

GENERAL INFOR- MATION

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RESPONSIBILITY STATEMENT

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the group management report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Frankenthal, 21 March 2018

KSB Management SE

The Managing Directors

INDEPENDENT AUDITOR'S REPORT

To KSB SE & Co. KGaA, Frankenthal/Pfalz

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS AND OF THE GROUP MANAGEMENT REPORT

AUDIT OPINIONS

We have audited the consolidated financial statements of KSB SE & Co. KGaA (formerly KSB Aktiengesellschaft), Frankenthal/Pfalz, and its subsidiaries (the Group), which comprise the statement of financial position as at 31 December 2017, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the financial year from 1 January to 31 December 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of KSB SE & Co. KGaA for the financial year from 1 January to 31 December 2017. We have not audited the content of those parts of the group management report listed in the "Other Information" section of our auditor's report in accordance with the German legal requirements.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § [Article] 315e Abs. [paragraph] 1 HGB [Handelsgesetzbuch: German Commercial Code] and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as at 31 December 2017, and of its financial performance for the financial year from 1 January to 31 December 2017 and
- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the group management report does not cover the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

Pursuant to § 322 Abs. 3 Satz [sentence] 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

BASIS FOR THE AUDIT OPINIONS

We conducted our audit of the consolidated financial statements and of the group management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted

Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the “Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report” section of our auditor’s report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the consolidated financial statements and on the group management report.

KEY AUDIT MATTERS IN THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January to 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matters of most significance in our audit were as follows:

- 1 Recoverability of goodwill**
- 2 Accounting treatment for customer-specific construction contracts**
- 3 Recognition and presentation of transactions with “related parties”**

Our presentation of these key audit matters has been structured in each case as follows:

- 1 Matter and issue
- 2 Audit approach and findings
- 3 Reference to further information

Hereinafter we present the key audit matters:

1 Recoverability of goodwill

- 1 In the Company’s consolidated financial statements goodwill amounting in total to EUR 70.5 million is reported under the “Intangible assets” balance sheet item. Goodwill is tested for impairment by the Company once a year or when there are indications of impairment to determine any possible need for write-downs. Impairment testing is carried out at the level

of the cash-generating units to which the relevant goodwill is allocated. The carrying amount of the relevant cash-generating unit, including goodwill, is compared with the corresponding recoverable amount in the context of the impairment test. The recoverable amount is generally calculated on the basis of the value in use, and in one case on the basis of the fair value less costs of disposal. The present value of the future cash flows from the respective cash-generating unit normally serves as the basis of valuation. The present values are calculated using discounted cash flow models. For this purpose, the adopted medium-term business plan of the Group forms the starting point which is extrapolated based on assumptions about long-term rates of growth. Expectations relating to future market developments and assumptions about the development of macroeconomic factors are also taken into account. The discount rate used is the weighted average cost of capital for the relevant cash-generating unit. The impairment test resulted in the recognition of a write-down amounting to a total of EUR 5.6 million with respect to the cash-generating unit KSB Seil Co. Ltd., Busan/South Korea. The outcome of this valuation is dependent to a large extent on the estimates made by the executive directors with respect to the future cash inflows from the respective cash-generating unit, on the discount rate used, the rate of growth as well as other assumptions, and is therefore subject to considerable uncertainty. Against this background and due to the complex nature of the valuation, this matter was of particular significance in the context of our audit.

- ② As part of our audit, we assessed the methodology employed for the purposes of performing the impairment test, among other things. After matching the future cash inflows used for the calculation against the adopted medium-term business plan of the Group, we assessed the appropriateness of the calculation, in particular by reconciling it with general and sector-specific market expectations. We also assessed the appropriate consideration of the costs of Group functions. In the knowledge that even relatively small changes in the discount rate applied can have a material impact on the value of the entity calculated using this method, we focused our testing in particular on the parameters used to determine the discount rate applied, and assessed the calculation model. We evaluated the sensitivity analyses performed by the Company, in order to reflect the uncertainty inherent in the projections. We evaluated that the necessary disclosures were made in the notes relating to cash-generating units for which a reasonably possible change in an assumption would result in the recoverable amount falling below the carrying amount of the cash-generating units including the allocated goodwill.

Overall, the measurement parameters and assumptions used by the executive directors are in line with our expectations and are also within the ranges considered by us to be reasonable.

- ③ The Company's disclosures on goodwill are contained in section IV. note 1 of the notes to the consolidated financial statements.

2 Accounting treatment for customer-specific construction contracts

- 1 Revenue totaling EUR 376.5 million reported in the consolidated financial statements of KSB SE & Co. KGaA is attributable to customer-specific construction contracts. Provided that the criteria of IAS 11 have been met, the revenue is recognized in accordance with the percentage-of-completion method, with the estimate of the stage of completion being based on the ratio of contract costs actually incurred to the planned total costs (“cost-to-cost method”). In particular, estimating the planned total costs and appropriately allocating the costs actually incurred to the contracts are based on the estimates and assumptions made by the executive directors. Against this background and due to the resulting uncertainties and the complexity of the accounting treatment, this matter was of particular significance in the context of our audit.
- 2 During our audit we assessed the processes and controls established by the Group in relation to recognizing revenue from customer-specific construction contracts taking into account the stage of completion. In addition, we examined projects on a sample basis to determine whether they met the requirements for the recognition of revenue in accordance with the percentage of completion pursuant to IAS 11. Moreover, we evaluated the determination of the stage of completion of customer-specific contracts on the basis of the cost-to-cost method and the resulting proportion of revenue recognized, considering that a prospective loss must be recognized immediately. In this connection we assessed the calculation of not only the planned total costs but also the costs actually incurred. We assessed the stage of completion, among other things based on interviews with project managers and by inspecting project documentation. In addition, we assessed the consistency of the methods used to calculate the costs incurred. Furthermore, we addressed the inherent audit risk in this audit area by audit procedures that were consistently carried out throughout the Group. We were able to satisfy ourselves that overall the established systems and processes as well as controls in place are appropriate and that the estimates and assumptions made by the executive directors concerning the recognition and measurement of revenue according to the stage of completion are appropriately documented.
- 3 The Company’s disclosures regarding revenue from customer-specific construction contracts are contained in sections III., IV. note 6 and section V. note 11 of the notes to the consolidated financial statements.

3 Recognition and presentation of transactions with "related parties"

- 1 In the financial year 2017, the Group generated revenue from the sale of goods and services with related parties and incurred expenses from the sale of goods and services. The definition of related parties pursuant to IAS 24 includes both entities and natural persons that are directly or indirectly controlled or significantly influenced by KSB SE & Co. KGaA, as well as entities and natural persons that directly or indirectly control, or exert significant influence over, KSB SE & Co. KGaA (hereinafter referred to as "related parties"). Legal transactions with related parties are generally executed at arm's length. The Company has made disclosures in the consolidated financial statements on legal transactions that were not originally executed at arm's length in the financial year 2017 but were compensated for in the course of the financial year.

By the end of the financial year 2017, the Company had received reimbursements from agreements on compensation for disadvantages in the amount of EUR 2.5 million, which were recognized in "other operating income". EUR 0.1 million of this amount relates to the period from January to April 2017, EUR 2.1 million relates to the financial years from 2006 to 2016 and EUR 0.3 million relates to cost reimbursements for tax processing. An external law firm was involved in the calculation of the compensation for disadvantages and the assertion of the claims. This resulted in tax obligations including interest in the total amount of EUR 5.1 million for the years from 2007 to 2016 that were agreed as part of an actual agreement with the tax authorities based on an expert opinion prepared by an external tax consultancy firm. As part of legal investigations commissioned by the Company which are still ongoing, other claims of the Company extending beyond the agreements already reached in the financial years 2016 and 2017 will be assessed by an external law firm.

Against this background and given the risk that not all transactions with related parties have been recognized by the Company, or that the disclosures on the related parties in the consolidated financial statements are incomplete or incorrect, this matter was of particular significance during our audit.

- 2 As part of our audit, initially we conducted discussions with the executive directors and the legal department of KSB SE & Co. KGaA to obtain an understanding of the establishment of the organizational measures used to identify and approve the conclusion of agreements with related parties, as well as the controls established by the Company in this regard, and assessed these measures and controls. Furthermore, we obtained a full list of all agreements and business relationships with related parties from the executive directors of KSB SE & Co KGaA. We obtained letters of confirmation from the supervisory board members of KSB SE & Co. KGaA in office in the financial year 2017, the managing directors of KSB Management SE (as the former members of the Board of Management of KSB Aktienge-

sellschaft as the Company's legal predecessor) and KSB Stiftung, Kühborth Stiftungs GmbH and Johannes und Jacob Klein GmbH (formerly Klein Pumpen GmbH) as parent companies, in which they list the business relationships, both those in line with the arm's length principle and those not in line with the arm's length principle, with KSB SE & Co. KGaA in the financial year 2017. By comparing the full list of the agreements and business relationships with the related parties against the customer and vendor accounts set up in the financial accounting records of KSB SE & Co. KGaA, we examined whether there were any other business relationships with related parties not specified by the Company. We also examined that the new agreements concluded with the related parties in the financial year since May 2017 had been approved by the supervisory board. We also evaluated that agreements with related parties that were not concluded at arm's length in the previous years and up until April 2017 were terminated or adjusted to reflect standard market conditions in the financial year 2017. We assessed the controls established by the Company to evaluate agreements with related parties for adherence to the arm's length principle prior to a contract conclusion. We assessed the Company's calculations on the disadvantages suffered by it, which were taken as a basis for the agreements on compensation for disadvantages. In addition, we compared the incoming payments at KSB SE & Co KGaA with these agreements. With regard to the recognition of possible risks resulting from legal disputes and tax risks, we also obtained confirmations from attorneys and tax consultants as at 31 December 2017. Based on our audit procedures, we were able to satisfy ourselves that the estimates and assumptions made by the executive directors relating to the disclosures on transactions with related parties are substantiated and sufficiently documented.

- ☐ The Company's disclosures on transactions with related parties are contained in section IX. of the notes to the consolidated financial statements.

OTHER INFORMATION

The executive directors are responsible for the other information. The other information comprises the following non-audited parts of the group management report:

- the statement on corporate governance pursuant to § 289f HGB and § 315d HGB included in section "Corporate Governance Statement" of the group management report
- the corporate governance report pursuant to No. 3.10 of the German Corporate Governance Code
- the separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB

The other information comprises further the remaining parts of the annual report – excluding cross-references to external information – with the exception of the audited consolidated financial statements, the audited group management report and our auditor's report.

Our audit opinions on the consolidated financial statements and on the group management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

RESPONSIBILITIES OF THE EXECUTIVE DIRECTORS AND THE SUPERVISORY BOARD FOR THE CONSOLIDATED FINANCIAL STATEMENTS AND THE GROUP MANAGEMENT REPORT

The executive directors are responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS AND OF THE GROUP MANAGEMENT REPORT

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems.
- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.
- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.
- Perform audit procedures on the prospective information presented by the executive directors in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

FURTHER INFORMATION PURSUANT TO ARTICLE 10 OF THE EU AUDIT REGULATION

We were elected as group auditor by the annual general meeting on 10 May 2017. We were engaged by the supervisory board on 29 June 2017. We have been the group auditor of KSB SE & Co. KGaA, Frankenthal/Pfalz, without interruption since the financial year 2015.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Dr. Ulrich Störk.

Mannheim, 21 March 2018

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Dr. Ulrich Störk
Wirtschaftsprüfer

ppa. Christina Pöpperl
Wirtschaftsprüferin

GLOSSARY

ABBREVIATIONS

ANSI

American National Standards Institute

API

American Petroleum Institute

API 610

New edition of a centrifugal pump code for the petrochemical industry

GDP

Gross domestic product

ISO 14001

International standard stipulating requirements for environmental management systems

IMF

International Monetary Fund

VDMA

Verband Deutscher Maschinen- und Anlagenbau e. V.
[German Engineering Federation]

KEY CORPORATE AND TECHNICAL TERMS

Additive manufacturing

Previously referred to as rapid prototyping; it describes a process which enables quick and cost-effective production of patterns, samples, prototypes, tools and final products.

Business Innovation Lab

A think tank where a KSB team develops future-proof business models for the age of digitalisation

CE marking

The CE marking documents that goods are in conformity with the health and safety requirements of the European Union.

Downstream

Activities in the oil and gas industry are categorised as upstream or downstream. The term "downstream" is used to describe the processing of crude oil into petroleum products.

GHG Protocol (Greenhouse Gas Protocol)

Standard for measuring CO₂ and other greenhouse gas emissions

IE5 synchronous reluctance motor

Highly energy-efficient motors whose specially designed rotor laminations guide the lines of magnetic flux. Rare earths are not required to manufacture these motors.

Installed Base

KSB sales channel for expanding business in the area of spare parts and support services

International Labour Organisation (ILO)

The specialised agency of the United Nations is responsible for

setting and implementing international labour and social standards.

Make in India

Indian government campaign to boost India's domestic economy

One Belt, One Road

Chinese government project to develop an intercontinental infrastructure network between China and countries in Asia, Europe and Africa

Rapid prototyping

See additive manufacturing

Retrofitting

Refurbishment of pumps as an alternative to buying new products

SAP C4C

Cloud-based IT solution for customer relationship management in Sales and Service

Stakeholders

Groups of persons that are directly or indirectly affected by the activities of a company; KSB's main stakeholders are our customers, suppliers, investors, employees and the public.

UN Global Compact

United Nations initiative for responsible company management based on ten universal principles

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ONLINE NEWS

You will find the latest news
 on the KSB Group at: www.ksb.com

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CONCEPT AND DESIGN

KSB Communications, Frankenthal
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PHOTOGRAPHY

KSB Image Library
 Robert Kwiatek, Frankenthal (p. 4/5, 6, 27, 36/37,
 40/41, 44/45, 48/49)
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PRINTING

Ottweiler Druckerei und Verlag GmbH, Ottweiler



As a signatory to the United Nations Global Compact , KSB is committed to endorsing the ten principles of the international community in the areas of human rights, labour standards, environmental protection and anti-corruption.

A print version of the KSB Group's Annual Report is additionally available in German. We also publish German and English versions online in PDF and HTML formats at <http://annualreport2017.ksb.com>

