

REPORT OF THE SUPERVISORY BOARD

The 2017 financial year was dominated by personnel and structural changes, including the change in legal form of KSB Aktiengesellschaft to a partnership limited by shares [*Kommanditgesellschaft auf Aktien*] by resolution of the Annual General Meeting on 10 May 2017, which was successfully completed by entry in the *Handelsregister* [German Commercial Register] on 17 January 2018. Under section 203, sentence 1 of the *UmwG* [*Umwandlungsgesetz* – German Transformation Act], the members of the Supervisory Board of KSB Aktiengesellschaft became members of the Supervisory Board of KSB SE & Co. KGaA for the rest of their term in office. By contrast, a *Kommanditgesellschaft auf Aktien* (KGaA) has no Board of Management; the latter's tasks have been performed by the general partner of the company, KSB Management SE, Frankenthal, since the change in legal form came into effect. This company is represented by Managing Directors, with the previous members of the Board of Management of KSB AG having been appointed to these positions. For the 2017 financial year and the subsequent period until 17 January 2018, this report is based on the former structure of a public limited company under German law [*Aktiengesellschaft*] with the Board of Management as the management and representative body. Where periods after 17 January 2018 are discussed herein, this report refers to the new legal form of a KGaA.

Throughout the last financial year, the Supervisory Board continued to perform its tasks with great care in accordance with the law, the Articles of Association and the Rules of Procedure. We regularly advised the Board of Management on corporate management issues and monitored its work. The Supervisory Board was consulted directly and at an early stage with regard to decisions of fundamental importance. The Board of Management informed us in a comprehensive and timely manner, and in compliance with its duty to inform under the law and Rules of Procedure, about the position of the company, in particular its business, financial and staffing situation, planned investments, as well as relevant corporate planning and strategic and organisational development issues via written and oral reports prepared regularly and on an ad hoc basis. As in the past, we continued to meet on a regular basis to discuss selected issues in the absence of the Board of Management.

We discussed all business transactions significant for the company in detail on the basis of the Board of Management's reports. Any departures in business developments from the plans and targets were reviewed and commented on in detail by the Board of Management. We adopted our resolutions on the reports and proposals by the Board of Management after thorough examination and discussion. Beyond the intensive work in the plenary sessions and in the committees, the Chairman of the Supervisory Board in particular and other Supervisory Board members were in frequent contact with the Board of Management outside the meetings to discuss the current business development and significant transactions as well as questions of strategy, planning, risk assessment, risk management and compliance.

Conflicts of interest of the Supervisory Board members Klaus Kühborth and Monika Kühborth within the framework of the below discussion of relations covering the supply of services of KSB AG to its majority shareholder, Johannes und Jacob Klein GmbH (formerly Klein Pumpen

GmbH), as well as to other related parties, were disclosed to the Supervisory Board; both did not participate in the taking of resolutions on this subject area. In the reporting period, no other conflicts of interest arose involving members of the Board of Management and Supervisory Board that would have been subject to disclosure in the Report of the Supervisory Board.

MAIN FOCUS OF WORK IN THE SUPERVISORY BOARD PLENARY SESSIONS

Key topics of our consultations with the Board of Management were the revision of strategic objectives, the monitoring of the roll-out of a shared services organisation decided on in 2016 and the continued development of the corporate organisation, including the appointment of four new members to the Board of Management with a view to the change in legal form implemented early in 2018. The analysis of business development in the segments and Regions represented an additional focus, as did major investment projects at various sites. We dealt on an ongoing basis with the company's economic position, the progress of the new efficiency improvement programme, and the prospects facing selected markets. Based on the recommendations and suggestions contained in the German Corporate Governance Code, we also looked at fundamental aspects of good corporate governance. Special emphasis was placed on corporate culture as KSB again recorded and evaluated employees' views concerning the company by means of an international spot check.

In 2017 four regular Supervisory Board meetings and a constituent meeting were held; the committee also met three times to discuss special topics. The performance of KSB Aktiengesellschaft and the Group was the subject of regular discussions, primarily with regard to net assets, financial position, employment levels and strategic direction, as well as material investment, divestment and acquisition projects.

The Board of Management regularly explained to us in detail the ways in which KSB can achieve the planned growth for the coming years, including the underlying methodological and strategic considerations. Required investments were subjected to critical analysis before being approved and their implementation was subsequently monitored by us. In this context, the Supervisory Board approved significant financial resources to maintain the high technical level of plants on a Group-wide basis, while at the same time taking into account specific site-related aspects. We also repeatedly dealt with the status of the comprehensive investments that were initiated in recent years. For instance, we convinced ourselves that, in particular, the expansion work in our French and our Indian subsidiary is making good progress at the sites in La Roche-Chalais and Shirwal. The fundamental upgrade of the Pakistani foundry and the construction of our new building in Moscow were largely completed. The latter will serve both administrative and production purposes, and we thereby aim to strengthen the close business relationships with Russia and in the neighbouring states. As reported in previous years, considerable technically demanding preparations were required to win a major Chinese order

for the delivery of pumps. We expect the successful implementation of this ambitious project, whose completion is scheduled for 2018, to strengthen KSB's market position over the long term. We therefore had the Board of Management continuously update us on the status of order processing. Where the start or expansion of business activities led to property acquisitions, we discussed the long-term impact of such measures.

In the light of the ongoing change of requirements to be met by an efficient corporate structure, we completed the discussion about the transformation of KSB AG. To align the company with the future requirements of capital markets and to secure its independence over the long term, the Supervisory Board decided at the start of 2017 to prepare the conversion of KSB AG into a – still stock exchange-listed – partnership limited by shares. After obtaining approval from the Annual General Meeting in May 2017, this was implemented by entry in the German Commercial Register on 17 January 2018.

We also used the past financial year for a fundamental redesign of corporate management. Following the proposal of the Personnel Committee in each case, four new members of the Board of Management were appointed, including Dr. Stephan J. Timmermann as the Chairman [*Sprecher*] of the Board of Management. With Dr. Peter Buthmann's departure as of the end of 2017 following his retirement, we completed the reshuffle. We see major potential for our business in the opportunities provided by a stronger focus on certain areas of responsibility. In the course of the change in the legal form of KSB, the members of the Board of Management were appointed Managing Directors of the general partner.

Repeatedly on the agenda was the continued development of other aspects of the corporate organisation. We devoted particular attention to the reduction in internal administrative expenses, for instance by monitoring the programme kicked off at the end of 2015 by the Board of Management to improve efficiency in all Group areas, which also includes reducing the number of Group companies. Against this background, the outsourcing of standardised processes to external services providers (shared services) was also of great importance. With this ambitious project, KSB aims to further standardise internal processes, in particular in the commercial areas, and optimise cost structures permanently in the future. Some adjustment requirements became apparent upon the start of the implementation of this demanding project; we discussed them in detail with the Board of Management. Another focus of our deliberations continued to be the progress made towards strengthening our value-based corporate culture, with the Board of Management providing regular updates. Both interesting findings and new needs for action emerged from a spot check employee engagement survey as a follow-

up process to the broadly designed 2016 survey. These have to be addressed in order to continue the constructive dialogue with staff and meet their expectations. By doing this we ensure that the employees' willingness to perform and engagement are continually strengthened.

We also considered the relations covering the supply of services of KSB AG to its majority shareholder and other related parties in the year under review. After initial indications that individual services to related parties may no longer have been provided on an arm's length basis or may have been settled either incorrectly or not at all in the past, the Supervisory Board, together with the Board of Management, commissioned auditing and tax consultancy firms as well as a law firm with a comprehensive independent examination of the facts along with the resulting consequences. The Chairman of the Audit Committee reported regularly on the status of this matter.

For the September session, the Supervisory Board convened for a meeting at the Lille site in France. On this occasion, we discussed in detail with the Board of Management its considerations on the realignment of the individual Board of Management portfolios. Within the scope of compliance with the non-financial reporting requirements imposed by law we commissioned the auditors to review this report. The local management informed us of the opportunities and risks of the French market. In addition, we visited the modern technical facilities at the plant.

At the two sessions in November and December, a focus was on the general economic development in China and the consequences this may have on the organisation of KSB's business in this important market. We also looked at business performance during the financial year and, in particular, at planning for 2018.

MAIN FOCUS OF WORK IN THE COMMITTEES

In order to perform its duties efficiently, the Supervisory Board worked with five committees in 2017. These prepare the Supervisory Board's resolutions and the special topics to be discussed in the plenary sessions. In addition, they also make their own decisions – to the extent that this is legally permissible – within the scope of their areas of responsibility. This allocation has proved worthwhile in practice. The Chairs of the committees regularly and comprehensively report in the plenary sessions on the content and results of the work carried out in the committees.

COMMITTEES OF THE SUPERVISORY BOARD

and their Chairs, as well as number of meetings in the year under review

CORPORATE DEVELOPMENT COMMITTEE

Until 28 February 2017
 Dr. Martin Auer
 From 23 March 2017
 Oswald Bubel
 No. of meetings: 4

NOMINATION COMMITTEE

Until 28 February 2017
 Dr. Thomas Seeberg
 From 23 March 2017
 Dr. Bernd Flohr
 No. of meetings: 3

PERSONNEL COMMITTEE

Until 28 February 2017
 Dr. Thomas Seeberg
 From 23 March 2017
 Dr. Bernd Flohr
 No. of meetings: 9

AUDIT COMMITTEE

Until 14 April 2017
 Dr. Jörg Matthias Großmann
 From 15 April 2017
 Klaus Burchards
 No. of meetings: 7

MEDIATION COMMITTEE

Until 28 February 2017
 Dr. Thomas Seeberg
 From 23 March 2017
 Dr. Bernd Flohr
 No. of meetings: 0

The **Nomination Committee** prepared proposals for the appointment of shareholder representatives to the Supervisory Board, in particular the Supervisory Board's nominations for the election of Supervisory Board members by the Annual General Meeting on 10 May 2017. It convened three times in the year under review. In looking for and evaluating suitable candidates with the requisite expertise and experience of the industry, long-term succession planning is a key factor.

The **Corporate Development Committee** deals with the company's strategic development, as well as with annual planning and finance, and technology issues. At four meetings in the year under review, it discussed in particular the areas of strategy controlling, production management and innovation, and – on an ongoing basis – looked at a number of major investments, which require the approval of the Supervisory Board. The development of certain business types, including but not limited to the general and project businesses, also figured on the agenda, as did tie-in measures during acquisitions and selected projects. The Committee looked in detail at the optimisation of production capacities within our international manufacturing network and the progress of global production integration. Another focus was on the opportunities offered by digitalisation, which need to be closely observed and harnessed. In addition to members of the Board of Management, the Heads of the relevant specialist departments also regularly took part in the committee meetings.

The **Personnel Committee** held nine meetings in the year under review. It primarily addresses personnel decisions as well as topics relating to the Board of Management's remuneration, including the terms of the individual service contracts, as well as other Board of Management issues. Decisions on the appointment and remuneration of members of the Board of Management were made in plenary session, with the committee acting in a preparatory capacity in each case. In the year under review, the Committee also discussed staff development issues with the aim of ensuring that any need for action in terms of filling Board of Management positions and positions at the management level directly below the Board is identified at an early stage and followed up. Not least, the Committee is promoting the internal developments within the company that aim at an increased proportion of women in leadership roles.

The main focus of deliberations in the financial year was the specific preparation of the personnel decisions for Board of Management positions. For instance, the Supervisory Board consented to the early resignation of Werner Stegmüller from the Board of Management – at his own request – effective 31 May 2017. As successor for the Finance portfolio and member of the Board of Management, the Supervisory Board appointed Dr. Matthias Schmitz on 22 March 2017, initially for a term of office of three years from 1 June 2017 to 31 May 2020. Ralf Kannefass was appointed on 9 May as the Board of Management member responsible for the Sales portfolio for a term of three years, from 1 July 2017 to 30 June 2020. The term of office of the long-standing member of the Board of Management and Human Resources Director, Dr. Peter Buthmann, was extended, for six months until the end of 2017, to ensure adequate continuity in the Board of Management. The Supervisory Board approved that the age limit applicable to members of the Board of Management was moderately exceeded. On 12 September 2017, Dr. Stephan Bross was appointed member of the Board of Management (Technology) for five years with effect from 15 September 2017 until 14 September 2022. Finally, the Supervisory Board appointed Dr. Stephan J. Timmermann as Chairman [*Sprecher*] of the Board of Management on 18 October 2017 from 13 November 2017 until 30 November 2020 and therefore for about three years; from 1 January 2018, Dr. Timmermann also assumed the role of Human Resources Director. All the above decisions were based on the proposals of the Personnel Committee.

The competencies of the committee changed with the coming into effect of the change in legal form. It now essentially decides on the approval of any internal transactions with KSB Management SE, its Administrative Board members and/or its Managing Directors, on the consent to other activities of these persons, the granting of loans to them and on any matters related to the remuneration of the Supervisory Board members.

The seven meetings of the **Audit Committee** in the year under review were always attended by a member of the Board of Management and, on several occasions, by the auditors and the Heads of relevant departments. The Committee discussed the 2016 annual and consolidated

financial statements, as well as the corresponding audit reports submitted by the auditors. The Audit Committee also prepared the independent examination by the Supervisory Board of the financial statements, the management reports and the proposal on the appropriation of the net retained earnings. In addition, the 2015 half-year financial report was discussed with the Board of Management. Moreover, the Committee presented a substantiated recommendation to the Supervisory Board for the election of the auditors at last year's Annual General Meeting. It then assigned to the auditors the audit of the annual and consolidated financial statements for the 2017 financial year and specified the key audit areas. The declaration of independence by the auditors was obtained in accordance with the recommendations of the German Corporate Governance Code (section 7.2.1), and the auditors' continued independence and performance of non-audit services were monitored. The Committee also focused on monitoring accounting, the accounting process, the risk management system – taking into account the relevant reports from Internal Audits – and the effectiveness of the internal control and auditing system, including compliance and the auditing of the annual financial statements. In this context, the committee members discussed in detail the supply of services to Johannes und Jacob Klein GmbH, as well as to other related parties. In the context of the clarification of facts and rectification, they also examined the measures taken by the Board of Management to obtain compensation for any disadvantages experienced by the company.

There was no requirement during the financial year under review to convene the **Mediation Committee** required by section 27(3) *MitbestG* [*Mitbestimmungsgesetz* – German Co-Determination Act]. It became obsolete with the coming into effect of the change in legal form.

CORPORATE GOVERNANCE AND STATEMENT OF COMPLIANCE

The Supervisory Board continuously monitored developments in corporate governance standards throughout the financial year. The Board of Management and the Supervisory Board have so far reported on corporate governance at KSB in accordance with section 3.10 of the German Corporate Governance Code as part of the Corporate Governance Statement pursuant to sections 289f(2 and 3) and 315d *HGB* [*Handelsgesetzbuch* – German Commercial Code]. On 12 September 2017 they issued a joint updated statement of compliance in accordance with section 161 of the *AktG* [*Aktiengesetz* – German Public Companies Act] and made it permanently available to shareholders on the company's web site. The general partner will now take the place of the Board of Management at KSB SE & Co. KGaA. KSB Aktiengesellschaft complied with the German Corporate Governance Code's recommendations subject to a few justified exceptions. The same applies to KSB SE & Co. KGaA, unless limited deviations from the Code arise from the change in legal form. On 21 March 2018, the Supervisory Board and the general partner, acting via its Managing Directors, issued a joint statement of compliance updated in this respect.

AUDIT OF THE 2017 ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS

The Supervisory Board examined the annual financial statements and the management report of KSB SE & Co. KGaA (formerly KSB AG) for the year ended 31 December 2017, which were prepared in accordance with the provisions of the *Handelsgesetzbuch (HGB)*, as well as the consolidated financial statements and the group management report for the year ended 31 December 2017, which were prepared in accordance with the International Financial Reporting Standards (IFRSs), and the proposal by the general partner on the appropriation of the net retained earnings. This also applies to the combined separate non-financial report of the company and the Group.

The accounting documentation, the proposal by the general partner on the appropriation of the net retained earnings, the non-financial reports and the audit reports submitted by the auditors were provided in good time to all members of the Supervisory Board. The documents were discussed in detail by the Audit Committee, in particular on 14 March 2018, as well as in the Supervisory Board plenary session on 21 March 2018 and explained in depth by the Managing Directors of the general partner. The auditors attended the meetings of both bodies, reported on the findings of the audit and were available to provide additional information.

The Mannheim office of PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Frankfurt, audited the annual financial statements and the management report of KSB SE & Co. KGaA (formerly KSB AG) for the year ended 31 December 2017, as well as the consolidated financial statements and the Group management report for the year ended 31 December 2017, and issued an unqualified opinion. The key audit areas defined for the auditors by the Audit Committee for the year under review mainly included the recognition of sales revenue based on the accrual principle of accounting and the recording and presentation of transactions with related parties. The non-financial reports were reviewed. The auditors reported on their findings on these key audit areas both orally and in writing.

The Supervisory Board concurs with the auditors' findings. Following the final result of the examination by the Audit Committee and its own review, the Supervisory Board raised no objections to the annual financial statements, consolidated financial statements, management report and Group management report, as well as the separate non-financial report of the company and the Group. In accordance with the recommendation of the Audit Committee, the Supervisory Board approved the annual financial statements prepared by the general partner. The proposal of the general partner on the appropriation of the net retained earnings of KSB SE & Co. KGaA, and in particular the increase in the dividend to EUR 7.50 per ordinary no-par-value share and EUR 7.76 per preference no-par-value share, is deemed to be appropriate by the Supervisory Board in accordance with its own review; it concurs with it.

DEPENDENT COMPANY REPORT

The auditors also audited the dependent company report for the 2017 financial year prepared by the general partner in accordance with section 312 of the *AktG* and issued the following unqualified audit opinion on this report:

“On completion of our audit and assessment in accordance with professional standards, we confirm that

1. The actual amounts and disclosures in the report are correct.
2. The consideration paid by the company for the transactions listed in the report was not inappropriately high, or disadvantages were compensated.”

The report of the general partner and the audit report were provided in good time to all members of the Supervisory Board and were also discussed by the Audit Committee and in plenary sessions. The auditors attended the meetings of both bodies, reported on the material findings of the audit and were available to provide additional information. The Supervisory Board concurs with the auditors’ findings. Both the recommendation by the Audit Committee and the final results of the Supervisory Board plenary session’s examination did not give rise to any objections to the dependent company report prepared by the general partner and to the statement by the general partner at the end of the dependent company report.

CHANGES TO THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

The changes to the Board of Management, i.e. the appointment of Dr. Stephan Bross, Ralf Kannefass, Dr. Matthias Schmitz and Dr. Stephan J. Timmermann as well as the departure of Werner Stegmüller and Dr. Peter Buthmann are described above in detail.

Dr. Martin Auer and Dr. Thomas Seeberg resigned from their office as members of the Supervisory Board as of 28 February in the reporting year, with Dr. Seeberg also stepping down from his position as Chairman of the Supervisory Board. Dr. Stella Ahlers and Dr. Jörg Matthias Großmann resigned from their office as members of the Supervisory Board with effect from the end of 20 March and 14 April 2017, respectively. Monika Kühborth, Oswald Bubel and Dr. Bernd Flohr were appointed members of the Supervisory Board by order of the *Amtsgericht Ludwigshafen am Rhein* [Local Court] on 21 March 2017 and Klaus Burchards by order of 18 April 2017, as successors for members who had stepped down. The Supervisory Board elected Dr. Flohr as its Chairman in the session of 22 March 2017. All new members were confirmed in their office by the Annual General Meeting on 10 May 2017, and Dr. Flohr

was re-elected as the Chairman of the Supervisory Board in the immediately following constituent Supervisory Board meeting. Due to his appointment as member of the Board of Management, Dr. Stephan Bross left the Supervisory Board with effect from 14 September 2017; Dr. Hans Stefan Wiß succeeded him as the elected replacement candidate. Monika Kühborth and Oswald Bubel resigned as members of the Supervisory Board as of the end of January 2018 in order to focus on their responsibilities at KSB Management SE. In their stead, Arturo Esquinca and Prof. Dr.-Ing. Corinna Salander were appointed members of the Supervisory Board by order of the *Amtsgericht Ludwigshafen am Rhein* dated 26 February 2018. The Supervisory Board would like to thank the members who have left the Board for their close cooperation. We also thank Dr. Seeberg for his prudent leadership.

The Supervisory Board would like to thank the Board of Management, the employees and employee representatives of all Group companies for their continued constructive and committed work during the past financial year.

Frankenthal, 21 March 2018

The Supervisory Board