

# No. 1

## The engine company.

Report 1st Half year 2005

- ▶ Second quarter of 2005 first without marine service contribution
- ▶ Comparable EBIT up 19 percent in first six months
- ▶ Equity ratio up to 22.3 percent

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## Financial Statements DEUTZ Group, 1st Half year 2005

Key Figure Summary in € million	4-6/2005	4-6/2004*	1-6/2005	1-6/2004*
New orders	357.5	356.4	704.2	682.8
Unit sales (units)	51,472	47,734	96,510	87,843
Sales	338.5	324.5	623.0	583.3
Foreign sales proportion in %	71.5	74.5	72.2	73.6
Earnings before interest, taxes, depreciation, and amortisation (EBITDA)	26.6	32.6	45.5	51.6
Operating profit (EBIT)	13.5	19.3	19.5	25.0
Profit on ordinary activities	7.1	11.4	6.1	9.5
Extraordinary income/expenses (-), net	-	-40.0	67.0	-40.0
Profit/loss	6.7	-29.6	60.7	-32.2
Earnings per share in € (undiluted)	0.07	-0.32	0.66	-0.35
Earnings per share in € (diluted)	0.06	-0.29	0.52	-0.32
Balance sheet total (June 30)	990.7	1,040.3	990.7	1,040.3
Stockholders' equity (June 30)	221.0	137.5	221.0	137.5
Stockholders' equity proportion (in %)	22.3	13.2	22.3	13.2
Cash flow from normal operating activities	19.9	25.2	-37.7	9.9
Net financial debt (June 30) <sup>1)</sup>	58.8	230.7	58.8	230.7
Investments	10.4	4.3	15.3	16.4
Research and development expenditure	15.1	14.7	31.8	29.0
No. of employees (June 30)	5,184	5,570	5,184	5,570

<sup>1)</sup> Net financial debt: liabilities towards credit institutions less liquid assets

Segments	4-6/2005	4-6/2004*	1-6/2005	1-6/2004*
<b>New orders in € million</b>	<b>357.5</b>	<b>356.4</b>	<b>704.2</b>	<b>682.8</b>
Compact engines	274.3	258.6	527.6	487.8
DEUTZ Power Systems	83.2	97.8	176.6	195.0
<b>Sales in units</b>	<b>51,472</b>	<b>47,734</b>	<b>96,510</b>	<b>87,843</b>
Compact engines	51,262	47,507	96,174	87,512
DEUTZ Power Systems	210	227	336	331
<b>Sales in € million</b>	<b>338.5</b>	<b>324.5</b>	<b>623.0</b>	<b>583.3</b>
Compact engines	252.4	244.9	468.5	448.1
DEUTZ Power Systems	86.1	79.6	154.5	135.2
<b>Operating profit (EBIT) in € million</b>	<b>13.5</b>	<b>19.3</b>	<b>19.5</b>	<b>25.0</b>
Compact engines	15.6	22.5	20.4	35.4
DEUTZ Power Systems	-1.4	2.3	1.6	-2.9
Other	-0.7	-5.5	-2.5	-7.5

\* Including marine service business

## Dear Shareholders, dear Friends of our Company,

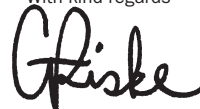
our business has developed successfully during the first half of 2005. Sales on a comparable basis, in other words, with the portion contributed by the marine service business removed, rose by 10 percent to € 623.0 million. The DEUTZ Power Systems segment recorded the greatest improvement. This business, which was restructured last year is now progressing faster and better than we had expected. The compact engines business also did well. Due to increased unit sales in the USA and Germany, sales at € 468.5 million, was 4.6 percent higher than in the same period last year.

Profits did even better than sales. Comparable operating profit (EBIT) increased by 19 percent to € 19.5 million. Clearly and positively affected by the sale of the marine service business, the first six months ended with a net profit of € 60.7 million after tax.

The effect on our balance sheet was similarly positive. At 30 June 2005, our equity ratio was 22.3 percent. This is the best figure we have achieved since 1984. Net financial debt came down to below € 60.0 million. This means that in the last 5 years we have cut over € 270 million from the amount owing to banks.

Dear shareholders - to sum it up, your company has been doing well. We remain confident that the measures – namely, to improve our cost structure, changes in unit sales mix and increase prices – will take effect during the second six month period so that we will, to a great extent, be able to offset the negative effect of higher raw material prices. We are assuming that the basic economic situation does not significantly deteriorate. Thus we can confirm our outlook for the year 2005. We shall see sales significantly increased in our core segments. DEUTZ Power Systems will make a positive contribution to EBIT. Therefore 2005 will bring us a step closer towards a position in which we will be able to distribute dividend.

With kind regards



Gordon Riske

Chairman of the Management Board

# Management Report 1st Half year 2005

**Economic environment** The continuing high oil price, and the recent, rather lifeless performance of the global economy have again cast into doubt the economic outlook for the euro area and Germany. Particularly in the industrial sector, we foresee a slowdown in economic activity. The rate of growth that we achieved during the first quarter, therefore, will slow down considerably. From the current perspective, though, there is no reason to fear that economic output will decline, as the global economy continues to enjoy robust growth – particularly due to strong, sustained expansion in Asia - although at rather low levels. The US economy is also expanding.

**Development of the business** The figures for the second quarter of 2005 are the first without of the contribution from the marine service business, which was sold on 31 March 2005. This means that comparisons with the same quarter and the first six months last year can only be meaningful through adjusting last year's figures.

During the second quarter of 2005, DEUTZ grew unit sales by 7.8 % and sales by 4.3 %. When the contribution made to sales by the marine service business in the second quarter of 2004 is removed, the increase in sales on a comparable basis is still a little more than double. Operating profit in the second quarter was € 13.5 million, under last year's figure (€ 19.3 million). On the one hand, this was caused by higher raw material costs and, on the other, by losing the healthy profits from the marine service business in the second quarter of 2005. On a comparable basis, i.e. without the profits from the marine service business in the second quarter in 2004, profit rose by around 26 %.

New orders during the first six months were slightly up on the year before, by 3.1 % from € 682.8 million to € 704.2 million. This progress is the result of the new engine business with compact engines.

During the first six months of the year in the compact engines segment, new orders rose by 8.2 % to € 527.6 million (2004: € 487.8 million). Continued strong demand in North America, in particular, has been behind the rise. As a consequence of the new focus on the power generation business, the DEUTZ Power Systems segment suffered a 9.4 % decline, to € 176.6 million (2004: € 195.0 million). The strong rise in new orders for gas engines was more than offset by the planned fall in new orders for diesel engines. This increase stems mainly from Eastern Europe, South-East Asia and the Benelux coun-

tries. The focus on decentralised power generation with gas engines is a vital part of the DEUTZ Power Systems segment's strategy.

In the first six months, unit sales of engines rose by 9.9 % to 96,510 engines (2004: 87,843). Unit sales in the compact engines segment rose to 96,174 engines (2004: 87,512). Unit sales in the DEUTZ Power Systems segment stood at 336 engines (2004: 331).

The DEUTZ Group's total sales during the first six months of 2005 was € 623.0 million, 6.8 % higher than for the same period last year (€ 583.3 million). On a comparable basis, without the contribution to sales of the marine service business in the second quarter of 2004, sales rose by around 10 %.

Crucial to the increase in sales was the lively demand for compact engines in North America, which was reflected in the growth of the Mobile Machinery segment. Almost 70 % of the growth in Mobile Machinery came from increased demand in the materials handling area and an increase in construction machinery. Our partner Volvo also played its part in this positive trend.

During the first six months of the year in the compact engines segment, sales rose by 4.6 % to € 468.5 million (2004: € 448.1 million). A major contributing factor was the improvement in North American sales. In the DEUTZ Power Systems segment, a steep increase in new gas engine systems helped sales grow by 14.3 % to € 154.5 million (2004: € 135.2 million). In the second quarter of last year, this segment included sales from the marine service business, which is no longer the case since 1 April as the business has been sold. On a comparable basis, sales still grew by around 42 % in the second quarter and by around 33 % in the first six months as a whole.

The domestic share of total sales was 27.8 % (2004: 26.4 %), with the foreign share being 72.2 % (2004: 73.6 %).

**Profit Trend** Compared with the stated previous year, in the first six months of this year, operating profits (EBIT) fell by 22.0 % to € 19.5 million (2004: € 25.0 million). On a comparable basis, without the contribution made by the marine service business, operating profit rose by around 19 %.

In the compact engines segment, the operating profit of € 20.4 million was below last year's figure (€ 35.4 million). The decline may be traced to higher material costs and far higher expenditure on research and development, caused by preparations for the TIER III emission standards and start-up expenditure for the new commercial vehicle engine. There were also exchange

rate effects and a negative effect from reclassifying costs that last year were still being shown in the other segment.

After it had suffered a loss of € -2.9 million in the first six months of last year, the DEUTZ Power Systems segment increased operating profit by € 4.5 million to € 1.6 million. The result for the quarter, a loss of € -1.4 million, results from the absence of any contribution from the marine service business. When the marine service was included, last year, there was a positive result of € 2.3 million. On a comparable basis, the loss for the quarter was around € 5 million less than last year.

In the other segment there was a loss of € -2.5 million (2004: € 7.5 million). This reduced loss was due to an extended allocation of costs to the business segments commencing with the first quarter of 2005, and to further cost reductions.

By improving the total output, achieving better net interest expenses and declining personnel costs the company managed, despite the increase in expenditure on materials and the absence of positive contribution from the marine service business, to achieve a profit from ordinary activities of € 6.1 million (2004: € 9.5 million). On a comparable basis – i.e. without the contribution from the marine service business in the second quarter of 2004 – the result for the same six months last year was € 0.9 million.

With the extraordinary income of € 67.0 million from the sale of the marine service business, the DEUTZ Group achieved a net profit of € 60.7 million after tax in the first six months of 2005. In the first half of 2004, the general provision of € 40 million for restructuring the medium-sized and large engines business contributed to a loss of € 32.2 million.

Undiluted earnings per share thus improved from € -0.35 to € 0.66. Taking the convertible profit-participation certificates and convertible bonds into account, the diluted earnings per share was € 0.52 (2004: € -0.32).

**Asset and financial situation** At 30 June the balance sheet total was € 990.7 million, i.e. around € 30.5 million above that at 31 December 2004, when it was € 960.2 million. This is an increase of 3.2 %. This rise is due to the company's positive business development and the associated increase in inventory and trade receivables. This may be contrasted with equity that has risen to € 221.0 million, increased provisions and a reduction in the amount payable to banks and trade payables. So the equity ratio is now 22.3 % after 16.2 % at the end of December 2004 and 13.2 % at 30 June 2004.

The balance sheet total is 4.8 % below that at 30 June 2004 (€ 1,040.3 million). This is the result of strict efforts to reduce working capital.

Due to the first quarter inflow of funds from the sale of the marine service business, net financial debt has dropped from € 100.0 million at the end of December 2004 to € 58.8 million, and is therefore some € 172 million below the same period last year (€ 230.7 million).

**Cash flow** The cash flow from normal operating activities was € 37.7 million, which is € 47.6 million less than last year's figure of € 9.9 million. 2004's deferred expenditure associated with the restructuring of the medium-sized and large engines business had a major effect on this. The high trade payables figure of 31 December 2004 was also reduced, while there was still a buildup in the period between the end of December 2003 and June 2004.

The cash flow from investing activities, at € 78.9 million (2004: € -16.4 million), includes around € 94 million from the sale of the marine service business and € 15.3 spent on investments.

The cash flow from financial activities was € -36.3 million (2004: € -0.1 million) and is the result of reducing the amounts owed to credit institutions in the second quarter. Overall, this enabled the company to reduce the 31 December 2004 net financial debt figure by € 41.2 million to € 58.8 million.

**Investments** Total investments made during the first six months of 2005 were € 15.3 million, which is 6.7 % below the figure in the same period of 2004 (€ 16.4 million). Investments are to rise steeply, however, in the second half of 2005, and last year's overall figure will be exceeded.

A large part of the investment was in tangible assets related to the construction of the commercial engine assembly hall in Cologne-Porz.

The compact engines segment accounted for € 13.6 million (2004: € 14.2 million) and the DEUTZ Power Systems segment for € 0.9 million (2004: € 0.6 million).

**Research and development** Research and development expenditure in the first half of 2005 was € 31.8 million, 9.7 % above the level of the previous year (€ 29.0 million). The proportion of spending on research and development to sales from new engines remained unchanged from the same period in previous year, at 6.9 %. In the compact engines segment the expenditure of € 26.4 million was 18.9 % higher than last year's figure (€ 22.2 million). The increase is a result of the planned expenses to upgrade engines

to meet the TIER III emission standards which will come into force from 2006 and the expenditure for developing the new commercial vehicle engine.

Research and development expenditure in the DEUTZ Power Systems segment fell to € 5.4 million (€ 6.8 million).

**Employees** As of 30 June 2005, DEUTZ had 5,184 employees worldwide (2004: 5,570). Most of the personnel measures taken in connection with the restructuring of the DEUTZ Power System segment were included in the cutback. As of 1 April 2005, 181 employees in the marine service business also moved to Wärtsilä. The number of employees in Germany fell by 5.0 % to 4,026 (2004: 4,238). The number of employees working at foreign locations declined by 13.1 % to 1,158 (2004: 1,332). This sharp fall was particularly due to the movement of staff from the marine service business, many of whom were employed at foreign locations. Two Scandinavian companies were also sold off at the end of the last financial year.

**DEUTZ shares** The progress made by DEUTZ shares during the first quarter of 2005 continued even more strongly during the second quarter. Standing at € 4.13 at period-end, this represented a very firm improvement of 41.0 % over the price at the end of 2004. The SDAX and the Prime Industrial sector index were both left trailing in its wake. During the same period, the SDAX gained 21.0 %, while the Prime Industrial sector index was only 3.5 % up.

The quarterly low was € 3.55 on 29 April, while the quarterly high closing was at € 4.38 on 11 April. During the course of 12 April, the day of the 2004 balance sheet press conference, the share price rose as high as € 4.55 at one point.

The average number of shares traded per trading day during the first six months was around 244,000.

At the end of the quarter, the company's market capitalisation was € 376.4 million, 41.0 % higher than at the end of December 2004 (€ 267.1 million).

**Outlook** The Management Board confirms the company's overall outlook for 2005. During the course of the year, the planned-for loss of sales from the marine service business which was sold off on 31 March will be offset by a significant increase in sales from the core segments. Measures taken to improve the company's cost structure, price rises and changes to the unit sales mix will take effect during the second six month period. In terms of operating profit, the negative impact of higher raw material prices will be largely offset.

DEUTZ Power Systems will already be making a positive contribution to EBIT this year. Therefore 2005 will bring DEUTZ a step closer towards a position in which it will be able to distribute dividend.

Cologne, July 2005

DEUTZ AG  
The Management Board

## Financial Statements DEUTZ Group, 1st Half year 2005

Balance Sheet in € million	June 30, 2005	Dec. 31, 2004*
<b>Assets</b>		
Business expansion expenses	37.5	35.7
Intangible and tangible assets	371.8	383.8
Financial assets	60.4	59.4
Inventories	237.1	230.7
Trade receivables	204.2	190.3
Liquid assets	12.8	7.9
Other current assets, prepaid expenses and deferred charges	66.9	52.4
<b>Total</b>	<b>990.7</b>	<b>960.2</b>
<b>Stockholders' equity and liabilities</b>		
Stockholders' equity	221.0	155.6
Convertible profit-participation certificates	25.6	25.6
Provisions	437.7	418.9
Bonds	67.3	67.3
Amounts owed to credit institutions	71.6	107.9
Trade payables	104.5	121.9
Other accounts payable and deferred income	63.0	63.0
<b>Total</b>	<b>990.7</b>	<b>960.2</b>

Statements of Stockholders' Equity in € million	June 30, 2005	Dec. 31, 2004*
Subscribed capital	233.0	233.0
Capital reserves	9.0	9.0
Currency translation	2.1	-2.6
Accumulated loss	-82.6	-64.0
Profit/loss	60.7	-18.6
Minority interests	-1.2	-1.2
<b>Total</b>	<b>221.0</b>	<b>155.6</b>

\* Including marine service business

## Financial Statements DEUTZ Group, 1st Half year 2005

Profit and Loss Account in € million	4-6/2005	4-6/2004*	1-6/2005	1-6/2004*
<b>Sales</b>	<b>338.5</b>	<b>324.5</b>	<b>623.0</b>	<b>583.3</b>
Increase / decrease (-) in finished goods and work in process / Own work capitalised	-10.6	-1.0	-1.2	19.3
<b>Total output</b>	<b>327.9</b>	<b>323.5</b>	<b>621.8</b>	<b>602.6</b>
Cost of materials	-200.1	-184.4	-371.2	-338.5
Personnel expenses	-74.4	-76.3	-149.1	-152.2
Depreciation	-13.1	-13.3	-26.0	-26.6
Other operating expenses and income	-26.8	-30.2	-56.0	-60.3
Interest expenses, net	-6.4	-7.9	-13.4	-15.5
<b>Profit on ordinary activities</b>	<b>7.1</b>	<b>11.4</b>	<b>6.1</b>	<b>9.5</b>
Extraordinary income/expenses (-), net	-	-40.0	67.0	-40.0
Taxes	-0.4	-1.0	-12.4	-1.7
<b>Profit/loss</b>	<b>6.7</b>	<b>-29.6</b>	<b>60.7</b>	<b>-32.2</b>

Cash Flow Statement (simplified) in € million	1-6/2005	1-6/2004*
Cash flow	29.8	33.3
Business expansion expenses	-1.8	-2.8
Changes in working capital	-39.7	-20.2
Changes in other receivables, short-term provisions and other liabilities	-26.0	-0.4
<b>Cash flow from normal operating activities</b>	<b>-37.7</b>	<b>9.9</b>
Cash flow from investing activities	78.9	-16.4
Cash flow from financial activities	-36.3	-0.1
<b>Changes in liquid funds</b>	<b>4.9</b>	<b>-6.6</b>

\* Including marine service business

The accounting and valuation principles adopted for the 2004 financial statements were also applied to the half-year report.

This half-year report has been drawn up in compliance with both the DRS 6 (German Accounting Standards) and the German Commercial Code (HGB).