

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.

¹⁾ IMF World Economic Outlook Update, January 2017.

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

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