

Overview of 2016

Fundamental features of  
the Group

Internal control system

**DEUTZ AG****DEUTZ Compact Engines**

- Liquid-cooled engines of up to 8 litres cubic capacity

**DEUTZ Customised Solutions**

- 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 Engines that rely on outdated technology and that are intended for use in applications in countries or application segments with only very low requirements in terms of product quality,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)
<b>Construction Equipment</b>	Excavators	Cummins, USA
	Wheel loaders	Isuzu, Japan
	Pavers	Weichai, China
<b>Material Handling</b>	Mining equipment	Yanmar, Japan
	Forklift trucks	Cummins, USA
	Telehandlers	VW, Germany
	Lifting platforms	Yanmar, Japan
<b>Agricultural Machinery</b>	Ground support equipment	Zhejiang Xinchai, China
	Tractors	Deere, USA
<b>Stationary Equipment</b>	Harvesters	Kubota, Japan
	Gensets	Perkins, UK
	Pumps	Yanmar, Japan
<b>Automotive</b>	Compressors	Cummins, USA
	Rolling stock	Kubota, Japan
	Special vehicles	Perkins, UK
	Trucks	Fiat Powertrain, Italy
	Buses	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 <sup>1)</sup> (average)	%	17.9	17.6
ROCE (before exceptional items) <sup>1)</sup>	%	3.1	0.6
R&D ratio	%	4.0	3.3
Free cash flow <sup>1)</sup>	€ million	4.7	35.0

<sup>1)</sup> 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
<b>Capital employed</b>	<b>748.3</b>	<b>757.1</b>
<b>Capital employed (average for the year)</b>	<b>752.7</b>	<b>792.7</b>
<b>EBIT (before exceptional items)</b>	<b>23.4</b>	<b>4.9</b>
<b>ROCE (before exceptional items)</b>	<b>3.1%</b>	<b>0.6%</b>

**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 dividend 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.