# GROUP MANAGEMENT REPORT


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# BASIC PRINCIPLES OF THE GROUP

## GROUP BUSINESS MODEL

The KSB Group's mission is to supply customers around the world with top-quality pumps and valves as well as related systems. We also provide a wide range of service offerings to users of these products.

KSB SE & Co. KGaA (until 17 January 2018: KSB Aktiengesellschaft), Frankenthal / Pfalz, Germany, as the parent company, directly or indirectly holds the shares in the companies belonging to the Group. Besides it, 9 domestic and 73 foreign companies are fully consolidated; 6 other companies are accounted for under the equity method. KSB is currently represented in over 40 countries with its own subsidiaries.

As well as KSB SE & Co. KGaA itself, the companies in the KSB Group with the highest sales revenue are

- KSB S.A.S., Gennevilliers (Paris), France
- KSB Shanghai Pump Co., Ltd., Shanghai, China
- KSB Pumps Limited, Pimpri (Pune), India
- GIW Industries, Inc., Grovetown / Georgia, USA
- KSB Service GmbH, Frankenthal, Germany
- KSB BRASIL LTDA., Várzea Paulista (Brazil)
- KSB Italia S.p.A., Milan, Italy

Our basic business model has not changed during the year under review. External economic and political changes, however, have had a partial effect on our business. These are – where relevant and material to KSB – described in the following sections.

### ORGANISATION, MANAGEMENT AND CONTROL

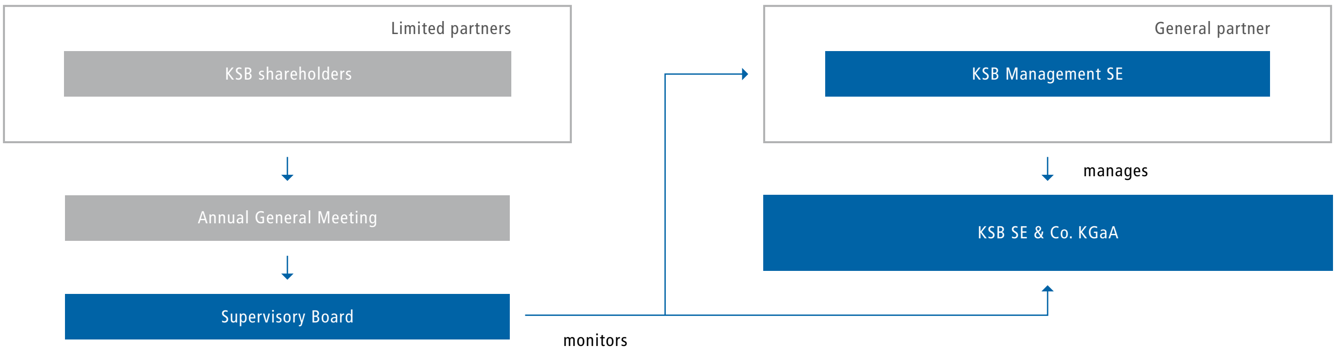
In the year under review, the Board of Management of KSB Aktiengesellschaft managed and controlled the KSB Group. This body formed of at least two persons under the Articles of Association was assisted in operational decisions by a management team of senior executives. Managers and employees implemented the strategy and instructions of the Board of Management within an organisation that is structured according to responsibilities for product groups, corporate functions and regions.

All organisational units in the KSB Group act with the aim of ensuring sustainable, profitable growth that will secure both KSB's financial independence and its medium- and long-term future. Management is monitored by a Supervisory Board consisting of twelve members. The Annual General Meeting of shareholders appoints six members of the Supervisory Board, with the remaining six being delegated by the employees under the terms of the *Mitbestimmungsgesetz* [German Co-determination Act].

The KSB Group organises its business activities in three segments based on product groups: Pumps, Valves and Service. The Pumps segment covers single- and multistage pumps, and associated control and drive systems. Applications are industry (manufacturing, chemical / petrochemical, transport), energy supply, water transport and waste water treatment, construction / building services and the hydraulic transport of solids in mining. The Valves segment covers butterfly, globe, gate, control, diaphragm and ball valves, as well as associated actuators and control systems. The applications for these products are essentially identical to those for pumps. The Service segment covers the installation, commissioning, start-up, inspection, servicing, maintenance and repair of pumps, related systems and valves for all these applications, as well as modular service concepts and system analyses for complete systems.

After the reporting period, KSB Aktiengesellschaft changed its legal form to that of an SE & Co. KGaA by entry in the *Handelsregister* [German Commercial Register] on 17 January 2018. The partnership limited by shares [*Kommanditgesellschaft auf Aktien* – KGaA] is a common legal form in Germany for companies with a family- and foundation-dominated ownership structure. The Annual General Meeting of KSB AG adopted a resolution on 10 May 2017 on the announced change in the legal form of the company. The general partner is KSB Management SE, a European public limited company. The shares in this company are wholly owned (100 %) by

**Bodies / Structure**




The former KSB Aktiengesellschaft is now managed in the legal form of a partnership limited by shares [*Kommanditgesellschaft auf Aktien* – KGaA]. Management is the responsibility of KSB Management SE, the individually liable general partner. The responsibilities of the bodies are governed by law and the Articles of Associations. This is the basis for efficient corporate governance, which contributes to sustainable corporate growth.

Klein, Schanzlin & Becker GmbH, a subsidiary of the non-profit KSB Stiftung [KSB Foundation] and the Kühborth-Stiftung GmbH [Kühborth Foundation]. KSB SE & Co. KGaA and thus the KSB Group are managed via KSB Management SE, which has four Managing Directors and a five-member Administrative Board.

## MARKETS AND LOCATIONS

Within the KSB Group, centrifugal pumps account for around two thirds of sales revenue. These pumps, as well as valves, are sold to engineering contractors, OEMs and end users or, in some cases, distributed via dealers. The same applies to control and monitoring systems, and to package units with pumps and valves.

The best developed sales market for these products is Europe, where KSB operates its main manufacturing facilities in Germany and France. The main plant of the present KSB SE & Co. KGaA in Frankenthal is its largest in Europe, ahead of the production sites in Pegnitz (Bavaria) and Halle (Saxony-Anhalt) in Germany, and La Roche-Chalais in France.

The second-largest market for KSB products is currently the Region Asia / Pacific, followed by the Region Americas and the Region Middle East / Africa. Outside Europe, KSB's biggest manufacturing plants are in Brazil, China, India and the USA.

KSB manufactures products and components in a total of 16 countries; they are sold through the Group's own companies or agencies in more than 100 countries. With their products, the Group companies serve customers in industry including the chemical and petrochemical industries, customers in the energy and construction / building services sectors, transport equipment manufacturers and operators (e.g. ships, rail vehicles), water and waste water utilities, and mining companies. Once again in 2017, the top-selling markets for our products were the industrial and energy supply sectors.

In order to be able to offer our products at favourable prices, we combine the Group's purchasing requirements and source affordable suppliers around the world who meet our quality standards. The focus is currently upon Asian companies. We are able to maintain our market position as one of the leading pump and valve manufacturers through our good and long-term relationships with our customers and suppliers. Our highly trained and motivated employees as well as the high quality of our products have also helped cement our reputation.

## CONTROL SYSTEM

Based upon our matrix organisation, we determine our key financial performance indicators as follows:

Management decisions are taken primarily on the basis of the key indicators that are determined for the Pumps, Valves and Service segments: order intake, sales revenue and earnings before interest and taxes (EBIT). In 2016, instead of the latter control parameter, the operating earnings (EBIT excluding the effects from measuring construction contracts in accordance with IAS 11) were relevant. Following a change in internal reporting, the sales revenue and effects on earnings from construction contracts under IAS 11 have been reported at segment level since January 2017. As a result, sales revenue and EBIT including these effects were reported to Management and decisions taken on this basis in the reporting year under review.

For further information on these key indicators see the Notes to the Consolidated Financial Statements, section VIII. Segment Reporting.

For the control of the entire Group, we use the key indicators of order intake, sales revenue, earnings before income taxes (EBT), pre-tax return on sales as well as the net financial position, and from the 2018 financial year onwards also the earnings before interest and taxes (EBIT). The pre-tax return on sales describes the ratio between the earnings before income taxes (EBT) and the sales revenue; net financial position is the balance of financial liabilities and interest-bearing financial assets (current and non-current financial instruments, interest-bearing loans, cash and cash equivalents, and receivables from cash deposits). When specifying and evaluating these key indicators, we are guided on the one hand by developments in the market, and on the other by the performance of our key competitors.

We do not consult any non-financial performance indicators for controlling the Group and for making decisions regarding management issues.

## RESEARCH AND DEVELOPMENT

Innovations are a fundamental pillar of our activities and are part of the core elements of our strategy. We define them as solutions that create added value for customers and translate into new products, services or business models.

With our pumps and valves, we serve a broad range of technical applications. The integration of hydraulic and electronic systems is a focus of our activities. As many of our products come into contact with fluids that are more or less corrosive or abrasive, materials research is another key area of our developers' work.

In these activities, we are primarily drawing on our strong research and development competencies in Europe and India. In addition, we cooperate with external institutes and research facilities. Overall, we spent around € 47 million on R & D in the year under review. This equates to about 2 % of our sales revenue.

**€47 million**

Research and development expenses in 2017

# ECONOMIC REVIEW

## MACROECONOMIC ENVIRONMENT AND SECTOR VIEW

The growth of the global economy accelerated in the reporting year and at + 3.7 % developed slightly better than forecast by the International Monetary Fund (IMF) (+ 3.4 %). We regularly consider the forecast figures of the IMF in our annual growth planning. The economic upswing was seen in nearly all countries important for the global economy in 2017 as opposed to previous years.

Among the advanced economies, the euro zone countries (+ 2.4 %) and the US (+ 2.3 %) made particularly good progress. Performance in our European home market continued to be supported by a weak euro, which buttressed the export industry, as well as by low interest rates. They facilitated the financing of investments in industry and the construction sector, which also had a partial impact on our industry. The German economy performed better than expected in this environment, with an increase in the gross domestic product of 2.5 %. In this context, local industry production increased above average.

The economy in emerging economies saw are more expansionary trend than in the previous year. In this process, countries exporting commodities and energy sources benefited from tangible price increases. China and India, as the two key markets in Asia for KSB, showed a different performance. Whereas China continued its upswing and slightly exceeded the previous year's growth rate at 6.8 %, in India the cash reform and introduction of a national value-added tax prevented a similar rise as in 2016. However, India's economic growth remained at a high level at 6.7 %. In Brazil, where KSB continues to be the leading pump supplier, demand for industrial goods rose gain after a three-year recession. Production in Russia also saw an upward trend, but the sanctions of Western countries continued to weigh on economic performance.

### RISING DEMAND IN KEY SALES INDUSTRIES

Thanks to the improved market conditions, companies caught up with measures to upgrade or expand their technical systems. In this context, plans to boost efficiency and improve plant reliability played a central role. There was a continued trend towards automation of fluid transport systems, which we fit with pumps and valves.

In industry, which is a particularly important market for us, demand rose above all in the manufacturing sector, as well as in the chemical and petrochemical industries. In petrochemical companies, in particular, catch-up effects were the cause of an increase in investments.

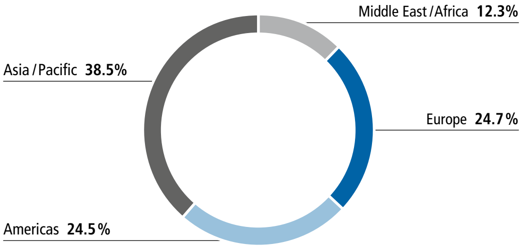
In addition to industry, water and waste water management was our second sales focus. In this area, our sales staff faced a market with a strong recovery in demand in the utilities sector. Furthermore, the start of major water supply and waste water treatment projects in China and India resulted in corresponding contracts being awarded.

As a result of the recovery of commodities prices, mining companies made investments to upgrade their plants that had been shelved for some time. In North America, oil sands mining picked up speed again. This is relevant for our business with slurry pumps from the US, which are used for the hydraulic transport of raw materials as well as residues.

Companies engaged in the liquefaction and transport of natural gas continued to largely refrain from investments due to their overcapacities, although gas prices were also on the rise. This made selling our high-performance cryogenic butterfly valves more difficult.

In the energy industry, the trend towards exiting coal continued. By contrast, operators of combined cycle power stations but also of nuclear power plants had a need for equipment goods and support services.

**World market of centrifugal pumps and valves**




Source: KSB estimate (February 2018), European Industrial Forecasting

In the construction industry, which benefited from the low interest rate level, demand for building services equipment continued to rise. However, this was more pronounced in residential construction than in the construction of commercial and public buildings, where our products are chiefly employed.

### UPTURN IN MECHANICAL ENGINEERING

After flat global mechanical engineering sales in 2016, the Oxford Economics research institute registered real growth of 6 % again in 2017. Sales revenue in the European core countries of Germany, France and Italy rose moderately at around 2 to 3%, while growth in the Netherlands, the United Kingdom and several Eastern European countries was stronger by comparison.

In China sales revenue increased by 8 %, and in India by 9 % despite weaker economic growth. In Latin America performance remained at a weak level at merely about 1 % after overcoming the recession in Brazil and Argentina.

The global sales revenue of German plants for the production of liquid pumps performed contrary to the upswing in mechanical engineering overall. They dropped by 0.6 % according to VDMA figures. At a plus of 2.3 %, industrial valves sales revenue also fell short of the overall industry's performance.

## BUSINESS DEVELOPMENT AND RESULTS OF OPERATIONS

Based on the stronger investment activities of our customers, our business position improved compared with the previous year. This was particularly true for industry and water and waste water management, our key sales markets in strategic terms. In addition, mining companies caught up on a larger scale with investments that had previously been deferred.

We made the most of market opportunities via the global KSB sales organisation, supported by our global manufacturing network, our service organisation and national dealership networks.

### ORDER INTAKE

The volume of orders received by KSB increased by € 108.8 million to € 2,265.3 million in the year under review. This 5 % increase corresponds to our expectation of a "marked improvement" in order intake. It is mainly attributable to the development of our business in the water and waste water sector, in industry and in mining. However, we also posted increases with products and services in the power plant business and in service for building services equipment. Currency exchange rate changes constituted – contrary to previous years – only a minor influencing factor at € –7.3 million.

A regional focus of order intake was the Region Asia/Pacific (+13.8 %). The orders received there made up about half of the growth. The companies in the Regions Europe and Americas have also developed positively, with the percentage growth of the American companies (+9.0 %) being stronger than that of the companies in our European home market (+2.8 %). Order intake performance at KSB AG (now KSB SE & Co. KGaA) at +3.8 % to € 780.0 million was above average; here, project orders placed by power stations and industrial plants were a major factor. The companies in the Region Middle East/Africa posted a fall in order intake by 7.7 %, among other things because some major customers placed their orders directly with European KSB companies.

**Pumps**
At € 1,473.6 million, the order intake in the pumps segment outperformed the prior-year value by € 87.0 million, corresponding to an increase of 6.3 %, which is in line with our expectation expressed in the previous year. The pump business, which was intensified by sales initiatives and new product launches, benefited from the recovery in the industrial market and the continued good performance of the water and waste water business. In the field of waste water transport and purification, our sales staff won over customers with an enhanced, particularly reliable waste water pump series. We also added new high-pressure and submersible borehole pumps to our water engineering portfolio. In addition, the broadening of our range of mechanical seals manufactured in-house had a positive effect on order intake.

Rising commodity prices strengthened demand from mining, which we served above all with US slurry pumps. In this field, at a 35.5 % increase, we posted the highest growth rate in the pumps segment. The focus was on replacement investments by customers; only a few mine operators tackled expansion projects. The demand situation in the fossil-fuelled power plant business remained challenging; order intake for boiler feed, condensate and cooling water pumps dropped further.

**Valves**
In the valves segment, we posted order intake up by 3.7 %; it rose by € 12.3 million to € 343.5 million. Most of the orders for globe, gate and butterfly valves came from industry. Chemical and petrochemical companies also placed more purchase orders again. The sale of the valves business of our US subsidiary KSB AMRI, Inc., which had specialised in the production and sale of butterfly valves for chemical applications, had an opposite effect.

The strongest growth rate was posted for orders for globe, gate and butterfly valves for energy generation applications, including high-safety valves for nuclear power plants in Europe and Asia. We did not yet see any improvement in the business with cryogenic butterfly valves for liquefied gas tankers and loading stations for the reasons outlined above. Our expectation of a significant improvement materialised.

**Service**
Order intake for support services rose by € 9.4 million to € 448.2 million. This slight increase of 2.1 % correlated with our forecast that growth in service would be weaker than that of pumps and valves. As expected, the sale of a French service company at the end of 2016 and the integration of several service companies into larger units in the USA and France had an opposite effect. In addition, as many as three service sites in the south of the USA were affected by the impact of the tropical hurricane Harvey in 2017.

We posted the strongest order intake overall in the water and waste water business as well as in the power plant sector. Energy providers in China and India, in particular, increasingly used our services. Service orders from mining and building services also rose, only orders from industry remained slightly below the previous year's level.

We were particularly successful regionally in Asia in 2017. There, we are continuously expanding our service organisation, thus winning new customers. 2017, for instance, saw the opening of a service centre in the south of China.

## SALES REVENUE
Our consolidated sales revenue improved year on year by € 39.3 million to € 2,205.0 million. This 1.8 % increase slightly exceeded our expectation of reaching the prior-year level. The intensification of our installed base business, which resulted in a higher share of orders with a short-cycle impact on sales revenue, was a positive factor. Exchange rate changes had only a minor impact on sales at € –5.8 million.

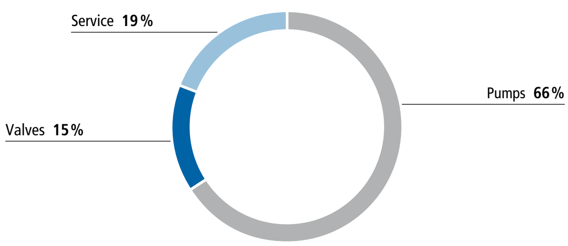
The Region with the strongest sales revenue continued to be Europe with a share of some 57 %, where in particular KSB AG (now KSB SE & Co. KGaA) and KSB S.A.S. also process orders from countries outside Europe. Overall, the sales revenue of the European countries rose by 1.4 %. KSB AG saw a rise of 2.7 % to € 780.8 million (previous year € 760.6 million). The strongest upward development was posted by the Asian companies with growth of 13.0 %. In contrast, sales revenue in the Region Americas (– 6.8 %) and the Region Middle East / Africa (– 3.6 %) contracted.

As the effects from construction contracts in the 2017 financial year can also be presented at segment level, as described above, the comparison with the prior-year figures is slightly limited.

**Pumps**
Sales revenue for pumps increased by € 15.9 million, equalling 1.1 %, to € 1,444.4 million. Growth drivers were above all our companies in Asia, with several local companies also invoicing major orders. Due to the lower number of project orders from previous years, however, the general business with standard products and the installed base business formed the basis of our pump sales revenue. Key growth sectors were the water and waste water sector as well as mining, which we are supplying with replacement pumps and spare parts in greater volumes again. Our expectation of a significant decline did therefore not materialise.

**Valves**
The rise in order intake did not yet have an impact on sales revenue in the reporting year. The order gap occurring in the project business in previous years was not offset by the developments in the general and installed base business. For that reason, sales revenue dropped again contrary to forecast. It declined by € 21.9 million, or 6.1 %, to € 338.8 million. In this context, the above-mentioned sale of the business of our US valve subsidiary KSB AMRI Inc. reduced sales revenue by about € 7.5 million.

**Sales revenue by segment**




**Service**
Sales revenue from support services met our expectations of a stable performance. While we assumed at the start of the year that the continued difficult order situation in the energy business and in the oil and gas industry would only permit sales revenue at the previous year's level, we posted growth of € 5.2 million over the year. The sales revenue volume thus rose by 1.2 % to € 421.7 million. In particular the Region Asia / Pacific benefited from the performance of our new service centres.

## EARNINGS BEFORE INTEREST AND TAXES (EBIT)

The KSB Group achieved earnings before interest and taxes (EBIT) of € 117.2 million (previous year: € 88.2 million). The Pumps segment contributed EBIT of € 79.9 million (previous year: € 60.9 million). This means that the forecast (of a significant rise) made in the previous year's report was exceeded. In the Valves segment, the predicted substantial growth in EBIT did not materialise; instead, the EBIT dropped to € 0.1 million (previous year € 8.8 million). This was caused by the write-down of the goodwill of KSB Seil Co., Ltd., South Korea. The EBIT of the Service segment rose strongly to € 37.3 million (previous year € 33.3 million), which confirmed our forecast.

In 2016, the preceding section referred to the operating earnings (EBIT excluding the effects from the measurement of construction contracts under IAS 11). An adjustment of the previous year's figures was not possible, as the effects from construction contracts could not be established at segment level. Additional information can be found in Section I. Basic Principles of the Group – Control System.

## TOTAL OUTPUT OF OPERATIONS

The above increase in sales revenue is also reflected in a higher total output of operations, totalling € 2,210.5 million compared with € 2,174.2 million in the previous year. Work in progress and inventories of finished goods remained virtually unchanged. Other work performed and capitalised amounts to € 5.6 million and is therefore unchanged year on year.

## INCOME AND EXPENSES

Other income declined from € 47.2 million to € 69.2 million, partly due to higher income from the disposal of assets and high insurance compensations.

The cost of materials increased in line with the total output of operations, meaning that the cost of materials as a percentage of total output of operations, at 40.2 %, remained unchanged year on year. Overall, the cost of materials increased to € 887.8 million compared with € 874.2 million.

€ 2.2 billion

Consolidated sales revenue in 2017

Staff costs fell by 0.3 % to € 796.7 million. Staff costs as a percentage of total output of operations dropped by 0.7 percentage points. The key factor was the continued reduction in headcount. Compared with 2016, the number of employees fell by 117, taking the total figure at the end of the year under review to 15,455. The European companies recorded the strongest decrease with a reduction of 249 staff. The biggest falls came at the French and German sites. Employee numbers were also markedly down in the Americas with 134 fewer people working for KSB on the reporting date compared with the end of December 2016. This development is the result of measures introduced to bring our cost structures into line with new market conditions. The KSB Group employed on average 392 fewer people than in the previous year. Based on the moderately higher total output of operations and simultaneous decrease in the number of employees, the average output per employee improved from € 137 thousand in the previous financial year to € 142 thousand.

The ratio of other expenses to total output of operations rose from 17.1 % to 17.8 %. In absolute terms, this represents a change from € 372.4 million to € 392.4 million. Causes were higher levels of repairs, external services and other staff costs, which could not be offset by lower selling costs.

Financial income / expense improved by € 3.2 million. This is primarily a reflection of the strong increase in income from investments accounted for using the equity method. Based on the contribution to income from our Chinese joint venture, we reported income totalling € 1.5 million. This compares with expenses of € 1.3 million in the previous year.

### EARNINGS

The KSB Group generated earnings before income taxes (EBT) of € 104.2 million, compared with € 74.6 million in 2016. Our previous year's forecast of a substantial increase in earnings therefore materialised. Correspondingly, the return on sales before tax increased from 3.5 % in the previous year to 4.7 %, also confirming our expectations expressed in 2016. The income tax rate rose substantially year on year and is now 50.0 % after 36.0 % in the previous year. This rise was attributable to considerably higher deferred tax expenses. Adjusted for the effects resulting from impairment losses on deferred taxes on tax loss carryforwards, the tax rate change in the USA and the write-down of goodwill of KSB Seil Co., Ltd., South Korea, the income tax rate is 37.4 %. Earnings after income taxes, which totalled € 52.1 million (previous year: € 47.8 million) and thus grew by 9.0 %, rose less markedly than earnings before income taxes (EBT) (39.6 %).

At € 14.9 million, earnings attributable to non-controlling interests remained unchanged compared with the previous year. Relative to earnings after income taxes, there was therefore a change from 31.0 % to 28.6 %.

Earnings attributable to shareholders of KSB AG (€ 37.2 million) were € 4.3 million higher than in the previous year (€ 32.9 million).

Earnings per ordinary share were € 21.10, compared with € 18.68 in the previous year, and € 21.36 per preference share, compared with € 18.94 in 2016.

€104.2 million

Consolidated earnings (EBT) in 2017

## FINANCIAL POSITION AND NET ASSETS

### FINANCIAL POSITION

The financial position of the KSB Group remains as solid as ever, as evidenced by a consistently high equity ratio.

**Equity**

The KSB Group's equity amounts to € 885.4 million (previous year: € 890.3 million). This includes KSB AG's subscribed capital of € 44.8 million as in the previous year. The capital reserve remains unchanged at € 66.7 million. Revenue reserves total € 611.9 million (previous year: € 614.2 million), including the proportion of earnings after taxes attributable to shareholders of KSB AG of € 37.2 million (previous year: € 32.9 million). € 162.1 million (previous year: € 164.6 million) is attributable to non-controlling interests. Due to the lower total equity and liabilities compared with the previous year, down 4.1 %, the equity ratio rose slightly to 39.3 % (previous year: 37.9 %).

The non-controlling interests mainly relate to the following companies: KSB Pumps Limited, India; GIW Industries, Inc., USA; KSB America Corporation, USA and KSB Shanghai Pump Co., Ltd., China.

**Liabilities**

The largest item under liabilities continues to be provisions for employee benefits, including, also as the largest item, pension provisions, which changed only slightly by € 2.6 million from € 589.5 million to € 586.9 million. A large number of the pension plans currently in place in the KSB Group are defined benefit models. We will be reducing the associated risks, such as demographic changes, inflation and salary increases, for example by increasingly introducing defined contribution plans for new staff.

Our obligations for current pensioners and vested benefits of employees who have left the company account for about 40 % of the amount recognised in the balance sheet. The rest relates to defined benefit obligations for our current employees.

39.3 %

Equity ratio in 2017

Other provisions for employee benefits, which are predominantly current, rose to € 101.5 million (previous year: € 86.9 million).

The development of other provisions, which we created almost exclusively for current uncertain liabilities, was stable (€ 99.8 million compared with € 99.6 million in 2016). An increase in the provisions for warranty obligations and contractual penalties as well as provisions for expected losses from uncompleted transactions offset declining provisions for restructuring measures and provisions for other obligations.

Non-current financial liabilities fell by € 3.7 million to € 54.3 million, which was caused by the reduction in bank loans and overdrafts. The loan against borrower's note, which still amounts to € 48. million, is expected to be repaid in 2019 and 2021.

Current liabilities decreased overall by € 102.7 million (€ 510.8 million compared with € 613.5 million at the 2016 year end). Trade payables rose only slightly to € 212.0 million (€ 210.8 million in the previous year) despite the higher business volume. Other non-financial liabilities increased (+ € 7.2 million), but other financial liabilities fell to the same extent (– € 7.9 million). The decrease in current financial liabilities by € 98.0 million is attributable to the planned repayment, referred to above, of the loan against borrower's note. Taking into account the fall in total equity and liabilities, the share of current liabilities in total equity is 22.7 % (previous year: 26.1 %).

**Investments**
The additions to intangible assets amounting to € 12.5 million (previous year: € 10.0 million) primarily concerned advance payments and own work capitalised for a new software to be deployed in Sales, as in the previous year.

Investments in property, plant and equipment in the reporting year amounted to € 89.4 million, considerably up on the figure of € 72.2 million for the previous year. The highest additions at € 29.0 million (previous year: € 21.1 million) relate to plant and machinery. A further € 20.4 million (previous year: € 23.6 million) relates to advance payments and assets under construction. As in 2016, the focus of our investment activities was Europe, and predominantly Germany and France. Outside of Europe, the highest additions were again made at our plants in India (in particular in Shirwal), in Pakistan, the USA and in China. We maintained our policies for measuring depreciation and amortisation in the year under review.

**Net financial position**
The net financial position, at € 288.0 million compared with € 259.5 million in the previous year, developed much more favourably than forecast twelve months earlier (€ 240 to 260 million) due to a decrease in trade receivables.

**Liquidity**
Cash flows from operating activities amounted to € 120.7 million, a year-on-year decrease of € 13.8 million. This was principally attributable to the high commitment of funds in trade receivables and other assets and in inventories (release of funds in previous year). This contrasted with higher advances received and provisions, which failed to offset the commitment of funds.

€ 288 million

Net financial position in 2017

The outflows from our investing activities decreased by € 105.8 million compared with 2016. The return of term deposits and commercial papers increased cash flows considerably. Accordingly, cash flows from investing activities rose significantly to € –8.2 million (previous year: € –114.0 million).

Negative cash flows from financing activities increased strongly, totalling € –106.0 million compared with € –9.6 million in the previous year. The reason are the planned repayments of the loan against borrower's note.

Cash and cash equivalents from all cash flows barely changed from € 288.9 million to € 289.5 million. Exchange rate effects amounting to € –6.8 million (previous year: € +4.3 million) contributed to this.

We assume that, in future, we will continue to be able to meet our outgoing payments largely from operating cash flow. From the current perspective our financial management is meeting the goal of ensuring our liquidity at all times essentially without any additional external financing measures. For more information on liquidity management (such as credit lines) see the section on Risk Reporting on the Utilisation of Financial Instruments elsewhere in this group management report.

**Contingencies and commitments**

The KSB Group's off-balance sheet contingent liabilities totalled € 16.1 million as at the reporting date (previous year: € 15.9 million). These arise mainly from collateral and performance guarantees.

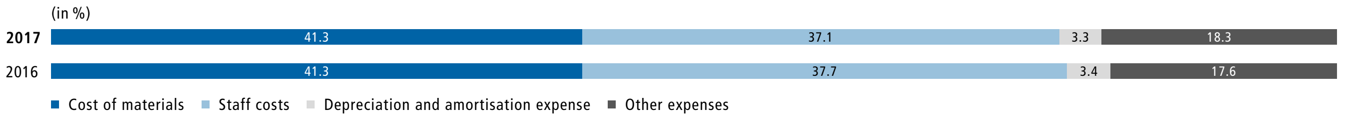
There are no other extraordinary obligations and commitments beyond the reporting date. Other financial obligations arise only within the normal scope from long-term rental, lease and service agreements (in particular IT and telecommunications) necessary for business operations and from purchase commitments amounting to € 12.2 million (previous year: € 17.9 million).

## NET ASSETS

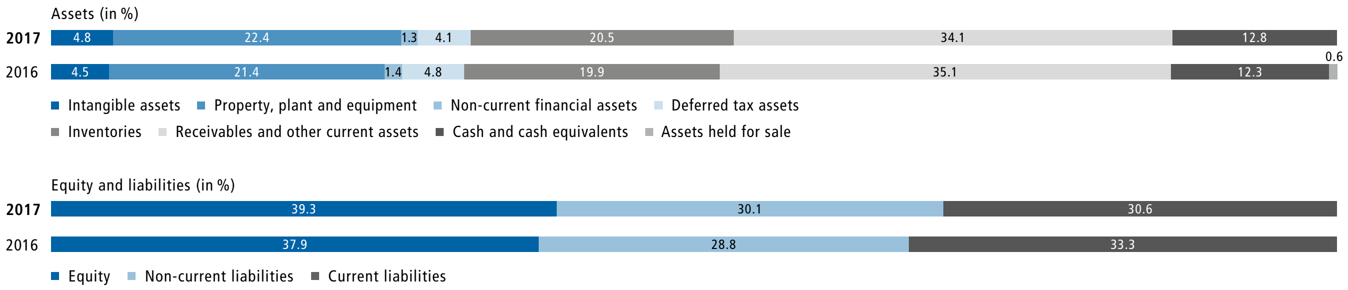
Our total assets fell by 4.1 % to € 2,253.4 million. Considerable decreases were recorded for both non-current assets (particularly deferred tax assets) and for other financial assets. Increases were only recorded in property, plant and equipment and intangible assets, as well as in other non-financial assets.

Around 28.5 % is attributable to fixed assets (previous year: 27.3 %). Intangible assets and property, plant and equipment with a historical cost of € 1,424.3 million (previous year: € 1,393.1 million) have carrying amounts of € 614.3 million (previous year: € 608.2 million). Intangible assets were reduced by € 5.6 milliion due to the above-mentioned write-down of goodwill of our company KSB Seil Co., Ltd., South Korea. This was more than offset by the advance payments made on intangible assets, meaning that the intangible assets rose from € 106.7 million to € 108.1 million. With investments in property, plant and equipment (€ 89.4 million) once again exceeding write-downs (€ 60.9 million), this balance sheet item increased by € 4.6 million. The carrying amount of financial assets and investments accounted for using the equity method

### Expenses in statement of comprehensive income




### Balance sheet structure




fell by a total of € 4.7 million to € 28.3 million. The investments accounted for using the equity method accounted for € – 2.3 million. Deferred tax assets decreased to € 91.7 million (previous year: € 112.2 million).

Inventories totalled € 461.9 million, down € 5.5 million from the 2016 year end. Materials, consumables and supplies as well as work in progress fell, whereas finished goods and goods purchased and held for resale increased. Inventories continued to tie up around 20 % of our resources.

Despite the higher business volume, trade receivables and PoC could be reduced by € 1.0 million compared with the 2016 year-end figure. Overall – taking into account the change in total assets – this balance sheet item accounts for approximately 27 % (previous year: 26 %) of total assets.

Other financial assets fell from € 187.0 million to € 117.0 million, as we wound up term deposits and commercial papers with a maturity of 3 to 12 months. This is contrasted by an increase in recoverable taxes from € 18.1 million to € 30.8 million. This increase is attributable to higher receivables from indirect taxes in Asia.

Cash and cash equivalents account for around 13 % of assets, totalling € 289.5 million (previous year: € 288.9 million).

There were no assets held for sale in the financial year, as we sold the valves business of our US subsidiary KSB AMRI Inc., and a Chinese company.

**Inflation and exchange rate effects**

There were no consolidated companies within the Group whose financial statements were required to be adjusted for the effects of inflation.

The currency translation of financial statements of consolidated companies that are not prepared in euro gave rise to a difference of € – 54.1 million (previous year € + 20.2 million). This was taken directly to equity.

## SUMMARY OF THE PERFORMANCE IN THE FINANCIAL YEAR

The forecasts made in the previous year's report were largely realised due to the circumstances outlined.

We participated in the stronger investment activities of our customers in industry and water and waste water management. Our customers also made previously deferred investments in mining, which had a positive impact on order intake, meaning that the significant improvements in order intake predicted in the previous year materialised. As expected, the growth of the Pumps and Valves segments exceeded the increase in the Service segment.

We slightly exceeded the stable sales revenue predicted in the previous year, although the forecast on the sales revenue development was not realised in all segments. For instance, sales revenue in the Pumps segments rose slightly (forecast in the previous year: significant decline). In the Valves segment, contrary to our expectations of a slight rise, there was a tangible fall. In the Service segment, however, our forecast of stable sales revenue proved correct.

The significant improvement in EBIT predicted in the previous year materialised as expected. In this context, the increase in the Pumps segment exceeded our forecast of significant growth; the substantial improvement predicted for the Service segment was confirmed. In the Valves segment, however, our expectation of a substantial rise did not materialise. Instead, EBIT fell strongly due to the write-down of goodwill of our company KSB Seil Co., Ltd., South Korea. Like the substantial improvement in EBIT outlined above, the earnings before income taxes (EBT) and the return on sales increased as expected. The earnings before income taxes (EBT) continue to be impacted by one-off costs in the amount of € 50 million, as expected. The net financial position, at € 288.0 million compared with € 259.5 million in the previous year, developed more favourably than predicted twelve months earlier.

Overall, therefore, order intake and sales revenue developed somewhat better than expected in the reporting year. Our expectations for the earnings figures of the Group were met in full overall. This also applies to the return on sales.

KSB continues to have a healthy financial basis for the future.

## DEPENDENT COMPANY REPORT

The Board of Management has submitted the dependent company report to the Supervisory Board. This concludes with the following declaration: "In accordance with section 312(3) of the *AktG* [*Aktiengesetz* – German Public Companies Act], we declare that our company – on the basis of the circumstances known to us at the time when the transactions were made – did not receive adequate compensation for all transactions listed in the dependent company report. All disadvantages have been compensated for in the course of the financial year. No measures subject to reporting requirements were undertaken in the financial year."

# REPORT ON EXPECTED DEVELOPMENTS

For 2018, the International Monetary Fund expects global growth in real terms of 3.9 %. Accordingly, the dynamic performance of the past year will continue and perhaps accelerate slightly. In this context, the IMF and other institutions assume a synchronous economic development, which includes all key economic areas.

In the industrialised nations, economic development will continue at a comparable growth speed as in 2017 based on expected growth of 2.3 %. Companies in these nations can benefit from growing demand from emerging markets in addition to a good domestic economy. In the euro zone, which is of key significance for our business, the favourable financing options continue to bolster the economic upswing. According to IMF figures, this should result in a gross domestic product that is higher by 2.2 %. Where this goes hand in hand with intensified investment activities, it will have a positive impact on the pumps and valves industry. Boosted by the tax reform, the growth signal in the USA is also green. Investment activities there will likely increase, which will create more favourable framework conditions for the local KSB companies.

The emerging market and developing countries are forecast to see slightly stronger momentum overall, which may result in an increase of 4.9 %. Economic prospects in the countries in Asia and Latin America that are key for our global business are promising. Economists expect 7.4 % GDP growth in India. This goes hand in hand with the expectation that the economy will overcome the uncertainty caused by the cash and tax reform. Our strong local production base will also help us to benefit from the Make in India campaign. In China it is to be expected that the expansionary momentum will drop to 6.6 % due to the politically intended shift towards a service-driven and sustainable economy. This goes hand in hand with measures to stem the growth in debts. The country remains a key growth market for equipment goods such as pumps and valves despite the slight weakening.

Argentina, Brazil, Chile and Peru will also continue to benefit from the recovery of commodity prices, as will Russia. In particular for our companies in South America, opportunities are therefore increasing to expand their business with pumps, valves and support services. In Russia we can use a new assembly and servicing plant to serve the reviving market in the current financial year.

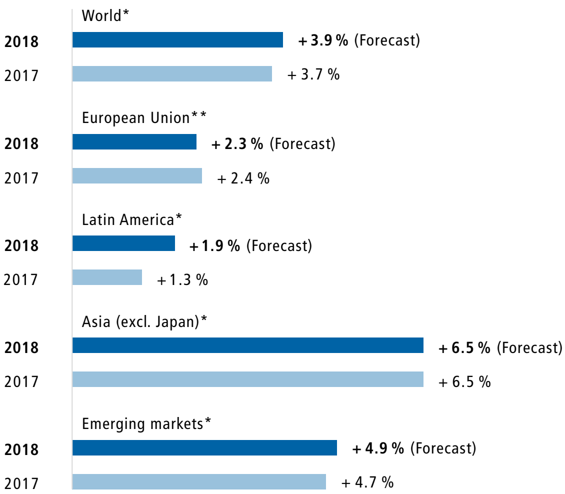
According to the assessment of the VDMA, the mechanical engineering sector will participate adequately in the global economic performance. Globally, the VDMA expects a real increase of 4 %; its forecast for the German mechanical engineering sector is only slightly weaker at 3.0 %.

As far as manufacturers of liquid pumps in Germany are concerned, the VDMA expects real sales revenue growth of 3 % in the current year; for industrial valves, the association expects an increase of 2 %.

## PROSPECTS IN ORDER INTAKE AND SALES REVENUE

The announced continuation of global economic growth is creating good framework conditions for an expansion of our business in and outside Europe. Overall, we are expecting continued growth of our order intake in the current year. This will be based largely on the expansion of our business with standard products, support services and spare parts. In addition, the rising willingness of our customers to invest gives rise to expectations that they will increasingly also tackle major projects. For these, we can supply products tailored to project specifications in addition to standard pumps and valves. Overall, we expect a tangible increase both in order intake and sales revenue.

**Gross domestic product growth**




* Source: International Monetary Fund (Januar 2018)
** Source: European Commission (February 2018);
additional information: euro zone +2.4 % (2017), +2.2 % (2018)

### Pumps

In the Pumps segment, we expect a strong increase in order intake; sales revenue is expected to grow tangibly. We expect the upward trend in industry and in water and waste water management to continue. To grow in these strategically paramount markets, we will optimise our product range and simultaneously intensify our activities to sell our renowned standard pumps for industrial and municipal water supply globally. To this end, we have expanded our production base and simplified the electronic selection and ordering of our standardised pumps. We also continue to focus on the support of major customers. Thanks to the breadth of our portfolio, which spans building services pumps through to specialised high-pressure pump sets, we can offer them comprehensive customer care.

### Valves

As far as order intake for valves is concerned, we expect significant growth driven, in particular, by demand from industry. Above all customers in the oil and gas sector will make investments that they had postponed. At the same time, we expect to be able to use opportunities for the sale of pipeline valves in water transport and the construction industry in Asia to also offer sales opportunities.

By contrast, demand for liquefied gas valves for tankers and loading stations will likely not rise again until the end of the year. We expect a falling order intake trend in the energy sector, where we see hardly any business opportunities in the construction and upgrading of coal power plants, except in Asia. Sales revenue for valves will increase slightly from today's perspective.

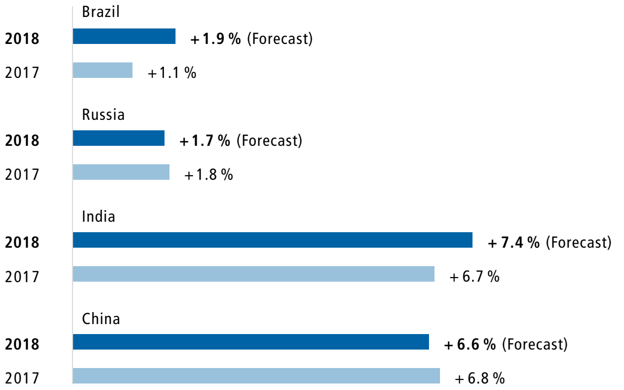
### Service

In Service, we have set ourselves the target of strong growth for the coming years. 2018 will still see opposing effects, which result from the streamlining of our structures in Germany and France. We nevertheless expect a stable order intake for the current year, whereas sales revenue is likely to grow tangibly.

To this end, we will not least strengthen our valves service, for which we also entered into new framework agreements in 2017. We also intend to expand our range of engineering services. With a view to creating a closer-knit customer service network, we plan to establish new service centres in Southern and Eastern Europe, the Middle East, China and the USA. Relevant acquisitions are also being considered.

In addition, our service range is continuously adapted to accommodate the roll-out of new products. This includes, for instance, the creation of hygienic workstations for the maintenance and repair of pumps for sterile processes. We aim to strengthen and expand the technical and organisational know-how of our specialists at a newly launched international service academy in 2018.

**Gross domestic product growth in the BRIC countries**




Source: International Monetary Fund (January 2018)

## SUMMARY OF EXPECTED DEVELOPMENT

For the current business period, we expect, as outlined above, a tangible improvement in order intake. Major orders will contribute to this, among others in India, where we have expanded our capacities. We expect a strong increase in the Pumps segment. The development in the Valves segment will be slightly weaker, but we still expect a significant increase in order intake. For the Service segment, however, we expect a stable order intake.

We expect sales revenue, too, to rise tangibly overall. In this context, we expect significant growth in the Pumps and Service segments, and a slight rise in the Valves segment.

We will be continuing with our measures for long-term improvements in our profit situation, which were initiated in the previous years. These aim to reduce material, staff and overhead costs. We expect savings that will have a positive effect on future earnings. For 2018, we are planning consolidated earnings before interest and income taxes (EBIT) that should tangibly exceed the prior-year level. EBIT in the pumps segment is planned to rise substantially. In the Service segment, we expect significant increases, while we expect only a stable earnings contribution from the Valves segment. Among other factors, the one-off development costs for major power plant valves, for which we have already received orders, and the further delay in the recovery of the business with liquefied gas valves are weighing on performance.

In terms of earnings before income taxes (EBT) and the return on sales, our expectation is that both key indicators will increase strongly.

For the net financing position, we plan to achieve a value significantly above the previous year.

The forecast horizon for all the afore-mentioned measures is the 2018 financial year. Material special factors beyond this period may result from our measures geared towards the long-term improvement of our profit situation.

## FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements and information that are based upon the assumptions of Management. They express our current forecasts and expectations with regard to future events. As a result, these forward-looking statements and information are exposed to risks and uncertainties that lie outside the Management's sphere of influence. We wish to point out that actual events or results may differ materially from the forward-looking statements and information mentioned, if one or more of the following opportunities or risks, or other opportunities, risks and uncertainties should materialise, or if the assumptions underlying the statements prove to be inaccurate.

# OPPORTUNITIES AND RISKS REPORT

As an organisation that operates throughout the world, the KSB Group is exposed to macroeconomic, sector-typical, financial and company-specific risks. Our risk policy is designed to enable us to grow sustainably and profitably. We aim to reduce the risks associated with our business and where possible avoid them completely. At the same time our global alignment and our extensive product range offer a wealth of opportunities. This includes in particular any opportunities that arise on the basis of our research and development activities, as well as any that are linked to the quality and cost effectiveness of our products. Our competitive position is also being strengthened by optimising our global sales and production network. We always review opportunities to expand our global presence and are able to achieve this through start-ups and acquisition projects.

We see opportunities and risks as possible future developments or events that may lead to forecast or target deviation. The deviation can be both positive and negative. In order to manage the varied opportunities and risks professionally and efficiently, we align our actions accordingly and focus upon the respective situation when selecting the persons responsible. In doing so, Controlling, Finance and Accounting as well as Internal Audits perform important monitoring tasks.

## RISK MANAGEMENT SYSTEM

KSB has implemented a Group-wide risk management system for identifying and assessing relevant risks and reporting these to Group headquarters. The risk management process of the KSB Group consists of the successive phases of identification, assessment, management, control, documentation and communication of risks. The six phases form a continuous and IT-based closed-loop system. This is documented in our risk management manual as well as the management responsibility and the description of all relevant tasks.

Managers are encouraged to take timely action to define and implement measures to limit or avoid damage that may result from the occurrence of risk events. All corporate and central functions and Group companies, including Group companies that are not consolidated, are included in the risk management system. The responsible managers are required to supply their relevant key business and financial indicators each month. As well as creating quarterly forecasts on business trends, they also twice a year report the recognised risks for the next 24 months from the reporting date for the categories of market and competitive risks, technological risks, project- and product-related risks, financial risks and procurement risks. Other business risks (environmental, human resources, etc.) are also reported in this cycle to the Risk Managers at the Group headquarters. We classify risks as qualitative and quantitative risks:

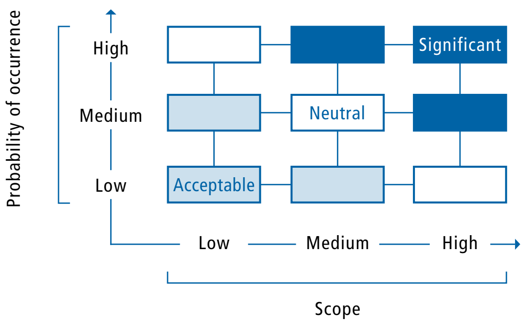
Qualitative risks are long-term developments that could have a negative impact on the KSB Group and which cannot or cannot yet be thoroughly quantified due to a lack of precise information. In order to still be able to evaluate them, however, we make estimates of the probability of occurrence and scope. With respect to probability of occurrence, the extent to which the information indicating the potential risk is detailed must be determined. The scope describes the potential influence of the individual risk on the earnings before interest and taxes (EBIT) of the KSB Group or the respective Group company.

Quantitative risks are those risks with possible monetary impact on the earnings of the KSB Group or the respective Group company. They are evaluated taking into account the probability of occurrence in combination with the potential amount of loss.

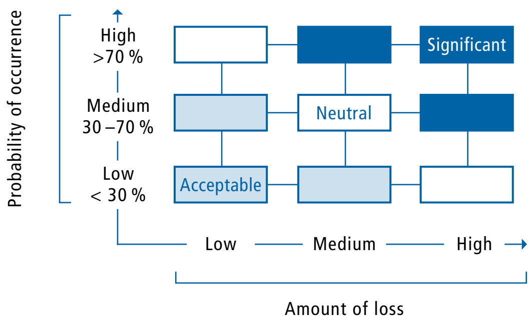
In order to assess whether qualitative and quantitative individual risks are significant for us, we classify them as acceptable, neutral or significant risks. We consider as material for the KSB Group all individual risks categorised as neutral or significant that are detailed in the “Individually assessed opportunities and risks” section. The relevant classification can be determined from the matrices below:

→ Qualitative risks – Quantitative risks

**Qualitative risks**




**Quantitative risks**




**Classification of amount of loss**

| | | Amount of loss in € thousands | | |
|---|---|---|---|---|
| **Magnitude** | **Sales revenue** | **Low** | **Medium** | **High** |
| Small companies | Up to € 20 million | 50 – 125 | 125 – 250 | > 250 |
| Medium-sized companies | € 20 to € 80 million | 75 – 250 | 250 – 500 | > 500 |
| Large companies, holding companies, organisational units | From € 80 million | 100 – 500 | 500 – 1,000 | > 1,000 |

Evaluation of the amount of loss is based on just three possible classifications: low, medium and high. The above criteria apply.

→ Classification of amount of loss

This approach gives us the necessary transparency to identify risks in their entirety and to manage them effectively, professionally and in an economically responsible manner.

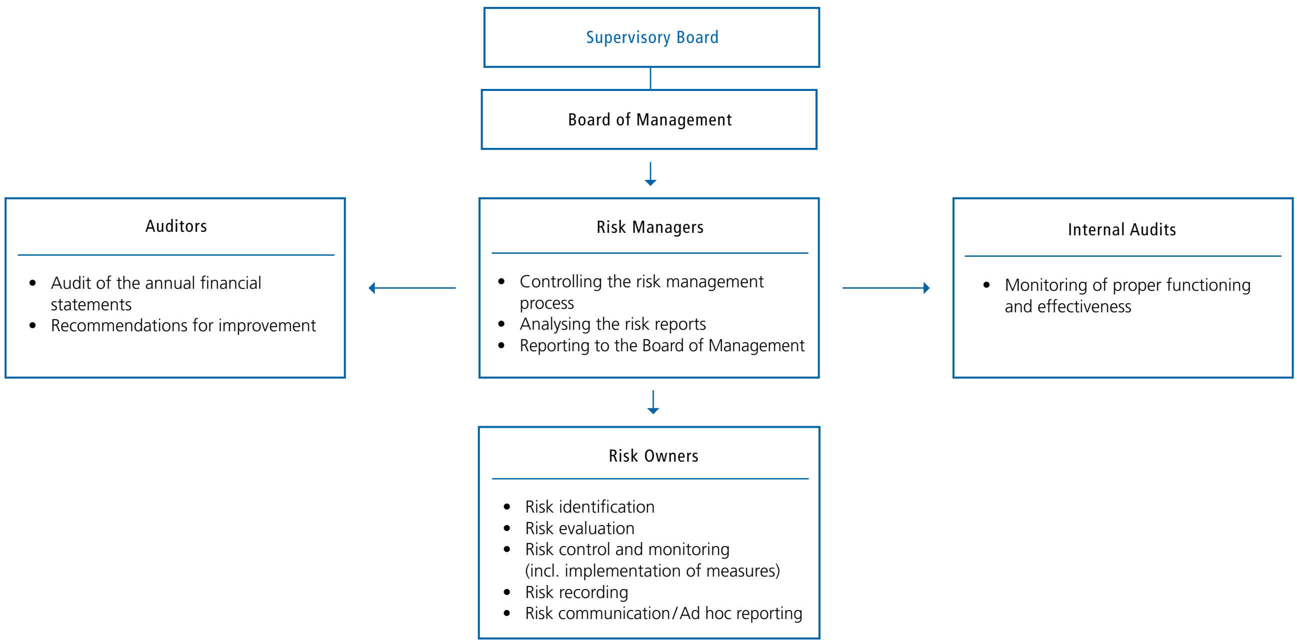
The bodies to which specific responsibilities and competencies were assigned in KSB's risk management system in the reporting year are shown and explained in the diagram below.

→ Risk management at KSB

The Board of Management of KSB AG had overall responsibility for risk management. It reported to the Supervisory Board during regular Audit Committee meetings and was monitored by the latter. The Board of Management was supported by the Chief Compliance Officer and the Group Finance and Accounting department. The latter coordinates the risk management process at Group level and investigates all reported risks to determine whether they are relevant for the financial statements. It ensures that there is a systematic link with the Group accounting process. The Board of Management and the Supervisory Board's Audit Committee received at least two risk reports per financial year. These reports include all the risks that are categorised as significant or neutral that exceed pre-defined threshold values individually or collectively, not considering any action that has been taken. Particularly critical topics are reported on an ad-hoc basis by the managers in charge. In contrast, opportunities are not taken into account in this system, but are examined separately in consultation with segment managers and regional managers applying a different assessment system.

With regard to financial risks we also make use of additional risk identification, assessment, management and communication. The central Finance department is responsible for this task which is described in further detail later in this section.

**Risk management at KSB**




Compliance risks are dealt with by the Chief Compliance Officer, who is assigned to the Legal and Compliance, Patents and Trademarks staff function. The Chief Compliance Officer is supported by the members of the Compliance Committee and the Compliance Managers of the individual companies.

The Internal Audits department is integrated into the risk management system as part of our internal control system. When planning audits, it prioritises areas according to potential risks and is provided with all the necessary information. The auditors ensure that all audited units adhere to the applicable guidelines, actively participate in the risk management system, and control or avoid their risks. Information obtained by Internal Audits on both the recognised risks and the countermeasures introduced in response forms an integral part of the reporting to the Board of Management and the Audit Committee of the Supervisory Board.

Our risk management system is regularly reviewed and promptly updated where necessary, for example, in the event of relevant legal or organisational changes. In addition, our auditor examines within the scope of the annual audit the early risk detection system, establishing that it is present and checking that it is fit for purpose.

## INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT SYSTEM WITH REGARD TO THE GROUP ACCOUNTING PROCESS

The accounting-related internal control system (ICS) contributes towards ensuring proper financial reporting. The aim is to ensure that the consolidated financial statements and group management report comply with all relevant regulations. Key elements of the ICS are – as well as the risk management system described above – guidelines and regulations, which include standard accounting and measurement policies. They must be applied to the full extent by all our Group companies. Functional separation and the principle of dual control are observed; this is ensured by the audits carried out by our Internal Audits department.

In addition, the Accounting department carries out regular analytical plausibility checks using time series analyses and actual/budget variance analyses. This enables us to identify significant changes early on, which we then examine for accounting and measurement discrepancies. The resulting findings are then discussed at management level.

The responsibility for Group accounting lies with the employees in the central Accounting KSB Group department. We employ the services of qualified external reviewers for certain calculations as part of financial reporting (such as the calculation of complex pension obligations using actuarial assumptions).

Binding schedules and guidelines apply to accounting within the KSB Group and to accounting at each individual subsidiary. The accounting methods that must be applied to compile the consolidated financial statements are defined in writing in a manual that we update and revise on a continual basis. This also includes the guidelines for posting intra-group transactions. We continually analyse new accounting principles and other official announcements with regard to their relevance and impact on the consolidated financial statements. We adapt our guidelines and manual where necessary and communicate any changes immediately to our companies. Accounting KSB Group monitors compliance with these regulations. This enables us to reduce the risk of compiling inappropriate financial statements or failing to publish them by the defined deadlines.

We automatically process the financial statement information for all Group companies using certified and tested standard consolidation software. Systematic checks are implemented to help us validate the data. Employees in Accounting KSB Group verify any warning signals that arise before using the data. The sequence of the processing steps is strictly specified through the use of the consolidation monitor within our IT system. This ensures the correct processing of data.

To enable a seamless and accurate accounting process, we only assign employees to this task who have the appropriate specialist know-how. These employees are trained on a regular basis to make sure that their expert knowledge remains up to date.

We have defined access authorisations for the accounting-related IT system. This protects the data against unauthorised access as well as improper usage and modification. The data is checked at many stages, helping to ensure the processing quality. Alongside regular system reviews by the auditors, these checks contribute to limiting operational risks.

## INDIVIDUALLY ASSESSED OPPORTUNITIES AND RISKS

The categories presented below – unless stipulated otherwise – include the qualitative and quantitative gross risks classified as significant or neutral and the main opportunities for our business development. The main influencing factor remains the economic development. All other opportunities and risks are assessed as secondary.

### Markets / Competition

- **Risks**

Our business opportunities are again affected by changes in the economic and political environments in the current reporting year.

We manage the risk of fluctuations in the economy and in demand by remaining active in several market sectors and industries with different economic cycles. Furthermore we are monitoring the development of the economic environment for our market sectors. If necessary, we adjust capacities, relocate production facilities and implement cost-cutting measures.

Asia remains our most important sales market for power plant equipment, including pumps and valves. However, competition in China intensified further. For the KSB Group, this has created increased pricing pressure and thus represents a “significant” risk. Political decisions too, such as the postponement or even abandonment of energy projects in several Chinese provinces, have impacted negatively on our business performance. In order to tap into the Asian market more widely, we have agreed a strategic alliance with our long-term partner, the Chinese SEC Group, in late 2015. This aims at closer cooperation so that KSB can achieve success in Asian power plant projects outside of China.

The risk from the political situation in various parts of this world, however, lost some significance year on year. According to our assessment, the framework conditions in the countries of the Region Middle East/Africa, which were presented in the 2016 annual report as risks, are no longer material risks in the financial year. However, the East/West relations that are under considerable strain given the political differences between Russia and the USA, and between Russia and most European countries, continue to be significant. This also becomes apparent in the Russian government's import substitution programme, which constitutes a "significant" risk. Russian companies are to increasingly order products that have been made in Russia or involve a high proportion of local value added. Our KSB company in Moscow has prepared for this development, setting up a local assembly site for industrial and water engineering pumps in leased premises. In addition, an own production site is being established, which will start operations in 2018 according to our plans. Our company almost doubled the domestic value added share already in the reporting year.

We considered the risk of a fall in demand in the petrochemical industry in China in our sales strategy. It is therefore no longer material for our expected business development, contrary to the previous year.

- **Opportunities**

Whereas business in the field of fossil-source energy generation remains weak, there is a trend towards growing demand for technical equipment from energy supply companies operating nuclear power stations. Here, KSB sees opportunities as a provider of high-safety components to participate in the supply of equipment, but also to provide maintenance and repair services for such plants with its specially qualified staff.

In China business prospects are arising in the retrofitting of coal-fired power plants, which are upgraded to become more efficient and environmentally friendly. In addition, KSB Shanghai Pump Co., Ltd. can contribute its expertise to the construction of fossil-fuelled power plants, which Chinese plant engineers are planning and installing in selected countries within the framework of the One Road, One Belt policy.

In China and India with their strong need to catch up with environmental protection requirements, ongoing action plans offer good opportunities for waste water pumps, which are required in sewage treatment plants and the requisite infrastructure. In India, in particular, which is suffering from serious air pollution, tackling the causes may also increase demand for flue gas desulphurisation pumps from our portfolio.

**Projects / Products**

- **Risks**

The markets' requirements for our products are constantly changing. We will only succeed if we meet our delivery deadlines and offer technically advanced products in good quality at affordable prices. To minimise the risk of delivery delays, which can lead to an adverse effect on our reputation with customers and also result in financial penalties, we constantly monitor our sales and manufacturing operations. If we discover that machinery needs to be renewed or capacities expanded, we examine these investment projects as part of a step-by-step approval process. By doing this, we counter the risk of schedule and cost overruns that is rated as "significant".

Regular market analysis and monitoring minimise the risk that our products will become technically obsolete or that we offer them at prices not acceptable in the market. At the same time, we are exposed to the risk posed by cheap products from Eastern Europe and Asia that compete with KSB's portfolio. This calls for continuous quality management, which we have introduced across the Group.

In our business, there are special requirements when it comes to the processing of large-scale projects with long contract terms. There are also always associated risks. There may be cost overruns, tighter import regulations, staff shortages, technical difficulties or quality problems – including possible contractual penalties – that reduce our margins. We therefore train our employees in project management and equip them with specialist knowledge. This enables them to identify the risks associated with longer-term orders at an early stage. With this in mind, our project managers are also provided with appropriate management tools. Decisions are made in conjunction with clearly structured authorisation processes.

There are also technical and financial risks to orders with newly designed products. We limit technical risks to the extent that we define intermediate steps for development work and subject partial solutions to assessments. This also applies to pumps that we provide within the framework of a major contract running over a number of years for the construction of a new type of power plant in China. We minimise financial risks by using appropriate contractual clauses, and ensure that advances cover the costs incurred. We set aside suitable provisions for warranty obligations and contractual penalty risks. These amounted to € 51 million in the consolidated financial statements for 2017 compared with € 50 million in the previous year; beyond this there is no other major residual risk (net risk).

The protection of intellectual property is also becoming ever more significant in our increasingly interconnected world. We are addressing a growing risk by registering patents early, monitoring Internet platforms for the sale of pumps and valves and taking legal action against anyone violating our rights.

- **Opportunities**

Digital transformation enables us to better fulfil customer requirements with new products and services and to generate competitive advantages. A new pump monitoring system to be launched in the market in the current year serves this aim. It sends values measured by sensors into a cloud for analysis and increases transparency for operators of machinery. As a result, deterioration and damage can be identified early on and appropriate measures be initiated. This can result in a higher number of service orders in the medium term. The introduction of the new SAP C4C cloud software enables us to better control service processes and to plan assembly assignments precisely.

There are also good chances that our customers will increasingly ask for products newly launched in 2017, such as high-pressure pumps and pressure booster sets, oil pumps to API standards, waste water pumps with high efficiencies and submersible borehole pumps. This also applies to new valves for use in water pipelines, ANSI valves for power plants and diaphragm valves with improved pneumatic actuators.

New high-efficiency waste water pumps open up opportunities for KSB BRASIL LTDA. to improve its market position in the waste water market compared with competitors.

The expansion of our range of mechanical seals to more than 30 type series provides added options for fitting pumps for the most varied applications with this core component or for supplying such seals as spare parts. By intensifying the sale of these components produced in-house, we are increasing the value-added depth and thus our pumps business profit.

**Finance / Liquidity**

- **Risks**

As a group with global operations, we are exposed to a wide variety of currency risks. We counter these with foreign exchange hedges. However, our global manufacturing network also offers us the opportunity to benefit from currency effects and to use these where appropriate in competition with other manufacturers. In addition to uncertainties regarding exchange rates, interest rate developments on the capital markets play a role for us. We use bank loans subject to variable interest rates to counter the interest rate risk by hedging our future interest payment flows accordingly.

Alongside the euro, the most important currencies for the KSB Group are the US dollar, the Indian rupee, the Brazilian real and the Chinese yuan. If the exchange rate differs from our assumptions, this would have positive or negative effects on our business volumes and our earnings. A strict receivables management system and the use of trade credit insurance helps us avoid situations where receivables cannot be collected from our customers.

Risks regarding margins and liquidity are typical of the project business. As well as the continued pressure on our selling prices, which is reducing our profit margins, these include unfavourable contract conditions such as reduced advances and tougher contractual penalties. As we comply exactly with our approval processes in the quotation phase, we minimise this risk. At the same time, this enables us to recognise and avoid liquidity shortages. Where necessary, we secure sufficient liquidity by agreeing appropriate credit lines early on.

Persistent recessions or newly emerging crises may adversely affect the financial situation of our customers. Resulting delays in payment and bad debts which were rated as "significant" in the financial year would weigh on our results of operations. The same effect might occur if the foreign exchange regulations become stricter for individual countries. We counter this by means of a strict receivables management system and intensive customer contacts.

Changing market conditions mean that our business models need to be fundamentally reviewed time and time again. This can also mean that we adjust our product range accordingly.

As regards tax matters, the global orientation of our activities must be taken into consideration. Based on our operative activities in numerous countries with varying tax laws and administrative interpretation, differentiated assessment is required for measuring our tax obligations. Uncertainty may arise due to different interpretations by taxable entities on the one hand and local finance authorities on the other. These may come to light during audits. By cooperating closely with external local tax specialists, we counteract the risk of having to pay back taxes, which is rated as "significant". As we continually monitor unclear issues, we can generally classify the probability of occurrence. Should a need for subsequent payment arise, we create the corresponding provisions in good time. In the 2017 consolidated financial statements, we set aside € 0 million (previous year: € 1.3 million) for circumstances that are classified as a significant or neutral risk. In addition, there are contingent liabilities in the expected amount of € 1.6 million (previous year: € 7.4 million).

**Procurement**

- **Risks**

Commodity prices and procurement times are subject to strong market-related fluctuations. This may adversely affect our earnings situation if we do not manage to make up for cost increases or pass them onto our customers. Delays or bottlenecks in our supply chain for raw materials and components may negatively impact our business operations. If we do not benefit promptly from declining procurement prices, the persistent pressure on the selling price of our products would have a negative effect on our earnings.

In the context of our procurement strategy, we are also careful to avoid becoming dependent on individual suppliers and thereby counteract the risk of a supplier default. If local conditions mean that it is impossible to ensure sufficient diversification in this regard, we make use of additional foreign business partners. In selected cases, we also integrate external expertise into our company, not least to make the best possible use of our capacity.

Our suppliers are also further developing their product ranges. In some cases, this results in changes to the specifications for the materials that we require. We consistently monitor any potential impact on the quality of our products. Should risks emerge, we reserve higher volumes based on the original material structure, where possible, and assess alternative procurement sources.

- **Opportunities**

Process improvements and new forms of the global procurement of materials and services are key elements of our Efficiency Improvement Programme. A reduction in costs is increasingly served by online auctions, which help to achieve favourable purchase prices thanks to the strong competition. The processes, which can be controlled with comparatively few members of staff, reduce the indirect procurement costs and offer the opportunity of a high level of transparency in supplier selection, which we can base on a large number of providers.

### Technology / Research and Development

- **Risks**

It is essential to our future success that we have a product and service range that is suited to the market in terms of technology, price and delivery time. The changing needs of our customers and new standards and regulations – especially in promising markets such as China – require that we continuously develop and improve our products and services. Research and development required for adjustments consumes significant financial and human resources, with no guarantee of success in either the medium or the long term.

To avoid any negative impact on earnings, it is important to recognise the market-related or technical risks early on. To this end, we are constantly updating our development process, which incorporates various control levels. As sales employees are regularly included in this process, risks arising from changes in markets or applications can be taken into account in good time in the evaluation.

- **Opportunities**

At our Business Innovation Lab we develop new business models on the basis of digital technologies. The aim is to offer customers smart solutions to problems in liquid transport using plant-based data and to simultaneously ensure a high level of security and transparency of their processes. In a test phase, we check these models for functionality and marketability in order to tap new business opportunities.

For example, we deal with application software (apps) for the remote control of our products, the electronic change of fixed speeds – as an alternative to mechanical adjustments – as well as the miniaturisation of power electronics and its integration in the motor. New cooling concepts and loss-reduced semiconductors serve precisely this purpose. In the current year, we will be launching a cloud-based system for pump monitoring into the market for the first time, which will provide users with structured information and early warnings. We see opportunities of receiving orders in a noteworthy volume for this new development as early as in 2018.

With a view to serving our customers in the oil and gas industry, we focused on the development of pumps to API 610 standards in 2017 and enhanced our range of products for downstream applications. This opens up opportunities for winning additional orders. Initial order successes for new API pumps were recorded already in 2017.

As far as pumps for energy engineering are concerned, a focus of our development work was on product adjustments in order to supply combined-cycle power plants in North America with the technical equipment needed. To this end, we expanded our portfolio with new variants of boiler feed and condensate pumps. On the basis of these technological developments, we expect to boost sales in this application area.

We have established a dedicated development team to provide large tubular casing pumps meeting the required specifications. This enables us to produce customised variants of this product for the project business in a narrow time frame. We received orders for this type of pump in 2017 for cooling water supply and for flood control. The latter will increase in significance on account of global warming. Aiming to expand the business with tubular casing pumps, we are currently driving the development of fish-friendly propellers. They will expand the potential uses of these pumps.

Rapid manufacturing will have an impact on the availability of parts. Using CAD data, it is today possible to manufacture the components of pumps and valves anywhere in the world. We achieved further progress in the use of additive manufacturing processes in 2017 and will install a large stainless steel powder bed 3D plant in the current year. The use of this technology allows offering customers new production alternatives and receiving corresponding orders.

**Other business-specific risks – Environment**

- **Risks**

Our business activities, primarily in the area of production, are subject to numerous environmental protection laws and regulations. Environmental damage of any kind (for example, groundwater contamination, renovation needed due to outdated construction materials or unpleasant odours arising from the use of chemicals) may result in losses not covered by an insurance policy. Therefore, at all company sites officers monitor compliance with laws and regulations as well as with internal KSB rules, which in some cases exceed the prescribed environmental standards. If we discover any contamination, we set aside provisions to meet the liabilities for the necessary clean-up work. In the 2017 consolidated financial statements, these amounted to just under € 0.2 million for significant or neutral risks.

As part of acquisition projects, we examine properties for possible contamination before purchase. We take account of critical issues by way of corresponding contractual regulations with the seller and implement appropriate measure in consultation it.

In markets where environmental regulations are becoming more stringent, there is a risk that our products and own or purchased services may cause infringements that lead to us losing our market authorisation and which damage our reputation. A change in rules on liability in environmental protection can also increase the risks for our business success. As a member of national and international professional associations we become aware of imminent changes in environmental law early on. We also continually update the legal frameworks that are in place in our Operational Units, enabling us to ensure that our employees always abide by the applicable law. This is also monitored by external auditors as part of the management certifications.

- **Opportunities**

At KSB, environmental awareness is combined with an active and forward-looking approach as well as internal processes that enable permanent cost reductions. This applies, for instance, to all measures that reduce energy consumption in production, service and in the administrative areas. Inversely, we offer the users of our products the opportunity to reduce their electricity costs by selecting energy-efficient KSB products.

Hazards to people and nature may emanate from the production and processing methods of manufacturing companies. Our global environmental management system helps us to identify these risks early on and to initiate protective measures in good time. We thereby not only prevent pollution, but also its financial consequences.

Drawing on a functioning and certified environmental management system, we fulfil a requirement of numerous public-sector customers, large companies and entire industries such as the automotive sector. For them, evidence of an environmental management system is an increasingly important criterion in the selection of suppliers. By having our production and service plants checked by auditors and certified to international standards, we and our customers are both assured that KSB companies respect the environment. Our commitment to the UN Global Compact also meets the expectations of our customers and improves our order opportunities with companies that pick their suppliers with a view to their responsibility for the environment and society, among other things.

### Other business-specific risks – Human resources, legal aspects and IT

#### ▪ Risks

To achieve our growth and profitability business objectives, we need qualified employees at all our locations, including technical specialists. Due to the demographic change in some countries, the competition for these and other highly skilled professionals is increasing, and will intensify if economic recovery sets in. We counter this risk with demand-oriented measures, systematic human resources planning and international recruitment processes.

Changing market conditions can have a negative impact on the funded status of our pension obligations. Strong fluctuations in the evaluation of capital market interest rates to be paid may have a considerable impact on the Group’s earnings and the equity carried on the balance sheet. To limit this risk, we validate alternative models.

Like all companies, KSB has to adapt to new market conditions. We are currently implementing a global efficiency improvement programme, which also encompasses staff reduction measures. By seeking out socially responsible solutions in the areas of the company concerned and by keeping our employees up to date at all times, we are aiming to keep motivation high and to avoid the departure of employees from key positions.

Changes to our processes and organisational structure, such as the introduction of shared services centres, require clearly defined project responsibilities and valid project plans, as well as the selection of suitably qualified external partners. This helps to avoid teething troubles when changes are introduced to structures and processes, as such problems could impact on the expected cost benefits.

Other potential risks associated with the activities of our employees include dishonest conduct or violations of laws, that could damage the image of KSB. We counter these risks and safeguard our reputation among our customers by organising regular compliance training and through individual initiatives in critical regions.

We address maintenance and repair risks, which could result in production downtime or health hazards for persons, by monitoring them permanently. As soon as necessary refurbishment work is identified, we implement the requisite measures in good time. For instance, we are currently overhauling our heating systems and planning structural measures regarding roofing at the Frankenthal site.

Legal disputes cannot always be avoided within the framework of our business activities. These are usually disputes arising from operations, generally involving unclear warranty issues. If as a result of these issues we expect negative effects on the success of our business, we set aside corresponding provisions, which cover not only the anticipated amount of loss, but also the costs of proceedings. To rule out a net risk, the 2017 consolidated financial statements include about € 1 million (previous year: € 3 million) for those cases classified as significant or neutral risks. We have also created provisions for litigation with authorities and for staff matters. These amount to just under € 3 million overall (previous year: € 2 million) to cover any cases we classify as significant or neutral within our risk assessment methodology. Overall, we rate the risk from legal disputes in the financial year to be significant.

The manipulation and loss of electronic data can lead to serious commercial disadvantages. We limit this risk by means of adequate security systems and access procedures. An increased centralisation of the IT systems of our various operating units assists us in this. In this way, we implement high security standards and thus reduce the risk of data loss or corruption.

- **Opportunities**

To remain successful, we need to keep seeking opportunities to optimise our services for customers, simplify processes and reduce costs. In this context, ideas and improvement suggestions by employees provide key impulses. With a view to translating such ideas into innovations, we launched an Internet-based ideas management portal in 2017. Its aim is to generate more employee ideas and to have other portal users provide their comments on or expand them. We will globalise the tool, which was initially rolled out in Germany, in order to use the ideas potential of our employees worldwide.

## IMPORTANT OPPORTUNITIES AND RISKS BY SEGMENT

As in the previous year, the opportunities and risks for the Pumps, Valves and Service segments are most influenced by economic development. The future development of China remains important to KSB. Particularly in Eastern Europe, uncertainty regarding political risk is of great significance to the Pumps and Valves segments, and to a lesser degree to Service. Compared with the previous year, we rate the political situation in some countries in the world to be no longer material for the business of the KSB Group. However, political decisions on energy projects in China and the considerable strain on East/West relations continue to be significant risks for us. Worsening payment morale also bears corresponding risk potential for future business. As regards our most significant influencing factor, the economic development, our risk assessment compared with the previous year has changed in that the development of the oil price is no longer a significant risk for the KSB Group. We now assume that the oil price will not recover fully in the coming years, and we have implemented this factor in our strategy. If the oil price were to develop better than expected, however, this would likely have positive effects on our business. The economic development in general continues to be the most significant risk for us due to the difficulty of assessability. By contrast, we continue to hope that our measures intended to foster growth will provide us with considerable support in achieving our goals. Our customers are also often affected by recessions and more intense competition, which can decrease their ability to pay in individual cases.

Negative currency changes in growth countries could threaten our exports, in particular those from our European plants. But this would also enable our production facilities in the countries affected to benefit from such developments and to increase their export volumes.

## RISK REPORT ON THE UTILISATION OF FINANCIAL INSTRUMENTS

Central financial management in the KSB Group performs its duties within the framework of the guidelines laid down by the Board of Management. We base the nature and scope of all financial transactions exclusively on the requirements of our business and do not conduct business of a speculative nature. The aim is to ensure liquidity at all times and to finance our activities under optimal conditions. With respect to our export business, we hedge foreign exchange and credit risks to the greatest extent possible. We continuously improve our receivables management methods with the goal of settling our outstanding amounts by their due dates.

We are exposed to the following financial risks as a consequence of our business activities:

On the one hand, we are exposed to credit risk. We define credit risk as potential default or delays in the receipt of contractually agreed payments. We are also exposed to liquidity risk, which is the risk that an entity will be unable to meet its financial obligations, or will be unable to meet them in full. Finally, we are exposed to market risk. The risk of exchange rate or interest rate changes may adversely affect the economic position of the Group. Risks from fluctuations in the prices of financial instruments are not material for us.

We use foreign exchange hedges to reduce the risks from transactions involving different currencies, These are generally currency forwards, which we use both for transactions that have already been recognised and for future cash flows from orders still to be processed. At year end, the notional volume of currency forwards used to hedge exchange rate risks was € 276.5 million (previous year: € 269.8 million). Foreign currency items denominated in US dollars account for the major volume hedged by forwards. By strengthening our production sites worldwide, we can realise "natural" currency hedging in currency markets that continue to be volatile.

To minimise interest rate risks, we concluded interest rate swaps to hedge cash flows from underlyings amounting to € 0.0 million (previous year: € 39.5 million). Underlyings and hedge transactions share the same variable interest rates and maturities (1 year).

We limit all these risks through an appropriate risk management system, defining how these risks are addressed through guidelines and work instructions. In addition, we monitor the current risk characteristics and continuously provide the information obtained in this way to the Board of Management and the Supervisory Board in the form of standardised reports and individual analyses.

For more information on the three risk areas and the impact on the balance sheet, see the Notes, section VI. Additional Disclosures on Financial Instruments.

## OVERALL ASSESSMENT OF OPPORTUNITIES AND RISKS

The opportunities and risks for the KSB Group are mainly derived from macroeconomic influencing factors and their effects on the global mechanical engineering markets and the competition.

The overall risk situation improved a little compared with the previous year. The reason for this is that we no longer rate the oil price to be a significant risk. Overall, we expect an economic performance in line with the IMF forecast for next year. Our structural measures will afford us additional support in achieving our objectives. The weakening economic momentum in the growth markets as well as political developments, however, continue to constitute risks, as described in the risk situation by segments. The same applies to geopolitical instabilities, decisions on sanctions and volatile currencies. Such circumstances would have a negative effect on our business volumes as well as our budgeted earnings.

In this environment, the KSB Group continues to rely on its ability to match capacities and resources to the changing market conditions. For us, a solid financial position and an efficient cost structure are vital in order to maintain our long-term competitiveness. We are convinced that we can continue to successfully overcome the risks arising from the above-mentioned challenges.

The risk management system in place as well as the related organisational measures allow the Board of Management to identify risks in a timely manner and to take adequate measures. In view of the somewhat uncertain situation, the focus of activities in 2018 will continue to be on the management of market risks. The Board of Management states that, based on the risk management system established by the KSB Group, at present there are no risks that could lead to a lasting and significant impact on the net assets, financial position and results of the KSB Group.

# ACQUISITION-RELATED DISCLOSURES

A summary of the acquisition-related disclosures required by section 315(4) of the *HGB* [*Handelsgesetzbuch* – German Commercial Code] is given below and explanatory information is provided pursuant to sections 175(2) and 176(1) of the *AktG* [*Aktiengesetz* – German Public Companies Act]. Information is disclosed only to the extent that it applies to KSB AG (KSB SE & Co. KGaA since 17 January). In the following, only the term KSB AG will be used.

KSB AG's share capital amounts to € 44.8 million, of which € 22.7 million is represented by 886,615 no-par-value ordinary shares and € 22.1 million by 864,712 no-par-value preference shares. Each no-par-value share represents an equal notional amount of the share capital. All shares are bearer shares. They are listed for trading on the regulated market and are traded in the General Standard segment of the Frankfurt Stock Exchange.

Each ordinary share entitles the holder to one vote at KSB AG's Annual General Meeting. Some 84 % of ordinary shares are held by Johannes und Jacob Klein GmbH, Frankenthal (until 4 May 2017, the company operated as Klein Pumpen GmbH), whose shares are majority-owned by KSB Stiftung [KSB Foundation], Stuttgart. The preference shares carry separate cumulative preferred dividend rights and progressive additional dividend rights. Detailed information on the share capital and shareholders holding an interest of more than 10 % is provided in the Notes to the Consolidated Financial Statements. Holders of preference shares are entitled to voting rights only in the cases prescribed by law. The issue of additional ordinary shares does not require the consent of the preference shareholders. Similarly, the issue of additional preference shares does not require the consent of the preference shareholders provided that the subscription rights do not exclude newly issued senior or pari passu preference shares.

The company is authorised by a resolution passed at the Annual General Meeting on 6 May 2015 to purchase, until 5 May 2020, company shares of any type totalling up to 10 % of the current share capital or, if lower, of the share capital at the time of this authorisation being exercised. The Board of Management shall be entitled to: (1) sell company shares purchased on the basis of this authorisation either on the stock exchange or by another means that safeguards the rule of equal treatment of all shareholders, for example by means of an offer to all of the company's shareholders; (2) sell the acquired shares of the company with the consent of the Supervisory Board, excluding shareholders' subscription rights, if the shares are sold for cash and at a price that is not materially lower than the market price for company shares of the same type and with the same features at the time of the sale. This authorisation is limited to the sale of shares that overall represent no more than 10 % of the existing share capital on the date on which such authorisation becomes effective or, if the amount is lower, the date this authorisation is exercised. The 10 % limit shall be reduced by the proportional amount of share capital for shares (i) issued within the scope of a capital increase during the term of the authorisation excluding subscription rights pursuant to section 186(3) sentence 4 of the *AktG* or (ii) to be issued for the purpose of servicing warrants and convertible bonds, provided that the bonds were issued during the term of the authorisation excluding subscription rights pursuant to section 186(3) sentence 4 of the *AktG*; (3) sell the shares with the consent of the Supervisory Board, excluding shareholders' subscription rights, to third parties for the purpose of acquiring companies, parts thereof and/or financial interests in companies as well as within the scope of corporate mergers or (4) redeem the acquired shares without any further resolution of the Annual General Meeting in full or in part, including in several partial steps. The redemption may also take place without a capital reduction by adjusting the proportional amount of the other no-par-value shares in the company's share capital. In such cases, the Board of Management shall be authorised by the Articles of Association to adjust the number of no-par-value shares. KSB AG has not yet made use of this authorisation to purchase treasury shares.

There are no resolutions by the Annual General Meeting authorising the company's Board of Management to increase the share capital (authorised capital).

In accordance with its Articles of Association, KSB AG was managed by at least two Board of Management members. The Supervisory Board decided on the appointment and termination of the mandate of members of the Board of Management in accordance with the statutory provisions. Since 17 January 2018, KSB Management SE has conducted the business of KSB SE & Co. KGaA. Under the Articles of Association, the management of KSB SE & Co. KGaA is the responsibility of the Managing Directors.

Amendments to the company's Articles of Association are resolved by the Annual General Meeting. If the amendments only affect the wording of the Articles of Association, they can be made by the Supervisory Board, which operates and is formed in accordance with the regulations of the German Co-determination Act.

# CORPORATE GOVERNANCE STATEMENT (SECTION 315d OF THE HGB IN CONJUNCTION WITH SECTION 289f OF THE HGB)

The Corporate Governance Statement pursuant to section 289f of the *HGB* [German Commercial Code] in conjunction with section 315d of the *HGB* dated 21 March 2018 is accessible to the public at www.ksb.com > Investor Relations > Corporate Governance / Corporate Governance Statement.

In addition to the Corporate Governance Report (including the Statement of Compliance in accordance with section 161 of the *Aktiengesetz* [German Public Companies Act], the Corporate Governance Statement includes relevant information on corporate governance practices applied at KSB SE & Co. KGaA that go beyond statutory requirements. Also described are the working methods of the Board of Management and Supervisory Board, and the composition and working methods of the committees of the Supervisory Board.

# STATEMENT ON THE NON-FINANCIAL REPORT (SECTIONS 315b, 315c IN CONJUNCTION WITH SECTIONS 289b TO 289e OF THE HGB)

The separate combined non-financial report is prepared in accordance with sections 315b, 315c in conjunction with 289b to 289e of the *HGB* and disclosed together with the group management report in accordance with section 325 of the *HGB*. The report can be accessed at: www.non-financial-report2017.ksb.com

# REMUNERATION OF THE BOARD OF MANAGEMENT (REMUNERATION REPORT)

The Remuneration Report summarises the principles applied when determining the remuneration arrangements for the Board of Management of KSB AG. It is prepared in accordance with the recommendations of the German Corporate Governance Code (item 4.2.5) and explains the remuneration system in place for Board of Management members. This system is geared towards sustainable corporate development. It is adopted by the Supervisory Board plenary session based on the recommendation of the Personnel Committee and reviewed at regular intervals. The same applies to individual Board of Management compensation amounts.

The remuneration arrangements for the Board of Management were structured as clearly and transparently as possible. The total amount of remuneration for the individual Board of Management members was determined based on various parameters. Criteria for assessing the appropriateness of the remuneration included the responsibilities of the individual Board of Management members, their personal performance, the economic situation, the company's success and prospects as well as customary remuneration amounts when taking peer companies and the remuneration structure used elsewhere within the company into consideration.

The remuneration of the Board of Management consisted of fixed and variable components. Fixed components were granted regardless of performance and consisted of a fixed sum plus benefits, as well as pension commitments (retirement, disability, widow's or orphan's pension). The fixed sum made up 60 % of the maximum annual salary and was paid out as a monthly basic remuneration. All Board of Management members were equally entitled to the accompanying fringe benefits which included the private use of a company car, payment of insurance premiums and any payments associated with a post-contractual non-competition clause. No loans or advance payments were granted to members of the Board of Management in the year under review.

To ensure the sustainability of the nature of the remuneration, the variable remuneration component consisted mainly of future-oriented components determined on the basis of a multi-year assessment. They were partly based (60 %) on the degree of implementation of the corporate strategy and its actual market success, and partly (20 %) on the return on investment measured according to the economic value added method based on a past average value over a medium-term horizon. The short-term share (20 %) was based on the development of the net financial position in the respective financial year as compared with the planned development. The total amount of the variable remuneration components was limited in order to take extraordinary, unforeseen developments into account.

The weighting factors above do not reflect the additional possibility of a bonus, to be paid out in individual cases at the discretion of the Supervisory Board, of no more than three monthly salary payments per financial year in recognition of any special performance of individual members of the Board of Management. Such decisions are only made on an irregular basis, meaning that they do not necessarily have to be made annually.

In December 2017 the Supervisory Board discussed and decided to adjust the measurement bases for variable remuneration as of 2018. Determination of the long-term components is now carried out on the basis of the net profit plus depreciation/amortisation weighted for 3 years. The short-term share is measured in equal proportions based on the development of the annual EBIT margin, sales revenue and success in the achievement of a personal goal.

Furthermore, when Board of Management contracts are concluded it is agreed that payments made to a Board of Management member in the event of his or her Board of Management tenure being terminated prematurely without good reason shall not exceed the value of two years' remuneration including fringe benefits (settlement cap in accordance with item 4.2.3 of the German Corporate Governance Code). No other payments have been promised to any Board of Management members in the event of termination of service; similarly no compensation will be paid in the event of a takeover offer. If a contract of service is terminated by a Board of Management member for cause, the company shall not make any severance payments. On 6 May 2015 – using a legally permissible option – the Annual General Meeting again resolved not to disclose the details of the compensation for individual members of the Board of Management for a period of five years.

In total, the short-term benefits (total remuneration) paid to the members of the Board of Management for their activities in the 2017 financial year amounted to € 1,858 thousand (previous year: € 1,250 thousand), and the payments for benefits after termination of work € 1,422 thousand (previous year: € 1,388 thousand). € 2,934 thousand (previous year: € 5,255 thousand) has been provided for pension obligations to current members of the Board of Management, and € 42,202 thousand (previous year: € 39,309 thousand) to former members of the Board of Management and their surviving dependants; total benefits paid to these persons amounted to € 2,422 thousand in the year under review (previous year: € 2,244 thousand). No stock options or other share-based payment arrangements are granted to members of the Board of Management.

The short-term benefits (total remuneration) paid to members of the Supervisory Board amounted to € 834 thousand for the 2017 financial year (previous year: € 716 thousand). Information on the structure of the remuneration arrangements for the Supervisory Board is provided in the Corporate Governance Statement pursuant to section 289f of the *HGB*.

Frankenthal, 21 March 2018

KSB Management SE
The Managing Directors