presented new developments that are further expanding our product range, such as the TCD 2.2 diesel and gas engines, a gas variant of the tried-and-trusted TCD 2.9 and the TCD 5.0. As part of a collaborative partnership with Liebherr, we are also planning to expand our product portfolio in the upper power range by adding four new diesel engines. We are thus always quick to offer our customers the solutions of tomorrow.

Overall, our business performance in the year under review was in line with our expectations. Despite market conditions continuing to be difficult and our customers remaining reluctant to invest, we were able to meet or exceed our forecasts for revenue and earnings. Although unit sales were down by 3.8 per cent, revenue advanced by 1.0 per cent year on year to €1,260.2 million. In the 2015 annual report, we had predicted that revenue would stagnate or, at best, rise slightly. At €1,261.4 million, new orders were up by 2.9 per cent on the previous year. It is encouraging that our profitability improved significantly despite an only moderate increase in the volume of business. Operating profit (EBIT) rose from €4.9 million in 2015 to €23.4 million in 2016. The EBIT margin reached 1.9 per cent, compared with 0.4 per cent the year before. We had forecast a moderate increase in the EBIT margin. Net income grew from €3.5 million to €16.0 million. This led to a significant improvement in earnings per share, which came to €0.14 (2015: €0.04). Free cash flow dropped from €35.0 million to €4.7 million, largely because of the sharp rise in working capital. In operational terms, we implemented the measures to optimise the network of sites in Germany and consolidate our activities in China as planned and, in most cases, completed them. We achieved the first positive effects from the optimisation of our site network in the reporting year. Going forward, we will continue to focus on increasing efficiency and flexibility and lowering the break-even point still further. On that basis, we will be able to benefit significantly from a recovery in the market.

EMPLOYEES

Overview of the DEUTZ Group's workforce

Headcount

	31 Dec 2016	31 Dec 2015
DEUTZ Group	**3,665**	**3,730**
Thereof		
In Germany	2,827	2,910
Outside Germany	838	820
Thereof		
Non-salaried employees	2,177	2,221
Salaried employees	1,403	1,401
Trainees	85	108
Thereof		
DEUTZ Compact Engines	2,989	3,050
DEUTZ Customised Solutions	676	680

Number of employees adjusted At the end of 2016, the DEUTZ Group employed a total of 3,665 people, 65 fewer than at the end of 2015 (a fall of 1.7 per cent). As at 31 December 2016, we also had a further 182 people on temporary employment contracts, compared with 151 a year earlier. By offering fixed-term contracts and employing temporary workers, DEUTZ can respond flexibly to any fluctuations in demand. Around 6 per cent of all staff at DEUTZ had fixed-term or temporary contracts as at 31 December 2016.

77 per cent of our workforce is employed in Germany. Most of these employees are based in Cologne – 2,202 as at 31 December 2016. 411 employees are based at the Ulm facilities. Of the 838 employees outside Germany, 421 of them work at our DEUTZ Spain subsidiary.

DEUTZ Group: Breakdown of workforce by location

Headcount

	31 Dec 2016	31 Dec 2015
Cologne	2,202	2,269
Ulm	411	410
Other	214	231
In Germany	**2,827**	**2,910**
Outside Germany	838	820
Total	**3,665**	**3,730**

Looking at it by segment, DEUTZ Compact Engines employed 2,989 people as at 31 December 2016, 2.0 per cent fewer than it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 676, down by 0.6 per cent compared with the end of 2015.

New collective pay agreement for Zafra DEUTZ Spain has concluded a collective pay agreement with the works council that will remain in force until 2018. Employees will receive a cost-of-living allowance. In addition, new pay grades are being introduced for temporary employees and for work on new products in order to maintain our competitiveness and to be able to offer new products to third-party customers with a good prospect of success. This agreement is a reflection of the forward-looking and constructive collaboration between the Company, the trade union and the works council.

Vocational training at DEUTZ Young people in Germany embarking on their career have the opportunity to choose an apprenticeship in various occupations at DEUTZ, ranging from electronics, skilled metalworking and warehouse logistics to mechatronics and business administration. Last year, 27 young women and men started vocational training at our Company. Overall, 54 apprentices were employed at the Cologne site and 19 at the DEUTZ plant in Ulm. We employed six apprentices at both the components plant in Herschbach and the Xchange plant in Übersee, Bavaria.

Our training centre in Cologne also provides vocational training, on a part-time and full-time basis, for apprentices from 17 other companies. In 2016, our overall ratio of trainees to total employees was 3.0 per cent in Germany (2015: 3.7 per cent). All apprentices and trainees passing the final examination were given a permanent employment contract.

Again in 2016, our training centre received recognition and several of our apprentices were commended for their achievements. We also participated once again in various training fairs and careers information events to give young people the opportunity to establish personal contact with the Company. For many years, we have been striving to attract young women to engineering careers by taking part in events such as Girls' Day. Currently, around 8.0 per cent of apprentices at DEUTZ are female.

As part of our site optimisation programme, our training centre was relocated from the Cologne-Deutz site to new facilities in Cologne-Porz in summer 2016.

Recruitment activities successful By attending 'meet@thköln' in Cologne and 'bonding' in Aachen, we were again able to find students to help out in various areas of the Company. In the year under review, there were 171 interns employed in our Company, of whom 19 students wrote their bachelor dissertations with us and six wrote their master's dissertations. A total of 40 students spent a practical semester at DEUTZ.

Investing in people In 2016, we carried out succession planning from divisional head to team leader level to ensure that we are consistently able to appoint suitable successors for managerial positions with disciplinary responsibility. Another focus of our succession planning was to identify promising young professionals who should be given specific support with their career planning. This will allow us to continue fulfilling vacant managerial positions with people from within our own ranks.

After carrying out a joint analysis of the specific skills gaps with our managers, we have also expanded our range of inhouse courses for the professional development of our employees and made training on DEUTZ technologies a key focus. A total of 150 inhouse seminars attended by more than 1,100 people were held.

To upgrade the skills of our shop-floor staff, we continued to work with a training provider that specialises in production management and lean management and again made good use of the seminars on occupational health and safety offered by the professional association for the wood and metal industries. In 2016, we also continued our management development activities. At the Ulm site, for example, the 'management driving licence', a modular management training course, was completed by nine managers from different departments.

A rotation programme for high-potential candidates, covering production, quality and design, has been introduced at the Zafra site for the four best engineering graduates from the University of Extremadura and the two best graduates from the dual vocational training scheme. The programme aims to give potential employees for DEUTZ Spain the training they need over a twelve-month period.

Focus on promoting health After relocating from Cologne-Deutz to Cologne-Porz in early 2016, the occupational healthcare centre started operating from its new premises. The 'Ergonomics in the workplace' project continues unabated at the Cologne site. The focus was on the assembly area and the service warehouse. As part of the ERGO-DEUTZ initiative, 340 workstations in Ulm were ergonomically assessed, improvements made where necessary and employees shown how they could introduce exercises into their daily routine to alleviate the problems of sitting at a desk.

Rewards for creativity Our bonus-based ideas management system gathers creative suggestions for improvement from DEUTZ employees. Last year, more than 1,000 ideas were submitted.

CORPORATE SOCIAL RESPONSIBILITY

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

Learning about technology in the engine museum The number of visitors to the DEUTZ engine museum continues to rise. It includes exhibits on the origins and history of global motorisation and shows original machines from the early days of the engine. This all started more than 150 years ago with the founding of N.A. Otto & Cie., the predecessor of today's DEUTZ AG. The Company's history department, which is run on a voluntary basis, and the 'Friends of DEUTZ's Engine Collection' initiated joint projects with the Rhineland Regional Association, the Knowledge Foundation of the Sparkasse savings bank in Cologne/Bonn, the German Museum in Munich and the Luxembourg Science Center last year. DEUTZ also promotes a continual dialogue of ideas in order to nurture enthusiasm for technology among the general public, particularly young people.

As in previous years, DEUTZ took part in the 'Nacht der Technik' engineering and technology evening on 23 June 2016. Visitors were able to take a guided tour of our engine museum and the assembly hall at our Cologne-Porz site.

Helping young people and the unemployed into work For more than 25 years, we have been working with IN VIA – an association under the auspices of the German Caritas organisation – and the German Federal Employment Agency to provide career preparation courses for young people with learning and social difficulties. In 2015/2016, a total of 36 participants underwent basic metalwork training over a ten-month period at the DEUTZ training centre, which equipped them with a wealth of skills needed to take up a career. In 2016, 84 per cent of those who completed this training then enrolled on a vocational apprenticeship scheme, which is a relatively high proportion.

Valuable contribution from people with disabilities DEUTZ has been successfully working with NOSTRA GmbH for more than 30 years. People with disabilities work as full and equal employees at DEUTZ AG's Cologne-Kalk site, where they are responsible for the picking and packaging process for the entire range of engine spare parts. Day in, day out, they prove that people with disabilities make a valuable, economically viable contribution in the modern world of work. Today, for example, around 50 full-time employees pack engine parts and put together gasket sets and spare parts kits. Highly complex certification standards, such as DIN EN ISO 9001, have been achieved.

DEUTZ has also successfully worked in partnership with GWK, a not-for-profit organisation based in Cologne, for more than 40 years. Currently, over 110 people work for us at various sites on tasks including processing packaging and assembly orders, using machines to produce additional articles such as belt pulleys and oil level gauges and handling printing orders. The many different work steps enable the integration of employees with a variety of abilities who benefit from the continuity of the repetitive tasks.

Variety of community activities DEUTZ has been supporting the community with its 'DEUTZ fulfils your wish' Christmas initiative for a number of years. In 2016, around 120 youngsters from Kalker Kindermittagstisch wrote down their wishes on 'wish notes' and hung them on the Christmas tree so that DEUTZ employees had the chance to make their wishes come true. Kalker Kindermittagstisch serves a hot meal to the children every day and supervises them while they do their homework. Employees at the Cologne-Kalk plant also organised a donations drive as part of this community project.

Our employees demonstrated their generosity in various other ways during 2016. In the spring, apprentices at our Ulm site got involved with 'Guter Hirte' in Ulm, an organisation that looks after young single parents with small children, young people in need and child refugees without parents. And in December, employees in Ulm collected donations for 'Radio 7 Drachenkinder', a fundraiser organised by the radio station for traumatised local children who have experienced a lot of suffering as a result of illness, disability or severe setbacks in life.

DEUTZ choir reaches a milestone The 100 voices of the DEUTZ choir celebrated 70 years of singing in 2016. They marked the occasion with two gala concerts entitled 'Tales from Vienna' at the Cologne Philharmonic Hall on 25 and 26 June. Another highlight was a concert tour to Berlin, where the choir's appearances included a benefit concert at the Kaiser Wilhelm Memorial Church on 29 September. On 10 and 11 December, the choir again gave outstanding performances at its three Advent concerts in Cologne-Gürzenich, at which it was joined by the Domstadt Philharmoniker orchestra. At these concerts, donations were collected by 'Kölner Kreidekreis', which supports orphans and children who have been taken into care.

Engagement as a matter of course DEUTZ has also long been committed to diversity management: we value the diversity of our individual employees around the world – in terms of gender, origin, age, religion and disability – and we try to harness this for the success of the Company. For example, we have a clear target to increase the number of management positions within the DEUTZ Group that are occupied by women. Further information can be found in the corporate governance report on pages 129 et seq. of this annual report.

The members of the Board of Management and managers at DEUTZ AG are also fully aware of their responsibility to lead by example. They have been contributing personally to various charitable associations, trade associations, committees, trusts and other forums for many years.

ENVIRONMENT

DEUTZ upholds its responsibility for protecting the environment and preventing climate change in a variety of ways, and our environmentally friendly products and resource-efficient production methods play an important role in this regard. Our environmental management system enables us to keep track of aspects that are highly relevant to the environment, such as keeping the air clean, avoiding and correctly disposing of waste, protecting against soil and water pollution and sustainably reducing energy consumption. Furthermore, the Board of Management of DEUTZ AG set a core environmental target for 2016 of a year-on-year reduction in carbon dioxide emissions of 2 per cent per engine produced.

ENERGY MANAGEMENT SYSTEM

After successfully implementing the energy management system and obtaining certification for it in recent years, we made organisational and technological refinements to the system in 2016.

For example, the energy teams were reorganised in connection with the restructuring of the Cologne and Ulm sites and we introduced a KPI system for monitoring energy targets in the plants. Data capture was further improved by integrating mobile data entry technology into the energy monitoring system. This system provides a basis for identifying potential savings through the use of detailed analyses.

At operational level, this involved implementing the resulting measures as well as planning and implementing the energy concepts in new buildings. The energy teams' hard work enabled us to achieve annual savings of 715 MWh from a total of 20 projects.

As well as maintaining the continuous improvement process, our focus for 2017 is to raise awareness among employees in areas of production where energy consumption is high. We will also concentrate on carrying out an efficient closure of the plant in Cologne-Deutz and completing the energy concept in the new shaft centre.

DEUTZ Group: Energy consumption in our plants [1]

MWh

	2016	2015
Electricity	79,837	80,283
Natural gas	35,795	34,243
District heating	23,017	23,857
Heating oil	4,440	3,863
Diesel fuel [2]	20,144	21,335
LPG [3]	310	–

[1] Plants in the DEUTZ Group, excluding joint ventures.
[2] At 9.85 kWh/litre (mean).
[3] At 12.8 kWh/kg (mean).

ENVIRONMENTAL MANAGEMENT SYSTEM

One of the ways in which the effectiveness of DEUTZ AG's environmental management system can be seen is that key aspects, such as sustainability, are taken into consideration when workstations are being planned. The system has had its compliance with DIN EN ISO 14001 reconfirmed by the certification body DNV GL 2016.

For example, when shaft production was relocated from the Cologne-Deutz site to Cologne-Porz, the supply of coolant was centralised at the same time. This has a number of advantages in the machining of shafts. Centralised control of the system means it is no longer necessary to monitor a large number of individual machines. The useful life of the cutting fluid can now be used optimally, thereby conserving resources and reducing hazardous waste. Permanent, centralised monitoring of key parameters of the cutting fluid also ensures a high level of manufacturing quality. This is directly beneficial from both a financial and an environmental perspective. We anticipate that fluid consumption will decrease by between 5 and 10 per cent this year.

Internal environmental and energy audits, which are conducted by a team of specialists according to a defined schedule, help to ensure that the processes being audited comply with statutory requirements and that departmental targets are met. Our environmental management system also helps in this regard and its rule set is continuously updated and analysed to ascertain at an early stage whether any process changes are needed.

In 2016, DEUTZ AG began to implement the new requirements arising from the risk- and opportunity-based approach of the ISO 14001:2015 standard for environmental management. The first results, particularly the assessment of opportunities, will be examined by the external auditors in spring 2017.

Focus on reducing emissions The assessment of environmentally relevant processes has shown that the emissions from operating the engine test bays during development and production have a strong impact on our environmental footprint. To be able to better evaluate the overall impact, DEUTZ analyses total annual emissions of the greenhouse gas CO_2 as well as of the pollutants dust, nitrogen oxide and benzene.

DEUTZ Group: Annual CO_2 emissions in our plants [1]

Tonnes

	2016	2015
CO_2 emissions (Scope 1)	13,433	13,251
CO_2 emissions (Scope 2)	51,315	51,070
CO_2 emissions (Scope 3)	1,224	532
Total CO_2 emissions	65,972	64,853

Scope 1: CO_2 emissions caused by combustion in our own facilities.
Scope 2: CO_2 emissions relating to purchased energy (e.g. electricity, district heating).
Scope 3: CO_2 emissions from flying and the use of hire cars.
[1] Plants in the DEUTZ Group, excluding joint ventures.

Another analysis shows total CO_2 emissions resulting from the direct or indirect consumption of energy per engine produced during the reporting period:

DEUTZ Group: Emissions per engine in our plants[1]

Emissions per engine

	2016	2015
Carbon dioxide (kg)	470	460
Nitrogen oxide (kg)	0.22	0.128
Dust (g)	2.7	2.6
Benzene (mg)[2]	<85.0	44.8

[1] CO_2 in plants in the DEUTZ Group, excluding joint ventures. The other data relates to German plants.
[2] Measurement uncertainty is three times higher than the measured value.

There was a small year-on-year increase in carbon dioxide emissions per engine, which rose by 2.2 per cent. This means that the target of reducing carbon dioxide emissions by 2.0 per cent per engine produced was not achieved. The reason for this is that around two-thirds of the test bay emissions are attributable to research and development activities, whereas production testing only accounts for about a third. More endurance testing aimed at refining engines with large cubic capacities and improving product quality led to the increase. Ultimately, however, these tests play a part in ensuring that our future engines put fewer emissions and less CO_2 into the environment when they later go into operation. The per-engine level of other emissions (dust, nitrogen oxide and benzene) also increased in 2016 for the same reason, even though the revision rate in engine production has been successfully lowered and testing programmes have been significantly streamlined and further standardised.

The state-of-the-art, high-performance exhaust gas aftertreatment system used in the production test bays at the German sites ensures that DEUTZ remains comfortably within permitted limits and, in some cases, is very significantly below them.

FOCUS ON WATER POLLUTION CONTROL

The relocation of shaft production provided an opportunity to check that the production machines were not causing water pollution. This thorough inspection of the machines was carried out in order to pinpoint and completely eliminate any leaks from what are normally inaccessible places.

Moreover, the collection trays were designed with generous dimensions on-site by a specialist company. We invested €450 thousand in the installation of the collection trays, which play a key role in water pollution control.

All equipment that can contain or collect water pollutants and that is subject to mandatory inspection requirements is inspected at defined regular intervals by experts in order to comply with water pollution control requirements and increase technical uptime.

The risk of contaminating water courses and soil as a result of operating this equipment has been significantly reduced because we invested in renewing our machinery as part of the relocation of shaft production from Cologne-Deutz to Cologne-Porz.

SAFETY MANAGEMENT

Over the past few years, ongoing measures in the area of occupational health and safety have led to a reduction in the frequency of accidents.

However, the latest environmental KPIs show that the frequency of accidents[1] and the number of notifiable accidents per thousand employees has increased despite safer workplaces being designed and improvements made to our health and safety organisation. Accident frequency, which is the number of notifiable workplace accidents in relation to the number of hours worked, stood at 20.9 in 2016 (2015: 12.9) and was thus significantly higher than in the previous year. Similarly, the number of notifiable accidents per thousand employees increased to 27.9 (2015: 17.7). The investigations carried out after the accidents did not reveal any clear systemic reasons for the accidents so, after reviewing the risk assessments, the necessary instructions were provided to the individuals affected in most cases.

One of the ways in which the DEUTZ AG safety organisation has been improved is the provision of cross-departmental training for fire wardens. This training, which consists of both theoretical and practical parts, was run by the works fire brigade.

[1] Accident frequency: number of accidents per million hours worked (as defined by the employers' liability insurance association).

DEUTZ AG

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

BASIC PRINCIPLES AND BUSINESS PERFORMANCE OF DEUTZ AG

DEUTZ AG is the parent company of the DEUTZ Group. At home and abroad, DEUTZ AG has various direct and indirect subsidiaries and equity investments. The subsidiaries include a production facility in Spain and several companies that perform sales and service functions. The Chinese production company – DEUTZ Engine (Shandong) Co., Ltd. in Linyi, China – is currently being wound up. In 2016, the sales and service company DEUTZ (SHANGHAI) INTERNATIONAL TRADE Co., Ltd. was established in Shanghai, China. DEUTZ AG holds 100 per cent of the voting shares in this company. In total, DEUTZ AG has a direct or indirect stake in 28 companies (2015: 27 companies). DEUTZ AG is also by far the largest production company of the DEUTZ Group and provides the head-office functions for the Group. For details of DEUTZ AG's equity investments, please see the list of shareholdings on page 119 of the annual report.

Because the business performance and financial situation of DEUTZ AG are essentially the same as for the DEUTZ Group, we make reference here to the ‘Business performance in the DEUTZ Group’ section on page 29 et seq. of this combined management report.

Because of the significance of DEUTZ AG within the Group, and its heavy interdependencies with other Group companies, the Group is managed at the level of DEUTZ AG. In addition to the key performance indicators used for management at Group level, the net income of DEUTZ AG, as the relevant variable in the payment of dividends, is also an element of the management system of the Company. The internal management system for the DEUTZ Group is described on page 27 et seq. of this combined management report. The DEUTZ Group’s net income in accordance with IFRS is reconciled to DEUTZ AG’s net income in accordance with the German Commercial Code (HGB):

DEUTZ AG: Reconciliation

€ million

DEUTZ Group net income (IFRS)	**16.0**
Consolidation of equity investments	10.5
DEUTZ AG income (IFRS)	**26.5**
Material differences due to different financial reporting standards	
Recognition of development expenditure	33.0
Measurement of provisions for pensions and other post-retirement benefits	–5.0
Recognition of deferred taxes	–8.6
Other differences relating to the financial reporting standards	–0.8
DEUTZ AG net income (HGB)	**45.1**

RESULTS OF OPERATIONS

Overview of DEUTZ AG’s results of operations

€ million

	2016	2015
Revenue	**1,151.8**	**1,120.8** [1]
Cost of sales	–998.3	–978.0 [1]
Research and development costs	–45.0	–43.6
Selling and administrative expenses	–69.3	–70.3 [1]
Other operating income	37.7	38.6 [1]
Other operating expenses	–21.4	–35.9 [1]
Net investment income	4.4	5.6
Operating profit (EBIT)	**59.9**	**37.2** [1]
Interest expenses, net	–5.7	–8.2
Income taxes	–8.6	–1.7
Other taxes	–0.5	–0.5
Net income	**45.1**	**26.8**

[1] Following the initial application of the German Accounting Directive Implementation Act (BilRUG) in the annual financial statements of DEUTZ AG for the year ended 31 December 2016, the prior-year figures have been restated to improve comparability.

Revenue In 2016, the revenue generated by DEUTZ AG amounted to €1,151.8 million, an increase of 2.8 per cent compared with 2015 (€1,120.8 million). This trend was primarily due to increased demand in our largest application segments, Construction Equipment and Agricultural Machinery. In the Construction Equipment application segment, revenue rose by 8.3 per cent to €346.0 million (2015: €319.4 million). Agricultural Machinery saw an even bigger increase of 12.3 per cent to €177.0 million (2015: €157.6 million). As a result of the initial application of the German Accounting Directive Implementation Act (BilRUG) in the annual financial statements of DEUTZ AG for the year ended 31 December 2016, items amounting to €1.8 million are reported under revenue that were previously recognised under other operating income. To improve comparability, the prior-year figure has been adjusted by €2.2 million.

In terms of regions, revenue in the Asia-Pacific region rose by a substantial 17.2 per cent to €132.6 million. We also saw growth in our largest region, EMEA (Europe, Middle East and Africa), where revenue advanced by 3.1 per cent to €835.9 million. By contrast, revenue in the Americas region decreased by 5.5 per cent to €184.2 million.

Earnings performance In 2016, DEUTZ AG generated an operating profit (EBIT) of €59.9 million (2015: €37.2 million). The year-on-year increase of €22.7 million was mainly due to lower expenses resulting from the interest-rate-related adjustment to provisions for pensions and other post-retirement benefits, as well as the reversal of impairment losses recognised on our receivables from the equity investment Ad. Strüver KG. By disposing of the building lease for a plot of land that was no longer used for production purposes, Ad. Strüver KG improved its liquidity significantly, which means the receivables became recoverable again. The earnings of DEUTZ AG also benefited from the increased volume of business and lower cost of materials.

Earnings before interest, tax, depreciation and amortisation (EBITDA) at DEUTZ AG amounted to €105.6 million in 2016, compared with €93.5 million in 2015.

Cost of sales DEUTZ AG's cost of sales came to €998.3 million in 2016 (2015: €978.0 million). The year-on-year increase of €20.3 million was mainly attributable to the volume-related rise in the cost of materials. The gross margin improved from 12.7 per cent to 13.3 per cent. As the prior-year figure for revenue has been restated due to the initial application of the BilRUG, the prior-year figure for the cost of sales has also been adjusted upwards by €1.6 million in order to improve comparability. Correspondingly, selling expenses and general and administrative expenses have been reduced by €1.6 million.

Research and development costs Research and development costs rose only slightly year on year, by €1.4 million, to reach €45.0 million (2015: €43.6 million). Research and development costs largely comprised staff costs and cost of materials. Investment grants received and capitalised development expenditure were deducted. Unlike the development expenditure in the DEUTZ Group, which is recognised in accordance with IFRS requirements, the development expenditure in DEUTZ AG is recognised in accordance with HGB provisions and only expenditure relating to projects that started after initial application of the German Accounting Law Modernisation Act (BilMoG) at DEUTZ AG is capitalised.

Selling and administrative expenses Selling and administrative expenses in 2016 came to €69.3 million, a small decrease of €1.0 million compared with the previous year (2015: €70.3 million). This decrease was mainly the result of one-off transition costs in 2015 that were incurred in connection with the switch of IT service provider. When measured as a proportion of revenue, selling and administrative expenses also fell year on year, from 6.3 per cent in 2015 to 6.0 per cent in 2016. To improve comparability, the prior-year figure for selling and administrative expenses has been reduced by €1.6 million following the initial application of the BilRUG.

Other operating income Other operating income fell by €0.9 million year on year to €37.7 million (2015: €38.6 million). This decline was mainly the result of lower exchange-rate gains and the absence of the income in connection with the disposal of the shares in WEIFANG WEICHAI DEUTZ DIESEL ENGINE CO., LTD. in Weifang, China, that had been recognised in the previous year. These effects were offset by the reversal of impairment losses recognised on our receivables from the equity investment Ad. Strüver KG. As a result of the initial application of the BilRUG in the annual financial statements of DEUTZ AG for the year ended 31 December 2016, items that were previously recognised under other operating income have been reported under revenue. To improve comparability, the prior-year figure for other operating income has been adjusted by €2.2 million.

Other operating expenses Other operating expenses fell by €14.5 million year on year to €21.4 million (2015: €35.9 million). This decrease was predominantly caused by the much lower expenses relating to the interest-rate-related adjustment to provisions for pensions and other post-retirement benefits, as well as by foreign-currency transactions. The year-on-year reduction of €10.4 million in this interest-rate effect was due to using the ten-year average interest rate instead of the seven-year average interest rate to discount pension liabilities in 2016 for the first time following the implementation of new legal requirements.

As a result of the initial application of the BilRUG in the annual financial statements of DEUTZ AG, other operating expenses for 2016 include the annual addition of the difference of €2.3 million in provisions for pensions and other post-retirement benefits caused by the transition to the BilMoG. This was previously recognised under extraordinary expenses. To improve comparability, the prior-year figure has been adjusted.

Net investment income Net investment income was down on the previous year, declining by €1.2 million to €4.4 million (2015: €5.6 million). This was primarily because the prior-year figure for net investment income had been boosted by an exchange-rate gain in connection with the winding-up of the equity investment DEUTZ Engine (China) Co., Ltd. in Linyi, China.

Net interest expense Net interest expense amounted to €5.7 million in 2016 (2015: net expense of €8.2 million). This year-on-year improvement of €2.5 million was mainly attributable to reduced interest expenses for pensions and lower utilisation of credit lines.

Income taxes Income taxes came to €8.6 million in 2016 (2015: €1.7 million). Of this total, current tax expenses accounted for €6.0 million (2015: €2.7 million) and deferred tax expenses for €2.6 million (2015: deferred tax income of €1.0 million). The main reason for the rise in current tax expenses is the improvement in results of operations.

Net income Owing, in particular, to the much better level of operating profit, the net income for the reporting year increased significantly, rising by €18.3 million year on year to €45.1 million (2015: €26.8 million). At the start of 2016, we had predicted a year-on-year decrease in net income, which means we exceeded our forecast. One of the main reasons why we did better than the forecast was the reversal of impairment losses recognised on our receivables from the equity investment Ad. Strüver KG. Another reason was the change in the period, from seven years to ten years, used to determine the average interest rate for measuring pension liabilities. The contribution to earnings of €10.4 million from the positive effect arising from determination of the average interest rate cannot be distributed as a dividend.

In view of the positive level of net income, the Board of Management and Supervisory Board propose using €8.5 million of the accumulated income for the financial year to pay a dividend of €0.07 per share.

FINANCIAL POSITION

Overview of DEUTZ AG's financial position

€ million

	2016	2015
Cash flow from operating activities	50.7	88.7
Cash flow from investing activities	–44.5	–41.0
Cash flow from financing activities	–23.1	–23.9
Change in cash and cash equivalents	–16.9	23.8
Free cash flow	6.0	46.7
Cash and cash equivalents at 31 Dec	80.8	97.7

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

Financial management in the DEUTZ Group is one of the core functions of the Group, and DEUTZ AG holds responsibility for this function. The basic principles and objectives of financial management at DEUTZ AG are therefore largely the same as those of the Group, as is the funding of DEUTZ AG. In this regard, please refer to the relevant sections on page 38 et seq. of this combined management report.

Liquidity Cash flow from operating activities amounted to €50.7 million last year (2015: €88.7 million). The sharp year-on-year fall of €38.0 million was mainly due to the higher volume of current receivables from affiliated companies and the change in working capital. Whereas there had been a marked decrease in working capital in 2015, the level of working capital fell only slightly in the reporting period. Another significant reason for the fall was the rise in income tax payments.

The cash flow from investing activities in 2016 was minus €44.5 million (2015: minus €41.0 million). This change was primarily due to lower cash receipts in connection with disposals of investments. In 2015, following the winding-up of DEUTZ Engine (China) Co., Ltd., headquartered in Linyi, China, an amount of approximately €5.0 million had been withdrawn from the additional paid-in capital of the holding company, DEUTZ Engine China GmbH, and repaid to DEUTZ AG.

Cash flow used for financing activities in 2016 totalled €23.1 million (2015: €23.9 million). This decrease was primarily due to lower interest expense. As in the previous year, cash flow used for financing activities included a dividend payment to shareholders of €8.5 million.

Free cash flow decreased year on year, falling by €40.7 million to €6.0 million (2015: €46.7 million). This was due, above all, to the significant reduction in cash flow from operating activities.

Capital expenditure After deducting investment grants, DEUTZ AG's capital expenditure in 2016 amounted to a total of €52.1 million (2015: €52.9 million). As in 2015, spending primarily related to property, plant and equipment, with €41.2 million being spent on these assets after deducting grants (2015: €42.2 million). The investing activities relating to property, plant and equipment focused on the construction of the shaft centre in Cologne-Porz, where production was progressively ramped up from mid-2016 onward. There were also additions in connection with replacement investments in machinery and tools. Capital expenditure on development projects totalled €7.5 million (2015: €6.1 million) and mainly related to the development of the new TCD 2.2 and TCD 5.0 engine series.

NET ASSETS

Overview of DEUTZ AG's net assets

€ million

	31 Dec 2016	31 Dec 2015
Non-current assets	494.4	493.4
Current assets	410.1	408.0
Prepaid expenses	1.6	1.8
Deferred tax assets	83.7	86.3
Total assets	**989.8**	**989.5**
Equity	508.8	472.2
Provisions	254.3	269.4
Liabilities	226.2	247.5
Deferred income	0.5	0.4
Total equity and liabilities	**989.8**	**989.5**
Working capital (€ million)	63.2	67.7
Working capital ratio (31 Dec, %)	5.5	6.1
Equity ratio (%)	51.4	47.7

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

Non-current assets Non-current assets at 31 December 2016 amounted to €494.4 million (31 December 2015: €493.4 million). The small year-on-year increase was primarily the result of the higher volume of internally generated intangible assets. Unlike the development expenditure recognised in the consolidated financial statements in accordance with IFRS, development expenditure in DEUTZ AG's annual financial statements is only capitalised if it relates to projects that began after the initial application of the BilMoG at DEUTZ AG. For this reason, only development expenditure on new engine projects that are still at the development stage is capitalised. As these development projects cannot yet be depreciated or amortised, the additions were not offset by depreciation or amortisation.

Current assets As at 31 December 2016, current assets amounted to €410.1 million. This increase of €2.1 million compared with twelve months earlier (31 December 2015: €408.0 million) mostly resulted from the higher volume of receivables from affiliated companies and other assets as at 31 December 2016. Decreases in inventories and in cash and cash equivalents largely offset the overall increase in current assets.

Working capital Working capital as at 31 December 2016 was €63.2 million (31 December 2015: €67.7 million), a small year-on-year decrease of €4.5 million. The main factor in this reduction was the lower level of raw materials and consumables and of bought-in parts at the end of 2016. Consequently, trade payables also declined. Trade receivables fell only slightly. The working capital ratio decreased to 5.5 per cent as at the balance sheet date[1] (31 December 2015: 6.1 per cent) owing to the reduction in working capital coupled with the increased volume of business.

Deferred tax assets Deferred tax assets contracted by €2.6 million year on year to €83.7 million (31 December 2015: €86.3 million). This reduction arose, in particular, from temporary differences between the carrying amounts in the tax accounts and in the financial statements under HGB for internally generated intangible assets. Whereas development expenditure is capitalised in the financial statements under HGB, this is prohibited in the tax accounts. The resulting deferred tax liabilities were offset against deferred tax assets as far as possible.

Equity ratio Owing to the positive level of net income, equity advanced by €36.6 million to €508.8 million (31 December 2015: €472.2 million). The rise was partly offset by the distribution of a dividend to the shareholders of DEUTZ AG of €8.5 million for 2015. The equity ratio increased slightly to reach 51.4 per cent (31 December 2015: 47.7 per cent).

Provisions At 31 December 2016, provisions stood at €254.3 million (31 December 2015: €269.4 million). This year-on-year decrease of €15.1 million was primarily attributable to the reduction in provisions for potential warranty claims in the future, as well as to lower provisions for pensions and other post-retirement benefits and lower provisions for income taxes.

Liabilities As at 31 December 2016, liabilities had fallen by €21.3 million to €226.2 million (31 December 2015: €247.5 million). The main factor here was the decline in liabilities to banks, which were scaled back as planned. Moreover, there was a year-on-year decrease in trade payables as at the balance sheet date due to a reduction in orders of raw materials and consumables.

EMPLOYEES

As at 31 December 2016, a total of 2,864 people were employed by DEUTZ AG. This meant that the number of employees had fallen by 79 year on year (31 December 2015: 2,943 employees). We also had a further 159 people on temporary employment contracts as at 31 December 2016, compared with 124 a year earlier. Employing temporary workers enables us to respond flexibly to any fluctuations in demand.

[1] Working capital ratio as at the balance sheet date: ratio of working capital (inventories plus trade receivables less trade payables) at the end of the reporting period to revenue for the preceding twelve months.

Looking at it by segment, DEUTZ Compact Engines employed 2,383 people as at 31 December 2016, 71 fewer than it had employed a year earlier. The number of employees at DEUTZ Customised Solutions was 481, which was eight fewer year on year.

OPPORTUNITY AND RISK REPORT

DEUTZ AG is integrated into the risk management system of the DEUTZ Group. As a head-office function, risk management for the Group is performed by DEUTZ AG. Information about the structuring and mechanics of the risk management system and of risk management with regard to financial instruments can be found in our notes on pages 57 et seq.

Because DEUTZ AG is closely integrated with the other Group companies, its risk and opportunities situation is essentially the same as that of the Group. Risks arising from subsidiaries may have an effect on DEUTZ AG because of the carrying amount of an equity investment, reduced dividend payments and the internal business relations. The risks and opportunities associated with the DEUTZ Group are described on pages 57 to 61 of this combined management report.

Information about DEUTZ AG's internal accounting-related control system and about risk management with regard to the use of financial instruments at DEUTZ AG can be found on page 60 et seq. of this combined management report.

OUTLOOK

DEUTZ AG performs the head-office functions of the DEUTZ Group and is the biggest production company within the Group by some margin. Because of DEUTZ AG's wide-ranging relationships with other Group companies and because of its size within the Group, the expectations presented in the Group outlook for 2017 are essentially the same as those for DEUTZ AG. We therefore anticipate that the revenue of DEUTZ AG will develop largely in line with the statements made for the DEUTZ Group. As the one-off effect resulting from the reversal of the impairment losses recognised on our receivables from Ad. Strüver KG in the reporting year will not be repeated, we expect net income in 2017 to be slightly lower than in 2016. Moreover DEUTZ AG's Board of Management decided in February 2017 to examine whether the Cologne-Deutz site can be sold quickly on attractive terms and has authorised the initiation of negotiations on selling the site. If the outcome of these negotiations is positive, DEUTZ AG may be able to generate a substantial one-off gain within a short period of time – and possibly recognise some of this gain in 2017 – depending on the specific contractual arrangements. Further information can be found in the outlook for the DEUTZ Group on pages 61 to 63.

CORPORATE GOVERNANCE DECLARATION PURSUANT TO SECTION 289A HGB

The corporate governance declaration pursuant to section 289a HGB is an integral element of the combined management report. We refer here to our remarks on pages 129 to 134 of the annual report.

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

Composition of the issued capital There were no changes to the issued capital (share capital) of DEUTZ AG in 2016. As at 31 December 2016, the issued capital amounted to €308,978,241.98 and was divided into 120,861,783 no-par-value bearer shares.

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

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

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

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

As far as the appointment and removal of members of the Board of Management are concerned, sections 84 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 and 133 AktG also apply in the case of changes to the Statutes.

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

The Board of Management is currently not authorised to issue or buy back shares.

FURTHER DISCLOSURES

No bearers of shares have any special rights conferring authority to control the Company.

Numerous employees have direct shareholdings in DEUTZ AG. There are no restrictions affecting the direct exercise of rights of control in connection with these shares.

A consortium of banks has provided DEUTZ AG with a syndicated, revolving cash credit line of €160 million. DEUTZ AG also took out a loan with the European Investment Bank that has a remaining balance of €54.0 million. Under the terms of the loan agreements, the lenders can demand that the outstanding loan be repaid within a specified period in the event of a change of control, i.e. one or more people acting jointly acquire a direct or indirect shareholding of at least 50 per cent of all shares and/or voting rights in DEUTZ AG.

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

The service contracts of the Board of Management members Dr Ing Helmut Leube (a member and the Chairman of the Board of Management until 31 December 2016), Dr Frank Hiller (a member and the Chairman of the Board of Management from 1 January 2017) and Dr Margarete Haase stipulate the following provision in the event of a change of control: if their appointment (1) is revoked within nine months of the change of control or (2) ends within nine months of a change to the legal form of DEUTZ AG and subject to certain other requirements, they will receive 150 per cent of the severance cap pursuant to article 4.2.3 of the German Corporate Governance Code. As set out in the service contracts, a change of control is deemed to occur when one or more other people or other companies acting jointly within the meaning of section 30 of the German Securities Acquisition and Takeover Act (WpÜG) acquire(s) 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 (in the case of Dr Hiller) the current major shareholder, AB Volvo, acquires more than 30 per cent of the voting rights in the Company alone or with others, or if (in the case of Dr Leube and Dr Haase) the current major shareholder, AB Volvo, or the former major shareholder, the Same DEUTZ-FAHR Group, acquires more than 30 per cent of the voting rights in the Company.

The long-term incentive plans (LTI), under which the most senior managers in the DEUTZ Group (executives and managing directors of major subsidiaries) are granted virtual options that they can exercise after a vesting period and upon achievement of certain performance targets (see pages 113 et seq. of this annual report), contain the following provision in the event of an entity – either alone or acting jointly with an affiliated company – acquiring a minimum of 50 per cent of the shares in DEUTZ AG: provided one of the performance targets has been achieved, the LTI participants may exercise their options within a short time frame after the acquisition, even if the vesting period has not yet expired.

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

EXPLANATORY STATEMENT BY THE BOARD OF MANAGEMENT IN CONNECTION WITH SECTIONS 289 (4) AND 315 (4) HGB

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

REMUNERATION REPORT

REMUNERATION OF THE BOARD OF MANAGEMENT

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

The calculation of the annual bonus is based on the degree of attainment of annual performance targets (short-term targets). The number, content and weighting of the short-term targets are set annually by the Supervisory Board at its due discretion after consulting with the respective Board of Management member. The minimum level of target attainment for the payment of a bonus is 75 per cent; the maximum level of target attainment relevant to the payment of the bonus is 150 per cent. The highest amount that can be paid as a bonus in the case of maximum target attainment is determined by the respective service contract. Only 60 per cent of the annual bonus is paid out at the end of the year. The rest of the bonus is paid out in two equal instalments of 20 per cent, subject to the attainment of further medium-term financial targets (medium-term targets), at the end of a further one year and two years, whereby the amount that is paid out is based on the level of attainment of these medium-term targets (to a maximum of 150 per cent). The highest permissible amounts for these further payments are also contractually agreed.

The targets for all payments are set at the beginning of the year for which the bonus is to be paid.

Details regarding the virtual performance shares are set forth in a long-term incentive plan for the Board of Management (LTI plan BoM), which forms part of the contractual agreements with the Board of Management members. The number of virtual performance shares allocated to a Board of Management member is calculated each year on the basis of the contractually specified euro amount divided by a reference price. The reference price is the average closing price of DEUTZ AG shares in Xetra trading (or a comparable successor system) on the Frankfurt Stock Exchange during the 60 trading days preceding the grant date. Virtual performance shares represent an entitlement to payment of a cash amount in accordance with the provisions of the LTI plan BoM. The cash amount per virtual performance share corresponds to the average closing price of DEUTZ shares in Xetra trading (or a comparable successor system) on the Frankfurt Stock Exchange during the last 60 trading days prior to the expiry of a vesting period of four years after the grant date, and is limited to a maximum of 1.5 times the reference price. Entitlement to the cash payment only arises, however, if either the market price of DEUTZ shares has increased by at least 30 per cent relative to the reference price or the market price of DEUTZ shares has outperformed the MDAX (or a future index replacing the MDAX) by at least 10 percentage points during the vesting period. A further requirement is that the Board of Management member makes a personal investment by holding one DEUTZ share for every 20 virtual performance shares received.

The variable remuneration is designed in a way that the majority of it is measured against performance over several years. The overall remuneration structure is designed to support the sustainable growth of the Company.

Additional benefits received by the members of the Board of Management include, in particular, a company car and allowances towards insurance policies.

Benefits granted

€ thousand

	Dr Ing Helmut Leube **Chairman of the Board of Management** Retired on 31 December 2016			
	2015	**2016**	2016 (min)	2016 (max)
Fixed remuneration	725	725	725	725
Additional benefits [1]	175	173	173	173
Total	**900**	**898**	**898**	**898**
One-year variable remuneration [2]	360	360	–	540
Multi-year variable remuneration				
2016–2017 deferral	240	–	–	–
2017–2018 deferral	–	240	–	360
LTI 2015–2019 [3]	222	–	–	–
LTI 2016–2020 [3]	–	207	–	300
Total	**822**	**807**	**–**	**1,200**
Total remuneration	**1,722**	**1,705**	**898**	**2,098**

Instead of the target values for one-year variable remuneration and for deferrals from one-year variable remuneration required under the German Corporate Governance Code (DCGK), the figures in the table below for total remuneration indicate the remuneration figures that are required to be disclosed under the applicable accounting standards. For the one-year variable remuneration, these represent the provision for the annual bonus for 2016, adjusted for any over- or under-allocation in the previous year. With regard to the deferrals from the one-year variable remuneration, the figures represent the amounts vested and recognised in provisions in 2016.

One-year variable remuneration	227	–		
2014–2015 deferral	26	–		
2015–2016 deferral	23	–		
Total remuneration	**1,398**	**1,105**		

[1] Includes payment into a life insurance policy.

[2] The figures given for one-year variable remuneration and for deferrals from one-year variable remuneration represent the amount granted for full achievement of targets.

[3] Share-based remuneration represents the fair value of the options on the date of grant. In 2016, the Board of Management members were granted a total of 147,577 options (2015: 125,657 options). Of this total, 58,446 options were granted to Dr Leube (2015: 52,357 options), 43,835 options to Dr Haase (2015: 39,268 options) and 45,296 options to Mr Wellenzohn (2015: 34,032 options). Please refer to Note 31 in the consolidated financial statements for a description of the structure of the share-based remuneration agreements. General contractual conditions are identical for all members of the Board of Management.

If the employment contract of a member of the Board of Management is terminated prematurely without good cause, the member of the Board of Management receives a severance payment equivalent to the total remuneration for the period until the original termination date of his or her contract of employment up to a maximum of two years. For the purpose of this severance payment, the amount of total remuneration is determined by the total remuneration paid for the last full financial year, or the anticipated total remuneration for the then current financial year, if appropriate (cap on severance pay in accordance with article 4.2.3 of the German Corporate Governance Code).

In connection with the premature termination of his Board of Management contract with effect from 31 December 2016, Dr Leube was granted a severance payment of €1,743 thousand in 2016. The severance payment reflects the total amount of remuneration that he would have received for the original remaining term of the contract. It includes performance-based components of €803 thousand and was paid in full in 2016. In accordance with Dr Leube's contract, an amount of €150 thousand was also paid into a benevolent fund in respect of 2017 on his behalf.

The service contracts of the Board of Management members Dr Ing Helmut Leube and Dr Margarete Haase stipulate a special provision in the event of a change of control. Further details can be found in the section 'Disclosures pursuant to sections 289 (4) and 315 (4) HGB' on page 52 et seq.

The table below presents the total remuneration of the Board of Management in accordance with the recommendation in the German Corporate Governance Code dated 5 May 2015. In line with this recommendation, the benefits granted in 2016 and those actually paid are reported separately.

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

Dr Margarete Haase				Michael Wellenzohn			
2015	**2016**	2016 (min)	2016 (max)	2015	**2016**	2016 (min)	2016 (max)
580	580	580	580	420	520	520	520
147	146	146	146	111	109	109	109
727	**726**	**726**	**726**	**531**	**629**	**629**	**629**
270	270	–	405	210	255	–	383
180	–	–	–	140	–	–	–
–	180	–	270	–	170	–	255
166	–	–	–	144	–	–	–
–	155	–	225	–	160	–	233
616	**605**	**–**	**900**	**494**	**585**	**–**	**870**
1,343	**1,331**	**726**	**1,626**	**1,025**	**1,214**	**629**	**1,499**
138	242			107	188		
20	–			13	–		
17	18			14	14		
1,068	**1,141**			**809**	**991**		

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

Benefits paid

€ thousand

	Dr Ing Helmut Leube Chairman of the Board of Management		Dr Margarete Haase		Michael Wellenzohn	
	2016	2015	**2016**	2015	**2016**	2015
Fixed remuneration	725	725	580	580	520	420
Additional benefits	173	175	146	147	109	111
Total	**898**	**900**	**726**	**727**	**629**	**531**
One-year variable remuneration	–	227	–	138	–	107
Multi-year variable remuneration						
2014–2015 deferral	28	60	21	45	13	29
2015–2016 deferral	23	–	17	–	14	–
Other	–	–	–	–	–	–
Total	**51**	**287**	**38**	**183**	**27**	**136**
Total remuneration	**949**	**1,187**	**764**	**910**	**656**	**667**

The total expense for share-based payments recognised in the reporting year amounted to €367 thousand for Dr Leube (2015: €92 thousand), €275 thousand for Dr Haase (2015: €90 thousand) and €242 thousand for Mr Wellenzohn (2015: €73 thousand).

REMUNERATION OF THE SUPERVISORY BOARD

The remuneration paid to the Supervisory Board is specified in article 15 of the Company's Statutes. This stipulates that the members of the Supervisory Board of DEUTZ AG receive fixed annual remuneration of €22,500. They also receive a fee of €2,500 for each Supervisory Board meeting they attend and are reimbursed for their out-of-pocket expenses. The chairman of the Supervisory Board receives double these amounts, and his deputy one-and-a-half times.

In addition, each member of a Supervisory Board committee receives an attendance fee of €2,500 for each committee meeting attended. The chairman of a committee is entitled to twice this sum, his deputy to one-and-a-half times the amount.

In addition, DEUTZ reimburses the members of the Supervisory Board for any VAT they incur in connection with the performance of their mandate.

The following table shows the breakdown of total remuneration paid to members of the Supervisory Board for their work as Supervisory Board members:

	Fixed remuneration	Attendance fees	**Total**
€			
Hans-Georg Härter Chairman	45,000	80,000	**125,000**
Werner Scherer Deputy Chairman	33,750	67,500	**101,250**
Sabine Beutert	22,500	22,500	**45,000**
Hans-Peter Finken	22,500	12,500	**35,000**
Gisela Füssel (from 1 June 2016)	13,156	10,000	**23,156**
Dr Ing Hermann Garbers	22,500	12,500	**35,000**
Göran Gummeson	22,500	12,500	**35,000**
Leif Peter Karlsten	22,500	12,500	**35,000**
Herbert Kauffmann	22,500	55,000	**77,500**
Alois Ludwig	22,500	12,500	**35,000**
Dietmar Paust (until 31 May 2016)	9,344	2,500	**11,844**
Dr Witich Roßmann	22,500	12,500	**35,000**
Dr Herbert Vossel	22,500	12,500	**35,000**
Total	**303,750**	**325,000**	**628,750**

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 opportunities, but also gives rise to business-specific risks.

Our objective is to generate profits on a sustained basis and to increase these profits significantly over the medium and long term in order to develop the Company and secure its future. It is therefore critically important to identify and assess business risks at an early stage and take corrective action where required. DEUTZ has an appropriate risk management system to ensure it can meet this requirement.

Such a system heightens employees' sense of responsibility and raises their awareness of potential or existing risks. It also helps everyone involved to identify, analyse and communicate risks in good time and to initiate effective corrective action.

The basic principles, monitoring standards, personnel responsibilities, functions and procedures in the risk management system have been defined by the Board of Management of DEUTZ AG and summarised in a manual that is continually updated. A systematic reporting structure provides the basis for the work of the Risk Management Committee and ensures that all major risks are documented and communicated, and that appropriate corrective action is taken and documented at an early stage.

The DEUTZ Group conducts risk inventories four times a year. These risk inventories are carried out in all functions and areas of the Company and in the main affiliated companies to identify whether new risks have arisen compared with the Company's short-term and medium-term planning. The risks are categorised by importance, based on estimated probability of occurrence and potential impact. At the same time, a review is carried out to establish whether and how action that has been agreed and implemented has successfully minimised the known risks or whether there is still a need for further action. The Risk Management Committee then analyses the risks and the progress of the action that is being taken and reports to the Board of Management on the results of the risk inventory. To enable the Company to respond promptly at all times to any possible risks that may arise, risk officers and their employees are under an obligation to submit immediate reports on any new material risks or if there is an increase in the threat from known risks. These reports are to be separate from the regular reporting requirements. The risk management system does not identify opportunities, only risks.

Each year, the Group internal audit department and the independent auditors carry out an audit of DEUTZ AG's system for the early identification of risks pursuant to section 91 (2) AktG to assess whether the system is functioning efficiently. Suggestions for improvements proposed by the internal audit department, the Risk Management Committee or the auditors are promptly implemented by DEUTZ.

RISK MANAGEMENT IN RELATION TO FINANCIAL INSTRUMENTS

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

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

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

The Finance Committee, which meets every quarter, or on an ad-hoc basis as required, provides a forum at which operational issues relating to risk management and other financially relevant decisions are discussed. The Finance Committee consists of the relevant member of the Board of Management plus representatives of the treasury and finance departments.

The objective of risk management is to mitigate fluctuations in profits and cash flows caused by volatility in commodity, interest-rate and foreign-exchange markets. Derivative financial instruments are used only for hedging purposes, i.e. only in connection with corresponding underlying transactions arising from the Group's ordinary business activities or financial transactions that have a countervailing risk profile to that of the hedging transaction. The nature and scope of the hedged items are specified in a binding financing directive.

DEUTZ works exclusively with leading banks in order to minimise counterparty risk.

The treasury department manages the lines of credit in accordance with the Group's financing principles. Subsidiaries are funded primarily by DEUTZ Group loans.

We manage the financial risk as follows:

Risk from bad debts We protect ourselves against the risk of bad debts by constantly monitoring our situation through electronic and other means and by regularly analysing receivables and their breakdown. The Company takes out credit insurance to cover a large proportion of its receivables where payment for goods has not been received in advance or is not covered by a letter of credit.

Currency risk arising from operating activities Currency risk, primarily in US dollars, which arises as a result of transactions with third parties denominated in foreign currency, is monitored by means of a central currency management system and mitigated by the use of derivative financial instruments. The DEUTZ Group's net currency exposure is normally hedged by forwards equivalent to 50 to 80 per cent of open items. DEUTZ is also taking specific action to increase the volume of purchasing in US dollars; this enables the Company to counteract exchange-rate risks from sales invoiced in US dollars by way of natural hedging.

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

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

Further information on financial risk management can be found in Note 26 on page 100 et seq.

RISK ASSESSMENT

The assessment of risks in the DEUTZ Group is based on the estimated probability of occurrence in conjunction with the potential impact of the risk on the business objectives. In the following risk report for the DEUTZ Group, the risks are categorised as either 'low', 'moderate' or 'high'. Risks that have been classified as 'low' would be expected to have a low impact of up to €10 million on financial position and financial performance. Risks classified as 'moderate', however, would have a significant impact (between €10 million and €50 million) and risks classified as 'high' would have a major impact of over €50 million on financial position and financial performance. Risks to the Company's survival as a going concern are described as such.

DEUTZ Group: Risk assessment

Probability of occurrence (%)	minor	moderate	significant	critical	very critical
80–99	low	moderate	moderate	high	high
60–79	low	moderate	moderate	high	high
40–59	low	moderate	moderate	moderate	high
20–39	low	low	moderate	moderate	moderate
1–19	low	low	low	moderate	moderate

Impact

RISK

As with the internal risk report, the following presentation of the current risk situation is focused on the risk factors that are important for the DEUTZ Group. Consequently, risks that are referred to were categorised at least as 'low' before measures to counter the risk were taken into account. In contrast to the internal risk management, the risks in the following description are more strongly aggregated and are listed by risk category. Unless otherwise stated, the risks refer to 2017 and relate to both the DCE and DCS segments.

EXTERNAL RISK

Market risk We operate in sales markets that are characterised by particular sensitivity to cyclical influences. Currently, they are also showing increasing protectionist tendencies. This can have a negative impact on the financial position and financial performance of the DEUTZ Group. As well as having a direct effect on unit sales and revenue, this may also impact negatively on the value of the assets on our balance sheet. We operate in very cyclical markets in our main application segments, Construction Equipment and Material Handling, and in our principal sales regions of Germany, western Europe and

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

In the medium and long term, we seek to mitigate regional and application-related sales risks by aligning our development activities with our product strategy and by entering into alliances. Close alliances with our key customers are of considerable importance in enabling us to achieve these sales targets, although there is a risk of becoming dependent on them in the long term. We therefore pursue a strategy of signing up new customers and progressively expanding our business with them. These business development activities are particularly focused on Asia.

We are very well diversified and well positioned for the future in terms of the geographical and sectoral distribution of our customers. We supply the market-leading manufacturers in the various application segments. Despite the countermeasures that are in place, we cannot completely control the external risks. In view of the measures in place, we continue to categorise the market risk as ‘moderate’ in respect of the achievement of our corporate targets for 2017 because the economic situation in our sales markets remains volatile.

By contrast, the United Kingdom's upcoming departure from the European Union does not constitute a material external risk because our volume of business in the country is comparatively low.

STRATEGIC RISK

Our business strategy is focused on expanding our customer and product base and on further globalisation and internationalisation. This strategy presents the DEUTZ Group with numerous opportunities but is, of course, also associated with risks. Target markets might not grow as anticipated, while new product developments may not be as well received by customers as predicted or may not be able to compete with rival products.

We attempt to mitigate these risks by precisely analysing trends in our markets and by taking into account external market research. For example, our analysis of the future viability of diesel technology confirms that it will continue to play a major role in our application segments over the long term. We also enter into close alliances with our major customers in the target markets. Finally, we closely monitor our strategic projects so that we are able to respond immediately to changes.

In view of the measures in place, we categorise the strategic risks with regard to the attainment of our financial targets as ‘low' in 2017 and as 'moderate’ in the medium term.

OPERATIONAL RISK

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

We have set up local quality departments to ensure quality in all plants and relevant areas of the Group. These departments systematically analyse sources of errors and defects, optimise production processes, take action to minimise the risk in production start-ups and reduce warranty risks. A central quality management organisation ensures that standardised processes and methods are in place and carries out regular audits. In addition, DEUTZ has defined uniform standards for the selection of suppliers and, in close cooperation with the suppliers, continuously improves the quality of supplied parts.

Regular certification audits and additional quality initiatives also enable us to handle the significant technical complexity of engines and to satisfy the steadily increasing quality requirements of our customers. In 2016, for example, we introduced the zero-error strategy. The idea of this quality assurance programme is to detect errors before they actually occur. And where errors do occur, we have to learn from them quickly in order to not repeat them.

Sufficient provisions are recognised on the balance sheet to account for warranty risks. In view of the precautionary measures that have been taken, we categorise any further quality risks that could negatively impact on our financial targets as ‘low’ for 2017.

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

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

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

OTHER RISKS

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

As well as the loss of confidential information, it is conceivable that forged documents could be used to siphon off capital without authorisation. Cyber risks such as these could have a negative impact on our market position and limit our financial flexibility. This might ultimately harm our reputation.

We have put a series of measures in place to protect against cyber risks. As well as regular security training for employees, these include security measures for computer hardware and IT security guidelines that have been laid down by management. In view of the precautions that have been taken, we continue to categorise these risks as 'low'.

Legal risks As a Group with multinational operations, DEUTZ is subject to a variety of regulations under tax, competition and patent law as well as to other legal and statutory requirements. Existing and potential legal disputes are recorded and analysed on an ongoing basis at DEUTZ; they are assessed in terms of their legal and financial impact and an appropriate amount is recognised in the risk provisions in the accounts. The outcome of legal disputes is uncertain, however. This means that there are further risks, not accounted for through provisions on the balance sheet, that could negatively impact on our financial targets.

Groupwide standards such as the general terms and conditions of business, sample contracts for various uses and implementation provisions in the form of organisational guidelines are refined on an ongoing basis and reduce the level of new legal risks at DEUTZ. The legal affairs department and external lawyers are also regularly consulted about projects and the finalisation of contracts that fall outside the scope of the standards developed for day-to-day business. Given the positive overall progress in ongoing cases and in view of the measures that have been taken either to avoid or minimise risk, we now categorise the legal risk as only 'low'.

OVERALL ASSESSMENT OF THE RISK SITUATION

We identify and evaluate material risks on an ongoing basis using our risk management system. Appropriate action is taken to manage these risks and, as far as possible, bring them under control. Changes in material risks are monitored regularly at Group level. Currently, the DEUTZ Group has not identified any risks that either individually or in their totality could jeopardise the continued existence of the enterprise as a going concern. Legal and short-term strategic risks decreased in comparison with 2015. Other risk factors changed only marginally year on year. Consequently, the overall risk level fell slightly compared with 2015. Because of the precautions that have been taken and our position in the market, we are confident in our ability to successfully manage the existing risks and overcome the resulting challenges – despite conditions remaining difficult.

ACCOUNTING-RELATED INTERNAL CONTROL SYSTEM

The risk management system forms part of, and is closely linked to, the internal control system. Whereas the risk management system focuses on the identification, analysis, assessment, communication and management of risk, the internal control system (ICS) brings together activities aimed at avoiding or limiting risk.

The Board of Management is responsible for setting up, monitoring, refining and ensuring the effectiveness of the ICS. Even a properly structured ICS is unable to provide absolute security; it can only provide a relative amount of security in helping to achieve targets and/or avoid material misstatements.

The aim of the internal accounting-related control system is to ensure that accounting is carried out consistently and in accordance with statutory requirements, generally accepted accounting principles and internal guidelines. The accounting process itself includes those operating processes that provide the value flows for financial reporting, the process for preparing the consolidated financial statements, and all information sources and processes from which the significant disclosures in the consolidated financial statements are derived.

In order to ensure that the consolidated financial statements are properly and consistently prepared, the Group adheres to the fundamental principles of separation of functions, having work checked by a second member of staff and IT access restrictions to prevent unauthorised access to relevant data. There are written procedural instructions and, in particular, Group accounting guidelines that are regularly updated at head office and communicated throughout the Group. Each reporting entity is responsible for compliance with the guidelines, and the data reported to DEUTZ's Group accounting department is validated on an ongoing basis during the preparation of monthly financial statements. Data is reported to the Group head office using a standard reporting tool that has been implemented throughout the Group. Additional control mechanisms covering the risks in the main processes, thereby guaranteeing a reliable accounting and reporting system, are normally set up locally at departmental level. Where necessary, we also use external service providers, such as independent assessors of pension liabilities. The Group accounting department ensures that these requirements are adhered to across the Group.

Information relevant to accounting is shared on an ongoing basis with the Head of Finance, Accounting and Compliance and passed on to the Chief Financial Officer in regular meetings.

Besides discussing the single-entity and consolidated financial statements, the Audit Committee set up by the Supervisory Board regularly discusses the quarterly financial reporting. In addition, the Audit Committee's monitoring function includes the ICS set up by the Board of Management as well as the accounting process itself.

The internal audit department prepares a risk-based audit plan and verifies whether the statutory regulations and the DEUTZ Group's internal guidelines for its entire control and risk management system are being complied with. As part of its monitoring function it reviews whether the defined controls are functioning effectively. The findings of these reviews are reported directly to the Board of Management and allow us to eliminate any deficiencies that have been identified and ensure that the ICS is continually refined.

OPPORTUNITIES REPORT

In the fast-paced, dynamic markets in which the DEUTZ Group operates, there are, in addition to the aforementioned risk factors that can negatively impact on the attainment of the business objectives, also opportunities that can have a positive effect on the business objectives of the Group for 2017 and beyond. Identifying and harnessing these opportunities is the responsibility of the individual operating segments of the Group. Unlike risks, opportunities are not collated and assessed centrally.

Unless otherwise stated, the opportunities described below refer to 2017 and relate to the DCE and DCS segments.

Economic situation in relevant markets Developments in the global economy have a major effect on the financial position and financial performance of the DEUTZ Group. If our expectations regarding the macroeconomic situation in our most important markets of Europe, the USA and Asia are exceeded, and in view of the measures we have already taken to boost efficiency (particularly the optimisation of our network of sites in Germany), we may perform significantly better than we predicted.

Research and development Increasingly stringent emissions standards and general technological progress are placing huge demands on our entire industry. We are one of the innovation leaders and have a very strong competitive position thanks to our proven expertise, our many years of experience and our efficient processes in the research and development of diesel engines and other drive systems. The development of gas engines with a capacity of up to 4 litres and the expansion of our portfolio of products with a capacity of over 4 litres will enable us to reinforce this strong competitive position.

Production and quality The digital transformation of manufacturing, referred to as Industry 4.0, is exploring new approaches to production. The first projects in the service business are due to start soon. In combination with projects to improve quality and the introduction of the zero-error strategy, this may lead to substantial efficiency increases and greater customer satisfaction in the short to medium term.

OUTLOOK

ECONOMIC FORECASTS REMAIN UNCERTAIN

The International Monetary Fund (IMF)[1)] has confirmed its forecasts for the next few years, anticipating a stronger rate of growth in industrialised countries as well as in developing countries and emerging markets. Following growth of 3.1 per cent in 2016, the IMF predicts that the global economy will expand by 3.4 per cent in 2017 and by 3.6 per cent in 2018.

The economy of the eurozone is likely to generate growth of 1.6 per cent, compared with 1.7 per cent last year. Germany's growth rate will probably be slightly lower, remaining unchanged at 1.5 per cent. The US economy is expected to receive further stimulus, growing at a rate of 2.3 per cent in 2017 and 2.5 per cent in 2018, compared with 1.6 per cent in 2016. The IMF also anticipates slower growth rates for China: having risen by 6.7 per cent last year, GDP is predicted to rise by 6.5 per cent in 2017 and 6.0 per cent in 2018.

1) IMF World Economic Outlook Update, January 2017.

The business climate index[1] published by the ifo Institute of Economic Research, which covers trade and industry in Germany, dropped from 111.0 points to 109.8 points in January 2017. Although companies were more satisfied with their current business position, they were feeling slightly less optimistic about the coming months. The ISM purchasing managers' index[2] in the USA made a surprising jump to 56.0 points as at 1 February 2017 – its highest level since November 2014.

DIESEL ENGINES MARKET

For construction equipment in 2017, we anticipate that unit sales in North America will move within a range of –5 per cent to +5 per cent while the European market will expand by between 0 per cent and 5 per cent and the Chinese market by between 5 per cent and 10 per cent. We expect growth in the material handling market to be between 0 per cent and 10 per cent in Europe, whereas the North American and Chinese markets are likely to remain within a bandwidth of –5 per cent to +5 per cent. We also predict that the agricultural machinery market in Europe will remain fairly static within a range of –5 per cent to +5 per cent. In China, we expect the light and medium-duty truck sector to generate slight growth of between 0 per cent and 5 per cent.

As a rule, the diesel engines market largely follows the applications and markets of the machinery and equipment in which the engines are installed.

UNIT SALES, REVENUE

Although, as already said, we anticipate that the market will stagnate, or perhaps grow slightly, we can already see early signs of a potential improvement in the market. Last year, many of our European customers largely used up the inventories that they had built up in 2014 in anticipation of the new emissions standard. This provides a very strong base effect for us. Production for a number of projects with new customers is still being ramped up, which should also have a beneficial impact. We believe the service business's revenue will continue to go up.

Owing to the increasing proportion of higher-value engines to meet the new emissions standards in Europe and America, the value of the diesel engines market will continue to increase at a faster rate than its unit sales.

We therefore anticipate a marked rise in revenue overall. The increase in revenue will be fuelled by the DCE segment, whereas we expect the DCS segment's revenue to decrease slightly. This is because the effects of the advance production of engines for the new emissions standard and the projects with new customers are predominantly in the DCE segment. 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.

EARNINGS

We expect the EBIT margin before exceptional items to increase moderately. The margin will be boosted, above all, by better capacity utilisation and the positive effects of optimising our network of sites. However, unlike in 2016, we do not anticipate any licensing income this year. From this year, we reckon on annual efficiency gains of around €10 million from the optimisation of our network of sites, primarily in connection with the new shaft centre, the relocation of Xchange assembly activities to Ulm and the absence of costs from the Cologne-Deutz site. We already realised about half of this gain in 2016. We expect earnings to rise in both the DCE and the DCS segment.

Furthermore, we anticipate positive exceptional items from property transactions in the near future. Firstly, in 2016 we disposed of a building lease for a plot of land of our equity investment Ad. Strüver KG (GmbH & Co.), Hamburg, that was no longer being used for production purposes; this will result in a positive exceptional item of around €10 million this year. Secondly, DEUTZ AG's Board of Management decided in February 2017 to examine whether the Cologne-Deutz site, which covers an area of around 160,000 square metres and is no longer required for operational purposes following the successful optimisation of our site network, can be sold quickly on attractive terms. The Board of Management has authorised the initiation of negotiations on selling the site. If the outcome of these negotiations is positive, DEUTZ may be able to generate a substantial one-off gain within a short period of time, depending on the specific contractual arrangements. It may be possible to recognise some of this gain as early as 2017.

As a result of the anticipated slight increase in earnings – before positive exceptional items – we believe there will be a small year-on-year rise in return on capital employed (ROCE) before exceptional items in 2017.

COMMODITIES, COLLECTIVE PAY AGREEMENTS

Commodity prices We expect a further small rise in price levels in the primary markets this year, driven by slightly higher growth of the global economy.

No collective pay bargaining in 2017 The collective payment agreement from 2016 expires on 31 December 2017, and one of its key points is a 2 per cent pay increase with effect from 1 April 2017.

[1] ifo Institute of Economic Research, January 2017.
[2] ISM purchasing managers' index, February 2017.

RESEARCH AND DEVELOPMENT EXPENDITURE

We predict that research and development spending will rise to between approximately €60 million and €70 million, of which up to €15 million will be capitalised. This is because of new engine projects in relation to the upcoming EU Stage V that will lead to the expansion of our engine portfolio.

CAPITAL EXPENDITURE

We forecast that our capital expenditure in 2017 (excluding capitalisation of research and development expenditure) will be around €70 million, of which up to €15 million for the planned project with Liebherr.

JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD

The market environment in China is likely to remain challenging in 2017. We expect the revenue and earnings of our joint venture DEUTZ (Dalian) Engine Co., Ltd. to improve slightly. Its performance will depend heavily on its capacity utilisation and thus on market conditions.

WORKING CAPITAL RATIO, FREE CASH FLOW AND EQUITY RATIO

Our prediction for the working capital ratio, measured as the quarter-end average, is for a slight improvement on the figure of 17.9 per cent as at 31 December 2016. In addition, we expect positive free cash flow to be at the same level as 2016. If negotiations on the sale of the Cologne-Deutz site are successful, we forecast that free cash flow will be in the mid- to high-double-digit million euro range.

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

EMPLOYEES

Optimisation of site network The measures to optimise our network of sites remain on schedule. Following the completion of the first stage of the relocation from Übersee to Ulm in 2015, the reconditioned exchange engine business went through a process of continuous improvement during 2016. The final stage of the relocation should be completed as scheduled on June 30, 2017.

Flexible employment So that we can respond appropriately to cyclical fluctuation in our industry, we will continue to make use of fixed-term and temporary contracts, even though the terms and conditions will change significantly as a result of the new German Labour Leasing Act (AÜG).

STATUTORY REGULATIONS, EXHAUST EMISSIONS STANDARDS

Regulation (EU) 2016/1628 on the introduction of Stage V from 2019 came into force on 6 October 2016. This will largely harmonise EU and US limits on gaseous emissions in all power categories. There will also be a limit on the number of particulates emitted by diesel engines for mobile machinery in the 19 to 560 kW power output range. Our TCD engines equipped with a diesel particulate filter in the 2.9 to 7.8 litre cubic capacity range already meet this new limit. Furthermore, our 'Stage V ready' label guarantees that the entire DEUTZ TCD engine range from 2.2 to 16 litres cubic capacity will meet EU Stage V without the need for modifications to customers' equipment. No further tightening of exhaust emissions limits in the USA is currently on the horizon.

Disclaimer This management report includes certain statements about future events and developments, together with disclosures and estimates provided by the Company. Such forward-looking statements include known and unknown risks, uncertainties and other factors that may mean that the actual performances, developments and results in the Company or those in sectors important to the Company are significantly different (especially from a negative point of view) from those expressly or implicitly assumed in these statements. The Board of Management cannot therefore make any guarantees with regard to the forward-looking statements made in this management report.