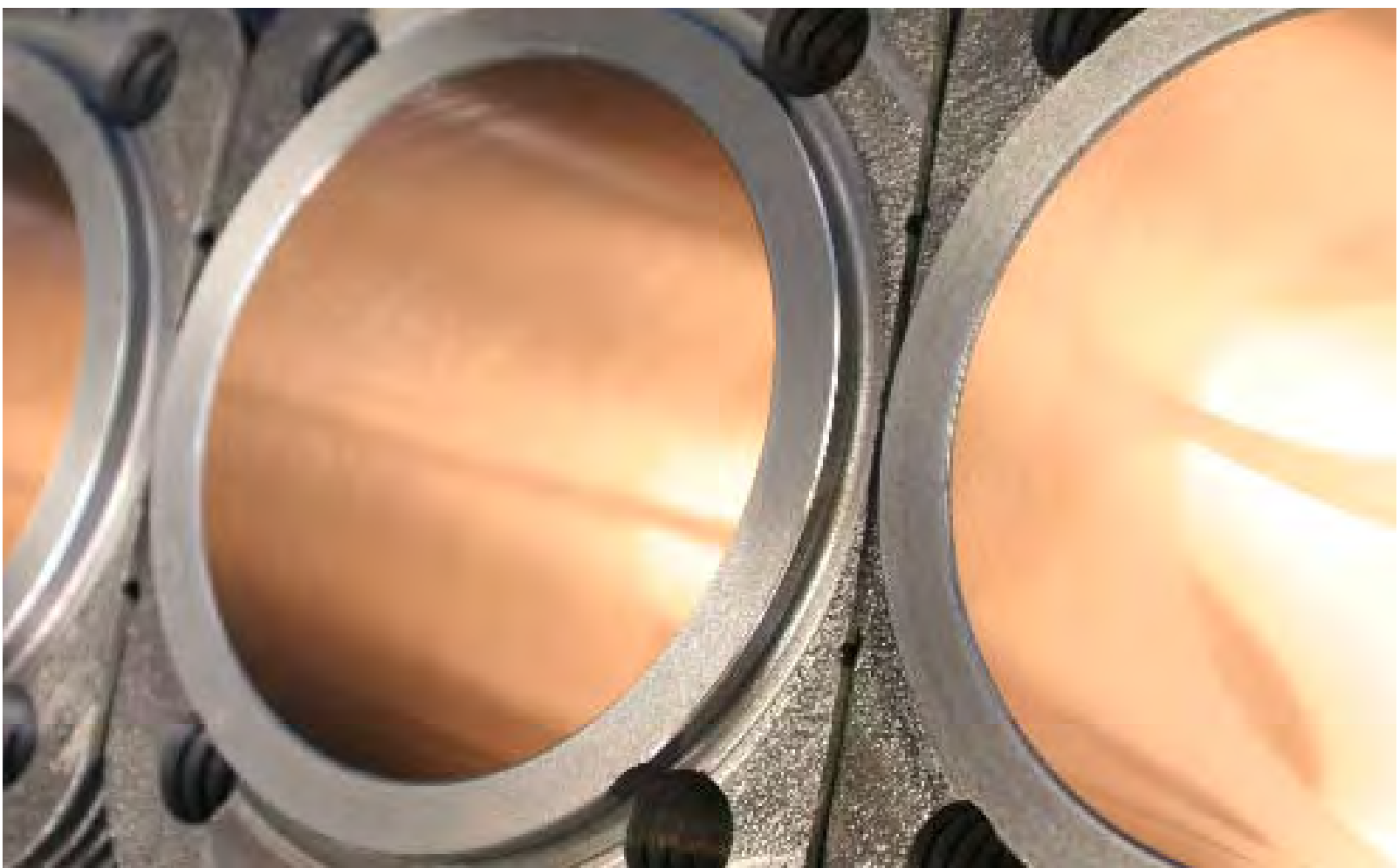


# Excellent Prospects



## DEUTZ Group: Key figures

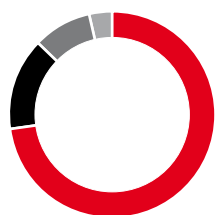
		HGB 2003	HGB 2004	IFRS 2004	IFRS 2005	IFRS 2006	Change in %
New orders	€ million	1,179.7	1,264.9	1,265.1	1,350.5	1,623.0	20.2
Unit sales	No.	156,237	173,440	173,440	195,843	237,293	21.2
Compact Engines	No.	155,523	172,684	172,684	195,082	236,588	21.3
DEUTZ Power Systems	No.	714	756	756	761	705	-7.4
Revenue	€ million	1,172.6	1,242.1	1,242.3	1,322.8	1,490.0	12.6
thereof excl. Germany	%	74.6	74.5	74.5	73.0	73.4	-
Compact Engines	€ million	843.0	909.7	909.9	999.7	1,175.9	17.6
DEUTZ Power Systems	€ million	329.6	332.4	332.4	323.1	314.1	-2.8
EBITDA	€ million	104.9	104.4	81.8	180.0	158.8	-11.8
EBITDA before one-off items	€ million	104.9	104.4	113.9	121.5	146.8	20.8
EBIT	€ million	44.0	50.1	18.5	114.7	93.5	-18.5
Operating profit (EBIT before one-off items)	€ million	44.0	50.1	53.5	62.5	81.5	30.4
EBIT margin before one-off items	%	3.8	4.0	4.3	4.7	5.5	-
Net income/loss before income taxes	€ million	9.4	-15.9	-16.5	84.7	69.7	-17.7
Net income/loss	€ million	6.0	-18.6	-18.7	71.4	61.5	-13.9
Total assets	€ million	1,017.0	960.2	1,029.1	1,063.8	1,162.9	9.3
Fixed assets	€ million	466.5	443.2	462.5	479.2	499.1	4.2
Equity	€ million	169.7	155.6	158.7	247.0	358.5	45.1
Equity ratio	%	16.7	16.2	15.4	23.2	30.8	-
Cash flow from operating activities	€ million	34.6	92.9	111.9	143.4	110.2	-23.2
Net financial debt <sup>1)</sup>	€ million	224.2	100.0	124.2	15.7	10.8	-31.2
Working capital as a percentage of revenue <sup>2)</sup>	%	30.5	24.1	25.3	18.0	15.8	-
Capital expenditure (excl. capitalisation of R&D)	€ million	40.7	41.0	43.0	67.6	85.8	26.9
Depreciation	€ million	64.0	54.4	63.3	65.3	65.3	-
Research and development	€ million	54.9	69.5	69.5	66.9	66.4	-0.7
Employees as at 31 December	Number	5,454	5,472	5,472	5,058	5,327	5.3

<sup>1)</sup> Net financial debt: bank debt minus cash and cash equivalents

<sup>2)</sup> Working capital: inventories plus trade receivables minus trade payables

## DEUTZ Group: Revenue by regions

€ million (2005 figures)



■ **1,085.9** (925.6): Europe/Africa  
 ■ **214.4** (193.2): Americas  
 ■ **137.7** (140.0): Asia-Pacific  
 ■ **52.0** (64.0): Middle East

## DEUTZ Group: Revenue by segments

€ million (2005 figures)



■ **1,175.9** (999.7): Compact Engines  
 ■ **314.1** (323.1): DEUTZ Power Systems

# DEUTZ segments

	Compact Engines		DEUTZ Power Systems	
Application segments				
Revenue € million	2006	2005	2006	2005
Engines	998.8	831.1	191.6	176.2
Mobile Machinery	440.9	374.1	–	–
Stationary Equipment	255.4	200.9	189.3	149.9
Agricultural Machinery	146.8	145.8	–	–
Automotive	119.4	68.6	–	–
Marine	12.5	14.5	2.3	26.3
Miscellaneous	23.8	27.2	–	–
Service	177.1	168.6	122.5	146.9
DEUTZ Group	1,175.9	999.7	314.1	323.1

# Highlights 2006




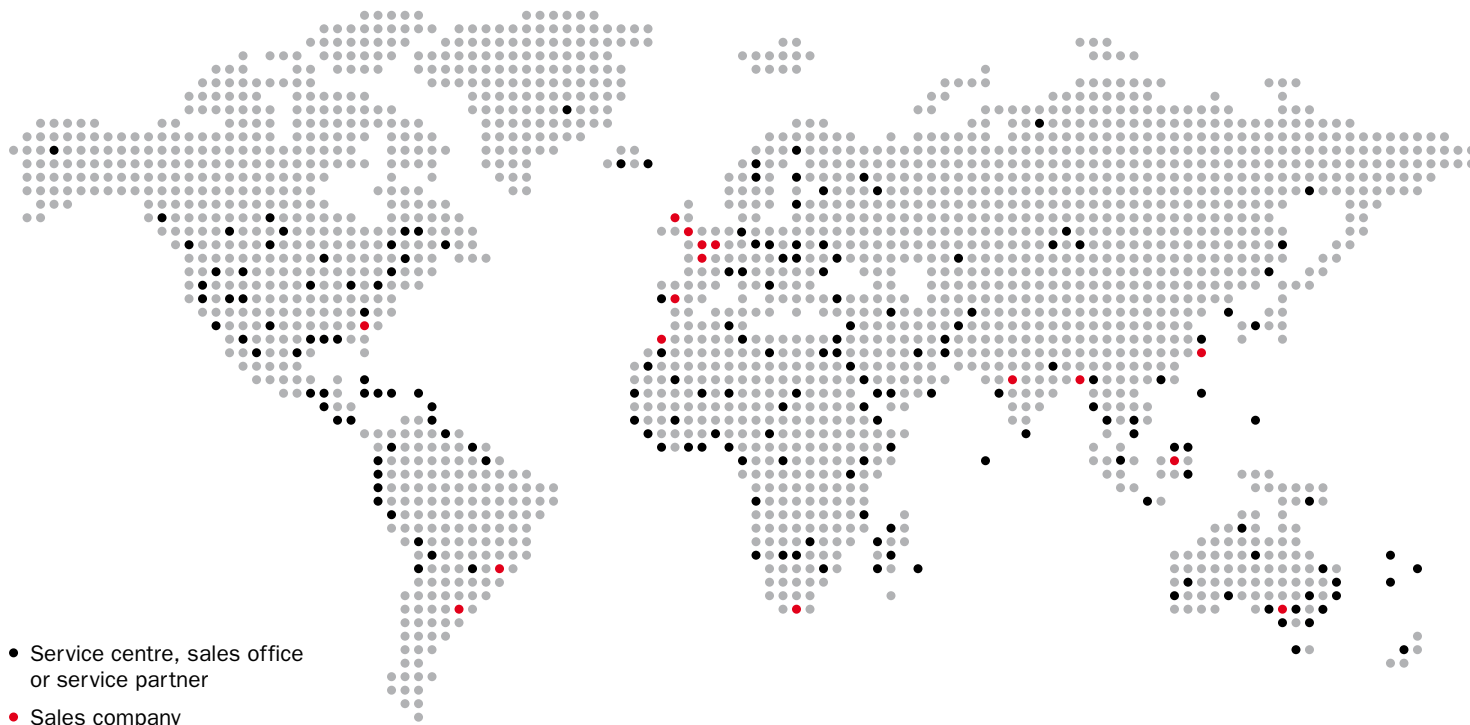
**February** The new TCD 2013 4V commercial vehicle engine compliant with Euro IV emission standards goes into production at the new assembly hall specially constructed at the Cologne-Porz site for this model. Full capacity utilisation is planned for 2007.



**March** Ulm becomes the company's competence centre for the air-cooled engine business. Management Board, Works Council and trade union are united in the plan to make the long-standing location at Ulm fit for the future. The works are benefiting from an investment of €10 million, creating around 100 new jobs.

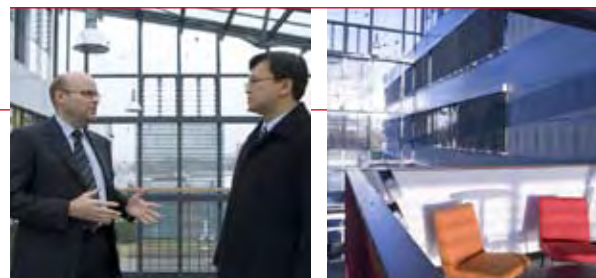
## Worldwide presence

More than 800 independent DEUTZ sales and service partners in more than 130 countries  
5 production/components works • 16 sales companies • 12 sales offices • 16 service centres



**April** At Intermat in Paris, one of the largest construction equipment trade fairs in the world, DEUTZ showcases its range of compact engines with up to 500 kW power output. All the featured engines comply with EU Stage III A and EPA Tier 3 non-road emission standards.

**June** At the PowerGen Europe trade fair in Cologne, DEUTZ Power Systems presents an advanced version of its successful TCG 2016 gas engine alongside its familiar range of products. A particular feature of this engine, which has been specially designed for biogas applications, is its significantly improved electrical efficiency.



### December 2006

- On 18 December, DEUTZ AG and FAW Jiefang Automotive Co. Ltd., China, sign an agreement to establish a joint venture for the production and marketing of diesel engines. This is a major expansion of the long-established alliance between DEUTZ and the FAW Group.
- In mid-December 2006, the keys to the new DEUTZ AG headquarters at Cologne-Porz are handed over. Head office functions, sales, research and development, and a major portion of compact engine production are now brought together on one site.



**September** On 18 September, DEUTZ AG joins Deutsche Börse's MDAX index. DEUTZ shares receive noticeably more attention from the capital markets as a result. There is an increase in the number of banks regularly including DEUTZ shares in their analysis coverage.

**No other factor** has had such a marked effect in recent years on the market for compact engines as emissions legislation. And in future, too, the success of engine manufacturers will to a large extent depend on their ability to meet the conflicting demands of ever higher performance on the one hand and lower fuel consumption and reduced emission limits on the other hand.



9



10



12



15

**10** Exhaust emissions legislation affects everyone

**12** DEUTZ: know-how from 140 years of engine manufacturing

**16** Is the internal combustion engine coming to the end of the road?

**18** Interview with Karl Huebser, Management Board: Technology



18



# Foreword

Dear shareholders,  
and friends  
of the company,

2006 was one of the most successful years in the long history of the company. We were able to achieve a continuous increase in growth during the course of the year, generating revenue of almost €1.5 billion, which was up 13 per cent on 2005. We increased operating profit by a good 30 per cent to around €82 million, resulting in an EBIT margin of 5.5 per cent, a noticeable improvement on 2005. The equity ratio is now 31 per cent.

Working capital was just under 16 per cent of revenue, once again well below our target figure of 20 per cent of revenue despite significant expansion in the business. Together with the excellent development in earnings this enabled us to increase return on capital employed (ROCE) to around 10 per cent. In the year under review, we invested more than €100 million in property, plant and equipment and development in order to help satisfy the high level of global demand for our engines. The net income for the year attributable to the Group amounted to €61.5 million. We can therefore look back on 2006 with a great deal of satisfaction.

In the Compact Engines segment, our attention was focussed on two particular issues in the year under review. Even more stringent exhaust emission legislation relating to engines between 130 and 560 kW came into force on 1 January 2006. From this date, these engines became subject to the EU Stage III A emission standard in Europe and the EPA Tier 3 standard in the USA. From a production point of view, the launch of new and further developed engine series in this output range was therefore one of the big challenges to which the company managed to respond superbly.

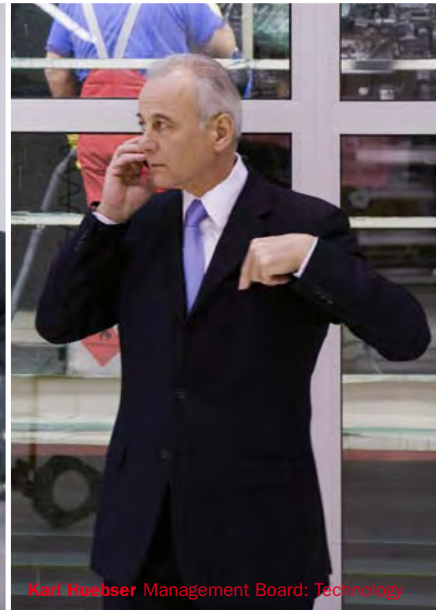




**Helmut Meyer** Management Board: Finance/Personnel



**Gordon Riske** Chairman of the Management Board



**Karl Hübner** Management Board: Technology

In addition, we saw the ramp-up in production of our new commercial vehicle engine, the TCD 2013 4V, which is manufactured in an assembly hall specially constructed for this series. Following the start of series production in 2006 on schedule, we expect to move to full capacity utilisation in the new assembly hall in the current year. This means that 2007 will see a further significant increase on the rise in revenue achieved in 2006 in automotive applications.

In the year under review, we formed a new business area, DEUTZ Customised Solutions. This business area includes, in particular, all air-cooled series, together with liquid-cooled engines with a capacity of over 8 litres. A significant step in this regard was the concentration of activities related to these engines at the Ulm location, which will be the air-cooling competence centre in our group of production sites. At the turn of 2006/2007, we relocated the assembly of air-cooled engine series from Cologne-Deutz to Ulm.

Since the start of 2005, DEUTZ Power Systems has been focusing on the development of innovative products, services and technologies for decentralised power generation systems, primarily based on gas engines. The gas engines convert both natural gas and non-natural gases into electricity, heat and/or cooling. In the second year after the realignment in this segment, the proportion of unit sales, engine revenue and new engine orders accounted for by gas engines reached a level that was already significantly higher than originally expected. 90 per cent of unit sales, 91 per cent of revenue and 95 per cent of new orders are now accounted for by gas engines.

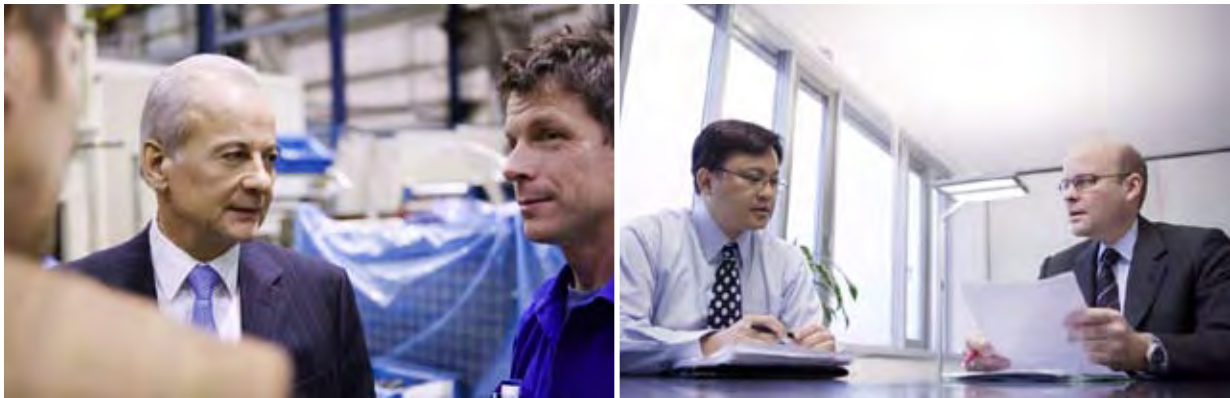


Operating profit of around €15 million in the first full year without the marine service business clearly demonstrates that the decision to focus on the power generation gas engine business was correct. In 2005, still over two thirds of the operating profit of €12 million had been generated by the marine service business. Biogas applications represent significant market potential for DEUTZ Power Systems. In the year under review, 25 per cent of installed capacity was accounted for by engines that can be run on biogas.

In September 2006, DEUTZ AG joined Deutsche Börse's MDAX index, the critical criteria for membership being stock market turnover and the market capitalisation of the company's free float. We consider this to be a recognition of our efforts over the last few years to restore the company to sustainable profitability. Following the gradual achievement of our stated goals, investors have now regained confidence in the DEUTZ AG equity story. The stock market rewarded our excellent performance in 2006 with a leap in the share price of 143 per cent, DEUTZ shares emerging as the top performers in the MDAX at the end of the year. Market capitalisation saw a threefold increase to €1.15 billion.

In December, we initiated the establishment of a joint venture in Asia with FAW, our partner of many years' standing. The joint venture will be responsible for the production and sales of engines in Asia. The joint venture in China at the Dalian site has an initial production capacity of around 150,000 engines a year and can be expanded to 200,000 engines in the medium term. Dalian will therefore become DEUTZ's second largest production location after Cologne.





The joint venture opens up the prospect of even greater growth in the business, taking us beyond 300,000 engines a year. In future, we will be in a position to service our customers in Asia, one of the most important growth markets, from local plants. With our range of products, outstanding workforce and an appropriately aligned strategy, we are extremely well prepared to cope with the expansion phase that lies ahead.

Given the high level of orders on hand and the strong sustained inflow of new orders, we expect to see a rise in unit sales in 2007. As far as the cost of raw materials is concerned, we are assuming that the existing situation will remain unchanged for the most part. The target unit sales figure for 2007 is around 260,000 engines. Revenue is expected to rise by 6 to 10 per cent. Operating profit will continue to show an improvement. The “7 up” efficiency and growth programme aims to ensure that an EBIT margin of 7 per cent is achieved in 2007. In 2007, we expect to see the net income for the year increase by a double-digit million euro amount compared with 2006. We continue to expect the ROCE to reach 12 per cent in 2008. We are endeavouring to sustain an equity ratio in excess of 30 per cent. Given the level of net income forecast, we are planning the distribution of a dividend in 2008 based on the 2007 results.

**With kind regards,**

Gordon Riske

Karl Huebser

Helmut Meyer

# Report of the Supervisory Board



**Dr Giuseppe Vita**  
Chairman

## **Cooperation between Management Board and Supervisory Board**

In 2006, the Supervisory Board regularly monitored the management of the company and advised the Management Board on major decisions. To this end, the Supervisory Board was regularly and comprehensively informed in timely fashion by the Management Board, orally and in writing, about business performance, risk management and corporate planning, including financial, capital expenditure and personnel planning, and about transactions with a mandatory consent requirement and any other significant individual transactions. Corporate strategy was the subject of intensive discussions between the Management Board and the Supervisory Board. Outside meetings of the Supervisory Board, the Chairman of the Supervisory Board also remained in regular contact with the Chairman of the Management Board.

## **Supervisory Board meetings**

Seven meetings of the Supervisory Board took place in 2006. All members of the Supervisory Board were present at each of the meetings. The meetings discussed up-to-date profit and risk reports as well as budget and medium-term planning, capital expenditure, and progress reports on individual projects, such as the development of the business area DEUTZ Customised Solutions and the establishment of a joint venture in China. Where required to do so by law or by the Statutes of the company, the Supervisory Board gave the required consent after a detailed examination of the situation and deliberations with the Management Board. Outside the individual meetings, the Management Board regularly informed the members of the Supervisory Board in writing about important events. In addition, the Chairman of the Supervisory Board was kept informed by the Chairman of the Management Board on an ongoing and timely basis about all important transactions and imminent decisions.

## **Statement on the mandatory offer from SAME DEUTZ-FAHR**

The statement on the mandatory offer from SAME DEUTZ-FAHR Holding & Finance BV (SDF) was discussed in detail between the members of the Supervisory Board and between the Management Board and Supervisory Board at an extraordinary meeting of the Supervisory Board. Pursuant to section 35 German Securities Acquisition and Takeover Act (WpÜG), SDF had announced in May 2006 that, following the conversion of profit-sharing rights, its share of the voting rights in DEUTZ AG had exceeded 30 per cent and that it had therefore acquired control pursuant to section 29 (2) WpÜG. Pursuant to the provisions of WpÜG, it was therefore mandatory for SDF to issue an offer to acquire all the ordinary bearer shares in DEUTZ AG against payment of a reasonable price. On 3 June 2006, SAME DEUTZ-FAHR made an offer of €6.12 per DEUTZ share. In the joint statement by the Management Board and Supervisory Board published on 9 June 2006, it was recommended that the shareholders reject this offer. First, at the time of the offer, the value of DEUTZ shares calculated using all applicable methods was significantly higher than the offer price. Secondly, the Management Board and the Supervisory Board were of the opinion that the independence of the company was a significant prerequisite for optimum exploitation of the potential value added in DEUTZ. Prof. Dr Marco Vitale, as president of SAME DEUTZ-FAHR, did not participate in the voting of the Supervisory Board on the statement.

## **Corporate governance**

At its meeting on 23 November 2006, the Supervisory Board held an in-depth discussion of the German Corporate Governance Code in the version dated 12 June 2006 and issued a declaration of compliance pursuant to section 161 German Stock Corporation Act (AktG). In December 2006, the declaration of compliance was posted on the website of the company where it is permanently available to shareholders.

The Supervisory Board reviewed its own efficiency using a comprehensive questionnaire which was then discussed in detail. Overall, the outcome was positive. On balance, there were just a few points of criticism and the Supervisory Board will endeavour to make further improvements in these areas.

The Supervisory Board has created three committees to ensure that its work is carried out efficiently.

## Committees

The Human Resources Committee is responsible for deciding on the content, conclusion and amendment of employment contracts with the members of the Management Board appointed by the Supervisory Board, on all issues arising in this connection and on issues arising between members of the Management Board and the company. The Human Resources Committee also prepares the appointment of the members of the Management Board. The Human Resources Committee met once during the year under review. Issues relating to the remuneration of the members of the Management Board were the subject of the discussions at the meeting.

The Audit Committee deals in particular with issues relating to accounting and risk management, ensuring the necessary independence of the auditor, engaging the auditors to audit the annual accounts, specifying key audit issues and agreeing fees. In the year under review, the Audit Committee held two meetings and discussed, in particular, the consolidated and single-entity annual financial statements for 2005 and risk management.

The Arbitration Committee is formed pursuant to section 27 (3) German Codetermination Act and is responsible for issues relating to the appointment of members of the Management Board described in section 31 (3) of the Act. The Arbitration Committee was not required to convene in 2006.

The Supervisory Board was informed of the outcome of discussions in the committees.

Mandates, together with the composition of the Supervisory Board and its committees, are shown separately in detail on pages 124 to 127. Related-party disclosures are shown on page 114 of the notes to the consolidated financial statements.

The Management Board has included in the management report and group management report certain disclosures pursuant to sections 289 (4) and 315 (4) HGB relating to arrangements that may be significant in the success of any public takeover bid for DEUTZ AG. In the opinion of the Supervisory Board, the arrangements described are normal for publicly traded companies comparable with DEUTZ AG.

## Notes to the disclosures made pursuant to sections 289 (4) and 315 (4) HGB

The single-entity annual financial statements of DEUTZ AG prepared in accordance with HGB and the consolidated annual financial statements prepared in accordance with IFRS, together with the respective management reports, were audited by PricewaterhouseCoopers AG, Wirtschaftsprüfungsgesellschaft, Düsseldorf, Germany, the auditors appointed by the Annual General Meeting. The auditors found the books, records and transactions to be consistent with the law and the Statutes of the company and issued an unqualified opinion. The auditors also audited the report on relationships with subsidiaries and associates (dependency report) produced by the Management Board pursuant to section 312 German Stock Corporation Act (AktG).

## 2006 single-entity and consolidated annual financial statements discussed in detail

The single-entity annual financial statements of DEUTZ AG, the consolidated annual financial statements, the management reports, dependency report and auditors' reports were made available to all members of the Supervisory Board and were examined by the Supervisory Board. The auditors explained the audit findings in detail to the Audit Committee meeting held on 13 March 2007, and to the Supervisory Board meeting held on 22 March 2007, and answered questions raised by the members of the Audit Committee and Supervisory Board.

The Supervisory Board noted with approval the findings of the auditors' report on DEUTZ AG and the consolidated financial statements, and the findings of the audit of the dependency report. According to the concluding findings of its own audit, the Supervisory Board raised no objection to the single-entity annual financial statements, the consolidated annual financial statements, or to the declaration of the Management Board at the end of the dependency report and approved the single-entity annual financial statements and consolidated annual financial statements. The annual financial statements have thus been adopted.

In addition, the dependency report for 2006 pursuant to section 312 AktG submitted by the Management Board was endorsed by the auditor and returned with the following remark: "After carrying out an audit and assessment in accordance with our duty, we confirm that:

1. The actual disclosures in the report are accurate;
2. In the legal transactions listed in the report, payments made by the company were not unreasonably high and disadvantages have been compensated;
3. In the activities listed in the report, there is no reason that would give rise to a materially different assessment from that of the Management Board."

Having carried out its own audit of the dependency report, the Supervisory Board raised no objection. The Supervisory Board also noted and approved the findings of the report audit submitted by the auditors.

#### **Changes to the membership of the Supervisory Board**

There were some changes to the membership of the Supervisory Board during the year under review. Dr Michael Endres resigned as Chairman and member of the Supervisory Board at the Annual General Meeting held on 22 June 2006. Dr Endres had been chairman of the Supervisory Board since 1995. He made a great and lasting contribution to the company when he helped it to overcome a serious crisis threatening the very future of the company. His support during the strategic refocussing and restructuring process was invaluable. Peter Zühlsdorff also resigned from the Supervisory Board on 22 June 2006. Mr Zühlsdorff had also been a member of the Supervisory Board for more than ten years. His advice and close cooperation with the Management Board was greatly appreciated. The Supervisory Board is extremely grateful to both these gentlemen for their years of service and tremendous work in the interests of the company.

At the Annual General Meeting in June 2006, the shareholders approved the new members proposed by the Supervisory Board itself and elected Dr Giuseppe Vita and Gino Mario Biondi to the Supervisory Board. At its meeting immediately following the Annual General Meeting, the Supervisory Board elected Dr Giuseppe Vita as its new chairman.

In January 2007, there was a further change to the Supervisory Board of DEUTZ AG. Gino Mario Biondi stepped down as a member of the Supervisory Board with effect from 12 January 2007. At the request of DEUTZ AG, the Cologne local court appointed Dr Massimo Bordi as his successor with effect from 18 January 2007 until the Annual General Meeting to be held on 24 May 2007. The Supervisory Board will propose to the Annual General Meeting in May that Dr Massimo Bordi be confirmed as a member of the Supervisory Board of DEUTZ AG.

The Supervisory Board would like to express its thanks and appreciation to all employees, the elected employee representatives and the Management Board for the work they have carried out with such a high level of commitment. This commitment was a critical factor in making 2006 a very successful year for DEUTZ.

Cologne, March 2007

The Supervisory Board



Dr Giuseppe Vita  
Chairman



# “Smog, exhaust gases, noise – what has to happen before our children can grow up in a healthier environment? Is anyone ...





# ... doing anything about this? And is it really as simple as cleaner engines = cleaner environment = better future ...?

## It's certainly not the panacea but,

### **Exhaust emissions legislation affects everyone**

There is nothing we need quite as much as the air we breathe. Without this mixture of gases in the atmosphere, life on earth as we know it would not exist. Almost 30,000 litres of air pass through our lungs every day; consequently, keeping our atmosphere clean is one of our highest priorities. However, increasing economic affluence is all too frequently linked to increasing pollution of the natural environment. The pollutants which we pump out into the atmosphere and that consequently affect our bodies have been the subject of discussion for years; the same goes for the question as to how pollution can be reduced or prevented entirely. Far less well-known than, say, the Kyoto protocol, which is aimed at reducing global emissions of climate-damaging gases, is emissions legislation. These legal regulations limit pollutant emissions in the exhaust gases from internal combustion engines which, in every conceivable form, ensure our mobility, safety and comfort. The directives contained in exhaust emissions legislation therefore have a major impact on the engine manufacturers of this world when developing new drive systems.

**It all began with Euro I** Almost 14 years ago, on 1 October 1993, the Euro I standard came into force for vehicles with a permissible gross weight of more than 3.5 tonnes. EU directive 91/542/EEC established uniform limits, applicable for the first time throughout the EU, for nitrogen oxide (NO<sub>x</sub>) and particulates in diesel engine exhaust gases from commercial vehicles and buses. It permitted 9.0 g/kWh of NO<sub>x</sub> and 0.36 g/kWh of particulate emissions. Now, following on from the Euro II and III stages, legislators have specified considerably more stringent limits in the Euro IV standard, applicable since 1 October 2006: 3.5 g/kWh for nitrogen oxides and 0.02 g/kWh for particulate emissions – reductions of over 60 and 90 per cent respectively!

**There are still no standard rules** Regrettably, the problem with achieving global harmonisation of standards is also illustrated by emissions legislation. Although the USA and the EU are clearly leading the world as far as reducing exhaust gas emissions is concerned, the limit values applicable in the USA sometimes vary, different test procedures are used and new regulations are introduced at different times from those in the EU.

Although other countries such as Japan, China, Brazil and Russia have also introduced exhaust emission standards, which are largely based on the European or American directives, most are lagging several years behind the required extent of emissions reductions.

**Different laws for industrial engines** To complete this confusing picture, there are yet other regulations and directives for all internal combustion engines installed in equipment which is not licensed for use on public roads – the so-called non-road applications. The definitive directive for EU states is 97/68/EC; its first stage came into effect on 1 April 1999. Fortunately, the regulations for industrial engines are largely the same in the EU and the USA as far as the limits and the effective dates for their introduction are concerned. This makes it easier for engine manufacturers to plan their development work. In contrast with the legislation governing road vehicles, there are different limits with different times for their introduction for non-road

equipment such as construction and agricultural machinery, material handling equipment, depending on their engine-power class. Therefore, the current Stage IIIA comes into effect in three steps; on 1 January in 2006, 2007 and 2008 respectively.

No other factor has had such a marked effect in recent years on the market for compact engines as emissions legislation. And in future, too, the success of engine manufacturers will to a large extent depend on their ability to meet the conflicting demands of ever higher performance on the one hand and lower fuel consumption and reduced emission limits on the other hand.

## Exhaust emission limits “Non-road”

### US standard

Emission standard	Power kW	NO <sub>x</sub>	HC	PM	in force from
		[g/kWh]	[g/kWh]		
		NO <sub>x</sub> + HC		[g/kWh]	
Tier 3	37 – < 75	4.7		0.40	1.1.2008
	75 – < 130	4.0		0.30	1.1.2007
	130 – 560	4.0		0.20	1.1.2006
Interim Tier 4	19 – < 37	7.5		0.30	1.1.2008
	37 – < 56	4.7		0.30	1.1.2008
	56 – < 130	3.4	0.19	0.02	1.1.2012
Final Tier 4	130 – 560	2.0	0.19	0.02	1.1.2011
	< 19	7.5		0.40	1.1.2008
	19 – < 56	4.7		0.03	1.1.2013
Tier 4	56 – < 130	0.4	0.19	0.02	1.1.2015
	130 – 560	0.4	0.19	0.02	1.1.2014

### EU standard

Emission standard	Power kW	NO <sub>x</sub>	HC	PM [g/kWh]	in force from
		[g/kWh]	[g/kWh]		
		NO <sub>x</sub> + HC			
Stage III A	19 – < 37	7.5		0.60	1.1.2007
	37 – < 75	4.7		0.40	1.1.2008
	75 – < 130	4.0		0.30	1.1.2007
	130 – 560	4.0		0.20	1.1.2006
Stage III B	37 – < 56	4.7		0.025	1.1.2013
	56 – < 130	3.3	0.19	0.025	1.1.2012
	130 – 560	2.0	0.19	0.025	1.1.2011
	56 – < 130	0.4	0.19	0.025	1.10.2014
Stage IV	130 – 560	0.4	0.19	0.025	1.1.2014

### Emission limits for construction machinery in Japan (Ministry of Construction)

Emission standard	Power kW	NO <sub>x</sub> [g/kWh]	HC [g/kWh]	PM [g/kWh]	in force from
Stage II	8 – < 19	9.0	1.5	0.8	1.10.2003
	19 – < 37	8.0	1.5	0.8	1.10.2003
	37 – < 75	7.0	1.3	0.4	1.10.2003
	75 – < 130	6.0	1.0	0.3	1.10.2003
	130 – 560	6.0	1.0	0.2	1.10.2003

### Emission limits for special motor vehicles in Japan (Ministry of Transportation)

Emission standard	Power kW	NO <sub>x</sub> [g/kWh]	HC [g/kWh]	PM [g/kWh]	in force from
Stage II	19 – < 37	6.0	1.0	0.40	1.10.2007
	37 – < 56	4.0	0.7	0.30	1.10.2008
	56 – < 75	4.0	0.7	0.25	1.10.2008
	75 – < 130	3.6	0.4	0.20	1.10.2007
	130 – 560	3.6	0.4	0.17	1.10.2006

## Exhaust emission limits “On-road”

### US standard

Emission standard	NO <sub>x</sub>	HC	PM	in force from
	[g/kWh]	[g/kWh]		
	NO <sub>x</sub> + HC		[g/kWh]	
EPA Onroad 2004	3.22		0.134	1.1.2004
EPA Onroad 2007 <sup>1)</sup>	0.268	0.188	0.0134	1.1.2007

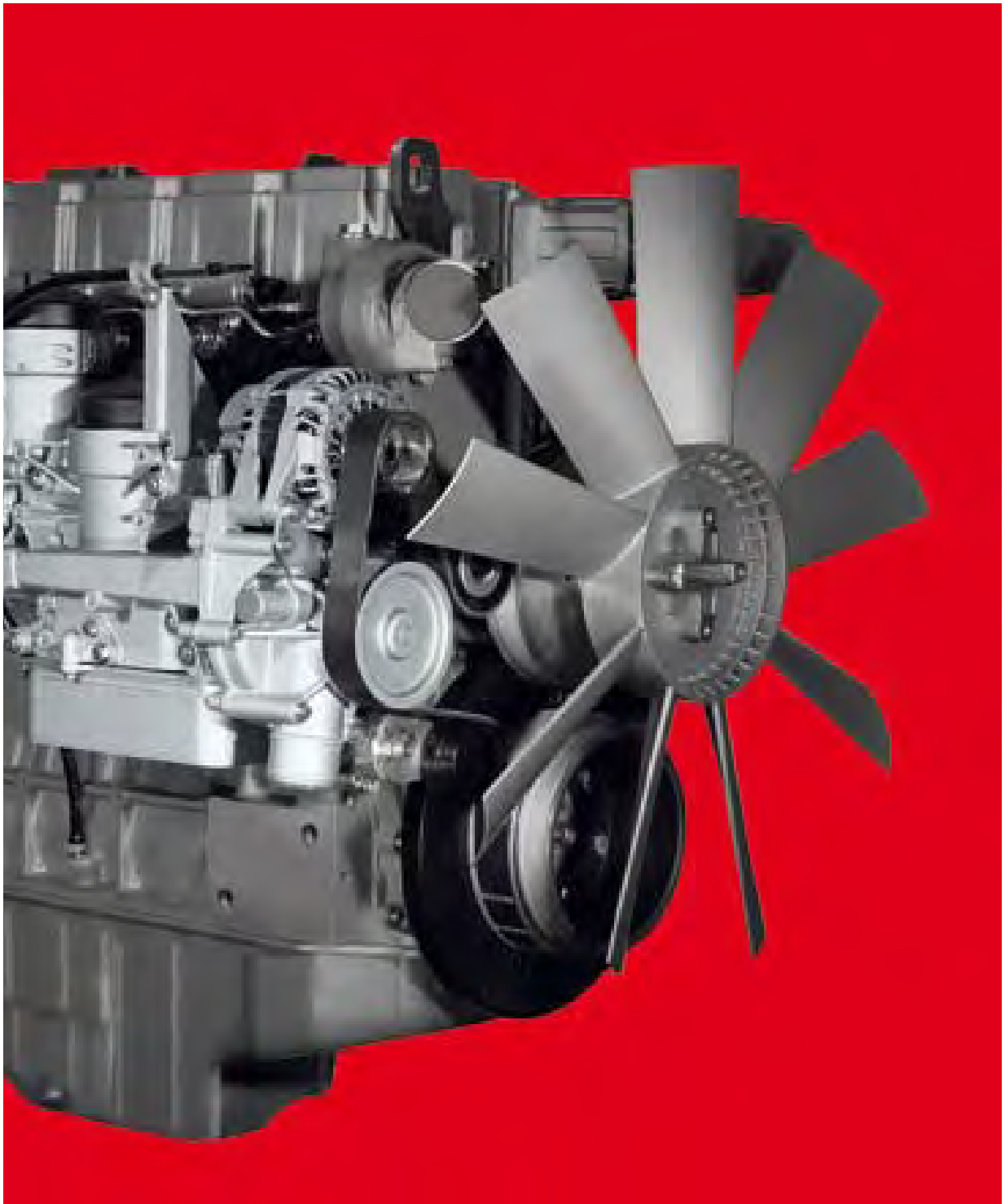
<sup>1)</sup> 1.1.2007–31.12.2009: 50% phase in for NO<sub>x</sub>.

### EU standard

Emission standard	Test cycle	NO <sub>x</sub> [g/kWh]	HC [g/kWh]	PM [g/kWh]	in force from
Euro IV	ESC	3.5	0.46	0.02	1.10.2006
	ETC	3.5	0.46	0.03	
Euro V	ESC	2.0	0.46	0.02	1.10.2009
	ETC	2.0	0.46	0.03	

NO<sub>x</sub> = Nitrogen oxides; HC = Hydrocarbons; PM = Particulate Matter

... but, by **reducing emissions**  
**engine manufacturers**  
**will be making an**  
important contribution to better air quality.



## DEUTZ: know-how from 140 years of engine manufacturing

The pioneering spirit and innovative strength of Nicolaus August Otto and Eugen Langen, the two founders of the company, provide the inspiration and motivation for the daily work of the research and development staff here at DEUTZ. The aim of our work is to build the best engines in the world to meet the requirements of our customers.

**In the beginning was the idea** Topping the priority list when developing a new engine are the performance requirements which our customers expect from their machinery and therefore from our engines. From this emerges an idea of how to implement these requirements, an idea which must be made to comply with emissions legislation regulations. Between the idea and series production, the engine passes through a complex development process which can last up to three years in the case of a completely new development.



**DEUTZ Common Rail System (DCR)** The DCR combines the advantages of common rail technology with the compact installation dimensions of DEUTZ engines. The essential features are the two high-pressure pumps, built into the crankcase and driven by the camshaft, which produce a uniformly high pressure in the rail.

**Are there any market opportunities for the product?** First, the market opportunities for the planned new engine are examined and an engineering concept drawn up, containing fundamental design features such as the type of cooling, number of cylinders and the injection system to be employed. From the initial idea emerges a preliminary study which examines whether and how the planned product fits into our corporate and product strategy and estimates its profitability. If the evaluation is positive, the engine moves into the concept phase where quality, production and other concepts are drawn up, initial suppliers selected and the product specifications elaborated. At the same time, profitability is checked and cost analyses carried out. If all the lights still show green, the development phase will begin in which components such as the crankshaft or cylinder heads are specified and initial prototypes trialled in customers' own equipment. The first quality audits will be conducted in parallel.

**The innovation goes into series production** The next phase sees the start of the procurement of parts, components and production equipment. Both the engine and its components will be given technical approval and the process of certifying adherence to the emissions regulations starts. The sales and service documentation is produced before the project moves on to the preproduction phase where the production team and the sales and service staff are trained and the engine is put through endurance testing using series production parts. The supplier – production – customer process chain is optimised and series production ramp-up is planned in detail.

The end of this product development process is marked by approval for the engine to go into series production; deliveries to customers of engines "Made by DEUTZ" can begin.

**As much engineering as necessary** Every new or further development of an engine must remain within the bounds set by emissions legislation. So as to reduce pollutant and noise emissions, we offer our customers a modular system, the DEUTZ Variable Emission Reduction Technology System (DVERT®) for our compact engines with power ratings of up to 500 kW. This ensures that the optimum power and economic efficiency for the relevant application is achieved while, at the same time, it adheres to the prescribed exhaust emission standard. In other words, only as much engineering effort as necessary.

For engines below 100 kW, we currently prefer mechanical injection systems with unregulated exhaust gas recirculation and without electronic engine control or management. In the power output range between 100 and 250 kW, our engines are fitted with mechanical or electronically regulated high-pressure injection systems. Here, we offer either an in-line injection pump system or our DEUTZ common rail system (DCR). Both systems are combined with regulated cooled exhaust gas recirculation. Engines with four-valve technology are available for the most demanding requirements.



**4-valve technology** Compared with 2-valve technology, the two intake and two outlet valves in 4-valve engines provide a better cylinder filling. In addition the central location of the injection nozzle enhances combustion.



**Cooled external exhaust gas recirculation (EGR)** Part of the exhaust gas is recirculated back to the combustion chamber; the lower proportion of oxygen (O<sub>2</sub>) in the intake air reduces the nitrogen oxides in the exhaust gas. With cooled EGR the combustion temperature is lowered and thus the NO<sub>x</sub> emissions are further reduced.

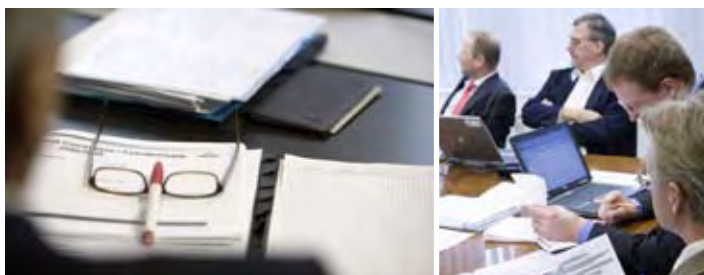


Above 250 kW we equip all engines with a pump-line-nozzle (PLN) system which uses an electronically regulated solenoid valve, the DEUTZ MVS®. In this power output range, every cylinder head is equipped with four-valve technology.

**Exhaust gas aftertreatment essential in future** These internal engine solutions ensure that our engines comply with current Stage IIIA emission standards for non-road applications. However, these measures will no longer be adequate for the

next stage, to be introduced from 2011. An exhaust gas aftertreatment system with a particulate filter and a catalytic converter for nitrogen oxides will be required then. The Selective Catalytic Reduction (SCR) process is available for reducing NO<sub>x</sub> emissions. The process uses ammonia and a catalyst to reduce the nitrogen oxides to nitrogen gas. We have been successfully employing this technology in the series production of our Euro IV engines for commercial vehicles and buses since the end of 2006.

How much development effort lies behind a low-emission **engine?** And in ...



**Round-table design meetings** Market opportunities, engineering design, profitability – before starting on specific development work, the concept for a new engine is gone over with a fine-toothed comb.



**An engine emerges** Always pushing the limits of the technically feasible a little further but not losing sight of the commercially realistic – that's design work at DEUTZ.



**Testing in full swing** Experimental engines run for thousands of hours on the test rigs, innumerable parameters are measured and evaluated, every individual part is checked and checked again. Only then does the engine undergo practical testing in the truck or construction equipment.



**High-quality series production** The right drive system solution for every customer; that's our development maxim for DEUTZ engines. And in the assembly hall we put this claim to high-quality series production into practice – just in time.



# future?

**You hear so much about new fuels and drive technologies. Couldn't these already be used much more widely?**

## **Is the internal combustion engine coming to the end of the road?**

Anyone who has been following the media reports about environmentally friendly mobility in recent years could easily reach the conclusion that the internal combustion engine was nearing its end. However, we are convinced that the 4-stroke internal combustion engine – which Nicolaus August Otto, our company's founder, developed from a functional principle to series-production readiness 130 years ago still has a long way to go. Because of its robust design, its multiplicity of uses and its still huge potential for development it will play the dominant role in very many application segments even in the decades to come.

**The potential for optimising combustion** In coming years, engine manufacturers will initially concentrate their development work on further optimising fuel combustion. The most effective adjustment mechanism for this is the injection system. There is still a great deal of development potential to be exploited here, for example by increasing injection pressures still further, by multiple injection and by even more precise apportioning and homogenisation of the fuel-air mix.

**One engine, various fuels** The use of alternative fuels goes hand in hand with optimising the combustion process. The foreseeable scarcity and thus the increase in price of oil-based fuels such as diesel and petrol will force a search for alternatives. This is where internal combustion engines can demonstrate their huge advantage: they can be run on numerous different types of fuel, ranging from petrol and diesel to hydrogen. One of the more important alternatives for the diesel engine is rape methyl ester (RME), a fuel produced from [rape oil](#), and now being increasingly taken up in the German agricultural sector because of its favourable tax treatment. A diesel engine can be converted to run on RME at relatively little cost; this is an option which DEUTZ has been offering its customers for a number of years. The advantage of this so-called biodiesel is partly the considerable reduction in emissions of particulates, hydrocarbons and carbon monoxide. This positive effect is, however, partly offset by the slight increase in nitrogen oxide emissions and higher fuel consumption.

**Synthesis does it** In the next few years, the proportion of synthetically produced fuels will also increase significantly. Synthetic fuels can be subdivided into the "Gas to Liquid" (GTL) fuels, based on natural gas and also known as "synfuels", and the "Biomass to Liquid" (BTL) fuels, produced from biomass which also go under the name of "sunfuels". Both fuels enjoy the advantage of being produced synthetically from a base material containing carbon; this allows the characteristics of the fuel and the combustion process in the engine to be more

**1 Rape methyl ester (RME, biodiesel)** Biodiesel is produced from vegetable oils esterified with methanol and is very similar to mineral-based diesel. As a climate protection measure, today's diesel fuel already contains up to 5 per cent RME.

**2 Hydrogen (H<sub>2</sub>)** Hydrogen can be used either as fuel in an internal combustion engine or in a fuel cell for electrolysis with oxygen. Hydrogen is not a primary energy source; it first needs to be produced using energy.



closely harmonised with each other than is the case when refining mineral oil fuels. The result is a large potential for further reductions in NO<sub>x</sub> and particulate emissions. An additional advantage of the BTL fuels is that they are produced from biomass and thus have a largely neutral carbon dioxide (CO<sub>2</sub>) budget. However, with the increasing use of fuels produced from biomass, the question as to where the biomass to produce the fuel in such large quantities is to come from is often forgotten. According to the German specialist agency for renewable resources, "Fachagentur Nachwachsende Rohstoffe", renewable raw materials, i.e. agricultural and forestry products not intended for use as foodstuffs, are already being grown on roughly 13 per cent of the arable land in Germany.

**Hydrogen is still a long way into the future** One alternative which looks very attractive at first sight is using hydrogen. Combustion of this gas produces water vapour and nitrogen oxides, the latter however in considerably smaller volumes than with petrol or diesel engines. And the internal combustion engine is most definitely suited to being run on hydrogen. There are, however, two serious disadvantages which suggest that using hydrogen as a fuel – whether in the internal combustion engine or in the fuel cell – will not be an economical alternative for some decades. First, producing hydrogen is very energy-intensive. Since electricity is at present largely generated from fossil fuel sources, the total CO<sub>2</sub> emissions from producing and combusting hydrogen would exceed the emissions from using diesel or petrol. Second, hydrogen has the very low boiling point of -253°C; this would require costly precautions to be put in place for the distribution and storage of hydrogen and for refuelling vehicles and machinery.

**Would alternative drive systems be the solution?** When considering emissions, the question which naturally springs to mind is whether there is an alternative to the internal combustion engine. The answer is a clear and simple "No". No current drive concept offers a genuine alternative to the internal combustion engine as regards sturdiness, reliability and versatility. However, the hybrid drive, i.e. combining an internal combustion engine with an electromotor, is already providing some interesting options. The strengths of this

drive concept lie in storing and making use of the excess energy produced by the internal combustion engine under part-load operation. This energy is stored in a battery and is released again via an electromotor to the drive train whenever the vehicle accelerates or is driven at full-load operation. This division of labour between an internal combustion engine and an electromotor can save up to 20 per cent of the fuel; however, it is clear that the most sensible use for it is in applications with a high proportion of part-load operation. This is the case with, for example, wheel loaders, forklift trucks and aircraft towing vehicles. We are convinced that this drive concept has potential advantages for many of our customers and we are therefore undertaking a pilot project to investigate the possible option of using hybrid technology in mobile machinery.

In contrast, it will still be a decade or two until the fuel cell – already treated in recent years as the prime candidate for replacing the internal combustion engine – is employed on a large scale in vehicles and industrial applications. However tempting clean power generation from the electrolysis of hydrogen and oxygen may be in principle, there is still a long way to go before this type of drive system can meet the demands which are made of the internal combustion engine as regards torque, variable power output and power/weight ratio.

**The all-rounder will meet with competition** Along the way, we shall first see the optimisation of those fuels which are based on fossil energy sources; and later on, the proportion of fuels produced from renewable energy sources will increase. At the same time, the internal combustion engine will be improved further but will meet with competition, first from the hybrid drive and later from the hydrogen engine and the fuel cell. DEUTZ is also working hard at these alternative design concepts so that we can offer the right drive option to our customers at the right time.



**3 Hybrid drive** The internal combustion engine and the electromotor are combined in the hybrid drive. Generating and converting energy and the subsequent release of that energy occur at different times; the energy is buffer-stored in a battery.



**4 Fuel cell** In a fuel cell drive system, the fuel cell employs a chemical reaction to generate the electric power for an electromotor which drives the vehicle or equipment.



# Interview



**Karl Huebser,**  
Management Board: Technology

**Mr Huebser, is emissions legislation a curse or a blessing?** When you see that since 1993, the year in which the Euro I standard was introduced, emissions from diesel engines in commercial vehicles have fallen by up to 90 per cent and that a reduction of roughly 60 per cent has been achieved for industrial motors in eight years, this is of course, a very positive thing for all of us. As an international engine manufacturer, we benefit from the development pressure imposed by emissions legislation. It separates the wheat from the chaff; you can only survive in this hard-fought competitive market if, like us, you are innovative and invest appropriately in advanced technologies.

**How has development work changed compared with former times?** The demands are clearly greater than 15 or 20 years ago. For one thing, development cycles are becoming ever shorter, meaning that we always have less time to implement technical improvements. For another, it's a question of balancing our customers' wishes for better performance and lower consumption with the constant lowering of the limits in emissions legislation.

**Which fuel will DEUTZ engines be burning in ten years?** We shall probably first see further optimisation of diesel fuel, for example, a significant reduction in the proportion of sulphur. Then, the proportion of synthetic fuels will also grow in the next few years, both the GTL fuels, produced from gaseous raw materials, and the BTLs or sunfuels, based on biomass. And finally, hydrogen may well come to the fore, whether used in the internal combustion engine or in the fuel cell.

**What is your estimate of the chances for alternative drives?** There is no other drive concept at present which is a match for the internal combustion engine as regards versatility, reliability and economic efficiency. The technology is fully mature and the internal combustion engine still has much optimisation potential as far as consumption and emissions are concerned. It also has the great advantage that it can be run on many different fuels ranging from petrol to RME (i.e. biodiesel) to hydrogen. The hydrogen engine and the fuel cell will only achieve large scale success once the technical and commercial problems of generating and distributing hydrogen have been solved. In contrast, we shall pretty soon see the hybrid drive in non-road applications.

**Is DEUTZ well prepared for implementing new technologies?** We can look back on over 140 years of experience in engine construction; our engines are capable of using RME fuels and we are working hard at employing hybrid technology in mobile machinery. We are conducting pilot projects to research the potential of the gas engine and of the hydrogen-powered internal combustion engine and the fuel cell. Yes, we are well prepared for the future and we shall continue to play an active part in shaping it.

“I find it a great challenge to be working at DEUTZ, building engines which are ever more clean, economical and quiet and which also offer our customers even more performance. I’m proud of being able to make an important contribution to a

**cleaner environment**  
and, as a result, to a better life for us all in the  
**future.”**





# Strategy

DEUTZ IS AN INDEPENDENT MANUFACTURER OF ENGINES WITH CORE COMPETENCIES IN THE DEVELOPMENT, DESIGN, PRODUCTION AND SALES OF DIESEL AND GAS ENGINES. IN 2006, DEUTZ ENTERED A NEW PHASE OF STRATEGIC DEVELOPMENT: AFTER ESTABLISHING THE NECESSARY OPERATING AND FINANCIAL BASIS IN PRIOR YEARS, THE FOCUS WAS NOW SWITCHED TO GENERATING A SIGNIFICANT BOOST TO GROWTH AND PROFITABILITY.

## Compact Engines

The Compact Engines segment concentrates on diesel engines up to 500 kW for

- Mobile machinery: construction equipment, material handling equipment, ground support equipment, underground equipment
- Stationary equipment: generators, pumps, compressors
- Agricultural equipment: tractors and other agricultural machinery
- Automotive applications: commercial vehicles (trucks, buses), rail vehicles
- Marine applications: merchant vessels and vessels used by public authorities.

DEUTZ is well established in these sectors. Throughout the world, the “DEUTZ” brand stands for quality and customised engine solutions.

## Growth via strategic partnerships

DEUTZ is seeking to establish long-term cooperations with major high-volume equipment and vehicle manufacturers. DEUTZ has had an alliance with AB Volvo since 1998 involving 4-litre to 8-litre engines. Since then it has been able to achieve consistent expansion of the venture. The engines are used in construction equipment, gensets and commercial vehicles.

In 2003, DEUTZ agreed the basic terms of a cooperation with the Italian agricultural equipment manufacturer, SAME DEUTZ-FAHR Group S.p.A., to produce engines for use in agricultural equipment. Under this agreement, SAME DEUTZ-FAHR will gradually cease its own engine production in Italy and DEUTZ will take over as the principal engine supplier to the Italian group from 2007.

Both alliances are making a significant contribution to the growth in business for engines with a capacity of 4 to 8 litres. In the year under review, unit sales in this engine category rose by just under 28 per cent to over 100,000 engines. Further significant increases will be achieved in 2007 as a result of accelerated expansion in these cooperations.

## DEUTZ 2001 – 2012, 4 phases

### 2001–2003

Relaunch – 5 key points

### 2004–2005

Restructuring and focussing



- Focussing the of model range
- Concentration of production
- Leaner structures
- Quality offensive
- Promotion of cooperations

- Strategic realignment of mid-sized and large engines to focus on power generation using gas engines (DEUTZ Power Systems)
- Start of optimisation and expansion of production capacity
- Reinforcement of existing cooperations

- Preparation for an innovation offensive
- Turnaround and basis for accelerated growth

In 2006, the TCD 2013 4V commercial vehicle engine jointly developed with Volvo entered series production on schedule. The engine is fully compliant with the Euro IV and V emission standards. From 1 October 2006, the Euro IV emission standard applied to commercial vehicles in Europe; compliance with the Euro V standard is mandatory from 1 October 2009. This best-in-class engine, with its particularly high power density, is used in medium-sized Volvo and Renault trucks and buses. The assembly hall specially constructed for the production of this commercial vehicle engine has a capacity of 30,000 engines a year and can be expanded to 50,000 engines. In the year under review, unit sales and revenue in automotive applications registered a significant upturn following the start of production for this engine. This trend will be accelerated in the current year.

#### New product development for commercial vehicle ap- plications

Future internationalisation of the business will be focussed on the Asia-Pacific region. The company strengthened its presence in China, an important market of the future, as early as 2002 when it entered into a technology transfer agreement with the Chinese commercial vehicle manufacturer China First Automobile Works Group Corp. (FAW). This partnership was taken a step further in December 2006 with an agreement to establish a joint venture in China. The joint venture, in which 50 per cent of the company is owned by DEUTZ AG and 50 per cent by FAW Jiefang Automotive Co., Ltd. (FAW Jiefang), a wholly owned subsidiary of FAW, will produce diesel engines primarily destined for the Asian market.

#### Development of inter- national business in the Asia-Pacific region

Among other things, FAW Jiefang's contribution to the joint venture will be a new state-of-the-art plant in which it will manufacture licensed DEUTZ engines. Its initial annual capacity as from 2007 will be 50,000 engines, and this could eventually be increased to 100,000 engines. The engines will be used in commercial vehicles and in industrial applications, such as construction equipment and agricultural machinery. They will mainly be sold to international DEUTZ clients in Asia and to the FAW Group. The joint venture will also have sufficient capacity to manufacture a further 100,000 or so local engines for the FAW Group and the local Chinese market. The value of the DEUTZ investment in this joint venture is of the order of €60 million.

As far as DEUTZ is concerned, this alliance with FAW reinforces both its position in the global commercial vehicle segment and growth in the 4-litre to 8-litre engine class. In the medium term, this commitment in a low-wage country will improve the cost structure across the group of DEUTZ production sites.

After all the necessary approvals have been obtained, the joint venture will be brought into operation in the current financial year and it will be rapidly integrated into existing structures. Efforts will be concentrated in particular on the commencement of production at the new engine plant.

#### 2006–2008 Acceleration

#### 2009–2012 Expansion



- Optimisation of locations
- Development of DEUTZ Customised Solutions
- Internationalisation – establishment of DEUTZ Dalian
- Expansion of existing business
- Further strengthening of cooperation strategy
- Broadening of product range
- “7 up”, efficiency and growth programme

- Continuation of internationalisation and growth strategy
- Development of two new business areas
- Engines for alternative fuels
- Added-value services for customers

**Engines with capacities of less than 4 litres**

In the last few years, DEUTZ has added to its range of engines with capacities of less than 4 litres by introducing new series with lower power outputs, specifically with outputs below 50 kW. There is an increasing trend towards compact units in this market segment. In Europe and North America, there are particular growth prospects in this segment as far as mobile machinery is concerned. In 2006, DEUTZ sold over 98,000 engines in this class, representing a growth of around 17 per cent.

**Optimisation of sites**

For more than 60 years, air-cooled diesel engines have been one of the company's core competencies. At the end of the year under review, all activities concerned with these air-cooled diesel engines were concentrated at the Ulm facility, together with the liquid-cooled engine business for units with capacities over 8 litres. To accommodate these changes, some €10 million is being invested in the expansion of the site. Ulm has therefore become the company's competence centre for air-cooled engine activities. As part of the further development of its product portfolio, DEUTZ also started production in 2006 of an air-cooled engine compliant with Stage 3 emission standards. In the year under review, the company sold a total of 33,000 air-cooled engines, a 17 per cent increase on 2005. Across all output ranges, this makes DEUTZ the global market leader for this type of engine.

**Compact engines service**

The service business comprises commissioning, spare parts supply, repairs, servicing and maintenance support for customers. The global service network consists of the company's own subsidiaries and service centres, together with authorised dealers. The parts service is managed via three centralised warehouses in Germany, the USA and Singapore. Compact engines are supported with the availability of parts for around ten years. The range of service support operations was gradually expanded in 2006. For example, 2006 saw the introduction of hologram security labels for genuine parts to help fight product piracy, a new oil diagnostics procedure to facilitate an assessment of engine wear, and specifically designed service packages tailored to local customer requirements. An important part of the service business is also the availability of reconditioned exchange parts and engines promoted under the name "DEUTZ Xchange".

**Gas engines for decentralised power generation**

**DEUTZ Power Systems**

In the year under review, DEUTZ Power Systems took another significant step closer to achieving its declared goal of becoming the global market leader in gas engines. Further concentration of research and development activities on optimising the current engine portfolio in terms of efficiency, performance and environmental friendliness has reinforced the company's role as a technological leader. This trend has been supported by the company's specialisation in renewable energy sources and is reflected in the unit sales achieved. In 2006, gas engines accounted for around 90 per cent of the engines sold in DEUTZ Power Systems, compared with a figure of 57 per cent in 2005. In the year under review, installed gas engine output amounted to a total of around 681 MW, equivalent to an increase of almost 40 per cent year-on-year. Of this total output, around 36 per cent was accounted for by engines run on renewable energy sources, in particular biogas. This growth is being helped by the advantageous conditions created by a sustained increase in the importance of environmental and climate protection; the conversion of these special gases into electricity, heat and/or cooling contributes to the reduction in emissions that have a negative impact on climate.

**Expansion of market position**

In 2006, DEUTZ Power Systems has also continued the expansion of its international presence. Measured on the basis of the output of newly installed gas engines, global market share was increased to around 18 per cent. The growth markets of Europe and Asia were the focus of this expansion, and will continue to be so in the current financial year. DEUTZ Power Systems is the market leader for gas engine applications in Germany with a market share of around 42 per cent. The push towards the segment's independence with its own clear focus was underpinned by the development of its own subsidiaries and distribution partnerships, and by the uniform presentation of all its activities under the DEUTZ POWER SYSTEMS brand name. The service business was also substantially reinforced as part of this strategy. With the continuous expansion in its service offering, ranging from pure machine maintenance and repair to complete project development and power plant operation services, DEUTZ Power Systems is in an excellent position to achieve further growth in its existing long-term customer relationships and capture a leading market position in the future.

# Interview



**Gordon Riske**  
Chairman of the Management Board

**What gives you greater satisfaction – managing a turnaround or growth?** One after the other in the same company! Managing the turnaround in DEUTZ – in a business subject to long development cycles – was certainly a great challenge. The decisions demanded in a turnaround phase are not always easy. You have to be persistent and rigorously implement the action required to achieve your defined goals, even if this involves severe cuts, such as the closure of the foundry in 2003. Now, where we have stabilised our operating business, we can devote ourselves to issues that we just didn't have the strength to cope with five years ago. Demand for our engines is continuously rising worldwide and we are increasingly working at full capacity. We are therefore investing more in the expansion of production capacity and, at the same time, increasing our presence in regions with strong growth.

**What do you think are DEUTZ's competitive advantages?** Our technological expertise, independence and flexible structures mean that we are an ideal partner in a market that is subject to increasingly rapid change and increasingly stringent requirements as far as the reduction of emissions is concerned. Established as the very first engine manufacturer, we are now, with over 140 years of experience, the engine company with the longest tradition in the world. Our extensive value chain includes development, design and the production of engines, together with associated service support operations. A critical factor for our customers is that we do not produce our own equipment or vehicles because our business involves a comprehensive transfer of knowledge between customer and supplier. Our lean organisation means that we are in a position to respond very quickly to customer requirements. In this way, we are also able to generate competitive advantages for our customers.

**“You have to be persistent and rigorously implement the action required to achieve your defined goals.”**

**In 2007 you initiated the “7 up” programme. What is the purpose of this programme?**

“7 up” stands for the achievement of an EBIT margin of 7 per cent in 2007. The goals of the supporting action plan are an increase in efficiency and growth. This involves, for example, the optimisation of internal processes, the improvement of procurement processes and the optimisation of in-house production. The development of DEUTZ Customised Solutions, the business area built around air-cooled engine activities, is part of “7 up”. It also includes measures to improve service revenue.

**Alliances ensure stability. To what extent can growth be planned?** Cooperation with major equipment and vehicle manufacturers to a great extent actually secures our stability and growth. However, fluctuations in the markets in which our customers are active also indirectly affect our business. If customers sell fewer units of equipment than originally planned, then they will also only purchase the corresponding number of engines. However, we have a broadly structured customer base and the barriers to market entry in this business are high: original equipment manufacturers normally consider a change of supplier before a new stage of emission standards comes into force or a new generation of equipment is to be launched. Lead times for the installation of production-ready engines in customer applications can be up to three years.

# DEUTZ shares

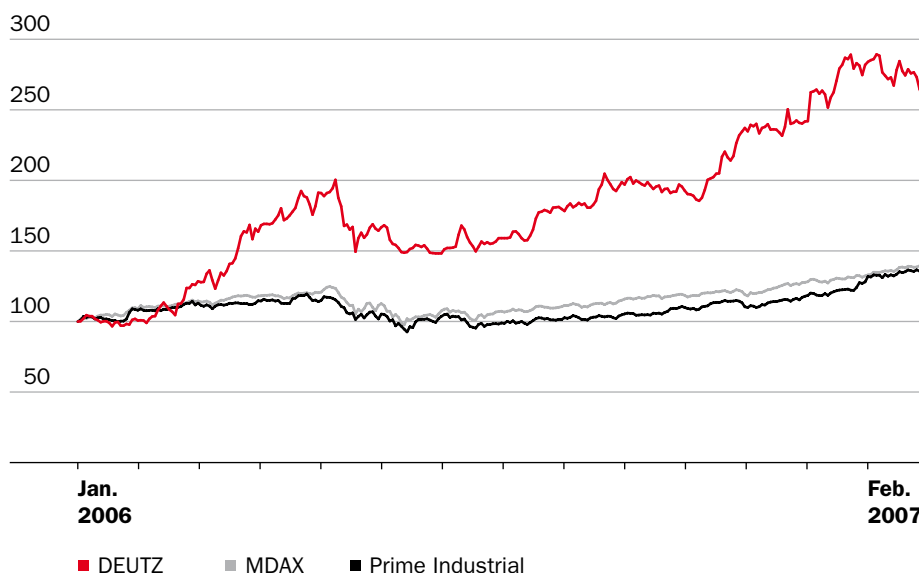
WITH A GAIN OF 143 PER CENT, THE PERFORMANCE OF DEUTZ SHARES IN 2006 WAS SPECTACULAR. A HIGHLIGHT WAS THE INCLUSION OF THE SHARES IN THE MDAX INDEX IN SEPTEMBER. AT THE END OF 2007, AND AFTER A GAP OF SOME 20 YEARS, DEUTZ AG WILL ONCE AGAIN BE IN A POSITION TO DECLARE A DIVIDEND WITH THE POSSIBILITY OF A DIVIDEND PAYMENT FOR 2007.

## DEUTZ shares are top MDAX performer with gain of 143 per cent

In 2006, DEUTZ shares performed extraordinarily well, delivering above-average growth. At the end of 2006, the DEUTZ share price closed at €10.05, up 143 per cent on the 2005 closing price. This means that DEUTZ shares were the year's top MDAX performers, leaving both this index and the Prime Industrial sector index trailing far in their wake. The MDAX rose by around 29 per cent with the sector index gaining just 19 per cent. The leading share index in Germany, the DAX, was up 22 per cent year-on-year at the end of 2006.

### Share price performance

in %



## Profit trend, membership of MDAX and prospects in China reflected in share price performance

There was a good deal of movement in the share price during the course of the year. After dipping to a low for the year of €4.00 on 18 January 2006, the share price began to move upwards, a trend that continued in the second quarter of 2006. In the period April to June it reached a high of €8.32, before falling back to a low for the period of €6.15 at the end of the quarter. Following excellent company results, which were then rewarded by the markets, and membership of the MDAX, the upward trend was significantly reinforced during the second half of the year. In mid-August, the share price first reached €7.00 before passing the €8 mark in mid-September. Following publication of results for the third quarter, the share price reached €9.00 for the first time on 15 November 2006. The announcement on 18 December 2006 of the establishment of a joint venture in China provided a further boost with the share price reaching its overall high for the year of €10.40 on this day.

## Conversion of profit-sharing rights and bonds

There was a significant increase in the number of shares in issue at 31 December 2006 as a result of the conversion of profit-sharing rights and bonds, in particular by SAME DEUTZ-FAHR Holding & Finance BV, during the course of the year under review.

Of the bonds issued in 2004, 9,339,625 convertible bonds were converted to shares in 2006 by various bond holders, which means that, since the issue, a total of 13,195,301 conversion rights have been exercised, leaving 6,597,697 outstanding at 31 December 2006. At the end of 2006, 1,212 profit-sharing rights remained available for conversion.



The result was that the exercise of profit-sharing rights and convertible bonds produced an increase in the number of shares at the balance sheet date to 114,326,416 (31 December 2005: 95,003,621)

Given the significant increase in the number of shares at the end of the year and the sharp increase in the share price, the market capitalisation of DEUTZ AG showed an almost threefold increase at the end of 2006 to €1.15 billion, compared with the figure of €393.3 million at the end of 2005. At the end of December 2006, DEUTZ was therefore ranked at 52 in the Deutsche Börse AG share rankings (which only take into account free float). Based on trading volume, DEUTZ AG was ranked at 47.

### Threefold increase in market capitalisation

Earnings per share is calculated by dividing the consolidated net profit for the year by the weighted average number of shares in issue. In 2006, the average number of shares in issue was 107.2 million. The undiluted earnings per share in the year under review amounted to €0.57. The figure in 2005 was €0.77, although this was based on a significantly lower average weighted number of shares of 92.6 million.

### Earnings per share €0.57

In 2006, DEUTZ AG generated a net income for the year of €29.7 million. After taking into account a loss carried forward from 2005 of €21.6 million and an addition to the legal reserve of €0.4 million, the accumulated income (before appropriation of profit) was €7.7 million. The net profit for 2006 therefore enabled full recovery of the outstanding losses carried forward in DEUTZ AG. The Management Board is proposing that the accumulated income at 31 December 2006 be retained in the new financial year.

### Dividend declaration expected for 2007

On the basis of this carry-forward and the projected results in 2007, DEUTZ AG will have a sufficient accumulated income at the end of 2007 to once again permit the declaration of a dividend after a gap of some 20 years, opening up the possibility of a dividend payment in 2008.

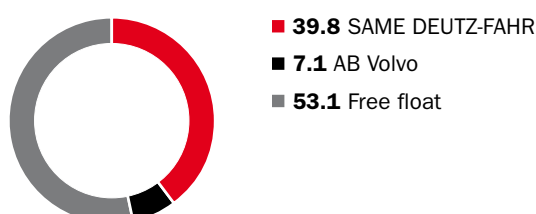
The largest single shareholder continues to be SAME DEUTZ-FAHR Group S.p.A (SDF). The size of the SDF shareholding increased during the course of the year from 29.9 per cent at the end of December 2005 to 39.8 per cent at the end of 2006. The increase was mainly the result of the conversion of profit-sharing rights and bonds. Although there was some fluctuation in the proportion of shares held by AB Volvo as a result of the increased number of shares following conversions by bond holders during the course of the year and the purchase of additional shares by Volvo itself in July 2006, its shareholding at the end of 2006 was, as at the end of 2005, 7.1 per cent. In addition, FMR Corp., USA, a company in the Fidelity Group, exceeded the reporting requirement trigger level in April 2006 with a holding of 5.1 per cent. In December, the FMR shareholding fell back to 4.98 per cent.

### Stable shareholder structure

Following the conversion of profit-sharing rights and bonds in May, SAME DEUTZ-FAHR Holding & Finance BV exceeded the threshold of a 30 per cent shareholding in DEUTZ AG and issued a mandatory offer to acquire all DEUTZ shares pursuant to the provisions of the German Securities Acquisition and Takeover Act (WpÜG). The offer at a price of €6.12 per share was valid from 3 June to 3 July 2006. The Management Board and Supervisory Board of DEUTZ AG issued a joint statement recommending that shareholders reject the offer. First, at the time of the offer, the value of DEUTZ shares calculated using all applicable methods was significantly higher than the offer price. Secondly, the Management Board and the Supervisory Board were of the opinion that the independence of the company was a significant prerequisite for optimum exploitation of the potential value added in DEUTZ.

### Mandatory offer in June 2006

#### Shareholder structure as at 31 December 2006 in %



**DEUTZ included in  
research coverage of  
numerous banks**

In the year under review, seven banks added DEUTZ to their research coverage. There are therefore now eleven institutions regularly reporting on DEUTZ and carrying out intensive analyses of DEUTZ performance:

- Berenberg Bank
- Bankhaus Lampe
- Cazenove
- Dresdner Kleinwort
- DZ Bank
- HSBC Trinkaus & Burkhardt
- M. M. Warburg
- Sal. Oppenheim
- Solventis Wertpapierhandelsbank
- UBS
- Viscardi Securities

**Investor relations  
activities in 2006**

Communication with institutional and private investors focusses on a continuous flow of comprehensive information regarding the ongoing business performance of the company accompanied by details on topics of particular importance for the strategic positioning of the company. In conference calls for analysts and investors alongside every interim report, DEUTZ reports in detail on current business performance and on the prospects for the Group. The corresponding presentations are made available simultaneously on the Internet. In addition, the Management Board makes presentations on the company in roadshows and in one-on-one meetings, both in Germany and abroad. In 2006, roadshows were held in London, Frankfurt, Paris, Milan, Geneva/Zurich and New York/Boston. Finally, DEUTZ also took part in stock market conferences. Prospective investors can find a wide variety of information on the DEUTZ AG website ([www.deutz.com](http://www.deutz.com)) to help them assess DEUTZ shares. This information includes, in particular, press releases, company reports, shareholder structure and investor relations presentations. Important forthcoming dates are summarised in a financial calendar, which is also available on the website.

**DEUTZ shares**

ISIN	DE0006305006
WKN	630500
Reuters	DEZG.F
Bloomberg	DEZ.GR
Market segment	Official market/Prime Standard
Traded at	Xetra, Frankfurt, Düsseldorf

	<b>2006</b>	<b>2005</b>
Number of shares (31 December)	114,326,416	95,003,621
Number of shares (average)	107,161,106	92,584,625
Share price (31 December) in €	10.05	4.14
Share price (high) in €	10.40	4.68
Share price (low) in €	4.00	2.86
Market capitalisation in € million	1,148.9	393.3
Undiluted earnings per share (€)	0.57	0.77
Diluted earnings per share (€)	0.52	0.62

Based on Xetra closing prices

# Interview

**Helmut Meyer**

Management Board: Finance/Personnel



**How do you assess the current shareholder structure?** We have a stable shareholder structure based around our two major shareholders, SAME DEUTZ-FAHR and Volvo. Both of these shareholders have a long-term strategic orientation; we also have industrial cooperation agreements with both of them, each covering a period of 15 years. Engine manufacture is a long-term business, in which close cooperation between supplier and customer is indispensable. Our engines are normally tailored to the precise requirements of customer equipment as part of a collaborative relationship over many years. The aim of our major investors in holding shares in DEUTZ is therefore twofold: to provide a secure foundation for the industrial partnership and to support their overall strategic interests. The current shareholder structure also secures our independence in the marketplace, which is important for the DEUTZ business model. We share the opinion with SAME DEUTZ-FAHR that the independence of DEUTZ represents a significant factor in the success of the business.

**Do you have any comment on the regional distribution of your shareholders?** As far as we know, apart from the holdings of our major shareholders, appreciable shareholdings are held by fund management companies based in the United Kingdom and the USA. These shareholders are followed by investors in Germany. Hitherto, investors in other European countries have been of minor significance.

**With which other equities is DEUTZ comparable?** We tend to compare ourselves with market players who, like us, are independent engine manufacturers, and with the major equipment and vehicle manufacturers who also produce engines for their own requirements. A company particularly worthy of note in the first category is the American company, Cummins Inc. In the second category, Caterpillar, John Deere, Kubota, Volvo, MAN and AGCO are particularly important. These companies are the major influential players in the sectors in which we sell most of our engines, such as construction equipment, agricultural machinery and commercial vehicles. This peer group also best represents the wide range of influences and the international structures that are relevant to our business, for example the American economy in the construction equipment sector or the European economy as far as medium-sized trucks are concerned.

**To the surprise of many, DEUTZ joined the MDAX in September. What changes did this mean for DEUTZ?** You can say with some certainty that the markets became significantly more aware of DEUTZ as a result. This is noticeable from the increase in research coverage by the banks and also from a higher demand from investors for management meetings. We are also receiving more attention from the media, and in more detail. Not least, in the MDAX we are also exposed to a new yardstick in the capital markets. Share liquidity is also higher than in the SDAX. This now offers larger investors more of an opportunity to invest in our shares.

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# Corporate governance report

DEUTZ AG PLACES THE UTMOST IMPORTANCE ON TRANSPARENT AND RESPONSIBLE CORPORATE MANAGEMENT AND CONTROL WITH THE AIM OF ACHIEVING LONG-TERM GROWTH IN ENTERPRISE VALUE.

## Declaration of compliance

In accordance with their corporate responsibilities, the Management Board and the Supervisory Board held intensive consultations on the extent to which it was and is appropriate for DEUTZ AG to apply in detail the rules and recommendations of the German Corporate Governance Code (DCGK) as set out in the version dated 12 June 2006. The following declaration of compliance provides information on the results of these internal consultations.

The declaration of compliance in 2005 reported that shareholders were not offered the option of following the Annual General Meeting using modern communication media. However, since the relevant section of the DCGK (section 2.3.4) is not a recommendation, but simply a suggestion, and shareholders are otherwise offered sufficient means by which they can exercise their rights, this item has not been included in the current declaration of compliance. The departure from the DCGK regarding the publication of Management Board salaries reported under points 2 and 3 of the 2005 declaration of compliance could now be summarised under point 2 of the current declaration of compliance following amendments to the DCGK. DEUTZ is endeavouring to ensure that it will have to report even fewer deviations from the DCGK in the declaration of compliance for 2007. The current declaration of compliance dated December 2006 has been published on the DEUTZ website, as have previous declarations. DEUTZ AG complies with all the recommendations with the following exceptions:

1. The D&O insurance taken out by DEUTZ AG for the members of the Management Board and Supervisory Board does not provide for any excess because the adjustment of the contracts to accommodate this change would lead to considerable additional cost for the company (item 3.8 (2) DCGK).
2. We have not hitherto published remuneration details for members of the Management Board and Supervisory Board on an individualised basis (items 4.2.4, 4.2.5 and 5.4.7 (3) DCGK). The company will disclose remuneration details for members of the Management Board and Supervisory Board in accordance with legal and DCGK requirements starting with the annual financial statements for 2006.
3. There is no age limit in DEUTZ AG for members of either the Management Board or Supervisory Board (items 5.1.2 (2) sentence 3 and 5.4.1 sentence 2 DCGK).
4. The consolidated financial statements for 2005 were delayed slightly owing to the transition to IFRS; these financial statements were only available to the public from 2 May. For the same reason, the interim report for the first quarter 2006 was only published on 24 May 2006. In future, the company will comply with the deadlines under item 7.1.2 sentence 2 DCGK.



DEUTZ aims to live up to the confidence placed in the company by shareholders, employees and customers by exercising good, responsible management and control. Open, constructive dialogue and continuous cooperation between Management Board and Supervisory Board are of particular importance for good corporate governance. The Management Board and Supervisory Board were particularly focussing on ensuring the benefit of returns for all shareholders in DEUTZ when they recommended in their joint statement that shareholders should reject the mandatory offer that was issued by SAME DEUTZ-FAHR to DEUTZ shareholders during the year under review. Further details can be found in the report of the Supervisory Board on page 6 of this annual report.

Good corporate governance also means transparency as well as the provision of timely, consistent information to all parties involved in capital markets, media and interested members of the general public. DEUTZ reports four times a year on the performance of the company and on any material changes. Relevant information, such as press releases, ad hoc statements, changes to voting rights, investor relations presentations, interim and annual reports, is made available in German and English to all target groups on the company's website at [www.deutz.com](http://www.deutz.com). The financial dates page provides up-to-date information on significant dates in the company's financial year. In addition to the regular publication of information, DEUTZ AG also provides details of circumstances that are not publicly known and that could have a significant impact on the DEUTZ share price were they to become known. The reporting therefore complies with the rules defined in the German Corporate Governance Code.

DEUTZ AG is a German public limited company and the executive and monitoring functions in the company are therefore assumed by the Management Board and Supervisory Board. The Management Board currently comprises three members. In accordance with the provisions of the German Codetermination Act, the Supervisory Board of DEUTZ AG comprises twelve members, six members being the representatives of the shareholders and six members being the representatives of the employees. No member of the Supervisory Board was previously a member of the company's Management Board at any time in the past. In the period under review, there were no consultancy or other service agreements in existence between the members of the Supervisory Board and the company. The Supervisory Board advises and monitors the Management Board. The committees formed by the Supervisory Board take responsibility for some of the activities of the Supervisory Board. The Supervisory Board of DEUTZ AG has created three committees. These are the Human Resources Committee and Audit Committee pursuant to section 7 (1) and (2) of the rules of procedure for the Supervisory Board and a committee pursuant to section 27 (3) German Codetermination Act (Arbitration Committee). In each case, these committees comprise representatives of both the shareholders and employees. The responsibilities of the committees and the key areas in which they provide advice are set out in the report of the Supervisory Board in this annual report. The membership of the committees is shown on page 127.

## Responsible cooperation between Management Board and Supervisory Board

## Transparent reporting

## Supervisory Board and committees

## Remuneration of the Management Board

### Remuneration report

The annual remuneration of individual members of the Management Board consists of fixed and variable components. The variable remuneration component is profit-related and is based on the development of certain key performance indicators, such as revenue, EBIT margin, ROCE and net financial debt in the Group. Further information on the remuneration paid to the Management Board can be found in the notes to the consolidated annual financial statements on page 118.

## Remuneration of the Supervisory Board

The remuneration of the Supervisory Board is fixed by section 15 of the Statutes of the company. The members of the Supervisory Board of DEUTZ AG receive a fixed annual remuneration of €12,500. They are also entitled to claim reimbursement of their expenses, plus an attendance fee of €1,000 for each Supervisory Board meeting they attend. The members of the Supervisory Board also receive €2,000 each for each percentage point by which the dividend exceeds 4 per cent of the paid-in share capital; this is payable proportionately in the case of fractions of percentage points. The chairman of the Supervisory Board receives double these amounts, and his deputy one and a half times. The chairmanship and membership of Supervisory Board committees is remunerated separately in accordance with the German Corporate Governance Code. In addition, each member of a Supervisory Board committee receives an attendance fee of €1,000 for each committee meeting attended. The chairman of a committee is entitled to twice this sum, his deputy to one and a half times. The members of the Supervisory Board also receive reimbursement of any value-added tax incurred by them in performance of their work for the Supervisory Board. Further information on the remuneration paid to the Supervisory Board can be found in the notes to the consolidated annual financial statements on page 118.

## Dealings subject to reporting requirements

Under section 15a German Securities Trading Act (WpHG), persons exercising a management function in DEUTZ AG must report their own dealings in shares of the company, or in financial instruments based on such shares, to the company and to the German Financial Supervisory Authority within five working days. This obligation also applies to persons who are closely related to such a person.

In 2006, DEUTZ AG received two such notifications. According to these notifications, on 16 August 2006, the Chairman of the Management Board, Gordon Riske, sold 50,000 privately issued options entitling the holder to purchase one no-par value share in DEUTZ AG per option. The exercise price per option was €2.70. The sale was conducted outside the stock exchange at a price of €4.20 per option. In addition, on 21 December 2006, Mr Riske sold 150,000 privately issued options entitling the holder to purchase one no-par value share in DEUTZ AG per option. The exercise price per option was €5.50. The sale was conducted outside the stock exchange at a price of €4.50 per option. Both dealings were published without delay on the DEUTZ AG website. Further details on the share-based remuneration programme can be found in the notes to the consolidated annual financial statements on page 117 of this annual report.

At 31 December 2006, there was no ownership subject to reporting requirements pursuant to item 6.6 (2) German Corporate Governance Code.



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# Group Management Report

## INTRODUCTION

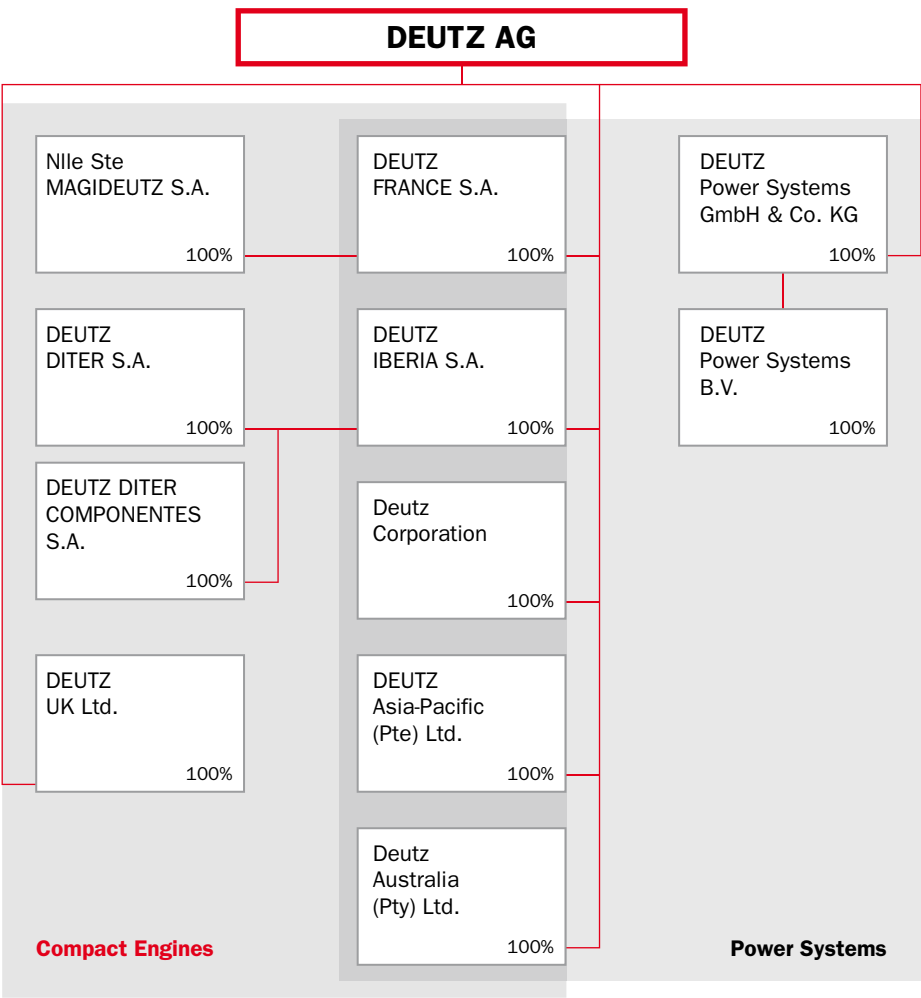
The figures for the years 2005 and 2006 are only comparable on a limited basis owing to the sale of the marine service business on 31 March 2005. This restriction on comparability affects the consolidated figures and, at segment level, those for DEUTZ Power Systems. To improve comparability, the comments on important key figures for the Group and the DEUTZ Power Systems segment also refer to adjusted figures for 2005.

## GROUP STRUCTURE AND BUSINESS ACTIVITIES

DEUTZ is an independent manufacturer of diesel-powered and gas-powered engines. The Group's activities are divided into two segments: Compact Engines and DEUTZ Power Systems.

DEUTZ AG is the executive and operating parent company in the DEUTZ Group and it owns the various German and international subsidiaries. These subsidiaries are production companies and companies with sales and service functions. The largest subsidiary is DEUTZ Power Systems with its own production, sales and service functions. DEUTZ customers are supported by 16 sales companies, 12 sales offices, 16 service centres and over 800 sales and service partners in more than 130 countries around the world. The largest distribution company is the Deutz Corporation, located in Atlanta, USA.

### Organisational structure



## Location of sites

DEUTZ's main own production sites are located in Germany and Spain. The company operates joint ventures in Argentina and China with local partners. The central, and largest, location for the production of compact engines is situated in Cologne-Porz, where the company operates one of the most ultra-modern engine plants in the world. This location is also home to the DEUTZ research and development centre and, since the beginning of 2007, the head office of the Group. Group production and assembly sites in the Cologne region also include Cologne-Deutz, Cologne-Kalk and Herschbach. Production of engines with a capacity of more than 8 litres is located at the Ulm site, which has also been DEUTZ's centre of production for air-cooled engines since the turn of 2006/2007. Gas engines for decentralised power generation are developed and manufactured in Mannheim at DEUTZ Power Systems. Production at the site located at Zafra in Spain is concentrated on the principal components required by the Cologne and Ulm plants.

At the end of 2006, DEUTZ entered into an agreement with a subsidiary of the largest Chinese commercial vehicle supplier, China First Automobile Works Group Corp. (FAW) for the joint production and sales of diesel engines. The joint venture, known as DEUTZ (Dalian) Engine Co. Ltd. (DEUTZ Dalian), will be under the day-to-day management of DEUTZ and is provisionally expected to commence operations in mid-2007 after all the necessary outstanding official approvals have been received.

## Focus on complete engines and decentralised power generation plants

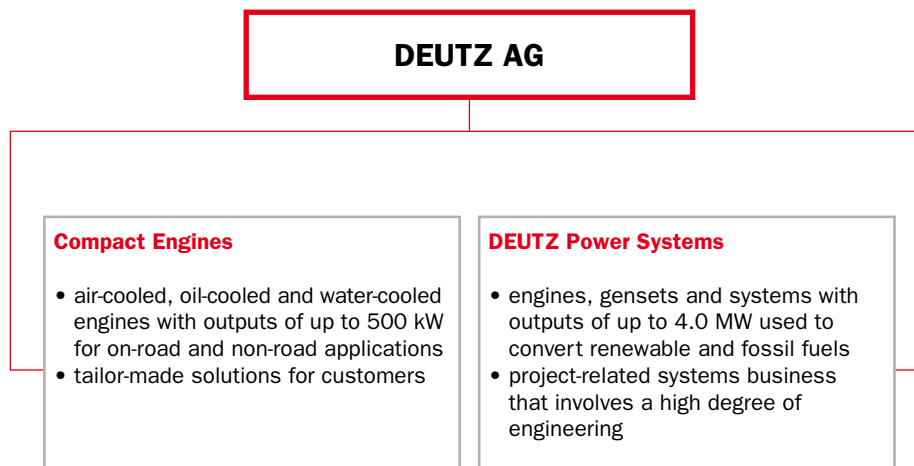
DEUTZ has two business segments, each of which covers the entire value creation process of development, design, production and sales: the "Compact Engines" segment is concerned with the manufacture of liquid-cooled and air-cooled engines, the "DEUTZ Power Systems" segment with the manufacture of installations for decentralised power generation. The compact engines manufactured by DEUTZ are almost exclusively diesel-powered, whereas the engines produced by DEUTZ Power Systems tend to be gas-powered for the most part.

The Compact Engines segment covers engines with outputs up to 500 kW. The product range includes engines with air, water and oil-cooling systems. A particular focus is on engines with a cylinder capacity of 4 to 8 litres. The business is broken down according to application segments, mainly as follows: Mobile Machinery, Agricultural Machinery, Stationary Equipment and Automotive. The product range is complemented by comprehensive service support, which is continuously expanded and tailored to customer requirements. A complete global network, comprising subsidiaries, service centres and authorised dealers provides customer support services including commissioning, supply of spare parts, repairs, and servicing and maintenance of the supplied engines.

DEUTZ Power Systems is a leading global systems supplier of complete solutions for decentralised power generation. These solutions are highly efficient and environmentally friendly, using gas and diesel engines with an output range from 180 to 4,000 kW. The business is focussed on the fast-growing market for power generation units with gas engines based on renewable fuels such as biogas, mine gas or sewer gas. DEUTZ Power System engines convert both natural gas and non-natural gases into electricity, heat and/or cooling. DEUTZ Power Systems also supplies the customer service backup required, including commissioning, maintenance and general overhauls. This comprehensive range of products and services provides optimum coverage of market requirements. Supporting maintenance contracts cover periods of up to 15 years. The supply of complete solutions including comprehensive customer service is the core competence of DEUTZ Power Systems and the main driver in the business model.

## DEUTZ – the engine company

Independent engine manufacturer and supplier of power-generation systems



DEUTZ supplies engines to a range of different sectors, which means that the company's customer structure is well diversified.

There is a diverse structure of suppliers and customers in the engines market. The market is divided into captive manufacturers, who produce equipment and vehicles as well as their own engines, and non-captive manufacturers, whose core competence is specifically the manufacture of engines. DEUTZ is a non-captive manufacturer.

According to calculations made by the company, the relevant market in 2006 for industrial engines to DEUTZ's Compact Engines segment was around 1.9 million engines. DEUTZ has a strong international position in this non-captive market with a market share of around 12 per cent. In the last few years, DEUTZ has entered into strategic alliances that have opened up additional potential previously confined to the captive market. Cooperation agreements exist with the Volvo Group in Sweden for 4 to 8-litre capacity engines to be used in commercial vehicles, construction machinery and gensets, and with the SAME DEUTZ-FAHR Group in Italy for agricultural machinery engines.

According to the company's own estimates, the size of the annual market for gas engines in the output range relevant to DEUTZ Power Systems, i.e. 180 to 4,000 kW per unit, is around 4,500 engines. This equates to a total output of around 3,800 MW. Based on the gas engine output of 681 MW installed by DEUTZ Power Systems in the year under review, this means that its global market share is around 18 per cent. DEUTZ Power Systems is the market leader in the German market for gas engine applications with a market share of around 42 per cent. In the last year, it installed 210 MW out of a total market of around 500 MW.

### Diverse structure of the market and competitive environment

In various market segments, DEUTZ faces competitors whose range of services and applications is in part comparable with that offered by DEUTZ.

<b>Application segments</b>	<b>Application</b>	<b>Major competitors</b>
<b>Mobile Machinery</b>	Construction equipment Material handling equipment Ground support equipment	Kubota (J), Yanmar (J), Perkins (UK)
<b>Stationary Equipment</b>	Generator sets Pumps Compressors	Perkins (UK), Cummins (USA), Caterpillar (USA)
<b>Agricultural Machinery</b>	Tractors Harvesters Forest machinery	Perkins (UK), Deere & Company (USA), Sisu Diesel (FIN)
<b>Automotive</b>	Trucks Busses Railcars	Cummins (USA), Caterpillar (USA), MAN (GER)
<b>Power generation</b>	Decentralised power plants	GE Jenbacher (A), Caterpillar (USA), Wärtsilä (FIN)

#### Influencing factors

The main drivers behind DEUTZ business performance are continuing global industrialisation and, simultaneously, rapidly growing demand for environmentally friendly equipment and vehicles. The particular growth regions in the last few years were the USA and Asia. The market for compact engines is characterised by the continuing development towards increasingly powerful, but at the same time, more economical, quieter engines with lower emissions. This is not least the result of more stringent legal requirements regarding permissible emissions. The capacity to meet increasing customer requirements for efficient, service-friendly engines also demonstrates the competitiveness of the company. The same also applies to DEUTZ's innovative strength, i.e. its ability to ensure that engine systems continue to be developed on an ongoing basis.

A factor that is of great importance specifically to DEUTZ Power Systems is the amount of private and public capital investment in infrastructure projects for the supply of electricity and heating. The implementation of the Kyoto agreements that is now under way is providing a stimulus to international projects aimed at reducing greenhouse gases. In Europe, demand for decentralised gas power plants is increasing as a result of existing legislation on the use of renewable energy sources for power generation.

Given DEUTZ's high level of value creation in Germany, significant commercial factors include high labour costs and other associated costs in Germany. Competitiveness is also affected by changes in exchange rates in the case of euro-zone manufacturers who export most of their output. Raw material costs are also a significant factor in business performance, especially the cost of steel scrap.



## INTERNAL CONTROL SYSTEM

DEUTZ defines its budget and medium-term targets using selected key performance indicators that form an integral part of an internal control system. The main performance indicators are unit sales, revenue, EBIT margin, working capital ratio, return on capital employed (ROCE), equity ratio and net financial debt. Among other things, performance values from competitors are used as a basis for determining benchmarks. A monthly reporting process enables the Management Board to track changes in these performance indicators. Selected figures are the subject of weekly management meetings.

In 2006, DEUTZ achieved significant improvements in all key performance indicators:

- Unit sales +21.2 per cent
- Revenue +12.6 per cent (+14.6 per cent on a like-for-like basis)
- EBIT margin 5.5 per cent (2005: 4.7 per cent)
- Average working capital for year as percentage of revenue: 18.5 per cent (2005: 24.0 per cent)
- ROCE 9.8 per cent (2005: 7.7 per cent)
- Equity ratio 30.8 per cent (2005: 23.2 per cent)
- Net financial debt €10.8 million (2005: €15.7 million)

DEUTZ has set itself the objective of achieving an increase in revenue that is disproportionately high compared with the market and thereby continuing to improve both operating profit and return on capital employed over the long term. In 2006, DEUTZ entered a new strategic phase of development: after establishing the necessary operating and financial basis in prior years, the focus was now switched to generating a significant boost to growth and profitability.

The priorities for DEUTZ in the next few years are regional expansion, an increasing focus on selected product areas with simultaneous expansion of service support, and the further systematic development of strategic alliances with Volvo, SAME DEUTZ-FAHR and FAW. The strategic objectives of DEUTZ are as follows:

- To become one of the top three suppliers in the global market for engines with a capacity of 4 to 8 litres
- To double unit sales of engines with a capacity greater than 4 litres
- To consolidate its position as the international market leader in air-cooled engines
- To become global market leader in gas engines for decentralised power generation using natural gas and special gases
- To ensure service accounts for 20 per cent of consolidated revenue by expanding the range of service support operations with a disproportionately high increase in new business.

DEUTZ made good progress towards achieving its strategic objectives in 2006. In 4-litre to 8-litre engines, DEUTZ unit sales climbed to 101,659 engines, an increase of 27.9 per cent. This meant that global market share was again increased. Market position will see a significant improvement as a result of the joint venture currently being set up with FAW in China. The joint venture has an initial capacity of 150,000 engines a year; in the next stage of expansion, production of up to 200,000 engines a year will be possible. Unit sales of engines with a capacity of less than 4 litres rose by 17.3 per cent to 98,092. 2006 unit sales of air-cooled engines over all output ranges were also successful with 33,001 engines sold, an increase of 17.3 per cent. DEUTZ service revenue rose to €299.6 million in 2006 and accounted for 20.1 per cent of consolidated revenue (2005: €292.4 million on a like-for-like basis). The expansion of the service business in the Compact Engines segment did not result in service business accounting for a higher proportion of segment revenue because of the disproportionately high level of expansion in new compact engines business with major equipment manufacturers who themselves take responsibility for service support to a large extent. Revenue growth in the DEUTZ Power Systems segment also resulted from the supply of new engines. In subsequent years, there will be an increase in service business as a function of the growth in the number of gas engines in circulation.

### Key performance indicators

### Significant improvements in all key performance indicators

### Objectives

### Successful implementation of strategic objectives

## ECONOMIC ENVIRONMENT

### Accelerated growth in Europe and Asia in 2006

The upturn in the global economy continued in 2006. However, there was a slowdown during the course of the year. The reason for this was a lower pace of economic growth in the USA and Japan. Nevertheless, gross domestic product in the USA was still 3.4 per cent higher than in 2005. The gross domestic product in Japan rose in the last year by 2.2 per cent. In Asia, overall growth continued apace. In 2006, there was a further acceleration in the strong economic expansion in China, with gross domestic product up by 10.7 per cent. An acceleration in growth was also manifest in Europe, driven once again by a noticeable contribution from exports. There was also a rise in capital investment, giving a boost to investment in both equipment and construction. In Europe, the stronger growth also had an impact on the labour market and consumer spending. Contrary to fears expressed by many commentators, the healthy growth climate was not dampened by rising energy prices. Growth in euro-zone countries was 2.8 per cent. The upturn in the German economy also received a considerable boost in 2006. Gross domestic product in Germany saw growth not achieved since 2000, driven by the gathering pace of sustained capital investment. The growth rate was 2.7 per cent. The overall increase in capacity utilisation was such that companies once again began to take on additional staff.

### Record production in German engineering companies

According to the German Engineering Federation (VDMA), German engineering companies posted a new production record in 2006 of around €158 billion. Apart from the sustained high level of international demand, the main reason for this was unexpectedly high domestic demand. Over the whole year, production rose by 7.4 per cent, new orders by 16 per cent. At around 92 per cent, capacity utilisation was at a level not seen since 2000.

### Clear positive sector trend

The main customer sectors relevant to DEUTZ Compact Engines are the construction equipment, agricultural equipment and commercial vehicles sectors. In Europe, demand for both commercial vehicles and agricultural equipment received a significant boost in 2006. Western European agricultural equipment manufacturers benefited from the demand for state-of-the-art machinery. The largest European bus and truck producers were manufacturing at their capacity limits. Manufacturers and suppliers benefited from an acceleration in overall economic activity and from a recovery in fleet investment by long-distance road hauliers operators. Since 2003, the construction sector has been growing more rapidly than the rest of the economy in Europe. In 2006 alone, growth was over 3 per cent. The construction machinery industry profited from this sustained trend and from the appreciable boost to demand from China and from the USA where the building industry continued to be robust.

The global energy industry saw an increase in demand, particularly for decentralised power generation, as a result of an overall rise in investment confidence. The largest capital investments were seen in some of Germany's neighbours, for example in Benelux countries. In Germany, excellent growth in the market for biogas plants up to 1 MW continued. This was mainly the result of the German Renewable Energy Act. Growth in Europe was focussed for the most part on publicly subsidised natural gas applications. Hitherto unused natural gas and special gas reserves are also helping growth in this sector.

**DEUTZ Group in brief**

	<b>2006</b>	<b>2005</b>	<b>Change in %</b>
€ million			
Orders on hand	366.9	233.9	56.9
New orders	1,623.0	1,350.5	20.2
Unit sales (units)	237,293	195,843	21.2
Revenue	1,490.0	1,322.8	12.6
thereof excl. Germany (%)	73.4	73.0	–
EBIT	93.5	114.7	–18.5
One-off items	12.0	52.2	–77.0
Operating profit (EBIT before one-off items)	81.5	62.5	30.4
EBIT margin before one-off items (%)	5.5	4.7	–
Net income	61.5	71.4	–13.9
ROCE (%)	9.8	7.7	–
Total assets	1,162.9	1,063.8	9.3
Equity	358.5	247.0	45.1
Equity ratio (%)	30.8	23.2	–
Net financial debt	10.8	15.7	–31.2
Working capital	235.1	238.1	–1.3
as a percentage of revenue (as at 31 Dec.)	15.8	18.0	–
as a percentage of revenue (average)	18.5	24.0	–
Cash flow from operating activities	110.2	143.4	–23.2
Capital expenditure (excl. capitalisation of R&D)	85.8	67.6	26.9
Research and development	66.4	66.9	–0.7
Number of employees as at 31 December	5,327	5,058	5.3

**BUSINESS PERFORMANCE IN THE DEUTZ GROUP**

In 2006, the DEUTZ Group achieved a 20.2 per cent increase in the level of new orders to €1,623.0 million (2005: €1,350.5 million). A major contributory factor was the increase in the Compact Engine segment to €1,289.1 million, 25.7 per cent up on 2005. On a like-for-like basis (i.e. disregarding the contribution of the marine service business from January to March 2005), new orders in DEUTZ Power Systems rose by 10.6 per cent to €333.9 million. The like-for-like improvement in new orders for the Group as a whole was 22.3 per cent.

The orders on hand at 31 December 2006 increased to €366.9 million, up 56.9 per cent on the equivalent figure at 31 December 2005 (€233.9 million) and therefore ensured that capacity would be fully utilised for the first quarter of 2007.

With unit sales of 237,293 engines in the period under review, DEUTZ exceeded the equivalent unit sales figure of 195,843 engines in 2005 by 21.2 per cent. 236,588 of these engines (2005: 195,082) were in the Compact Engines segment and 705 engines (2005: 761) in DEUTZ Power Systems. DEUTZ global market share in compact engines improved in 2006 from around 11 per cent to around 12 per cent. In DEUTZ Power Systems, global market share rose to around 18 per cent, compared with 13 per cent in 2005.

**Significant rise in new  
orders and orders on hand**

**Unit sales up 21 per cent**

**Unit sales**  
units

<b>2006</b>	<b>237,293</b>
2005	195,843
2004	173,440
2003	156,237
2002	154,032

In 2006, DEUTZ generated the strongest growth in unit sales in the Europe and Africa region with a 25.0 per cent increase to 167,097 engines and in the Asia-Pacific region with a 21.8 per cent increase to 9,111 engines. Significant growth in unit sales of 14.7 per cent was achieved in the Americas where DEUTZ sold 54,628 engines in 2006. The Middle East region saw a drop in unit sales of 9.2 per cent to 6,457 engines following a reduction in the volume of project business.

**Revenue up 15 per cent  
on a like-for-like basis**

In 2006, consolidated revenue rose by 12.6 per cent to €1,490.0 million (2005: €1,322.8 million). On a like-for-like basis, this was equivalent to an increase of 14.6 per cent. Double-digit growth in the Compact Engines segment provided the largest contribution to the increase in consolidated revenue. There was a drop in revenue from diesel engines, as planned, as a result of the continued restructuring in DEUTZ Power Systems during 2006. On the other hand, the company was able to achieve an increase of 38 per cent in revenue from gas engines. The like-for-like increase in revenue in DEUTZ Power Systems of 4.7 per cent reflected the successful strategic focus in this segment on gas engines for decentralised power generation. The impact of exchange rates on the development of consolidated revenue was negligible.

**Revenue**  
€ million

<b>IFRS</b>	<b>2006</b>	<b>1,490.0</b>
	2005	1,322.8
	2004	1,242.3
<hr/>		
<b>HGB</b>	2003	1,172.6
	2002	1,160.9

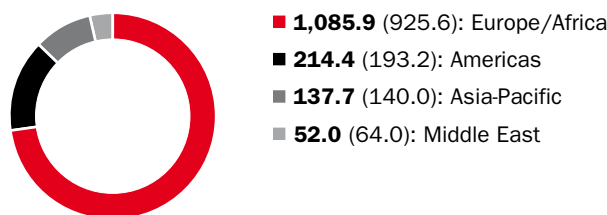
**European revenue  
(excluding Germany)  
up 22 per cent**

Viewed regionally, Europe and Africa recorded the strongest growth with an increase of 17.3 per cent over the whole of 2006. Within Germany, the figure was 10.9 per cent following a new upturn in the compact engines business during the course of the year. In the rest of Europe, revenue was up 22.3 per cent. The Americas continued to experience an excellent 11.0 per cent growth. Consolidated revenue in the Asia-Pacific region dropped in the year under review by 1.6 per cent compared with 2005 as a result of the withdrawal of DEUTZ Power Systems from marine applications. Revenue growth in the Compact Engines segment of around 16 per cent in this region was not able to compensate for the withdrawal which was still showing some effect in 2006. The revenue trend in the Middle East was downwards in line with the drop in unit sales.



## DEUTZ Group: Revenue by regions

€ million (2005 figures)



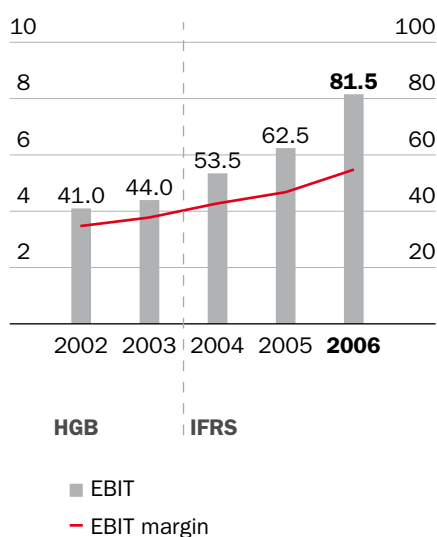
Operating profit (EBIT before one-off items) showed an improvement in the year under review of 30.4 per cent from €62.5 million to €81.5 million. This means that the EBIT margin before one-off items rose significantly from 4.7 per cent to 5.5 per cent. Disregarding the contribution from the marine service business up to March 2005, operating profit in 2005 would have been €54.2 million. On a like-for-like basis therefore, the increase in operating profit was actually 50.4 per cent. In the Compact Engines segment, operating profit in the year under review rose by 21.1 per cent to €68.3 million (2005: €56.4 million).

The DEUTZ Power Systems segment achieved an operating profit of €14.9 million (2005: €12.0 million), in particular as a result of successful growth in the gas engines business. On a like-for-like basis excluding the marine service business, there was a noticeable improvement in the operating profit in DEUTZ Power Systems with an increase of €11.2 million.

Operating profit up by a good 30 per cent

## EBIT and EBIT margin

in %/€ million



The cost-of-materials ratio in the DEUTZ Group rose to around 62 per cent compared with 60 per cent in 2005. This reflects the impact of increased purchasing of technology components for new engine series. Improved productivity and economies of scale had a noticeable effect on the staff costs ratio, which fell from around 23 per cent in 2005 to 21 per cent in 2006. One-off items from the sale of the marine service business in 2005 also impacted on the figures for 2006, as well as on those for 2005. In 2005, the year of the disposal, these one-off items amounted to €52.2 million. In 2006, there was still an item amounting to €12.0 million in this category. Including one-off items, EBIT in the year under review amounted to €93.5 million compared with €114.7 million in 2005.

There was an improvement of €6.4 million in net interest expense as a result of a significant reduction in net financial debt, which comprises all interest-bearing liabilities, and the conversion of bonds, which reduced the amount of interest paid. Net income before income taxes in 2006 was therefore €69.7 million. The equivalent figure of €84.7 million in 2005 included the aforementioned one-off amount, as did EBIT after one-off items. Despite the high loss carry-forward, DEUTZ still reported a tax expense due to minimum taxation regulations. The income tax rate is at 11.8 per cent. DEUTZ generated net income of €61.5 million in 2006. The net income for 2005 of €71.4 million had included the aforementioned one-off item relating to the disposal of the marine service business. The undiluted earnings per share in 2006 were €0.57 (2005: €0.77).

## BUSINESS PERFORMANCE IN THE COMPACT ENGINES SEGMENT

	2006	2005
€ million		
New orders	1,289.1	1,025.4
Unit sales (units)	236,588	195,082
Revenue	1,175.9	999.7
Operating profit (EBIT before one-off items)	68.3	56.4

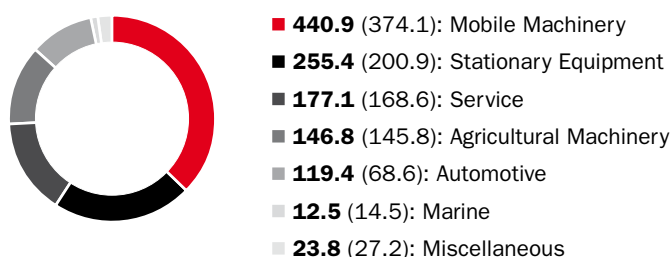
### Compact engines with high growth

The business development in the Compact Engines segment over the whole of 2006 showed a very robust, double-digit growth rate. New orders climbed to €1,289.1 million (2005: €1,025.4 million), an increase of 25.7 per cent. The main contributing factors were the new engines business, which was up 29.7 per cent, and the service business, which registered respectable growth of 5.7 per cent.

The company was able to increase engine unit sales by 21.3 per cent to 236,588 engines (2005: 195,082 engines). DEUTZ enjoyed particularly sharp growth of 27.9 per cent in unit sales of liquid-cooled engines with a capacity of 4 to 8 litres. DEUTZ sold a total of 101,659 (2005: 79,473) compact engines in this category in 2006. This included for the first time 8,000 commercial vehicle engines in the new TCD 2013 4V series, which meets the Euro IV emission standard applicable from 1 October 2006. Growth in unit sales of engines with a capacity of up to 4 litres was also encouraging at more than 17.3 per cent. The company sold 98,092 (2005: 83,629) engines in this category. Further expansion also took place in the air-cooled engines business. Unit sales in this category rose to 33,001, up 17.3 per cent on 2005. In the year under review, segment revenue rose to €1,175.9 million (2005: €999.7 million), an increase of 17.6 per cent. The main areas of growth in 2006 by market segment were in engines for Mobile Machinery, Stationary Equipment and Automotive.

### Compact Engines: Revenue by application segments

€ million (2005 figures)



In the largest application segment, Mobile Machinery, DEUTZ delivered a 17.9 per cent increase in revenue. This increase was derived from construction equipment, material handling equipment, ground support equipment, all of which generated double-digit growth rates. Growth was particularly strong in construction equipment in Germany which recorded an increase of around 22 per cent. Growth in material handling equipment was focussed particularly in the USA.

Revenue from engines in the Stationary Equipment application segment increased in 2006 by 27.1 per cent. All applications – compressors, pumps and gensets – achieved double-digit growth. This also applied in particular to the pump engines business in the USA. The Europe/Africa and Asia-Pacific regions were the main growth regions for these applications.

In the Automotive application segment, where revenue in 2006 rose by 74.1 per cent, DEUTZ enjoyed the considerable benefit of the first deliveries of the new TCD 2013 4V commercial vehicle engine for the European market from the newly constructed assembly hall at Cologne-Porz. Most of these deliveries took place in the third and fourth quarters of 2006.

Revenue trends in agricultural applications reflected the further development of the alliance with SAME DEUTZ-FAHR. Despite this, revenue from agricultural equipment remained overall at the level of 2005: some spending in 2005 had clearly been brought forward as a result of new emission standards coming into force in 2006 and revenue in 2006 was correspondingly lower.

Revenue from marine engines was below the 2005 level following a drop in demand in Asia and the end of one-off individual projects in the Middle East.

## Mobile Machinery largest application segment

Further growth in the compact engines service business was driven forward with the help of intensive marketing. This produced an increase in service revenue of 5 per cent. The spare parts business and the Xchange business involving reconditioned exchange parts were expanded. The expansion of the service offering to include important new components also contributed to the increase in revenue over 2005. A new element is the “DEUTZ Oil Diagnosis” diagnostics procedure, accompanied by the “DEUTZ Quality Class” lubricant quality levels. Both service packages allow customers to achieve a noticeable improvement in the economic optimisation of engine operation. The third new element is an innovative security label for genuine parts, providing increased protection against product piracy.

## Service revenue up 5 per cent

In the Compact Engines segment, operating profit in 2006 rose by 21.1 per cent to €68.3 million (2005: €56.4 million). Above all, the critical factor in this increase was the double-digit increase in unit sales. The EBIT margin for the segment rose from 5.6 per cent in 2005 to 5.8 per cent in the year under review.

## BUSINESS PERFORMANCE IN THE DEUTZ POWER SYSTEMS SEGMENT

	2006	2005
€ million		
New orders	333.9	325.1
Unit sales (units)	705	761
Revenue	314.1	323.1
Operating profit (EBIT before one-off items)	14.9	12.0

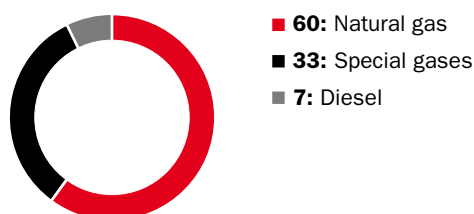
In the DEUTZ Power Systems segment, new orders in 2006 were slightly above the 2005 level at €333.9 million (2005: €325.1 million). Like-for-like, i.e. excluding the contribution from the marine service business up to March 2005, this represents significant growth of roughly 11 per cent. Increases in new orders were the result of a higher level of sustained demand from commercial greenhouses in Benelux countries and from agricultural companies, in this case primarily related to biogas installations in Germany, mainly for engines up to 2 MW power output. In addition, the company was able to expand the business for engines in the 4 MW output category as a result of a good level of new orders, principally from European countries other than Germany.

## New orders up 11 per cent on a like-for-like basis

## Significant expansion in the gas engines business

The total number of engines sold fell in line with forecasts to 705 engines (2005: 761 engines) owing to the reduction in deliveries of diesel engines, a key element in the company's strategy. On the other hand, unit sales of gas engines increased by around 45 per cent, reflecting the company's objective of becoming the global market leader in this type of engine. Around 90 per cent of engine unit sales in DEUTZ Power Systems were therefore accounted for by gas engines in 2006, compared with a figure of 57 per cent in 2005. In 2006, the installed output of gas engines sold amounted to a total of around 681 MW, about 40 per cent up on 2005. Approximately 36 per cent of this installed output was accounted for by engines powered by renewable energy sources. The installed output accounted for by diesel-powered engines was around 56 MW.

### Installed output by energy source in %



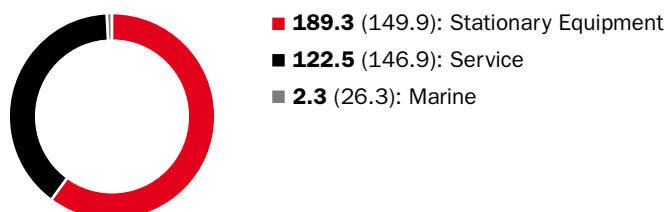
As in the case of unit sales, the revenue trend in the DEUTZ Power Systems segment reflected the planned withdrawal from the marine market segment to be replaced by a strategic focus on gas engines for decentralised power generation. At €314.1 million, reported segment revenue was down 2.8 per cent on 2005 (2005: €323.1 million).

## Revenue up 5 per cent on a like-for-like basis

On a like-for-like basis, DEUTZ Power Systems generated revenue growth of 4.7 per cent. Strong demand in European countries outside Germany was the driver for growth in the business for new plants using gas engines, enabling this business to make a significant contribution with an increase in revenue of 38.1 per cent. This means that gas engines accounted for around 91 per cent of new installation revenue, compared with around 72 per cent in 2005.

The drop in DEUTZ Power Systems service business of 16.6 per cent was down to the contribution to revenue from the marine service business still included in the figures for the first quarter of 2005. On a like-for-like basis, the level of service business was almost the same as that in 2005. It is only after a number of years that the growth in the number of gas engines will lead, in part, to a requirement for maintenance services and a corresponding increase in service revenue. The excellent growth in unit sales of new installations in 2006 has therefore not yet been reflected with a corresponding rise in service revenue.

### DEUTZ Power Systems: Revenue by application segments € million (2005 figures)



## Quadruplicated operating profit on a like-for-like basis

The success of the gas engines business and the optimisation of organisational and cost structures carried out in 2006 led to a considerable improvement in operating profit on a like-for-like basis (disregarding the contribution from the marine service business up to March 2005) to €14.9 million, an increase of €11.2 million. The EBIT margin for DEUTZ Power Systems in 2006 was 4.7 per cent.

## NET ASSETS AND FINANCIAL STRUCTURE

Responsibility for financial management in the DEUTZ Group is held by DEUTZ AG as the overall parent company in the Group. This responsibility primarily comprises management of the lines of credit required by the company, cash pooling and any necessary foreign exchange hedging. Centralised cash pooling ensures optimum use of cash within the Group.

**Financial management centrally organised**

The Group has adequate lines of credit; these are unsecured for the most part. At the end of 2006, only approximately half of the available credit facilities were actually being used by the company. A considerable reduction in the use of the credit facilities had already been achieved in 2005. In the last few years, DEUTZ has increasingly concentrated its business in a small group of national and international banks with whom the company maintains a close working relationship. DEUTZ is not reliant on support from individual banks.

**Significant reduction in lines of credit**

Of the convertible bonds issued in 2004 conferring options that entitled holders to acquire more than 19.8 million shares, 13.2 million conversion options have been exercised, with 9.3 million being exercised in 2006 alone. In addition, 998.3 thousand profit-sharing rights have been converted into over 9.9 million shares. The equity in the DEUTZ Group has risen significantly as a result. The conversion of bonds and profit-sharing rights has led to a reduction in interest expenses.

**Two-thirds of convertible bonds converted into shares**

The extremely positive change in the DEUTZ Group's financial structures is also reflected in the significant improvement in the risk rating determined by the banks and by a reduction in interest rates payable on bank loans used. This reduction has partially compensated for increasing interest rates in money and capital markets.

Cash flow in various currencies is pooled at Group level and currency risk reduced by natural hedging. The risk in residual or foreseeable currency surpluses is hedged by the head office finance department in accordance with internal guidelines.

### DEUTZ Group: Summary cash flow statement (simplified)

	2006	2005
€ million		
EBIT	93.5	114.7
<b>Cash flow from operating activities</b>	<b>110.2</b>	<b>143.4</b>
Capital expenditure on intangible assets, property, plant and equipment and investments	-95.7	-83.5
Cash receipts from the sale of businesses and proceeds from the sale of non-current assets	-1.1	85.0
<b>Cash flow from investing activities</b>	<b>-96.8</b>	<b>1.5</b>
<b>Cash flow from financing activities</b>	<b>-11.8</b>	<b>-104.7</b>
<b>Change in cash and cash equivalents</b>	<b>1.6</b>	<b>40.2</b>

**Cash flow trend reflects excellent earnings trend**

In the year under review, the positive results from operations led to a cash flow from operating activities of €110.2 million (2005: €143.4 million).

Compared with 2005, there was therefore a contraction in cash flow from operating activities, mainly because cash flow in 2005 saw most of the effect of the working capital optimisation programme initiated at the end of 2004.



Cash flow from investing activities amounted to –€96.8 million in the year under review. The higher investment outflows in 2006 compared with 2005 were mainly attributable to the expansion of capacity for compact engines and the construction of a new head office building. Adjusted for the one-off effect from the disposal of the marine service business, cash flow from investing activities in 2005 amounted to –€81.3 million. Including the disposal proceeds, the figure in 2005 was €1.5 million.

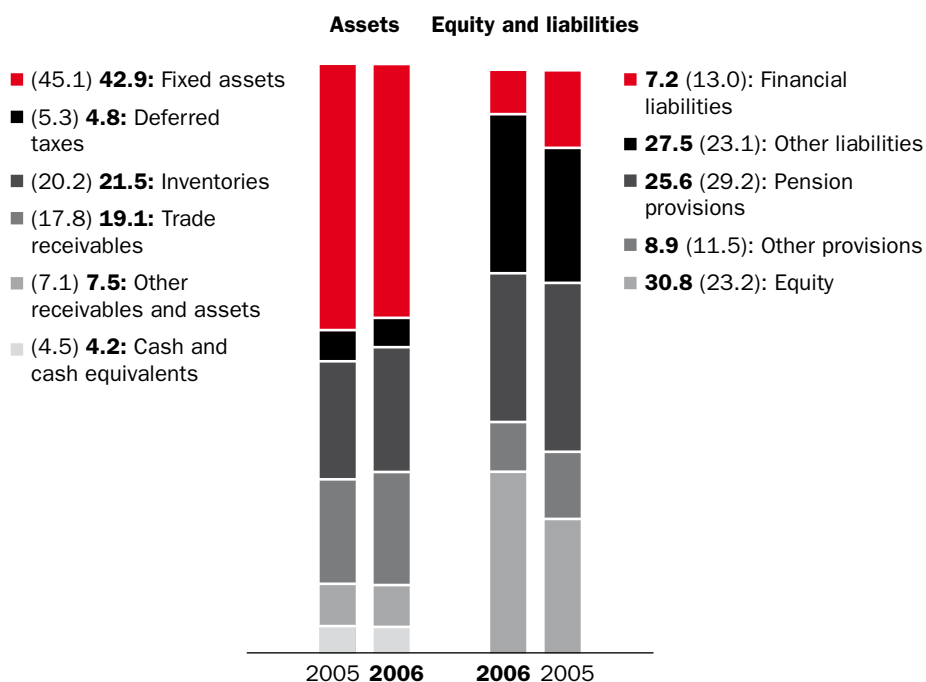
Cash flow from financing activities mainly comprised the redemption of bank loans and interest payments amounting to €11.8 million over the year. The high negative cash flow from financing activities in 2005 of –€104.7 million mainly resulted from the comprehensive redemption of bank loans, made possible in particular by the disposal of the marine service business.

#### Increase in total assets resulting from the expansion in business volume

At 31 December 2006, total assets in the DEUTZ Group had risen to €1,162.9 million, an increase of around €99 million on the equivalent figure for 31 December 2005. The increase in total assets reflects the significant rise in business volume.

As a consequence of investing activities, fixed assets rose by €19.9 million to €499.1 million. These investing activities were concentrated on expansion of production capacity at the Cologne and Zafra facilities and the completion of the new head office building at Cologne-Porz.

#### DEUTZ Group: Balance sheet structure in %



Compared with the end of 2005, working capital at 31 December 2006 registered a slight fall to €235.1 million (2005: €238.1 million) despite the increase in business volume. The rise of €32.8 million in trade receivables to €222.0 million was caused by the increase in revenue. The €35.0 million increase in inventories to €249.6 million was necessary in order to enable the company to cope with the considerably higher business volume in 2006 and prepare for a continuation of the brisk business activity in 2007. As a consequence of the associated rise in purchasing volume, trade payables also rose by €70.7 million to €236.4 million.

In 2006, the working capital ratio clearly fell well within the DEUTZ target figure of 20 per cent of revenue. The sustained improvement in the working capital position is demonstrated in particular by the average of the ratios achieved at the end of each of the four quarters during the year. In 2006, this average ratio was 18.5 per cent compared with 24.0 per cent in 2005. At 31 December 2006, the working capital to revenue ratio was 15.8 per cent, an even greater improvement on the figure at the end of 2005.

After repayment of current financial liabilities, the remaining cash and cash equivalents at the end of 2006 amounted to €49.4 million (2005: €48.4 million).

In 2006, DEUTZ was able to achieve a further considerable increase of €111.5 million in equity, taking total equity to €358.5 million. The principal factors behind this increase were the positive net income and the conversion of profit-sharing rights and convertible bonds. The conversions were responsible for a €49.4 million rise in issued capital. In the year under review, the equity ratio rose by 8 percentage points to 30.8 per cent (2005: 23.2 per cent). This means that the equity ratio has doubled since 2004.

**Working capital target met despite the significant business expansion**

**Equity ratio reaches excellent 31 per cent**

#### Equity ratio in %

IFRS	2006		30.8
	2005		23.2
	2004		15.4
<hr/>			
HGB	2003		16.7
	2002		9.1

Current and non-current pension provisions were reduced as planned in the year under review by €12.7 million. Other current and non-current provisions were €16.4 million lower than the figure for 2005. The reversal of guarantee provisions had a positive impact on the overall level of provisions.

Financial liabilities, i.e. the total of all interest-bearing liabilities, saw a substantial drop in 2006 to €83.4 million (2005: €138.1 million). A significant factor in this reduction was the extensive conversion of profit-sharing rights and convertible bonds. The repayment of current bank liabilities also had a positive impact. Given an almost unchanged level of cash and cash equivalents, net financial debt, i.e. the balance of bank loans less cash and cash equivalents, saw a slight reduction to €10.8 million (2005: €15.7 million).

## CAPITAL EXPENDITURE

### Significant growth in investing activities

In 2006, the value of investing activities amounted to €108.2 million (2005: €85.9 million). Capital expenditure comprised intangible assets of €36.8 million (2005: €31.6 million), property, plant and equipment of €70.8 million (2005: €53.7 million) and financial assets of €0.6 million (2005: €0.6 million). The capital expenditure in the year under review included €22.4 million on capitalised development costs, compared with €18.3 million in 2005. A large proportion of the increase in capital expenditure in 2006 was the result of the expansion of capacity for compact engines in Cologne and Zafra. A further proportion was accounted for by the development of the Ulm facility in connection with the relocation of air-cooled engine production from Cologne to Ulm.

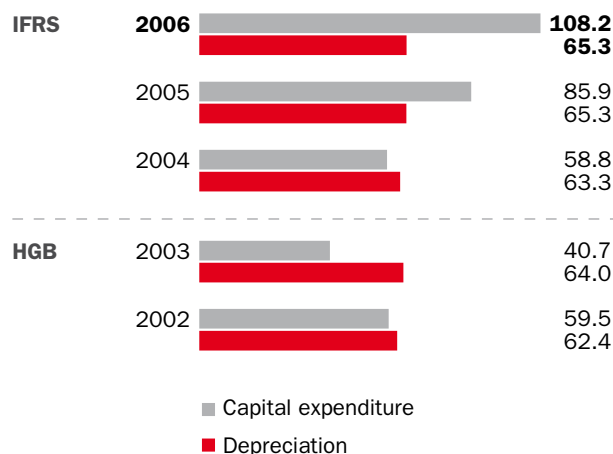
### Expansion in production capacity for compact engines

Overall, capital expenditure in the Compact Engines segment was considerably higher than in the last few years at €104.3 million (2005: €80.7 million). Specifically, capacity expansion was focussed on the TCD 2013 4V series for commercial vehicle and industrial applications and, in addition to the installation of capacity at Cologne-Porz for further new engine series, the expansion of component manufacturing facilities at Cologne-Deutz, Cologne-Kalk, Herschbach and Zafra. In more detail, the expenditure involved, for example, the purchase of crankshaft milling machines, machining centres and hardening machines. The relocation to the new head office building at the Cologne-Porz facility was completed on schedule at the end of 2006. The new head office building, at a cost of around €10 million, was the largest individual item of capital expenditure in the year under review. Capital investment in the expansion of the Ulm facility involved the initial cost of an automatic high-bay storage facility for parts and engines, an automatic small parts storage facility and a major functional hall of 800 square metres to accommodate goods inward, the preparation of materials and goods outward. The relocation of air-cooled engine production from Cologne-Deutz to Ulm took place over the 2007 New Year.

In the DEUTZ Power Systems segment, the capital expenditure of €3.9 million (2005: €5.2 million) was specifically concentrated on production infrastructure improvements. This included the completion of a state-of-the-art genset testing area and work to improve the internal flow of materials.

Depreciation and amortisation in the DEUTZ Group was unchanged on 2005 at €65.3 million (2005: €65.3 million). This was broken down into €17.6 million on intangible assets and €47.7 million on property, plant and equipment. Since 2005, capital expenditure has once again been significantly in excess of depreciation and amortisation, reflecting the objective of stronger growth in the next few years and the associated expansion of capacity.

### DEUTZ Group: Capital expenditure and depreciation € million

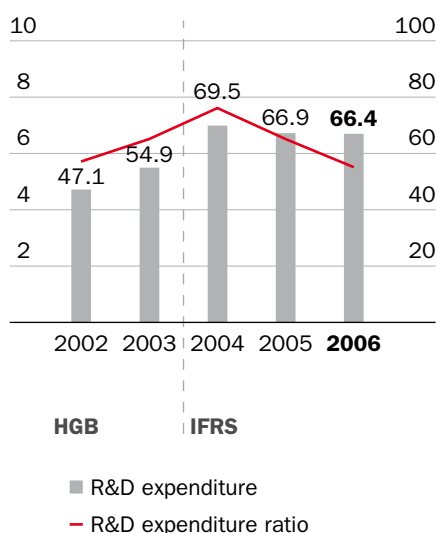


## RESEARCH AND DEVELOPMENT

Compliance with legal emission standards and differentiation from competitors are the focus of research and development activities (R&D) at DEUTZ. Actual goals are to reduce exhaust emission values, fuel consumption and noise emissions whilst at the same time achieving the greatest possible enhancements in engine performance. Viewed over a number of years, the R&D ratio at DEUTZ has been between 5 and 8 per cent of new engine revenue and has therefore been sustained at a high level. There are changes in the ratio and absolute amounts over fluctuating bands depending on the development phase of the engine series concerned. Total R&D expenditure in 2006 was €66.4 million, which means that it was almost at the same level as in 2005 (2005: €66.9 million). The ratio of R&D expenditure to new engine business revenue was 5.6 per cent compared with 6.6 per cent in 2005. R&D activities at DEUTZ are broken down into four project categories: pre-development, new development, further development and customer applications/series production support. In 2006, there was a particular increase in the proportion of expenditure accounted for by pre-development compared with 2005.

**High R&D ratio of 5.6 per cent continues**

**DEUTZ Group: Research and development expenditure**  
in %/€ million



In 2006, DEUTZ employed 459 persons (2005: 435 persons) in research and development. The R&D activities of the Group are mainly concentrated in Cologne, although there is a second site located at Dursley in the United Kingdom. The R&D facility for DEUTZ Power Systems is situated in Mannheim.

The strong culture of innovation in DEUTZ is also mirrored in the industrial property rights owned by the Group. In the year under review, a total of 34 inventions were filed as patent applications. 28 of these applications were in Germany, and 6 abroad. At the end of 2005, the company held a total of 387 patent applications, patents and utility models, of which 206 were in Germany, and 181 abroad.

In 2006, R&D expenditure in the Compact Engines segment amounted to €54.8 million compared with €55.9 million in 2005. The ratio of R&D expenditure to new engine revenue was 5.5 per cent (2005: 6.7 per cent).

Milestones in research and development activity in the segment in 2006 were the successful production launch of the TCD 2013 4V commercial vehicle engine and industrial engines with full electronic engine control, both in the 4-litre to 8-litre capacity category. Ongoing development projects were focussed on new and existing series for non-road applications. Important current projects include the development of engines that can run on rapeseed oil and the development of a hybrid drive which will be presented at the bauma construction machinery trade fair in April 2007.

**Developments for new emission standards**

In R&D activities in the Compact Engines segment, DEUTZ concentrates on the further development of its core technologies of exhaust gas aftertreatment, fuel injection, supercharging and combustion, engine management, electronics and basic engine development. In addition, the in-house development of software for customer-specific solutions is also being built up as a core competence.

Key current research areas in the Compact Engines segment are as follows:

- Development of basic principles for technologies to achieve EU Stages III B and IV/EPA Tier 4 emission standards for non-road applications and to achieve the Euro V and VI emission standards for on-road applications (injection systems, combustion development, supercharging)
- Exhaust gas aftertreatment technologies, such as selective catalytic reduction and state-of-the-art particulate filter systems
- Research projects, for example, on innovative particulate filter technologies for exhaust gas aftertreatment and on strategies for the monitoring and regeneration of future particulate filter systems
- Alternative fuels, drive concepts, new design concepts and fuel consumption reduction on existing systems

#### High-performance engines for biogas applications

In the DEUTZ Power Systems segment, €11.6 million was spent on R&D compared with €11.0 million in 2005. The ratio of R&D expenditure to new engine revenue was 6.1 per cent, compared with 6.2 per cent in 2005.

The focus of R&D activities in the year under review was the targeted optimisation of existing and newly developed engines in the 340 to 4,000 kW output range. Efforts were concentrated on achieving performance enhancement of up to 50 per cent. Biogas engines in particular, which have hitherto only been produced with a maximum output of 500 kW, will continue to gain in importance and will increasingly be used in applications requiring higher output ranges. In 2006, DEUTZ Power Systems also pursued development projects related to all types of process and waste gases. These mainly involved the TCG 2032 series, which enjoys a unique selling proposition for applications of over 2 MW output in that it is equipped for hydrogen-rich gases. Further development also took place in the concept of antechamber lean combustion in terms of increased efficiency and reduced emissions.

## PROCUREMENT

In 2006, there was a clear steadying on DEUTZ's most important raw materials market for steel scrap, the main material used by iron foundries. On average, steel scrap prices rose by 6 per cent compared with 2005. As far as non-ferrous metals are concerned, copper and aluminium prices rose by 70 per cent and 50 per cent respectively. However, only small amounts of these metals are used in DEUTZ's base products. The company was able to cushion the effect of the rise in prices by negotiating agreements, entering into additional supplier contracts and continuing its global sourcing strategy.

Significant items in the cost of materials are foundry products, fuel injection equipment and measurement and control devices.

In the year under review, foundry products accounted for 21 per cent of the cost of materials, followed by fuel injection equipment, which accounted for 10 per cent. The cost of measurement and control devices together amounted to 6 per cent of the cost of materials. Other important material subcategories are generators and starters, turned parts, sheet metal parts, DIN and standard parts, together with forged parts. Following the series production start-up of engines compliant with Stage 3 emission standards and the ramp-up in production of the new commercial vehicle engine, the proportion of the cost of materials accounted for by high-value fuel injection systems and measurement and control devices has risen. The effect of this has been to push up the cost-of-materials ratio from 60 per cent in 2005 to 62 per cent.

2006 saw further development in the use of the latest purchasing tools, such as e-procurement and more intensive use of the established purchasing options via electronic catalogues. Some of the C part volume was procured using the latter.



The electronic sourcing and procurement platform, Newtron ([www.newtron.de](http://www.newtron.de)), was also introduced in 2006. Newtron is one of the top three global Internet-based providers of sourcing solutions in the automotive industry. The platform allows users to carry out online invitations to tender and auctions on a global basis and in multiple languages.

## PRODUCTION

The start of series production of the new Euro IV commercial vehicle engine in the year under review required a gradual ramp-up in production in the new Cologne-Porz assembly hall specially constructed in 2005 for this engine type. This engine set new technical and organisational standards, particularly in terms of efficiency, product quality and delivery performance. For example, the company was able to reduce the normal order lead time of three weeks by over 50 per cent.

### New commercial vehicle engine in series production

The series production start-up of engines with DEUTZ common rail compliant with Stage 3 emission standards for industrial applications was another key development in production in 2006. The engines were integrated into existing processes for preparation, assembly and testing. This included accommodating the cleanliness requirements for the cutting-edge injection system.

### First series production engines compliant with Stage 3 emission standards

The production system installed in 2003 to manage the manufacture of compact engines, which mapped the entire process chain from goods inward to the delivery of manufactured engines in a standardised management system, also underwent further expansion in 2006. A key element was the further development of various continuous improvement process (CIP) methods. The production system makes a considerable contribution to enhancing productivity and quality, increasing delivery reliability and lowering inventory levels.

In parts and components production, the priority was on the commissioning of new production facilities aimed at enhancing efficiency and expanding capacity.

## EMPLOYEES

### DEUTZ Group: employees

	31 Dec. 2006	31 Dec. 2005
Number		
<b>DEUTZ Group</b>	5,327	5,058
<b>thereof</b>		
Germany	4,307	4,035
Outside Germany	1,020	1,023
<b>thereof</b>		
Non-salaried employees	3,100	2,836
Salaried employees	2,041	2,028
Apprentices	186	194
<b>thereof</b>		
Compact Engines <sup>1)</sup>	4,331	3,998
DEUTZ Power Systems <sup>1)</sup>	996	1,060

<sup>1)</sup> Incl. apprentices

## Jobs created

At the end of 2006, DEUTZ had 5,327 employees throughout the world. This amounts to 269 employees (5.3 per cent) more than in 2005 (5,058 employees). The increase in capacity was mainly focussed in production departments to accommodate the increase in engine production and the start of production for the new commercial vehicle engine. In the period under review, an average of 255 persons were employed under temporary employment agreements, representing an increase of 141 over 2005. This increase took into account the rise in the demand for labour in the start-up phase of the expansion of capacity.

At the end of 2006, there were 186 apprentices in Germany (2005: 194). This means that the ratio of apprenticeships to the number of German employees dropped to 4.3 per cent (2005: 4.8 per cent). In 2006, all apprentices passing the final examination were given a fixed-term employment contract.

### DEUTZ Group: Staff costs

	2006	2005
€ million		
Wages	132.8	111.9
Salaries	127.4	135.0
Social security contributions	51.8	50.2
Cost of severance payments and post-employment benefits	6.1	4.0
<b>DEUTZ Group</b>	<b>318.1</b>	<b>301.1</b>

At 31 December 2006, DEUTZ had a total of 4,307 employees in Germany (2005: 4,035) and 1,020 elsewhere (2005: 1,023).

At the balance sheet date, there were 4,331 employees in the Compact Engines segment (2005: 3,998) and 996 employees (2005: 1,060) in the DEUTZ Power Systems segment. The small reduction in the latter followed the structural realignment of international sales in DEUTZ Power Systems.

### DEUTZ Group: Breakdown of employees by location

	31 Dec. 2006	31 Dec. 2005
Cologne	2,832	2,607
Mannheim	668	667
Ulm	407	354
Other German locations	400	407
<b>Germany</b>	<b>4,307</b>	<b>4,035</b>
<b>Outside Germany</b>	<b>1,020</b>	<b>1,023</b>
<b>Total</b>	<b>5,327</b>	<b>5,058</b>

## Jobs trend in Compact Engines in line with increasing capacity utilisation

The rise in the number of employees in the Compact Engines segment was brought about by the start-up of production for the new commercial vehicle engine and the expansion of production at the Cologne-Porz facility. In a first step, the relocation of air-cooled engine production to Ulm was accompanied by a rise in the number of jobs at this location, even in 2006 prior to the actual relocation. This will result in the creation of a total of 100 new jobs and 10 apprenticeships at the Ulm facility. New production shift patterns were introduced at Cologne-Porz following the extensive increase in production schedules: since October 2006, assembly and order processing have been operating in three shifts. At the two other Cologne facilities and Herschbach, a system of 20 shifts a week is being operated in machining departments. The concentration of the assembly of air-cooled engines in Ulm has facilitated a special innovative payscale agreement, offering advantages to both employees and company: a modification of the current collective pay agreements and the use of a flexible working time model mean that, from 2007, employees at Ulm are calculated to be working an extra two hours. A significant element is a model under which employees can convert hours worked into personal pension contributions.

DEUTZ attaches great importance to in-house vocational apprenticeships and traineeships to ensure that the necessary skilled employees will be available in the future. The company offers both technical and commercial apprenticeships, seven technical trades and four commercial occupations are available under the scheme. The trainee programme offered by DEUTZ aims to promote and develop skilled managers and other specialist personnel. Under this programme, seven university graduates also joined a 15-month programme in 2006 in which they are to be employed in several divisions of the company, both in Germany and abroad. Personal support from “mentors” and functional support from “sponsors” are as much an integrated part of the programme as the opportunity to make presentations to, and have regular contact with, the Management Board.

**Trainee programme for young managerial talent**

2006 saw a continuation of the programme initiated in 2005 to improve occupational pensions. A further 4 percentage points of employees joined the scheme, taking total participation to 26 per cent of the workforce. DEUTZ AG makes a voluntary employer contribution to occupational pensions for salaried employees paid under the collective pay agreement. The contribution is subject to certain conditions and can be up to 9 per cent. When paying into the pension scheme, employees have the option to defer part of their salary, either on a gross or net basis. Employees outside the collective pay agreement have the option of deferred compensation.

**Employees take up occupational pension scheme**

## ENVIRONMENT

For some years now, DEUTZ AG has been operating an environmental management system in accordance with DIN EN ISO 14001, under which all environmentally relevant processes are continuously assessed and subject to systematic improvements. Resources are therefore used on an optimum basis, the number of workplace accidents is reduced, downtime is minimised and production risks are restricted. The management system is subject to ongoing evaluation by internal and external experts. Internal audits are carried out monthly; external audits are carried out annually by an auditor from an authorised certification authority. The effect of this is that any potential hazards present in the company are limited to tolerable residual risks.

**Environmental management system optimises production processes**

In the year under review, environmental protection measures were carried out involving the replacement of underground tanks, organisational optimisation of the central waste collection point and the commissioning of a wash area that meets the provisions of the German Water Resources Act. Various areas of the company were fitted with alarm systems and extinguisher equipment to aid the identification of problems and hazards. The new head office building constructed at the Cologne-Porz facility is supplied with process heating. A special heating distribution system and optimum insulation of the building guarantee that operating costs will be minimised.

**Waste volume reduced by 15 per cent**

The 15 per cent drop in waste volume over the last year is attributable to the use of a waste water centrifuge in the coloration department at Cologne-Porz, increased use of recirculating load containers and to a drop in the volume of packaging, for example by the use of larger batch sizes.

The increase in electricity and gas consumption in 2006, by 9 per cent and 2 per cent respectively, is mainly attributable to the significant increase in the number of engines manufactured. However, the consumption of electricity and gas per engine manufactured fell by 12 per cent and 18 per cent respectively.

Total expenditure on environmental protection and health and safety in 2006 was almost unchanged at €6.2 million (2005: €6.3 million).

The rate of notifiable accidents per thousand employees is an important key indicator in evaluating accidents in the company. The efficiency of health and safety management systems, and in particular the success of corrective measures, can be measured on the basis of this value. In the last few years, the number of workplace accidents per thousand employees in DEUTZ AG has regularly been below the figure supplied by the engineering employers' liability insurance association, the figure used as the benchmark in the industry. In 2005, there were 36 notifiable workplace accidents recorded in DEUTZ based on the notifiable accident criteria, and in 2006 only 33. Whereas the engineering industry accident insurer reported a slight increase in the occurrence of accidents in the first 6 months of 2006, the number of notifiable accidents at DEUTZ fell by 8 per cent, despite the significant expansion in the production programme.

## RESULTS OF OPERATIONS FOR DEUTZ AG

### DEUTZ AG: Income statement

	2006	2005
€ million		
Revenue	1,103.0	987.9
<b>Profit from ordinary activities</b>	<b>20.6</b>	<b>21.4</b>
Net extraordinary income/expenses	12.0	46.1
Income taxes	-2.2	-11.8
Other taxes	-0.7	-0.4
<b>Net income</b>	<b>29.7</b>	<b>55.3</b>
Loss carried forward	-21.6	-76.9
Addition to the legal reserve	-0.4	-
<b>Accumulated income/loss</b>	<b>7.7</b>	<b>-21.6</b>

The annual financial statements of DEUTZ AG are prepared in accordance with the requirements of the German Commercial Code (HGB) and the German Joint Stock Corporation Act (AktG). In 2006, DEUTZ AG generated revenue of €1,103.0 million (2005: €987.9 million).

#### Loss carry-forward fully recovered

The profit from ordinary activities was €20.6 million (2005: €21.4 million). Including an extraordinary result of €12.0 million (2005: €46.1 million), and after taxes, this produced a net income for the year of €29.7 million (2005: €55.3 million). After taking into account the loss carried forward from 2005 of €21.6 million and an addition to the legal reserve of €0.4 million, the accumulated income (before appropriation of profit) was €7.7 million. The net income for 2006 therefore enabled full recovery of the outstanding losses carried forward in DEUTZ AG. The Management Board is proposing that the accumulated income at 31 December 2006 be retained in the new financial year.

On the basis of this carry-forward and the projected results in 2007, DEUTZ AG will be in a position to declare a dividend after a gap of some 20 years, opening up the possibility of a dividend payment in 2008.

The financial statements of DEUTZ AG were given an unqualified opinion by PricewaterhouseCoopers AG. They are published electronically in the German Federal Gazette and are sent to the German register of companies. They can be requested from DEUTZ AG and are available on the company's website.

## DEPENDENCY REPORT

The Management Board of DEUTZ AG has submitted a report for the year ended to the Supervisory Board as required under section 312 of the German Joint Stock Corporation Act (AktG). This report covers the relationships between the companies in the DEUTZ Group and the SAME DEUTZ-FAHR Group. The Management Board issued the following concluding statement:

“For all the legal transactions and activities stated, our company received an appropriate consideration for each legal transaction in accordance with the circumstances known to us at the time the transactions were conducted or the activities carried out and was not disadvantaged as a result of measures that were taken.”

## STATEMENTS PURSUANT TO SECTION 315 (4) HGB

The issued capital (share capital) of DEUTZ AG amounted to €292,270,841.53 at the end of 2006 (2005: €242,872,900.51) and was divided into 114,326,416 no-par-value bearer shares (2005: 95,003,621).

At the end of 2006, SAME DEUTZ-FAHR Holding & Finance B.V., Amsterdam, Netherlands, held a direct investment in DEUTZ AG representing 39.8 per cent of voting rights. Via SAME DEUTZ-FAHR Holding & Finance B.V. the following companies and individuals held indirect investments in DEUTZ AG to the same amount:

- SAME DEUTZ-FAHR Group S.p.A., Treviglio, Italy
- Intractor B.V., Amsterdam, Netherlands
- Belfort S.A., Luxembourg, Luxembourg
- Messrs Vittorio, Aldo and Francesco Carozza and Ms Luisella Carozza-Cassani.

According to sections 7 (1) and (2) of the Statutes of DEUTZ AG:

“(1) The Management Board shall comprise at least two members.

(2) The Supervisory Board shall determine the number of members of the Management Board and the allocation of responsibilities. It may draw up and issue rules of procedure.”

As far as the appointment and removal of members of the Management Board are concerned, sections 84, 85 German Stock Corporation Act (AktG) and section 31 German Codetermination Act (MitbestG) also apply.

According to section 14 of the Statutes of DEUTZ AG:

“The Supervisory Board may change the wording but not the spirit of the Statutes.”

Sections 179, 133 AktG also apply in the case of changes to the Statutes.

The authority of the Management Board is derived from the legal provisions and from the rules of procedure laid down by the Supervisory Board.

Pursuant to section 4 (5) of the Statutes of DEUTZ AG, the Management Board is authorised, with the consent of the Supervisory Board, to increase the issued capital until 21 June 2011 through the issue of new no-par-value shares against cash or non-cash contributions on one or more occasions up to a total amount of €120,000,000. Capital increases against non-cash contributions may not exceed a total of €80,000,000.

**Composition of the issued capital**

**Direct or indirect investments representing more than 10 per cent of voting rights**

**Legal provisions and Statute provisions regarding the appointment and removal of members of the Management Board and regarding changes to the Statutes**

**Authority of the Management Board, in particular with regard to share issue or buyback**



#### Further statements

There are no restrictions affecting voting rights or the transfer of shares.

No bearers of shares have any special rights conferring authority to control the company.

A large number of employees are direct shareholders in DEUTZ AG. These shareholdings do not give rise to any constraints on the direct exercising of control rights.

There are no material agreements in DEUTZ AG that are subject to a condition requiring a change of control in the event of a takeover bid.

DEUTZ AG has no indemnification agreements with members of the Management Board or employees that would come into force in the event of a takeover bid.

#### Explanatory statement by the Management Board in connection with sections 289 (4) and 315 (4) HGB

The information contained in the management report and Group management report pursuant to sections 289 (4) and 315 (4) HGB relate to arrangements that may be significant in the success of any public takeover bid for DEUTZ AG. It is the opinion of the Management Board that these arrangements are normal for publicly traded companies comparable with DEUTZ AG.

### REMUNERATION REPORT

Total Management Board remuneration for 2006 in DEUTZ AG and the Group was €2.6 million. The annual remuneration of individual members of the Management Board consists of fixed and variable components. The variable remuneration component is profit-related and is based on the change in certain key performance indicators, such as revenue, EBIT margin, ROCE and net financial debt in the Group. Further information on remuneration can be found on page 118.

### OVERALL ASSESSMENT OF 2006

#### Acceleration in growth in the course of the year

In contrast to the very cautious prognosis for general economic growth, especially in Germany and Europe, issued by economic research institutes and trade associations at the start of 2006, DEUTZ experienced a demand for its engines across all applications and in almost all regions that was unexpectedly robust and gathered pace during the course of the year. Overall, growth in new orders in the Group was at the top end of our original forecasts. Domestic new orders in particular were above the predictions made at the start of the year. The company was able to achieve unit sales well in excess of its target for the Group of around 210,000 engines. Only bottlenecks in the supply of parts prevented an even greater growth in unit sales beyond the level actually achieved.

There was a corresponding level of growth in Group revenue. This was mainly attributable to the domestic business, which was better than expected, and the continued strength of the business in the USA. The start of full production for the new commercial vehicle engine had a noticeable impact in the third and fourth quarters.

#### Key performance indicators reach and exceed target values

The DEUTZ Group was able to achieve in full the significant improvement in operating margin being pursued by the company. The change in raw material prices relevant to DEUTZ was in line with expectations and did not have any appreciable negative impact on profits during the year under review.

The increase in the equity ratio to around 31 per cent exceeded the company's predictions. The conversion of profit-sharing rights and convertible bonds was the main reason the original target of 25 per cent was exceeded. The successfully achieved growth in profit and the improvement in working capital both led to a rise in ROCE to 9.8 per cent. Despite significant expansion in the business accompanied by a corresponding impact on inventories and trade receivables, the working capital ratio again fell within the target value of 20 per cent of revenue, as planned.

Following very encouraging overall business performance in 2006, DEUTZ was in a healthy condition at the end of the year under review, economically speaking. The main contributing factors were the product portfolio, the high level of employee technological expertise, strong market positions and a robust profitability and financial situation. The excellent profit performance meant that it was possible to eliminate in full the accumulated losses carried forward in DEUTZ AG.

## EVENTS AFTER THE BALANCE SHEET DATE

No events occurred after the balance sheet date that had a material impact on the net assets, financial position or results of operations in the DEUTZ Group.

## RISK REPORT

DEUTZ operates in a variety of sectors and regions worldwide and manages its business through the operating segments of the Group parent company, its own subsidiary companies, service centres, sales offices and authorised dealers. This exposes the company to various business-specific risks.

DEUTZ's prime corporate goal is to achieve sustainable profits and increases in profit, so that the company can continue to develop and enjoy a secure future. The achievement of this goal requires, among other things, the early recognition and measurement of risks, together with the timely implementation of action to prevent these risks arising, or at least mitigate their effects if they do arise. DEUTZ therefore operates a risk management system that raises employee awareness of their own responsibility and encourages them to monitor risks themselves and that meets the requirements of the German Control and Transparency of Companies Act (KonTraG). Risks must be identified, analysed and communicated in good time and effective countermeasures must be taken to prevent the occurrence of risk.

The basic principles, monitoring standards, responsibilities, functions and procedures in the risk management system have been defined by the Management Board of DEUTZ AG and set out in a manual that is continually updated in the light of new knowledge. A mandatory reporting system and a Risk Management Committee ensure that all major risks are documented and communicated, and that appropriate countermeasures are taken and documented at an early stage.

As part of a regular risk inventory normally carried out four times a year, checks are carried out in all parts of the company and its functions to establish whether and to what extent approved measures have had or are having an effect and whether any major new risks have arisen from the mandatory planning for the current year or from medium-term planning. Appropriate countermeasures are decided by the Management Board on the basis of the analyses and suggestions made by the Risk Management Committee. Independently of the regular reports, ad hoc reports also have to be submitted if any new major risks arise or the threat from known risks increases. A risk inventory was carried out four times during 2006, as planned.

### Risk management system

#### **Sales risks**

In the last few years, DEUTZ has taken a range of strategic decisions to successfully safeguard itself against sales risks. The action taken includes close alliances with major customers such as Volvo and SAME DEUTZ-FAHR. DEUTZ has also consistently pursued a strategy of building on its market positions in growth areas and regions, creating a broader regional basis and stronger product expertise which gives the company greater independence from economic influences. On this basis, the DEUTZ Power Systems segment was focused from 2005 on gas engines for decentralised power generation. At the end of 2006, DEUTZ AG and FAW Jiefang Automotive Co. Ltd., China, signed an agreement to establish a joint venture for the production and marketing of diesel engines. In this way, DEUTZ aims to achieve a significant strengthening of its current activities in the strategically important Asian markets, particularly China. In addition, DEUTZ has concentrated its development activities on product strategy objectives that are closely interlinked with sales strategy as part of its overall marketing planning. Ongoing market monitoring ensures that the product strategy is kept up to date, for example by taking into account changes in customer requirements, competitor behaviour or more stringent legislation on exhaust emissions. This means that development work is carried out with the efficient use of time and in line with customer requirements and that the risk of misdirected development effort is limited.

#### **Production risks**

To avoid misdirected planning and capital expenditure, the necessary production capacity is reviewed annually under rolling medium-term plans, and weekly as part of operational assembly programme planning, and then coordinated with sales expectations for the individual model series and engine types. In the last few years, a rationalisation of production has also reduced the risk of under-utilising capacity. This rationalisation has primarily been achieved by a focus on core competencies. The forecast growth in production will be covered by the specific expansion of capacity, particularly in Cologne and Zafra, by the future procurement of core components from DEUTZ Dalian in China, and by the allocation of supplementary production to externally contracted manufacturers.

#### **IT risks**

The information and communication technology (ICT) infrastructure and the range of applications used in DEUTZ AG have been subject to further development in line with the company's strategic objectives. The company's hardware and software technologies and systems are updated by DEUTZ in close cooperation with external service providers. This ensures that any currently available potential improvements in terms of the efficiency of ICT operation and the effectiveness of the business process support systems can be exploited over the long term on the basis of an ICT portfolio that is both up to date and fit for the future. Strategic business processes have been, and continue to be, migrated in DEUTZ AG and in the subsidiaries in France, Spain and the USA using mySAP ERP 2005 software.

#### **Organisational risks**

To reduce organisational risks, specific head office departments in DEUTZ AG and DEUTZ Power Systems GmbH & Co. KG support the individual operating units. The organisational combination into head office functions and services of responsibilities covering all locations and segments, together with corresponding guidelines, guarantees the application of standardised processes throughout the Group. All operating levels, including subsidiaries outside Germany, are integrated into a detailed planning, control and reporting system. The core elements of the system are: revolving short-term and medium-term plans, monthly budget/actual analyses, quarterly forecasts and regular review/planning meetings. Under this system, all major business events that have occurred or are expected are considered and any necessary action is initiated promptly.

Quality assurance in all plants and areas of the company is based on a centralised quality system. Sources of errors and defects are systematically analysed, production processes optimised and action taken to minimise the risk in series production start-ups. This means that warranty risks are reduced. In addition, DEUTZ has uniform standards for the selection of suppliers and uses process audits to achieve continuous improvement in supplier quality. Over the past few years, these quality activities have led to a significant reduction in the costs of errors and defects. The basic principles of quality management are set out in a quality management manual. It is broken down into three parts. The first part, quality policy, describes the generally applicable quality principles and definitions. The second part contains the most important quality processes. The third part focuses on the continuous improvement process. It includes numerous methods and systems for controlling and improving product and process quality. The manual is also available to employees in an online version that can be used interactively.

#### Quality risks

To minimise financial risks, financial planning is carried out annually with regular analysis of variances during the course of the year. A weekly rolling forecast is produced showing the cash inflows and outflows for the subsequent four weeks. DEUTZ works with leading banks to ensure the availability of loan financing. Responsibility for financial management in the DEUTZ Group is held by DEUTZ AG as the overall parent company in the Group. Head office cash pooling ensures optimum use of cash in the Group. The head office finance department is also responsible for managing the lines of credit in DEUTZ AG and the subsidiaries in accordance with internal financing guidelines. The Group has adequate lines of credit at its disposal.

#### Financial risks

The risk from bad debts is restricted by constant monitoring and regular analysis of receivables and their breakdown. Receivables are to a large extent covered by credit insurance. Exchange rate risks are monitored under a head office currency management system and reduced by the use of hedging transactions. DEUTZ is also taking specific action to increase the volume of purchasing in US dollars; this enables the company to counteract exchange rate risks from sales invoiced in US dollars. Risks arising from the translation of financial statements of subsidiaries drawn up in currencies other than the euro are not hedged.

DEUTZ uses interest rate swaps to hedge the risk of increasing interest rates in variable interest agreements. This protects the current interest rate over the term of the loan. Another initiative in this regard was the convertible bond issued in 2004 paying interest of 3.95 per cent for a term of five years.

The procurement of components, feedstock and services from third parties can be subject to risks related to unexpected supply problems, unforeseen price increases or market shortages. DEUTZ counters these supplier-related risks by close monitoring of markets and the use of long-term supply agreements; the quality of goods supplied is also checked continuously. For the procurement of important components, the company carries out initial sampling followed by acceptance on site at supplier premises by specially qualified DEUTZ employees. In 2006, DEUTZ also increasingly developed double-sourcing strategies for the supply of critical components, safeguarding capacity and purchase prices with the development of subcontracted third-party production and second suppliers. Global sourcing activities were intensified and expanded.

#### Procurement risks

Existing and impending litigation is constantly documented, analysed and assessed with regard to its potential legal and financial impact. This ensures that appropriate action is taken promptly and any necessary provision is included in the financial statements. Internal company standards such as the "General terms and conditions of business", sample contracts for various uses and implementation provisions in the form of organisational guidelines reduce the possibility of new legal risks occurring. The Legal Affairs Department and, if necessary, external lawyers are also regularly consulted for projects and the finalisation of contracts that fall outside the scope of the standards developed for day-to-day business.

#### Legal risks

Risks from litigation were again reduced in 2006. The claim by the Greek tax authorities against a Greek subsidiary of DEUTZ AG for supplementary tax payments and penalties amounting to a total of €35 million is still pending. In four cases, private persons have also brought an action against more than a hundred companies, including the American subsidiary of DEUTZ AG, for alleged damage to health caused by asbestos.

All existing legal risks are regularly assessed and taken into account in the ongoing risk provision.

#### **Risks in accounting for deferred taxes**

Under IFRS, deferred tax assets are recognised for future tax reductions relating to tax credits on losses carried forward. Future changes in German tax legislation may have a negative impact on whether these losses carried forward can in fact be used and therefore also on the value of the deferred tax assets recognised by the DEUTZ Group in its financial statements.

#### **Future tax risks**

The last tax audit took place, with some interruptions, over the period 17 March 2003 to 10 March 2006 and covered the years 1998 to 2001. The report of the tax auditor has now been received. The provisions made to cover the adjusted tax assessments are adequate.

#### **Overall assessment of risk situation**

An analysis of currently identifiable individual risks does not give rise to any indications that there was any risk, either individually or in combination with other risks that represented, or could represent, a threat to the DEUTZ Group as a going concern during the year under review and beyond.

### **OUTLOOK**

#### **Economic climate remains positive**

Although overall global economic growth is expected to see a slight slowdown in 2007 according to current economic forecasts, the general trend will continue to be noticeably upwards. The prospect of a slower pace of growth applies to all industrial countries without exception. Experts believe that in the USA, in particular, growth will be appreciably slower than in the last four years. Economic expansion in Europe overall is expected to drop back only slightly. Although the situation in Germany favours further growth, government financial policy imposes significant constraints. According to commentators, there will also be little noticeable cooling off in the Asian economy. The rate of expansion in China will continue to be higher than in any other industrialised country, even if double-digit growth rates are no longer being predicted for the next few years.

Given the momentum in domestic demand already observed at the end of 2006 and forecasts of international demand that recently have been better than expected, the German Engineering Federation (VDMA) is predicting that production in German engineering will be up 4 per cent in 2007. Not long ago, in the autumn of 2006, the VDMA was only forecasting 2 per cent growth for 2007.

#### **Sector growth continues to be favourable**

Experts believe that global demand for construction equipment will continue to rise in 2007. They predict that an expected slowdown in the USA will be compensated by growth in demand in other regions, in particular in Eastern Europe and Asia.

The excellent business climate for commercial vehicles in Europe will also continue in 2007, even if growth rates are expected to be lower than in 2006. As before, this business will be driven mainly by sustained export demand. Following the introduction of the Euro IV emission standard in Europe for commercial vehicles with a permissible gross weight of over 3.5 tonnes, the next stage in emission reductions will be implemented on 1 October 2009. Companies who convert their fleets to the lower emission limits, even before the introduction of Euro V, can save two euro cents a kilometre on the cost of the truck toll on German motorways. Depending on vehicle mileage, this can lead to appreciable savings. It is reasonable to expect that this will stimulate demand in 2007 and 2008.



Forecasts as far as tractors and agricultural equipment are concerned are generally restrained. The VDMA is predicting a downturn in Germany of around 5 per cent over the whole of 2007. This is the result of spending brought forward to 2006 because of the implementation of the Stage III A emission standard in Europe from 1 January 2007 for tractors in the 75–130 kW category. Western European markets are generally considered by DEUTZ to be stable, whereas a growth in demand is expected in Eastern Europe.

There will be further significant growth of up to 10 per cent in the global market for decentralised power generation. Demand for decentralised power generation in Europe will be stimulated by various government development activities, particularly in Italy, France and Spain. Market experts in Europe are expecting to see growth of over 15 per cent in the market for biogas applications. There is a significant trend towards securing power generation by the use of decentralised systems and a need to install these systems quickly at a manageable cost. Apart from growing ecological awareness, a critical factor in the use of decentralised power generation systems is the price of gas relative to that of electricity.

Against the background of market growth that is generally significantly more robust than hitherto expected, DEUTZ sees good global opportunities to drive forward the accelerated growth in its own business initiated in 2006.

As emission legislation in future becomes ever more stringent throughout the world, DEUTZ sees in this development the opportunity to reinforce its own market position. First, there is the strength of the company's R&D activities; technological expertise and the size of the DEUTZ R&D budget represent significant barriers to market entry, setting DEUTZ apart from other market players. Secondly, DEUTZ, as a non-captive manufacturer, will continue to benefit from the sustained trend among equipment and vehicle manufacturers towards sourcing out their engine production.

The joint venture between DEUTZ and FAW Jiefang Automotive Co., Ltd., Changchun, China, the agreement on which was signed on 18 December 2006, will open up huge opportunities for further regional expansion and the further targeted development of DEUTZ's position in the market for engines with a capacity of 4 to 8 litres. The possibility of purchasing components from the joint venture also represents a long-term opportunity for reducing costs.

The joint venture to produce and market diesel engines, trading under the name DEUTZ (Dalian) Engine Co. Ltd. (DEUTZ Dalian), is expected to commence operations once the usual approvals for this type of transaction have been obtained from the relevant public authorities and bodies. Seen from today's viewpoint, DEUTZ AG expects to commence operations during the middle of 2007. The heart of the joint venture, the new engine plant for the production and assembly of Euro III-compliant engines, will come into full production within two years of the start of operations. Alongside this development, products from the other plants in the joint venture will be marketed to the FAW Group and existing Chinese customers.

The Management Board expects that the development phase of the joint venture, i.e. the first two years, will incur start-up losses of a single-digit million euro amount in each year. It is planned to consolidate the joint venture using the equity method and the impact of the consolidation will mainly be reflected in the DEUTZ financial debt and net interest expenses, as well as in net investment income.

A significant change to the reporting structure from 2007 will be the removal from the Compact Engines segment of air-cooled engines and engines with a capacity of more than 8 litres. From 2007, DEUTZ Customised Solutions will be reported as a separate segment. This segment was built up during the course of 2006 with the strategic objectives of clear product differentiation and a more intensive customer relationship. As part of this development, Ulm became the centre for the production of air-cooled engines, including the development of gensets. DEUTZ Customised Solutions will focus on individual customer solutions.

**Opportunities created by technological expertise, outsourcing trends and internationalisation**

**Joint venture in China to start operations from mid-2007**

**Change in segment reporting**

**Internationalisation and capacity expansion driven forward**

In 2007 and subsequent years, a considerable amount of attention will be given to the expansion of the DEUTZ Dalian joint venture in China. DEUTZ will invest around €60 million in 2007 for 50 per cent of the shares in the joint venture. Other capital expenditure in the DEUTZ Group will continue to rise in 2007 and will remain at a high level in 2008. The company is planning capital expenditure of well over €100 million for 2007, in addition to the funds dedicated to the joint venture in China. As in previous years, the capital expenditure will be primarily intended for the expansion of production facilities and the further development of the product range.

R&D expenditure will also remain at a high level in the next few years. Given the planned increase in revenue, the R&D ratio is expected to drop again slightly in 2007, but remain roughly at the same level for 2008.

The priorities in the next two years will be growth, continuing optimisation of facilities and the further expansion of strategic alliances, in addition to continuous product innovation. DEUTZ will ensure that the further development of the product range is rigorously driven forward. A key development in 2007 will be the introduction of engines in the 75 to 130 kW class compliant with the EU Stage III A/EPA Tier 3 emission standards. The introduction of engines with output below 75 kW will then follow in 2008.

As a non-captive engine manufacturer focussing on selected growth areas for Compact Engines and decentralised power generation systems, DEUTZ is very well positioned in all the regional markets that it covers. The establishment of the DEUTZ Dalian joint venture has also created the basis for further expansion in Asia, in particular in China. Product innovation, expansion of its position as market leader in 4-litre to 8-litre engines and the further expansion of international alliances will be the key areas of strategic development in DEUTZ in the coming years.

**Growth in unit sales, revenue and profit continues**

Given the very good level of orders on hand accompanied by a strong sustained inflow of new orders, the Management Board is predicting rising unit sales in 2007 for all application segments, together with a high level of capacity utilisation. Assuming the current general economic conditions continue, the excellent growth in unit sales is also expected to be sustained in 2008. The further expansion of strategic alliances will make a significant contribution in this regard. 2008 will also be the first full financial year of the joint venture in China with the international presence of DEUTZ thereby appreciably enhanced. A rise in unit sales is forecast in 2007 and 2008 for both Compact Engines and DEUTZ Power Systems gas engines. Unit sales figures will increase, in particular, in the Automotive and Agricultural Machinery applications. The growth will come particularly from expansion of further activities with our alliance partners, Volvo and SAME DEUTZ-FAHR, in line with joint planning. Business with other equipment manufacturers will also continue to expand.

The DEUTZ target unit sales figure for 2007 is around 260,000 engines. Consolidated revenue is expected to rise by 6 to 10 per cent. Operating profit will continue to show an improvement in 2007. A contribution will also come from the “7 up” efficiency and growth programme initiated at the beginning of 2005, individual elements of which were implemented from 2006. Among other things, this project includes the optimisation of internal processes and cost structures, improvements in procurement structures, reduction of material costs, optimisation of in-house production and the expansion of service support operations.

2006 saw the first positive effects on profit of the “7 up” efficiency and growth programme. The objective of this initiative is to meet the target of an EBIT margin of around 7 per cent in 2007, rather than in 2008 as originally planned. DEUTZ planning for 2007 is based on exchange rates that remain unchanged on 2006 on average. Most of the currency surplus for 2007 is already hedged. As far as the cost of raw materials is concerned, DEUTZ is again assuming that the situation will be as in 2006 for the most part.

**EBIT margin of  
7 per cent in 2007**

Given the forecasts for unit sales, revenue and operating profit (EBIT before one-off items), DEUTZ will once again be able to generate an increase in profit before tax in 2007. However, the expected interest expenses for the joint venture in China will impact on the net interest expense for the Group. The start-up costs will also be reflected in net investment income. Nevertheless, DEUTZ is predicting that net income will show an increase in 2007 of a double-digit million euro amount.

**Double-digit growth in net  
income**

The return on capital employed is still expected to reach 12 per cent in 2008. DEUTZ is endeavouring to sustain an equity ratio in excess of 30 per cent. Given the level of net income forecast, DEUTZ is planning the distribution of a dividend in 2008 based on the 2007 results.

**Dividend declaration goal  
for 2007**

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 Management Board cannot therefore make any warranty with regard to the statements made in this management report. The company gives no undertaking that it will update forward-looking statements to bring them into line with future developments.



# Consolidated Financial Statements 2006

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# Consolidated Financial Statements

## INCOME STATEMENT FOR THE DEUTZ GROUP

	Note	2006	2005
€ million			
<b>Revenue</b>	1	<b>1,490.0</b>	<b>1,322.8</b>
Changes in inventories and other own work capitalised	2	21.9	-1.7
Other operating income	3	51.8	126.7
Cost of materials	4	-933.8	-787.9
Staff costs	5	-318.1	-301.1
Depreciation and amortisation	6	-65.3	-58.6
Impairment	6	-	-6.7
Other operating expenses	7	-157.7	-183.3
Gains on investments measured at equity	8	3.2	3.3
Other investment income	8	1.3	1.2
Reversal of impairment losses on non-current financial assets	8	0.2	-
<b>EBIT</b>		<b>93.5</b>	<b>114.7</b>
<b>thereof one-off items</b>	3	<b>12.0</b>	<b>52.2</b>
<b>thereof operating profit (EBIT before one-off items)</b>		<b>81.5</b>	<b>62.5</b>
Interest expenses, net	9	-22.1	-28.5
thereof finance costs		-24.1	-30.6
Other taxes	10	-1.7	-1.5
<b>Net income before income tax</b>		<b>69.7</b>	<b>84.7</b>
Income taxes	10	-8.2	-13.3
<b>Net income</b>		<b>61.5</b>	<b>71.4</b>
thereof minority interest		-0.6	-0.2
thereof attributable to the shareholders of the parent enterprise		62.1	71.6
<b>Earnings per share</b>	11		
Undiluted earnings per share (€)		0.57	0.77
Diluted earnings per share (€)		0.52	0.62



## BALANCE SHEET FOR THE DEUTZ GROUP

**Assets**

	Note	31 Dec. 2006	31 Dec. 2005
€ million			
Property, plant and equipment	12	374.6	360.5
Intangible assets	13	100.3	94.9
Financial assets measured at equity	14	12.8	13.1
Other financial assets	15	11.4	10.7
<b>Fixed assets</b>		<b>499.1</b>	<b>479.2</b>
Deferred tax assets	16	56.2	56.5
<b>Non-current assets</b>		<b>555.3</b>	<b>535.7</b>
Inventories	17	249.6	214.6
Trade receivables	19	222.0	189.2
Other receivables and assets	16/19	84.2	73.5
Cash and cash equivalents	20	49.4	48.4
<b>Current assets</b>		<b>605.2</b>	<b>525.7</b>
Non-current assets held for sale	18	2.4	2.4
<b>Total assets</b>		<b>1,162.9</b>	<b>1,063.8</b>

**Equity and liabilities**

Issued capital		292.3	242.9
Additional paid-in capital		24.1	20.1
Other reserves		-1.8	1.6
Retained earning		0.4	-
Accumulated income/accumulated loss		43.5	-18.2
<b>Equity attributable to the shareholders of the parent enterprise (DEUTZ Group's interest)</b>		<b>358.5</b>	<b>246.4</b>
Minority interest		-	0.6
<b>Equity</b>	21	<b>358.5</b>	<b>247.0</b>
Provisions for pensions and other post-retirement benefits	22	271.2	283.6
Deferred tax provisions	16/22	0.5	0.7
Other provisions	22	52.0	42.4
Financial liabilities	23	69.5	114.2
Other liabilities	23	2.8	1.9
<b>Non-current liabilities</b>		<b>396.0</b>	<b>442.8</b>
Provisions for pensions and other post-retirement benefits	22	26.5	26.8
Provision for current income taxes	16/22	6.5	8.3
Other provisions	22	44.7	70.7
Financial liabilities	23	13.9	23.9
Trade payables	23	236.4	165.7
Other payables	23	80.4	78.6
<b>Current liabilities</b>		<b>408.4</b>	<b>374.0</b>
<b>Total equity and liabilities</b>		<b>1,162.9</b>	<b>1,063.8</b>

## STATEMENT OF CHANGES IN EQUITY FOR THE DEUTZ GROUP

	Issued capital	Additional paid-in capital	Retained earning	Fair value reserve <sup>1), 2)</sup>	Currency translation reserve <sup>1)</sup>	Accumulated income/accumulated loss	Total Group interest	Minority interest	Total
€ million									
<b>Balance at 1 Jan. 2005</b>	<b>233.0</b>	<b>18.0</b>	<b>–</b>	<b>–0.2</b>	<b>–3.1</b>	<b>–89.8</b>	<b>157.9</b>	<b>0.8</b>	<b>158.7</b>
Increase from exercise of conversion rights on convertible bonds	9.9	2.1					12.0		12.0
Accumulated other comprehensive income/loss (thereof reversals recognised in period income)				–1.1 <sup>3)</sup>	6.0		4.9		4.9
				(0.0 <sup>4)</sup> )			(0.0 <sup>4)</sup> )		(0.0 <sup>4)</sup> )
Net income						71.6	71.6	–0.2	71.4
Total of net income and accumulated other comprehensive income/loss in reporting period				–1.1	6.0	71.6	76.5	–0.2	76.3
<b>Balance at 31 Dec. 2005</b>	<b>242.9</b>	<b>20.1</b>	<b>–</b>	<b>–1.3</b>	<b>2.9</b>	<b>–18.2</b>	<b>246.4</b>	<b>0.6</b>	<b>247.0</b>
<b>Balance at 1 Jan. 2006</b>	<b>242.9</b>	<b>20.1</b>	<b>–</b>	<b>–1.3</b>	<b>2.9</b>	<b>–18.2</b>	<b>246.4</b>	<b>0.6</b>	<b>247.0</b>
Increase from exercise of conversion rights on convertible bonds	23.9	6.1					30.0		30.0
Increase from exercise of conversion rights on profit-sharing rights	25.5	–2.1					23.4		23.4
Accumulated other comprehensive income/loss (thereof reversals recognised in period income)				2.3 <sup>3)</sup>	–5.7		–3.4		–3.4
				(0.5)			(0.5)		(0.5)
Net income						62.1	62.1	–0.6	61.5
Total of net income and accumulated other comprehensive income/loss in reporting period				2.3	–5.7	62.1	58.7	–0.6	58.1
Appropriations to retained earnings			0.4			–0.4	–		–
<b>Balance at 31 Dec. 2006</b>	<b>292.3</b>	<b>24.1</b>	<b>0.4</b>	<b>1.0</b>	<b>–2.8</b>	<b>43.5</b>	<b>358.5</b>	<b>–</b>	<b>358.5</b>

<sup>1)</sup> On the face of the balance sheet these items are aggregated under “Other reserves”

<sup>2)</sup> Reserves from the measurement of cash flow hedges and reserves from the measurement of available-for-sale financial assets

<sup>3)</sup> See Note 21 for further information

<sup>4)</sup> Below €50,000

## CASH FLOW STATEMENT FOR THE DEUTZ GROUP

See Note 28 for cash flow disclosures

	2006	2005
€ million		
<b>EBIT</b>	<b>93.5</b>	<b>114.7</b>
Interest income	1.3	1.3
Other taxes paid	-1.7	-1.5
Income taxes paid	-10.7	-7.2
Depreciation, amortisation expense and impairment losses on non-current assets	65.5	65.3
Gains/losses on sale of businesses	-12.0	-67.0
Gains/losses on the sale of non-current assets	0.5	0.5
Gains/losses on measurement at equity	-1.1	-0.3
Other non-cash income and expenses	-13.8	-15.2
Change in inventories	-40.6	26.1
Change in receivables and other current assets	-34.6	15.0
Change in current provisions and liabilities (excluding financial liabilities)	65.3	10.4
Change in non-current provisions and liabilities (excluding financial liabilities)	-1.4	1.3
<b>Cash flow from operating activities</b>	<b>110.2</b>	<b>143.4</b>
Capital expenditure on intangible assets, property, plant and equipment	-95.1	-83.1
Capital expenditure on investments	-0.6	-0.4
Cash receipts from the sale of businesses	-2.0	82.8
Proceeds from the sale of non-current assets	0.9	2.2
<b>Cash flow from investing activities</b>	<b>-96.8</b>	<b>1.5</b>
Interest expenses	-7.9	-10.9
Cash receipts from borrowings	46.2	112.9
Repayments of loans	-50.1	-206.7
<b>Cash flow from financing activities</b>	<b>-11.8</b>	<b>-104.7</b>
Cash flow from operating activities	110.2	143.4
Cash flow from investing activities	-96.8	1.5
Cash flow from financing activities	-11.8	-104.7
<b>Change in cash and cash equivalents</b>	<b>1.6</b>	<b>40.2</b>
<b>Cash and cash equivalents at 1 January</b>	<b>48.4</b>	<b>7.8</b>
Change in cash and cash equivalents	1.6	40.2
Exchange rate-related change in cash and cash equivalents	-0.6	0.4
<b>Cash and cash equivalents at 31 December</b>	<b>49.4</b>	<b>48.4</b>

## SEGMENT REPORTING FOR THE DEUTZ GROUP

See Note 29 for segment reporting disclosures

Breakdown by business segment	Compact Engines		DEUTZ Power Systems	
	2006	2005	2006	2005
€ million				
External revenue	1,175.9	999.7	314.1	323.1
Intersegment revenue	7.7	9.4	0.5	0.6
<b>Total revenue</b>	<b>1,183.6</b>	<b>1,009.1</b>	<b>314.6</b>	<b>323.7</b>
<b>Total depreciation, amortisation and impairment</b>	<b>58.7</b>	<b>53.5</b>	<b>6.6</b>	<b>11.8</b>
thereof depreciation and amortisation	58.7	53.5	6.6	5.1
thereof impairment	–	–	–	6.7
<b>Segment EBIT before one-off items<sup>1)</sup></b>	<b>68.3</b>	<b>56.4</b>	<b>14.9</b>	<b>12.0</b>
<b>Segment earnings in accordance with IFRS</b>	<b>66.7</b>	<b>54.9</b>	<b>24.9</b>	<b>62.0</b>
<b>Net income</b>				
Segment assets	777.3	691.9	249.4	238.5
Segment liabilities	541.8	490.3	136.9	128.9
Segment capital expenditure	104.3	80.7	3.9	5.2
Material non-cash expenses (excl. depreciation)	13.4	11.7	11.3	34.8
Net gain on measurement at equity	1.2	1.4	2.0	1.9
Carrying amount of investments in enterprises measured at equity	4.7	4.2	8.1	8.9

<sup>1)</sup> Before one-off items including share of profit/loss from investments measured using the equity method, investment income and profits/losses from the sale of investments

Breakdown by region	Revenue from external customers		Segment assets		Capital expenditure	
	2006	2005	2006	2005	2006	2005
€ million						
Europe	1,037.4	881.3	934.1	847.2	106.5	84.9
Africa	48.5	44.3	7.1	8.2	0.1	–
Europe/Africa	1,085.9	925.6	941.2	855.4	106.6	84.9
Americas	214.4	193.2	58.2	51.4	1.2	0.6
Asia-Pacific	137.7	140.0	28.1	25.8	0.4	0.4
Middle East	52.0	64.0	–	–	–	–
<b>Total</b>	<b>1,490.0</b>	<b>1,322.8</b>	<b>1,027.5</b>	<b>932.6</b>	<b>108.2</b>	<b>85.9</b>

	Other		Total of segments		Reconciliation/ Consolidation		DEUTZ Group	
	2006	2005	2006	2005	2006	2005	2006	2005
	–	–	1,490.0	1,322.8	–	–	1,490.0	1,322.8
	–	–	8.2	10.0	–	–	8.2	10.0
	–	–	<b>1,498.2</b>	<b>1,332.8</b>	–	–	<b>1,498.2</b>	<b>1,332.8</b>
	–	–	<b>65.3</b>	<b>65.3</b>	–	–	<b>65.3</b>	<b>65.3</b>
	–	–	65.3	58.6	–	–	65.3	58.6
	–	–	–	6.7	–	–	–	6.7
	<b>–1.7</b>	<b>–5.9</b>	<b>81.5</b>	<b>62.5</b>	–	–	<b>81.5<sup>1)</sup></b>	<b>62.5<sup>1)</sup></b>
	<b>–2.2</b>	<b>–7.2</b>	<b>89.4</b>	<b>109.7</b>	<b>4.1</b>	<b>5.0</b>	<b>93.5<sup>1)</sup></b>	<b>114.7<sup>1)</sup></b>
					<b>–27.9</b>	<b>–38.3</b>	<b>61.5</b>	<b>71.4</b>
	0.8	2.2	1,027.5	932.6	135.4	131.2	1,162.9	1,063.8
	30.1	50.2	708.8	669.4	454.1	394.4	1,162.9	1,063.8
	–	–	108.2	85.9	–	–	108.2	85.9
	0.7	2.5	25.4	49.0	–	–	25.4	49.0
	–	–	3.2	3.3	–	–	3.2	3.3
	–	–	12.8	13.1	–	–	12.8	13.1

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# Notes to the consolidated financial statements

## 1. BASIS OF PRESENTATION

### 1.1 Parent company

The parent company is DEUTZ AG. Its head office is located at Ottostrasse 1, Cologne, Germany, and the company is entered under No. HRB 281 in the commercial register at the local court in Cologne.

DEUTZ AG shares are publicly traded on the stock exchanges in Frankfurt and Düsseldorf, where they have been listed in the MDAX segment since 18 September 2006.

DEUTZ is an independent manufacturer of diesel-powered and gas-powered engines. The Group's activities are divided into two segments: Compact Engines and DEUTZ Power Systems, each of which covers the entire value creation process of development, design, production and sales: the "Compact Engines" segment is concerned with the manufacture of liquid-cooled and air-cooled engines, the "DEUTZ Power Systems" segment with the manufacture of installations for decentralised power generation. The compact engines manufactured by DEUTZ are almost exclusively diesel-powered, whereas the engines produced by DEUTZ Power Systems tend to be gas-powered for the most part.

### 1.2 Accounting standards

The consolidated financial statements of DEUTZ AG for the year ended 31 December 2006 have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU. The standards comprise the IFRS and International Accounting Standards (IAS) promulgated by the International Accounting Standards Board (IASB), together with the interpretations of both the International Financial Reporting Interpretations Committee (IFRIC) and the Standard Interpretations Committee (SIC).

The consolidated financial statements are consistent with the statutory obligations applicable to publicly traded parent companies subject to disclosure requirements pursuant to section 315a (1) of the German Commercial Code (HGB) in conjunction with Article 4 of Regulation (EC) No. 1606/2002 of the European Parliament and of the Council dated 19 July 2002 concerning the adoption of current international accounting standards in the version applicable at the time (IAS Regulation). The supplementary provisions of the German Joint Stock Corporation Act (AktG) have been applied. The Group management report as at 31 December 2006 has been prepared in accordance with the HGB.

The accounting policies described below have been consistently applied. The financial statements of the consolidated German and foreign enterprises have been prepared as at the balance sheet date of the consolidated financial statements (31 December 2006) and are based on uniform accounting policies.

### 1.3 Adoption of the International Financial Reporting Standards (IFRS)

The DEUTZ Group's consolidated financial statements prepared for the parent company DEUTZ AG have been prepared in accordance with uniform accounting policies. The International Financial Reporting Standards (IFRS) that are binding throughout the European Union have been adopted. The standards that are not yet binding are not expected to have any material impact on the consolidated financial statements.

### Changes to accounting policies

The International Accounting Standard Board (IASB) and the International Financial Reporting Interpretation Committee (IFRIC) have issued some amendments to existing International Financial Reporting Standards (IFRS), together with some new IFRSs and IFRICs, the application of which is mandatory for financial years beginning on or after 1 January 2006. The IFRS/IFRIC below have been applied in the DEUTZ Group for the first time in the annual financial statements for 2006.



**IFRS 6, “Exploration and Evaluation of Mineral Resources”**, governs the accounting treatment of expenditures relating to the exploration and evaluation of mineral resources. The first-time adoption of IFRS 6 has had no impact on the DEUTZ Group’s consolidated financial statements. The further amendments to IFRS 1 and IFRS 6 only affect first-time users of IFRS that are adopting IFRS 6 prematurely. They have therefore had no impact on the DEUTZ Group’s consolidated financial statements.

**IAS 19 (amended in 2004), “Actuarial Gains and Losses, Group Plans and Disclosure”**, permits actuarial gains and losses to be taken to equity. DEUTZ has decided not to utilise this option. The amendment of this standard requires further information on defined benefit obligations to be disclosed in the notes to the consolidated financial statements. Apart from the additional disclosures in the notes, the adoption of this standard has had no impact on the DEUTZ Group’s consolidated financial statements.

The amendment to **IAS 21, “Net Investment in a Foreign Operation”**, states that exchange differences arising from monetary items that form part of a net investment in a foreign operation should be reported separately in equity. Its adoption has had no material impact on the DEUTZ Group’s consolidated financial statements.

Various **amendments to IAS 39** were adopted for the first time last year. The first of these amendments concerns the option to recognise financial instruments – subject to certain restrictions – as financial assets or financial liabilities **at fair value in the income statement (fair value option)**. DEUTZ has not utilised this option. The amendment concerning the recognition of **issued financial guarantees**, which fall within the scope of IAS 39, has had no impact on the DEUTZ Group’s consolidated financial statements either. The third amendment relates to the recognition of **cash flow hedges for currency risks arising from future intercompany transactions that are highly likely to materialise**. DEUTZ adopted this amendment in 2005.

**IFRIC 4, “Determining Whether an Arrangement Contains a Lease”**, describes criteria that can be used to identify elements of leases within agreements that are not formally classified as leases. Identified lease elements that meet the criteria of IFRIC 4 are recognised as leases under the relevant provisions of IAS 17. The adoption of this interpretation has had no material impact on the DEUTZ Group’s consolidated financial statements.

**IFRIC 5, “Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds”**, governs the recognition of claims and obligations resulting from funds set up for the decommissioning of plant or equipment and similar obligations. The first-time adoption of this interpretation last year has had no impact on the DEUTZ Group’s consolidated financial statements.

**IFRIC 6, “Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment”**, governs the accounting treatment of disposal obligations resulting from the EU directive on electrical and electronic equipment. The first-time adoption of this interpretation last year has had no impact on the DEUTZ Group’s consolidated financial statements.

**Standards, amendments and interpretations that have been published but have yet to be adopted.** The International Accounting Standard Board (IASB) and the International Financial Reporting Interpretation Committee (IFRIC) have issued further standards (IFRS) and interpretations (IFRIC), the application of which was not yet mandatory in 2006. Some of these rules require formal adoption by the EU before they can be applied, but this adoption has not yet been completed.

**IFRS 7, “Financial Instruments: Disclosures”**, combines and extends the notes to the consolidated financial statements applicable to financial instruments, which were previously described in IAS 32, and the disclosure requirements of IAS 30, which previously only applied to banks and similar financial institutions; in future these must be applied by all sectors. As a result of the publication of IFRS 7, disclosure requirements concerning capital management have been added to IAS 1. IFRS 7 and the amendments to IAS 1 must be applied for the first time for financial years commencing on or after 1 January 2007. As these amendments relate exclusively to disclosure requirements, they will have no impact on the DEUTZ Group’s net assets, financial position, results of operation or cash flows.

**IFRS 8, “Operating Segments”**, provides for the mandatory application of the “Management Approach” in segment reporting. Under this approach, the segments and the presentation of disclosures are based on the breakdown used internally by the most senior level of management to make decisions about how resources are allocated between segments and to assess the performance of segments. Mandatory application of IFRS 8 is required for the first time in financial years that commence on or after 1 January 2009. Apart from amended disclosures in the notes, the first-time adoption of IFRS 8 is not expected to have any material impact on the DEUTZ Group’s net assets, financial position, results of operation or cash flows.

**IFRIC 7, “Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies”**, must be adopted for the first time in financial years commencing on or after 1 March 2006. The first-time adoption of IFRIC 7 is not expected to have any material impact on the DEUTZ Group’s consolidated financial statements.

**IFRIC 8, “Scope of IFRS 2”**, must be adopted for the first time in financial years commencing on or after 1 May 2006. The first-time adoption of IFRIC 8 is not expected to have any material impact on the DEUTZ Group’s consolidated financial statements.

**IFRIC 9, “Reassessment of Embedded Derivatives”**, must be adopted for the first time in financial years commencing on or after 1 June 2006. The impact of first-time adoption of IFRIC 9 on DEUTZ consolidated financial statements is currently being reviewed.

**IFRIC 10, “Interim Financial Reporting and Impairment”**, must be adopted for the first time in financial years commencing on or after 1 November 2006. The impact of first-time adoption of IFRIC 10 on DEUTZ consolidated financial statements is currently being reviewed.

**IFRIC 11, “IFRS 2: Group and Treasury Share Transactions”**, must be adopted for the first time in financial years commencing on or after 1 March 2007. The first-time adoption of IFRIC 11 is not expected to have any material impact on the DEUTZ Group’s consolidated financial statements.

**IFRIC 12, “Service Concession Arrangements”**, must be adopted for the first time in financial years commencing on or after 1 January 2008. The first-time adoption of IFRIC 12 is not expected to have any material impact on the DEUTZ Group’s consolidated financial statements.

#### 1.4 Critical estimates and assumptions made for the purposes of recognition

The preparation of the consolidated financial statements in accordance with IFRS requires estimates and assumptions to be made that have an impact on the recognition, measurement and reporting of assets and liabilities, the disclosure of contingent liabilities at the balance sheet date and the reporting of income and expenses. Estimates and assumptions giving rise to a material risk in the form of adjustments to the carrying amounts of assets or liabilities over the next financial year are discussed below in the income statement and balance sheet disclosures. They primarily relate to provisions for pensions and other post-employment benefits, doubtful receivables, deferred tax assets for losses carried forward, definition of the useful life of assets, implementation of the impairment test (required once a year as a minimum) relating to intangible assets not yet available for use and the recognition of provisions for pending and potential legal disputes. Adjustments to estimates are recognised in income when better knowledge becomes available.

#### 1.5 Miscellaneous

The consolidated financial statements have been prepared in euros. Unless stated otherwise, the figures in the notes to the consolidated financial statements are stated in millions of euros (€ million).

The balance sheet is structured by maturity (current and non-current); the income statement is presented under the nature-of-expense method. In the interest of clarity, some items on the face of the balance sheet and the income statement have been aggregated and are mentioned and explained separately in the notes to the consolidated financial statements.

These consolidated financial statements prepared in accordance with IFRS were approved for publication by resolution of the Management Board on 5 March 2007 and received the consent of the Supervisory Board on 22 March 2007.

## 2. BASIS OF CONSOLIDATION

The financial statements of the consolidated German and foreign enterprises have been prepared and audited as at the balance sheet date of the consolidated financial statements (31 December 2006).

#### Consolidated enterprises and associates

Subsidiaries are all enterprises (including special-purpose entities) in which DEUTZ AG exerts direct or indirect control over their financial and business policy. The ability to exert control is generally deemed to exist in cases where more than 50 per cent of the enterprise's voting rights are held. Any assessment of whether control can be exerted will include potential voting rights that can currently be exercised or converted. Subsidiaries are fully consolidated from the point at which control passes to DEUTZ AG. They are deconsolidated from the point at which this control ends.

The consolidated financial statements include DEUTZ AG as well as five (2005: four) German enterprises and ten (2005: eleven) foreign enterprises in which DEUTZ AG holds the majority of voting rights either directly or indirectly or – as in the case of the special-purpose entity Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf – possesses a majority of the opportunities and risks.

DEUTZ Beteiligung GmbH, Cologne, has been included in the consolidation for the first time after taking over the investment in Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf.

DEUTZ of America Corporation, Atlanta (USA), has been merged with Deutz Corporation, Atlanta (USA).

Associates are enterprises over which DEUTZ AG exerts a significant influence but does not have control. These are generally enterprises in which DEUTZ AG holds between 20 per cent and 50 per cent of the voting rights. Two (2005: two) foreign enterprises according to the rules governing associates and one (2005: one) joint venture have been consolidated.

Page 121 of the annex to the notes to the consolidated financial statements lists the companies consolidated as part of the DEUTZ Group as at 1 December 2006. Full disclosure of shareholdings is published in the electronic German Federal Gazette.

### 3. PRINCIPLES OF CONSOLIDATION

The financial statements of the individual enterprises (including the financial statements of associates) have been consistently prepared and audited in accordance with the statutory regulations on consolidation based on uniform accounting policies.

Equity is consolidated by offsetting the carrying amount of investments against the DEUTZ Group's share of the consolidated subsidiaries' proportionate remeasured equity at the time they are acquired or consolidated for the first time, taking into account any utilisation of the exemption option granted by IFRS for opening balance sheets at 1 January 2004.

Equity is consolidated under the purchase method. The cost of an acquisition corresponds to the fair value of assets transferred, equity instruments issued and liabilities incurred or assumed at the time of the transaction, plus the costs directly attributable to the acquisition. Assets, liabilities and contingent liabilities identifiable as part of a business combination are measured at their fair value at the time of the transaction for the purposes of first-time consolidation, irrespective of the extent of any minority interest.

Any positive differences are capitalised as goodwill; any negative goodwill is recognised in income.

Equity attributable to third parties outside the DEUTZ Group is reported on the face of the consolidated balance sheet as minority interest.

Income, expenses, assets and liabilities arising between consolidated enterprises are eliminated. Unrealised losses are also eliminated unless the losses indicate an impairment of the asset transferred.

The consolidation of associates under the equity method follows the same principles with respect to positive and negative goodwill and the timing of the consolidation of equity. The DEUTZ Group's share of these enterprises' net profit is reported as investment income on the face of the income statement. Once DEUTZ's share of a loss incurred by an associate equals or exceeds the DEUTZ Group's shareholding in this enterprise (including other unsecured receivables), the DEUTZ Group must not recognise any further losses unless it has assumed obligations or made payments on behalf of the associate.

### 4. CURRENCY TRANSLATION

The items in the financial statements of each Group enterprise are measured in the currency that corresponds to the currency of the primary economic environment in which the enterprise operates (functional currency).

Balance sheet items – with the exception of equity – have been translated into the DEUTZ Group's functional currency (euro) at closing rates. Income and expense items – including the net profit or loss – have been translated at the average rates for the year. Equity – with the exception of the net profit or loss – has been translated at the prevailing closing rates for the previous year.

Translation differences arising from the translation of equity at historical rates and the translation of the net profit or loss at average rates for the year are reported under accumulated other comprehensive income/loss. In the year under review, this figure was reported at –€5.7 million (2005: €6.0 million).

Foreign-currency transactions are translated into the functional currency at the exchange rates prevailing at the time of the transaction. Gains and losses resulting from the settlement of such transactions and from the translation of foreign-currency monetary assets and liabilities at closing rates are reported on the face of the income statement unless they are recognised in equity as qualified cash flow hedges.

The exchange rates used for currency translation purposes are shown in the table below:

		Average exchange rates		Closing rates at 31 Dec.	
		2006	2005	2006	2005
USA	1 USD	0.79	0.81	0.76	0.85
UK	1 GBP	1.47	1.46	1.49	1.46
Singapore	1 SGD	0.50	0.49	0.50	0.51
Australia	1 AUD	0.60	0.62	0.60	0.62

## 5. ACCOUNTING POLICIES

Significant accounting policies used to prepare these consolidated financial statements are described below.

### 5.1 Income statement

**Revenue generated by the sale of engines and services** comprises the fair value received less VAT, discounts and price reductions.

Revenue and other income is recognised as follows:

**Revenue from the sale of engines** is recognised once a DEUTZ Group enterprise has delivered to a customer and the risk has passed to the customer. Estimates of outstanding costs are covered by accruals and deducted from revenue.

**Revenue generated by services** is recognised at the time the service is provided.

**Interest income, user fees, dividends and other income** are recognised pro rata temporis using the effective interest method. Revenue from user fees is deferred and recognised pro rata temporis according to the commercial content of the relevant agreements.

Dividend income is recognised at the time the right to receive the payment arises. Other operating income is recognised according to contractual agreement on the transfer of risks and rewards.

Income from embedded derivatives requiring bifurcation is also reported under other operating income.

### 5.2 Balance sheet

#### Property, plant and equipment

Property, plant and equipment are recognised at cost and, if depreciable, take account of depreciation and any impairment.

The cost of purchase or cost of conversion includes expenses directly attributable to the acquisition or production of the asset. The cost of conversion also includes an appropriate proportion of production overheads. Borrowing costs are recognised as a current expense.

Any subsequent cost of purchase or conversion is only recognised as part of the cost of the asset if future economic benefits are likely to accrue to the DEUTZ Group and the cost of the asset can be reliably determined. Repairs and maintenance are expensed in the year in which they are incurred.

Land is not depreciated.

Buildings are depreciated over their estimated useful life.

Mobile assets are always depreciated on a straight-line basis pro rata temporis over their useful life, allowing for a residual value. Low-value assets are depreciated on a straight-line basis pro rata temporis over five years.

The following useful lives are generally used for depreciation purposes:

	<b>Economic life</b> in years	<b>Depreciation rate</b> (%)
Buildings and grounds	15–33	3.03–6.67
Plant and equipment	10–15	5–6.67
Office furniture and equipment	3–10	10–33.3

Gains and losses on the disposal of assets represent the difference between sales proceeds and carrying amount and are recognised in the income statement.

Plant and equipment on finance leases are recognised at the lower of their fair value and the present value of the minimum lease payments and are depreciated over their useful life or the term of the lease, if shorter.

#### **Intangible assets**

Acquired intangible assets are recognised at the cost of purchase at the time of acquisition and internally produced assets are recognised at the cost of conversion, less amortisation expense and impairment losses in each case. The cost of purchase or conversion includes directly attributable costs. The cost of conversion also includes an appropriate proportion of overheads.

The following principles are applied:

**Concessions, trademarks and other acquired intangible assets.** These are recognised at amortised cost and amortised on a straight-line basis over their estimated useful life of three to ten years.

**Internally produced intangible assets.** Development costs are capitalised if they can be clearly allocated to a newly developed product or process that is technically feasible and is intended for the enterprise's own use or marketing activities. They are generally amortised on a straight-line basis over the expected production cycle.

Costs involved in the development or maintenance of computer software are expensed as incurred. Costs directly incurred by the manufacture of certain individual software products at the disposal of the DEUTZ Group are recognised as an intangible asset if the enterprise is likely to derive an economic benefit for more than one year as a result and this benefit exceeds the costs incurred. The useful life of this capitalised cost of computer software is three to ten years.

**Impairment of property, plant and equipment and intangible assets.** The DEUTZ Group checks at each balance sheet date whether there is any indication that an asset may be impaired (IAS 36.9).

An impairment test is conducted at least once a year on intangible assets with an indeterminate useful life, intangible assets not yet available for use, and construction in progress (IAS 36.10). A five-year planning horizon is used. The interest rate applied is 5.5 per cent.



An impairment loss corresponding to the amount by which the carrying amount exceeds the recoverable amount is recognised. The recoverable amount is the higher of the asset's fair value less costs to sell and the value in use.

When impairment tests are conducted, assets are aggregated at the lowest-possible level at which cash flows can be separately identified (cash-generating units [CGU]). Bottom-up tests are used to allocate assets to the CGUs. The starting point of this process is the individual asset, which is aggregated as part of a production-related group of assets at locations with other assets until independent cash inflows can largely be allocated to the emerging CGU.

**Determination of cost of capital.** DEUTZ calculates its cost of capital as the average equity and debt capital weighted according to the respective market values (weighted average cost of capital [WACC]).

The cost of equity capital corresponds to the rates of return expected by our shareholders and is derived from capital market information.

Our borrowing costs are based on the financing terms and conditions of our pension benefit obligations, profit-sharing rights and convertible bonds.

### Government grants

IAS 20 states that government grants for specific assets should be recognised as income over the periods necessary to match them with the related costs which they are intended to compensate. The DEUTZ Group deducts government grants relating to purchases of non-current assets from the cost of the respective asset. The amount of depreciation and amortisation is based on the cost of purchase after deduction of such grants.

### Income taxes

**1. Deferred taxes.** As required by IAS 12, deferred taxes are recognised on all temporary differences between the tax base of assets and liabilities and their carrying amounts in the IFRS financial statements.

Deferred tax assets are recognised to the extent that sufficient future taxable profits are likely to be generated over the planning period against which temporary differences can be offset.

DEUTZ recognises deferred tax liabilities resulting from temporary differences in connection with investments in subsidiaries and associates. They are not recognised if the reversal of the temporary differences can be controlled and these are unlikely to be reversed in the foreseeable future. The amount of temporary differences for which no deferred tax liabilities are recognised is stated in the notes to the consolidated financial statements.

Deferred tax assets and liabilities are netted if the DEUTZ Group is entitled to have the actual tax assets offset against tax liabilities and if the deferred taxes relate to income taxes levied by the same tax authority.

Deferred taxes are recognised at the rates anticipated on recognition of the asset or liability. The anticipated tax rate is the rate that is either already in force or has been announced at the balance sheet date, provided this announcement is equal to the material effect of the rate actually coming into force.

**2. Actual tax expense.** Actual income tax expenses for the current period and for previous periods are recognised at the amount that is expected to be paid to or reimbursed by the tax authorities or has already been paid.

**3. Assumptions and estimates.** The DEUTZ Group is obliged to pay income taxes in various countries. It needs to make estimates for the recognition of tax provisions and deferred taxes. It also has to make estimates to determine whether it needs to recognise deferred tax assets or make adjustments to deferred tax assets. DEUTZ mainly recognises deferred tax assets on losses carried forward. The losses carried forward in DEUTZ AG for corporation tax and trade tax purposes are €1 billion. Deferred tax assets are not recognised or their amount is adjusted if it is not sufficiently certain that the tax asset actually exists. There are uncertainties with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Differences between the actual amounts and our assumptions or future revisions of these assumptions can cause changes in the amounts of tax paid in future periods. If the actual amounts (in areas affected by estimates) differed by 10 per cent from the Management Board's estimates, the DEUTZ Group would have to increase its current tax liability by 10 per cent and reduce its deferred tax asset if this difference were to its detriment; conversely, it would have to reduce its current tax liability by 10 per cent and increase its deferred tax asset by 10 per cent if the difference were to its advantage.

### **Inventories**

Raw materials and consumables as well as bought-in parts and spare parts are recognised at cost or at the lower of cost and net realisable value less further costs incurred. The cost of purchase is based on weighted average procurement prices.

Work in progress and finished goods are recognised at the cost of conversion, which includes directly attributable costs as well as a proportion of production overheads. If the net realisable value less further costs incurred is less than the cost of conversion, the latter figure is recognised.

Additional adjustments are made to cover risks resulting from inventories' period of storage and impaired usability as well as contract-related losses.

Borrowing costs are not capitalised.

### **Non-current assets held for sale**

Non-current assets are classified as "held for sale" and recognised at the lower of their carrying amount and their fair value less costs to sell if their carrying amount essentially derives from their sale rather than from their continued use.

### **Primary financial instruments**

Primary financial assets in the DEUTZ Group cover the following categories in accordance with IAS 39:

- Loans and receivables
- Available-for-sale financial assets

### **Loans and receivables**

Loans and receivables comprise trade receivables and other receivables. They are initially recognised at their fair value taking into account any relevant transaction costs and subsequently measured at amortised cost under the effective interest method. Their cost of purchase corresponds to their principal amount. If assets in this category do not bear market rates of interest, they are recognised at their present value. Impairment losses are recognised if there are objective indications that contracts have not been performed as agreed. The impairment loss represents the difference between the carrying amount and the present value of future cash flows under the effective interest method.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not traded in an active market. They arise when the DEUTZ Group provides money, goods or services directly to a customer or other debtor. They are classified as current assets, except for those that only fall due 12 months after the balance sheet date. These are reported as non-current assets. This category comprises interest-bearing assets, trade receivables, and cash and cash equivalents.

The loans granted by the DEUTZ Group are initially recognised at their fair value, as required by IAS 39, and subsequently at amortised cost; they are discounted to their present value under the effective interest method. Receivables and other assets are initially recognised at their fair value and subsequently at amortised cost.

Cash and cash equivalents comprise cash on hand and unrestricted credit balances held with banks.

Non-interest-bearing primary financial assets with maturities of more than one year are discounted at the usual market rate of 5.5 per cent.

Doubtful accounts receivable are recognised at an amount that is deemed feasible based on historical default rates. As soon as it becomes known that the risk attaching to a certain receivable exceeds the general credit risk (e.g. insufficient creditworthiness on the part of the customer, disagreement on the existence or amount of the receivable, inability to enforce the receivable for legal reasons, etc.), the receivable is examined and – if there are indications that it is irrecoverable – written off. Changes in the default ratio have no material impact.

**Available-for sale financial assets.** Available-for-sale securities and equity instruments are recognised at their fair value where this can be reliably determined; the fair value of assets traded in an active market is derived from their market price at the respective balance sheet date. Assets whose fair value cannot be determined either using recognised measurement methods (e.g. discounted cash flow) or from their market prices are recognised at cost.

Changes in fair value are reported under accumulated other comprehensive income/loss (revaluation reserve). Tests are conducted at each balance sheet date to determine whether there are any objective indications that a financial asset or group of financial assets may be impaired. A material or permanent fall in the fair value below the carrying amount is regarded as an indication of impairment. If such an indication exists, the losses reported in the revaluation reserve under accumulated other comprehensive income/loss are removed from this reserve and recognised in the income statement.

**Other investments.** Other investments are initially recognised at their fair value plus transaction costs. Permanent impairment losses are recognised in income. Reversals of impairment losses are reported as accumulated other comprehensive income/loss.

**Non-current securities.** Non-current securities are recognised at their fair value. Changes in fair value are generally reported as accumulated other comprehensive income/loss, and permanent impairment losses are recognised in income. Reversals of impairment losses are reported as accumulated other comprehensive income/loss if they relate to equity instruments.

#### **Primary financial obligations**

The DEUTZ Group's primary financial instruments on the liabilities side comprise

- Financial liabilities
- Trade payables and other liabilities

Liabilities are classified as “current” unless the DEUTZ Group has an unconditional right not to repay the liability until at least 12 months after the balance sheet date. DEUTZ classifies all financial liabilities as “other liabilities”.

Liabilities are usually initially recognised at their fair value less transaction costs. They are subsequently recognised at amortised cost; any differences between the amount disbursed (less transaction costs) and the amount repaid are recognised in the income statement under the effective interest method over the term of the liability.

### **Recognition of derivatives**

**Derivative financial instruments.** DEUTZ only uses derivative financial instruments (interest-rate and currency derivatives) for hedging purposes as part of its business operations.

DEUTZ only regularly uses derivative financial instruments to reduce the foreign currency risk in forecast transactions involving foreign currencies and to reduce interest rate risk. It mainly uses forwards, options, option combinations and interest-rate swaps.

They are initially recognised at their fair value on the day they are concluded and are subsequently measured at the fair value prevailing at the time. The fair value of derivatives corresponds to the present value of estimated future cash flows. The fair value of currency forwards is based on the forward exchange rate at the balance sheet date.

Changes in the fair value of derivatives not used for hedging purposes under hedge accounting guidelines (non-hedging derivatives) are immediately recognised in the income statement.

**Cash flow hedges.** Forecast transactions (cash flows) in foreign currency are hedged using cash flow hedges. The effective portion of the changes in the fair value of derivatives designated as cash flow hedges is recognised as accumulated other comprehensive income/loss. The ineffective portion of the changes in fair value is reported on the face of the income statement under other expenses (exchange differences).

The changes in fair value reported in the reserve for cash flow hedges are reclassified to the income statement in the period in which the hedged item is recognised in income.

The fair values of derivatives designated as cash flow hedges are stated in Note 24. Certain changes in the reserve for cash flow hedges are shown under equity (fair value reserve).

**Equity.** Ordinary shares (no-par-value bearer shares) are classified as equity.

Costs directly attributable to the issuance of new shares and options are deducted from the issue proceeds and reported in equity, less any tax advantages. The cost of issuing new shares or options that are directly related to a business combination is added to the cost of purchase.

The right to exercise profit-sharing rights and convertible bonds is recognised in equity at fair value less pro rata transaction costs. The fair value derives from the beneficial fact that these instruments bear no interest or less interest than similar debt instruments without conversion rights.

### **Provisions**

**Provisions for pensions and other post-retirement benefits.** The occupational pension scheme offered by the DEUTZ Group takes account of the relevant legislation in various countries and the benefits that each company provides for its staff. The resultant obligations relate to both existing pensions and entitlements to future pensions.

The occupational pension scheme takes the form of defined-benefit pension plans, which are funded by the recognition of pension provisions. Since pension plans in Germany were closed to new members in 1996, employees there can no longer acquire any further employer-funded pension entitlements. Currently, therefore, accretion interest cost is simply added to existing pension provisions. One subsidiary in the UK offers a funded pension plan.

There are also defined-contribution pension plans (e.g. direct insurance). The mandatory contributions are immediately recognised as staff costs. In this case, the recognition of provisions is not required because the DEUTZ Group has no obligation apart from the obligation to pay premiums.

When defined-benefit pension plans are measured, pension obligations are recognised in accordance with IAS 19. The provisions recognised on the face of the balance sheet correspond to the defined benefit obligation at the balance sheet date less the fair value of plan assets, adjusted for cumulative unrecognised actuarial gains and losses and unrecognised past service cost.

The defined benefit obligation is calculated once a year by an independent actuary using the projected unit credit method. The anticipated future pension benefits vested at the balance sheet date are discounted using the interest rate on investment-grade corporate bonds that are denominated in the same currency in which the benefits are paid and whose terms to maturity correspond to those of the defined benefit obligations. This calculation also factors in assumptions and estimates about future staffing levels, wage and salary increases, future pension increases and - where available - the anticipated long-term return on plan assets.

Given this scenario, the DEUTZ Group uses various statistical and other models to measure its pension obligations accurately. The discount rate used is mainly based on an index of high-quality fixed-income investments at the plans' valuation dates and on a plan-specific estimate of the age structure of staff. These calculations also factor in statistical information such as natural wastage and mortality probabilities. Calculations of the anticipated return on plan assets are based on a long-term view of global capital market returns that considers the duration of pension obligations and a diversified investment strategy.

Because of changes in economic and market conditions, the costs and liabilities actually incurred may differ significantly from the estimates made on the basis of actuarial assumptions. The rate of pension and salary increases, the longevity of those entitled to pension benefits and the discount rate used can have a material impact on the amount of the defined benefit obligation and, consequently, on future pension costs. A change of 0.5 percentage points in the discount rate used is estimated to cause the majority of pension benefit obligations to be adjusted by between 4 per cent and 5 per cent. A change of 0.5 percentage points in the projected rate of pension increase would cause the majority of pension benefit obligations to rise by 4.5 per cent. These changes in assumptions result in actuarial gains or losses. If they exceed 10 per cent of the defined benefit obligation, the DEUTZ Group recognises them in income over the anticipated residual service period of active staff members entitled to pension benefits.

**Other provisions.** Other provisions are recognised if there are legal or constructive obligations towards third parties that arise from past events and are likely to result in an outflow of resources. Furthermore, it must be possible to estimate the obligation reliably. Provisions are not recognised for future operating losses.

If a number of identical obligations exist, the probability of an outflow of resources based on this group of obligations as a whole is calculated.

Provisions are recognised at their settlement value calculated at the balance sheet date and take account of projected cost increases. Non-current provisions are discounted to their present value.

Under IFRS, income from the reversal of provisions is credited to the same expense items to which the provisions were originally charged at the time they were recognised.

**Contingent liabilities.** Contingent liabilities are potential obligations that arise from past events and whose existence will only be confirmed by the occurrence of one or more uncertain future events that, however, are beyond the control of the DEUTZ Group. Furthermore, present obligations may constitute contingent liabilities if the likelihood of an outflow of resources is not sufficiently probable for the recognition of a provision and/or the amount of the obligation cannot be sufficiently reliably estimated.

**Pending and potential legal disputes.** DEUTZ AG and some of its subsidiaries are involved in a number of legal disputes and arbitration proceedings. These relate to risks concerning product liability, patent law, tax law, competition law and antitrust law. Financial provision has been made to cover the risks arising from this litigation.

At present it is not possible to predict the outcome of these pending cases with any degree of certainty beyond the provisions already recognised. We do not expect them to have a significantly adverse impact on the DEUTZ Group's financial position or financial performance.

The overall position of the legal risks facing the DEUTZ Group is explained in more detail in Note 26. A change of 5 per cent in the level of provisions recognised for litigation can increase or reduce the Group's profits by €0.3 million. A 5 per cent variation in the interest rate or a 5 per cent increase or decrease in the assumed probability of a certain risk or event materialising would not have a material impact on the Group's profits.

## 6. FINANCIAL RISK MANAGEMENT

The financial risk management systems used by the DEUTZ Group are explained below.

### Financial risk factors

Owing to its global business operations, the DEUTZ Group is exposed to various financial risks that can arise from adverse movements and trends in the international interest rate, foreign exchange, sales and procurement markets. The overarching risk management strategy used is designed to mitigate potentially negative effects on the DEUTZ Group's financial position. To minimise financial risk, financial planning is carried out annually with monthly analysis of variances during the course of the year.

DEUTZ works with leading banks to ensure the availability of loan financing. The Group has adequate lines of credit at its disposal. The head office Treasury department manages the lines of credit in accordance with the Group's financing principles. If required, these lines of credit are made available to subsidiaries and secured by guarantees from DEUTZ AG.

The Treasury department identifies, measures and hedges financial risk in close collaboration with the Group's operating segments. The Management Board specifies written principles for the Group's overarching risk management strategy as well as guidelines for certain areas, such as how to manage currency risk, interest rate risk and credit risk and how to use derivative and non-derivative financial instruments.



The objective of risk management is to reduce profit and cash flow fluctuations caused by volatility in interest rate and foreign exchange markets. Derivative financial instruments are only used for hedging purposes, i.e. only in conjunction with corresponding hedged items from the Group's ordinary business activity that have a countervailing risk profile to that of the hedging transaction. The nature and scope of the hedged items are specified in a binding financial directive.

## Market risk

**Currency risk.** The DEUTZ Group operates internationally and, consequently, is exposed to currency risk arising from exchange rate movements in various foreign currencies, principally the US dollar.

The Group's Treasury department uses futures contracts, options and option combinations to hedge currency risk emanating from the net position on forecast transactions and recognised assets and liabilities in any foreign currency.

Between 30 per cent and 70 per cent of the net positions budgeted for the following year are usually hedged, as are 100 per cent of project-based firm commitments.

**Liquidity risk.** Prudent liquidity management includes holding a sufficient reserve of cash and cash equivalents, the option of obtaining funding through adequate bank loans and the ability to issue short and long-term capital market instruments. Because the business environment in which the DEUTZ Group operates is constantly changing, the Treasury department aims to maintain the necessary degree of flexibility in its funding at all times by ensuring that it has sufficient unused credit lines at its disposal.

**Interest rate risk.** DEUTZ mitigates the risk of rising interest rates on variable interest rate agreements by using interest rate derivatives, which means that most of the interest rate risk on long-term, floating-rate bank loans is hedged using interest rate swaps.

In addition, a convertible bond was issued in 2004 paying a coupon of 3.95 per cent for a term of five years.

## Other operational risks

**Credit risk.** There are no significant concentrations of potential credit risk in the DEUTZ Group. The risk from bad debts is restricted by constant monitoring and regular analysis of receivables and their breakdown. Receivables are to a large extent covered by credit insurance. Further measures, such as guarantees and creditworthiness checks, are used to protect against credit risk. The Group has also put in place procedures and guidelines to ensure that products and services are only sold to customers who have a satisfactory payment record. Appropriate write-downs are applied to allow for the credit risk attaching to financial assets.

Exchange rate risks are monitored under a centralised currency management system and reduced by the use of hedging transactions. DEUTZ is also taking specific action to increase the volume of purchasing in US dollars; this enables the company to counteract exchange rate risks from sales invoiced in US dollars. Risks arising from the translation of financial statements of subsidiaries drawn up in currencies other than the euro are not hedged.

Agreements on derivative financial instruments and financial transactions are only concluded with financial institutions of impeccable credit standing.

## NOTES TO THE INCOME STATEMENT

(figures given in millions of euros unless stated otherwise)

### 1. REVENUE

The tables below give a breakdown of revenue by segment and geographical sales region:

#### Segments

	2006	2005 <sup>1)</sup>
€ million		
Engines	998.8	831.1
Service	177.1	168.6
<b>Compact Engines</b>	<b>1,175.9</b>	<b>999.7</b>
Engines	191.6	176.2
Service	122.5	146.9
<b>DEUTZ Power Systems</b>	<b>314.1</b>	<b>323.1</b>
<b>Total</b>	<b>1,490.0</b>	<b>1,322.8</b>

#### Sales regions

	2006	2005 <sup>1)</sup>
€ million		
<b>Europe/Africa</b>	<b>1,085.9</b>	<b>925.6</b>
thereof Germany	395.8	356.9
thereof rest of Europe	641.6	524.4
thereof Africa	48.5	44.3
<b>Americas</b>	<b>214.4</b>	<b>193.2</b>
<b>Asia-Pacific</b>	<b>137.7</b>	<b>140.0</b>
<b>Middle East</b>	<b>52.0</b>	<b>64.0</b>
<b>Total</b>	<b>1,490.0</b>	<b>1,322.8</b>

<sup>1)</sup> Including marine service business: 3 months of 2005

### 2. CHANGES IN INVENTORIES AND OTHER OWN WORK CAPITALISED

#### Changes in inventories

Changes in inventories of finished goods and work in progress in 2006 amounted to €9.1 million (2005: –€20.2 million).

#### Other own work capitalised

Other own work capitalised amounted to €12.8 million (2005: €18.5 million). This primarily comprised the costs of new engine development and the further development of existing engines to comply with current and future exhaust emission standards, together with development costs for 2008/2009 engine series.

### 3. OTHER OPERATING INCOME

	2006	2005
€ million		
Income from the disposal of the marine service business	12.0	67.0
Income from recharged costs and services	20.2	42.9
Exchange rate gains	1.8	3.9
Income from the measurement of derivatives (excl. interest rate derivatives)	4.4	0.8
Rentals and leases	3.1	1.7
Income from disposal of non-current assets and deconsolidation	0.3	1.6
Sundry other income	10.0	8.8
<b>Total</b>	<b>51.8</b>	<b>126.7</b>

In 2005, a provision was recognised in connection with the disposal of the marine service business and reported as a one-off item in the income statement. In 2006, €12.0 million was reversed.

The income from the measurement of derivatives relates to the measurement of embedded foreign-currency derivatives.

### 4. COST OF MATERIALS

	2006	2005
€ million		
Cost of raw materials and consumables, bought-in parts and goods sold	887.3	746.7
Cost of services procured	39.6	34.6
Impairment of raw materials, bought-in parts and goods produced	6.9	6.6
<b>Total</b>	<b>933.8</b>	<b>787.9</b>

## 5. STAFF COSTS

	2006	2005
€ million		
Wages	132.8	111.9
Salaries	127.4	135.0
Social security contributions	51.8	50.2
Cost of severance payments	2.7	1.7
Cost of post-employment benefits	3.4	2.3
<b>Total</b>	<b>318.1</b>	<b>301.1</b>

The average number of employees during the years is given in the section “Information under German Accounting Standards”.

## 6. DEPRECIATION, AMORTISATION AND IMPAIRMENT

This item gives details of depreciation and amortisation – which represent the scheduled apportionment of the cost of purchase over the assets’ estimated economic life – and impairment, which was determined using an impairment test as described under IAS 36.

### Depreciation and amortisation

	2006	2005
€ million		
Property, plant and equipment	47.7	47.1
Intangible assets	17.6	11.5
<b>Total</b>	<b>65.3</b>	<b>58.6</b>

### Impairment (write-downs)

	2006	2005
€ million		
Property, plant and equipment	–	6.7
<b>Total</b>	<b>–</b>	<b>6.7</b>

## 7. OTHER OPERATING EXPENSES

	2006	2005
€ million		
Expenses for general services	48.6	46.8
Special selling expenses	36.3	38.5
Cost of rentals and leases	17.4	18.5
Office, postal, telecommunications, advertising and other administrative expenses	13.2	14.1
Cost of fees, contributions and advice	12.1	12.0
Travel, entertainment and representation expenses	9.0	8.7
Expenses for structural adjustments (disposal of the marine service business)	–	8.5
Insurance costs	5.0	5.4
Adjustments of receivables and other financial assets	1.4	4.5
Exchange rate losses	4.6	2.4
Costs of disposal of non-current assets	0.8	1.2
Sundry other expenses	9.3	22.7
<b>Total</b>	<b>157.7</b>	<b>183.3</b>

Income from the reversal of provisions reduces the amount of expenses and is credited to the expense items to which the accrual of the provisions was originally charged.

## 8. GAINS AND LOSSES ON FINANCIAL ASSETS MEASURED AT EQUITY, OTHER INVESTMENT INCOME AND REVERSAL OF IMPAIRMENT ON NON-CURRENT FINANCIAL ASSETS

	2006	2005
€ million		
Profit distributions on financial assets measured at equity	2.1	3.1
Other income on financial assets measured at equity	1.1	0.2
<b>Gains (losses) on financial assets measured at equity</b>	<b>3.2</b>	<b>3.3</b>
<b>Other investment income</b>	<b>1.3</b>	<b>1.2</b>
<b>Reversal of impairment on non-current financial assets</b>	<b>0.2</b>	<b>–</b>
<b>Total</b>	<b>4.7</b>	<b>4.5</b>

## 9. INTEREST EXPENSES, NET

	2006	2005
€ million		
Interest received on credit balances held with banks	0.6	0.4
Other interest income	1.4	1.7
<b>Interest income</b>	<b>2.0</b>	<b>2.1</b>
Interest paid on liabilities owed to banks	-3.9	-5.4
Interest paid on convertible bonds and profit-sharing rights	-3.1	-6.1
Interest cost of pension provisions and similar obligations	-14.1	-16.1
Other interest expense and similar charges	-3.0	-3.0
<b>Interest expenses (financial expenses)</b>	<b>-24.1</b>	<b>-30.6</b>
<b>Interest expenses, net</b>	<b>-22.1</b>	<b>-28.5</b>

Other interest income includes €0.7 million (2005: €0.7 million) income from the plan assets in an international subsidiary.

## 10. TAXES

**Other taxes.** Other taxes essentially comprise real property taxes.

**Income tax expenses.** The table below gives a breakdown of income tax expenses:

	2006	2005
€ million		
Actual income taxes	-9.2	-15.4
thereof unrelated to the reporting period	(-)	(-)
Deferred taxes	1.0	2.1
thereof unrelated to the reporting period	(-)	(-)
<b>Total</b>	<b>-8.2</b>	<b>-13.3</b>

Accumulated other comprehensive income/loss for 2006 includes deferred tax assets of €0.6 million (2005: €0.4 million). There are no actual taxes under this item.

The tax reconciliation table shows the reconciliation from anticipated income taxes to effective taxes as shown on the face of the income statement. Effective income taxes include actual and deferred taxes. The applicable tax rate is 39 per cent (2005: 39 per cent) and comprises corporation tax at 25 per cent, the solidarity surcharge at 5.5 per cent and the average trade tax rate.

	2006	2005
€ million		
<b>Net income before income taxes</b>	<b>69.7</b>	<b>84.7</b>
Anticipated tax	27.2	33.0
Difference in local basis of assessment	0.3	0.4
Tax rates outside Germany	-0.8	-0.5
Subsequent recognition of or changes in adjustment and non-recognition of deferred tax assets on losses carried forward	-18.0	-22.1
Change in tax rates	-	-
Effect of non-deductible expenses	1.4	0.5
Effect of tax-exempt income	-	-0.1
Gains or losses on enterprises measured at equity	-	-0.1
Tax-exempt income on the disposal of consolidated enterprises	-	2.1
Effect of impairment or the reversal of impairment on the carrying amount of investments	-	-
Other	-1.9	0.1
<b>Effective tax expense</b>	<b>8.2</b>	<b>13.3</b>
Effective tax rate (%)	11.8	15.7

The applicable weighted average tax rate is 39 per cent (2005: 39 per cent).

The subsequent recognition of, or changes in adjustments to, and the non-recognition of deferred tax assets on losses carried forward essentially relate to

- the change in deferred tax assets following the utilisation of losses carried forward in the reporting period
- the capitalisation of deferred taxes on losses carried forward that can be utilised in subsequent years

## 11. EARNINGS PER SHARE

Earnings per share are calculated in accordance with IAS 33. The DEUTZ Group calculates undiluted earnings per share by dividing the net profit attributable to its shares by the weighted average number of shares outstanding.

To calculate diluted earnings per share, it factors in dilutive effects such as profit-sharing rights and convertible bonds. In doing so, it assumes that these profit-sharing rights and convertible bonds are converted into shares. Consequently, net profit is increased by the derecognition of the interest cost. The resultant tax expense is recognised.

	2006	2005
€ million/Shares in thousands		
Net profit	61.5	71.4
Weighted average number of shares outstanding	107,161	92,585
<b>Earnings per share (€)</b>	<b>0.57</b>	<b>0.77</b>
<b>Dilutive effect</b>		
Increase in net profit resulting from derecognition of interest cost on dilutive convertible profit-sharing rights and convertible bonds	3.2	4.2
Current and deferred taxes	-1.2	-1.6
<b>Adjusted net profit for the period</b>	<b>63.5</b>	<b>74.0</b>
Weighted average number of shares outstanding (diluted)	120,936	118,517
<b>Diluted earnings per share (€)</b>	<b>0.52</b>	<b>0.62</b>



## NOTES TO THE BALANCE SHEET

### 12. PROPERTY, PLANT AND EQUIPMENT

#### Gross figures

##### Cost of purchase/conversion

	Land, lease- hold rights and buildings	Plant and equipment	Office fur- niture and equipment	Construction in progress	Total
€ million					
<b>Balance at 1 Jan. 2005</b>	<b>226.6</b>	<b>448.8</b>	<b>181.4</b>	<b>6.0</b>	<b>862.8</b>
Changes in scope of con- solidation	-0.7	-0.2	-0.6	-	-1.5
Exchange differences	0.4	0.2	0.6	-	1.2
Additions	5.8	18.4	19.4	10.1	53.7
Disposals	-2.7	-10.1	-5.4	-	-18.2
Reclassifi- cations	-	5.3	0.1	-5.3	0.1
<b>Balance at 31 Dec. 2005</b>	<b>229.4</b>	<b>462.4</b>	<b>195.5</b>	<b>10.8</b>	<b>898.1</b>

#### Gross figures

##### Depreciation and impairment

	Land, lease- hold rights and buildings	Plant and equipment	Office fur- niture and equipment	Construction in progress	Total
€ million					
<b>Balance at 1 Jan. 2005</b>	<b>51.0</b>	<b>297.7</b>	<b>150.4</b>	<b>-</b>	<b>499.1</b>
Changes to the basis of consolidation	-0.5	-0.2	-0.4	-	-1.1
Exchange differences	0.2	0.2	0.4	-	0.8
Additions	5.9	30.5	10.7	-	47.1
Impairment	6.3	0.4	-	-	6.7
Disposals	-0.3	-9.7	-5.0	-	-15.0
Reclassifi- cations	-	-0.2	0.2	-	-
<b>Balance at 31 Dec. 2005</b>	<b>62.6</b>	<b>318.7</b>	<b>156.3</b>	<b>-</b>	<b>537.6</b>
<b>Net carrying amount at 31 Dec. 2005</b>	<b>166.8</b>	<b>143.7</b>	<b>39.2</b>	<b>10.8</b>	<b>360.5</b>

**Gross figures****Cost of purchase/conversion**

	Land, leasehold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
€ million					
<b>Balance at 1 Jan. 2006</b>	<b>229.4</b>	<b>462.4</b>	<b>195.5</b>	<b>10.8</b>	<b>898.1</b>
Exchange differences	-0.1	-	-0.3	-	-0.4
Additions	14.9	22.2	19.5	14.2	70.8
Capital investment grants	-	-2.8	-4.9	-	-7.7
Disposals	-0.8	-17.6	-13.0	-0.1	-31.5
Reclassifications	2.1	8.5	0.2	-10.8	-
<b>Balance at 31 Dec. 2006</b>	<b>245.5</b>	<b>472.7</b>	<b>197.0</b>	<b>14.1</b>	<b>929.3</b>

**Gross figures****Depreciation and impairment**

	Land, leasehold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
€ million					
<b>Balance at 1 Jan. 2006</b>	<b>62.6</b>	<b>318.7</b>	<b>156.3</b>	<b>-</b>	<b>537.6</b>
Exchange differences	-0.1	-0.1	-0.2	-	-0.4
Additions	5.5	31.5	10.7	-	47.7
Impairment	-	-	-	-	-
Disposals	-0.4	-16.9	-12.9	-	-30.2
Reclassifications	-	-	-	-	-
<b>Balance at 31 Dec. 2006</b>	<b>67.6</b>	<b>333.2</b>	<b>153.9</b>	<b>-</b>	<b>554.7</b>
<b>Net carrying amount at 31 Dec. 2006</b>	<b>177.9</b>	<b>139.5</b>	<b>43.1</b>	<b>14.1</b>	<b>374.6</b>

The additions to property, plant and equipment primarily comprised capital expenditure on the expansion of capacity for Compact Engines at the facilities in Cologne and Zafra, the expansion of the Ulm facility in connection with the relocation of air-cooled engine production and on the construction of the new head office building at Cologne-Porz.

A carrying amount of €1.2 million was recognised for land and buildings on finance leases at a German subsidiary (2005: €1.2 million).

Government grants at a Spanish subsidiary were deducted from the cost of purchasing the property, plant and equipment. In 2006, government grants of €2.2 million were received. At 31 December 2006, the balance of government grants recognised in the consolidated financial statements was €4.4 million (2005: €3.0 million). In 2006, €0.8 million (2005: €0.7 million) was recognised in income in the form of reductions applied to depreciation.

Commitments to purchase property, plant and equipment and intangible assets (purchase commitments) amounted to €36.8 million (2005: €23.6 million).

Bank debt of €29.5 million (2005: €51.6 million) is secured by mortgages.

### 13. INTANGIBLE ASSETS

#### Gross figures

##### Cost of purchase/conversion

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
<b>Balance at 1 Jan. 2005</b>	<b>90.9</b>	<b>48.9</b>	<b>139.8</b>
Change in basis of consolidation	-0.1	-	-0.1
Exchange differences	0.2	-	0.2
Additions	13.3	18.3	31.6
Disposals	-	-	-
Reclassifications	-	-	-
<b>Balance at 31 Dec. 2005</b>	<b>104.3</b>	<b>67.2</b>	<b>171.5</b>

#### Gross figures

##### Amortisation and impairment

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
<b>Balance at 1 Jan. 2005</b>	<b>60.9</b>	<b>4.1</b>	<b>65.0</b>
Change in scope of consolidation	-0.1	-	-0.1
Exchange differences	0.2	-	0.2
Additions	7.6	3.9	11.5
Impairment	-	-	-
Disposals	-	-	-
Reclassifications	-	-	-
<b>Balance at 31 Dec. 2005</b>	<b>68.6</b>	<b>8.0</b>	<b>76.6</b>
<b>Net carrying amount at 31 Dec. 2005</b>	<b>35.7</b>	<b>59.2</b>	<b>94.9</b>

**Gross figures**  
**Cost of purchase/conversion**

	<b>Concessions, trademarks and similar rights</b>	<b>Internally produced intangible assets</b>	<b>Total</b>
€ million			
<b>Balance at 1 Jan. 2006</b>	<b>104.3</b>	<b>67.2</b>	<b>171.5</b>
Exchange differences	-0.1	-	-0.1
Additions	14.3	22.5	36.8
Capital investment grants	-6.3	-7.4	-13.7
Disposals	-1.9	-	-1.9
Reclassifications	-	-	-
<b>Balance at 31 Dec. 2006</b>	<b>110.3</b>	<b>82.3</b>	<b>192.6</b>

**Gross figures**  
**Amortisation and impairment**

	<b>Concessions, trademarks and similar rights</b>	<b>Internally produced intangible assets</b>	<b>Total</b>
€ million			
<b>Balance at 1 Jan. 2006</b>	<b>68.6</b>	<b>8.0</b>	<b>76.6</b>
Exchange differences	-	-	-
Additions	9.4	8.2	17.6
Impairment	-	-	-
Disposals	-1.9	-	-1.9
Reclassifications	-	-	-
<b>Balance at 31 Dec. 2006</b>	<b>76.1</b>	<b>16.2</b>	<b>92.3</b>
<b>Net carrying amount at 31 Dec. 2006</b>	<b>34.2</b>	<b>66.1</b>	<b>100.3</b>

The additions to intangible assets essentially relate to the capitalisation of the costs of new engine development and the further development of existing engines to comply with current and future exhaust emission standards, and capitalisation of the costs of enhancing the 2008/2009 engine series.

The income statement includes research and development costs of €44.0 million for 2006 and €48.6 million for 2005.

## 14. FINANCIAL ASSETS MEASURED AT EQUITY

The shares held by the DEUTZ Group in associates, none of which are listed companies, are as follows:

	<b>2006</b>	<b>2005</b>
€ million		
<b>1 January</b>	<b>13.1</b>	<b>11.7</b>
Addition arising from measurement at equity	0.5	1.4
Disposal arising from measurement using the equity method	-0.8	-
<b>31 December</b>	<b>12.8</b>	<b>13.1</b>

The following table shows the principal balance sheet and income statement items for investments measured using the equity method:

	31 Dec. 2006	31 Dec. 2005
€ million		
Assets	61.4	71.4
Liabilities	22.1	27.1
Revenue	69.8	62.7
Earnings	9.3	9.0

One of the associates has a different financial year (ended 30 November 2006) and one of the companies is a joint venture.

## 15. OTHER FINANCIAL ASSETS (NON-CURRENT)

### Summary

	31 Dec. 2006	31 Dec. 2005
€ million		
Investments <sup>1)</sup>	5.9	5.6
Non-current securities <sup>2)</sup>	1.5	1.6
Loans <sup>3)</sup>	3.4	3.5
Derivatives <sup>4)</sup>	0.6	–
<b>Total</b>	<b>11.4</b>	<b>10.7</b>

<sup>1)</sup> Available-for-sale financial assets measured at cost because fair values cannot be determined

<sup>2)</sup> Available-for-sale financial assets measured at fair value

<sup>3)</sup> Primary receivables measured at amortised cost

<sup>4)</sup> Derivatives measured at fair value

### Re 1): Available-for-sale financial assets

Changes in investments were as follows:

€ million			
<b>Balance at 1 Jan. 2006</b>	<b>5.6</b>	<b>Balance at 1 Jan. 2005</b>	<b>7.0</b>
Additions	0.4	Additions	–
Disposals	–0.1	Disposals	–1.4
Impairment	–	Impairment	–
<b>Balance at 31 Dec. 2006</b>	<b>5.9</b>	<b>Balance at 31 Dec. 2005</b>	<b>5.6</b>

The additions and deductions relate to international investments.

### Re 2): Non-current securities

This item includes €1.5 million (2005: €1.6 million) in securities in the form of shares and bonds. The securities are used as a form of investment for the pension obligations of a foreign subsidiary.

### Re 3): Loans

Impairments are recognised to cover the existing risks attaching to loans. The fair value of loans approximates to their carrying amount.

## 16. DEFERRED TAXES, ACTUAL INCOME TAX ASSETS AND LIABILITIES

At the balance sheet date, DEUTZ AG had unutilised tax losses carried forward for corporation tax and trade tax, in each case amounting to approximately €1 billion. Further tax loss carry forwards were also available to international companies in the Group. Under IAS 12.34 et seq., these have been recognised to the extent that future taxable profits are sufficiently likely to be available against which the unutilised tax losses can be offset.

The table below gives a breakdown of the deferred taxes and the actual income tax assets and liabilities reported on the face of the balance sheet:

	2006	2005
€ million		
<b>Non-current</b>		
Deferred tax assets	56.2	56.5
Deferred tax provisions	0.5	0.7
<b>Current</b>		
Actual income tax assets	0.3	0.4
Provision for income taxes	6.5	8.3
Income tax liabilities	0.6	0.3

Current deferred taxes are reported on the face of the balance sheet under non-current assets, as required by IAS 1.

The last tax audit took place, with some interruptions, over the period 17 March 2003 to 10 March 2006 and covered the years 1998 to 2001. The report of the tax auditor has now been received. The financial provisions made to cover the adjusted tax assessments are adequate.

The table below gives a breakdown of deferred tax assets and liabilities:

	Deferred taxes in 2006		Deferred taxes in 2005	
	Assets	Liabilities	Assets	Liabilities
€ million				
<b>Assets</b>				
Intangible assets	–	27.3	–	27.1
Property, plant and equipment	12.6	–	11.3	0.1
Investments and financial assets measured using the equity method	–	1.6	0.2	1.4
Inventories	0.5	1.8	3.3	1.6
Receivables and other assets	0.6	12.6	0.7	7.2
<b>Liabilities</b>	<b>34.5</b>	<b>6.0</b>	<b>33.3<sup>1)</sup></b>	<b>2.2<sup>1)</sup></b>
<b>Losses carried forward</b>	<b>53.4</b>		<b>45.2</b>	
<b>Tax credits</b>	<b>–</b>		<b>0.6</b>	
<b>Consolidation</b>	<b>2.1</b>	<b>–1.1</b>	<b>0.4</b>	
<b>Other</b>	<b>0.4</b>	<b>0.2</b>	<b>0.4</b>	
<b>Deferred taxes (gross)</b>	<b>104.1</b>	<b>48.4</b>	<b>95.4</b>	<b>39.6</b>
Netting	–47.9	–47.9	–38.9	–38.9
<b>Deferred taxes (net)</b>	<b>56.2</b>	<b>0.5</b>	<b>56.5</b>	<b>0.7</b>

<sup>1)</sup> 2005 annual report: gross figure

Total temporary differences relating to investments in subsidiaries and associates that have a tax impact on disposal amount to €11.5 million for deferred tax assets and €45.3 million for deferred tax liabilities. DEUTZ AG is able to control the timing of the reversal of these temporary differences. Furthermore, these temporary differences are unlikely to be reversed in the foreseeable future as a result of future profit distributions or the disposal of investments.

In addition to the tax loss carryforwards on which deferred taxes have been recognised, there are loss carryforwards of the following amounts and with the following expiry periods for which deferred taxes have not been recognised because the losses cannot be utilised.

**Loss carryforwards on which deferred taxes have not been recognised**

	<b>2006</b>	<b>2005</b>
€ million		
Corporation tax	867.5	889.4
Trade tax	900.6	917.0
Tax credits outside Germany	54.1	50.5

**Thereof: expiry periods for German and international losses carried forward**

	<b>German corp. tax/local tax</b>		<b>German trade tax</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
€ million				
Less than 5 years	14.0	9.7	4.2	
5–9 years	21.4	37.1	2.6	
Indefinitely	832.1	893.1	893.8	917.0

**17. INVENTORIES**

	<b>31 Dec. 2006</b>	<b>31 Dec. 2005</b>
€ million		
Raw materials and consumables, bought-in parts and spare parts	140.5	114.6
Work in progress	50.7	43.3
Finished goods	58.4	56.7
<b>Total</b>	<b>249.6</b>	<b>214.6</b>

The carrying amount of inventories at 31 December 2006 written down to net realisable value amounted to €38.2 million (2005: €37.8 million). The figure for inventories includes long-term inventories with a value of €12.0 million.

The table below shows the impairment of inventories:

	<b>2006</b>	<b>2005</b>
€ million		
Balance at 1 January	53.4	58.8
Changes	+5.5	–5.4
<b>Balance at 31 December</b>	<b>58.9</b>	<b>53.4</b>



## 18. NON-CURRENT ASSETS HELD FOR SALE

The non-current assets held for sale at 31 December 2006 relate to land and buildings in the special-purpose entity Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf, at Cologne-Deutz (€0.9 million) (2005: €0.9 million) and in the company DEUTZ Power Systems B.V., Rotterdam, in Rotterdam (€1.5 million) (2005: €1.5 million). These enterprises intend to sell the assets within 12 months of the balance sheet date.

## 19. RECEIVABLES AND OTHER ASSETS (EXCLUDING TAXES)

	31 Dec. 2006	31 Dec. 2005
€ million		
Trade receivables <sup>1)</sup>	234.8	201.1
Less adjustments	-12.8	-11.9
<b>Trade receivables (net)</b>	<b>222.0</b>	<b>189.2</b>
<b>Other receivables and assets</b>		
Receivables from investments <sup>1)</sup>	5.8	6.6
(thereof trade receivables)	(4.2)	(3.8)
(thereof other receivables)	(1.6)	(2.8)
Advances paid on property, plant and equipment and inventories	8.9	6.5
Derivative financial instruments <sup>2)</sup>	6.0	0.8
Sundry other receivables <sup>3)</sup>	54.1	50.7
Receivables arising from other taxes	6.7	5.2
Prepaid expenses	2.4	3.3
<b>Total</b>	<b>83.9</b>	<b>73.1</b>

The DEUTZ Group is exposed to a credit risk with respect to its operating activities and its outstanding accounts. Appropriate write-downs are applied to account for identifiable risks of this type. The maximum credit risk theoretically possible corresponds to the carrying amount in each case.

In the reporting period, total write-downs of €18.9 million (2005: €27.6 million) were applied to receivables due from investments.

Re <sup>1)</sup> Measured at amortised cost.

Re <sup>2)</sup> The derivative financial instruments essentially consist of foreign-currency derivatives embedded in purchase agreements.

Re <sup>3)</sup> Sundry other receivables include unavailable deposits of €17.7 million (including interest) from the disposal of the marine service business. The availability of these funds is restricted for a period of 24 months from the date on which the agreement came into effect. Sundry other receivables of €6.0 million fall due in more than one year.

## 20. CASH AND CASH EQUIVALENTS

This item comprises cash on hand and credit balances held with banks.

## 21. EQUITY

### Summary

	2006	2005
€ million		
Issued capital	292.3	242.9
Additional paid-in capital	24.1	20.1
Other reserves	-1.8	1.6
Retained earning	0.4	-
Accumulated income/accumulated loss	43.5	-18.2
<b>Equity attributable to the shareholders of the parent enterprise</b>	<b>358.5</b>	<b>246.4</b>
Minority interest	-	0.6
<b>Total</b>	<b>358.5</b>	<b>247.0</b>

### Issued capital

At the end of 2006, the issued capital (share capital) of DEUTZ AG amounted to €292,270,841.53 (2005: €242,872,900.51) and was divided into 114,326,416 (2005: 95,003,621) no-par-value bearer shares.

In 2006, 9,339,625 (2005: 3,854,546) convertible bonds and 998,317 (2005: nil) profit-sharing rights were converted into a total of 19,322,795 (2005: 3,854,546) no-par-value shares in DEUTZ AG.

### Disclosures under the German Securities Trading Act (WpHG)

AB Volvo (publ), SE-40508 Gothenburg, Sweden, notified the regulatory authorities pursuant to sections 21 (1) and 24 WpHG that its shareholding in DEUTZ AG fell below the 10 per cent threshold on 23 October 2003 and now amounts to 7.09 per cent of the voting rights.

SAME DEUTZ-FAHR Group S.p.A., V. le Cassani 14, 24047 Treviglio (BG), Italy, notified the regulatory authorities pursuant to sections 21 (1) and 24 WpHG that the shareholding of SAME DEUTZ-FAHR Holding & Finance B.V., Herengracht 548, 1017 CG Amsterdam, Netherlands, in DEUTZ AG exceeded the 25 per cent threshold on 2 July 2004 and now amounts to 29.90 per cent of the voting rights. These voting rights are attributable to SAME DEUTZ-FAHR Group S.p.A. pursuant to section 22 (1) number 1 WpHG.

In 2006, the parent company (DEUTZ AG) received the following new notifications concerning the above shareholdings.

In a letter dated 6 June 2006, INTAL INTERNATIONAL S.A., Luxembourg, notified the following pursuant to section 21 et seq. WpHG:

“The share of voting rights held by SAME DEUTZ-FAHR Holding & Finance B.V., Rokin 55, 1012 KK Amsterdam, Netherlands, in DEUTZ AG exceeded the thresholds of 5 per cent and 10 per cent on 21 November 2003; on 21 November 2003 this share amounted to 14.47 per cent and is now 38.88 per cent. Pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) WpHG, the voting rights are fully attributable to SAME DEUTZ-FAHR Group S.p.A., V. le Cassani 14, 24047 Treviglio (BG), Italy. As a result, the share of voting rights held by SAME DEUTZ-FAHR Group S.p.A. in DEUTZ AG on 21 November 2003 also exceeded the threshold of 5 per cent and 10 per cent; on 21 November 2003 this share amounted to 14.47 per cent and is now 38.88 per cent.

We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you pursuant to sections 21 et seq. WpHG in our own name and in the name of and on the behalf of the company and natural persons specified under (i) and (ii) below that the share of voting rights held in DEUTZ AG by

- (i) Intractor B.V., Rokin 55, 1012 KK Amsterdam, Netherlands,
- (ii) Messrs Vittorio Carozza, Francesco Carozza and Aldo Carozza and Ms Carozza-Cassani, each at V. le Cassani, 14, 24047 Treviglio (BG), Italy, and
- (iii) INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg,

on 21 November 2003 exceeded the thresholds of 5 per cent and 10 per cent, with the share on 21 November 2003 amounting to 14.47 per cent; the share is now 38.88 per cent. These voting rights are fully attributable to the companies and natural persons specified under (i) to (iii) above pursuant to section 22 (1) sentence 1 number 1, and section 22 (3) WpHG.”

In a further letter dated 6 June 2006, INTAL INTERNATIONAL S.A., Luxembourg, notified the following pursuant to section 21 et seq. WpHG:

“The share of voting rights held by SAME DEUTZ-FAHR Holding & Finance B.V., Rokin 55, 1012 KK Amsterdam, Netherlands, in DEUTZ AG exceeded the threshold of 25 per cent on 2 July 2004; on 2 July 2004 this share amounted to 29.90 per cent and is now 38.88 per cent. Pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) WpHG, the voting rights are fully attributable to SAME DEUTZ-FAHR Group S.p.A., V. le Cassani 14, 24047 Treviglio (BG), Italy. As a result, the share of voting rights held by SAME DEUTZ-FAHR Group S.p.A. in DEUTZ AG on 2 July 2004 also exceeded the threshold of 25 per cent; on 2 July 2004 this share amounted to 29.90 per cent and is now 38.88 per cent.

We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you pursuant to sections 21 et seq. WpHG in our own name and in the name of and on the behalf of the company and natural persons specified under (i) and (ii) below that the share of voting rights held in DEUTZ AG by

- (i) Intractor B.V., Rokin 55, 1012 KK Amsterdam, Netherlands,
- (ii) Messrs Vittorio Carozza, Francesco Carozza and Aldo Carozza and Ms Carozza-Cassani, each at V. le Cassani 14, 24047, Treviglio (BG), Italy, and
- (iii) INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg,

on 2 July 2004 exceeded the threshold of 25 per cent, with the share on 2 July 2004 amounting to 29.90 per cent; the share is now 38.88 per cent. These voting rights are fully attributable to the companies and natural persons specified under (i) to (iii) above pursuant to section 22 (1) sentence 1 number 1, and section 22 (3) WpHG.”

In a letter dated 15 November 2006, INTAL INTERNATIONAL S.A., Luxembourg, notified the following pursuant to section 21 et seq. WpHG:

“We, INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you pursuant to sections 21 et seq. WpHG that the share of the voting rights held by INTAL INTERNATIONAL S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, in DEUTZ AG on 8 November 2006 fell below the thresholds of 5 per cent, 10 per cent and 25 per cent and is now 0 per cent.”

In a letter dated 15 November 2006, Belfort S.A., Luxembourg, notified the following pursuant to sections 21 et seq. WpHG:

“We, Belfort S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, hereby notify you pursuant to sections 21 et seq. WpHG that the share of the voting rights held by Belfort S.A., 54, Boulevard Napoléon 1er, 2210 Luxembourg, in DEUTZ AG on 8 November 2006 exceeded the thresholds of 5 per cent, 10 per cent and 25 per cent and is now 40.32 per cent. These voting rights are attributable to us pursuant to section 22 (1) sentence 1 number 1 and section 22 (3) WpHG.”

In 2006, the parent company (DEUTZ AG) received further new notifications.

Fidelity Management & Research Company, 82 Devonshire Street, Boston, Massachusetts 02109, USA, notified pursuant to section 21 (1) WpHG that the share of voting rights held by Fidelity Management & Research Company in DEUTZ AG on 20 April 2006 exceeded the threshold of 5 per cent and now amounts to 5.06 per cent. The voting rights are attributable to Fidelity Management & Research Company pursuant to section 22 (1) sentence 1 number 6 WpHG.

FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, notified in summary form pursuant to section 21 (1) WpHG that the share of voting rights held by FMR Corp. in DEUTZ AG on 20 April 2006 exceeded the threshold of 5 per cent and now amounts to 5.10 per cent, including the share in the above-mentioned section. These voting rights are attributable to FMR Corp. pursuant to section 22 (1) sentence 2 in conjunction with section 22 (1) sentence 1 number 6 WpHG.

In a letter dated 28 December 2006, Fidelity International Limited, Kingswood Fields, Millfield Lane, Lower Kingswood, Tadworth, Surrey KT20 6RB, UK, notified us of the following pursuant to sections 21 (1) and 22 (1) of the WpHG:

“Pursuant to section 21 (1) of the German Securities Trading Act (WpHG), we hereby notify you that the share of the voting rights held by FMR Corp., 82 Devonshire Street, Boston, Massachusetts, USA, in DEUTZ AG on 22 December 2006 fell below the threshold of 5 per cent and now amounts to 4.98 per cent. This share of the voting rights was attributable to Fidelity Management & Research Company pursuant to 22 (1) (2) of the WpHG in conjunction with section 22 (1) (1), number 6 of the WpHG.”

In a letter dated 2 January 2007, Fidelity International Limited, Kingswood Fields, Millfield Lane, Lower Kingswood, Tadworth, Surrey KT20 6RB, UK, notified us of the following correction pursuant to sections 21 (1) and 22 (1) of the WpHG:

“By order and on behalf of Fidelity Management & Research Company, 82 Devonshire Street, Boston, Massachusetts 02109, USA, we hereby notify you pursuant to section 21 (1) WpHG that the share of voting rights held by Fidelity Management & Research Company in DEUTZ AG on 22 December 2006 fell below the threshold of 5 per cent and now amounts to 4.83 per cent. The voting rights are attributable to Fidelity Management & Research Company pursuant to section 22 (1) 1 number 6 WpHG.

By order and on behalf of FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, we hereby notify you in summary form pursuant to section 21 (1) WpHG that the share of voting rights held by FMR Corp. in DEUTZ AG on 22 December 2006 fell below the threshold of 5 per cent and now amounts to 4.98 per cent, including the share referred to in section 1. These voting rights are attributable to FMR Corp. pursuant to section 22 (1) 2 WpHG in conjunction with section 22 (1) 1 number 6 WpHG.”

### **Authorised capital**

The annual general meeting held on 22 June 2006 approved a resolution to create new authorised capital. The Management Board is authorised, with the consent of the Supervisory Board, to increase the issued capital until 21 June 2011 through the issue of new no-par-value shares against cash or non-cash contributions on one or more occasions up to a total amount of €120,000,000. Capital increases against non-cash contributions may not exceed a total of €80,000,000.

If the capital is increased against cash contributions, the shareholders must be granted pre-emptive rights. The new shares may be transferred to a bank specified by the Management Board subject to an undertaking by the bank to offer the shares to shareholders (indirect pre-emptive right). The Management Board is authorised, with the consent of the Supervisory Board, to exclude the pre-emptive rights of shareholders in the following cases:

- for fractional amounts;
- in so far as is necessary to grant holders of bonds with conversion rights, option rights or conversion obligations issued by DEUTZ AG subscription rights to new shares to the extent that would be required if they were to exercise their conversion or option rights or fulfil their conversion obligations;

- if the issue price of the new shares is not significantly below the market price and the shares issued under the exclusion of pre-emptive rights pursuant to section 186 (3) sentence 4 German Joint Stock Corporation Act (AktG) in total do not exceed 10 per cent of the issued capital either at the effective date or at the time this authorisation is exercised. The aforementioned 10 per cent threshold includes shares that are acquired on the basis of an authorisation granted by the annual general meeting and sold during the period of this authorisation pursuant to section 71 (1) number 8 sentence 5 AktG in conjunction with section 186 (3) sentence 4 AktG. This restriction also includes shares that have been or are to be issued in order to service bonds with conversion rights, option rights or conversion obligations in so far as the bonds were issued during the term of this authorisation under the exclusion of pre-emptive rights in accordance with section 186 (3) sentence 4 AktG.

The Management Board is also authorised, with the consent of the Supervisory Board, to exclude pre-emptive rights in so far as the capital increase is made against non-cash contributions in the context of the acquisition of an enterprise, parts of an enterprise or investments in an enterprise.

### Conditional capital

**Convertible profit-sharing rights.** The annual general meeting voted on 29 June 1995 to increase the company's conditional share capital by DM 50,000,000 by issuing 10,000,000 bearer shares with a par value of DM 5. The increase in conditional capital was to be used to grant conversion rights to the holders of profit-sharing rights issued by the company at the end of August 1995.

The conditional capital will only be increased to the extent that the holders of profit-sharing rights utilise their conversion rights.

**Convertible bonds.** The Annual General Meeting voted on 28 June 2001 to increase the company's conditional share capital by up to €16,600,000. The conditional capital will only be increased if

- a) the holders or creditors of conversion rights or warrants attached to the convertible bonds or bonds with warrants issued by DEUTZ AG, or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding, on or before 27 June 2006 utilise their conversion rights or option rights, or
- b) the holders or creditors of the convertible bonds issued on or before 27 June 2006 by DEUTZ AG or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding who are obliged to exercise their conversion rights fulfil their conversion obligations.

The new shares entitle their holders to a share of the company's profits from the beginning of the financial year in which they are created through the exercise of conversion rights or option rights or through the fulfilment of conversion obligations.

The Annual General Meeting voted on 27 May 2004 to increase the company's conditional share capital by up to €34,000,000. The capital will only be increased if

- a) the holders or creditors of conversion rights or warrants attached to the convertible bonds or bonds with warrants issued by DEUTZ AG, or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding, on or before 26 May 2009 utilise their conversion rights or option rights or
- b) the holders or creditors of the convertible bonds issued on or before 26 May 2009 by DEUTZ AG or by companies in which DEUTZ AG directly or indirectly holds a majority shareholding who are obliged to exercise their conversion rights fulfil their conversion obligations.

The new shares entitle their holders to a share of the company's profits from the beginning of the financial year in which they are created through the exercise of conversion rights or option rights or through the fulfilment of conversion obligations.

### Additional paid-in capital

The additional paid-in capital contains premiums and contributions from shareholders as well as the equity component of compound financial instruments such as non-interest-bearing profit-sharing rights and low-interest-bearing convertible bonds.

### Other reserves

Translation differences arising from the translation of equity at historical rates and the translation of the net profit or loss at average rates for the year are reported under accumulated other comprehensive income/loss. In 2006, a loss of –€5.7 million (2005: income of €6.0 million) was reported.

The net gains or losses on the effective portion of the changes in the fair value of derivative financial instruments designated as cash flow hedges are added to the reserve for cash flow hedges. €1.9 million was added in 2006 (2005: –€1.3 million).

Gains of €0.4 million (2005: €0.1 million) on changes in the fair value of available-for-sale financial instruments that are unlikely to be permanent were added to the revaluation reserve.

In 2006, there was no hedging ineffectiveness requiring reclassification from the reserve for cash flow hedges to income.

The reserve for cash flow hedges and the revaluation reserve are both reported in the fair value reserve in the statement of changes in equity.

### Net income

The table below gives a breakdown of the net profit:

	2006	2005
€ million		
EBIT before one-off items	81.5	62.5
One-off items	12.0	52.2
<b>EBIT</b>	<b>93.5</b>	<b>114.7</b>
Interest expenses, net	–22.1	–28.5
Other taxes	–1.7	–1.5
<b>Income before income taxes</b>	<b>69.7</b>	<b>84.7</b>
Income taxes	–8.2	–13.3
<b>Net income</b>	<b>61.5</b>	<b>71.4</b>
thereof minority interest	–0.6	–0.2
thereof attributable to the shareholders of the parent enterprise	62.1	71.6

### Minority interest

This relates to the minority interest in Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf.

## 22. PROVISIONS (CURRENT AND NON-CURRENT)

### Summary

	31 Dec. 2006	31 Dec. 2005
€ million		
Provisions for pensions and other post-retirement benefits	297.7	310.4
Deferred tax provisions	0.5	0.7
Provision for current income taxes	6.5	8.3
Other provisions	96.7	113.1
<b>Total</b>	<b>401.4</b>	<b>432.5</b>

### Provisions for pensions and other post-retirement benefits

DEUTZ AG has both defined-contribution plans and defined-benefit plans for its employees.

#### 1) Defined-contribution plans

Employees in Germany receive statutory social insurance benefits where contributions are paid as part of income. In DEUTZ, there are also further direct insurance and pension scheme entitlements that are financed by employees. These plans are treated as defined-contribution plans because the company has no obligation beyond the payment of contributions to public and private insurers. Ongoing contribution payments are reported as an expense for the period concerned.

In 2006, the employer proportion of statutory pension insurance amounted to €19.0 million (2005: €17.9 million). A further €1.9 million (2005: €1.1 million) was paid into direct insurance and pension insurance under deferred compensation arrangements.

#### 2) Defined-benefit plans

### Defined benefit obligation for pensions and other post-retirement benefits

	31 Dec. 2006	31 Dec. 2005
€ million		
Non-funded	319.1	334.5
Funded	18.5	21.1
<b>Total</b>	<b>337.6</b>	<b>355.6</b>

The pension obligations of DEUTZ AG and its German subsidiaries are measured under the projected unit credit method, as required by IAS 19, and take account of future salary and pension increases as well as adjustments to other benefits.

No employer-funded pension entitlements have been granted to new employees joining the DEUTZ Group in Germany since 1995 (closed pension plans). Enterprises outside Germany have funded pension plans that are wholly or partly covered by plan assets.



The measurement of pension obligations is based on actuaries' reports and the following actuarial assumptions:

**Actuarial assumptions: Germany**

	<b>2006</b>	<b>2005</b>
(%)		
Discount rate	4.58	4.12
Anticipated return on plan assets	n.a.	n.a.
Rate of pension increase	1.5 (from 2007)	1.35 (from 2008)
Rate of salary increase	n.a.	n.a.

**Outside Germany**

	<b>2006</b>			<b>2005</b>		
(%)	US	UK	Weighted	US	UK	Weighted
Discount rate	8.5	5.1	5.4	8.5	4.7	4.97
Anticipated return on plan assets	n.a.	5.5	5.5	n.a.	5.50	5.50
Rate of salary increase	4.0	4.1	4.1	4.0	3.80	3.81
Rate of pension increase	3.0	2.5	2.54	3.0	2.50	2.54

The table below shows the reconciliation of the defined benefit obligation and plan financing analysis to the carrying amount of provisions:

**Reconciliation of the defined benefit obligation**

	<b>31 Dec. 2006</b>	<b>31 Dec. 2005</b>
€ million		
Size of defined benefit obligation for pensions and other post-retirement benefits	337.6	355.6
External fair value plan assets	-14.3	-13.0
Actuarial gain (+)/loss (-)	-25.6	-32.2
<b>Pension provisions reported on the face of the balance sheet</b>	<b>297.7</b>	<b>310.4</b>

The table below shows the reconciliation of the defined benefit obligation:

	<b>2006</b>	<b>2005</b>
€ million		
<b>DBO at 1 January</b>	<b>355.6</b>	<b>352.1</b>
Service cost	0.7	0.8
Employee contributions	0.2	n. a.
Interest	14.1	16.1
Unrecognised past service cost	-1.3	n. a.
Gain (-)/loss (+)	-6.1	9.7
Exchange differences	0.3	0.5
Pensions paid	-25.9	-26.0
Reclassifications	n.a.	2.4
<b>DBO at 31 December</b>	<b>337.6</b>	<b>355.6</b>

The new actuarial gains were mainly the result of the change in discount rate in the German plans. The new unrecognised past service costs arose following a transition in UK pension plans and were immediately amortised in 2006.

#### Change in plan assets

	2006	2005
€ million		
Market value of the plan assets at the beginning of the financial year	13.0	10.5
Expected income from plan assets	0.7	0.7
Gains (+)/losses (–) on plan assets	0.3	1.3
Exchange differences	0.3	0.3
Employer contributions	0.4	0.6
Employee contributions	0.2	0.2
Pensions paid from plan assets	–0.6	–0.6
<b>External fair value plan assets</b>	<b>14.3</b>	<b>13.0</b>

Total pension obligation expenses after utilisation of provisions were broken down as follows:

	2006	2005
€ million		
Service cost	0.7	0.8
Interest cost	14.1	16.1
Anticipated return on plan assets	–0.7	–0.7
Amortisation of actuarial gains/losses	–	–
Amortisation of unrecognised past service cost	–1.3	–
<b>Total</b>	<b>12.8</b>	<b>16.2</b>

Interest cost and return on plan assets are reported under interest expenses, net. The actual return on plan assets in 2006 amounted to €1.0 million (2005: €2.0 million).

#### Plan assets breakdown

	2006	2005
(%)		
Shares	61	60
Debt instruments	38	39
Real estate	0	0
Other assets	1	1

The external plan assets relate to just one foreign subsidiary and contain neither securities issued by Group enterprises nor assets used by the DEUTZ Group.

### Financing status and adjustments based on past experience

	2006	2005
€ million		
Defined benefit obligation for pensions and other post-retirement benefits	337.6	355.6
External fair value plan assets	-14.3	-13.0
Plan funding surplus/shortfall	323.3	342.6
Gains/losses based on historical experience		
from obligations	6.4	-0.1
from plan assets	0.3	1.3

### Other provisions

The table below gives a breakdown of other provisions:

	31 Dec. 2006			31 Dec. 2005		
€ million	Total	With a residual term of up to one year	With a residual term of more than one year <sup>1)</sup>	Total	With a residual term of up to one year	With a residual term of more than one year <sup>1)</sup>
Guarantees	23.5	13.2	10.3	27.9	17.8	10.1
Imminent losses on pending transactions	5.4	3.5	1.9	8.1	5.0	3.1
Personnel	29.4	7.5	21.9	19.1	7.5	11.6
Restructuring	3.3	3.3	–	5.6	5.6	–
Other	35.1	17.2	17.9	52.4	34.8	17.6
<b>Total</b>	<b>96.7</b>	<b>44.7</b>	<b>52.0</b>	<b>113.1</b>	<b>70.7</b>	<b>42.4</b>

<sup>1)</sup> Generally less than five years

Other provisions are recognised at their settlement value calculated at the balance sheet date and take account of projected cost increases. Non-current provisions are discounted at a rate of 5.5 per cent.

Other provisions cover all identifiable risks and other contingent liabilities. The main items covered are the cost of guarantees and potential risks, discounts and price reductions, contractual risks, imminent losses on pending transactions and provisions for obligations to employees, such as pre-retirement part-time working and collective pay agreements. The provisions also cover commitments relating to the disposal of the marine service business.

Restructuring provisions are only recognised to cover the costs directly attributable to the restructuring.

The table below shows the changes to other provisions in 2006:

	Guarantees	Imminent losses on pending transactions	Personnel	Restructuring	Other	Total
€ million						
<b>1 Jan. 2006</b>	<b>27.9</b>	<b>8.1</b>	<b>19.1</b>	<b>5.6</b>	<b>52.4</b>	<b>113.1</b>
Amounts added	3.4	0.1	16.2	–	5.7	25.4
Exchange differences	–0.1	–	–0.1	–	–0.5	–0.7
Amounts utilised	–1.9	–1.1	–5.7	–2.2	–5.4	–16.3
Amounts reversed	–4.6	–1.7	–0.1	–0.1	–18.4	–24.9
Accrued interest and effect of changes in interest rates	0.1	–	–	–	–	0.1
Reclassifications	–1.3	–	–	–	1.3	–
<b>31 Dec. 2006</b>	<b>23.5</b>	<b>5.4</b>	<b>29.4</b>	<b>3.3</b>	<b>35.1</b>	<b>96.7</b>

#### Provisions for taxes

Provisions for taxes are discussed under Note 16.

### 23. FINANCIAL LIABILITIES, TRADE PAYABLES AND OTHER LIABILITIES

#### Summary

	31 Dec. 2006			31 Dec. 2005		
€ million	Total	With a residual term of 1–5 years	With a residual term of more than 5 years	Total	With a residual term of 1–5 years	With a residual term of more than 5 years
<b>Financial liabilities</b>						
Profit-sharing rights	– <sup>1)</sup>	–	–	22.8	22.8	–
Convertible bonds	20.8	20.8	–	48.7	48.7	–
Liabilities to banks	60.2	41.0	5.4	64.1	40.3	–
Liabilities under finance leases	2.4	0.5	1.8	2.5	0.5	1.9
<b>Total</b>	<b>83.4</b>	<b>62.3</b>	<b>7.2</b>	<b>138.1</b>	<b>112.3</b>	<b>1.9</b>
<b>Trade payables</b>	<b>236.4</b>			<b>165.7</b>	–	–
<b>Other liabilities</b>	<b>83.2</b>	<b>2.8</b>	–	<b>80.5</b>	<b>1.9</b>	–
<b>Total</b>	<b>403.0</b>	<b>65.1</b>	<b>7.2</b>	<b>384.3</b>	<b>114.2</b>	<b>1.9</b>

<sup>1)</sup> €31,000

### **Profit-sharing rights**

The annual general meeting on 29 June 1995 voted to authorise the Management Board, with the consent of the Supervisory Board, to issue registered profit-sharing rights with transfer restrictions with a total par value of up to DM 50,000,000 on or before 31 December 1996.

In August 1995 the Management Board decided, with the consent of the Supervisory Board, to utilise this authorisation and to issue profit-sharing rights with a total par value of DM 50,000,000. The 1,000,000 registered profit-sharing rights with transfer restrictions were issued in the ratio of one for 59 against cash contributions at the issue price of DM 100 for each profit-sharing right with a par value of DM 50.

The profit-sharing rights entitle the holder to an annual dividend payment equal to the dividend paid on shares of the same par value and to a share of the liquidation proceeds up to the amount of the issue price. If the profit-sharing rights fall due for repayment before this date, only the par value is paid. The holder does not participate in any losses.

The profit-sharing rights do not entitle the holder to attend the company's annual general meeting nor to any voting rights, options on new shares or new profit-sharing rights.

The company or the holders of profit-sharing rights can terminate the profit-sharing rights with effect from the day after any annual general meeting by giving six months' notice; however, the earliest effective termination date is the day after the annual general meeting at which the annual financial statements for the financial year ending on 31 December 2006 are presented.

The profit-sharing rights can be exchanged for shares of DEUTZ AG in the ratio of one for one based on their par value. In 2006, 998,317 profit-sharing rights were converted into shares in DEUTZ AG.

The benefit accruing from the non-interest-bearing nature of profit-sharing rights has been allocated as an equity instrument to additional paid-in capital. Interest is accrued on the debt capital portion of profit-sharing rights at the historical market rate of 9 per cent under the effective interest method. The profit-sharing rights outstanding at the end of 2006 totalled €31,000 (2005: €22.8 million).

### **Convertible bonds**

In July 2004, the Management Board of DEUTZ AG issued a convertible bond for €67.3 million with the consent of the Supervisory Board. This convertible bond pays an annual coupon of 3.95 per cent on its par value of €3.40, has a maturity of five years and falls due for repayment on 22 July 2009. The issue price was €3.40. Each bond can be converted into one no-par-value share of DEUTZ AG and the bondholder can exercise the conversion right at any time on or before 10 July 2009.

The capital market interest rate appropriate to the bond's maturity and risk profile was found to be 6.5 per cent at the date of issue on 22 July 2004. The difference between this comparable capital market interest rate and the bond's coupon constitutes the value of the conversion right. This value of €7.2 million – minus the transaction costs payable on the equity component (€0.3 million) – was allocated to additional paid-in capital at the date of issue. The liability resulted from the bond's par value recognised at the date of issue, minus the value of the conversion right allocated to additional paid-in capital and the transaction costs payable on the debt capital portion (€1.6 million). Interest is accrued on the repayment amount over the bond's maturity under the effective interest method and recognised in income.

9,339,625 of these bonds were converted into shares in 2006.

The convertible bond incurred the following interest expense:

	2006	2005
€ million		
Coupon	1.4	2.4
Accrued interest	1.0	1.8
<b>Total</b>	<b>2.4</b>	<b>4.2</b>

#### Liabilities to banks, liabilities to investments and liabilities under finance leases

The table below shows the effective interest rates paid on current liabilities to banks:

	2006	2005
(%)	€	€
Short-term interest rate	4.47	3.23
Long-term interest rate (up to five years)	4.71	3.48
Long-term interest rate (over five years)	4.71	–

#### Fair value of financial liabilities (excluding derivatives)

	Carrying amount		Fair value	
	2006	2005	2006	2005
€ million				
Profit-sharing rights	– <sup>1)</sup>	22.8	– <sup>1)</sup>	22.8
Convertible bonds	20.8	48.7	20.8	48.7
Liabilities to banks	60.2	64.1	60.2	64.1
Liabilities under finance leases	2.4	2.5	2.4	2.5
<b>Total</b>	<b>83.4</b>	<b>138.1</b>	<b>83.4</b>	<b>138.1</b>

<sup>1)</sup> €31,000

The carrying amounts of current and non-current **financial liabilities** are denominated in the following currency:

	2006	2005
€ million		
Euros	83.4	138.1
<b>Total</b>	<b>83.4</b>	<b>138.1</b>

**Liabilities under finance leases**

The table below shows a reconciliation of future minimum lease payments to their recognised present values and their due dates:

	31 Dec. 2006	31 Dec. 2005
€ million		
<b>Future minimum lease payments</b>		
due in less than 1 year	0.2	0.2
due in 1-5 years	0.9	0.9
due in more than 5 years	2.4	2.6
<b>Total</b>	<b>3.5</b>	<b>3.7</b>
Interest implicit in future minimum lease payments	1.1	1.3
<b>Present value of future minimum lease payments (liabilities under finance leases)</b>		
due in less than 1 year	0.1	0.1
due in 1-5 years	0.5	0.5
due in more than 5 years	1.8	1.9
<b>Total</b>	<b>2.4</b>	<b>2.5</b>

Because the term of the lease covers the majority of the asset's economic life, even though legal title to the asset is not transferred, the lease is classified as a finance lease.

**Trade payables and other liabilities**

	31 Dec. 2006	31 Dec. 2005
€ million		
<b>Trade payables</b>	<b>236.4</b>	<b>165.7</b>
<b>Other liabilities</b>		
Derivatives	–	1.4
Liabilities to investments	4.7	4.9
Liabilities arising from other taxes	5.2	3.5
Personnel-related liabilities	17.1	18.9
Sales and marketing liabilities	30.0	23.2
Advances received	12.3	10.8
Other liabilities and deferred income	13.9	17.8
<b>Total</b>	<b>83.2</b>	<b>80.5</b>

Personnel-related liabilities include social insurance premiums and outstanding annual holiday entitlements. Other liabilities include accruals of €47.3 million (2005: €45.9 million).



## 24. DERIVATIVE FINANCIAL INSTRUMENTS

The following derivative financial instruments were reported at the balance sheet date:

	Notional amounts 2006	Notional amounts 2005	Market values 2006	Market values 2005
€ million				
Currency forwards	32.3	31.3	0.8	-0.9
Currency options	62.1	45.8	0.6	-0.4
Interest-rate swaps	26.2	31.5	0.6	-0.1
Embedded derivatives	-	-	4.7	0.8

At the balance sheet date, the DEUTZ Group held US dollar-denominated currency forwards with a notional amount of €27.5 million (2005: €31.3 million) and US dollar-denominated currency options with a notional amount of €62.1 million (2005: €45.8 million) as a hedge against currency risk.

Of the derivative financial instruments in place at the balance sheet date, transactions with a notional amount of €87.8 million (2005: €100.6 million) and a market value of €1.4 million (2005: -€1.4 million) were designated as cash flow hedges. In 2006, there was no hedging ineffectiveness requiring reclassification from the reserve for cash flow hedges to income under other operating expenses (2005: €21,000).

The embedded derivatives relate to purchasing contracts denominated in foreign currency.

## 25. CONTINGENT LIABILITIES AND OTHER FINANCIAL OBLIGATIONS

### Contingent liabilities

The following contingent liabilities existed in the DEUTZ Group at the balance sheet date:

	31 Dec. 2006	31 Dec. 2005
€ million		
Liabilities on endorsed bills of exchange	2.9	2.9
Liabilities on guarantees	12.8	14.9
Liabilities on warranties	1.6	3.5
<b>Total</b>	<b>17.3</b>	<b>21.3</b>

### Other financial obligations

The table below shows the notional amounts and due dates of other financial obligations under operating leases:

	31 Dec. 2006	31 Dec. 2005
€ million		
<b>Lease obligations</b>		
due in less than 1 year	9.4	12.7
due in 1-5 years	26.9	17.1
due in more than 5 years	3.5	5.3
<b>Total</b>	<b>39.8</b>	<b>35.1</b>

The above obligations relate to leases on real estate and mobile assets.

Commitments to purchase property, plant and equipment and intangible assets amounted to €36.8 million as at 31 December 2006 (2005: €23.6 million).

Obligations under leases are partly offset by receivables of €1.0 million (2005: €2.7 million) from subleases.

## 26. LEGAL DISPUTES

DEUTZ AG and some of its subsidiaries are involved in a number of legal disputes, claims for damages and arbitration proceedings that have an impact on the Group's financial position.

Risks from litigation were substantially reduced in 2006. The claim by the Greek tax authorities against a Greek subsidiary of DEUTZ AG for supplementary tax payments and penalties totalling about €35 million is still pending, as are the actions brought by private persons against more than 100 companies, including two American subsidiaries of DEUTZ AG, for alleged damage to health caused by asbestos.

Financial provision has been made to cover litigation risks facing the respective Group companies if the event in question occurred before the balance sheet date and the companies' legal representatives estimate the probability of an outflow of resources to be more than 50 per cent. In the case of legal disputes where no financial provision has been made, it is estimated that the probability of an outflow of resources with economic benefit will be less than 10 per cent.

We do not expect the above risks to have a significantly adverse impact on the DEUTZ Group's financial position or financial performance beyond the financial provision already made.

## 27. RELATED-PARTY DISCLOSURES

In addition to its consolidated subsidiaries, the DEUTZ Group maintains relationships with related parties.

These include the business relationships between the DEUTZ Group and entities in which it holds investments as well as the following DEUTZ shareholders (including their subsidiaries), who are in a position to exert a significant influence over the DEUTZ Group. These are

- SAME DEUTZ-FAHR Holding & Finance B.V., Amsterdam, Netherlands (Group), and
- AB Volvo Power (publ), Gothenburg, Sweden (Group).

Related parties also include the Supervisory Board, the Management Board and other members of the management team.

The table below shows the volume of material products and services either provided for or received from entities in which the DEUTZ Group holds investments:

	Products and services provided for		Products and services received		Receivables 31 Dec.		Liabilities 31 Dec.	
	2006	2005	2006	2005	2006	2005	2006	2005
€ million								
UZEL DEUTZ MOTOR SANAYI (Istanbul, Turkey)	–	10.3	–	2.5	–	1.9	–	–
Other investments	11.0	12.1	3.7	3.7	5.8	4.7	4.7	4.9
<b>Total</b>	<b>11.0</b>	<b>22.4</b>	<b>3.7</b>	<b>6.2</b>	<b>5.8</b>	<b>6.6</b>	<b>4.7</b>	<b>4.9</b>

The investment in UZEL DEUTZ MOTOR SANAYI, Istanbul, Turkey, was sold during 2006. DEUTZ AG continues to maintain business relationships with UZEL DEUTZ MOTOR SANAYI.

€18.9 million (2005: €27.6 million) of the receivables due from subsidiaries and associates had been written down at 31 December 2006; this incurred an expense of €0.3 million (2005: €7.4 million) in 2006.

The table below gives a breakdown of the business relationships between the DEUTZ Group and its shareholders, including their subsidiaries:

	<b>SAME DEUTZ-FAHR Group</b>		<b>Volvo Group</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
€ million				
Engines & spare parts supplied	67.0	51.5	219.6	128.2
Services	4.3	3.5	15.0	22.9
Receivables as at 31 December	36.7	22.6	45.8	22.1

All business was conducted at arm's-length market rates.

The following services were provided for the Supervisory Board, the Management Board and other members of the management team as related parties of the DEUTZ Group.

	<b>Supervisory Board</b>		<b>Management Board</b>		<b>Other members of management</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
€ million						
Current remuneration	0.3	0.3	2.6	2.5	2.8 <sup>1)</sup>	2.2

<sup>1)</sup> Including a compensation of €96,000

The DEUTZ Group did not maintain material business relationships with any other related parties.

## NOTES TO THE CASH FLOW STATEMENT

### 28. CASH FLOW STATEMENT

The presentation of the DEUTZ Group's cash flow statement is consistent with IAS 7 and is broken down into sources of cash flow.

Cash flow from operating activities include dividend income of €2.1 million for 2006 (2005: €3.1 million).

Cash and cash equivalents increased by €1.0 million to €49.4 million and correspond to the cash and cash equivalents reported on the face of the balance sheet.

## NOTES TO THE SEGMENT REPORTING

### 29. SEGMENT REPORTING

The presentation of the DEUTZ Group's segment reporting is consistent with IAS 14; its primary format is broken down by business segment and its secondary format by region.

#### Business segments

The primary reporting format is broken down into the following business segments and takes account of the DEUTZ Group's structural organisation and internal reporting systems, its products and services and its risk/return profile:

**Compact Engines.** This segment comprises new engine business and the servicing of air-cooled, water-cooled and oil-cooled diesel engines with an output of up to 500 kW.

**DEUTZ Power Systems.** The DEUTZ Power Systems segment brings together the gas-engine and diesel-engine business for decentralised power generation in the 180 kW to 4,000 kW power output range.

**Other.** This segment contains Group and consolidation activities that do not belong in any other segment.

#### Reconciliation of segment data to Group figures

The presentation of the reconciliation is consistent with IAS 14.67 and contains the effects of consolidation as well as the amounts arising from the differences in definition of the content of individual segment items compared with the corresponding Group items. Transfers between segments are reported at fair value.

#### Regions

The secondary reporting format is based on the DEUTZ Group's internal regional sales structure (Europe/Africa, Americas, Asia-Pacific, Middle East). Revenue is shown according to the location of customers; assets and capital expenditure are shown according to the location of consolidated enterprises.

**The following text describes the breakdown of segment data:** External revenue shows the revenue received by segments from external customers. Revenue generated between segments is shown as intersegment revenue.

Depreciation, amortisation and impairment relate to property, plant and equipment and intangible assets.

Segment earnings before one-off items constitutes the IFRS definition of segment earnings plus profit/loss from investments measured at equity, other investment income and gains or losses on the disposal of financial assets.

Segment earnings in accordance with IFRS is defined as segment revenue less segment expenses. Gains or losses on the disposal of financial assets, net gain on measurement at equity, other investment income, interest income, interest expense, and taxes are not included.

Segment assets include operating assets and comprise intangible assets, property, plant and equipment, inventories, non-interest-bearing receivables and other assets.

Segment liabilities comprise financial obligations arising from operating activities. They include provisions – especially pension provisions – and non-interest-bearing liabilities (excluding tax obligations).

Segment capital expenditure consists of purchases of intangible assets and property, plant and equipment.

Non-cash expenses include additions to other provisions.

## OTHER INFORMATION

### 30. EVENTS AFTER THE BALANCE SHEET DATE

No material events occurred after the balance sheet date.

### 31. REMUNERATION PROGRAMMES

During the reporting period the DEUTZ Group operated two stock-based remuneration programmes that confer entitlements to equity instruments (shares). The remuneration programme grants freely transferable options on DEUTZ shares. To exercise these options, the holder must be a member of the Management Board on the exercise date. If the member of the Management Board is removed from office (before his or her contract is due to expire), the options expire on the date of his or her removal. Provided the purchase price is paid, the options can be exercised at any time except for a period of ten days prior to the company's annual general meeting; however, the earliest date on which they may be exercised is 1 August 2002.

The company issued a total of 150,000 options with an exercise price of €5.50 per share and 250,000 options with an exercise price of €2.70 per share. The exercise period for 200,000 options with an exercise price of €2.70 runs from February 2000 to July 2008, and the period for a further 50,000 options with an exercise price of €2.70 runs until January 2010. The exercise period for options with an exercise price of €5.50 runs from February 2000 to January 2010. All options were granted in 2000. No new options have been granted in subsequent years.

In 2006, 50,000 options issued with an exercise price of €2.70 and 150,000 options issued with an exercise price of €5.50 were sold to a person outside the DEUTZ Group. At 31 December 2006, there were no options that remained to be exercised (31 December 2005: 200,000 options).

## STATEMENTS UNDER GERMAN ACCOUNTING STANDARDS

### Average number of employees during the year

	2006	2005
Non-salaried employees	3,104	2,963
Salaried employees	2,030	2,082
Apprentices	171	178
<b>Total</b>	<b>5,305</b>	<b>5,223</b>

### Corporate governance

In December 2006, the Management Board and the Supervisory Board of DEUTZ AG issued a declaration of compliance with the recommendations of the German Corporate Governance Code government commission in the version dated 12 June 2006 pursuant to section 161 AktG and made this declaration permanently available to shareholders on the company's website ([www.deutz.com](http://www.deutz.com)).

### Auditors' fees

The following expenses were incurred in 2006:

	2006
€ thousand	
Auditing	521
Other advisory and attestation services	155
Other services performed for the parent or subsidiaries	117
<b>Total</b>	<b>793</b>

**Total remuneration paid to the Management Board, former members of the Management Board, and the Supervisory Board (Management Board and Supervisory Board remuneration)**

**Management Board**

The following table shows the breakdown of total remuneration paid to members of the Management Board:

	<b>Fixed remuneration</b>	<b>Variable bonus</b>	<b>Other</b>	<b>Total</b>
€ thousand				
Gordon Riske	609	300	25	934
Karl Huebser	450	275	258 <sup>1)</sup>	983
Helmut Meyer	490	175	23	688
<b>Total</b>	<b>1,549</b>	<b>750</b>	<b>306</b>	<b>2,605</b>

<sup>1)</sup> Including payment of life insurance premiums

The remuneration paid to former members of the Management Board or their surviving dependants came to €1,386,000 in DEUTZ AG and in the Group; a provision of €13,330,000 has been recognised to cover pension obligations to these persons.

**Supervisory Board**

The following table shows the breakdown of total remuneration paid to members of the Supervisory Board:

	<b>Fixed remuneration</b>	<b>Meeting attendance fees</b>	<b>Total</b>
€			
Dr Giuseppe Vita Chairman (22 Jun. to 31 Dec.)	–	7,000	7,000
Dr Michael Endres Chairman (1 Jan. to 22 Jun.)	25,000	11,000	36,000
Werner Scherer Deputy Chairman	18,750	15,000	33,750
Gino M. Biondi (22 Jun. to 31 Dec.)	–	3,000	3,000
Professor Klaus-Otto Fruhner	12,500	7,000	19,500
Reinhold Götz	12,500	7,000	19,500
Michael Haupt	12,500	10,000	22,500
Dr Helmut Lerchner	12,500	7,000	19,500
Helmut Müller	12,500	7,000	19,500
Karl-Heinz Müller	12,500	9,000	21,500
Dr Witich Roßmann	12,500	7,000	19,500
Peter Schwab	12,500	7,000	19,500
Professor Dr Marco Vitale	12,500	7,000	19,500
Peter Zühlsdorff (1 Jan. to 22 Jun.)	12,500	6,000	18,500
<b>Total</b>	<b>168,750</b>	<b>110,000</b>	<b>278,750</b>

### **Advances and loans to members of the Management Board and the Supervisory Board**

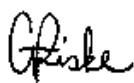
On 31 December 2006 there were no outstanding advances or loans to any members of the Management Board or the Supervisory Board, nor had any guarantees or other warranties been issued in favour of any such persons.

### **Supervisory Board and Management Board**

Information on the members of the Supervisory Board and the Management Board, including directorships held at other companies, is given in a separate list on page 124.

Cologne, 5 March 2007

DEUTZ Aktiengesellschaft  
Management Board



Gordon Riske



Karl Huebser



Helmut Meyer



## INDEPENDENT AUDITORS' REPORT

We have audited the consolidated financial statements – comprising the balance sheet, the income statement, the statement of changes in equity, the cash flow statement and the notes to the consolidated financial statements – and the group management report prepared by DEUTZ Aktiengesellschaft, Cologne, Germany, for the financial year from 1 January to 31 December 2006. The preparation of the consolidated financial statements and the group management report in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union, and the supplementary provisions of commercial law applicable in accordance with section 315a (1) of the German Commercial Code (HGB) is the responsibility of the company's management. Our responsibility is to express an opinion on the consolidated financial statements and the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with section 317 HGB and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW: German Institute of Auditors). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable accounting standards and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the internal control system relating to the accounting system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of the enterprises included in the consolidated financial statements, the determination of the companies to be included in the consolidated financial statements, the accounting and consolidation principles used and significant estimates made by the management, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the European Union, and the supplementary provisions of commercial law applicable in accordance with section 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and, as a whole, provides a suitable understanding of the Group's position and suitably presents the opportunities and risks of future development.

Düsseldorf, 5 March 2007

PricewaterhouseCoopers  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft



Kreibich  
Wirtschaftsprüfer  
(German Public Auditor)



ppa. Klütsch  
Wirtschaftsprüfer  
(German Public Auditor)

## SHAREHOLDINGS OF THE DEUTZ GROUP

As at 31 December 2006

Ref. No.	Name and registered office of the company	Holding (%)	Equity (€ thousand)	Net income/loss (€ thousand)
1	DEUTZ AG	–	322,304	29,673
<b>Consolidated subsidiaries</b>				
<b>Germany</b>				
2	DEUTZ Power Systems GmbH & Co. KG, Mannheim	100.0	49,088	7,690
3	Unterstützungsgesellschaft mbH of DEUTZ Aktiengesellschaft, Cologne	100.0	26	–
4	Ad. Strüver KG (GmbH & Co.), Hamburg	94.0	–2,992	–876
5	Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf	19.6	–2,925	–213
6	DEUTZ Beteiligung GmbH, Cologne	100.0	30	–6
<b>Outside Germany</b>				
Europe/Africa				
7	DEUTZ Power Systems B.V., Rotterdam (Netherlands)	100.0	2,733	1,069
8	DEUTZ DITER S.A., Zafra (Spain)	100.0	–4,081	218
9	DEUTZ DITER COMPONENTES S.A., Zafra (Spain)	100.0	17,817	3,769
10	DEUTZ FRANCE S.A., Gennevilliers (France)	100.0	11,235	1,152
11	DEUTZ IBERIA S.A., Madrid (Spain)	100.0	8,966	2,300
12	DEUTZ UK Ltd., Cannock (UK)	100.0	4,130	2,312
13	Nlle Ste MAGIDEUTZ S.A., Casablanca (Morocco)	100.0	1,448	391
Americas				
14	Deutz Corporation, Atlanta (USA)	100.0	39,069	5,317
Asia-Pacific				
15	DEUTZ Asia-Pacific (Pte) Ltd., Singapore (Singapore)	100.0	4,575	726
16	Deutz Australia (Pty) Ltd., Braeside (Australia)	100.0	4,435	1,144
<b>Associates</b>				
<b>Outside Germany</b>				
17	ASIA POWER (PRIVATE) LIMITED, Colombo (Sri Lanka)	31.8	27,206	6,034
18	D. D. Power Holdings (Pty) Ltd., Elandsfontein (South Africa)	30.0	7,401	2,394
19	DEUTZ AGCO MOTORES S.A., Haedo (Argentina) <sup>1)</sup>	50.0	4,992	922

<sup>1)</sup> Joint ventures in accordance with IAS 31.38

# Annual Financial Statements (HGB)

## BALANCE SHEET OF DEUTZ AG

### Assets

	31 Dec. 2006	31 Dec. 2005
€ million		
<b>Expenses for the expansion of operations</b>	<b>31.1</b>	<b>41.5</b>
Intangible assets	29.1	30.5
Property, plant and equipment	303.7	290.2
Investments	164.6	163.8
<b>Fixed assets</b>	<b>497.4</b>	<b>484.5</b>
Inventories	109.2	77.3
Receivables and other assets	229.5	239.2
Cash and cash equivalents	36.7	40.7
<b>Current assets</b>	<b>375.4</b>	<b>357.2</b>
Prepaid expenses	2.4	5.2
<b>Total assets</b>	<b>906.3</b>	<b>888.4</b>

### Equity and liabilities

Issued capital	292.3	242.9
Additional paid-in capital	21.9	15.3
Retained earning	0.4	–
Accumulated profit/loss	7.7	–21.6
<b>Equity</b>	<b>322.3</b>	<b>236.6</b>
Profit-sharing rights	– <sup>1)</sup>	25.6
Provisions	339.3	364.4
Other liabilities	244.7	261.8
<b>Total equity and liabilities</b>	<b>906.3</b>	<b>888.4</b>

<sup>1)</sup> €31,000

## INCOME STATEMENT OF DEUTZ AG

	2006	2005
€ million		
Revenue	1,103.0	987.9
Change in inventories	9.1	-19.8
Other own work capitalised	0.2	6.0
<b>Total output</b>	<b>1,112.3</b>	<b>974.1</b>
Other operating income	74.2	72.3
Cost of materials	-771.2	-640.5
Staff costs	-211.4	-201.9
Depreciation	-56.0	-22.3
Other operating expenses	-120.9	-154.2
Net investment income	10.0	7.3
Net interest expense	-16.4	-13.4
<b>Profit from ordinary activities</b>	<b>20.6</b>	<b>21.4</b>
Net extraordinary income/expenses	12.0	46.1
Income taxes	-2.2	-11.8
Other taxes	-0.7	-0.4
<b>Net income</b>	<b>29.7</b>	<b>55.3</b>
Loss carried forward	-21.6	-76.9
Additions to legal reserve	-0.4	-
<b>Accumulated profit/accumulated loss</b>	<b>7.7</b>	<b>-21.6</b>

## SUPERVISORY BOARD

### **Dr Giuseppe Vita**

Chairman (from 22 June 2006)

Chairman of the Supervisory Board of Axel Springer AG, Berlin

- a) HUGO BOSS AG, Metzingen, Chairman  
Axel Springer AG, Berlin  
Vattenfall Europe AG, Berlin
- b) Riunione Adriatica di Sicurtà (RAS) S.p.A., Milan (Italy), Chairman  
Barilla S.p.A., Parma (Italy)  
Humanitas S.p.A., Milan (Italy)

### **Dr Michael Endres**

Chairman (until 22 June 2006)

Former member of the Management Board of Deutsche Bank AG, Frankfurt/Main

- a) ARCOR Verwaltungs AG, Eschborn  
Landesbank Berlin, Berlin  
Schott AG, Mainz
- b) Gemeinnützige Hertie-Stiftung, Frankfurt/Main, Chairman  
Hertie School of Governance, Berlin

### **Werner Scherer<sup>1)</sup>**

Deputy Chairman

Chairman of the Group Works Council of DEUTZ AG, Cologne

### **Gino M. Biondi**

(from 22 June 2006 to 12 January 2007)

CEO of SAME DEUTZ-FAHR Deutschland GmbH, Lauingen

### **Dr Massimo Bordi**

(from 18 January 2007)

CEO of SAME DEUTZ-FAHR Group S.p.A., Treviglio (Italy)

- b) SAME DEUTZ-FAHR ITALIA S.p.A., Treviglio (Italy)  
SAME DEUTZ-FAHR DEUTSCHLAND GmbH, Lauingen  
SAME DEUTZ-FAHR POLSKA SP Z.O.O., Melgiew (Poland), Chairman  
SAME DEUTZ-FAHR NORTH AMERICA INC., Delaware (USA)  
SAME DEUTZ-FAHR SCHWEIZ AG, Schwarzenbach (Switzerland)  
SAME DEUTZ-FAHR FRANCE, S.A.S, Senlis (France)  
SAME DEUTZ-FAHR IBERICA SA, Alcobendas Madrid (Spain)  
SAME DEUTZ-FAHR UK Ltd., Barby, Nr. Rugby, Warwickshire (UK)

**Professor Klaus-Otto Fruhner**

Managing Director of K.O.F.-Projektberatung GmbH, Cologne

**Reinhold Götz<sup>1)</sup>**

Deputy Chief Executive of IG Metall Administrative Office Mannheim

a) MVV-Energie AG, Mannheim  
Stadt Mannheim Beteiligungsgesellschaft mbH, Mannheim

b) Sparkasse Rhein-Neckar-Nord, Mannheim

**Michael Haupt**

Former member of the Group Board of AB SKF, Gothenburg (Sweden)

**Dr Helmut Lerchner**

Management consultant, Aichtal-Rudolfshöhe

a) ElringKlinger AG, Dettingen/Erms, Chairman

**Helmut Müller<sup>1)</sup>**

Chairman of the Senior Staff Committee of DEUTZ AG, Cologne

b) Henkelhausen Holding GmbH, Krefeld

**Karl-Heinz Müller<sup>1)</sup>**

Deputy Chairman of the Group Works Council of DEUTZ AG, Cologne

**Dr Witich Roßmann<sup>1)</sup>**

Chief Executive of IG Metall Cologne, Cologne

a) Ford Werke GmbH, Cologne  
Ford Holding Deutschland GmbH, Cologne

**Peter Schwab<sup>1)</sup>**

Chairman of the Works Council of DEUTZ Power Systems GmbH & Co. KG, Mannheim

b) DEUTZ Power Systems GmbH & Co. KG, Mannheim

**Professor Dr Marco Vitale**

President of Vitale-Novello & Co. SRL, Milan (Italy)

- b) SAME DEUTZ-FAHR DEUTSCHLAND GmbH, Lauingen
  - SAME DEUTZ-FAHR ITALIA S.p.A., Treviso (Italy), Chairman
  - SAME DEUTZ-FAHR Holding & Finance B.V., Amsterdam (Netherlands)
  - SAME DEUTZ-FAHR POLSKA SP.Z.O.O., Melgiew (Poland)
  - SAME DEUTZ-FAHR KOMBAJNI d.d., Zupanja (Croatia)
  - BANCA POPOLARE DI MILANO, Milan (Italy)
  - C. BORGOMEIO & Co. SRL, Rome (Italy)
  - CONNECT SUD SRL, Palermo (Italy)
  - EDRA MEDICAL PUBLISHING & NEW MEDIA, Milan (Italy), Chairman
  - IALE INFORMATICA S.p.A., San Lazzaro di Savena (Italy)
  - PEDEMONTANA LOMBARDA S.p.A., Milan (Italy), Chairman
  - PICTET INTERNATIONAL CAPITAL MANAGEMENT, Luxembourg (Luxembourg)
  - PICTET & C. SIM S.p.A., Turin (Italy)
  - SELTERRING S.p.A., Brescia (Italy)
  - SORIN GROUP, Milan (Italy)
  - THERA S.p.A., Brescia (Italy)
  - VINCENZO ZUCCHI S.p.A., Milan (Italy)

**Peter Zühlsdorff**

(until 22 June 2006)

Shareholder-Director of DIH Deutsche Industrie Holding GmbH, Frankfurt/Main

- a) Escada AG, Munich, Chairman
  - SinnLeffers AG, Hagen, Chairman
  - Kaisers Tengelmann AG, Viersen
  - Merck KGaA, Darmstadt
- b) Tengelmann Verwaltungs- und Beteiligungs GmbH Mülheim a. d. R.
  - DSD – Duales System Deutschland GmbH, Cologne
  - The New Germany Fund, Inc., New York (USA)

<sup>1)</sup> Employee representatives on the Supervisory Board

a) Membership of statutory German supervisory boards within the meaning of section 125 AktG

b) Membership of comparable German or international supervisory bodies within the meaning of section 125 AktG



## SUPERVISORY BOARD COMMITTEES

### Human Resources Committee

Dr Giuseppe Vita (Chairman)  
Werner Scherer (Vice-Chairman)  
Michael Haupt

### Audit Committee

Michael Haupt (Chairman)  
Werner Scherer (Vice-Chairman)  
Karl-Heinz Müller  
Dr Giuseppe Vita

### Arbitration Committee

(Section 27 (3) German Codetermination Act)

Dr Giuseppe Vita (Chairman)  
Werner Scherer (Vice-Chairman)  
Michael Haupt  
Peter Schwab

## MANAGEMENT BOARD

### **Gordon Riske (49)**, Cologne

Chairman

Markets

- a) ISRA VISION SYSTEMS AG, Darmstadt  
Dräger AG, Lübeck
- b) DEUTZ FRANCE S.A., Gennevilliers (France), Chairman  
Deutz Corporation, Atlanta (USA), Chairman  
DEUTZ UK Ltd., Cannock (United Kingdom), Chairman  
DEUTZ Asia-Pacific (Pte) Ltd., Singapore (Singapore), Chairman  
DEUTZ Power Systems GmbH & Co. KG, Mannheim, Chairman

### **Karl Huebser (61)**, Overath

Technology

- b) DEUTZ DITER S.A., Zafra (Spain), Chairman  
DEUTZ DITER COMPONENTES S.A., Zafra (Spain), Chairman  
WEIFANG WEICHAI DEUTZ DIESEL ENGINE LTD., Weifang (China)

### **Helmut Meyer (57)**, Düsseldorf

Finance, Personnel

- b) DEUTZ IBERIA S.A., Madrid (Spain), Chairman  
DEUTZ UK Ltd., Cannock (United Kingdom)  
Deutz Corporation, Atlanta (USA)  
DEUTZ Asia-Pacific (Pte) Ltd., Singapore (Singapore)  
Motorpal a.s., Jihlava (Czech Republic)  
DEUTZ Power Systems GmbH & Co. KG, Mannheim

a) Membership of statutory German supervisory boards within the meaning of section 125 AktG

b) Membership of comparable German or international supervisory bodies within the meaning of section 125 AktG

## GLOSSARY

**4-valve technology** The cylinder heads of internal combustion engines of this type have two inlet valves for supplying fresh air and two exhaust gas outlet valves. Compared with 2-valve technology, the enlarged valve orifice area improves cylinder filling, thus achieving greater performance from the same cubic capacity, although the benefits are only apparent at higher engine speeds. The central location of the injection nozzle also enhances combustion.

**Benchmark** Important reference values used for comparison with a company's own key performance indicators.

**Biogas** Gas produced during the oxygen-free fermentation of organic material. The agricultural sector has the largest production potential for biogas.

**Captive market, captive segment** Market segment comprising equipment and vehicle manufacturers that produce engines in-house.

**Catalyst** A substance that, without itself undergoing any permanent chemical change, increases the rate of a chemical reaction.

**Common rail** Injection system for diesel engines in which a common fuel rail (or pipe) mounted behind the injection pump is used to serve all the cylinders as a reserve of pressure and to control the injection pressure independently of the speed at which the engine is turning over.

**Conference call** A time-saving and inexpensive alternative to conventional meetings with analysts and investors because those taking part do not have to be physically present.

**Corporate governance** The German Corporate Governance Code contains the rules and recommendations valid in Germany for the management and supervision of publicly traded companies with Aktiengesellschaft status.

**DAX** A share index comprising Germany's 30 largest companies on the Frankfurt Stock Exchange in terms of market capitalisation and liquidity. They are listed in the Prime Standard.

**Declaration of compliance** Section 161 of the German Joint Stock Corporation Act (AktG) states that the management board and supervisory board of publicly traded German companies must submit an annual declaration of compliance detailing to what extent they have implemented the recommendations of the German Corporate Governance Code.

**Dependency report** A report submitted by a company's management board in compliance with section 312 of the German Joint Stock Corporation Act (AktG) detailing the company's relations with affiliated companies and subsidiaries.

**DEUTZ Common Rail** Common rail injection system, in which the rail is supplied with fuel via two high-pressure pump elements.

**DIN EN ISO 14001** Deutsches Institut für Normung, European Norm, International Organization for Standardization – 14001; an international, European and German industrial standard for environmental management.

**D&O insurance** Stands for “directors’ and officers’ insurance”; a liability insurance policy that a company takes out to indemnify its directors and senior managers against claims for damages.

**DVERT® DEUTZ Variable Emission Reduction Technology** A combination of systems, components and procedures that are used as modules to create technically optimised and, at the same time, cost-effective solutions for reducing exhaust and noise emissions.

**EBIT** Earnings before interest and tax.

**Emissions legislation** Sets limits for certain exhaust gas constituents in engine-powered vehicles and equipment. Also specifies test procedures, implementation schedules and, in certain cases, transitional periods.

**EPA TIER 1, 2, 3, 4** US emission standards for non-road applications. Set limits for pollutants such as nitrogen oxides, hydrocarbons and particulates (diesel) in exhaust gas.

**Equity ratio** The ratio of a company's equity to its total assets.

**Equity story** As there is no widely accepted definition of the term “equity story”, it is interpreted and used in a number of different ways in day-to-day communication with the capital market. The equity story essentially comprises the reasons and justifications as to why investors interested in a company's shares should buy or hold them.

**EU I, II, III A, III B, IV** Exhaust standard laid down by the European Union for mobile machinery. Sets limits for pollutants such as nitrogen oxide, hydrocarbons and particulates (diesel) in exhaust gas.

**Euro 1, 2, 3, 4, 5** Emission standards laid down by the European Union. Set limits for pollutants such as nitrogen oxides, hydrocarbons and particulates (diesel) in exhaust gas.

**Exhaust gas aftertreatment** Process for purifying combustion gases, by either mechanical or chemical means, once they have left the combustion space or combustion chamber. Typical examples include catalytic converters and particulate filters.

**Exhaust gas recirculation (EGR)** Process for reducing the nitrogen oxides ( $\text{NO}_x$ ) produced during the combustion of fuel in diesel engines, gasoline engines, gas turbines, heating boilers, etc. The process feeds part of the exhaust gas back for re-combustion. The effect is to reduce the likelihood of nitrogen and oxygen being able to react with one another by reducing the proportion of oxygen ( $\text{O}_2$ ) in the intake air. In cooled EGR systems, the combustion temperature is lowered which brings about a further reduction in  $\text{NO}_x$  emissions.

**Free float as defined by Deutsche Börse AG** Irrespective of the size of shareholding, the free float includes all shares held as short-term investments by asset managers, trust companies, unit trusts, pension funds, venture capitalists, fund managers and foreign investment companies.

**International Accounting Standards (IAS)** International accounting standards created by the International Accounting Standards Committee (IASC), which was set up in London in 1973. The IASC was replaced by the International Accounting Standards Board (IASB) in 2001.

**International Financial Reporting Standards (IFRS)** International accounting standards for publicly traded companies; EU Regulation 1606/2002 of 19 July 2002 ("IAS Regulation") states that these companies must prepare their consolidated financial statements in accordance with IFRS as from 2005. IFRS accounting is designed to improve the comparability of financial statements prepared by publicly traded companies subject to disclosure requirements worldwide.

**Investor relations** The relationship between a publicly traded company and its shareholders.

**ISIN** International Security Identification Number; a ten-digit number prefixed by a country code (DE = Germany, CH = Switzerland, etc.) that is used to identify international securities.

**Kyoto Protocol** In 1997, around 150 countries signed the so-called Kyoto Protocol, which agreed quantitative targets for reducing the emissions of six vital trace gases, including carbon dioxide and methane. The industrialised nations undertook to reduce their emissions by an average of 5% below 1990 levels between 2008 and 2012.

**Landfill gas** Gas produced in landfill waste sites as a result of the activity of microorganisms.

**Market capitalisation** The market value of a publicly traded company; it is calculated by multiplying the share price by the total number of shares in issue.

**MDAX** An index selected by Deutsche Börse AG comprising 50 medium-sized companies (mid-caps) which come immediately below DAX shares in terms of market capitalisation and liquidity. The MDAX only contains the shares of companies from traditional sectors. These can be either German or international companies.

**Mine gas** Methane gas (CH<sub>4</sub>) that is released by coal mining and the resultant scratching of the coal. The mining of coal reduces the pressure on the seams (layers containing the coal), causing them to loosen so that the methane gas accumulates in the air in the mine. To prevent a dangerous build-up of methane, the gas is sucked out of the seams before they are mined through the application of subpressure. The gas that is sucked out is known as mine gas.

**Multiple injection** Multiple fuel injection into the combustion chamber of an engine during the combustion cycle. Enhanced control of the combustion speed makes it possible to reduce, for example, nitrogen, particulate and noise emissions.

**Non-captive market** In the context of this Annual Report, this term refers to independent engine manufacturers which are not part of a company that itself manufactures vehicles or equipment.

**Non-natural gases** In the context of this Annual Report these are gases (with the exception of the fossil fuel natural gas) that can be used as fuel in combustion engines. These include gases from landfill sites, coking plants, sewage-treatment plants and coal mines as well as biogas produced by agriculture.

**Non-road applications** In the context of this Annual Report, this term refers to engine-powered equipment that is not licensed for use on public roads but which is subject to the provisions of emissions legislation.

**On-road applications** In the context of this Annual Report, this term refers to engine-powered commercial vehicles and buses which are subject to the provisions of emissions legislation.

**Prime Industrial** A sectoral index published by Deutsche Börse AG that includes all traditional industrial companies in the Prime Standard.

**Prime Standard** Standard set by Deutsche Börse AG for companies looking to raise capital from international investors. These companies have to meet stringent international disclosure requirements. Admission to the Prime Standard is a prerequisite for inclusion in the DAX, MDAX, TecDAX and SDAX indices.

**Pump-Line-Nozzle (PLN) system** Injection system for diesel engines, in which a short, high-pressure line connects the individual pump with the injection nozzle.

**Renewable Energies Law** Came into force in Germany in March 2000; last amended in 2004. Its objective is to promote the development of renewable energies for generating power as a core element of climate protection.

**Roadshow** A period or event during which a company's senior executives conduct intensive face-to-face meetings with investors and analysts. Roadshows are usually held at international financial centres such as London, New York or Frankfurt.

**ROCE** The return on the capital employed by a company.

**SDAX** An index published by Deutsche Börse AG that comprises smaller companies – so-called small caps – from traditional sectors. It consists of 50 stocks listed in the Prime Standard section of the official stock market, which come immediately below the MDAX in terms of market capitalisation and liquidity.

**Securities Trading Act** The German Securities Trading Act (WpHG) came into force in the wake of the Third Financial Markets Act with the main aim of protecting investors.

**Selective Catalytic Reduction (SCR)** Catalytic reduction of nitrogen oxides in the exhaust gas of combustion engines whereby the reducing agent urea is injected into the exhaust gas. In the hot exhaust gas, the urea disintegrates to form ammonia which converts the nitrogen oxide into harmless molecular nitrogen.

**Sewer gas** A gas that arises in the anaerobic reactors of sewage plants as a metabolic product of the microorganisms contained in the sludge.

**Solenoid valve system** Fuel injection system in which the valves are actuated by an electro magnet. Depending on the construction type, the valves can be actuated extremely quickly, at frequencies of up to several kilohertz.

**Soot and particulate filters** Devices for reducing the particulates contained in the exhaust gases of diesel engines. There are two types of filter, which work in very different ways: wall-flow filters (surface-type filters), in which the exhaust gas penetrates a porous wall; and flow filters (deep-bed filters), in which the exhaust gas flows through the filter itself.

**Working capital** The sum of inventories and trade receivables less trade payables.

**Xetra** This stands for "Exchange Electronic Trading" and is the name given to the electronic dealing system run by Deutsche Börse AG (also known as screen-based trading).

# Financial Dates

Dates 2007	Event	Location
27 March	Annual Results press conference Publication Annual Report 2006	DEUTZ AG, Cologne
28 March	Analysts' meeting	Frankfurt/Main
10 May	Publication Report 1st Quarter 2007 Conference call with analysts and investors	–
24 May	Annual General Meeting 2007	Koelnmesse, Cologne
1 August	Publication Report 1st Half-year 2007 Press conference Conference call with analysts and investors	DEUTZ AG, Cologne
8 November	Publication Report 1st to 3rd Quarter 2007 Conference call with analysts and investors	–
<b>Dates 2008</b>		
21 May	Annual General Meeting 2008	Koelnmesse, Cologne

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