

Tognum AG

Report of the Executive Board to the Annual General Meeting on 18 May 2010

Volker Heuer

Chairman of the Executive Board and CEO of Tognum AG

Only the spoken German word shall be valid.

This version of the report is a translation of the German original manuscript and has been prepared for the convenience of English-speaking readers only. This means that it is neither in general nor legally binding and that for the purposes of interpretation only the spoken German word shall be valid.

UNDER EMBARGO UNTIL 18 May 2010, with the beginning of the report of the Executive Board

Dear shareholders and shareholder representatives,
dear guests and friends of our company,
dear colleagues,

May I wish you all – also on behalf of my colleagues on the Executive Board – a very warm welcome here today.

There are some facts of life we have little influence on – the weather, for example, or birthdays and crises. And that's the way it should be.

It was the **weather** in fact, or to be more precise, a storm that ultimately led to the existence of our company. Engine trouble forced an airship built by Count Zeppelin to make an emergency landing near Stuttgart. A strong gale came up some time later, tore it from its mooring and blew it into a nearby orchard. The airship, which was filled with flammable hydrogen, caught fire and was completely gutted. Its designer wasn't discouraged by the freak accident – on the contrary. Supported by a wave of solidarity, Count Zeppelin continued his work. To do this, however, he needed to improve the quality of the engines and design them to meet the airship's specific requirements. What was needed above all was a high power output combined with low weight. As a result, the young engine builder Karl Maybach was given the opportunity to install his engine into the next generation of airship. To this end, they decided to set up a company together – the predecessor company of MTU and the beginnings of what was ultimately to become the Tognum Group as we know it today. This all took place a good one hundred years ago. The company's history has been inextricably linked with the City of Friedrichshafen and the economic region of Lake Constance ever since.

We have been through a number of storms since then and survived unscathed, including economic crises, crises in specific markets, and local crises. Two world wars and the international financial crisis of 1929 did not affect us substantially. The challenges of the past have made us what we are today: a premium manufacturer of high-speed diesel engines, propulsion systems and distributed energy systems, and a technology leader determined to be the preferred supplier, offering its customers the best solutions. A strong team made up of people filled with the spirit of innovation who have a passion for engineering and technology and the courage to constantly seek new avenues. A forward-looking company operating on a global scale that thinks and acts long term. We accept our responsibilities towards society and people in whose regions we operate.

In 2009, our **100th anniversary** year, our mettle was tested once again. The economic barometer indicated stormy weather ahead and a strong wind was blowing in our direction. Once again we were able to demonstrate that we can handle inclement weather. We celebrated our milestone anniversary – in a manner that was appropriate to the occasion, of course, and also appropriate to the turbulent market conditions. We were particularly delighted to have the German Chancellor Dr. Angela Merkel as one of our guests – here in the Graf-Zeppelin-Haus. Our special celebration year produced lots of positive ideas, which we have been able to put to good use. The extensive reporting of the events considerably strengthened our image, which will now remain firmly fixed in the minds of the general public and our customers alike. In the process of reviewing the history of our company and taking a close look at our roots, we became acutely aware of our values, and this has ultimately been of great benefit to our corporate culture. It has also increased the awareness in the workforce of who we are and has resulted in a sense of togetherness that is stronger than ever.

It was also time for us all to roll up our sleeves and do something, because the global **financial and economic crisis** had left neither our customers nor Tognum itself unscathed. This time it had affected all our markets. Following a growth phase lasting several years, which resulted in an initial record performance in 2008, there followed a weaker year under the pressure of a global recession. Our business model and corporate strategy proved to be sound and once again performed well under pressure even in what has been the most severe crisis for decades. Competitors with regards to high-speed diesel engines which we measure ourselves against on average reported declines in revenue of 33 per cent. By comparison, with a decline of 19 per cent, Tognum performed well. There are companies in our business

sector who slipped into the red last year. We are making a profit, and our return on sales at 7.9 per cent is well above the average of 1.5 per cent, which is pretty good.

Following the sale of the Rotorion propeller shaft business, we are now focusing solely on our off-highway business in stationary and mobile applications on land and water. Our products and services are now used in over 20 different application areas in regions all over the world, which, in the event of economic fluctuations, enables us to compensate for lean periods in one market with successes in another. Last year demonstrated very clearly that this principle works even in a global and cross-sector economic crisis. With a broadly diversified product portfolio and growing after sales business, we have a strong operating position. This long-term strategy gives us stability – an advantage that sets us apart from most of our competitors.

There's not much we can do when the weather doesn't cooperate. There's also not much we can do when the economic situation and crises make our lives and business difficult. And there's not much we can do when birthdays or anniversaries occasionally arrive when nobody's really in the mood for celebrating. But we can make the best of such occasions. And that's precisely what we do at Tognum.

This also applies to the Annual General Meeting. Instead of holding our AGM this year at the Exhibition Centre, we have invited you to attend the meeting here in the Graf-Zeppelin-Haus. We decided to change the venue, because the dates we proposed collided with those of the Exhibition Centre. And we also think that the atmosphere here is appropriate to the occasion.

Review of 2009

We also did the best we could with the financial year just ended. We countered an extremely challenging economic environment by taking forward-looking action at an early stage. We have demonstrated that, even under adverse conditions, we are capable of generating sustainable profits and our business is future-proof. We managed 2009 well and met the revenue and earnings forecasts we had submitted at the start of the year reliably and in full.

The figures are already known to you from the Annual Report, so that I only need to mention the most important ones. The **order intake** for the group in 2009 was down 28 per cent to € 2,330 million compared with the strong performance in the year before. Revenues were also down 19 per cent to € 2,529 million. We had expected a drop of up to 20 per cent. Not including sales revenues from the Rotorion companies in 2008 and 2009, the decline would have been 17.8 per cent. In the case of the **adjusted EBIT margin** at 7.9 per cent, we were precisely in our target corridor of between 6 and 9 per cent. **Adjusted group earnings** amounted to € 121 million, with **adjusted earnings per share** amounting to € 0.92. Due to the high level of funds available from operating activities, we have been able to reduce our **net financial debt** significantly by 43 per cent to around € 192 million. At the same time, we were successful in strengthening our equity base again last year. At 27.6 per cent, our **equity ratio** in 2009 achieved its highest level since our IPO mid-2007. Our balance sheet is sound and we have sufficient liquidity and credit lines available. This ensures excellent prospects for the future. As a result of our financial and operational strength, we can stand by our long-term strategy and continue to pursue our projects. There are others in our sector who will find it difficult to keep up with us.

SEGMENT PERFORMANCE

Let us take a look now at what's been happening in the "Engines", "Onsite Energy & Components" and "Distribution" reporting segments. All three reported losses due to the economic situation. After sales business performed well in all segments and proved solid support. Customers tended to postpone new purchases of propulsion and energy systems, preferring to invest in service, repair or general overhaul, using new and remanufactured spare parts.

The **Engines segment** includes sales of diesel engines and propulsion systems which are used in a variety of application areas, such as in the marine, construction and oil and gas industries, in agriculture and in defence, to name but a few. Revenues in this segment amounted to 1,681 million euros and were thus 18 per cent below the preceding year's level. The adjusted EBIT margin was 8.1 per cent.

The **Onsite Energy & Components segment** covers decentralised energy systems based on diesel engines, gas engines, fuel cells and gas turbines. Engine components are also included, such as L'Orange brand fuel injection systems. The revenues in this segment were down 29 per cent to 719 million euros. Not including the propeller shaft business, the decline would have been 27 per cent. The adjusted EBIT margin was 3.8 per cent.

We included the **Distribution segment** for the first time at the start of 2009. The new segment contains all the Group-owned sales companies in the Europe and Asia/Pacific regions. Revenues in this segment were down 13 per cent to 524 million euros. As a result of the excellent performance in Asia, the adjusted EBIT margin in this segment increased to 9.5 per cent.

ANNUAL FINANCIAL STATEMENTS OF TOGNUM AG

So much for our review of the key financial indicators of the Tognum Group. What is relevant for the resolutions to be passed today is a look at the financial statements of Tognum AG. The income statement of the company as a single entity reports a **net profit** of 97.4 million euros. Taking into consideration the **profit carried forward** from the previous year of 109.4 million euros and the **allocation** of 48.7 million euros to **returned earnings** this results in **accumulated profits** of 158.1 million euros. The **equity** of the company at the end of the year had risen to 714.8 million euros.

DIVIDENDS AND SHARE PRICE

As Tognum shareholders, you can rely on a consistent dividend policy. At the IPO three years ago, we had announced that we intended to distribute between 30 and 50 per cent of the Group's net income in the form of dividends. Not only do we intend to do this for last year, but also for the years ahead. Our proposal on which you will later vote will be the payment of a **dividend** of 0.35 euros per share.

To everyone's delight, the price of the **Tognum share** has performed extremely well for a good year now. Following the crisis on the financial markets, most indices had fallen to multi-year lows by the end of the first quarter of 2009. At the end of March 2009, the Tognum share had reached an all-time low. Since then we have been seeing almost constant gains, with the share gaining a total of 28.9 per cent during the financial year just ended, closing at 11.60 euros. On 7 May this year, it reported a 24.3 per cent gain and thus performed much better than the MDAX, which rose 1.7 per cent.

ROBUST ACTION PLAN

Before we take a look ahead, I'd like to say a few words on the current situation. As our response to the economic crisis, we had put together an action package as early as autumn 2008 and created a database of ideas designed to stabilise our business in the short term. We call it our "Robust Action Plan". It focuses on four areas: the market and sales, employment, cash and risk management. Plus cost reduction and investment planning. I presented the details at our Annual General Meeting a year ago. It has been a great success. As a result of the programme we acquired around 100 million euros in 2009, which ultimately improved our net income.

We have brought our **sales** activities in line with the changes on the **markets**, for example, and have introduced appropriate price increases. We also check our budgets critically throughout the Group and, in view of the crisis, reduce **costs** where ever this appears possible and makes sense. In view of the turbulent market conditions, our comprehensive **risk management** system also examines in detail those risks that arise as a result of customers and business partners finding themselves in financial difficulties. We safeguard our own **liquidity** by pursuing a consistent approach to the management of net working

capital. Our **investments** are focused on strategically important projects and we will continue to pursue this policy this year.

One of these projects is the logistics centre for production we are planning to set up in Kluftern. The aim is to have all the parts required for an engine available at a central location that is physically close and conveniently located to the manufacturing and assembly facilities. The material is currently distributed over ten storage and logistics sites located in the Lake Constance region. Having them at one location will enable us to optimise logistics processes and delivery schedules, and improve cost effectiveness. It will also allow us to gain production space on the current factory premises. The region will also benefit in that production and with it numerous jobs in the region will be secured, and new jobs could be created. Ultimately, the optimised logistics system will result in better utilisation of vehicle capacity, which will subsequently reduce the environment impact.

We also make no compromises in the case of our research and development activities. Quite the contrary in fact: this is an area where we are continually increasing our budget and in 2010 will actually be making the largest R&D budget available in the history of our company. This is an approach that has served us well since 2006 and one we will continue to pursue in the future. And for good reason – with innovative cutting edge products we will be able to move ahead faster when the crisis is over and expand our competitive edge in the long term. I'll come back to this in a moment and present the technologies of the future in which we are investing.

All this requires an enormous amount of effort. The credit goes first and foremost to our **workforce**. On behalf of my colleagues on the executive board and certainly on your behalf as well, therefore, I would like to thank all the members of our workforce throughout the world for their tremendous willingness to take on responsibility, the flexibility and initiative in the light of the difficult global economic situation. Years ago, we sat down together and developed a forward-looking flexitime model for the Friedrichshafen location. This enables us to build up overtime in boom periods and now, in the crisis we have been going through, its full potential has been revealed. Members of our workforce reduced capacity to an enormous extent by debiting their working time accounts with negative hours for example. They also did without special payments and agreed to postpone part of the salary increase expected in the first six months of 2009. In the USA and in Germany, we had to lay off temporary workers and no longer extended temporary contracts. As a result of all these measures, we not only managed to keep our core workforce on board, but have been able to avoid introducing short-time work. There are few companies in our sector who can claim to have done such a thing in the kind of crisis we are currently going through. It points out quite clearly that, as far as our employment policy is concerned, we understand how to deal cautiously with the crisis.

All of this shows that the Robust Action Plan can already point to successes and achievements. Reason enough to continue this programme in 2010.

Independently of our Robust Action Plan, our **personnel strategy** focuses on the long-term employment of our core workforce. It is designed to offer qualified specialists interesting prospects for the future and precisely for this reason earned us the “Top Employer for Engineers 2009” quality seal of approval last year. We received the same award this year for the second year running, and in March of this year also received the “Top Employer in Germany 2010” award. Compared with other companies, we stand out at Tognum as a result of our strong commitment to talent management. We have an international trainee programme, for example, which lasts 18 months and offers young professionals an ideal opportunity to prepare for positions of responsibility. We also have a tradition of providing in-depth training for non-academics that goes back over 90 years. In 2009, for the second time since 2006, for instance, one of our engine mechanics was awarded the title of best apprentice in Germany, which shows that the investments we make in a modern learning environment for junior staff do pay off. Our 313 apprentices moved into the new training workshop at the Friedrichshafen location in 2009. We believe it is important to create the general background conditions that will ensure our employees feel comfortable in their working environment and have the freedom and opportunities they need to develop, so that ultimately they will be able to fully exploit their potential. Health management and

programmes that create a balance between career, family and leisure time activities are part and parcel of this concept.

Outlook

Let's look ahead now. What do we see happening in the current financial year? The challenges we face in our markets will be tough, because the crisis is not yet over. Tognum's business partners who equip their vehicles and machinery with our drive and propulsion systems have cleared their stocks and are still not prepared to commit themselves to any major investment. In view of the continuing volatility and unpredictability of the markets, they will probably remain cautious. Their ordering behaviour has changed fundamentally as a result of the crisis. Before 2009, they frequently ordered large quantities in advance for an entire year. In times of growth, production in their plants and ours was running at full capacity, which resulted in longer delivery times. Delivery times today are much shorter, which is also the reason why our customers now tend to place relatively small orders at shorter intervals.

How the overall economy and our business will develop over an extended period of time is difficult to predict. Generally speaking, tensions in the financial industry appear to be easing, but the reports from Greece and other European countries indicate that, in view of the ailing budgets, new risks are emerging. In spite of this, along with our financial results for 2009, which we presented mid-March of this year, we included a **forecast for 2010** that we continue to support. We expect the markets to become stable in the course of 2010. However, the economic stimuli will probably not be enough to create a long-term upswing. For this reason, we anticipate revenues of between € 2.3 and 2.5 billion for Tognum this year. In view of the high investments in R&D, the adjusted EBIT margin for the year is likely to be between 6 and 9 per cent. Our mid-term targets also remain unchanged: we intend to grow faster than the market on average and achieve a double-digit average return on sales.

PERFORMANCE IN THE FIRST QUARTER OF 2010

The business figures for the first quarter reflect our current assessment. As expected, revenue performance at around 509 million euros remained weak. By comparison with the same quarter last year, revenues were down by around 21 per cent. We nevertheless managed to achieve an adjusted EBIT margin of 8.4 per cent, which is within our target corridor for the year as a whole. The adjusted group earnings in the first quarter amounted to around € 22 million. This result is an adjusted earnings per share of € 0.17. Our order intake in the first three months of the current year was up by a pleasing 7 per cent to around € 697 million. If the orders intake included in the comparative figures of the same period last year for the Rotorion operations, which have since been sold, were eliminated, the increase would have amounted to no less than 13,5 per cent. We consider this to be an encouraging sign that demand is beginning to recover. However, it is still too early to talk of steady growth.

FIVE LONG-TERM GROWTH INITIATIVES

In the last part of my report, I would like to give you our mid-term and long-term view of the future.

We took the initial steps long ago and established five long-term growth initiatives, on which we concentrate on. They focus on the expansion of our business in propulsion systems and onsite energy systems, the expansion of our after sales business, the extension of our product portfolio and regional expansion.

1. Onsite Energy

The first pillar of our growth strategy is the expansion of our Onsite Energy business, which markets distributed energy systems. This is where, in addition to our after sales business, we expect to see our strongest growth as a result of the growing demand for energy. Under the MTU Onsite Energy brand, we are the only supplier to offer distributed energy systems based on diesel and gas engines, and on fuel cells and gas turbines. In November, we

launched a new generation of turnkey diesel gensets. This will enable us to further expand our business in stationary energy systems for emergency and continuous power generation. The new product family basically consists of an engine combined with a generator, cooling system, control system and supporting frame. From a variety of individual high-quality modules, the customer can put together a unit that meets his specific needs. He benefits from the high level of operational efficiency, cost effectiveness and short delivery times. I have quoted this example to demonstrate that we have developed from being a manufacturer of engines into a system supplier, and achieve more value added.

2. Propulsion

In the case of propulsion and drive systems, our second growth initiative, our system competence is increasingly in demand. Our focus is on both our standard and project-related systems business. And to this end, we offer automation and system solutions which strengthens our position as a one stop supplier: in the case of marine applications and in defence technology, we are already well positioned to provide integrated propulsion solutions. The future is in innovative hybrid systems and we have already reached an advanced stage in the development of prototypes for rail and marine applications. These are designed to significantly reduce life-cycle costs and cut emissions, and will also offer the customer more operational benefits and a higher level of practical convenience.

3. After Sales

Our after sales business is the third strategic initiative and a key growth driver. In the past, we have focused primarily on selling spare parts, offering training courses and providing our customers with technical documentation. In the course of the last four years, we have continuously expanded our range of products and services, in order to better meet the needs of our customers.

We take pride in the fact that our propulsion and energy systems exhibit maximum availability. This enables to guarantee the availability of our products in long-term maintenance contracts and to provide remote monitoring of engine performance in service. We included the remote monitoring of engines in our range of services for the first time last year. It is now an integral part of the all-round service packages that we make available to our customers around-the-clock all over the world. These include preventive maintenance using high-quality spare parts and performed by highly qualified service staff. Last year, we also extended our remanufacturing service, which involves the refurbishing and upgrading of engine parts or complete engines until the end of their service lives. We have implemented a standard procedure worldwide for this purpose.

We are convinced that high technological demands placed on our products, combined with the increasing number of MTU engines on the market, represent the ideal basis for long-term growth. In addition, we benefit from business relations of many years standing. Our business potential varies, however, depending on the application area. It ranges from options, in which the warranty period can be extended on payment of a surcharge, and regular test runs for emergency power generation systems for example, to complete long-term maintenance contracts including a general overhaul. All these services are designed to support our after sales business, with the aim being to make us indispensable to the customer throughout the engine's entire life cycle. This maximises the earnings potential of every single engine we sell and also ensures that, by the time it reaches the end of its service life, the engine will be replaced by a refurbished or a new Tognum product.

4. Product Portfolio

The continuing development of our product portfolio is the fourth pillar of our growth strategy. Just recently, we began to extend our product programme in the lower power range with the Series 1600 engines. We will supply these engines to power generation facilities and as from 2014 applications such as construction and industrial equipment. We are currently looking into the question of whether it makes sense economically to supply engines in this lower power range for marine applications and gas-driven power generation applications in the long term. In the case of marine applications, we are considering yachts and commercial ships.

We began series production of the Series 1600 engines for power generation applications in November last year. By the fourth quarter of 2010, we expect to have launched all the various

cylinder versions of this engine series – from six to twelve-cylinder – as scheduled. Tognum is the first engine manufacturer to offer engines in the power range of between 270 and 730 kilowatts designed and developed specifically for off-highway applications. Despite the difficult economic environment, there has been a very positive response from the market.

At the world's largest trade fair for construction machinery, Bauma, which was held in Munich mid-April, we presented our future range of engines for construction and industrial applications. Commencing in 2014, in the power range below 560 kilowatts, and thus below the Series 1600 engine, MTU will be supplementing its product programme with new four and six-cylinder engines designated Series 1000, 1100, 1300 and 1500. These will be based on the next generation of commercial vehicle engines supplied by Mercedes-Benz and will be designed by MTU specifically to meet the requirement profile of construction and industrial applications. This means that we already have solutions today that not only meet the emission standards that will be required by law as from 2014, but will also meet the standards with even less fuel consumption. We are well ahead of the competition in this area, and the supplier with the best technical solution to meet the tougher emission requirements will lead the field.

Incidentally, we have forward-looking propulsion technology and ways of generating environmentally friendly energy currently on display at the Shanghai World Expo 2010.

On the whole, we offer our customers a complete and also convincing new product portfolio that covers all their needs – in terms of both engine features and performance requirements.

5. Regional Expansion

And now to our fifth and last strategic growth initiative – regional expansion. In the last few years, we have focused on expanding our international operations along the entire value added chain from research and development to purchasing, production and assembly, down to sales and after sales.

In the course of this expansion, we have set up our first engineering and development centre in Asia, located in the Indian city of Pune, which will give us additional development capacity at low cost. The centre will work closely with our technology centre here in Friedrichshafen.

In addition, our global purchasing group continues to certify international suppliers. This is necessary because more and more clients are paying attention to ensure that contracts include local content and that local value added will result.

Another important element of our regional expansion strategy is to expand our production network and make it more international. Last year our first parts production plant outside Germany went into operation – the production of cylinder liners in Turkey. We announced recently that we were relocating our assembly site in the USA from Detroit to South Carolina, where benefits will include higher productivity, which will lead to lower costs. We will also set up the second parts production plant outside Germany for large engine components, cylinder heads and other components of our Series 2000 and 4000 engines. This will enable us to set up more effective global logistics processes and more flexible production. We have also set up a joint venture in China that will assemble the first gensets this year for Chinese nuclear power plants. Since 2007, we have assembled Series 2000 engines in China.

We are also pushing ahead with our global sales. We are already present in 130 countries with over 1,200 service organisations and dealerships. To penetrate into local markets more effectively, we are entering into cooperation agreements where it would appear to make sense. At the beginning of 2009, for example, we teamed up with a strong local partner of ours, Marubeni, a general trading house, to run our business in Japan in future on the basis of a joint venture agreement. In Spain last year, we acquired Casli, which had until then been operating as a distributor of Tognum products.

And finally, we have advanced the internationalisation of the last link in our value added chain, after sales. Approximately one year ago, we opened a service centre in the South of France. This is an ideal location to exploit, among other things, the business potential offered by the countless marine engines in the Mediterranean. Furthermore, MTU India in

Pune not only takes care of development, but also handles sales and after sales. We also have a training centre at our new location.

These five growth strategies emphasise that we have not been concerned primarily with limiting the damage caused by the economic crisis, but with the future of our company. Above all else, the long-term focus of these growth strategies must have made it clear to you as shareholders of the company that we have a clear target, and that target is to increase shareholder value in the long term. Because this long-term increase in shareholder value is the prerequisite for a positive performance of our share price. And as I said earlier, we intend to stand by our dividend policy.

As you can see, we have set our course for the future – in terms of both operations and strategy. And that is something you have every right to expect from a corporate management that takes its responsibilities seriously, as we do at Tognum. This also includes continuity on the executive board. As you have no doubt heard from the media, I have decided to leave Tognum at the end of September 2011. This is why I asked the supervisory board well in advance not to extend my contract by the usual three years, but by one further year only. At the same time, I have proposed that Joachim Coers succeeds me as CEO. I am especially pleased that the supervisory board unanimously approved both requests, since this means we have secured continuity in our corporate management and strategy at an early date.

Ladies and Gentlemen,

You are the owners of a global premium supplier that is strategically focused on the future and on the long-term increase in shareholder value. The basis of our success is our innovative power and our technological strengths, which we commit to achieving profitable growth: today and tomorrow. Thank you for accompanying us on this journey.

Disclaimer regarding forward-looking statements et al.:

This report also contains forward-looking statements based on assumptions and estimates of Tognum's Executive Board of Management. Although we assume that our assumptions and estimates on which we have based these forward-looking statements are realistic, we cannot guarantee that they will in the future prove to be correct. The assumptions and estimates, by their nature, may harbour risks and uncertainties that may cause the actual figures to differ considerably from the forward-looking statements. Factors that may cause such discrepancies include, among other things, changes in the economic and business environment, variations in exchange and interest rates, the introduction of competing products, lack of acceptance for new products or services and changes in corporate strategy. Tognum does not undertake any obligation to update, to review or to confirm the forward-looking statements or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this announcement.