

## Risk Report

### Risk Management System

The active and transparent management of the various risks within the operating segments is a key tool for ensuring corporate success. The comprehensive analysis and management of earnings-related risk factors and going-concern risks requires integrated planning, reporting, financial control as well as early warning systems and processes for the entire Group.

The current Group-wide risk management system was introduced in October 2006. We are continuously adapting it in line with current developments and regularly testing it for effectiveness. In financial year 2007/2008, audit firm KPMG conducted an external analysis of our risk management system, providing the Demag Cranes Group with valuable insights for its ongoing development. In financial year 2008/2009, these were translated into a Group-wide risk management guideline that came into effect on 10 March 2009. In particular, the system used to classify risks and risk strategies was optimised, the terminology and categorisations were adapted, risk assessment and measurement methods were harmonised, risk reporting was redesigned and the risk management process was reorganised.

The purpose of the uniform Group risk management system is to identify risks in good time, evaluate them and communicate them appropriately. As an integrated, ongoing management and control tool, it supports the decision making that allows opportunities to be exploited in a structured way and the risks that arise to be consciously accepted or either mitigated or averted by taking countermeasures. Risks are assessed in terms of the extent of the potential damage or loss and their probability of occurrence.

Risk management responsibilities are allocated in line with the Group structure. As a general rule, each operating segment in the Demag Cranes Group manages the risks arising in its own area of responsibility. For this purpose, each segment has a risk controller who supports the risk management process at segment level and checks the data for plausibility.

At Group level, a central risk controller has overall responsibility for preparing the Group risk report and coordinating the risk management process. All segment risks that may accumulate at Group level are recorded and managed centrally. Interim reports are prepared by way of a standardised, two-step reporting process at Group and segment level on a quarterly basis and immediately if risks materialise or damage is incurred. The most senior decision-making body is the risk committee, which uses the documentation and communications processes in place to ensure that the responsible decision makers and in particular the Management Board and Supervisory Board of Demag Cranes AG are informed regularly and in good time about risk factors that could materially affect the Company's business development.

As part of the continuous improvement process, preparations are currently being made for the introduction of a software solution with which we aim to record and report risks even more efficiently.

The Demag Cranes Group's risk early warning system complies fully with statutory requirements. The system was assessed by Deloitte & Touche GmbH Wirtschaftsprüfungsgesellschaft, Düsseldorf, in the course of auditing the Financial Statements.

## Significant Individual Risks

### Financial Risks

The Demag Cranes Group is exposed to financial risk in its operating activities. Monitoring, controlling and limiting this risk at Group level (financial risk management) and fine-tuning the Group's finances are the responsibility of Group treasury. The primary objective in this is to guarantee the Company's continued ability to operate as a going concern and its earning power. Rolling cash forecasts and central cash management ensure that the Group has adequate funding at all times, including in the form of bank borrowings and credit balances. Derivative financial instruments are used solely to hedge underlying transactions. Trading, settlement and back office functions are strictly separated.

The following financial risks are managed in the Demag Cranes Group:

#### ***Risks Related to the Master Financing Facility***

The credit facility is subject to certain covenants with regard to additional borrowing, purchases and disposals of assets, and the provision of collateral. There are also financial covenants to be observed during the lifetime of the credit facility. These include stipulated ratios for consolidated net debt<sup>4</sup> to consolidated operating EBITDA<sup>5</sup> (less than 2.75) and consolidated operating EBITDA<sup>5</sup> to consolidated net interest payable (greater than 4.0).

If the financial covenants are not met and their breach is not remedied or the lenders do not waive the covenants, there may be grounds for termination under the conditions of the credit facility. Among other things, the lenders would then be entitled to call due all amounts owed with immediate effect. There are also certain other contractually agreed circumstances whose occurrence can lead to termination with all outstanding amounts becoming due for repayment with immediate effect. A further right of termination exists in certain instances where a third party acquires a controlling or majority shareholding.

#### ***Currency and Interest Rate Risk***

Most Group business is transacted in euros, US dollars and pounds Sterling. The Group is mainly exposed to currency risk where payables and receivables exist or are likely to arise in a currency other than in its local currency. As part of active risk management, foreign currency payables and receivables are normally hedged as they arise using financial instruments (foreign exchange contracts) (see also the Notes to the Financial Statements under Note 33, Additional Disclosures on Financial Instruments).

Risk due to changes in market interest rates is liable to affect variable-rate loan exposures in particular and may have an adverse impact on cash flows (cash flow risk). For the lifetime of the variable-rate master loan agreement, interest rate swaps and collars are used to hedge this risk on a pro rata basis in line with forecast changes in loan exposure over time. The cash flow impact of interest rate changes is subject to regular analysis.

<sup>4</sup> Group net debt adjusted for downpayment guarantees exceeding EUR 35 million.

<sup>5</sup> Group operating EBITDA adjusted for non-cash charges under the MSP program.

**Liquidity Risk**

Liquidity risk can result in the Demag Cranes Group being unable to make available the funds needed to meet financial obligations entered into in its operating business or in connection with financial instruments. Safeguarding the liquidity of the Demag Cranes Group while allowing sufficient reserves for special eventualities is therefore an integral part of ongoing liquidity management. Resource equalisation within the Group through cash pooling and intercompany loans ensures that cash surpluses at individual Group companies are efficiently used to meet funding needs at others.

Sufficient lines of credit ensured that neither funding nor liquidity shortfalls arose in financial year 2008/2009. Under the master loan agreement entered into by Demag Cranes AG, the Group had EUR 140.0 million undrawn on a revolving credit facility at the balance sheet date (2007/2008: EUR 140.0 million). The facility can be drawn against for terms of between one and six months and has a total term of up to one year and nine months. Under the same master loan agreement, the Group also had access to EUR 16.4 million in undrawn combined credit and guarantee facilities at the balance sheet date (2007/2008: EUR 10.3 million).

**Credit Risk**

Credit risk arises when customers or other contractual partners delay or default in meeting their obligations under a business transaction and financial losses are suffered as a result. The Demag Cranes Group counters specific credit risk by only doing business with parties of good credit standing, primarily based on the ratings of national and international trade credit rating agencies, and by rigorously observing risk limits laid down by trade credit insurers. Credit risk is also avoided by agreeing advance payments and the use of documentary letters of credit.

**Compliance Risk**

Reporting on compliance risk covers risks such as legal risks, risks arising from breaches of compliance regulations and risks arising from fraudulent activity. The Demag Cranes Group has set up a compliance system that counters these risks through various compliance guidelines, compliance audits and employee training. No significant compliance risks have been identified at the present time.

The Management Board and the Compliance Officer review the compliance system of Demag Cranes AG regularly and adapt it to meet changing requirements.

**Operating Risks****Procurement Risks**

There are certain dependencies relating to suppliers of the Demag Cranes Group. These arise in part because there are only limited possibilities for changing suppliers of certain components and assemblies at short notice and in part because there is a technical/commercial dependency on suppliers of certain components, especially moulded components. The Group has defined clear procurement strategies for such cases to ensure long-term security of supply. In recent years, outsourcing has been increased in order to keep fixed costs at a much lower level, including in comparison with competitors. This also gives rise to dependencies on suppliers. The Company counters the resulting risks through careful selection and supervision of outsourcing partners using comprehensive supplier management systems. Bought-in parts account for a large proportion of production costs. As the steel industry, for example, is subject to strong cyclical movements, prices can be volatile. Through a wide range of specific measures, the Group constantly endeavours to secure prevailing market prices.

**Production Process Risks**

Production processes can give rise to complex risks, the main ones being unanticipated technical difficulties, unforeseen developments at project locations, problems at partner companies or subcontractors and the resulting disruptions to logistics. These risks are minimised by issuing comprehensive guidelines and procedural instructions on project and quality management, product and occupational safety as well as environmental protection. Risks are also mitigated through systematic employee training and development, continuous improvements to production processes and technologies, and regular plant and system maintenance.

The Group has adequate insurance cover for losses resulting from technical failure, fire, explosions and similar events.

**Major Project Risks**

Within the Group, potential major project risks, such as liability and earnings risks, are continuously monitored and mitigated through strict project management and control. Cost overruns can nevertheless occur, especially on major automated projects, but can be managed by limiting liability and concentrating on core products.

**Product Risks**

In order to maintain its competitiveness, the Demag Cranes Group works continuously to develop new products and improve the existing product range. Despite using state-of-the-art project management, monitoring and control techniques, new product development entails considerable cost risk. This risk lies not only in the actual development phase, but also after market launch, as the possible need for technical improvements can only be identified once products are in continuous operation in real-use conditions. Risks arising from product liability cannot be ruled out entirely. They may affect the Demag Cranes Group in the form of financial losses and damage to its reputation. Insurance has been taken out to cover product liability claims.

**Information Technology Risks**

In order to ensure the security and efficiency of our business processes both now and in the future, our IT systems are constantly being checked and developed. In order to limit the risk of failure of application-critical systems, websites and infrastructure components, the Group complies with industry standards, such as back-ups, redundant network connections and separate computer centres. In financial year 2008/2009, the new Group-wide IT strategy developed with the aim of increasing transparency in the segments, regions and companies was systematically introduced across all units. In particular, the SAP systems at Demag Cranes & Components GmbH and Gottwald Port Technology GmbH were uniformly updated to the current version 6.0.

### **Personnel Risks**

The future of our business largely depends on the dedication and performance of our employees. The Group seeks to meet the ever fiercer competition for highly qualified specialist and senior staff, as well as the related risk of loss of expertise due to staff turnover, by offering attractive training and development opportunities and performance-based compensation systems. In addition, it places particular emphasis on knowledge management within the Group by consistently supporting and advancing top management. As part of an employer branding initiative, we are also developing a new strategy to enhance the Group's attractiveness as an employer so that it can recruit tomorrow's employees and managers today.

### **Strategic Risks**

#### **Economic Risks**

Most of the products and services provided by the Demag Cranes Group can be allocated to the global market for cargo handling equipment and material logistics. Demand for such goods depends to a considerable extent on the performance of the overall economy. The weak economic environment and a waning appetite for investment are having a significant impact on the Demag Cranes Group's order book. With the outlook for the global economy still unclear, the Group does not expect any near-term improvement in the economic situation in its markets. To cushion the effects of the sharp drop in sales volumes and revenue as a result of the global financial and economic crisis, the Demag Cranes Group has already decided on a restructuring programme, which is currently in train.

The cranes and hoists offered by the **Industrial Cranes segment**, which are used in a range of industries and serve a variety of customer groups, are heavily dependent on economic cycles. It remains very difficult to forecast future market trends. The risks are increased because some of our end customers operate in cyclical sectors, i.e. in sectors that are particularly sensitive to changes in the economy as well as to global and regional trends. The tendency among customers to postpone decisions on capital expenditure is sharply reducing order intake in this segment.

The **Port Technology segment** is dependent on worldwide cargo volumes and growth in container handling. Falling demand has pushed down cargo rates on the main container routes, forcing shippers to combine cargo routes and take container vessels out of service. Port operators are responding by postponing major projects and decisions on capital spending. All product groups including Port Technology services are affected by the economic crisis. Over the medium and long term, however, we still anticipate further growth in global cargo traffic and therefore continuing demand for the relevant handling equipment.

The effects of the financial and economic crisis are also evident in the **Services segment**, albeit to a lesser extent than in the Group's other two segments. Lower utilisation of cranes by customers has led to a temporary drop in sales of higher-margin spare parts, as customers are delaying maintenance work and postponing refurbishment projects. However, the Demag Cranes Group expects the resulting backlog to be worked down gradually as the economy recovers since equipment will have to be maintained as usual in the interests of safety, reliability and availability.

#### **Price Competition**

The Demag Cranes Group operates in markets characterised by intense competition and in some cases considerable price pressure. This price pressure is particularly apparent in certain emerging economies. Here, technological benefits cannot always be given adequate consideration when making purchasing decisions owing to the sometimes very limited funds available for new investments.

In order to develop and maintain a competitive edge in spite of this, the Demag Cranes Group invests in developing products for differentiated customer and market segments as well as in expanding its distribution and service network.

#### **Competitive Risks**

Any company operating globally in the mechanical engineering sector faces risks arising from the activities of competitors. Observation of our competitors suggests that global competition will generally rise in the Demag Cranes Group's product segments. We will tackle these risks by constantly monitoring the market and developing product, pricing and marketing strategies on the basis of our observations.

#### **Assessment of Overall Risk for the Group**

According to our assessment of the overall risk, the current risks in aggregate will not threaten the Demag Cranes Group's ability to continue as a going concern or have a material adverse effect on its financial position or financial performance.