

Focussed

Annual Report 2005

DEUTZ

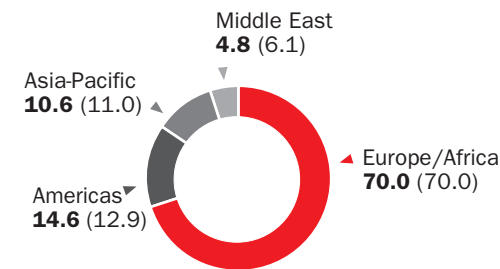


DEUTZ Group: Key figures

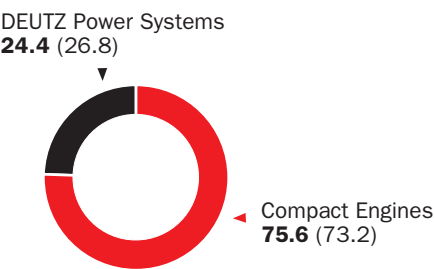
		HGB 2002	HGB 2003	HGB 2004	IFRS 2004	IFRS 2005	Change in %
New orders	€ million	1,138.8	1,179.7	1,264.9	1,265.1	1,350.5	6.8
Unit sales	No.	154,032	156,237	173,440	173,440	195,843	12.9
Compact Engines	No.	153,285	155,523	172,684	172,684	195,082	13.0
DEUTZ Power Systems	No.	747	714	756	756	761	0.7
Sales	€ million	1,160.9	1,172.6	1,242.1	1,242.3	1,322.8	6.5
thereof excl. Germany	%	74.5	74.6	74.5	74.5	73.0	–
Compact Engines	€ million	815.0	843.0	909.7	909.9	999.7	9.9
DEUTZ Power Systems	€ million	345.9	329.6	332.4	332.4	323.1	-2.8
EBITDA	€ million	103.0	104.9	104.4	81.8	180.0	–
EBITDA before one-off items	€ million	103.0	104.9	104.4	113.9	121.5	6.7
EBIT	€ million	41.0	44.0	50.1	18.5	114.7	–
Operating profit (EBIT before one-off items)	€ million	41.0	44.0	50.1	53.5	62.5	16.8
EBIT margin before one-off items	%	3.5	3.8	4.0	4.3	4.7	–
Net income/loss before income taxes	€ million	2.8	9.4	-15.9	-16.5	84.7	–
Net income/loss	€ million	2.0	6.0	-18.6	-18.7	71.4	–
Total assets	€ million	1,048.6	1,017.0	960.2	1,029.1	1,063.8	3.4
Non-current assets	€ million	496.8	466.5	443.2	462.5	479.2	3.6
Equity	€ million	95.0	169.7	155.6	158.7	247.0	55.6
Equity ratio	%	9.1	16.7	16.2	15.4	23.2	–
Cash flow from operating activities	€ million	56.5	34.6	92.9	111.9	143.4	28.2
Net financial debt ¹⁾	€ million	302.0	224.2	100.0	124.2	15.7	-87.4
Working capital as a percentage of sales ²⁾	%	31.9	30.5	24.1	25.3	18.0	-24.2
Capital expenditure (excl. capitalisation of R&D)	€ million	59.5	40.7	41.0	43.0	67.6	57.2
Depreciation	€ million	62.4	64.0	54.4	63.3	65.3	3.2
Research and development	€ million	47.1	54.9	69.5	69.5	66.9	-3.7
Employees as at 31 December	Number	5,470	5,454	5,472	5,472	5,058	-7.6

¹⁾ Net financial debt: bank debt minus cash and cash equivalents
²⁾ Working capital: inventories plus trade receivables minus trade payables

DEUTZ Group: Sales by regions
in % (2004 figures)



DEUTZ Group: Sales by segments
in % (2004 figures)



DEUTZ segments

	Compact Engines ¹⁾		DEUTZ Power Systems ²⁾	
Application segments				
Sales € million	2005	2004	2005	2004
Engines	831.1	740.4	176.2	158.0
Mobile Machinery	374.1	310.5	–	–
Stationary Equipment	200.9	205.5	149.9	123.5
Agricultural Machinery	145.8	124.3	–	–
Automotive	68.6	63.1	–	–
Marine	14.5	14.7	26.3	34.5
Others	27.2	22.3	–	–
Service	168.6	169.5	146.9	174.4
DEUTZ Group	999.7	909.9	323.1	332.4

¹⁾ Our compact engines have an output range of 4 to 500 kW. Within this segment we produce liquid-cooled and air-cooled diesel engines in Cologne, Ulm and Zafra (Spain).

²⁾ DEUTZ Power Systems supplies gas and diesel engines with an output range of 180 to 4,000 kW. Within this segment we produce gas and diesel engines in Mannheim.

Worldwide presence More than 800 independent DEUTZ sales and service partners in more than 130 countries
5 production/components works · 17 sales companies · 12 sales offices · 16 service centres



Highlights 2005

The year of innovation.

January 2005

In January, DEUTZ sells its marine service business for medium-sized and large engines. The Finnish Wärtsilä Group acquires the genuine spare parts business and the repair and maintenance business for marine and offshore applications with effect from 31 March 2006.

DEUTZ donates a mobile power generation unit to the Aceh region of Indonesia. Following the devastating impact of the tsunami, the unit is used to provide urgently needed support for the local power supply.

March 2005

DEUTZ presents its comprehensive range of diesel engines, developed to comply with Stage 3 emission standards, at the CONEXPO-CON/AGG trade show in Las Vegas, the world's largest trade fair for the construction and construction materials industries. It also unveils the new 2008/2009 series compact engines for the first time on the US market.

The new assembly hall for the TCD 2013 4V commercial vehicle engine was built in just six months and the first assembly lines are already being installed. This increases the yearly assembly capacity at the Cologne-Porz facility by 30,000 engines.

April 2005

The energy supply centre at the new AMD silicon chip factory comes on stream. Six TCG 2032 engines provide power, heat and refrigeration with the utmost precision.

The 2008 and 2009 series go into series production. These new compact engines complete DEUTZ's product range for the lower power output range from 9 to 50 kW.

July 2005

DEUTZ is awarded a major contract for Danish State Railways (DSB), supplying 400 TCD 2015 series engines to the train manufacturer Bombardier for use in the flagship of DSB's train fleet, the IC3.

September 2005

The first pre-series models of the new commercial vehicle engine come off the production line at the Cologne-Porz facility. The engines meet the future EURO 4 standard for on-road applications and signal the company's re-entry into full series production in the commercial vehicles application segment.

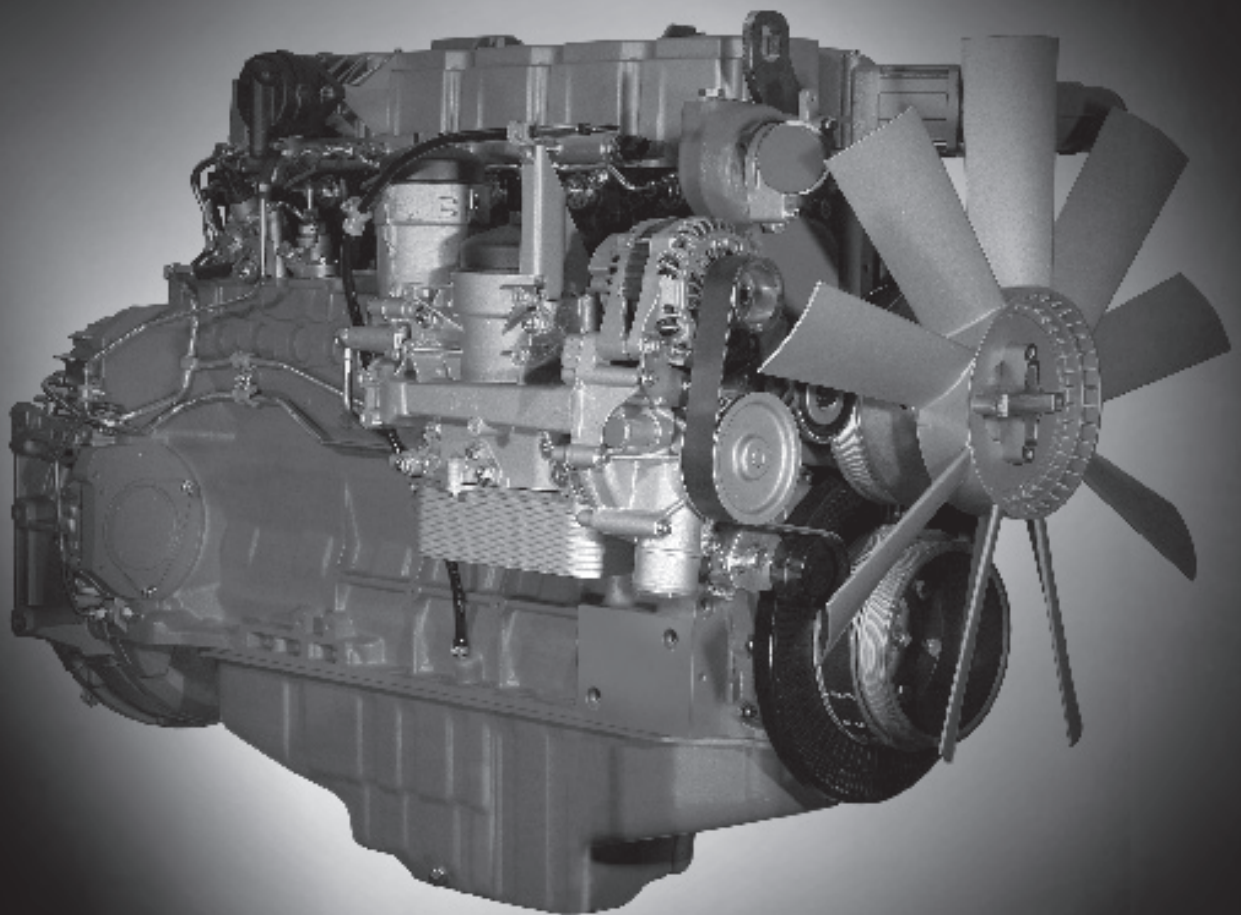
DEUTZ Power Systems (DPS) installs five engine-driven mine gas power plants in container versions for the Huainan Coal Mining Group in China. The decisive factor in winning this order is the company's extensive experience in special gas applications: in Germany alone DPS engines generate more than 180 MW of energy using mine gas as fuel.

October 2005

DEUTZ presents its new Stage 3 engines for agricultural applications at Agritechnica, the world's leading exhibition of agricultural machinery in Hanover. The Fendt Vario 936 tractor is awarded a gold medal for its innovative technology and pulls in the crowds at the exhibition. The tractor is powered by the newly developed TCD 2013 4V series AgriPower engine.

After a difficult period, DEUTZ has now put itself back on the road to success by concentrating on our core competence – top-class engine technology. Reason enough, we think, for this Annual Report to shine the spotlight on our engineering capabilities. The content of the report is also clearly focussed on your information requirements. Get to know us better: the DEUTZ drive system solutions, our strategies, our financial situation.

Just take a closer look...



» DEUTZ has grown more rapidly
than the market. «

**Dear shareholders,
Dear friends of the company,**



Gordon Riske

CEO

2005 was an extraordinarily successful year for DEUTZ. We met the challenge presented by an intensified competition and higher material costs with a strategy of innovation, flexibility, service and customer focus and we were rewarded with customer loyalty. This strategy also enabled us to accelerate business development. Sales grew by 6.5 per cent year-on-year to €1.32 billion. After adjusting for the contribution made by the marine service business sold during the course of the year, this equates to an increase of some 12 per cent, outstripping the market growth rate. The rise in operating profit of 16.8 per cent to €62.5 million was even more marked. The second half of the year, in particular, saw the benefit of the action taken to achieve an improvement in net income. The EBIT margin rose from 4.3 per cent to 4.7 per cent.

The improvement in internal processes had a positive impact on financial figures. We were able to reduce net financial debt by more than €100 million to just €15.7 million. Our company-wide working capital programme was also extremely successful. With working capital down to 18 per cent of sales in 2005, we have already managed to come in below our target figure of 20 per cent.

The improvement in operating profit and the income from the sale of the marine service business resulted in net income attributable to the Group of €71.4 million. This was a significant contributing factor to the clear improvement in ROCE to 7.7 per cent. The equity ratio also rose by eight percentage points to 23 per cent, mainly as a result of this successful development. The stock market also rewarded our efforts: our market capitalisation rose by 47 per cent.

In the DEUTZ Power Systems segment, our strategic focus on gas engines for decentralised power generation bore fruit rather faster than expected. In 2005, we succeeded in almost doubling the unit sales of gas engines compared with 2004. As a result, the proportion of overall segment unit sales attributable to gas engines climbed to almost 57 per cent and gas engines accounted for around 72 per cent of new engine sales. This means we have reached another milestone in our operating activities following the sale of the marine service business on 31 March 2005, which was an important step in the repositioning of the DEUTZ Power Systems segment. The success is also evident in the positive operating profit for the segment which was in line with our expectations.

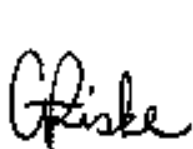
In 2005, we continued to further develop the Compact Engines segment. Firstly, we were able to reinforce our customer focus with a reorganisation in the regions and with key accounts. Secondly, we considerably accelerated in the pace of innovation in the company. This enabled

us to put everything in place for the start of series production of four new engine series in 2006. This included especially the TCD 2013 in a EURO 4 version for commercial vehicles and a Stage 3 version for use in agricultural machinery. A new assembly hall was constructed in Cologne specifically for this engine series; the hall became operational during 2005. By 2008, a total of 9 out of the 17 engine series that we manufacture will be more powerful, quieter and cleaner in line with the phased introduction of increasingly stringent exhaust emission standards. In addition, we also successfully completed the start of series production for the two liquid-cooled engine series, 2008 and 2009, in the lower output range of 9 to 50 kW. With an eye to our customers' requirements, this added some breadth to the DEUTZ product range.

We were very successful with the marketing of our new products. Total unit sales in the year under review grew to 195,843 engines, representing an increase of 13 per cent. We are conscious of the fact that we must maintain research and development expenditure at the current high level of 6.6 per cent of new engine sales. We have proven that we are once again in a position to deliver top-class technical performance and we will continue to maintain this position in the future. In this way, we will ensure that DEUTZ engines remain competitive in the years to come.

With an excellent level of operating profit, market growth and a new product base, DEUTZ is in good shape for the future. We have a sound financial basis and an efficient workforce, providing us with the necessary foundation for a successful future. Assuming there is no change in economic conditions, we forecast sales growth of between 3 and 6 per cent. We will continue to further develop the company in 2006 and we will see improvements in the results of operations. We are confident that we can achieve a further rise in operating profit. We remain firmly in pursuit of our goal for 2007, namely to be able to distribute a dividend again for the first time in over 20 years.

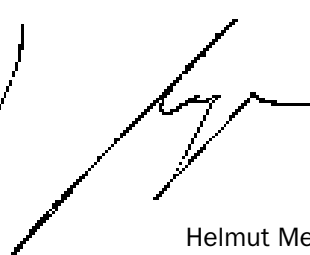
With kind regards,



Gordon Riske



Karl Huebser



Helmut Meyer



Karl Huebser (above)

Management Board: Technology



Helmut Meyer (below)

Management Board: Finance/Personnel

» **The Supervisory Board** has monitored the management of the company and advised the Management Board on major decisions. «

Report of the Supervisory Board



Dr. Michael Endres
Chairman

In 2005, the Supervisory Board continued to monitor the work of the Management Board on a regular basis and to provide advisory support. The Management Board provided detailed reports, both in writing and orally, for this purpose. The Chairman of the Supervisory Board also remained in close regular contact with the Chairman of the Management Board.

Meetings of the Supervisory Board and its committees The Supervisory Board met five times during the year under review. All members of the Supervisory Board normally attended the meetings. No member of the Supervisory Board missed more than one meeting. The Audit Committee of the Supervisory Board met twice and held detailed consultations with the auditors on the subject of not only the annual financial statements and the audit engagement, but also the risk position of the company and questions relating to future financial reporting in accordance with IFRS (International Financial Reporting Standards) and IAS (International Accounting Standards). The Human Resources Committee met on two occasions. Topics discussed included questions relating to the remuneration of the members of the Management Board and the renewal of appointments to the Management Board for those members whose term of appointment would be coming to an end. The Arbitration Committee required by the German Codetermination Act did not need to be convened. All members of the Supervisory Board received prompt information at Supervisory Board meetings about the work of the committees.

The five meetings of the Supervisory Board discussed the current earnings and risk position as well as questions relating to the budget, medium-term planning, production strategy and the progress of individual projects. Further important topics were the sale of the marine service business and the reorganisation of the medium-sized and large engines business (DEUTZ Power Systems).

Corporate governance The Supervisory Board also held detailed consultations in its meetings on the question of corporate governance and implementation of the recommendations and proposals in the German Corporate Governance Code. In its meeting held on 24 November 2005, the Supervisory Board discussed the declaration of compliance and the points under which it would seem appropriate to deviate from the recommendations of the code.

The Supervisory Board reviewed the efficiency of its own work during the past year by completing a questionnaire developed by the auditors KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft. The results of this exercise were highly satisfactory. Individual suggestions for improvement were discussed by the Board and implemented immediately.

The Supervisory Board's internal rules of procedure are available on the website of DEUTZ AG at www.deutz.com. The declaration of compliance pursuant to section 161 German Companies Act (Aktiengesetz), last submitted by the Supervisory Board and Management Board in December 2005, is also available on the company's website.

Financial statements 2005 The financial statements for 2005 were discussed at the meeting of the Supervisory Board held on 27 April 2006. The financial statements for the financial year 2005 prepared by the Management Board, the consolidated financial statements and the management reports, together with the bookkeeping system and the system for the early identification and monitoring of risks, have been audited by PricewaterhouseCoopers AG, Wirt-

schaftsprüfungsgesellschaft, Düsseldorf, Germany, and given an unqualified audit opinion. The financial statements, consolidated financial statements and management reports, together with the relevant auditors' reports, have been supplied to all members of the Supervisory Board. The documents relating to the financial statements were discussed in detail at the meeting of the Audit Committee held on 19 April 2006 and at the financials review meeting mentioned above. The Supervisory Board accepted and approved the findings of the audit.

In addition, the Supervisory Board carried out its own detailed audit of the financial statements for the year ended 31 December 2005, the management report, the consolidated financial statements and the Group management report. The concluding findings of its own audit did not give rise to any reservations. The Supervisory Board approved the financial statements and consolidated financial statements prepared by the Management Board. The financial statements have thus been adopted.

In addition, the dependency report for 2005 pursuant to section 312 German Companies Act (Aktiengesetz, 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 details in the report are correct;
2. In the legal transactions listed in the report, services rendered 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 to that of the Management Board."

Having carried out our own audit of the dependency report, we have no objection to the declaration of the Management Board at the end of the report. The Supervisory Board also noted and approved the findings of the report audit submitted by the auditor.

Personnel There were no changes to the Management Board or the Supervisory Board during the period under review.

On behalf of the Supervisory Board, I would like to thank the Management Board of DEUTZ AG for the work it has carried out in 2005. My thanks are also due to all employees of the DEUTZ Group and their elected representatives for their hard work and commitment. Their contribution is a decisive factor in the growth of the company.

Cologne, April 2006

The Supervisory Board



Dr. Michael Endres
Chairman

Air cooling – a classic design with prospects

DEUTZ air-cooled engines have a long tradition. Our development team has now made it possible for us to open up a new chapter. Cooled exhaust gas recirculation, electronic engine control and regulated particulate trap – an air cooling system fit for the future.



D 914L4, cooling fan



TCD 2013L6 4V, cooled external exhaust gas recirculation

The right answer to every challenge

Our motivation and our strength has always been in producing exactly the right engine for every application. The demands placed on equipment used in agricultural applications are rising massively; there is less and less difference between them and on-road applications. Premium engines with 4-valve technology and cooled external exhaust gas recirculation is our answer.

Return to glory

We have heralded our return to the commercial vehicle segment with an engine which has caused a stir in this sector – and the objective we set ourselves right from the start was that our comeback would be anything but mediocre. The innovative DEUTZ Common Rail injection system, fully electronic engine control, 4-valve technology and exhaust gas aftertreatment ensure outstanding performance with optimum emission control, demonstrating that we have more than met our goals.



TCD 2013L6 4V, DEUTZ Common Rail injection system



TCG 2032V16, gas mixer

It all comes down to the **mixture**

Our gas engines function particularly economically, extremely efficiently and are capable of running on the most varied natures and qualities of gas. One example of the many innovations is the gas mixer developed by DEUTZ Power Systems on the venturi tube principle. Its design ensures that there is only a slight pressure loss during the mixing process. No wonder that we have assumed a leading role in decentralised, engine-driven energy supply.

Any time at any place

We demand top quality and maximum reliability not just from our engines but from our service. Some 80,000 spare parts are stored on the shelves of our ultra-modern logistics centre: from the smallest sealing ring to a precision crankshaft. And, thanks to our ingenious logistics system, they can always be quickly on the spot. We provide a 24-hour delivery service to our global customers and dealers.



Service Logistics Centre, automated high rack warehouse

» **Only those** at the leading edge of rapidly evolving technologies will be able to survive in the marketplace. «

Strategy

DEUTZ faces challenges in four key areas in the future: the market segment for engines with a capacity of four to seven litres, air-cooled engines, decentralised energy supply with gas engines and the service business. DEUTZ has set itself clear strategic objectives for each of these areas that are clearly focussed on the needs of the market and of customers.

The challenge DEUTZ AG is operating in a market environment characterised by dynamic growth in the emerging markets of Asia, Eastern Europe and South America and by concentration among original equipment manufacturers (OEMs). At the same time, increasingly stringent emission standards are driving the trend in technological development towards engines that are more powerful, quieter and cleaner, but at the same time consume as little fuel as possible.

If we are to meet these challenges, we must commit a high level of expenditure to research and development, capital spending and the development of employee skills and qualifications, all of which must be aligned with customer and market requirements as part of our strategic planning. Our principal objectives are:

- To become one of the top three global suppliers in the market segment for engines with a capacity of 4 to 7 litres;
- To consolidate our position as the world's number one supplier of air-cooled engines;
- To become the global market leader in the field of gas engines for decentralised power generation using natural gas and special gases;
- To expand and develop the range of service support so that it accounts for 25 per cent of total sales.

4 to 7-litre engines From 1 October 2006, more stringent exhaust emission limits in accordance with the EURO 4 standard will apply in Europe for commercial vehicles and buses with a permissible weight of more than 3.5 tonnes. This applies equally to all engines delivered from this date onwards. The strict requirements in the commercial vehicle sector in terms of performance, emissions, fuel consumption and noise suppression are the main technology drivers in engine development and require considerable advance investment in research and development.

Emission limits have also been tightened for mobile machinery and tractors with outputs in the range from 130 to 560 kW in accordance with Stage 3A in Europe and TIER 3 in the USA. These provisions must be met by all engines supplied from 1 January 2006 onwards. Engines in output categories below 130 kW will become subject to the provisions in the next two years. These new emission standards require a comprehensive revision of the product range and the introduction of new electronic injection systems.

The co-operation agreement with Volvo is extremely important. DEUTZ is working together with Volvo to press ahead with the development of new and existing diesel engines in the 4 to 7 litre category for use in commercial vehicles, construction machinery and gensets. One of the successful outcomes of this alliance is the new TCD 2013 (EURO 4) commercial vehicle engine. During 2004 and 2005, there was investment in production and assembly capacity for this engine and a new assembly hall in Cologne was constructed. Future production at this site will include commercial vehicle variants of the TCD 2013 as well as other engines based on this design for use in the off-road sector.

Another cornerstone in the strategy is a co-operation agreement with the SAME DEUTZ-FAHR Group S.p.A. in Italy involving diesel engines for use in agricultural machinery with a high degree of technological sophistication. Under this co-operation agreement, Same will close its own engine production facility in Italy and, from 2007, will then purchase around 20,000 additional engines from DEUTZ. DEUTZ will therefore become the main engine supplier to one of the leading agricultural machinery manufacturers in Europe.

Both co-operation agreements support the overall plan to grow from around 196,000 units in 2005 to an annual production of significantly more than 250,000 units by 2008. This will enable the company to benefit increasingly from the advantages of economies of scale. The result will be an improvement in productivity and earnings performance.

Air-cooled engines Air-cooled diesel engines have long been one of the core competencies in the DEUTZ company. The main features of these engines are simple construction, a high degree of robustness in extreme climates and straightforward engineering. DEUTZ has now developed these engines for the next emission standard stage (Stage 3) and therefore secured the future of this proven product for the next decade. With sales of around 30,000 engines a year, DEUTZ is the global market leader across all power output categories. The company plans to reinforce this market position with an ongoing engine development process.

Power generation All activities related to the medium-sized and large engine business were brought together under the umbrella of DEUTZ Power Systems GmbH & Co. KG on 1 January 2005. Since then, DEUTZ Power Systems has completely focussed on the decentralised power generation business using gas and diesel engines. In addition to concentrating on natural gas as the cleanest fossil energy source, DEUTZ is expecting particularly strong growth in the short to medium term in the use of renewable energy sources, such as biogas and special gases. This includes the use of gases from landfill sites, sewage treatment plants, coking plants, mining, agriculture or the chemical industry as fuel for gas engines. The use of these gases for power generation makes an important contribution to the environmentally friendly disposal of these problem gases because uncontrolled release of methane into the earth's atmosphere significantly worsens the greenhouse effect. The early focus on these special gas applications, together with the increase in research and development activities in the field of gas engine construction, means that DEUTZ Power Systems has become the technology leader in this market.

Service Service business is the basis of long-term customer loyalty. DEUTZ has an extensive service network of 17 sales companies, 16 of its own service centres and around 800 sales and service partners in over 130 countries. Through this network, service support ensures that a high level of customer satisfaction is generated, which in turn has a positive impact on engine sales. Our plan is to use a specific package of measures to improve the range of services and increase the proportion of total sales accounted for by the service business to 25 per cent by 2008.

High advance outlay A high level of research and development expenditure, together with considerable capital expenditure, is required if all these objectives are to be achieved. Only those companies keeping pace with the rapid changes in technologies will be able to succeed in the long term. DEUTZ is meeting these challenges. In 2004 and 2005, spending on research and development and capital expenditure together amounted to just under €250 million. With this approach, DEUTZ has laid the foundations for a successful future.

»A 41.3 per cent increase in value over the year has made DEUTZ shares very popular in their respective indices.«

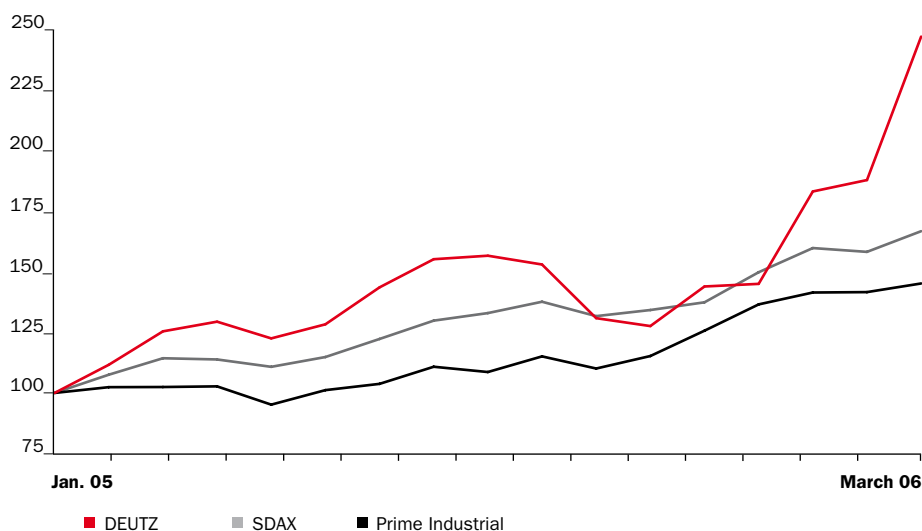
Shares

Investors have increasingly focussed on second-line equities over the past year and with a gain of more than 41 per cent for the year, DEUTZ shares were amongst the winners in the main indices. Combined with an increase in the number of shares, the rising share price has substantially increased the company's market capitalisation. A compelling success story, due in no small part to the company's vigorous IR activities.

Small and mid-caps outstrip DAX 2005 saw different developments in international stock markets. Whereas the American Dow Jones Industrial Average (DJIA) finished 0.6 per cent down at the end of the year under review compared to its level at the end of 2004, other markets profited, some of them considerably, from expansion in the global economy and continuing low interest rates. Investors focussed in particular on the Japanese Nikkei 225, which registered a gain of 40.2 per cent in 2005. The EURO STOXX 50 was undeterred by sluggish performance in the USA and climbed by 21.3 per cent. Sharp rises in share prices

Performance of the DEUTZ share

in %



were also a feature of the 2005 stock market year in Germany. At the end of 2005, the leading DAX index was showing a 27.1 per cent gain year-on-year making it one of the best European performers. The MDAX surged forward by 36.0 per cent. The prevailing positive mood had an even stronger effect on second-line stocks.

DEUTZ share price performs better than sector average With a gain for the year of 41.3 per cent, DEUTZ shares were among the favourites in their relevant indices. The SDAX climbed by 35.2 per cent. The Prime Industrial sector index could only manage a 24.2 per cent increase.

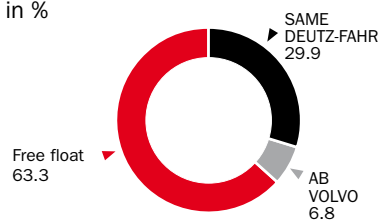
Starting from a price of €2.93 at the end of 2004 and a low for the year of €2.86 on 6 January 2005, the share price then started to move upwards in the first months of the year and accelerated at the beginning of April. After a brief correction, the DEUTZ share price rallied and resumed its upward course from May, hitting a high for the year of €4.68 on 3 August. September and October saw performance affected by profit-taking. On the back of continuing growth in sales and earnings in the third quarter, the share price was able to stage a sharp recovery and ended 2005 at €4.14. 2006 then started with an encouraging continuation in the upward trend. The announcement of preliminary results for 2005 on 20 February pushed the share price to over €5.00 on 23 February. During the course of March, the price continued its advance and passed the €6.00 mark. At the end of the first quarter 2006, DEUTZ shares closed at €6.98.

Sharp rise in market capitalisation Following the conversion of bonds issued in 2004, the number of shares in circulation at 31 December 2005 rose to 95.0 million compared with 91.1 million on the equivalent date in 2004. The increase in the number of shares and the sharp rise in the share price meant that the market capitalisation of DEUTZ AG at the end of 2005 rose to €393.3 million compared with €267.1 million 12 months previously; this represents an increase of 47.2 per cent.

Minor changes to shareholder structure There were minor changes to the shareholder structure at DEUTZ AG during the course of 2005. The largest single shareholder continues to be SAME DEUTZ-FAHR Group S.p.A. At the end of the year, the holding was unchanged at 29.9 per cent following a brief period at 28.8 per cent owing to the bond conversions. The proportion of shares held by AB Volvo fell slightly from 7.1 per cent to 6.8 per cent, again as a result of the bond conversions.

Transaction reporting in accordance with the requirements of the German Securities Trading Act (Wertpapierhandelsgesetz) only involved institutional investors in the year under review. In mid-March, DWS Investment GmbH reported a holding of 4.98 per cent, thereby falling below the threshold of 5 per cent. In mid-April 2005, FMR Corp., USA, a company in the Fidelity Group, exceeded the reporting trigger level with a holding of 5.2 per cent; according to FMR, the holding dropped again in October to 4.76 per cent, thereby falling back under the 5 per cent mark.

Shareholder structure in %



Step-up in IR activities bears fruit With the conclusion of restructuring and the focus on core competencies in the engine business, investor awareness of DEUTZ shares has been gradually reinforced. At the start of 2005, investor communications were put on a professional footing based on a clear equity story; a systematic investor relations operation was instigated to step up dialogue with capital markets.

Roadshows and conferences were held at the principal stock market locations of Frankfurt, London, Paris and New York. In addition, members of the Management Board held question and answer sessions in numerous face-to-face meetings with investors. For the first time, conference calls were offered to support investors in conjunction with the announcement of quarterly results.

DEUTZ aims to use active and open communication to allow all participants in capital markets to appropriately analyse the current position of the company and accurately assess business prospects on the basis of the corporate strategy. In 2006, the company will continue to press ahead with the activities necessary to pursue this aim.

All information relevant to the DEUTZ AG share price or imminent dates in the financial calendar can be viewed or downloaded from the company website (www.deutz.com). If you wish to contact the Investor & Public Relations department in person, the necessary details can also be found on the penultimate page of this Annual Report.

DEUTZ shares

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

	2004	2005
Number of shares (31 December)	91,149,075	95,003,621
Number of shares (average)	91,149,075	92,584,625
Share price (31 December) in €	2.93	4.14
Share price (high) in €	4.70	4.68
Share price (low) in €	2.41	2.86
Market capitalisation in € million	267.1	393.3
Earnings per share, undiluted, in €	-0.21	0.77
Earnings per share, diluted, in €	–	0.62

Based on Xetra closing prices

»» A trusting working relationship between the Management Board and the Supervisory Board is crucial to the successful management of a company. ««

Corporate governance report

DEUTZ AG considers the German Corporate Governance Code to be an important step towards transparent, responsible company management and control aimed at the long-term creation of economic value added.

Management Board and Supervisory Board 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. The Supervisory Board consists of 12 members, the membership being divided equally between employee and employer representatives. The same person cannot be a member of both the Management Board and the Supervisory Board. Employer representatives on the Supervisory Board are elected by the Annual General Meeting as the decision-making body of the shareholders, whereas the employee representatives are chosen by the employees.

The members of both the Management Board and the Supervisory Board have a duty of loyalty and care to the company. A wide range of interests, in particular those of the company, its shareholders, its employees and its creditors must be taken into account. A working relationship based on trust between the Management Board and Supervisory Board is of fundamental importance to the well-being of the company.

The directorships of the members of the Supervisory Board and Management Board are listed on page 90 of this Annual Report. Relationships with enterprises and related parties are described in the "Notes to the consolidated financial statements" from page 81 onwards.

Efficiency audit In 2005, the Supervisory Board reviewed the efficiency of its activities pursuant to item 5.6 of the German Corporate Governance Code. The results were highly satisfactory. Individual suggestions for improvement were discussed by the Board and implemented immediately.

Communication with shareholders The Management Board also attaches great importance in particular to the right of shareholders to comprehensive, prompt information on equal terms. DEUTZ AG therefore publishes its press releases, presentations, interim reports, annual reports and other relevant information in both German and English on its website at www.deutz.com so that this information is available to all target groups. The financial dates page provides up-to-date information on significant dates in the company's financial year.

Transactions subject to reporting requirements Under section 15a German Securities Trading Act (Wertpapierhandelsgesetz), 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 2005, DEUTZ AG received one such notification. In this notification, the member of the Management Board, Mr Karl Huebser, reported that, on 29 August 2005, he had sold 200,000 privately issued options entitling the holder to purchase one no-par value share in DEUTZ AG per option. The sale was conducted outside the stock exchange at a price of €2.00 per option. The options are based on a price of €2.70 per share.

At 31 December 2005, there was no ownership subject to reporting requirements pursuant to item 6.6(2) German Corporate Governance Code.

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 regulations of the German Corporate Governance Code. The following declaration of compliance provides information on the results of these internal consultations.

In December 2005, the Management Board and 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 2 June 2005 and made this declaration available on the website of the company on a permanent basis for the benefit of shareholders. DEUTZ AG complies with all the recommendations apart from the following exceptions:

1. There are currently no plans to facilitate personal attention to shareholders' rights through using fax and electronic media in the context of Annual General Meetings because we have not ascertained that our shareholders use these media (see sub-clauses 2.3.3 and 2.3.4).
2. The D&O insurance taken out by DEUTZ AG for the Management Board and Supervisory Board members does not provide for any retention, as such an alteration to contracts would entail substantial additional costs for the company (see sub-clause 3.8, paragraph 2).
3. Up until now we have not published the system of remunerating Management Board members and we have not clearly defined a share option plan because there is no option plan and because companies have not yet established a standardised policy towards remuneration (see sub-clause 4.2.3, paragraph 3).
4. We refrain from publishing individual details of the remuneration for Management Board and Supervisory Board members for the financial year 2005. (See sub-clause 4.2.4, sentence 2 and sub-clause 5.4.7, para. 3, sentence 1). Starting with the annual accounts for the financial year 2006 the company will publish the details of remuneration for Management Board and Supervisory Board members in accordance with the statutory regulations.
5. The annual accounts, the consolidated accounts and the interim reports were drawn up by the 3rd quarter of the 2005 financial year in compliance with the national regulations (German Commercial Code). The International Financial Reporting Standards (IFRS) will be used from the consolidated accounts for the 2005 financial year onwards (see sub-clause 7.1.1).

6. It will not be possible to comply with the 90-day limit according to sub-clause 7.1.2, sentence 2 for the financial year 2005. The Group accounts for the financial year 2005 will be a little delayed due to the migration to IFRS and will not be available until 2 May 2006.¹⁾ For the same reason the interim report for the 1st quarter of 2006 will not be available within the 45-day limit. Anticipated publication will be 24 May 2006.

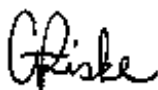
Cologne, December 2005

DEUTZ AG

On behalf of the Supervisory Board On behalf of the Management Board



Dr. Michael Endres



Gordon Riske

¹⁾ In the original version of the declaration, 10 May 2006 was stated as the publication date. The text has been amended as a result of resolutions taken by the Management Board and Supervisory Board on 27 April 2006.

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Group Management Report

Introduction

Publication of consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) 2005 is the first financial year for which DEUTZ has prepared its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), taking into account the additional stipulations of the German Commercial Code (Handelsgesetzbuch, HGB) and the German Companies Act (Aktengesetz, AktG). The Notes to the financial statements (page 50 et seqq. of this Annual Report) contain a statement of changes in net income and equity for 2004 attributable to the transition from HGB to IFRS.

The following table summarises the key figures for 2005 (IFRS only) compared with 2004 (HGB and IFRS):

	2005 IFRS	2004 IFRS	2004 HGB
€ million			
Sales	1,322.8	1,242.3	1,242.1
Operating profit (EBIT before one-off items)	62.5	53.5	50.1
One-off items	52.2	-35.0	-35.0
EBIT	114.7	18.5	50.1
Net income	71.4	-18.7	-18.6
Equity	247.0	158.7	155.6

Comparability of figures after the sale of the marine service business The figures for 2005 include a contribution from the marine service business covering a period of just three months up to 31 March 2005, at which point the business was sold. A year-on-year comparison is therefore of limited value, especially as far as new orders, sales and operating profit in the Group consolidation and in the DEUTZ Power Systems segment are concerned. The comments in the management report therefore also refer to adjusted prior-year values for these items.

Operating activities and structure

DEUTZ Group

DEUTZ is an independent manufacturer of diesel-powered and gas-powered engines. The core competency is the development, construction, assembly and sales of liquid-cooled and air-cooled engines, together with the manufacture of decentralised power generation plants. The activities of the Group are divided into two segments: Compact Engines and DEUTZ Power Systems.

Compact Engines

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 swept volume of 4 to 7 litres. According to application segments, the business is broken down as follows: Mobile Machinery, Agricultural Machinery, Stationary Equipment, Automotive and Marine.

From a market perspective, industrial engines are divided into captive and non-captive. In the captive market, vehicle and equipment manufacturers meet their engine requirements by developing and producing their own engines, and are not therefore subject to direct competition. In contrast, engine manufacturers in the non-captive market are operating in an open competitive environment.

DEUTZ has achieved a strong international position in the non-captive market. In the last few years, DEUTZ has also entered into strategic alliances that have opened up additional potential previously confined to the captive market. Co-operation agreements have been signed with the Volvo Group in Sweden for 4 to 7-litre capacity engines to be used in commercial vehicles, construction machinery and gensets, and with the Same Group in Italy for agricultural machinery engines.

Comprehensive aftersales service rounds off the product range offered. 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.

Focus on regional structure Effective 1 July 2005, the Compact Engines segment was reorganised by regions and key accounts. Since then, the global market has been subdivided into the four regions of Europe/Africa, Americas, Asia-Pacific and the Middle East (including Turkey), and into global key accounts. Each of these subdivisions has a manager with responsibility for sales and profit from new engine business and service activities. This new structure facilitates optimum alignment of sales, marketing and service networks with the various requirements in each of the markets. The objective is to increase the customer focus.

DEUTZ Power Systems

DEUTZ Power Systems GmbH & Co. KG was established on 1 January 2005 following withdrawal in the previous year from the Marine applications sector of the medium-sized and large engines business and a re-focus on engines for decentralised power generation. At the same time, sales and marketing for engines and aftersales service were amalgamated to working the markets more efficiently.

DEUTZ Power Systems is one of the leading global systems suppliers 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 based on renewable fuels such as biogas, mine gas or sewage gas.

DEUTZ Power Systems also supplies the customer service backup required with power generation, 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.

Marine service business sold DEUTZ sold the marine service business for medium-sized and large engines to the Finnish Wärtsilä Group with effect from 31 March 2005. The transaction included the genuine spare parts business, the repair and maintenance business for diesel-powered medium-sized and large engines in ships and offshore applications, and the transfer of employees in this business unit to Wärtsilä.

Equity investments

The investment structure in the Group was streamlined in the year under review, thereby reducing the complexity of the organisation. Several investments that were of little significance for further strategic development were sold, liquidated or merged into DEUTZ AG.

Internal control system

Performance measures in the Group 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 control elements are unit sales, sales, EBIT margin, working capital ratio, return on capital employed (ROCE), equity ratio and net financial debt. Benchmarks based on competitors are also used as a guide when defining these targets. A monthly reporting process enables the Management Board to track changes in these performance indicators. Selected details are discussed in weekly management meetings.

Economic environment

Cyclical trends

In 2005, growth trends in the global economy continued despite the steep hike in the price of oil. Growth was particularly dynamic in North America, Asia and China. Investment confidence was also strong in the oil-producing states of the Middle East. In Europe, above-average growth in Eastern Europe contrasted with a very sluggish economic recovery in Eurozone countries. Economic development was hampered in the first half of the year by the general reluctance of businesses to commit to investment as well as by the drop in household purchasing power caused by rising energy prices.

In Germany, the result was that gross domestic product grew by just 0.9 per cent compared with 1.6 per cent in 2004. On the other hand, 2005 turned into a good year again for German engineering companies. According to the German Engineering Federation (Verband Deutscher Maschinen- und Anlagenbau e.V.), production increased by 4 per cent in real terms. The level of new orders increased by 6 per cent. Exports were again the mainspring of this growth, increasing by 9 per cent. Domestic business fell by 1 per cent overall, but this disguised unusually strong growth in December.

Growth in non-captive market for compact engines The non-captive market for compact engines in the output range up to 500 kW – a market highly relevant to DEUTZ – grew by almost 6 per cent in 2005. Above-average growth was registered in Asia as a result of strong demand in China. Market volumes in Europe/Africa, the Americas and the Middle East climbed roughly between 3 per cent and 4 per cent.

Expansion in power generation using gas Decentralised power generation benefited from brisk demand for units based on renewable energy sources, such as biogas, landfill gas, sewage gas and mine gas. There has been a strong emphasis on activities relating to the limitation and reduction of greenhouse gas emissions as a result of the targets set under the Kyoto Protocol. This has created an increase in volumes, making projects in this area an increasingly attractive proposition. National regulations promoting renewable energies, such as the Renewable Energy Sources Act (Erneuerbare-Energien-Gesetz) in Germany, provided a further positive stimulus. In Europe, developments in Eastern Europe are of particular note, where many of the old boiler plants have to be replaced by new combined heat and power plants (CHP plants).

Renewable energy sources are becoming increasingly attractive as the price of fossil fuels rises. For example, the demand for gas-powered engines in Asia is being stimulated by low market prices for gas. On a global basis, gas engines in the 1 to 10 MW range are becoming increasingly important.

DEUTZ Group in brief

	2005	2004	Change in %
€ million			
New orders	1,350.5	1,265.1	6.8
Unit sales (units)	195,843	173,440	12.9
Sales	1,322.8	1,242.3	6.5
thereof excl. Germany (%)	73.0	74.5	–
EBIT	114.7	18.5	–
One-off items	52.2	-35.0	–
Operating profit (EBIT before one-off items)	62.5	53.5	16.8
EBIT margin before one-off items (%)	4.7	4.3	–
Net income/loss	71.4	-18.7	–
ROCE (%)	7.7	6.3	–
Total assets	1,063.8	1,029.1	3.4
Equity	247.0	158.7	55.6
Equity ratio (%)	23.2	15.4	–
Net financial debt	15.7	124.2	-87.4
Working capital	238.1	314.1	-24.2
as a percentage of sales	18.0	25.3	–
Cash flow from operating activities	143.4	111.9	28.2
Capital expenditure (excl. capitalisation of R&D)	67.6	43.0	57.2
Research and development	66.9	69.5	-3.7
Number of employees as at 31 December	5,058	5,472	-7.6

Business development

New orders and orders on hand

In 2005, DEUTZ achieved a 6.8 per cent increase in the level of new orders to €1,350.5 million (2004: €1,265.1 million). In fact, if the contribution of the marine service business from April to September 2004 is disregarded, this equates to an increase of around 12 per cent.

Significant activity in North American business Significant activity in the North American business, together with higher demand in Germany and elsewhere in Europe, led to an 11.7 per cent increase in the level of new orders in the Compact Engines segment to €1,025.4 million. Expansion in the new engines business was particularly strong.

Clear growth in power generation on a like-for-like basis

Despite the loss of orders from the marine service business, DEUTZ Power Systems reported a drop in new orders of just 6.4 per cent to €325.1 million. However, on a like-for-like basis, excluding the contribution from the marine service business from April to December 2004, this equates to an increase of almost 15 per cent. Significant increases were down to the gas engine business in Asia, Eastern Europe and Germany.

Orders on hand up 13 per cent At 31 December 2005, orders on hand stood at €233.9 million. This means that the 2004 value of €207.8 million was exceeded by 12.6 per cent.

Unit sales

In the year under review, DEUTZ was able to increase its engine unit sales by 12.9 per cent to 195,843 engines (2004: 173,440). 195,082 of these engines (2004: 172,684) were in the Compact Engines segment and 761 engines (2004: 756) in DEUTZ Power Systems.

Compact engine business continues to grow

DEUTZ was able to achieve an increase of 13.0 per cent in unit sales of compact engines in the year under review, outstripping the market growth rate. DEUTZ enjoyed particularly sharp growth of almost 30 per cent in the range of liquid-cooled engines with a capacity of up to 4 litres. Growth in unit sales of 4 to 7-litre engines was encouraging at more than 10 per cent.

It was mainly in North America that the continuation of the high level of growth was most noticeable. With over 47,000 compact engines, unit sales in this market were up 40 per cent. We were also able to acquire new customers in the dynamic Asian markets. For example, new contracts were signed in Vietnam and Indonesia for genset applications. In

Singapore, a manufacturer of concrete pumps will in future equip its units with DEUTZ engines. Significant sales successes were registered both in North America and Europe for engines to be used in locomotives. DEUTZ equipment is used by almost all leading agricultural machinery manufacturers, in particular the Italian Same Group and Fendt, the high-end manufacturer which forms part of the American AGCO Group. The new AgriPower engine built to Stage 3 exhaust emission standards will be used in the new Fendt flagship, the 936 series.

DEUTZ has also been able to increase unit sales significantly in the emerging markets of Eastern Europe. DEUTZ engines are reliable and economic, even when used in extreme conditions, and our major customers also include manufacturers of commercial vehicles in Belarus and Ukraine.

Growth in gas engines Although the overall increase in engine unit sales by DEUTZ Power Systems was only fractional at 0.7 per cent, unit sales of gas engines almost doubled. Alongside this development, significantly fewer diesel engines were sold, as planned. As a result, the proportion of overall segment unit sales attributable to gas engines climbed to almost 57 per cent. The installed power output of the gas engines sold amounted to a total of around 490 MW, of which around 35 per cent was accounted for by engines powered by renewable energy sources. This encouraging development is in line with the new corporate strategy for the segment.

DEUTZ Power Systems is continuing to develop its sales and marketing activities in accordance with the focus on decentralised power generation plants. The company's position in the international marketplace is being expanded with the involvement of new sales and service partners specialising in gas-powered power generation plants.

These technologically advanced gas engines are a leading product in the global market and various large-scale projects were completed during the year under review. In April 2005, the power supply plant of the American chip manufacturer AMD in Dresden came on stream. In this plant, six gas-powered gensets from DEUTZ Power Systems provide electricity, heat and cooling for one of the most ultra-modern semiconductor plants in the world. The contract for the expansion of the plant in 2006 to include a further three gas gensets has also been awarded to DEUTZ Power Systems.

Several Asian markets were entered during the year under review. Eleven natural gas gensets for power supply came on stream for a key customer in Indonesia. The American Embassy in New Delhi has also opted for decentralised power generation using a genset from DEUTZ Power Systems. A secure energy supply for industrial and domestic use is particularly important in the fast-growing Chinese economy. The number of natural gas installations rose considerably in 2005. Currently,

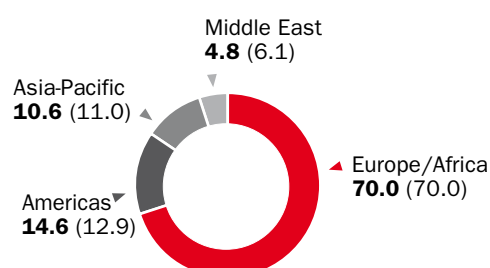
there is strong demand in China for innovative solutions, such as the use of mine gas for power generation. DEUTZ Power Systems installed five engine-driven mine gas power plants in container versions for the Huainan Coal Mining Group. Our high level of expertise in this application – plants with a total output of over 180 MW have already been installed by DEUTZ Power Systems in Germany – was the decisive factor in this contract. In addition to developments in the European markets of Poland and the United Kingdom, the mine gas business is therefore continuing to progress on an international basis; other target countries for this special gas application are India, Russia and Iran.

Sales

Given the growth in new orders and unit sales, DEUTZ was able to increase year-on-year sales in 2005 by 6.5 per cent to €1,322.8 million. Excluding the contribution from the marine service business from April to December 2004, this equates to an upturn of around 12 per cent.

Germany and North America above average In Europe/Africa, sales increased by 6.4 per cent to €925.6 million. For DEUTZ, this represents a further strengthening of its market position, mainly in Germany. Growth of 12.8 per cent to €356.9 million was achieved in Germany itself as a result of brisk demand for compact engines to be used in construction and agricultural machinery by customers with a heavy export bias, and as a result of demand in the gas engines business. In the other European countries, there was a small gain of 3.1 per cent to €524.4 million. The Americas region benefited from the boom in contracts in North America and reported an increase of 20.5 per cent to €193.2 million. In the Asia-Pacific region, DEUTZ enjoyed particular success with gas engines and pushed sales up by 2.6 per cent to €140.0 million. Sales in the Middle East region suffered from the negative impact of a drop in deliveries to agricultural machinery and commercial vehicle customers in Turkey.

DEUTZ Group: Sales by regions in % (2004 figures)



Compact engines up 10 per cent In the Compact Engines segment, DEUTZ generated sales of €999.7 million. Compared with sales of €909.9 million in 2004, this represents an increase of 9.9 per cent.

This strong growth is attributable to a large extent to positive developments in new engines business in the Mobile Machinery application segment. The rise in sales of 20.5 per cent in this area of the business to €374.1 million (2004: €310.5 million) is mainly based on excellent growth in construction machinery. The reason behind this development is strong domestic business, driven by customers with a heavy export orientation. The materials handling equipment business in North America also saw a significant increase.

In Stationary Equipment, sales fell slightly to €200.9 million (2004: €205.5 million). The gensets business in China dropped in line with overall developments in the sector. In contrast to global trends, the important US business in engines for pumps and welding units registered a very positive development.

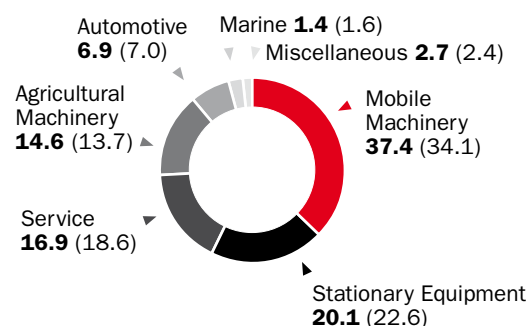
In the Agricultural Machinery application segment, DEUTZ expanded on its already strong market position. High growth rates with leading agricultural machinery manufacturers, such as Same and with AGCO's Fendt brand led to a 17.3 per cent rise in sales to €145.8 million (2004: €124.3 million).

Automotive sales increased by 8.7 per cent to €68.6 million (2004: €63.1 million). The drop in business with commercial vehicle manufacturers in Turkey and China was more than offset by a major order for engines in the 2015 series for Danish State Railways (DSB) and by deliveries to customers in Eastern Europe. 2005 also saw the start of deliveries of pre-series engines of the new TCD 2013 commercial vehicle engine.

At €14.5 million (2004: €14.7 million), sales in the Marine application segment was almost at the same level as in 2004. The slight drop in sales was down to a fall in demand in Asia.

In the service business for compact engines, sales of €168.6 million approached the level of 2004 (€169.5 million). There were improvements in the spare parts business and the Xchange® business for exchange parts. In contrast, sales from on-site customer service in the service centres declined.

Compact Engines: Sales by application segments in % (2004 figures)



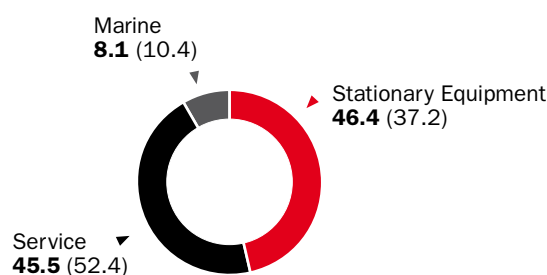
Significant progress at DEUTZ Power Systems Despite the loss of sales from the marine service business, the DEUTZ Power Systems segment generated sales of €323.1 million (2004: €332.4 million). After adjusting for the contribution from the marine service business from April to December 2004, this represents an increase in sales of around 20 per cent.

In line with the focus on decentralised power generation, the development of the gas engines business was pushed ahead specifically and benefited from strong demand in Germany, Eastern Europe and Asia. Sales leapt up by 48 per cent as a result. A significant increase in the proportion of segment sales accounted for by gas engines was therefore achieved rather faster than planned.

In contrast, sales from stationary diesel units declined by 38 per cent, although this was again in line with corporate strategy. As planned, new marine business in 2005 was restricted to the processing of the remainder of the existing contracts.

In the service business, as expected, sales of €146.9 million fell below the figure of €174.4 million achieved in 2004. However, if the contribution of the marine service business from April to December 2004 is disregarded, this represents a rise of 33 per cent. Within this business, sales of reconditioned Xchange® parts showed particular improvement.

DEUTZ Power Systems: Sales by application segments in % (2004 figures)



Earnings

Significant rise in operating profit before one-off items

In 2005, DEUTZ accelerated the upward trend in operating profit (EBIT before one-off items). Despite the rises in material costs, the company managed to achieve an operating profit of €62.5 million (2004: €53.5 million), representing an improvement of 16.8 per cent. The EBIT margin before one-off items therefore rose from 4.3 per cent to 4.7 per cent year-on-year. Disregarding the contribution from the marine service business from April to December 2004, operating profit more than doubled in 2005.

	2005	2004
€ million		
Sales	1,322.8	1,242.3
Operating profit (EBIT before one-off items)	62.5	53.5
One-off items	52.2	-35.0
EBIT	114.7	18.5
Interest expenses, net	-28.5	-33.4
Other taxes	-1.5	-1.6
Pre-tax earnings	84.7	-16.5
Income taxes	-13.3	-2.2
Net income/loss	71.4	-18.7

In the Compact Engines segment, operating profit in the year under review rose by 4.1 per cent to €56.4 million (2004: €54.2 million). The significant expansion in business volume and cost reduction measures in all areas more than compensated for the negative impact of material cost increases and currency influences.

In the year under review, the DEUTZ Power Systems segment recorded its first significant restructuring successes. With successful sales and marketing, in particular for gas engines, and the optimisation of organisational and cost structures, the segment was able to improve operating profit – disregarding the marine service business from April to December 2004 – by €25 million to plus €12.0 million. Compared with the 2004 figure of €13.1 million, including the marine service business for the full 12 months, operating profit fell by 8.4 per cent.

The other operating loss was reduced from €13.8 million in 2004 to €5.9 million because costs incurred in 2004 for projects across the Group no longer applied in 2005 and old burdens in connection with the industrial plant business had been eliminated.

After one-off items, EBIT in the year under review amounted to €114.7 million compared with €18.5 million in 2004. This figure includes a one-off amount in the year under review of €67.0 million resulting from the sale of the marine service business and a reduction in this amount relating to expenses

of €14.8 million for additional adjustments to achieve further optimisation of organisational structures. These structural adjustments were necessary as a result of the sale of the marine service business. The one-off expense of €35.0 million in 2004 related to the restructuring of the medium-sized and large engine business.

Turnaround in net income The net income was €71.4 million (2004: loss of €18.7 million) after taking into account income tax expense, the year-on-year improvement in net interest expenses of just under €5 million and the one-off items described above.

ROCE increased Return on capital employed (ROCE) rose to 7.7 per cent in the year under review compared with 6.3 per cent in 2004. This was due to the combination of strong operating profit with a concurrent reduction in the level of capital employed.

Net assets and financial structure

Improvement in balance sheet ratios At 31 December 2005, total assets amounted to €1,063.8 million, representing an increase of 3.4 per cent on the 2004 figure of €1,029.1 million. The balance sheet is broken down by maturity in accordance with IFRS.

DEUTZ Group: Balance sheet structure

in %	31 Dec. 2005	31 Dec. 2004
Assets		
Non-current assets	45.1	45.0
Deferred tax assets	5.3	5.1
Inventories	20.2	23.7
Trade receivables	17.8	20.7
Other receivables and assets	7.1	4.7
Cash and cash equivalents	4.5	0.8
Total assets	100.0	100.0
Equity and liabilities		
Equity	23.2	15.4
Non-current pension provisions	26.7	28.2
Other non-current provisions	4.1	3.3
Non-current financial liabilities	10.7	16.0
Other non-current liabilities	0.2	0.1
Current pension provisions	2.5	2.7
Other current provisions	7.4	5.2
Current financial liabilities	2.2	7.4
Trade payables	15.6	13.9
Other current liabilities	7.4	7.8
Total equity and liabilities	100.0	100.0

Non-current assets showed an increase of €16.7 million in the year under review, mainly as a result of the capitalisation of development costs for the new and ongoing development of engines and the completion of the new assembly hall. The high level of existing losses carried forward for DEUTZ AG, together with the increasing profit expectations for subsequent years, has, according to IFRS, led to an increase in deferred tax assets.

The significant reduction in inventories and trade receivables by a total of €53.5 million was the successful outcome in the year under review of efforts to press ahead with a rigorous working capital programme. After repayment of the short-term working capital bank loan, the level of cash and cash equivalents that remained was €48.4 million (2004: €7.8 million).

Equity ratio increased to 23 per cent On the 2005 balance sheet date, equity had increased by €88.3 million to €247.0 million. The high post-tax net income achieved in 2005 was a significant contributing factor to this increase. The exercise of conversion rights on approximately 3.9 million convertible bonds also had the effect of increasing equity. The resulting equity ratio of 23.2 per cent represented an improvement on the 15.4 per cent achieved in 2004.

Current and non-current pension provisions declined by €7.5 million in accordance with the planning. On the other hand, there were other non-current provisions that increased by €8.3 million owing, in particular, to future human resources obligations. The increase in the current accrued income tax expense is the consequence of the good operating profit achieved in the fourth quarter of 2005.

A good level of earnings, a cash inflow from the sale of the marine service business and action to slim down working capital allowed us to cut current and non-current financial liabilities by a total of around €102 million to €138.1 million. The allocation to other current provisions is mainly related to obligations in connection with the processing of the sale of the marine service business.

Working capital better than planned Working capital was reduced by €76.0 million to €238.1 million. The ratio to sales at 18 per cent came in well under the target value of 20 per cent. Net financial debt (excluding the convertible bond) fell in the year under review by over €100 million to just €15.7 million.

DEUTZ Group: Summary cash flow statement (simplified)

	2005	2004
€ million		
Earnings before interest and tax (EBIT)	114.7	18.5
Cash flow from operating activities	143.4	111.9
Capital expenditure on intangible assets, property, plant and equipment and investments	-83.5	-53.8
Cash receipts from the sale of businesses and proceeds from the sale of non-current assets	85.0	3.6
Cash flow from investing activities	1.5	-50.2
Cash flow from financing activities	-104.7	-78.9
Change in cash and cash equivalents	40.2	-17.2

The growth in earnings and net assets is reflected in the cash flow statement. The clear increase of €31.5 million to €143.4 million in cash provided by operating activities mainly arose from the reduction in working capital as well as from the significant operating profit.

Cash flow from investing activities amounted to €1.5 million compared with a cash flow figure of minus €50.2 million in 2004. The high level of investment in intangible assets, property, plant and equipment and financial investments could be fully financed with disinvestments, in particular the sale of the marine service business.

Cash flow from financing activities amounted to minus €104.7 million (2004: minus €78.9 million), due for the most part to a reduction in borrowing of around €94 million.

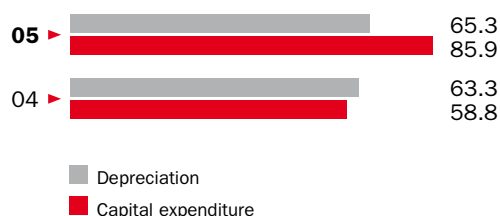
The level of cash and cash equivalents rose by €40.6 million to €48.4 million after the planned redemption of the non-current bank loan and the repayment of the short-term working capital loan.

Capital expenditure

In 2005, capital expenditure, including capitalised development costs, amounted to €85.9 million. This amount comprised intangible assets of €31.6 million, property, plant and equipment of €53.7 million and financial investments of €0.6 million. This compared with a total of €58.8 million including capitalised development costs in 2004, comprising intangible assets of €28.8 million, property, plant and equipment of €27.1 million and financial investments of €2.9 million. The capital expenditure in the year under review included €18.3 million on capitalised development costs, compared with €15.8 million in 2004.

€80.7 million (2004: €56.5 million) was invested in compact engines. Much of this investment was concentrated in the new assembly hall for the TCD 2013 series at the Cologne-Porz plant; the hall became operational during the year under review. In connection with this development, component production at the Cologne-Deutz and Zafra, Spain, sites was expanded. Further expenses arose in relation to the procurement of state-of-the-art machine tools and the further development of the engine range to take into account future exhaust emission standard stages.

DEUTZ Group: Capital expenditure and depreciation
€ million



In the DEUTZ Power Systems segment, capital expenditure amounted to €5.2 million (2004: €2.3 million). This expenditure was mainly focussed on infrastructure improvements to optimise material flow and the quality system, and on the procurement of new test benches.

Research and development

The business environment in which international engine manufacturers have to operate is characterised by the need to comply with exhaust emission standards. As a result of legislation in Europe and North America, these regulations are becoming increasingly stringent. In addition, the trend in technological development is towards engines that are increasingly powerful, quieter and cleaner, but at the same time consume as little fuel as possible. This requires new technologies, in particular to lower exhaust emission values within the space of a short development cycle.

High research and development ratio DEUTZ has accepted these challenges and has instigated considerably more intensive research and development (R&D) in the last few years. Total expenditure in 2005 was €66.9 million, representing a slight shortfall on the 2004 level (2004: €69.5 million). The ratio of R&D expenditure to sales in new engine business was 6.6 per cent compared with 7.7 per cent in 2004.

R&D expenditure in the Compact Engines segment amounted to €55.9 million (2004: €55.3 million). The ratio to new engine sales was therefore 6.7 per cent (2004: 7.5 per cent). In the DEUTZ Power Systems segment, €11.0 million was spent on R&D compared with €14.2 million in 2004. The ratio to new engine sales was 6.2 per cent compared with 9.0 per cent in 2004. The drop in this ratio is attributable to the loss of R&D activities in new engine business in the Marine application segment business. At the same time, R&D activities relating to gas engines were intensified during the year under review.

DEUTZ Group: Research and development expenditure
€ million



Key areas of development In the year under review, 435 employees were engaged in research and development activities at the Cologne and Mannheim plants in Germany and at Dursley in the United Kingdom. The key areas of activity were projects relating to the requirements of the new exhaust emission legislation. Important preliminary work was carried out in 2005 for several series production start-ups due in 2006. In addition to work on the newly developed TCD 2013 commercial vehicle engine, this preliminary work also involved the further development of series engines with lower output ratings in the Mobile Machinery, Automotive and Agricultural Machinery application segments.

Activities were also concentrated on optimising the combustion process, the introduction of the new DEUTZ Common Rail system for diesel injection and low-cost technical solutions for the reduction of exhaust gas emissions. In the year under review, DEUTZ was also involved in collaborative research projects, for example, relating to innovative filter materials for secondary exhaust gas emission treatment and strategies for monitoring and regeneration in future particle filter systems. Ongoing development focusses on the optimisation of existing systems in terms of the use of alternative fuels and a further reduction in fuel consumption. In addition, ongoing work is done on enhancing the performance and efficiency of engines, improving quality and lowering manufacturing costs.

Large number of industrial property rights The industrial property rights held by the DEUTZ Group provide testimony to the innovative strength of the company. In the year under review, a total of 32 inventions were filed as patent applications. 26 of these applications were in Germany, and six abroad. At the end of 2005, the company held a total of 394 patent applications, patents and utility models, 214 of which were in Germany, and 180 abroad.

Procurement and production

Intensification of global sourcing The optimisation of procurement by means of global sourcing and improvements in co-operation with suppliers continued to be consequently pursued. During the year under review, one of the greatest challenges was that presented by the increase in the price of raw materials. The sharp increase in raw material prices had a significant impact on material costs in DEUTZ via the cost of components. The heaviest pressure came from the price of foundry steel scrap, which more than doubled within a few months up to the end of the first quarter of 2005. Part of the negative impact was offset by intensifying global sourcing. In following a globally oriented purchasing strategy, the volume of US dollar-denominated purchasing was also increased. The objective in doing this is to reduce currency risk on the sales side with the assistance of natural hedging.

Cologne production facility expanded DEUTZ maintains production facilities in both Germany and abroad. The Cologne-Porz plant manufactures engine series with a power output range of 11 to 253 kW. This facility was substantially expanded during the year under review. In 2004 and 2005, assembly and production capacity was expanded at a cost of €50 million solely to accommodate the new TCD 2013 compact engine series. At the core of this investment is a new assembly hall with a capacity of up to 30,000 engines in the first phase of expansion. As a result of this development, annual capacity at Cologne-Porz has been increased to 210,000 engines. Engine assembly at the second engine facility in Cologne-Deutz has been concentrated in the last few years exclusively on air-cooled engine series with an output range of 24 to 149 kW. In the year under review, the previous annual capacity of some 50,000 engines was expanded by approximately 20,000 engines with the addition of an assembly line for the two new 2008 and 2009 liquid-cooled engine series in the lower output range of 9 to 50 kW. In addition to assembling engines, the Cologne plants also manufacture crankcases, camshafts, crankshafts and pipes for compact engine assembly.

The Ulm plant assembles liquid-cooled and air-cooled engines with power outputs from 114 to around 500 kW. Ulm also carries out mechanical fabrication of crankcases, crankshafts and various other components. Capacity is around 10,000 engines a year.

The Herschbach facility functions as the internal engine component supplier for the Group. Activities focus on the machining of aluminium, steel and cast-iron parts.

The Spanish plant at Zafra has an important function in the network of production locations as a supplier of components such as cylinder heads, conrods and gearwheels. The components are delivered to the German assembly lines as preassembled items ready for installation. In addition, the plant also produces a small number of air-cooled engines with an output range of 4 to 42 kW for special requirements and markets.

Production system successfully expanded A new production system for compact engines was set up in 2003. Under this system, the entire process chain from the receipt of goods through to the delivery of completed engines was integrated into a standard management system. Since its introduction, the system has been expanded continuously. In 2005, attention was concentrated on the order centre, bringing together the planning for sales, assembly and materials. This system makes a considerable contribution to enhancing productivity and quality, increasing delivery reliability and lowering inventory levels.

Mannheim focusses on gas engines The Mannheim site focusses for the most part on the production of gas engines with outputs up to 4,000 kW. It also manufactures diesel engines for stationary applications, as required. Mechanical fabrication includes crankcases, cylinder heads and conrods for in-house engine production requirements. Capacity is currently around 600 units a year.

Employees

Fall in number of employees At the end of 2005, DEUTZ employed 5,058 people worldwide. This amounts to 414 fewer employees (7.6 per cent) than in 2004 (5,472 employees). The reduction is mainly down to the sale of the marine service business. 181 employees were transferred to the purchaser, Wärtsilä, as part of the sale arrangements. In addition, the workforce was reduced by a further 162 employees as a result of restructuring at the Mannheim plant of DEUTZ Power Systems. The reduction in the number of subsidiaries also contributed to the decline in employee numbers.

The number of employees in Germany sank to 4,035 (2004: 4,284), and in other countries to 1,023 (2004: 1,188). In the year under review, an average of 114 persons were employed under temporary employment agreements – a contribution to more flexible employment arrangements for the deployment of personnel in production and assembly. At the end of 2005, the total number of employees in the Compact Engines segment was 3,998 (2004: 4,048), and in the DEUTZ Power Systems segment, 1,060 (2004: 1,424).

DEUTZ consistently attaches great importance to in-house vocational apprenticeships to ensure that the necessary skilled workforce will be available in the future. At the end of 2005, 194 young persons were in such an apprenticeship at DEUTZ in Germany (2004: 201). This means that the ratio of apprenticeships to the number of German employees rose to 4.8 per cent (2004: 4.7 per cent). Seven technical trades and four commercial occupations are available under the scheme. In 2005, all apprentices passing the final examination were given a fixed-term employment contract.

We also gave our attention to the systematic selection, promotion and development of young executive talent for assignment to demanding responsibilities in management and other specialist areas. University graduates are involved in hands-on projects as part of our training programmes and are supervised by mentors during the entire training period. In the year under review, seven new trainees were taken on. A large number of employees also took part in in-house professional development activities. The high level of commitment on the part of our employees was also evident in the 581 improvement ideas submitted during 2005.

Advances in occupational pension schemes One of the main topics during the year under review was the acceleration in the development of occupational pension schemes. With the support of the experts from outside the company, the number of employees entering into an occupational pension scheme was increased from 6 per cent of the workforce to 22 per cent at the end of the year. DEUTZ paid employees a contribution of up to 9 per cent, depending on the gross annual income of the employee concerned.

DEUTZ Group: Staff costs

	2005	2004
€ million		
Wages	111.9	116.9
Salaries	135.0	131.0
Social security contributions	50.2	51.5
Cost of severance payments and post-employment benefits	4.0	12.6
DEUTZ Group	301.1	312.0

DEUTZ Group: Employees

	31 Dec. 2005	31 Dec. 2004
Number		
DEUTZ Group	5,058	5,472
thereof		
Germany	4,035	4,284
Outside Germany	1,023	1,188
thereof		
Non-salaried employees	2,836	3,077
Salaried employees	2,028	2,194
Apprentices	194	201
thereof		
Compact Engines ¹⁾	3,998	4,048
DEUTZ Power Systems ¹⁾	1,060	1,424

¹⁾ incl. apprentices

DEUTZ Group: Breakdown of employees by location

	31 Dec. 2005	31 Dec. 2004
Number		
Cologne	2,607	2,599
Mannheim	667	830
Ulm	354	363
Other German locations	407	492
Germany	4,035	4,284
Outside Germany	1,023	1,188
Total	5,058	5,472

Environment

Further development in environmental management system

There was further development of the environmental management system in accordance with DIN EN ISO 14001 at the Cologne-Porz facility during 2005. This standard is met by all production installations with relevance to the environment, and by buildings and energy management. Since 2005, the compact engines training centre has also met the requirements of the standard. There is continuous, constructive dialogue between the supervising authorities and DEUTZ AG. Thus rapid implementation of legal requirements is ensured and production risks are minimised.

Important targets achieved Under the environmental targets DEUTZ has set for itself, waste was avoided, air exhaust emissions were reduced and water pollution control improved. An environmental programme has been created, focusing on these targets. Using an internal control system, implementation of the programme is monitored at regular intervals resulting in a continuous improvement process.

In 2005, a significant improvement was made to the process for the spraying of compact engines. A cool paint procedure was introduced, as a result of which 40 to 50 per cent of the overspray is recovered. In addition, environmentally friendly water-based paint is used. The consequence is a considerable drop in waste disposal costs and paint consumption. New tank storage facilities supply fuel to the test benches in the R&D department at Cologne-Porz. In addition, throughput and testing times for compact engines were optimised, thereby reducing exhaust emissions to the necessary minimum and generating savings in energy.

The total expenditure on environmental protection and health and safety amounted to €6.3 million in 2005. This compares with €6.5 million in 2004.

Results of operations for DEUTZ AG

The annual financial statements of DEUTZ AG are drawn up in accordance with the requirements of the German Commercial Code (HGB) and the German Companies Act (AktG). In 2005, DEUTZ AG generated sales of €987.9 million (2004: €1,099.1 million). Profit from ordinary activities was €21.4 in million (2004: €28.9 million). Including an extraordinary item of €46.1 million (2004: minus €35.0 million), and after taxes, this produced a net income for the year of €55.3 million (2004: net loss for the year of €8.8 million). This reduced the loss carried forward by DEUTZ AG from €76.9 million to €21.6 million. This brought DEUTZ AG considerably closer to being able to resume the payment of dividends.

DEUTZ AG: Income statement

	2005	2004
€ million		
Sales	987.9	1,099.1
Profit from ordinary activities	21.4	28.9
Net extraordinary income/expenses	46.1	-35.0
Income taxes	-11.8	-2.2
Other taxes	-0.4	-0.5
Net income/loss	55.3	-8.8
Loss carried forward	-76.9	-68.1
Accumulated loss	-21.6	-76.9

The financial statements of DEUTZ AG were given an unqualified opinion by PricewaterhouseCoopers AG. They are published in the German Federal Gazette and lodged with the commercial register of the local court in Cologne, Germany. They can be requested from DEUTZ AG and are available on the DEUTZ AG 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 Companies Act (AktG). This report covered relationships of DEUTZ Group companies with the Same 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.”

Risk report

Risk management system DEUTZ operates in a number of applications segments worldwide and manages its business through its own subsidiary companies, service centres, sales offices and authorised dealers. As a result, the company is exposed to various risks specific to its business and to the regions in which it operates.

The prime corporate goal is to achieve a sustainable profit, so that the company can continue to develop and enjoy a secure future. The achievement of this goal requires the early recognition and measurement of risks, together with the 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 the Risk Management Committee that has been set up for reporting purposes, ensure that all major risk areas are documented and communicated, and that appropriate countermeasures are taken and followed up at an early stage.

As part of a regular risk inventory, 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. 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 2005.

Unit sales risks In recent years, DEUTZ has consistently expanded its market position in growth regions and segments, entered into close co-operation with major customers and focussed its DEUTZ Power Systems segment on gas engines for decentralised power generation in order to protect itself against unit sales risks. 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 on 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 engine series and engine types. In the last few years, a rationalisation of production has also reduced the risk of underutilising capacity. This rationalisation has been achieved with the outsourcing of the foundry and a focus on core competencies. Production peaks are smoothed out by subcontracting some production activity to third-party providers.

IT risks DEUTZ pursues an IT strategy throughout the Group based on a standardised IT infrastructure. The regular updating of hardware and software to the latest technological standard and co-operation with external service providers enable the company to control the risks inherent in IT. Following migration of the main computer systems in DEUTZ AG to SAP R/3 software at the start of 2004, the necessary work then commenced in the subsidiaries and associated companies. This work is being carried out in stages and is planned to be completed by the end of 2006. This will create a complete, standardised software platform throughout the DEUTZ Group in line with the latest technological standard.

Organisational risks To reduce organisational risks, head office departments in DEUTZ AG and DEUTZ Power Systems GmbH & Co. KG support the individual sales departments. Together with the necessary guidelines, the organisational amalgamation of central functions and services across all locations and segments ensures uniform procedures throughout the company in its various functional areas.

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 risks Quality assurance in all plants and areas of the company is based on a sophisticated centralised quality system. Sources of errors and defects are systematically analysed, production processes optimised and action taken to minimise the risk in serial production start-ups. This means that warranty risks are reduced. In addition, uniform standards have been introduced for the selection of suppliers, as well as process audits for improving supplier quality. Over the past few years, these quality activities have led to a significant reduction in the costs of errors and defects.

Financial risks To minimise financial risk, financial planning is carried out annually with regular analysis of variances during the course of the year. DEUTZ works with leading banks to ensure the availability of loan financing. Overall, the Group enjoys sufficient lines of credit and was in fact able to implement significant reductions in 2005 compared to previous years. This was made possible by the profits achieved, the successful measures to reduce working capital and the cash inflow from the sale of the marine service business. The overall result is an increase in financial flexibility that can be used to support future corporate strategy.

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 was the convertible bond issued in 2004, paying interest of 3.95 per cent for a term of five years.

Procurement risks The procurement of components, preliminary products 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 thoroughly checked.

Legal 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 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.

Risks from litigation were to a large extent eliminated in 2005. 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.

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.

Other tax risks The latest external tax audit is still currently in progress and covers the period from 1998 to 2001. The final report of the tax auditor is not yet available. As things stand, the company is not expecting any material risks.

Outlook

Global economic upturn continues Despite the high price of crude oil, the upturn in the global economy is expected to continue in 2006. In addition to the USA, the main drivers of this growth remain the Asian countries, among which China is to the fore. Given the strong demand in these regions, economic experts are predicting an increase in investing activities in Western Europe, resulting in an acceleration in economic growth. In Germany, the beneficiaries of these conditions will be exporting companies, leading to a sharp rise in investment in machinery and equipment. Overall, however, domestic demand is expected to remain sluggish owing to the loss of purchasing power, itself a consequence of the high energy prices. Growth in gross domestic product in Germany for 2006 is forecast to exceed that achieved in 2005, mainly on the back of the rise in exports.

Above-average growth in relevant markets Against the background of strong growth in the global economy, the outlook for German engineering companies is favourable. The German Engineering Federation (VDMA) is forecasting that the companies in its sector will increase production in 2006 by two per cent to reach a new record level.

DEUTZ anticipates good levels of growth in markets relevant to its business. The non-captive market for diesel-powered industrial engines is likely to grow at an average of 6 per cent a year up to 2007. However, growth in individual regions will vary somewhat. Only 3 per cent growth is expected in the American off-road market. 4 per cent is forecast for Europe/Africa and the Middle East. Asia will achieve growth of as much as 9 per cent as a result of the strong demand in China.

In the decentralised power generation business using gas engines, DEUTZ anticipates global market growth of between 5 and 8 per cent. Growth in South East Asia and in the countries of the former Soviet Union is expected to be at the top end of the scale, whereas that for North America and Europe is more likely to be at the lower end. Business in Germany will receive a boost from the German Renewable Energy Sources Act. At a global level, growth in the next few years in application segments based on renewable energy sources, mainly those involving biogas, is expected to be around the 10 per cent mark.

Capital and R&D expenditure at a high level 2006 will see yet further intensification of capital spending activity. This will be concentrated on machinery required for the market launch of engines complying with the Stage 3 exhaust emission standards in Europe and the USA and offering power output in the range of 130 to 560 kW. Further capital spending

will be focussed on preliminary work related to the market launch on 1 January 2007 of engines with output of 75 to 130 kW. R&D expenditure is expected to remain at the high level seen in 2005.

Further increase in sales Assuming conditions remain the same, DEUTZ is expecting an increase in sales in 2006 of between 3 and 6 per cent. A certain amount of uncertainty is being caused by the volatility in prices for raw materials. Among other activities to reduce the associated risks, DEUTZ is driving forward its global sourcing programme. This includes expansion of the supplier network in low-cost countries for the procurement of certain engine series and components. The Management Board has assumed that the level of raw material prices at the end of 2005 will continue to prevail in 2006.

Increase in EBIT margin anticipated The growth in operating profit is expected to continue in 2006, and the EBIT margin is forecast to rise even further in 2007. The largest contribution to earnings will in turn come from the compact engines segment. In DEUTZ Power Systems, the focus on decentralised power generation has already borne its first fruit in 2005 – rather faster than expected. On this basis, further improvements in operating profit are forecast in this segment for 2006.

On target for dividends The medium-term financial targets up to 2008 are an EBIT margin of 7 per cent and a return on capital employed (ROCE) of 12 per cent. The goal for 2007 is to be able to distribute a dividend again for the first time for over 20 years.

This management report includes certain statements about future events and developments, together with details 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) to 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.

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Consolidated Financial Statements

Income statement of the DEUTZ Group

	Note	2005	2004
€ million			
Sales	1	1,322.8	1,242.3
Changes in inventories and other own work capitalised	2	-1.7	16.2
Other operating income	3	126.7	49.2
Cost of materials	4	-787.9	-734.5
Staff costs	5	-301.1	-312.0
Depreciation and amortisation	6	-58.6	-59.8
Impairment	6	-6.7	-3.5
Other operating expenses	7	-183.3	-183.8
Gains on investments measured at equity	8	3.3	3.3
Other investment income	8	1.2	1.2
Adjustments on non-current financial assets	8	-	-0.1
EBIT		114.7	18.5
thereof one-off items	9	52.2	-35.0
thereof operating profit (EBIT before one-off items)		62.5	53.5
Interest expenses, net	10	-28.5	-33.4
thereof financial expenses		-30.6	-35.2
Other taxes	11	-1.5	-1.6
Net income/loss before income taxes		84.7	-16.5
Income taxes	11	-13.3	-2.2
Net income/loss		71.4	-18.7
thereof minority interest		-0.2	-0.2
thereof attributable to the shareholders of the parent enterprise		71.6	-18.5
Earnings per share	12		
Earnings per share, undiluted, in €		0.77	-0.21
Earnings per share, diluted, in €		0.62	-

Balance sheet of the DEUTZ Group

Assets

	Note	31/12/2005	31/12/2004
€ million			
Property, plant and equipment	13	360.5	363.7
Intangible assets	14	94.9	74.8
Financial assets measured at equity	15	13.1	11.7
Other financial assets	16	10.7	12.3
Fixed assets		479.2	462.5
Deferred tax assets	17	56.5	52.9
Non-current assets		535.7	515.4
Inventories	18	214.6	244.2
Non-current assets held for sale	19	2.4	–
Trade receivables	20	189.2	213.1
Other receivables and assets	17/20	73.5	48.6
Cash and cash equivalents	21	48.4	7.8
Current assets		528.1	513.7
Total assets		1,063.8	1,029.1

Equity and liabilities

Issued capital		242.9	233.0
Additional paid-in capital		20.1	18.0
Other reserves		1.6	-3.3
Net income/loss		71.6	-18.5
Loss carried forward		-89.8	-71.3
Equity attributable to the shareholders of the parent enterprise (DEUTZ Group's interest)		246.4	157.9
Minority interest		0.6	0.8
Equity	22	247.0	158.7
Provisions for pensions and other post-retirement benefits	23	283.6	290.6
Deferred tax provisions	17/23	0.7	0.2
Other provisions	23	42.4	34.1
Financial liabilities	24	114.2	164.7
Other liabilities	24	1.9	0.5
Non-current liabilities		442.8	490.1
Provisions for pensions and other post-retirement benefits	23	26.8	27.3
Provision for current income taxes	17/23	8.3	0.1
Other provisions	23	70.7	53.6
Financial liabilities	24	23.9	75.5
Trade payables	24	165.7	143.2
Other liabilities	24	78.6	80.6
Current liabilities		374.0	380.3
Total equity and liabilities		1,063.8	1,029.1

Statement of changes in equity

	Issued capital	Additional paid-in capital	Fair value reserve ^{1), 2)}	Currency translation adjustment ¹⁾	Accumu- lated loss/ loss carried forward	DEUTZ Group's interest	Minority interest	Total
€ million								
Balance at 1/1/2004	233.0	11.1			-71.3	172.8	1.0	173.8
Premium on the issue of convertible bonds		6.9				6.9		6.9
Accumulated other comprehensive loss			-0.2 ³⁾	-3.1		-3.3		-3.3
Net loss					-18.5	-18.5	-0.2	-18.7
Sum of net loss and accumulated other comprehensive loss			-0.2	-3.1	-18.5	-21.8	-0.2	-22.0
Balance at 31/12/2004	233.0	18.0	-0.2	-3.1	-89.8	157.9	0.8	158.7
Increase due to exercise of conversion rights on convertible bonds	9.9	2.1				12.0		12.0
Accumulated other comprehensive income			-1.1 ³⁾	6.0		4.9		4.9
Reversal in net income			0.0 ⁴⁾			0.0		0.0
Net income					71.6	71.6	-0.2	71.4
Sum of net income and accumulated other com- prehensive income			-1.1	6.0	71.6	76.5	-0.2	76.3
Balance at 31/12/2005	242.9	20.1	-1.3	2.9	-18.2	246.4	0.6	247.0

¹⁾ These items are aggregated as "Other reserves" on the face of the balance sheet.

²⁾ Reserve from the measurement of cash flow hedges and reserves from the measurement of available-for-sale financial assets.

³⁾ See Note 22 of the notes to the consolidated financial statements for further details.

⁴⁾ Less than €50,000.

Cash flow statement of the DEUTZ Group

Notes to the cash flow statement: see note 29

	2005	2004
€ million		
Earnings before interest and tax (EBIT)	114.7	18.5
Interest income	1.3	1.1
Other taxes paid	-1.5	-1.6
Income taxes paid	-7.2	-1.4
Depreciation, amortisation and impairment of non-current assets	65.3	63.4
Gains/losses on the sale of businesses	-67.0	-
Gains/losses on the sale of non-current assets	0.5	0.2
Gains/losses on measurement at equity	-0.3	-2.0
Other non-cash income and expenses	-15.2	-21.5
Change in inventories	26.1	-2.6
Change in receivables and other assets	15.0	12.7
Change in current provisions and liabilities (excl. financial liabilities)	10.4	51.3
Change in non-current provisions and liabilities (excl. financial liabilities)	1.3	-6.2
Cash flow from operating activities	143.4	111.9
Capital expenditure on intangible assets and property, plant and equipment	-83.1	-52.4
Capital expenditure on investments	-0.4	-1.4
Cash receipts from the sale of businesses	82.8	-
Proceeds from the sale of non-current assets	2.2	3.6
Cash flow from investing activities	1.5	-50.2
Interest expenses	-10.9	-14.7
Cash receipts from borrowings	112.9	100.1
Repayment of loans	-206.7	-229.7
Cash receipts from convertible bonds	-	65.4
Cash flow from financing activities	-104.7	-78.9
Cash flow from operating activities	143.4	111.9
Cash flow from investing activities	1.5	-50.2
Cash flow from financing activities	-104.7	-78.9
Change in cash and cash equivalents	40.2	-17.2
Cash and cash equivalents on 1 January	7.8	25.1
Change in cash and cash equivalents	40.2	-17.2
Exchange rate-related change in cash and cash equivalents	0.4	-0.1
Cash and cash equivalents on 31 December	48.4	7.8

Segment reporting in the DEUTZ Group

Notes to the segment reporting: see note 30

Segments	Compact Engines		DEUTZ Power Systems	
	2005	2004	2005	2004
€ million				
Sales	999.7	909.9	323.1	332.4
Intersegment sales	9.4	0.7	0.6	–
Total sales	1,009.1	910.6	323.7	332.4
Total depreciation, amortisation and impairment	53.5	51.7	11.8	11.6
thereof depreciation and amortisation	53.5	51.7	5.1	8.1
thereof impairment	–	0.3	6.7	3.5
thereof reversal of impairment losses	–	-0.3	–	–
Segment EBIT before one-off items⁴⁾	56.4	54.2	12.0	13.1
Segment earnings as defined by IFRS	54.9	54.0	62.0	-23.2
Net income/loss				
Segment assets	691.9	691.1	238.5	247.7
Segment liabilities	490.3	464.5	128.9	111.1
Segment capital expenditure	80.7	56.5	5.2	2.3
Material non-cash expenses (excl. depreciation)	11.7	4.7	34.8	20.1
Net gain on measurement at equity	1.4	1.6	1.9	1.7
Carrying amount of investments in enterprises measured at equity	4.2	3.9	8.9	7.8

⁴⁾ Including measurement at equity, net investment income and gains/losses on the sale of investments.

Regions	Sales from external customers		Segment assets		Capital expenditure	
	2005	2004	2005	2004	2005	2004
€ million						
Europe	881.3	824.9	847.2	867.0	84.9	56.8
Africa	44.3	45.3	8.2	10.9	–	0.6
Europe/Africa	925.6	870.2	855.4	877.9	84.9	57.4
Americas	193.2	160.3	51.4	36.4	0.6	1.3
Asia-Pacific	140.0	136.5	25.8	30.3	0.4	0.1
Middle East	64.0	75.3	–	–	–	–
Total	1,322.8	1,242.3	932.6	944.6	85.9	58.8

	Other		Segments in total		Reconciliation/consolidation		DEUTZ Group	
	2005	2004	2005	2004	2005	2004	2005	2004
	–	–	1,322.8	1,242.3	–	–	1,322.8	1,242.3
	–	–	10.0	0.7	–	–	10.0	0.7
	–	–	1,332.8	1,243.0	–	–	1,332.8	1,243.0
	–	–	65.3	63.3	–	–	65.3	63.3
	–	–	58.6	59.8	–	–	58.6	59.8
	–	–	6.7	3.8	–	–	6.7	3.8
	–	–	–	-0.3	–	–	–	-0.3
	-5.9	-13.8	62.5	53.5	–	–	62.5⁴⁾	53.5⁴⁾
	-7.2	-15.0	109.7	15.8	5.0	2.7	114.7⁴⁾	18.5⁴⁾
					-38.3	-34.5	71.4	-18.7
	2.2	5.8	932.6	944.6	131.2	84.5	1,063.8	1,029.1
	50.2	54.2	669.4	629.8	394.4	399.3	1,063.8	1,029.1
	–	–	85.9	58.8	–	–	85.9	58.8
	2.5	4.7	49.0	29.5	–	–	49.0	29.5
	–	–	3.3	3.3	–	–	3.3	3.3
	–	–	13.1	11.7	–	–	13.1	11.7

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 Deutz-Mülheimer Strasse 147–149 in Cologne, Germany, and the company is entered under no. HRB 281 in the commercial register at the local court in Cologne.

The shares of DEUTZ AG are listed for official trading on the stock exchanges in Frankfurt and Düsseldorf, where they are listed in the SDAX small-cap segment.

DEUTZ is an independent manufacturer of diesel-powered and gas-powered engines. Its core competence is the development, design, assembly and sale of liquid-cooled and air-cooled engines, together with the manufacture of decentralised power generation plants. The Group's activities are divided into two segments: Compact Engines and DEUTZ Power Systems.

1.2 Accounting standards

The consolidated financial statements of DEUTZ AG for the 2005 financial year have been prepared for the first time in accordance with the International Financial Reporting Standards (IFRS) applicable throughout the European Union as at 31 December 2005. The IFRS comprise the IFRS promulgated by the International Accounting Standards Board (IASB), the International Accounting Standards (IAS), and 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 (Handelsgesetzbuch, 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 Companies Act (Aktiengesetz, AktG) have been applied. The Group management report as at 31 December 2005 has been prepared in accordance with the HGB.

The recognition and measurement rules described below have been consistently applied. The figures for the previous year have also been calculated based on the standards and interpretations adopted as at 31 December 2005. 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 2005) and are based on uniform recognition and measurement rules.

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 recognition and measurement rules. The International Financial Reporting Standards (IFRS) that were binding throughout the European Union at the balance sheet date have been adopted. The standards that are not yet binding are not expected to have any material impact on the consolidated financial statements.

Prematurely adopted standards, amendments and interpretations

DEUTZ adopted the following amendments to standards and interpretations before they came into force on 1 January 2006:

The amendment to IAS 39 "Financial Instruments: Recognition and Measurement": "Cash Flow Hedge Accounting of Forecast Intergroup Transactions" published by the IASB. The adoption of this amendment has had no material impact on the DEUTZ Group's consolidated financial statements.

Standards, amendments and interpretations that have been published but have yet to be adopted

The sections below describe adopted innovations and amendments of accounting standards that have not been adopted before they come into force:

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 adopted 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 adopted 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 financial position, financial performance or cash flows.

The interpretation in IFRIC 4 "Determining whether an Arrangement Contains a Lease" was adopted in December 2004. This must be applied to financial years commencing on or after 1 January 2006. IFRIC 4 states when agreements must be recognised under IAS 17 "Leases", even if they are not

described as such. This standard states that agreements fall within the scope of IFRIC 4 if their performance is dependent on the use of a certain asset and if, at the same time, they transfer to control its use. DEUTZ has decided not to apply this interpretation for the time being. It has yet to be decided when this interpretation will be adopted for the first time. Any adoption is not expected to have any material impact.

The amendment to IAS 19 “Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures” (which came into force on 1 January 2006) allows a further option. Actuarial gains and losses can be reported in full as accumulated other comprehensive income/loss in the period in which they occur. DEUTZ does not intend to utilise this option.

Further changes arising from the amendment to IAS 19 concern the notes to the consolidated financial statements. These have no impact on DEUTZ’s financial position, financial performance or cash flows.

The amendment to IAS 39 “The Fair Value Option” (which came into force on 1 January 2006) restricts the option to measure assets at fair value. DEUTZ does not utilise this option because its adoption would not be expected to have any material impact.

The amendment to IAS 21: “The Effects of Changes in Foreign Exchange Rates: Net Investment in a Foreign Operation” (which came into force on 1 January 2006) states that certain monetary assets and liabilities relating to a foreign operation should be seen as part of the net investment in this operation and that any resultant exchange differences should initially be reported as accumulated other comprehensive income/loss. An investigation of the effects of DEUTZ adopting this amendment has yet to be completed. However, its adoption would be unlikely to have any material impact.

DEUTZ decided not to adopt the amendments to IAS 39 and IFRS 4: “Financial Guarantee Contracts” before they came into force on 1 January 2006. Any adoption before this date would not have had any material impact on DEUTZ’s financial reporting.

DEUTZ has not adopted the following standards and interpretations:

- IFRS 6: Exploration for and Evaluation of Mineral Resources (which came into force on 1 January 2006)
- IFRIC 5: Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (which came into force on 1 January 2006)

- IFRIC 7: Applying the Restatement Approach under IAS 29 (which came into force on 1 March 2006)
- IFRIC 8: Scope of IFRS 2 (which came into force on 1 May 2006)
- IFRIC 9: Reassessment of Embedded Derivatives (coming into force on 1 June 2006).

Even if these standards and interpretations were adopted prematurely, however, they would be unlikely to have any effect on DEUTZ’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 notes to the income statement and the notes to the balance sheet. They essentially relate to pension provisions, doubtful accounts receivable, deferred tax assets on losses carried forward, the determination of assets’ economic life and the accrual of provisions for pending or imminent litigation. 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 have been approved for publication by resolution of the Management Board on 31 March 2006 and the consent of the Supervisory Board on 27 April 2006.

1.6 Explanation of the effects of the transition to international accounting standards

IFRS accounting

The consolidated financial statements have been prepared for the first time in accordance with IFRS under the rules of IFRS 1. DEUTZ AG has prepared the opening balance sheet as at 1 January 2004 in accordance with the IFRS applicable at 31 December 2005. In some cases, exemptions from this principle granted by IFRS 1 have been utilised in the preparation of the opening balance sheet. The recognition, measurement and consolidation methods previously used to prepare the consolidated financial statements of DEUTZ AG in accordance with the German Commercial Code (HGB) have therefore been modified in some cases.

The effects of the first-time adoption of IFRS (based on IFRS 1: First-time Adoption of IFRS) are presented in the reconciliation. 1 January 2004 has been chosen as the transition date.

Effects of the transition from HGB to IFRS

Reconciliation of equity and net loss for 2004

The transition to IFRS modified equity as at 1 January 2004 and 31 December 2004 and the net loss reported for 2004 as shown in the table below.

The starting point for the reconciliation of equity is the equity according to HGB at the respective balance sheet date.

	1/1/ 2004	31/12/ 2004	Net loss for 2004
€ million			
Equity as defined by the HGB	169.7	155.6	-18.6
Discontinuation of the capitalisation of expenses for the expansion of operations	-26.6	-35.7	-9.1
Differences in measurement of property, plant and equipment	2.1	2.6	0.5
Recognition of leases on equipment and buildings	-1.0	-1.0	–
Capitalisation of internally produced intangible assets	40.1	50.3	10.2
Capitalisation of deferred taxes on losses carried forward	37.3	37.3	–
Recognition of other deferred taxes	18.4	18.9	0.5
Remeasurement of inventories	-0.2	1.6	1.8
Change in adjustments on receivables	1.1	0.9	-0.2
Fair value of financial instruments	1.4	0.1	-1.1
Remeasurement of provisions for pensions and other post-retirement benefits	-48.9	-48.1	0.8
Measurement of profit-sharing rights	6.4	4.6	-1.8
Measurement of convertible bonds	–	1.8	1.8
Remeasurement of other provisions	2.8	-0.1	-2.9
Changes in the scope of consolidation	-29.2	-29.4	-0.2
Other changes in measurement	0.4	-0.7	-0.4
Equity as defined by IFRS	173.8	158.7	-18.7

The cumulative exchange differences computed under HGB have been restated as zero. Exchange differences have not been retroactively recalculated under IAS 21.

Findings that might have caused the estimates made under HGB rules to be amended have not been recognised.

The adjustments made under IFRS relate to the following items:

- **Expenses for the expansion of operations**

The capitalisation of expenses for the expansion of operations relating to the development of the Commercial Vehicles market segment, which is allowed under the HGB, is not permitted under IFRS. Where the conditions of IAS 38 were met, the capitalisable development costs included in these expenses have been recognised as internally generated development costs under intangible assets.

- **Property, plant and equipment**

Low-value assets, which were previously written off immediately, are now depreciated over five years.

- **Leases**

Leases are classified as either operating leases (which are reported on the lessor's balance sheet) or finance leases (shown on the lessee's balance sheet), as required by IAS 17. The financial obligations arising from the building lease held by a German subsidiary have been classified as a finance lease and reported as an asset on the balance sheet, and the resultant financial obligations have been recognised as a liability.

- **Intangible assets**

As required by IAS 38, this item essentially comprises the cost of developing and refining engines with respect to exhaust emission levels 2, 3 and EURO 4 and of enhancing the 2008/2009 engine series.

- **Deferred taxes**

The balance sheet-based approach of IAS 12 has been adopted for the recognition of deferred taxes. Under this method, deferred taxes have been recognised on temporary differences between the tax base and the IFRS carrying amount. The computation of deferred taxes under IAS 12 differs substantially from the income statement-based approach used under HGB. The most important differences between IFRS and HGB concern the obligation to capitalise deferred tax assets and deferred tax assets on tax losses carried forward where their utilisation is likely. Furthermore, temporary differences as defined by IAS 12 – in contrast to the HGB – include quasi-permanent differences, so that a broader basis of assessment is used for the recognition of deferred taxes under IAS 12.

- **Inventories**

Inventories have been remeasured owing to the discontinuation of the lower-of-cost-and-market rule, the ban on capitalising administrative overhead costs and an increase

in production overhead rates to bring them into line with IFRS standards.

- **Adjustments on receivables**

The general adjustments on receivables recognised under the HGB have been brought into line with the anticipated level of defaults based on historical data.

- **Fair value of financial instruments**

IAS 39 requires certain financial instruments to be measured at fair value. In the case of DEUTZ AG, these are derivatives used for hedging purposes such as interest-rate and currency hedges and embedded derivatives requiring bifurcation.

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

Pension provisions, which were previously recognised under the tax-based entry age normal method (sections 6a and 4d of the German Income Tax Act [EStG]), have been accounted for under the projected unit credit method prescribed by IAS 19 for defined-benefit pension schemes. This method takes account of future salary and pension increases as well as appropriate capital market interest rates. On the opening balance sheet, all actuarial gains and losses have been recognised as accumulated other comprehensive income/loss, and a pension provision that includes plan assets has been accrued in the amount of the actual benefit obligation. Subsequent actuarial gains and losses arising from discrepancies between anticipated and actual pension benefit obligations (experience-based gains and losses) and the change in measurement assumptions (assumptions-based gains and losses) are recognised in income over the anticipated residual service periods of active employees with vested pension rights in accordance with the corridor approach.

- **Profit-sharing rights**

The benefit accruing from the non-interest-bearing nature of profit-sharing rights, which is not recognised under the HGB, has been allocated as an equity instrument to additional paid-in capital under IFRS. Interest is accrued on the debt capital portion of profit-sharing rights at the historical market rate of 9% under the effective interest method.

- **Convertible bonds**

The transaction costs previously recognised as an expense under the HGB have been spread throughout the convertible bonds' term to maturity under IFRS. Furthermore, interest is accrued over the bonds' term to maturity under the effective interest method and recognised in income.

- **Other provisions**

The provisions recognised under the HGB have been reviewed to ensure that they constitute a current obligation to a third party and that they have been correctly measured and, where necessary, have been reclassified as liabilities. Non-current provisions have been recognised at their present value.

• Changes in the scope of consolidation

The adoption of the control concept prescribed by IFRS led to changes in the scope of consolidation. As required by SIC 12, Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf, has been consolidated as a special-purpose entity. The gains realised on the sale of land and buildings to the company under the HGB have been eliminated as intercompany profits.

Material differences between the IFRS and HGB cash flow statements

	2004	
€ million	IFRS	HGB
Cash flow from operating activities	111.9	92.9
Cash flow from investing activities	-50.2	-36.0
Cash flow from financing activities	-78.9	-74.6
Change in cash and cash equivalents	-17.2	-17.7

The main changes in the cash flow statement relate to changes in the reporting of development costs that can be capitalised under IAS 38 as part of cash flow from investing activities; they also concern interest payments as part of the cash flow from financing activities.

2. Scope 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 2005).

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% 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 four (2004: six) German enterprises and 11 (2004: 14) 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 – possess a majority of the opportunities and risks.

Having commenced business operations, DEUTZ Power Systems GmbH & Co. KG, Mannheim, has been consolidated for the first time.

The companies

- DEUTZ Beteiligungsverwaltung GmbH, Cologne,
- DEUTZ Grundstücksverwaltung GmbH, Cologne,
- DEUTZ Vermögensverwaltung GmbH, Cologne, and
- Industrie- und Rohrleitungsmontagen Koprek GmbH, Cologne,

have been merged with DEUTZ AG, Cologne, by transferring all their assets.

DEUTZ Austria GmbH, Vienna (Austria), was sold with effect from 1 January 2005. After DEUTZ Benelux NV, Antwerp (Belgium), and DEUTZ Canada Inc., Ville St. Laurent, Quebec (Canada), were sold or wound up in 2005, only their income and expenses for the year under review were included in the consolidated financial statements.

Associates are enterprises over which DEUTZ AG exerts a significant influence but does not have control. These are generally deemed to be enterprises in which DEUTZ AG holds between 20% and 50% of the voting rights. Three (2004: three) foreign enterprises have been consolidated according to the rules governing associates.

Page 87 of the annex to the notes to the consolidated financial statements lists the companies consolidated as part of the DEUTZ Group as at 31 December 2005. The full list of shareholdings is filed with the commercial register at the local court in Cologne (HRB 281).

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 recognition and measurement rules.

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 1 for opening balance sheets.

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 income is reported as investment income on the face of the income statement. If an associate's share of losses 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 income or loss – have been translated at the average rates for the year. Equity – with the exception of the net income 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 income or loss at average rates for the year are reported as accumulated other comprehensive income/loss. In 2005, €6.0 million (2004: €3.1 million) was added to equity.

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 rates		Closing rates 31 December	
		2005	2004	2005	2004
USA	1 USD	0.81	0.80	0.85	0.73
UK	1 GBP	1.46	1.47	1.46	1.14
Singapore	1 SGD	0.49	0.48	0.51	0.45
Australia	1 AUD	0.62	0.59	0.62	0.57

5. Recognition and measurement rules

The material recognition and measurement rules used to prepare these consolidated financial statements are described below.

5.1 Income statement

Sales recognition

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

Sales and other income is recognised as follows:

Sales from the sale of engines

Sales 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 provisions.

Sales from services rendered

Sales generated by services is recognised at the time the service is provided.

Interest and similar income, user fees, dividend income and other income

Interest and similar income is recognised pro rata temporis under 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 opportunities and risks.

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. 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 economic life.

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

The following economic lives are generally used for depreciation purposes:

	Economic life (years)	Depreciation rate (%)
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.

Property, plant and equipment on finance leases are recognised at the lower of their fair value and the present value of the lease instalments and are depreciated over either their economic life or the term of the lease.

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 and impairment 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 economic life of three to 10 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 anticipated 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 economic life of this capitalised cost of computer software is three to 10 years.

Impairment of property, plant and equipment and intangible assets

The DEUTZ Group checks at each balance sheet date whether there is any evidence that an asset may be impaired (IAS 36.9).

An impairment test is conducted at least once a year on intangible assets with an indeterminable economic life, intangible assets not yet available for use, and construction in progress (IAS 36.10).

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 [CGUs]). 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 separate cash flows can be allocated to the emerging CGU to the largest possible extent.

Determining the 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 in income in the period in which they arise. 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 reduction in the cost of purchase.

Income tax expenses

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. In this case, the amount of temporary differences for which no deferred tax liabilities are accrued 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 expenses

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 accrual 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 by DEUTZ AG for corporation tax and trade tax purposes amount to approximately €1 billion each. 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 is 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 is to its advantage.

Inventories

Raw materials and consumables as well as bought-in 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 assets. They are initially recognised at their fair value and subsequently measured at amortised cost under the effective interest method. Their cost of purchase corresponds to their nominal amount. If assets in this category do not bear market rates of interest, they are recognised at their present value. Impairments are recognised if there are objective indications that contracts have not been performed as agreed. Impairment 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. 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; 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 amortised cost.

Changes in fair value are recognised as 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 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 impairments 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 impairments 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 uses derivatives on a regular basis to mitigate the currency risk of forecast foreign-currency transactions and to reduce the 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 25. 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, taking account of deferred taxes. 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 accrual of pension provisions. Since pension plans in Germany were closed to new members in 1996, employees here can no longer acquire any further employer-funded pension entitlements. Existing entitlements therefore merely accrue interest. 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. Apart from paying these contributions, the DEUTZ Group has no further legal or constructive benefit obligations.

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 accrued 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 accrued for future operating losses.

If a number of identical obligations exists, 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.

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 accrued.

Contingent liabilities

Contingent liabilities are potential obligations that arise from past events and whose existence is only confirmed by the occurrence of one or more uncertain future events which, 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 accrual 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 accrued. 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 27. A change of 5 per cent in the level of provisions accrued 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 regular analysis of variances during the course of the year. DEUTZ works with leading banks to ensure the availability of loan financing. Overall, the Group enjoys sufficient lines of credit and was in fact able to implement significant reductions in 2005 compared to previous years. This was made possible by the profits achieved, the successful measures to reduce working capital, and the cash inflow from the sale of the marine service business. The overall result is an increase in financial flexibility that can be used to support future corporate strategy.

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; the use of derivative and non-derivative financial instruments; and the investment of excess liquidity. Derivative financial instruments are used to mitigate financial risk. The aim of this risk management strategy is to reduce the volatility of earnings and cash flow. This hedges the DEUTZ Group's profits against risks emanating from fluctuations in interest rates and exchange rates. 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 enterprises use futures contracts concluded with the Treasury department to hedge the foreign exchange risk emanating from forecast transactions and recognised assets and liabilities. The Treasury department hedges the net position in every foreign currency by concluding currency forwards, options and option combinations with external third parties.

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

Liquidity risk

Prudent liquidity management includes holding a sufficient reserve of cash and cash equivalents, the possibility to obtain funding through an adequate amount of 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.

Another initiative was the convertible bond issued in 2004, paying interest 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 adjustments are made and provisions accrued to manage 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 subsidiaries' financial statements prepared 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. Sales

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

Segments

	2005 ¹⁾	2004 ¹⁾
€ million		
Engines	831.1	740.4
Service	168.6	169.5
Compact Engines	999.7	909.9
Engines	176.2	158.0
Service	146.9	174.4
DEUTZ Power Systems	323.1	332.4
Total	1,322.8	1,242.3

Sales regions

	2005 ¹⁾	2004 ¹⁾
€ million		
Europe/Africa	925.6	870.2
thereof Germany	356.9	316.4
thereof rest of Europe	524.4	508.5
thereof Africa	44.3	45.3
Americas	193.2	160.3
Asia-Pacific	140.0	136.5
Middle East	64.0	75.3
Total	1,322.8	1,242.3

¹⁾ Including marine service business: 12 months of 2004, three months of 2005

The sales regions were reorganised in 2005. The sales generated by the Volvo Group worldwide is shown as part of the Europe region. Sales from Turkey is shown as part of the new Middle East region. The figures for 2004 have been adjusted accordingly.

2. Changes in inventories and other own work capitalised

Changes in inventories

The change in inventories in 2005 amounted to minus €20.2 million (2004: plus €0.2 million). The change in inventories for 2004 includes restructuring costs of €1.0 million.

Other own work capitalised

Other own work capitalised amounted to €18.5 million (2004: €16.0 million). This figure includes costs of €18.3 million (2004: €15.8 million) for the development and refining of engines with respect to exhaust emissions levels 2, 3 and EURO 4 and for enhancing the 2008/2009 engine series.

3. Other operating income

	2005	2004
€ million		
Income from the disposal of the marine service business ¹⁾	67.0	–
Income from recharged costs and services	42.9	39.1
Exchange rate gains	3.9	0.3
Income from the measurement of derivatives (excl. interest rate derivatives)	0.8	0.3
Rentals and leases	1.7	1.6
Income from the disposal of non-current assets and deconsolidations	1.6	0.9
Sundry other income	8.8	7.0
Total	126.7	49.2

¹⁾ See Note 9 for information on the disposal of the marine service business.

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

4. Cost of materials

	2005	2004
€ million		
Cost of raw materials and consumables, bought-in parts and goods sold	746.7	685.0
Cost of services procured	34.6	28.6
Impairment of raw materials, bought-in parts and goods procured (thereof restructuring costs)	6.6	20.9
	–	(11.5)
Total	787.9	734.5

5. Staff costs

	2005	2004
€ million		
Wages	111.9	116.9
Salaries	135.0	131.0
Social security contributions	50.2	51.5
Cost of severance payments	1.7	10.0
(thereof restructuring costs)	(–)	(9.6)
Cost of post-employment benefits	2.3	2.6
Total	301.1	312.0

The average number of employees during the year 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. The measurement of property, plant and equipment in 2004 also included the reversal of impairment losses.

Depreciation and amortisation

	2005	2004
€ million		
Property, plant and equipment	47.1	48.2
Intangible assets	11.5	11.6
Total	58.6	59.8

Impairment (write-downs)

	2005	2004
€ million		
Property, plant and equipment ¹⁾	6.7	3.5
Total	6.7	3.5

¹⁾ Including reversal of impairment losses.

€6.3 million of the impairment reported resulted from the structural adjustments necessitated by the disposal of the marine service business.

€2.9 million of the impairment reported for 2004 was due to the restructuring of the business in medium-sized and large engines.

7. Other operating expenses

	2005	2004
€ million		
Expenses for general services	46.8	43.1
Special selling expenses	38.5	37.0
Cost of rentals and leases	18.5	17.8
Office, postal, telecommunications, advertising and other administrative expenses	14.1	13.8
Cost of fees, contributions and advice	12.0	12.8
Travel, entertainment and representation expenses	8.7	9.0
Expenses for structural adjustments (disposal of the marine service business)	8.5	–
Restructuring costs	–	10.0
Insurance costs	5.4	5.3
Adjustments of receivables and other financial assets	4.5	4.4
Exchange rate losses	2.4	5.1
Cost of disposal of non-current assets	1.2	2.6
Sundry other expenses	22.7	22.9
Total	183.3	183.8

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 adjustments on non-current financial assets

	2005	2004
€ million		
Profit distributions on financial assets measured at equity	3.1	1.4
Other income on financial assets measured at equity	0.2	1.9
Gains (losses) on financial assets measured at equity	3.3	3.3
Other investment income	1.2	1.2
Adjustments on non-current financial assets	-	-0.1
Total	4.5	4.4

9. Income from the disposal of the marine service business and restructuring costs (one-off items)

Disposal of the marine service business

The marine service business was sold with effect from 31 March 2005 after the DEUTZ Group had already decided in 2004 to withdraw from the Marine Engines market segment as part of the restructuring of its business in medium-sized and large engines (DEUTZ Power Systems). A sale price of €114.6 million was agreed and included the disposal of property, plant and equipment and inventories worth €8.5 million. The sale price was settled with a payment of €97.5 million. Sundry other assets include unavailable deposits of €17.4 million from the sale 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 comes into effect.

Allowing for all transaction-related costs, the disposal of the marine service business generated an income of €67.0 million in 2005. Additional one-off expenses of €14.8 million were also incurred in the fourth quarter in connection with the structural adjustments necessitated by the sale:

	2005
Impairment	6.3
Other operating expenses	8.5
Total	14.8

Restructuring of DEUTZ Power Systems (formerly medium-sized and large engines)

The restructuring of the business in medium-sized and large engines in 2004 incurred expenses of €35.0 million. These are broken down as follows into the individual items of the income statement:

	2004
€ million	
Change in inventories (-)	1.0
Cost of materials	11.5
Staff costs	9.6
Impairment	2.9
Other expenses	10.0
Total	35.0

10. Interest expenses, net

	2005	2004
€ million		
Interest received on credit balances held with banks	0.4	0.2
Other interest income	1.7	1.6
Interest income	2.1	1.8
Interest paid on liabilities owed to banks	-5.4	-11.2
Interest paid on convertible bonds and profit-sharing rights	-6.1	-3.6
Interest cost of pension provisions and similar obligations	-16.1	-17.0
Other interest expense and similar charges	-3.0	-3.4
Interest expenses (financial expenses)	-30.6	-35.2
Interest expenses, net	-28.5	-33.4

11. Taxes

Other taxes

Other taxes essentially comprise real property taxes.

Income tax expenses

The table below gives a breakdown of income tax expenses:

	2005	2004
€ million		
Actual income taxes	-15.4	-1.4
(thereof unrelated to the reporting period)	(-)	(-)
Deferred taxes	2.1	-0.8
(thereof unrelated to the reporting period)	(-)	(-)
Total	-13.3	-2.2

The accumulated other comprehensive income/loss recognised in the reporting year gave rise to a deferred tax benefit of €0.4 million (2004: €0.1 million). The accumulated other comprehensive income/loss does not incur any actual taxes.

The tax reconciliation table shows the transition 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 (2004: 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.

	2005	2004
€ million		
Net income/loss before income taxes	84.7	-16.5
Anticipated tax	33.0	-6.5
Difference in local basis of assessment	0.4	-
Tax rates outside Germany	-0.5	0.6
Subsequent recognition of or changes in adjustments and non-recognition of deferred tax assets on losses carried forward	-22.1	3.7
Change in tax rates	-	-
Effect of non-deductible expenses	0.5	0.8
Effect of tax-exempt income	-0.1	-
Gains or losses on enterprises measured at equity	-0.1	-0.9
Tax-exempt income on the disposal of consolidated enterprises	2.1	-0.2
Effect of impairment or the reversal of impairment losses on the carrying amount of investments	-	5.5
Other	0.1	-0.8
Effective tax expense	13.3	2.2
Effective tax rate (%)	15.7	n/a

The applicable weighted average tax rate is 39 per cent (2004: 39 per cent).

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

- the capitalisation of deferred taxes on losses carried forward that can be utilised in subsequent years and
- unrecognised deferred tax assets on losses of consolidated enterprises in the reporting year.

12. 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 income 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 income is increased by the derecognition of the interest cost. The resultant tax expense is recognised.

The net loss reported for 2004 meant that there was no dilution of earnings per share in that year.

	2005	2004
€ million/shares in thousands		
Net income/loss	71.4	-18.7
Weighted average number of shares outstanding	92,585	91,149
Earnings per share (€)	0.77	-0.21
Dilutive effect		
Increase in net income due to dilutive effect of profit-sharing rights and convertible bonds	4.2	-
Current and deferred taxes	-1.6	-
Adjusted net income for the period	74.0	-
Weighted average number of shares outstanding (diluted)	118,517	-
Diluted earnings per share (€)	0.62	-

Notes to the balance sheet

13. Property, plant and equipment

Gross figures

Cost of purchase/conversion

	Land, lease- hold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
€ million					
Balance at 1/1/2004	226.6	451.1	181.4	2.2	861.3
Change in scope of consolidation	–	–	–	–	–
Exchange differences	-0.1	-0.1	-0.2	–	-0.4
Additions	0.3	10.5	9.6	6.7	27.1
Disposals	-0.2	-15.4	-9.6	–	-25.2
Reclassifications	–	2.7	0.2	-2.9	–
Balance at 31/12/2004	226.6	448.8	181.4	6.0	862.8

Gross figures

Depreciation and impairment

	Land, lease- hold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
€ million					
Balance at 1/1/2004	43.4	277.4	148.7	–	469.5
Change in scope of consolidation	–	–	–	–	–
Exchange differences	-0.1	0.1	-0.3	–	-0.3
Additions	6.1	30.4	11.7	–	48.2
Impairment	1.6	2.2	-0.3	–	3.5
Disposals	–	-12.4	-9.4	–	-21.8
Reclassifications	–	–	–	–	–
Balance at 31/12/2004	51.0	297.7	150.4	–	499.1
Net carrying amount at 31/12/2004	175.6	151.1	31.0	6.0	363.7

Gross figures

Cost of purchase/conversion

	Land, lease- hold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
€ million					
Balance at 1/1/2005	226.6	448.8	181.4	6.0	862.8
Change in scope of consolidation	-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
Reclassifications	–	5.3	0.1	-5.3	0.1
Balance at 31/12/2005	229.4	462.4	195.5	10.8	898.1

Gross figures
Depreciation and impairment

	Land, lease- hold rights and buildings	Plant and equipment	Office furniture and equipment	Construction in progress	Total
€ million					
Balance at 1/1/2005	51.0	297.7	150.4	–	499.1
Change in scope 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
Reclassifications	–	-0.2	0.2	–	–
Balance at 31/12/2005	62.6	318.7	156.3	–	537.6
Net carrying amount at 31/12/2005	166.8	143.7	39.2	10.8	360.5

A large proportion of the **additions** to property, plant and equipment related to capital spending on the construction of the new assembly hall for the TCD 2013 series at the Cologne-Porz plant. In connection with this development, the Group invested in component production at the Cologne-Deutz and Zafra sites.

A carrying amount of €1.2 million was recognised for land and buildings on finance leases at a German subsidiary (2004: €1.3 million).

Government grants at a Spanish subsidiary were deducted from the cost of purchasing the property, plant and equipment. Total government grants recognised at 31 December 2005 amounted to €3.0 million (2004: €3.6 million). In 2005, €0.7 million (2004: €0.6 million) was recognised in income (thus reducing depreciation).

Commitments to purchase property, plant and equipment and intangible assets (purchase commitments) amounted to €23.6 million (2004: €38.8 million).

Bank debt of €51.6 million (2004: €77.9 million) is secured by mortgages.

14. Intangible assets

Gross figures

Cost of purchase/conversion

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
Balance at 1/1/2004	93.5	40.8	134.3
Change in scope of consolidation	–	–	–
Exchange differences	-0.1	–	-0.1
Additions	13.0	15.8	28.8
Disposals	-22.0	-0.7	-22.7
Reclassifications	6.5	-7.0	-0.5
Balance at 31/12/2004	90.9	48.9	139.8

Gross figures

Amortisation and impairment

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
Balance at 1/1/2004	75.4	0.7	76.1
Change in scope of consolidation	–	–	–
Exchange differences	-0.1	–	-0.1
Additions	7.4	4.1	11.5
Impairment	–	–	–
Disposals	-21.8	-0.7	-22.5
Reclassifications	–	–	–
Balance at 31/12/2004	60.9	4.1	65.0
Net carrying amount at 31/12/2004	30.0	44.8	74.8

Gross figures

Cost of purchase/conversion

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
Balance at 1/1/2005	90.9	48.9	139.8
Change in scope of consolidation	-0.1	–	-0.1
Exchange differences	0.2	–	0.2
Additions	13.3	18.3	31.6
Disposals	–	–	–
Reclassifications	–	–	–
Balance at 31/12/2005	104.3	67.2	171.5

Gross figures

Amortisation and impairment

	Concessions, trademarks and similar rights	Internally produced intangible assets	Total
€ million			
Balance at 1/1/2005	60.9	4.1	65.0
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	–	–	–
Balance at 31/12/2005	68.6	8.0	76.6
Net carrying amount at 31/12/2005	35.7	59.2	94.9

The additions to intangible assets essentially relate to the capitalisation of the cost of developing and refining engines with respect to exhaust emissions levels 2, 3 and EURO 4 and of enhancing the 2008/2009 engine series.

The income statement includes research and development costs of €48.6 million for 2005 and €53.7 million for 2004.

15. Financial assets measured at equity

The DEUTZ Group's investments in associates, none of which is publicly traded, are reported as follows:

	2005	2004
€ million		
1 January	11.7	10.3
Addition arising from measurement at equity	1.4	1.4
31 December	13.1	11.7

One associate has a different financial year (ending on 30 November).

16. Other financial assets (non-current)

Summary

	31/12/2005	31/12/2004
€ million		
Investments ¹⁾	5.6	7.0
Non-current securities ²⁾	1.6	1.6
Loans ³⁾	3.5	3.2
Prepaid expenses	–	0.5
Total	10.7	12.3

¹⁾ Available-for-sale financial assets measured at amortised cost because their fair values cannot be determined.

²⁾ Available-for-sale financial assets measured at fair value.

³⁾ Primary receivables measured at amortised cost.

Re 1): available-for-sale financial assets

Changes in investments were as follows:

Balance at 1/1/2005	7.0	Balance at 1/1/2004	7.2
Additions	–	Additions	0.1
Disposals	-1.4	Disposals	-0.2
Impairment	–	Impairment	-0.1
Balance at 31/12/2005	5.6	Balance at 31/12/2004	7.0

The disposals in 2005 relate to foreign investments that were sold or wound up.

Re 2): non-current securities

This item includes €1.6 million (2004: €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

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

17. Deferred taxes, actual income tax assets and liabilities

At the balance sheet date, DEUTZ AG had unutilised tax loss carryforwards for corporation tax and trade tax of roughly €1 billion each. Further tax losses have been carried forward at foreign subsidiaries. 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:

	2005	2004
€ million		
Non-current		
Deferred tax assets	56.5	52.9
Deferred tax provisions	0.7	0.2
Current		
Actual income tax assets	0.4	0.4
Provision for income taxes	8.3	0.1
Income tax liabilities	0.3	0.2

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

The latest external tax audit is still currently in progress and covers the period from 1998 to 2001. The final report of the tax auditor is not yet available. As things stand, the company is not expecting any material risks.

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

	Deferred taxes in 2005		Deferred taxes in 2004	
	Assets	Liabilities	Assets	Liabilities
€ million				
Assets				
Intangible assets	–	27.1	–	20.7
Property, plant and equipment	11.3	0.1	11.7	0.1
Investments and financial assets measured at equity	0.2	1.4	1.2	0.1
Inventories	3.3	1.6	3.4	5.1
Receivables and other assets	0.7	7.2	5.5	11.4
Liabilities				
Provisions	25.7		20.7	11.3
Other liabilities	14.4	9.0	28.7	5.1
Losses carried forward	45.2		37.3	
Tax credits	0.6		0.8	
Consolidation	0.4			
Other	0.4		0.4	0.1
Deferred taxes (gross)	102.2	46.4	109.7	53.9
Netting	-45.7	-45.7	-56.8	-53.7
Deferred taxes (net)	56.5	0.7	52.9	0.2

Total temporary differences relating to investments in subsidiaries and associates that have a tax impact on disposal amount to €21.2 million for deferred tax assets and €12.9 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

	2005	2004
€ million		
Corporation tax	889.4	937.1
Trade tax	917.0	1,024.7
Tax outside Germany	50.5	60.0
Total	1,856.9	2,021.8

Thereof: expiry periods for German and international losses carried forward

	German corp. tax/ local tax		German trade tax	
	2005	2004	2005	2004
€ million				
Less than 5 years	9.7	13.3		
5–9 years	37.1	43.5		
Indefinitely	893.1	940.3	917.0	1,024.7

18. Inventories

	31/12/2005	31/12/2004
€ million		
Raw materials and consumables, bought-in parts and spare parts	114.6	124.0
Work in progress	43.3	60.5
Finished goods	56.7	59.7
Total	214.6	244.2

The carrying amount of inventories as at 31 December 2005 that had been written down to their net realisable value was €37.8 million (2004: €34.4 million).

The table below shows the impairment of inventories:

	2005	2004
€ million		
Balance at 1 January	58.8	45.6
Changes	-5.4	13.2
Balance at 31 December	53.4	58.8

No inventories were pledged as loan collateral in 2005. All inventories were pledged as collateral in 2004. The loan for which collateral was provided amounted to €18.6 million as at 31 December 2004.

The measurement of inventories under the percentage-of-completion method in the DEUTZ Power Systems segment had no impact as at 31 December 2005.

19. Non-current assets held for sale

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

20. Receivables and other assets (excluding taxes)

	31/12/2005	31/12/2004
€ million		
Trade receivables ¹⁾	201.1	225.5
Less adjustments	-11.9	-12.4
Trade receivables (net)	189.2	213.1
Other receivables and assets		
Receivables from investments ¹⁾	6.6	20.2
(thereof trade receivables)	(3.8)	(8.6)
(thereof other receivables)	(2.8)	(11.6)
Advances paid on property, plant and equipment and inventories	6.5	5.3
Derivative financial instruments ²⁾	0.8	0.3
Sundry other receivables ³⁾	50.7	15.3
Receivables arising from other taxes	5.2	4.2
Prepaid expenses	3.3	2.9
Total	73.1	48.2

The DEUTZ Group is exposed to a credit risk with respect to its operating activities and its outstanding accounts. Appropriate adjustments are made as a provision against identifiable risks of this type. The maximum credit risk theoretically possible corresponds to the carrying amount in each case.

In 2005, impairment of €27.6 million (2004: €25.7 million) was recognised on other receivables and assets.

Re ¹⁾ Measured at amortised cost.

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

Re ³⁾ Sundry other receivables include unavailable deposits of €17.4 million 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 comes into effect. Sundry other receivables of €6.7 million fall due in more than one year.

21. Cash and cash equivalents

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

22. Equity

Summary

	2005	2004
€ million		
Issued capital	242.9	233.0
Additional paid-in capital	20.1	18.0
Other reserves	1.6	-3.3
Net income/loss	71.6	-18.5
Loss carried forward	-89.8	-71.3
Equity attributable to the shareholders of the parent enterprise	246.4	157.9
Minority interest	0.6	0.8
Total	247.0	158.7

Issued capital

The issued capital (share capital) of DEUTZ AG amounted to €242,872,900.51 at the end of 2005 (2004: €233,018,911.12) and is divided into 95,003,621 no-par-value bearer shares (2004: 91,149,075).

In 2005, 3,854,546 convertible bonds (2004: 1,130) and no profit-sharing rights (2004: four) were converted into a total of 3,854,546 no-par-value shares of DEUTZ AG (2004: 1,170).

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 BV, 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.

The parent company (DEUTZ AG) received no further notifications concerning the above shareholdings in 2005.

Fidelity Investments International Limited, Windmill Court, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RG, UK, notified the regulatory authorities pursuant to section 21 (1) WpHG that the shareholding of FMR Corp., 82 Devonshire Street, Boston, Massachusetts 02109, USA, in DEUTZ AG exceeded the five per cent threshold on 11 April 2005 and now amounts to 5.21 per cent of the voting rights. 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.

Fidelity Investments International Limited, Kingswood Fields, Millfield Lane, Lower Kingswood, Tadworth, Surrey, KT20 6RB, UK, notified the regulatory authorities pursuant to section 21 (1) WpHG that the shareholding of FMR Corp., 82 Devonshire Street, Boston, Massachusetts, USA, in DEUTZ AG fell below the five per cent threshold on 17 October 2005 and now amounts to 4.76 per cent of the voting rights. We were also notified that these voting rights are attributable to Fidelity Management & Research Company pursuant to section 22 (1) sentence 2 in conjunction with section 22 (1) sentence 1 number 6 WpHG.

Deutsche Bank AG, Taunusanlage 12, 60325 Frankfurt am Main, Germany, notified the regulatory authorities pursuant to sections 21 (1) and 24 WpHG in conjunction with section 32 (2) of the German Investment Act (InvG) that the shareholding of its subsidiary DWS Investment GmbH, Mainzer Landstrasse 178-190, 60327 Frankfurt am Main, Germany, in DEUTZ AG fell below the five per cent threshold on 14 March 2005 and now amounts to 4.98 per cent of the voting rights.

Conditional capital

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 is 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 to the extent that

- a) the holders or creditors of conversion rights or warrants attached to the convertible bonds or bonds with warrants issued by DEUTZ AG or its direct or indirect majority shareholdings on or before 27 June 2006 utilise their conversion rights or option rights or
- b) the holders or creditors of the convertible bonds issued by DEUTZ AG or its direct or indirect majority shareholdings on or before 27 June 2006 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 conditional capital will only be increased to the extent that

- a) the holders or creditors of conversion rights or warrants attached to the convertible bonds or bonds with warrants issued by DEUTZ AG or its direct or indirect majority shareholdings on or before 26 May 2009 utilise their conversion rights or option rights or

- b) the holders or creditors of the convertible bonds issued by DEUTZ AG or its direct or indirect majority shareholdings on or before 26 May 2009 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 income or loss at average rates for the year are reported as accumulated other comprehensive income/loss. In 2005, €6.0 million (2004: €3.1 million) was added to equity.

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. Minus €1.3 million was added in 2005 (2004: €0).

Gains of €0.1 million (2004: losses of €0.2 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 2005, minus €21,000 of the reserve for cash flow hedges was charged to the income statement due to ineffectiveness.

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 (loss)

The table below gives a breakdown of the net income/loss:

	2005	2004
€ million		
EBIT before one-off items	62.5	53.5
One-off items	52.2	-35.0
EBIT	114.7	18.5
Interest expenses, net	-28.5	-33.4
Other taxes	-1.5	-1.6
Earnings before income taxes	84.7	-16.5
Income taxes	-13.3	-2.2
Net income/loss	71.4	-18.7
thereof minority interest	-0.2	-0.2
thereof attributable to the shareholders of the parent enterprise	71.6	-18.5

Minority interest

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

23. Provisions (current and non-current)

Summary

	31/12/2005	With a residual term of up to one year	31/12/2004	With a residual term of up to one year
€ million				
Provisions for pensions and other post-retirement benefits	310.4	26.8	317.9	27.3
Deferred tax provisions	0.7	–	0.2	–
Provision for current income taxes	8.3	8.3	0.1	0.1
Other provisions	113.1	70.7	87.7	53.6
Total	432.5	105.8	405.9	81.0

Provisions for pensions and other post-retirement benefits

Defined benefit obligation for pensions and other post-retirement benefits

	31/12/2005	31/12/2004
€ million		
Unfunded	334.5	335.9
Funded	21.1	16.2
Total	355.6	352.1

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

	2005	2004
in %		
Discount rate	4.12	4.7
Anticipated return on plan assets	n/a	n/a
Rate of pension increase	1.35 (from 2008)	1.35 (from 2008)
Rate of salary increase	n/a	n/a

Outside Germany

	2005	2004
in %		
Discount rate	4.97	5.6
Anticipated return on plan assets	5.5	6.1
Rate of pension increase	3.81	3.82
Rate of salary increase	2.54	2.54

The table below shows the reconciliation of the defined benefit obligation to the carrying amount of provisions:

	31/12/2005	31/12/2004
€ million		
Defined benefit obligation for pensions and other post-retirement benefits	355.6	352.1
Thereof		
Unfunded	334.5	335.9
Funded	21.1	16.2
External fair value plan assets	-13.0	-10.5
Actuarial gain/loss	-32.2	-23.7
Pension provisions reported on the face of the balance sheet	310.4	317.9

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.

The table below shows the changes in pension provisions:

	2005	2004
€ million		
Pension provisions as at 1 January	317.9	328.8
Expense reported on the face of the income statement	16.2	16.9
Contributions to plan assets	-0.6	-0.6
Pensions paid	-26.0	-26.4
Reclassification of provisions	2.4	–
Changes in scope of consolidation	–	-0.7
Exchange differences	0.5	-0.1
Pension provisions as at 31 December	310.4	317.9

The table below gives a breakdown of the total cost of pension benefit obligations:

	2005	2004
€ million		
Service cost	0.8	0.5
Interest cost	16.1	17.0
Anticipated return on plan assets	-0.7	-0.6
Amortisation of actuarial gains/losses	–	–
Total	16.2	16.9

Interest cost and return on plan assets are reported under net interest income/expense. The actual return on plan assets in 2005 amounted to €2.0 million (2004: €0.8 million). The employer's contribution to the German statutory pension insurance scheme in 2005 came to €17.9 million (2004: €18.2 million).

Other provisions

The table below gives a breakdown of the other provisions:

€ million	31/12/2005			31/12/2004		
	Total	With a residual term of up to one year	With a residual term of more than one year	Total	With a residual term of up to one year	With a residual term of more than one year
Guarantees	27.9	17.8	10.1	27.5	18.5	9.0
Imminent losses on pending transactions	8.1	5.0	3.1	6.2	2.8	3.4
Personnel	19.1	7.5	11.6	13.7	7.5	6.2
Restructuring	5.6	5.6	–	15.7	15.7	–
Other	52.4	34.8	17.6	24.6	9.1	15.5
Total	113.1	70.7	42.4	87.7	53.6	34.1

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 accrued to cover the costs directly attributable to the restructuring.

The table below shows the changes to other provisions in 2005:

	Guarantees	Imminent losses on pending transactions	Personnel	Restructuring	Other	Total
€ million						
1/1/2005	27.5	6.2	13.7	15.7	24.6	87.7
Amounts added	4.4	2.8	8.3	1.3	32.2	49.0
Amounts utilised	-3.5	-0.6	-1.7	-11.4	-3.2	-20.4
Amounts reversed	-0.2	-0.3	-0.9	–	-0.7	-2.1
Deconsolidations	-0.6	–	-0.3	–	-0.1	-1.0
Accrued interest and effect of changes in interest rates	-0.1	–	–	–	–	-0.1
Reclassifications	0.4	–	–	–	-0.4	–
31/12/2005	27.9	8.1	19.1	5.6	52.4	113.1

Provisions for taxes

Provisions for taxes are discussed under Note 17.

24. Financial liabilities, trade payables and other liabilities

Summary

	31/12/2005			31/12/2004		
€ 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
Financial liabilities						
Profit-sharing rights	22.8	22.8	–	20.9	20.9	–
Convertible bonds	48.7	48.7	–	58.9	58.9	–
Liabilities to banks	64.1	40.3	–	132.0	58.9	–
Liabilities to investments	–	–	–	24.2	23.0	–
Liabilities under finance leases	2.5	0.5	1.9	2.6	0.5	2.0
Other financial liabilities	–	–	–	1.6	0.5	–
Total	138.1	112.3	1.9	240.2	162.7	2.0
Trade payables	165.7	–	–	143.2	–	–
Other liabilities	80.5	1.9	–	81.1	0.5	–
Total	384.3	114.2	1.9	464.5	163.2	2.0

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. In addition, it has been separately agreed that 998,163 profit-sharing rights cannot be terminated until 31 December 2010.

The profit-sharing rights can be exchanged for shares of DEUTZ AG in the ratio of one for one based on their par value. No profit-sharing rights were exchanged for shares of DEUTZ AG in 2005.

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% under the effective interest method. The profit-sharing rights outstanding at the end of 2005 totalled €22.8 million (2004: €20.9 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 subscription 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 up to the repayment amount over the bond's maturity under the effective interest method and recognised in income.

3,854,546 convertible bonds were converted into shares in 2005.

The convertible bond incurred the following interest expense:

	2005	2004
€ million		
Coupon	2.4	1.2
Accrued interest	1.8	0.7
Total	4.2	1.9

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 in each currency:

	2005	2004			
in %	EUR	EUR	USD	GBP	SGD
Short-term interest rate	3.23	3.73	5.47	5.09	3.53
Long-term interest rate (up to five years)	3.48	4.11	–	–	–
Long-term interest rate (more than five years)	–	3.45	–	–	–

Fair value of financial liabilities (excluding derivatives)

	Carrying amount		Fair value	
	2005	2004	2005	2004
€ million				
Profit-sharing rights	22.8	20.9	22.8	20.9
Convertible bonds	48.7	58.9	48.7	58.9
Liabilities to banks	64.1	132.0	64.1	132.0
Liabilities to investments	–	24.2	–	24.2
Liabilities under finance leases	2.5	2.6	2.5	2.6
Other financial liabilities	–	1.6	–	1.6
Total	138.1	240.2	138.1	240.2

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

	2005	2004
€ million		
EUR	138.1	230.3
USD	–	2.3
GBP	–	2.8
SGD	–	4.8
Total	138.1	240.2

Significant assets were pledged as collateral for bank loans in 2004 under a deed of assignment and transfer-of-ownership agreement. The transfer-of-ownership agreement was terminated with effect from 30 June 2005.

Liabilities under finance leases

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

	31/12/2005	31/12/2004
€ million		
Future minimum lease payments		
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	2.6	2.8
Total	3.7	3.9
Interest implicit in future minimum lease payments	1.3	1.4
Present value of future minimum lease payments (liabilities under finance leases)		
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	1.9	2.0
Total	2.5	2.6

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

	31/12/2005	31/12/2004
€ million		
Trade payables	165.7	143.2
Other liabilities		
Derivatives	1.4	0.2
Liabilities to investments	4.9	5.1
Liabilities arising from other taxes	3.5	4.9
Personnel-related liabilities	18.9	17.5
Sales and marketing liabilities	23.2	22.1
Advances received	10.8	14.7
Other liabilities and deferred income	17.8	16.6
Total	80.5	81.1

Personnel-related liabilities include social insurance premiums and outstanding annual holiday entitlements. Other liabilities include accruals of €45.9 million (2004: €43.3 million).

25. Derivative financial instruments

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

	Notional amount 2005	Notional amount 2004	Fair value 2005	Fair value 2004
€ million				
Currency forwards	31.3	5.4	-0.9	0.3
Currency options	45.8	–	-0.4	–
Interest rate swaps > 1 year	31.5	45.1	-0.1	-0.2
Embedded derivatives	–	–	0.8	0.3

The DEUTZ Group held US dollar-denominated currency forwards with a notional amount of €31.3 million (2004: €5.4 million) and currency options in US dollar with a notional amount of €45.8 million (2004: €0) at the balance sheet date as a hedge against currency risk.

Of the derivative financial instruments held at the balance sheet date, derivatives with a notional amount of €100.6 million (2004: €0) and a fair value of minus €1.4 million (2004: minus €0.2 million) were designated as cash flow hedges. Due to ineffectiveness, €21,000 (2004: €0) of the reserve for cash flow hedges was charged to the income statement as other operating expenses.

26. Contingent liabilities and other financial obligations

Contingent liabilities

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

	31/12/2005	31/12/2004
€ million		
Liabilities on endorsed bills of exchange	2.9	6.1
Liabilities on guarantees	14.9	11.6
Liabilities on warranties	3.5	6.9
Total	21.3	24.6

Other financial obligations

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

	31/12/2005	31/12/2004
€ million		
Lease obligations		
due in less than 1 year	12.7	14.2
due in 1–5 years	17.1	24.9
due in more than 5 years	5.3	6.4
Total	35.1	45.5

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

Commitments to purchase property, plant and equipment amounted to €23.6 million as at 31 December 2005 (2004: €38.8 million).

Obligations under leases are partly offset by receivables of €2.7 million (2004: €3.8 million) from subleases.

27. 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 2005. 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.

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.

28. 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 its **equity investments** as well as the following **shareholders** (including their subsidiaries) of DEUTZ AG, which can exert a significant influence. These are

- SAME DEUTZ-FAHR Holding & Finance BV, 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 the DEUTZ Group's equity investments:

	Products and services provided for		Products and services received		Receivables 31 December		Liabilities 31 December	
	2005	2004	2005	2004	2005	2004	2005	2004
€ million								
UZEL DEUTZ MOTOR SANAYI (Istanbul, Turkey)	10.3	14.0	2.5	2.9	1.9	10.7	–	–
Other investments	12.1	12.7	3.7	3.5	4.7	9.5	4.9	5.1
Total	22.4	26.7	6.2	6.4	6.6	20.2	4.9	5.1

€27.6 million (2004: €25.6 million) of the receivables from investments had been adjusted as at 31 December 2005; this incurred an expense of €7.4 million in 2005 (2004: €1.6 million).

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

	SAME DEUTZ-FAHR Group		Volvo Group	
	2005	2004	2005	2004
€ million				
Engines and spare parts supplied	51.5	37.9	128.2	121.3
Services	3.5	4.2	22.9	25.3
Receivables as at 31 December	22.6	12.4	22.1	12.1

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.

	Supervisory Board		Management Board		Other members of management	
	2005	2004	2005	2004	2005	2004
€ million						
Current remuneration	0.3	0.3	2.5	2.4	2.2	1.8

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

Notes to the cash flow statement

29. 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.

The cash flow from operating activities includes dividend income of €3.1 million for 2005 (2004: €1.5 million).

Cash and cash equivalents increased by €40.6 million to €48.4 million and correspond to the cash and cash equivalents reported on the face of the balance sheet.

Notes to the segment reporting

30. 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 business and the servicing of air, water and oil-cooled diesel engines with an output of between 4 kW and 500 kW.

DEUTZ Power Systems This segment includes project-related systems business and the servicing of gas engines and diesel engines with a power range of between 180 kW and 4,000 kW and systems used to convert fossil and non-fossil fuels.

Other This segment contains business activities and consolidation measures that do not belong in any other segment.

Reconciliation of segment items 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 different 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.

Segment data is calculated as follows:

Sales constitutes the sales that the segments generate from their customers. Sales generated between segments is shown as intersegment sales.

Depreciation, amortisation and impairment relate to property, plant and equipment and intangible assets. The impairment in the DEUTZ Power Systems segment relates to structural adjustments to property, plant and equipment in connection with the disposal of the marine service business and the restructuring of the business in medium-sized and large engines in 2004.

Segment earnings before one-off items constitute the IFRS definition of segment earnings, which includes measurement at equity, net investment income or expense and gains or losses on the disposal of financial assets.

Under IFRS, **segment earnings** are defined as segment sales less segment expenses. Gains or losses on the disposal of financial assets, gains or losses on the measurement at equity of financial assets, 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

31. Events after the balance sheet date

No material events occurred after the balance sheet date.

32. 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 to 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 10 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 2005, 200,000 options that had been issued with an exercise price of €2.70 were transferred by way of sale to a person outside the DEUTZ Group. At 31 December 2005, 200,000 options (31 December 2004: 400,000 options) had not been exercised.

The weighted average exercise price over the options' residual maturity is €4.80 (31 December 2004: €3.75).

Information under German accounting standards

Average number of employees during the year (reported pursuant to section 314 (1) number 4 HGB)

	2005	2004
Non-salaried employees	2,963	3,157
Salaried employees	2,082	2,206
Apprentices	178	172
Total	5,223	5,535

Corporate governance

In December 2005, 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 2 June 2005 pursuant to section 161 AktG and made this declaration permanently available to shareholders on the company's website (www.deutz.com).

Auditors' fees

The following expenses were incurred in 2005:

	2005
€ thousand	
Auditing	684
Other advisory and attestation services	220
Other services rendered for the parent enterprise or subsidiaries	235
Total	1,139

Total remuneration paid to the Management Board, former members of the Management Board, and the Supervisory Board

Disclosure of directors' remuneration pursuant to section 314 (1) number 6 HGB

The total remuneration paid to the active members of the Management Board in 2005 amounted to €2,513,000 at DEUTZ AG and in the Group and consisted of fixed salaries of €1,937,000 and variable bonuses totalling €576,000.

The remuneration paid to former members of the Management Board and their surviving dependants came to €1,277,000 at DEUTZ AG and in the Group; a provision of €13,476,000 has been accrued to cover pension obligations to these persons.

The remuneration paid to the Supervisory Board in 2005 amounted to €168,750 at DEUTZ AG and in the Group and consisted solely of fixed remuneration. Each member of the Supervisory Board is paid a fixed annual amount of €12,500; the chairman receives twice this amount and the deputy chairman one-and-a-half times this amount.

Attendance fees for meetings of the Supervisory Board and its committees came to €84,500 at DEUTZ AG and in the Group. Each member of the Supervisory Board receives an attendance fee of €1,000 per meeting; the chairman receives twice this amount and the deputy chairman one-and-a-half times this amount.

Advances and loans to members of the Management Board and the Supervisory Board

On 31 December 2005 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 90.

Cologne, 31 March 2006

DEUTZ Aktiengesellschaft
The 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, for the financial year from 1 January to 31 December 2005. The preparation of the consolidated financial statements and the Group management report in accordance with International Financial Reporting Standards (IFRS), as applied throughout 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 financial position and financial performance 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

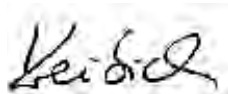
statements of the enterprises included in the consolidated financial statements, the scope of consolidation, the recognition and consolidation principles used and significant estimates made by the management, as well as evaluating the overall presentation of the consolidated financial statements and 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 IFRS, as applied throughout the European Union, and the supplementary provisions of commercial law applicable in accordance with section 315a (1) HGB and give a fair presentation of the Group's financial position and financial performance in accordance with these provisions. The Group management report is consistent with the consolidated financial statements and, on the whole, provides a suitable understanding of the Group's position and suitably presents the opportunities and risks of future development.

Düsseldorf, 31 March 2006

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft



Kreibich
Wirtschaftsprüfer
(German Public Auditor)



ppa. Kessels
Wirtschaftsprüferin
(German Public Auditor)

Shareholdings of the DEUTZ Group

As at 31 December 2005

No.	Name and registered office of company	Holding (%)	Equity (€ thousand)	Net income/loss (€ thousand)
1	DEUTZ AG	–	236,647	55,350
Consolidated subsidiaries				
In Germany				
2	DEUTZ Power Systems GmbH & Co. KG, Mannheim	100.0	41,831	433
3	Unterstützungsgesellschaft mbH der DEUTZ Aktiengesellschaft, Cologne	100.0	26	–
4	Ad. Strüver KG (GmbH & Co.), Hamburg	94.0	-2,116	-4,244
5	Deutz-Mülheim Grundstücksgesellschaft mbH, Düsseldorf	19.6	788	-226
Outside Germany				
Europe/Africa				
6	DEUTZ Power Systems B.V., Rotterdam (Netherlands)	100.0	2,097	276
7	DEUTZ DITER S.A., Zafra (Spain)	100.0	-4,299	-1,075
8	DEUTZ DITER COMPONENTES S.A., Zafra (Spain)	100.0	14,048	2,275
9	DEUTZ FRANCE S.A., Gennevilliers (France)	100.0	9,197	847
10	DEUTZ IBERIA S.A., Madrid (Spain)	100.0	6,666	660
11	DEUTZ UK Ltd., Cannock (UK)	100.0	7,212	381
12	Nlle Ste MAGIDEUTZ S.A., Casablanca (Morocco)	100.0	1,080	-235
Americas				
13	Deutz Corporation, Atlanta (USA)	100.0	20,447	5,755
14	DEUTZ of America Corporation, Atlanta (USA)	100.0	28,408	267
Asia-Pacific				
15	DEUTZ Asia-Pacific (Pte) Ltd., Singapore (Singapore)	100.0	3,849	1,060
16	Deutz Australia (Pty) Ltd., Braeside (Australia)	100.0	3,410	534
Associates				
Outside Germany				
17	DEUTZ AGCO MOTORES S.A., Haedo (Argentina)	50.0	4,636	1,364
18	ASIA POWER (PRIVATE) LIMITED, Colombo (Sri Lanka)	31.8	29,772	5,475
19	D. D. Power Holdings (Pty) Ltd., Elandsfontein (South Africa)	30.0	9,177	2,121

Annual Financial Statements (HGB)

Balance sheet of DEUTZ AG

Assets

	31/12/2005	31/12/2004
€ million		
Expenses for the expansion of operations	41.5	35.7
Intangible assets	30.5	15.2
Property, plant and equipment	290.2	148.9
Investments	163.8	243.6
Non-current assets	484.5	407.7
Inventories	77.3	166.9
Receivables and other assets	239.2	236.3
Cash and cash equivalents	40.7	3.1
Current assets	357.2	406.3
Prepaid expenses	5.2	8.0
Total	888.4	857.7

Equity and liabilities

Issued capital	242.9	233.0
Additional paid-in capital	15.3	13.2
Accumulated loss	-21.6	-76.9
Equity	236.6	169.3
Profit-sharing rights	25.6	25.6
Provisions	364.4	372.3
Liabilities	261.8	290.5
Total	888.4	857.7

Income statement of DEUTZ AG

	2005	2004
€ million		
Sales	987.9	1,099.1
Change in inventories	-19.8	-6.0
Other own work capitalised	6.0	9.4
Total output	974.1	1,102.5
Other operating income	72.3	74.7
Cost of materials	-640.5	-691.1
Staff costs	-201.9	-244.7
Depreciation	-22.3	-26.2
Other operating expenses	-154.2	-169.0
Net investment income	7.3	1.6
Net interest expense	-13.4	-18.9
Profit from ordinary activities	21.4	28.9
Net extraordinary income/expenses	46.1	-35.0
Income taxes	-11.8	-2.2
Other taxes	-0.4	-0.5
Net income/loss	55.3	-8.8
Loss carried forward	-76.9	-68.1
Accumulated loss	-21.6	-76.9

Supervisory Board

Dr Michael Endres

Chairman

Former member of the Management Board of Deutsche Bank AG, Frankfurt am Main

a) ARCOR Verwaltungs AG, Eschborn
Bankgesellschaft Berlin AG, Berlin
Landesbank Berlin, Berlin
Schott AG, Mainz

b) Gemeinnützige Hertie-Stiftung, Frankfurt/Main,
Chairman
Hertie School of Governance, Berlin

Werner Scherer¹⁾

Vice-Chairman

Chairman of the Group Works Council of DEUTZ AG,
Cologne

Professor Klaus-Otto Fruhner

Managing Director of K.O.F. Projektberatung GmbH,
Cologne

Reinhold Götz¹⁾

Deputy Chief Executive of IG Metall Administrative Office
Mannheim, Mannheim

b) Sparkasse Rhein-Neckar-Nord, Mannheim

Michael Haupt

Former member of the Group Board of AB SKF, Schweinfurt

Dr Helmut Lerchner

Management consultant, Aichtal-Rudolfshöhe

a) ElringKlinger AG Dettingen/Erms, Chairman

Helmut Müller¹⁾

Chairman of the Senior Staff Committee of DEUTZ AG,
Cologne

b) Henkelhausen Holding GmbH, Krefeld

Karl-Heinz Müller¹⁾

Vice-Chairman of the Group Works Council of DEUTZ AG,
Cologne

Dr Witich Roßmann¹⁾

Chief Executive of IG Metall Cologne, Cologne

a) Ford Werke GmbH, Cologne

Peter Schwab¹⁾

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., Treviglio (Italy),
Chairman
SAME DEUTZ-FAHR Holding & Finance B.V., Amsterdam
(Netherlands)
SAME DEUTZ-FAHR POLSKA Sp. z oo, Melgiew (Poland)
SAME DEUTZ-FAHR KOMBAJNI d.d., Zupanja (Croatia)
BANCA POPOLARE DI MILANO, Milan (Italy)
CASSA DI RISPARMIO DI ALESSANDRIA S.p.A., Alessan-
dria (Italy) (until 26 May 2005)
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)
LU-VE S.p.A., Varese (Italy)
(until 31 December 2005)
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)

Management Board

Peter Zühlsdorff

Shareholder-Director of DIH Deutsche Industrie Holding GmbH, Frankfurt am Main

- a) Escada AG, Munich, Chairman
Sinn Leffers 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)

¹⁾ Employee representatives on the Supervisory Board.

Gordon Riske (48), Cologne

CEO

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 (UK), Chairman
DEUTZ Asia-Pacific (Pte) Ltd., Singapore (Singapore), Chairman
DEUTZ Power Systems GmbH & Co. KG, Mannheim, Chairman

Karl Huebser (60), 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 (56), Düsseldorf

Finance, Human Resources

- b) DEUTZ IBERIA S.A., Madrid (Spain), Chairman
DEUTZ UK Ltd., Cannock (UK)
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 pursuant to section 125 AktG

b) Membership of comparable German or international supervisory bodies pursuant to 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. 4-valve technology is now standard in the passenger car sector; it is being increasingly used for industrial engines as emission regulations become stricter.

Benchmark Important reference values used for comparison with a company's own key performance indicators.

Captive market, captive segment Market segment comprising equipment and vehicle manufacturers that produce engines in-house.

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 cost-effective alternative to conventional meetings with analysts and investors because those taking part do not have to be physically present.

Convertible bond A bond issued by a publicly traded company that entitles the bearer to receive a fixed rate of interest as well as the option to exchange the bond for shares at a given date and at a predetermined ratio.

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 Companies 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 Companies Act (AktG) detailing the company's relations with affiliated companies and subsidiaries.

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.

Dow Jones Industrial Average (DJIA) A price-weighted index of 30 highly liquid shares of leading US corporations, most of which are industrial companies; this index is the oldest and most commonly cited of all market indicators.

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.

Emission Stages 1/2/3/4 Stages of European and US emission laws that prescribe adherence to certain exhaust emission standards for operating machinery equipped with diesel engines. The stages come into force in a certain chronological order, with the maximum permissible exhaust levels dropping from one level to the next.

Equity ratio The ratio of a company's equity to its total capital.

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.

EURO 4 Motor vehicle exhaust emission standards laid down by the European Union. It specifies limits for pollutants such as sulphur dioxide, nitrogen oxides, hydrocarbons and particulates (diesel) contained in exhaust gas. Comes into force in October 2006 for commercial vehicles and buses above a permissible gross weight of 3.5 tonnes.

EURO STOXX 50 An index published by Dow Jones comprising the 50 most important EU-based companies with the largest market capitalisations.

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 are the catalytic converter or particulate trap in passenger cars.

Exhaust gas recirculation (EGR) Process for reducing the nitrogen oxides (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 gases back for re-combustion. The effect of this is to slow down the rate of combustion by reducing the proportion of oxygen (O_2) in the intake air. This in turn reduces the proportion of NO_x in the exhaust gas.

Exhaust emission Stage 3A Exhaust emission standards for industrial engines laid down by the European Union. It specifies limits for pollutants such as sulphur dioxide, nitrogen oxides, hydrocarbons and particulates (diesel) contained in the exhaust gas. Came into force in January 2006 for engines in the 130 to 560 kW power category.

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.

Genset Short for "generating set"; mobile or stationary, engine-powered system for decentralised, mains-independent power generation.

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.

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.

Material handling Designation of a special application segment in which diesel engines are used for the equipment that handles all kinds of materials, such as forklift trucks, cranes and conveyor belts.

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_4) 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.

Nikkei 225 Japanese share index comprising the 225 most important Japanese companies measured by market capitalisation.

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.

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.

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, in which the exhaust gas penetrates a porous wall; and flow filters, in which the exhaust gas flows through the filter itself.

Special 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.

TIER 3 US exhaust emission standards for industrial engines; it specifies limits for pollutants such as sulphur dioxide, nitrogen oxides, hydrocarbons and particulates (diesel) contained in the exhaust gas. Came into force in January 2006 for engines with an output of over 130 kW.

Working capital In the context of this Annual Report: 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 2006	Event	Location
2 May	Annual Results press conference Publication Annual Report 2005	DEUTZ AG, Cologne
3 May	Analysts' meeting	Frankfurt/Main
24 May	Publication Report 1st Quarter 2006 Conference call with analysts and investors	–
22 June	Annual General Meeting 2006	Koelnmesse, Cologne
15 August	Publication Report 1st Half-year 2006 Press conference Conference call with analysts and investors	DEUTZ AG, Cologne
15 November	Publication Report 1st to 3rd Quarter 2006 Conference call with analysts and investors	–
Dates 2007		
27 March	Annual Results press conference Publication Annual Report 2006	DEUTZ AG, Cologne
24 May	Annual General Meeting 2007	Koelnmesse, Cologne

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