

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 2016. 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 2016 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, this can lead to us performing 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 stricter emissions standards for construction equipment and agricultural machinery that were introduced in China with effect from 1 October 2015 present us with the opportunity to capitalise on this competitive edge and increase our share of the Chinese market in the short to medium term.

Production and quality The digital transformation of manufacturing, referred to as Industry 4.0, is exploring new approaches to production. In combination with projects to improve quality, this may lead to substantial efficiency increases and greater customer satisfaction in the short to medium term.

OUTLOOK

GLOBAL ECONOMIC FORECASTS LOWERED

The International Monetary Fund (IMF)¹⁾ has lowered its forecast for global economic growth once again. Nonetheless, at 3.4 per cent for 2016 and 3.6 per cent for 2017, this forecast is still higher than the 2015 figure of 3.1 per cent.

In particular, the predictions for developing countries and emerging markets have been revised slightly downward. For the industrialised nations, the IMF anticipates an overall growth rate of 2.1 per cent in 2016 and 2017 (2015: 1.9 per cent). The eurozone economy is expected to expand again, by 1.7 per cent both this year and next year, following 1.5 per cent in 2015. The growth forecasts for Germany are the same. In Spain, the buoyancy seen recently will taper off slightly. The US economy is expected to grow at a rate of 2.6 per cent in both 2016 and 2017, compared with 2.5 per cent in 2015. In China, the pace of growth will probably slow again, falling from 6.9 per cent in 2015 to 6.3 per cent this year and 6.2 per cent next year.

The business climate index²⁾ published by the ifo Institute of Economic Research dropped slightly in January 2016. This index, which covers trade and industry in Germany, stood at 107.3 points most recently, compared with 108.6 points (seasonally adjusted) in December 2015. Expectations have particularly deteriorated. The ISM purchasing managers' index³⁾ in the USA stood at 48.2 points on 1 February 2016. This indicates that economic activity is currently contracting.

DIESEL ENGINES MARKET

For construction equipment in 2016, we anticipate that the market in both Europe and North America will move within a narrow range of -5 per cent to +5 per cent and that the Chinese market will see a further decline of around 10 per cent to 20 per cent. For agricultural machinery, we predict that the market in Europe will either remain at its current level or contract by up to 5 per cent. We also expect the medium and heavy-duty truck sector in China to remain within a narrow range of -5 per cent to +5 per cent.

¹⁾ IMF World Economic Outlook Update, January 2016.

²⁾ ifo Institute of Economic Research, January 2016.

³⁾ ISM Institute for Supply Management, February 2016.

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

NEW ORDERS, UNIT SALES, REVENUE

In view of the subdued market outlook and persistent reluctance to invest, we expect our engine sales to remain static. European customers still have engines in their inventories that they had bought in 2014 ahead of the introduction of new emissions standards. The resulting adverse impact on engine sales will be less pronounced than in 2015, however. This, coupled with production ramp-up for new customer projects, should compensate for any weaknesses in end customers' markets, particularly in the agricultural sector. 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.

Overall, we assume that revenue will stagnate or, at best, rise slightly. We expect revenue in both the DCE and DCS segments to follow a similar pattern. 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. Although we have significantly improved our flexibility over the last few years, we will continue to work hard on increasing it still further.

EARNINGS

The focus this year – in addition to the successful implementation of new customer projects, the site optimisation process and a quality offensive – is primarily on measures designed to further reduce costs and increase efficiency.

We expect the EBIT margin to increase moderately. As capacity utilisation is likely to change only insignificantly, this will be predominantly achieved with further cost-saving measures and the first positive effects from the optimisation of our site network. We are likely to benefit from the current movements in the US dollar exchange rate. We expect both our DCE segment and our DCS segment to achieve earnings growth.

As a result of the anticipated slight increase in earnings, we believe there will be a small year-on-year rise in return on capital employed (ROCE) in 2016.

COMMODITIES, COLLECTIVE PAY AGREEMENTS

Commodity prices We expect price levels in the primary markets to weaken again in 2016, driven by a slowing global economy and low demand in Asia.

Collective pay bargaining in the spring The current collective pay agreement for the metalworking and electrical engineering industries in Germany expires on 31 March 2016. We believe the negotiating parties will start the negotiation process soon after and reach an agreement in the second quarter on the basis of current economic data.

RESEARCH AND DEVELOPMENT EXPENDITURE

We predict expenditure on research and development of just over €50 million, thus slightly higher than the very low level of spending in 2015. The R&D ratio is therefore likely to increase marginally year on year.

CAPITAL EXPENDITURE

We forecast that our capital expenditure in 2016 (excluding capitalisation of research and development expenditure) will be around €55 million. This includes capital expenditure on site optimisation. Including capitalisation of research and development spending, we anticipate that capital expenditure will total approximately €75 million.

JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD

The market environment in China is likely to remain challenging and volatile in 2016. We are expecting the revenue of our DEUTZ (Dalian) Engine Co., Ltd. joint venture to remain flat but its earnings to improve slightly on the back of cost savings. 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 is around 17 per cent as the quarter-end average. Given that capital expenditure will remain well below the level of depreciation and amortisation, we forecast positive free cash flow in the low to mid-double-digit million euro range in 2016.

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

Flexible headcount adjustment Our aim is to end all short-time working as soon as possible and to return to full employment, although this will depend heavily on the level of orders on hand. If we require additional workers, we will again significantly increase the proportion of flexible contracts, whether fixed-term or temporary. As we operate in a cyclical industry, this is the best way that we can protect ourselves against fluctuations in demand.

Collective agreement on pre-retirement part-time employment We continue to offer older employees the opportunity to retire early by switching to pre-retirement part-time employment. Our expectation is that a significant number of our employees will take up this option in 2016.

STATUTORY REGULATIONS, EXHAUST EMISSIONS STANDARDS

The most stringent exhaust emissions standards yet for diesel engines have now been introduced in all power output categories in the European Union, in the form of 97/68 Stage IV, and in the USA, with EPA Tier 4. Stage V is scheduled to come into effect in the European Union in 2019¹⁾. Our TCD engines equipped with a diesel particulate filter in the 2.9 to 7.8 litre cubic capacity range already meet this new standard. No further tightening of exhaust emissions limits in the USA is on the horizon at the time of writing.

OUTLOOK FOR THE YEARS AHEAD

We forecast that global demand for capital equipment will recover in 2017. Moreover, we anticipate that, by then, European customers will have largely exhausted their inventories of engines bought ahead of the new emissions standards taking effect. From a current perspective, we therefore expect a marked improvement in the business situation in 2017, in terms of both revenue and the EBIT margin.

Global megatrends, such as increases in the world's population, advancing industrialisation in the agricultural sector and urbanisation, along with accompanying investment in infrastructure, are driving the further structural expansion of the global engine market. This will open up good opportunities for the continued advancement of the DEUTZ Group in the years to come. We plan to seize these opportunities in order to generate profitable growth.

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.

¹⁾ The EU Commission's Stage V proposals as published on 25 September 2014.