

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)<sup>1)</sup> 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.

<sup>1)</sup> IMF World Economic Outlook Update, January 2017.