

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 margin¹⁾ 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 WEICHA DEUTZ DIESEL ENGINE CO., LTD., Weifang, China, and income from the deconsolidation of DEUTZ Engine (China) Co., Ltd. Linyi, China.

Other operating expenses Other operating 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.

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

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

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.

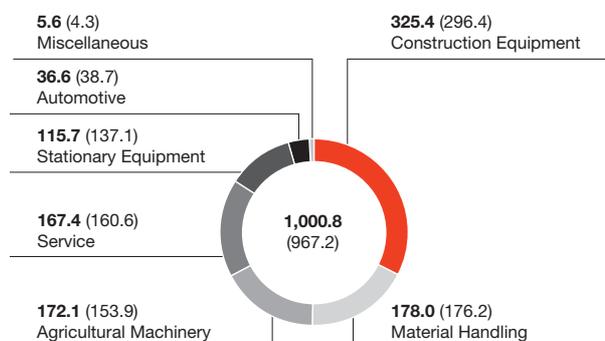
Slight year-on-year fall in unit sales The DCE segment's unit sales dropped by 1.6 per cent to 123,179 engines. The number sold in the previous year was 125,214 engines. In EMEA, our largest market, we sold 83,017 engines, which was 2.0 per cent more than in 2015. Unit sales went down by 13.1 per cent 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).

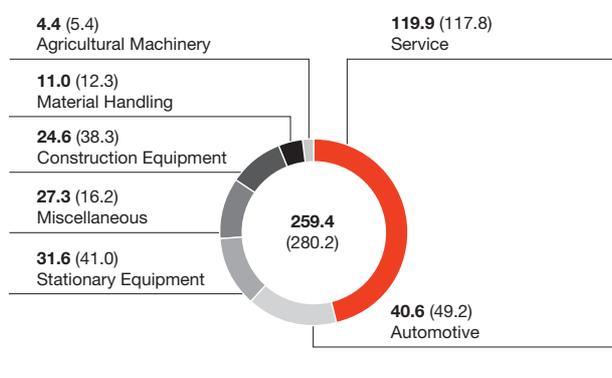
Engine sales down by a quarter Unit sales in the DCS segment declined by 25.5 per cent to 9,360 engines in 2016. This trend was repeated across all regions and, apart from Agricultural Machinery, across all application segments.

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.