



EMBARGO until 26th June 2003, 11.00 am

**Gordon Riske
Chief Executive Officer of DEUTZ AG
Speech to the Annual General Meeting of DEUTZ AG
on 26th June 2003, at 10.00 am,
in the KölnMesse, Congress-Centrum Ost, Cologne (Germany)**

Only the speech as given has any validity.

(chart 1)

Ladies and Gentlemen,
Dear Shareholders,
and all other friends of our company:

On behalf of the Management Board of DEUTZ AG I would like to bid you a warm welcome to our 2003 Annual General Meeting. I would like to greet the representatives of the Shareholders' Associations, the banks, and the media. My particular greetings go to all former and still active employees of our company. It gives me great pleasure to see that so many shareholders, customers, suppliers, and other friends of DEUTZ AG have come to see us here in Cologne today.

I intend to concentrate on three main subjects in my report today:

- ▶ Subject 1: The financial year that has just finished, 2002.
- ▶ Subject 2: The current financial year, 2003.
- ▶ Subject 3: The status of the implementation of the "Three-Pillars" strategy for the future of DEUTZ.

Subject 1: The 2002 financial year

Let us cast a glance back over a demanding and successful 2002. The trend in the world economy was marked by an upswing only in Asia, particularly in China, and a few countries in

Central and Eastern Europe. In our main markets, however, the past year was characterised by a very difficult economic environment.

No forward impetus came from Germany, Western Europe, or the USA, the markets that between them make up about three-quarters of our sales. Whilst in the USA the still strong growth at the beginning of the year lost more and more of its momentum as the year went by, the long-awaited revival of the economy in the second half of the year failed to make its appearance in Western Europe and particularly in Germany. All in all, the economic environment in 2002 can be seen to have been against us.

The DEUTZ team, however, did not allow itself to be thrown off course. After all, we had set ourselves some very specific goals for the 2002 financial year:

- ▶ achieve a break-even profit result – equivalent to hitting the bull's-eye;
- ▶ implement all the action in the second year of the DEUTZ Re-Launch /5-point programme;
- ▶ and continue with the systematic restructuring of the company.

Ladies and Gentlemen, we have attained our goals for 2002. DEUTZ has achieved a “decent” break-even figure, and we have improved on all our key dimensions. **(chart 2)**. Despite the uncertain economic situation and a slight fall in sales we have increased operating earnings by 47 percent and reached Euro 41 million. We have also achieved a corporate profit of Euro 2 million.

This is a considerable achievement, and I would like to take this opportunity to thank:

- ▶ the employees, for their very great hard work,
- ▶ the management team, for their sheer dogged endurance,
- ▶ and the shareholders and the Supervisory Board for their patience and support.

Now for a few words of explanation on the figures. In 2002 we achieved total sales of Euro 1.16 billion, only 2 percent less than in the preceding year. The structure of these sales, however, has changed significantly both in terms of the regional mix and of the product mix.

The economic difficulties besetting the European telecommunications industry and the generally restrained attitude of investors internationally towards decentralised power generation plant caused a clear fall-off in our sales of medium-sized and

large engines, **(chart 3)** but an increase of about 4 percent in service business meant that sales in this segment declined by only 21 percent to Euro 346 million.

We were able to make progress against the general trend with our compact engines and to increase unit sales by more than 5 percent. **(chart 4)** An even greater increase was achieved with engines in the cubic capacity range from 4 to 7 litres, where sales increased by as much as 9 percent, to Euro 815 million.

This means, all in all, that we have been able almost completely to compensate for the weak course of the business with our medium-sized and large engines.

We pursued four sales goals last year: **(chart 5)**

- ▶ increasing our market share in growth regions;
- ▶ increasing our market share in DEUTZ's core segments;
- ▶ widening our range of services as a "solutions-provider" to become a supplier of complete systems;
- ▶ and gaining new customers for series deliveries, thus sowing the seed today for the growth harvest of tomorrow.

Now, Ladies and Gentlemen, what have we achieved along this route?

- ▶ We greatly increased our presence last year in the growth regions in Asia and Eastern Europe (**chart 6**). In Eastern Europe we almost doubled our sales, to Euro 34 million. Our business in the People's Republic of China grew at an above-average rate, and here we were able to increase sales by more than 80 percent, to Euro 73 million. The whole Asia-Australia Region is now accounting for more than 20 percent of our company's sales and is already in third place behind Western Europe and Germany. We have thus come a long way towards our goal of making ourselves more immune to economic fluctuations.
- ▶ We have also made good progress during the financial year just finished in focussing on the core DEUTZ segments, which was our second goal. (**chart 7**) In the segment of mobile working machines we increased our sales by more than 10 percent, particularly through a rapid increase in our series deliveries to our strategic partner Volvo. In agricultural machinery the increase was about 12 percent, and sales in the automotive segment increased by an impressive 68 percent, to Euro 84 million. This application segment is already contributing more than 7 percent to our sales. We are thus creating a broad basis, in addition to our co-operation arrangements with Volvo, for the sales

success of our new commercial vehicle engine that we intend to bring onto the market in 2006.

► By supplying complete systems and being a “solutions-provider” we are rounding off our range of products and services for our customers with modular systems, which at the same time increases the share of value-creation that we keep in-house. **(chart 8)** This procedure, which we have already been following successfully for a long time in our DEUTZ ENERGY Division, has now been transferred to our compact engines for pumps and generators as well. Following the successful start of our air-cooled “Power Packs”, **(chart 9)** last year we brought a power pack with the 1013-series engine up to series readiness for our partner Volvo. Engines “Made by DEUTZ”, attachments from the DEUTZ modular system, and parts delivered by Volvo complement one another to produce a finished product for Volvo Penta. In addition to this we have prepared the start of series production on a new Power Pack based on our state-of-the-art 2012 series – the outcome of which, Ladies and Gentlemen, you probably saw in the lobby on your way in here.

► The fourth goal in our sales strategy, gaining new customers, is a major component in the future of our company. **(chart 10)** Our compact engines are mainly used in the se-

ries production of mobile working machines, and it is nothing unusual for two years to elapse from the first negotiations to the start of production on a new series of machines with DEUTZ engines. This is the time that both sides need for all the technical preparations, and the most important milestone along this route is the installation of the first prototype into our customer's machine. In 2002 we delivered about 80 such prototypes for series production to new and pre-existing customers, and thus took a big step forward into a secure future for our company.

Dear shareholders, our sales success in the market are of no significance if they do not bear testimony to the commercial success of our company. In the 2002 financial year we “hit the bull's-eye” – despite everything that was going on in the economy around us. **(chart 11)**

In addition to this we succeeded in making a considerable improvement in our liquidity. A strict asset-management programme enabled us to make a big reduction in the resources tied up in our company and to improve our cash flow (before financing) from last year's outflow of Euro 83 million to an inflow of Euro 38 million. We thus reduced our net financial indebtedness by Euro 38 million, to Euro 302 million. I would like at this point to thank our banks for their understanding and helpfulness, and particularly for bringing about a prolongation of our

credit facilities – a decision that nobody can take for granted these days.

As you can see, all the major key figures are displaying an upward trend. That, Ladies and Gentlemen, is the most important fact that I intend to convey to you today: DEUTZ has managed to reverse the trend.

This change in the trend was made possible by the DEUTZ Re-Launch / 5-point programme that started two years ago. **(chart 12)** Just to remind you, the five points of the programme are:

1. Focussing of the model range
2. Concentration of production
3. Leaner structures
4. Quality offensive, and
5. Promotion of co-operations

We were very successful once again in the second year of the DEUTZ Re-Launch / 5-point programme and achieved a profit improvement of about Euro 46 million over the baseline of the programme, which was the 2001 budget plan. **(chart 13)** We have thus once again clearly exceeded our target for 2002, which was Euro 35 million.

Ladies and Gentlemen, allow me here to explain the most important successes achieved by the Re-Launch Programme in the financial year just finished:

- ▶ The foundry was finally closed earlier than planned in October 2002. From this measure alone we expect a positive profit impact of about Euro 8 million, which will be effective from 2003 onwards. With this move we had to reduce our number of employees by 210, but more than half of them found new jobs in other parts of the company.
- ▶ We have also made progress in reducing administrative overheads, and last year eliminated another 311 jobs of this kind worldwide. Since 2000 we have slimmed down the departments in our company that were not directly involved in value-creation by a total of 620 jobs.
- ▶ Our strict asset-management programme was also particularly successful and enabled us to reduce our balance sheet total by Euro 172 million from its level in 2000. This programme is at one and the same time reducing our net financial indebtedness and the interest expenses we have to bear, and is also generating positive impetus for the profitability of DEUTZ.

- ▶ We are expecting further profit improvements, Ladies and Gentlemen, from two projects on the purchasing side that we initiated during the financial year just finished. One was entitled “Global Sourcing” and means that we are pushing ahead with internationalising our purchasing activities, opening up lower-cost purchasing sources, and making DEUTZ more resilient to fluctuations in exchange rates. The other was our new “Lead Supplier” concept, under which we are bundling the purchasing of similar parts and components with one lead supplier in each case and thus achieving a clear reduction in the cost of purchasing. We are expecting these two projects alone to reduce costs by Euro 15 million a year.

- ▶ We also further extended our global network with co-operation partners last year. Having already entered into new co-operation arrangements the year before in Turkey and the USA, we have now found two major partners for DEUTZ in the particularly important Chinese market. Firstly, the commercial vehicles manufacturer Norinco will be installing our 1015-series engines into his heavy lorries and from now until 2005 we will be supplying complete engines to China from our works in Ulm. During the course of 2005 Norinco will start his own local production in China of about 10,000 engines a year with production parts and

components supplied by DEUTZ. Secondly, we successfully concluded a new co-operation contract with FAW, the “First Automobile Works” in China. FAW is the biggest motor manufacturer in China and last year produced about 430,000 passenger cars and more than 150,000 trucks. DEUTZ has already been collaborating with FAW for ten years, and our 1013-series engines have successfully met all the challenges they have to face in the tough operating conditions of China. We are now starting a new chapter in our successful collaboration; whilst we will be delivering substantial unit quantities of DEUTZ engines to FAW in the output range from 90 to 220 kilowatts, at the same time we will be working jointly with FAW on the further development of these engines. In the second stage, starting in 2007, FAW will produce about 100,000 engines a year under licence in the People’s Republic of China.

We pursued intensive negotiations with people in the USA on possible collaboration in the field of medium-sized and large engines but broke them off at the end of last year because it had not proved possible to arrive at solutions that would have been satisfactory for both sides. The successes we are achieving with our DEUTZ Re-Launch / 5-point programme, however, gives us the confidence to believe that we will achieve our strategic goals in this segment. In me-

dium-sized and large engines we are concentrating our energies on the “renewable sources of energy” segment, in which above-average growth rates are being forecast for the medium-term future. Our sales organisation in the DEUTZ ENERGY Division was re-organised in 2002 with this in mind.

Dear Shareholders, the success achieved by the activities that we have initiated in the last two-and-a-half years are tangible: the productivity of all our works has risen, by 5 percentage points on average; the costs of maintaining our high quality standard are about 20 percent below their 2000 level; and our “EBIT return” has been raised to 3.5 percent. The “Cost run rate”, which we introduced at the beginning of the Re-Launch / 5-point programme as the yardstick for our cost trends, has dropped further to 91 percent. **(chart 14)** Although this means that we just missed our target for 2002, we are confident that we will reach our target of 89 percent for this year.

In addition to this we worked very hard last year on reducing the legal risks that have remained with DEUTZ AG, even after the sale of Humboldt-Wedag AG, in the final completion of earlier orders. The few risks that still remain are quantified regularly and taken into account in our provisions against risk. After the 2002 accounts were closed we brought the litigation with Gen-

eral Electric in the USA, which had been smouldering since 1998, to a definitive conclusion with an out-of-court settlement. Allowance had already been made in the 2002 accounts for the conclusion of these proceedings. This means that a further chapter, namely the settlement of critical problems from the past, is now almost completely closed.

Ladies and Gentlemen, Dear Shareholders, it gives me great pleasure to be able to present positive results to you today for the financial year just finished. We have passed an important point on our route to becoming a profitable company with a secure future. DEUTZ is showing a profit again and generating a positive cash flow.

This, Ladies and Gentlemen, ought to be the normal situation. But in view of the “burdens of the past” that had to be overcome, in view of the little financial room for manoeuvre that was available for restructuring, this can be regarded as a major success. With the DEUTZ Re-Launch / 5-point programme we have created a healthy basis in just two years for the future of DEUTZ – and have made DEUTZ fit for the future.

The stock market, Ladies and Gentlemen, has not yet shown adequate appreciation for the great progress we have been making. All over the world, 2002 was the worst year the stock

markets have seen in the last 30 years. On the German stock markets the indices showed substantial losses: over the course of the year the DAX fell by 44 percent and the MDAX lost 30 percent of its value. **(chart 15)** Compared with this slack environment, DEUTZ shares held up quite well and over the course of the year we achieved an increase in value of more than 4 percent; but against the background of the heavy losses in value in the preceding years this cannot give any of us much cause for rejoicing. All the same, here again we can see a change of trend into the right direction, and this positive trend has continued into the current year as well. Since 1st January 2003, DEUTZ AG shares have been registered on the “Prime Standard” of the German Stock Exchange, and they have been noted in the SDAX since the end of March. From the beginning of the year to the end of May the DEUTZ share price rose by a further 7 percent. It is now up to us to strengthen the confidence that has returned to the capital markets and to achieve constant value growth for our company by consolidating and building on the successes we have already achieved. Ladies and Gentlemen, I am firmly convinced that we will achieve this goal. Strengthening our equity capital base is in fact one of the most important tasks for the next two years if we are to implement the DEUTZ AG future strategy.

I would now like to turn to the second subject: the current financial year, 2003.

For the current year we have set our eyes on a further significant profit improvement over last year. The economy will not be giving us very much help here, as the first months of this year have made abundantly clear: the outstandingly good growth prospects in Asia are being hampered by the SARS epidemic, and the economic forecasts for the western industrialised countries, cautious though they already were at the start of the year, have been cut back step by step since then, so no durable recovery is in sight. Although the swift end to the Iraq War led to a slight improvement in the overall mood, nothing has changed in the fundamental economic problems.

The exchange rate of the US Dollar against the Euro has fallen even further than anyone last year expected it to do, and it has now reached a historic low. As of the end of May 2003 the US Dollar had lost 25 percent of its value against the Euro from its average value last year. This is substantially more than we and many other companies had allowed for in our plans for the 2003 financial year. This low dollar exchange rate is not only making our direct exports to the US market more difficult but is also hindering the exports of those of our customers in Germany and

the rest of Western Europe who install our engines in their products.

2003 is proving difficult not only on the market side; on the costs side as well we have to steer a careful course. The decline in the dollar exchange rate is depressing our profits by about Euro 14 million; the increase in energy prices resulting from the “ecology tax” is costing our company almost a further Euro 1 million; and, in addition to all this, last year’s collective wage agreement and the increases in the secondary costs of employment are raising our cost of labour by 3.6 percent on average over the year, or in other words by Euro 8 million.

Ladies and Gentlemen, in light of these trends we took extensive counter-measures back in February in order to keep DEUTZ on the right course:

- ▶ We set up a Contingency Plan reflecting the implications of reduced market expectations on the trends in our unit and value sales.
- ▶ We are basing our overheads costs budget on the Contingency Plan in order to prevent sales and costs trends from drifting apart. All departments in the company are working

intensively on further reducing their overhead costs, over and above the cuts that have already been made.

- ▶ To reduce costs on the materials side we are pressing ahead with our “global sourcing” activities and are transferring our sources of supply to low-wage countries – under the close supervision of our Quality Management, of course. At the same time we are increasing the US Dollar proportion of the materials we buy in so that we can reduce the exchange-rate impact on our profits.
- ▶ However, we are working at full pressure not only on the costs side but also on the market side to ensure that we achieve our goals. As part of our sales strategy we are now widening our “solutions-provider” activities to include medium-sized and large diesel engines from our Mannheim works as well. In addition to this we are also strengthening our market presence with new co-operation agreements, for instance in Eastern Europe.

These measures combined with the systematic pursuit of our successful DEUTZ Re-Launch / 5-point programme make us confident that we will achieve our goals for the 2003 financial year, despite weakness on the sales side and despite the exchange-rate problem. For the end of the year we are working on

the assumption that the profit situation will be satisfactory: to be precise, that profits will improve further from the level of the financial year just finished despite everything that is going on around us.

Ladies and Gentlemen, now that we have looked at the positive results for the 2002 financial year and are also looking confidently forward to 2003, I would like to come on to the third subject: the future of our company and the extent to which we have implemented our “Three-Pillar” strategy.

At the Annual General Meeting last year I presented this “Three-Pillar” strategy as the way ahead for DEUTZ, and we are putting this strategy systematically into effect. **(chart 16)**

- ▶ In the field of liquid-cooled compact engines we are growing constantly through our alliance with Volvo. **(chart 17)** We produced more than 50,000 engines in the cubic-capacity category from 4 to 7 litres last year, 36 percent more than in 2001, and this year we will add another 20 percent. It is our medium-term aim to become the world market leader in this output category. We are already investing a great deal of work in this future. Our new, state-of-the-art fuel injection system the DEUTZ Common Rail, is now in the test phase and will be ready for series production in time for our new commercial vehicle engine in 2006.

- ▶ In the field of air-cooled compact engines we are advancing in leaps and bounds. **(chart 18)** Our new 914-series has been in series production since 2002. The successor to the legendary 912/913 series is meeting all the requirements of current emission legislation – and it is only a few years ago that nobody in the industry would have thought that possible. The market launch of our new 909 and 910 series has been running since the beginning of 2003; they were developed and are being produced in our Spanish works in Zafra. As a result we now have a range of air-cooled engines from single-cylinder to 12-cylinder and from 4 to 400 kilowatts. That, Ladies and Gentlemen, makes DEUTZ absolutely unique!

- ▶ The third pillar is our business with medium-sized and large diesel and gas engines. **(chart 19)** It is the use of gas engines for the decentralised conversion of so-called renewable energy sources – dump gas, sewage gas, coking-plant gas, and bio-gas – that is gaining in significance. We are taking full account of this trend with our completely modernised model series, which made its first appearance on the market in the spring of this year with increased output and a higher efficiency ratio. There is plenty going on as well with the diesel engines, however: Now that the dispute with GE

has been settled we have the possibility of selling our 632 series not only as a gas engine but also as a diesel variant, thus expanding our output range upwards. Moreover, in the autumn of this year we will be presenting a new high-performance marine engine for yachts, high-speed ferries, and Coast Guard vessels, and under the heading of “solutions-provider” we are preparing a new product under the name of “Gentainer”: a complete container-mounted unit with a diesel or gas engine. It will widen our range upwards of modular-designed products for decentralised power generation. In addition to this, our Mannheim development engineers are already working on the next steps: common rail systems for our diesel engines, further increases in the efficiency ratios of our gas engines, and output increases for both variants. Ladies and Gentlemen, we are convinced that with the surge of innovations we will achieve our medium-term targets in this field.

- ▶ The basis for our “Three Pillars” strategy is engine servicing, which has now become a major point of differentiation against competition. **(chart 20)** That is why we are continually widening our range of services that we offer. Last year we expanded our “Xchange” programme, under which we supply refurbished parts and engines, to include our medium-sized and large engines.

In May 2003 we opened our DEUTZ Web Shop and are thus using the Internet as an additional sales channel for spare parts. We will be constantly strengthening these “e-business” activities over the coming years. For the operators of our gas engines in particular we are widening our range of service contracts to cover everything from routine servicing and maintenance to the full overhaul and even the operation of the plant. These services turn the sale of a new product into a complete package, to the benefit of both sides: “full service” for the customers, and greater value-creation for DEUTZ.

Ladies and Gentlemen, as you can see, in the last few years we have not only turned our minds to reducing costs but have also given special priority to the new strategic direction of our company. With innovative ideas and creative development work we have set the course towards DEUTZ’s durably profitable future. We are being drawn towards this future by a vision: “DEUTZ – the engine company. We set standards and shape the future!”
(chart 21)

Ladies and Gentlemen, we still have many opportunities and many challenges in front of us, but we have already successfully covered a great deal of the distance. Success only comes

to those who have the right companions with them on their journey: committed employees, reliable suppliers, loyal customers, and – importantly – investors who invest confidence as well as money in a company.

It is for this confidence, Dear Shareholders, that I would like to thank you very warmly on behalf of the Management Board of DEUTZ AG, and most personally on my own behalf. I hope that you will continue to place this confidence in us, because without your support and encouragement we would never be able to achieve our shared goals.

I would like to thank the DEUTZ employees most sincerely for the great commitment that they have shown towards their company. They have made a huge contribution to our success. I would also like to take this opportunity to thank all our suppliers and customers for their close and partner-like co-operation over these last years.

Ladies and Gentlemen, today is the day on which the future of DEUTZ begins. Let us shape this future together!

Thank you very much.

Charts:

- 1 DEUTZ – the engine company
- 2 Key figures (incl. unit sales, sales, new orders)
- 3 Unit sales, sales, new orders medium-sized and large engines
- 4 Unit sales, sales, new orders compact engines
- 5 Focus sales
- 6 Sales by region
- 7 Sales by application
- 8 Focus Sales
- 9 Power Pack Systems
- 10 Focus Sales
- 11 Key figures (incl. unit sales, sales, new orders)
- 12 Re-Launch 5-Points
- 13 Re-Launch results
- 14 Cost-run rate
- 15 Shares
- 16 Three-pillars strategy
- 17 Liquid-cooled compact engines
- 18 Air-cooled compact engines
- 19 Medium-sized and large engines
- 20 Service
- 21 DEUTZ – the engine company. We set standards....