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GROUP MANAGEMENT REPORT

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 AG, 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 79 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.

Besides KSB AG 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
- GIW Industries, Inc., Grovetown / Georgia, USA
- KSB Pumps Limited, Pimpri (Pune), India
- KSB Service GmbH, Frankenthal, Germany
- KSB Bombas Hidráulicas S.A., 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

KSB AG's Board of Management manages and controls the KSB Group. This body formed of two persons is assisted in operational decisions by a management team of senior executives. Managers and employees implement 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 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.

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. KSB AG's main plant 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 the Region Asia, followed by the Region Americas/Oceania 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 2016, 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 the operating result (i.e. earnings before interest and taxes (EBIT) excluding the effects from measuring construction contracts in accordance with IAS 11). For further information on these key indicators see the Notes to the Consolidated Financial Statements, section VIII. Segment Reporting.

In addition, we take the earnings before income taxes (EBT), pre-tax return on sales and net financial position into consideration for controlling the Group as a whole. 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 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.

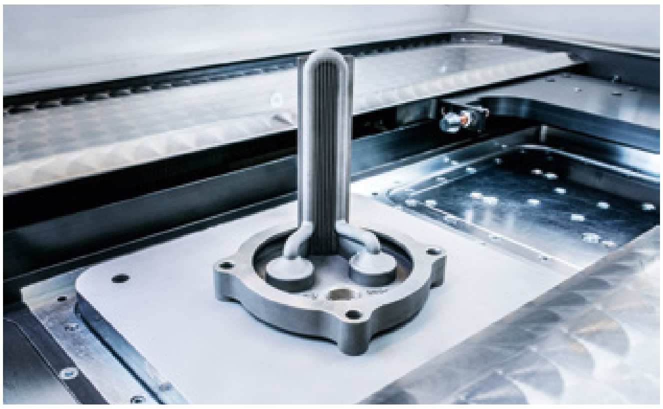
We do not consult any non-financial performance indicators for controlling the Group and for making decisions regarding management issues.

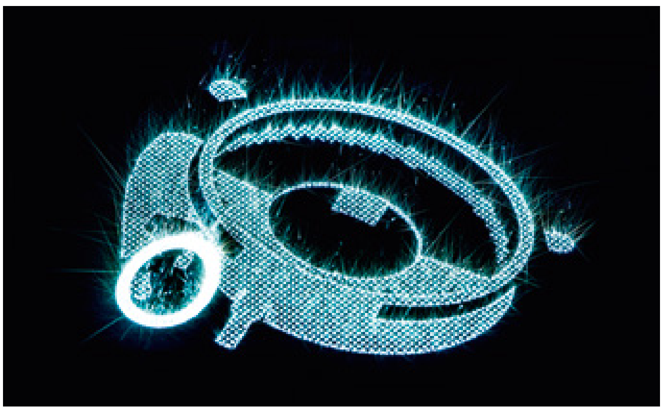
RESEARCH AND DEVELOPMENT

KSB provides pumps and valves for a broad range of technical applications. Diverse activities for the development of KSB's own products and refinement of its existing products form the basis of our long-term success. In 2016 we again made use of our research and development capacity at our centres in Europe, Asia and the USA. Our expenses in this area totalled approximately € 51 million for the year under review. This equates to about 2 % of our sales revenue.

Our work was focused on hydraulics and materials technology, as well as automation and drives. We also looked at the smart networking of pumps, valves and motors. Linking hydraulic and electronic systems opens up approaches for services of the kind that our customers expect in the context of Industry 4.0.

In terms of material research, we tested and explored the use of new materials for sealing elements and plain bearings. This involved intensive cooperation with external organisations and institutions of higher education, making important steps forward in extending the service life of these components.





Innovative manufacturing method: Laser melting allows the production of highly complex metal components which are built up layer by layer.

ECONOMIC REVIEW

MACROECONOMIC ENVIRONMENT AND SECTOR VIEW

Global economic growth remained subdued in 2016. The increase of a mere 3.1 % was weaker than forecast by the majority of economic research institutes. The International Monetary Fund (IMF), whose forecast provided the basis for our planning, also proved to have been overly optimistic, predicting 3.4 % growth in GDP. In the industrialised nations, economic development became markedly less dynamic during the reporting year. In contrast, the emerging markets and developing countries were able to more or less maintain the same rate of growth.

Consistently weak levels of demand for energy and raw materials, as well as unfavourable economic data from China, were key factors in what were far from satisfactory economic developments overall. Political crises, both new and emerging, also contributed to the state of the economy, impacting on global willingness to invest on the part of private companies and, in the countries hit by these crises, also government institutions.

Some three quarters of the modest growth recorded during the reporting year can be attributed to the world's emerging economies, with significant growth in Asia, where KSB has major production companies in China and India. Growth on the Chinese market, however, actually slowed. There was also a shift in growth from the industrial sector to services, as reported by the German Engineering Federation (VDMA). In two other BRIC countries, namely Brazil and Russia, we continued to find ourselves in a recessionary market environment with our range of products and services. South Africa, the location of a significant KSB sales and production company for the region, failed to record any appreciable growth in 2016.

The economy in the industrialised countries grew only slightly year on year, up by 1.6 %. The moderate recovery in the euro zone, KSB's most important sales market, continued. The single-currency area's gross domestic product grew by 1.7 %, although structural problems in some member states hampered any stronger push forward.

LACK OF GROWTH IN MECHANICAL ENGINEERING

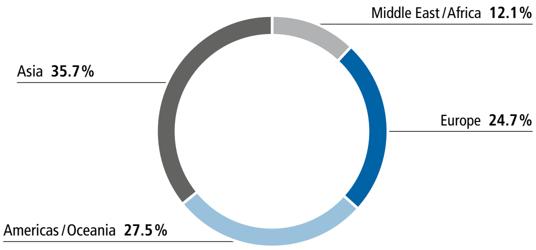
Global sales revenue from the mechanical engineering sector stagnated in 2016. According to figures from the VDMA, of which KSB is a member, demand for investment goods was too weak to trigger even a low level of growth. While increases were indeed in evidence in some emerging markets in Asia, sales in the mechanical engineering sectors in Europe and the USA were down on the previous year.

Sales revenue in Germany, as well as in France and Italy, remained at prior-year levels. According to the VDMA, companies were able to use successes in Europe and on many smaller markets to offset some major falls in business, particularly in relation to operations in Brazil, China and the USA. Sales revenues recorded by liquid pump and industrial valve producers in Germany were considerably weaker than for the mechanical engineering sector as a whole. In the pumps business, they declined by 6.0 %, with valves falling by 3.1 % year on year.

RISING DEMAND IN THE WATER INDUSTRY

Among the main sales markets for pumps and valves, the water and waste water sectors displayed the most stable growth. In the emerging economies with growing populations and rising standards of living, investments in the construction of new water infrastructures were a key focus. Wells, treatment plants and pumping stations are all being built, as well as municipal and industrial waste water systems. These applications require pumps for wet and dry installation, mixers for sedimentation tanks, and butterfly valves. Market conditions in the construction sector were also favourable, benefiting our products

WORLD MARKET OF CENTRIFUGAL PUMPS AND VALVES



Source: KSB estimate (February 2017), European Industrial Forecasting

used in pressure boosting, heating, ventilation and air-conditioning, and also drainage and garden technology products. Boosted by low interest rates, the construction boom continued.

In most other fields of application for our pumps and valves, demand either stagnated or fell further compared with 2015. This is particularly true of the oil and gas industry, which was hit hard by low energy and commodity prices. In contrast, the mining sector experienced a slight improvement, with prices for some minerals making up ground again. The oil-processing industry and gas producers only began to profit from slight price increases towards the end of the year, which meant that no additional projects were initiated during the year under review. Similarly, the transport of liquefied gas by tankers, which we fit with cryogenic valves, was a sector still dominated by overcapacity. There was a general lack of new shipbuilding, with replacement investments being kept to a minimum. In particular in the oil-producing countries, the slump also had an effect on secondary sectors; public investors lacked the funds for major projects.

In the energy sector, new power plants were only being planned and built on a very limited scale. To this extent, there was no let-up in the poor order levels affecting plant engineering contractors. For their part, they then only had a handful of orders to place with suppliers of components such as high-pressure pumps and valves. At the same time, fierce competition meant that some of these orders were not financially attractive. One exception was equipment for nuclear power stations, an area in which price pressure is not so acute and in which plans are in the pipeline, both in Asia and in Europe, for some new projects.

Generally weak business activity in industry across the globe also manifested itself in the manufacturing sector. Demand picked up in only a handful of countries, among them India. Overall, however, it fell short of expectations, even in Asia.

COMPETITORS TURN TO RESTRUCTURING

Given the weak demand in the sectors mentioned, coupled with currency-related reductions, global pump and valve manufacturers were often forced to accept dramatic falls in order intake. Their response to the market difficulties and decline in business was, in some cases, to introduce restructuring programmes. As in the case of KSB, these targeted large savings.

Where a national market proved particularly difficult, individual pump and valve producers also took steps to reduce their local production and sales capacity. This was particularly relevant in Brazil in 2016, with several companies cutting back their activities substantially.

In light of the small number of large-scale orders to be placed, some suppliers were willing to grant larger discounts in order to put their production capacity to good use. Consequently, pricing pressure in relation to projects from industry and the energy sector continued unabated.

BUSINESS DEVELOPMENT AND RESULTS OF OPERATIONS

In the 2016 financial year, we focused to a greater extent than before on meeting the needs of those customers who are already using our products. The strategy of offering these customers our services, replacement pump sets, and additional pumps and valves proved very successful. In addition, we focused on sales of our standard products, developing new distribution concepts specifically for our successful Eta industrial pump series.

The situation with regard to project business remained difficult, with fierce pricing competition continuing to affect orders to fit out power plants and petrochemical facilities. Consequently, we continued to shift our power plant pump activities to Asia in order to be closer to our customers and also to cut our manufacturing costs. In the oil and gas sector, and in petrochemicals, we took advantage of our global production network in order to be able to bid at the prices demanded by the market. Nevertheless, the number of new projects was very limited for the reasons outlined above.

In order to bring our cost structure into line with the changed market conditions, we launched our efficiency improvement programme in 2016. This programme is designed to cover a three-year period, during which time we will use a variety of global and regional measures to make cuts of around € 200 million overall to our material, staff and overhead costs. Key focuses of this programme include a reduction in our production sites and the merger of smaller companies. As far as purchasing is concerned, we will be using dedicated supplier events and online auctions to help to reduce our material costs. The reduction in staffing levels also associated with 1,300 different measures will be carried out in a socially responsible manner. With this in mind, we have rescheduled the end date of some measures to beyond the target year of 2018.

As predicted, the restructuring costs associated with the programme and additional one-off costs had a negative impact on profit performance in the year under review. For the Group, this amounted to around € 50 million, while worldwide savings were broadly similar in amount. Order intake and sales revenue remained down on prior-year levels.

ORDER INTAKE

At € 2,156.6 million, the KSB Group's volume of incoming orders was down € 104.6 million on 2015. We had begun the year still expecting to see a clear improvement in order intake, anticipating several large-scale assignments in the power plant sector. However, the decisions on the award of these contracts were delayed.

The 4.6 % decrease can be attributed to weak levels of demand in key customer segments, in particular the energy industry, but is also due to significant negative currency exchange effects. The conversion to our Group currency, the euro, resulted in reductions of around € 51 million. Fluctuations in the exchange rates between the euro and the Argentine peso, the Chinese yuan and the South African rand had a particularly strong impact.

Developments in Europe (– 5.2 %) and Americas / Oceania (– 8.4%) were primarily responsible for the decline in orders received, although the companies in the Region Middle East / Africa also faced a downward trend (– 3.0%). In Asia (+ 0.5 %), order intake was on a par with the previous year overall. Order levels posted by KSB Aktiengesellschaft, at – 3.7 %, held up more strongly than in the Group as a whole. Our German parent company recorded new orders totalling € 751.8 million, a figure boosted by an increase in orders from existing customers for service support, spare parts and new products.

Pumps

Order intake in the Pumps segment, totalling € 1,386.6 million, was down € 65.8 million on the previous year and therefore did not grow "significantly" as expected. The year-on-year change, at – 4.5 %, more or less corresponded to the overall development of new orders received by the Group. The difficult situation in the Middle East, economic problems in Brazil and Russia, and a change in the focus of government investments in China all contributed to the decline in pump orders.

Overall, the order situation in relation to pumps for the mining sector improved on the previous year, reacting to the signs of recovery mentioned above. However, the decline in orders received by our companies from the energy, chemicals / petrochemicals and transport sectors was sharper, and overall more significant to our business.

The sale of pumps to the construction industry in Europe was one specific area that developed positively. In addition to increased sales in circulator pumps, new compact lifting units also contributed to this upward development. In India, above all the level of new orders from the water industry was gratifying. Having revamped our range of well pumps, we saw the first signs of sales success in this field.

Valves

In the Valves segment, orders received in 2016 totalled € 331.2 million. Rather than stagnating, as expected, this meant that order intake fell by € 36.8 million or 10.0 %.

The key factor responsible for this decline was the renewed drop in demand for cryogenic valves that we supply worldwide for liquefied gas tankers and terminals. In light of the difficulties facing the oil and gas industry, shipping companies were being exceptionally cautious with regard to any plans to modernise or expand their fleets of tankers. Like the Pumps segment, the Valves business also reflected that the energy industry was holding back from the construction of new installations and thus from placing any purchase orders. This reticence impacted on new orders for high-pressure globe, gate and butterfly valves. With production capacity frequently being under-utilised, industry, in particular chemicals and petrochemicals, was another sector that did little to stimulate demand.

In contrast, business with pipeline valves for use in water supply systems developed very positively. Indeed, we expanded our market share in this sector, helped not least by our introduction of butterfly valves with diameters of up to 2 metres capable of withstanding pressures of up to 40 bar in either flow direction. In the construction sector, orders for our valves continued to be supported by the construction boom, itself triggered by low interest rates, and our sales figures were able to grow.

Service

In our Service segment, we failed to achieve the predicted “moderate” growth, with an order intake of € 438.8 million. Total orders for service support and related spare parts were € 2.0 million or 0.5 % down on the previous year.

We recorded positive growth rates through our service business in East and South-East Asia, particularly China and Indonesia, and in the Region Middle East / Africa. In Europe, our traditionally strong service business in Germany continued to be impaired by the shut-down of nuclear power plants. Growing business in mobile valve service for industrial customers partially offset this negative trend. Overall, however, the companies in Germany recorded a clearly negative figure. In contrast, French service business posted a positive performance, also buoyed by framework agreements with large companies.

In the Americas, the value of our service orders was down on the previous year, not least due to the continued decline in the mining sector. In South America, business in Argentina in particular developed very positively. This is not reflected in the Group’s order intake figures, however, due to the change in the peso / euro exchange rate.

SALES REVENUE

Consolidated sales revenue fell strongly year on year, totalling € 2,165.7 million. This represents a decrease of € 169.2 million or 7.2 % compared with 2015. We had been expecting to see a “significant” decline in the figures. € 49 million of the decrease can be attributed to changes in exchange rates. Their impact reduced the sales revenue figures reported by several companies after the conversion into the Group currency, the euro. We recorded falling sales revenue across all regions: Europe (– 7.4 %), Middle East / Africa (– 2.5 %), Asia (– 4.8 %) and Americas / Oceania (– 10.8 %). In Europe, KSB AG generated sales revenue of € 760.6 million, which equates to a decrease of 7.7 %.

Pumps

In our Pumps segment, in which we once again achieved around two thirds of consolidated sales revenue in 2016, there was, as expected, a significant decline in sales revenue, down by € 85.5 million to € 1,428.5 million. This represents a decrease of 5.6 %. All four regions were affected. Waning demand in earlier years for feed pumps for fossil-fuelled power plants had a particularly strong impact. However, the lull that has been in evidence in the oil and gas industry, as well as in mining, for several years now, with negative fall-out for other sectors, has long been hampering investment to the extent that there were fewer pump orders for large-scale projects during the past financial year.

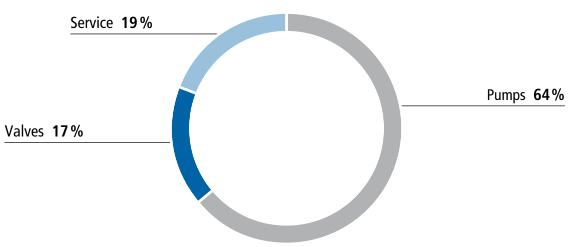
Valves

Similarly to order intake development, our Valves segment experienced the strongest decline in sales revenue in percentage terms. Sales revenue for globe valves, gate valves, butterfly valves and other valve types fell significantly (and not "substantially" as expected), down by € 23.8 million or 6.2 % to € 360.8 million. The decline in orders was particularly marked in the case of butterfly and diaphragm valves. In China and South Korea, weaker demand for butterfly valves in the marine sector was the main factor impacting on sales revenue.

Service

Sales revenue in our Service segment, at € 416.5 million, almost matched the previous year with, as anticipated, a slight increase of € 2.9 million (+ 0.7 %). This meant that we slightly exceeded the prior-year level in our most important market, namely Europe. In addition, our companies in the Region Middle East / Africa reported strong increases. This growth was, however, offset by the market-driven downward movement in the Americas and in some Asian countries. In China, where we actually recorded above-average growth, a major focus was on the modernisation of power plants.

SALES REVENUE BY SEGMENT



€2.17 billion

Consolidated sales revenue in 2016

EARNINGS BEFORE INTEREST AND TAXES (EBIT)

The KSB Group achieved earnings before interest and taxes (EBIT), excluding the effects from measuring construction contracts in accordance with IAS 11, of € 102.9 million (previous year: € 101.9 million). The Pumps segment contributed EBIT of € 60.9 million (previous year: € 55.4 million). This means that the forecast (of a substantial decline) made in the previous year's report did not materialise. As predicted, EBIT fell substantially in the Valves segment, totalling € 8.8 million (previous year: € 10.3 million). EBIT for the Service segment also declined substantially (and not moderately, as planned) to € 33.3 million (previous year: € 36.2 million). The reconciliation effect from the measurement of construction contracts under IAS 11 to EBIT changed by € – 18.1 million year on year.

TOTAL OUTPUT OF OPERATIONS

The above-mentioned decrease in sales revenue is also reflected in a lower total output of operations, totalling € 2,174.2 million compared with € 2,350.3 million in the previous year. Work in progress and inventories of finished goods increased by € 2.9 million, and thus by € 7.8 million less than in the previous year. In contrast, other work performed and capitalised rose by € 0.9 million.

INCOME AND EXPENSES

Other income declined from € 50.0 million to € 47.2 million, partly due to lower income from the reversal of provisions no longer required.

The cost of materials fell by 10.8 % and thus more strongly than total output of operations. In percentage terms, the cost of materials (€ 874.2 million) decreased from 41.7 % in the previous year to 40.2 % in the year under review. This can also be attributed to first successes of our efficiency improvement programme.

Staff costs fell by 2.5 % to € 798.8 million. In relation to total output of operations, however, this represented an increase of 1.8 percentage points. Key factors were a lower number of employees on the one hand, and collectively agreed salary increases on the other. Compared with 2015, the number of employees fell by 624, taking the total figure at the end of the reporting year to 15,572. The European companies reported the biggest fall with a reduction of 321 staff, 160 of whom had been employed at the Group's German sites. Employee numbers were also markedly down in the Americas with 157 fewer people working for KSB on the reporting date compared with the end of December 2015. 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 401 fewer people than in the previous year. Based on the significantly lower total output of operations and simultaneous decrease in the number of employees, the average output per employee fell from € 144 thousand in the previous financial year to € 137 thousand.

The ratio of other expenses to total output of operations fell from 17.5 % to 17.1 %. In absolute terms, this means a change from € 411.5 million to € 372.4 million, attributable to falling sales costs, lower administrative expenses and a lower level of third-party services.

Financial income / expense deteriorated by € 5.1 million. This is primarily a reflection of the lower income from investments accounted for using the equity method. Based on the contribution to income from our Chinese joint venture included in this item, we reported expenses totalling € 1.3 million. This compares with income of € 4.4 million in the previous year.

EARNINGS

The KSB Group generated earnings before income taxes (EBT) of € 74.6 million, compared with € 93.4 million in 2015. This means that the previous year's forecast of a substantial fall in earnings due to one-off costs was accurate. Correspondingly, the return on sales before tax decreased from 4.0 % in the previous year to 3.5 %, also confirming our expectations outlined in the previous year. The income tax rate was down, due to such factors as the reduced scope of non-tax-effective impairments on goodwill. The rate was 36.0 %, compared with 44.1 % in 2015. Earnings after income taxes, at € 47.8 million (previous year: € 52.2 million) were down 8.4 % and therefore did not fall as sharply as earnings before income taxes (EBT) (20.1 %).

€74.6 million

Consolidated earnings (EBT) in 2016

Earnings attributable to non-controlling interests were up from € 12.9 million to € 14.9 million. This can be attributed to improved contributions to earnings from our Asian companies. Relative to earnings after income taxes, there was therefore a change from 24.7 % to 31.0 %.

The earnings attributable to shareholders of KSB AG (€ 32.9 million) were € 6.4 million lower than in the previous year (€ 39.3 million).

Earnings per ordinary share were € 18.68, compared with € 22.30 in the previous year, and € 18.94 per preference share, compared with € 22.56 in 2015.

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 € 890.3 million (previous year: € 870.2 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 € 614.2 million (previous year: € 609.1 million), including the proportion of earnings after taxes attributable to shareholders of KSB AG of € 32.9 million (previous year: € 39.3 million). € 164.6 million (previous year: € 149.6 million) is attributable to non-controlling interests. Given that the increase in equity (+ 2.3 %) more or less corresponds to the rise in total assets (+ 2.6 %), the equity ratio remained constant (37.9 %; previous year: 38.0 %).

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 were up by € 63.5 million to € 589.5 million as at the reporting date primarily as a result of the lower discount rate for the German pension plans. 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 nearly half of the amount recognised in the balance sheet. The rest relates to defined benefit obligations for our current employees.

Other provisions for employee benefits, which are predominantly current, only changed slightly and total € 86.9 million (previous year: € 88.8 million).

The picture with regard to other provisions, which we created almost exclusively for current uncertain liabilities, is more or less stable (€ 99.6 million compared with € 100.8 million in 2015). Increased provisions for restructuring in conjunction with our efficiency improvement programme offset a decline in miscellaneous other provisions.

37.9 %

Equity ratio in 2016

Non-current financial liabilities decreased by € 75.5 million to € 58.0 million. This can be attributed to the reclassification of the € 74.5 million tranche of the loan against borrower's note due in 2017. Based on our current information, no external financing measures will be required for repayment. We placed this loan with a total volume of € 122 million at the 2016 year end back in 2012. It is divided into repayment tranches of 3 to 10 years.

Current liabilities increased overall by € 54.9 million (€ 613.5 million compared with € 558.6 million at the 2015 year end). Trade payables in particular were down, falling by € 28.0 million, as a result of the decline in the volume of business. In contrast, other non-financial liabilities (+ € 3.8 million) and other financial liabilities (+ € 3.5 million) rose slightly. The increase in current financial liabilities (+ € 75.6 million) can be attributed to the reclassification, referred to above, of the tranche of the loan against borrower's note due in 2017.

Taking into account the increase in total equity and liabilities, the share of current liabilities in total equity is 26.1 % (previous year: 24.2 %).

Investments

The additions to intangible assets amounting to € 10.0 million (previous year: € 8.3 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 € 72.2 million, slightly down on the figure of € 74.5 million for the previous year. The highest additions at € 23.6 million (previous year: € 27.7 million) relate to advance payments and assets under construction, as in the previous year. A further € 21.1 million are attributable to technical equipment and machinery (previous year: € 19.9 million). As in 2015, the focus of our investment activities was Europe, and predominantly Germany and France. Outside Europe, the highest additions were again recorded at our plants in Brazil, China, India and the USA. We maintained our policies for measuring depreciation and amortisation in the year under review.

Net financial position

The net financial position, at € 259.5 million compared with € 211.3 million in the previous year, developed more favourably than forecast twelve months earlier (slightly below € 211 million) due to a decrease in trade receivables and PoC.

€259.5 million

Net financial position in 2016

Liquidity

Cash flows from operating activities amounted to € 134.5 million, a year-on-year increase of € 17.9 million. This was principally attributable to the release of funds in trade receivables and PoC (commitment of funds in previous year). This contrasted above all with declines in advances received and liabilities, as well as an increase in inventories. The drop in earnings also had a negative impact on the development of cash flow compared with the same period of the previous year.

The outflows from our investing activities increased by € 79.5 million compared with 2015. The change in term deposits and commercial papers significantly reduced cash flow whereas an increase had been reported in the previous year. Accordingly, cash flows from investing activities were significantly lower at € – 114.0 million (previous year: € – 34.5 million).

Cash flows from financing activities improved strongly, totalling € – 9.6 million compared with € – 87.4 million in the previous year. While the overall amount of the loan against borrower's note remained unchanged compared with 2015, the previous year's cash flow included significant repayments.

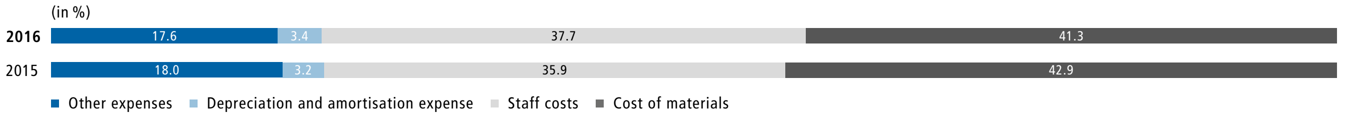
Cash and cash equivalents from all cash flows increased from € 273.1 million to € 288.9 million. Exchange rate effects amounting to € + 4.3 million (previous year: € – 0.1 million) contributed to this rise.

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.

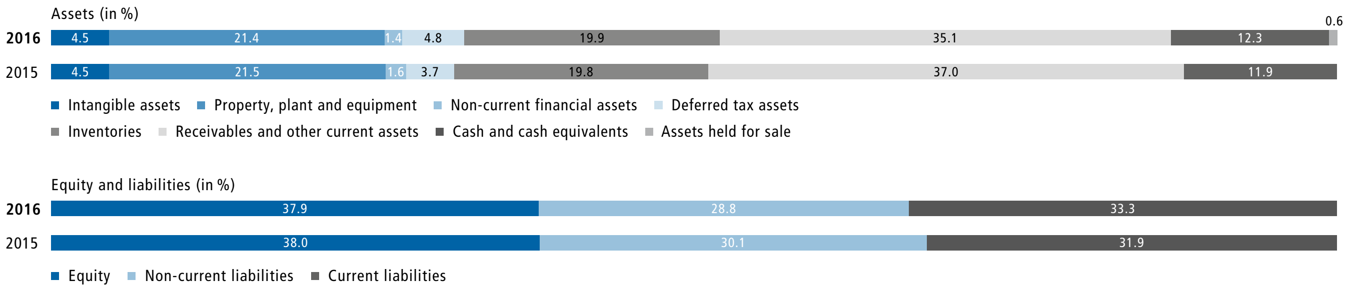
Contingencies and commitments

The KSB Group's off-balance sheet contingent liabilities totalled € 15.9 million as at the reporting date (previous year: € 13.4 million). These arise mainly from collateral and performance guarantees.

EXPENSES IN STATEMENT OF COMPREHENSIVE INCOME



BALANCE SHEET STRUCTURE



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 € 17.9 million (previous year: € 20.0 million).

NET ASSETS

Our total assets increased by 2.6 % to € 2,350.2 million. Increases, in some cases considerable, were recorded for both non-current assets (particularly deferred tax assets) and for cash and cash equivalents. This contrasted with lower receivables and other assets.

Approximately 27 % is attributable to fixed assets (previous year: just under 28 %). Intangible assets and property, plant and equipment with a historical cost of € 1,393.1 million (previous year: € 1,336.4 million) have carrying amounts of € 608.2 million (previous year: € 595.9 million). With investments in property, plant and equipment (€ 72.2 million) once again exceeding write-downs (€ 61.7 million), this balance sheet item increased by € 7.8 million. Reclassifications to "Assets held for sale", mainly relating to the sale of valves operations in the USA in January 2017, had the opposite effect. The carrying amount of financial assets and investments accounted for using the equity method fell by a total of € 4.2 million to € 33.0 million. The investments accounted for using the equity method accounted for € –4.8 million.

Inventories totalled € 467.4 million, up € 13.0 million on the 2015 year end. Raw materials, consumables and supplies, work in progress and advance payments all increased, while finished goods and goods purchased and held for resale were down on the previous year. Inventories continued to tie up around 20 % of our resources.

As a result of the lower business volume, trade receivables and PoC were € 49.4 million down on the 2015 year-end figure. Overall, taking into account the change in total assets, this balance sheet item accounts for approximately 26 % (previous year: 29 %) of total assets.

Other financial assets increased from € 156.2 million to € 187.0 million, on account of a rise in the proportion contained therein of fixed-term deposits with terms of more than 3 and up to 12 months, including commercial papers, and an increase in receivables from loans to other equity investments, associated companies and joint ventures.

Cash and cash equivalents continue to account for around 12 % of assets, totalling € 288.9 million (previous year: € 273.1 million).

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 + € 20.2 million (previous year: + € 1.2 million). This was taken directly to equity.

SUMMARY OF THE BOARD OF MANAGEMENT

The forecasts made in the previous year's report have not been fully realised due to the circumstances outlined. The weak state of the economy had a major impact on our core markets in some areas, and thus also on the achievement of our order intake targets. A further negative effect resulted from delays in the award of orders for large-scale projects. Consequently, our order intake was down by 4.6 %, and the significant improvement that we were seeking failed to materialise.

Weak demand across the world in several important sectors held back the growth in our business. For various products we also once again experienced that our pricing flexibility was not sufficient in order to achieve satisfactory margins in a tougher competitive situation. The resulting impact differed across the various segments.

Consequently, sales revenue developed somewhat more poorly than expected (strong rather than "significant" decline).

As forecast, our earnings figures were impacted by one-off costs (around € 50 million across the Group). Positive effects were recorded as a result of cost-cutting measures initiated earlier (also around € 50 million across the Group). Their contribution was actually slightly higher than expected. Overall, while the substantial falls predicted in earnings before income taxes and return on sales did occur, the figures in real terms were higher than originally planned.

The sales revenue forecast (significant decrease) for the Pumps segment proved correct. Earnings generated were, however, € 5.5 million up on the 2015 figure and did not fall substantially, as anticipated. Order intake was expected to rise significantly, but actually fell by 4.5 % as a result of the general economic environment.

The difficult market situation also had an impact on the Valves segment. Consequently, the stable order intake that had been expected did not materialise, with orders down by 10.0 %. This translated into significant decreases in sales revenue. A year ago we were even expecting a substantial downward trend. Earnings, as predicted, were well down on the previous year.

In the Service segment, our forecasts of slight sales revenue growth proved correct. Counter to expectations, the decline in earnings was substantial, rather than moderate. Our order intake target (moderate increase) could not be achieved, however, and we were faced with a slight fall.

The net financial position, at € 259.5 million compared with € 211.3 million in the previous year, developed more favourably than forecast twelve months earlier (slightly less than € 211 million).

Our business development in the reporting year in terms of order intake and sales revenue was thus somewhat less favourable overall than expected. In terms of our earnings figures and net financial position, however, the overall picture was somewhat better than anticipated.

KSB continues to have a healthy financial basis for the future. The measures initiated to permanently improve our cost structures will strengthen this basis for the long term.

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. Before the end of the financial year, the company was granted a legal title to an adequate benefit as compensation. No measures subject to reporting requirements were undertaken in the financial year."

REPORT ON EXPECTED DEVELOPMENTS

The International Monetary Fund (IMF) expects real growth of 3.4 % for the current year. The UN organisation is forecasting a 1.9 % increase in growth in the industrialised nations. The continuation of an expansionist monetary policy may contribute to this. However, the favourable basic financial parameters are being countered by both the structural problems referred to above and also by new political uncertainties. The latter include protectionist tendencies in some of the markets relevant to our business. Growth in the euro zone is expected to remain more or less unchanged.

With regard to the emerging markets and developing countries, the IMF is forecasting growth of 4.5 % in real terms despite a slight slowing of growth in China again. In contrast, in India, Asia's second-largest market, structural reforms are intended to improve overall economic development. In Latin America, including Brazil, which is an important production base for us, the situation can be expected to change for the better, if commodity prices recover. A normalisation of oil and gas prices would be expected to generate a positive development in the Arab producing countries too.

The German Engineering Federation (VDMA) believes that the benefits of this global economic development will be below average for the mechanical engineering sector. Globally, the VDMA expects to see a real increase of just 2 %, but its forecast for the German mechanical engineering sector is even more pessimistic, at a mere + 1 %. This forecast is based on such factors as the weakness of some "raw material-related areas" and unresolved geopolitical crises, but also the aforementioned protectionist trends.

As far as producers of liquid pumps in Germany are concerned, the VDMA is expecting sales revenue to stagnate during the current year. With regard to industrial valves, the Association is even forecasting a 3 % drop in sales.

SIGNIFICANT GROWTH IN ORDER INTAKE, SALES REVENUE MORE OR LESS STABLE

In light of this economic outlook, we are planning on the basis that our order intake will only rise slightly in the current year, with sales revenue set to remain more or less stable. We primarily expect to see our business in standard products, service and spare parts pick up. Ultimately, a key factor in order intake will be whether and to what extent project business recovers again and whether we can win new projects from potential customers on the basis of our technical expertise and our pricing.

Pumps

We expect to see a significant increase in demand for centrifugal pumps of the kind we primarily produce and sell. This is likely to be supported by growth in the water and waste water market and by investment activity in the chemicals and petrochemicals industry gradually picking up speed again. New petrochemical projects, as well as projects in relation to water and waste water engineering are expected, for example, on the markets in Saudi Arabia and Iran, if oil prices rise again. Further major waste water projects are at the planning stage in East Asia, North America and North Africa.

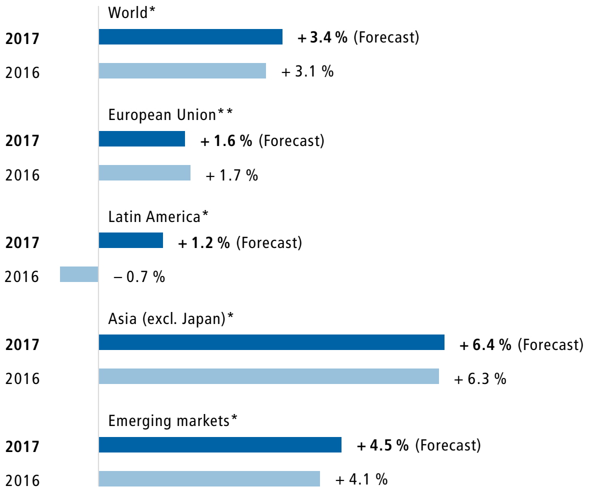
Generally speaking, the trend towards energy-efficient solutions is one factor that could lend impetus to our business with automation equipment and energy-saving motors. This is particularly true of building services in Germany, where the "National Energy Efficiency Action Plan" calls for solutions to reduce electricity consumption. We are expecting to see increased demand for our high-efficiency circulator pumps in particular.

In the manufacturing sector, the indicators point to only slight growth. In mining, further improvements in order intake are anticipated for 2017.

The situation with regard to conventional energy generation, however, remains as difficult as ever.

Overall, we expect the Pumps segment to experience significant growth in order intake and a significant decline in sales revenue.

GROSS DOMESTIC PRODUCT GROWTH



* Source: International Monetary Fund (January 2017)
** Source: European Commission (February 2017); additional information: euro zone + 1.7 % (2016), + 1.6 % (2017)

Valves
In the Valves segment we are also expecting the keen level of demand from the water and waste water industry to continue. This relates to the construction of new plants and to replacement investments designed to secure existing infrastructure. The main areas of demand are Asia and the Middle East, as well as North America. Given the favourable market environment in the construction sector, we are expecting to see the order situation for butterfly valves, globe valves and gate valves used in building services change for the better.

Should oil and gas prices return to normal, a slightly higher level of demand for valves can be expected from the petrochemicals sector. There is also the likelihood of a slight increase in other industrial sectors, including chemicals.

In the energy supply sector, in contrast, we do not yet see any sign of a sustainable market recovery. We are expecting prices for power plant valves to remain under pressure.

Based on the sales momentum described, as well as technical innovations and sales initiatives for the global expansion of our valves business, we look set to achieve a significant increase in orders, with a slight rise in sales revenue.

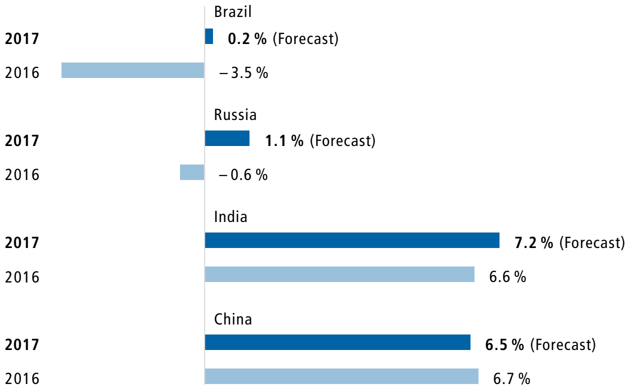
Service
In the Service segment, we are continuing to expand our infrastructure, focusing on China, India and the USA. By setting up new bases in proximity to key industrial centres, we are working to partially offset the decline in service business for nuclear power plants, primarily in Germany. We are expecting to see considerable order intake from our new service centres, which were set up in Abu Dhabi, Australia, Indonesia, Canada, Malaysia, Mexico, Saudi Arabia and Turkey in 2016. We also foresee good growth prospects for our business in India, where we have realigned our service organisation and extended our range of services, and are aiming to achieve above-average growth during the current year.

In addition, we are anticipating increased interest in the current year in our service to check and improve the energy efficiency of pump systems. This is particularly relevant to customers from industry and local authorities who are looking for ways to cut costs.

Given the ongoing difficulties in the oil and gas industries, demand for service from this sector will remain muted at first. Similarly, we are not expecting any increase in orders from the energy sector in 2017, with service frequently being kept to a minimum. As Germany gradually withdraws from nuclear energy, orders from operators of nuclear power plants are also set to fall further.

Consequently, we are only expecting to see a slight increase in order volume and stable sales revenue in the Service segment in 2017. It is still difficult to predict how order intake will develop in the Middle East, with the level of new orders influenced by the political crises in this region of the world.

GROSS DOMESTIC PRODUCT GROWTH IN THE BRIC COUNTRIES



Source: International Monetary Fund (January 2017)

BOARD OF MANAGEMENT'S SUMMARY OF EXPECTED DEVELOPMENT

For the current business period we anticipate, as detailed above, a marked improvement in order intake, driven primarily by an upturn in our business with standard products, spare parts and service support. As already mentioned, we expect all segments to make a positive contribution, with Pumps and Valves recording a larger increase in percentage terms than Service. The negative impact from the measurement of construction contracts under IAS 11 on sales revenue is expected to be significantly lower. Accordingly, sales revenue will be more or less stable from today's perspective. Significant falls in the pumps business are likely to be offset by a slight rise in valves. We are planning for stable sales revenue in our Service segment. We will be continuing as before with our measures for long-term improvements in our profit situation. These aim to reduce material, staff and overhead costs. As part of this approach we will be looking to drive forward with our programme to redistribute tasks within our global manufacturing network. We will also be creating the basis for further reductions in the number of KSB companies and for streamlining our product range. Consequently, earnings figures will again be burdened by one-off costs in the current year, with around € 50 million forecast worldwide. However, in 2017 we will already be seeing further positive effects from our cost-cutting programmes (worldwide, at a comparable level to 2016). We are therefore planning on a segment result, in other words earnings before interest and taxes (EBIT) excluding the effects from measuring construction contracts under IAS 11 that, depending on the level of one-off costs for efficiency improvement measures, should be well above the previous year's figure. We are expecting substantial growth from Valves and Service, and significant increases in Pumps to contribute to this. Based on what is likely to be a less negative impact from measuring construction contracts under IAS 11, earnings before taxes (EBT) will also be well up on 2016 levels. As a consequence, our return on sales would improve substantially.

With regard to our net financial position, we are anticipating a figure of between € 240 and 260 million.

The forecast period for the above figures and information, which we have drawn up taking into account the opportunities and risks presented below, covers the 2017 financial year. Material special factors beyond this period may result from our measures geared towards the long-term improvement of our profit situation, which are aimed at reducing material, staff and overhead costs.

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.

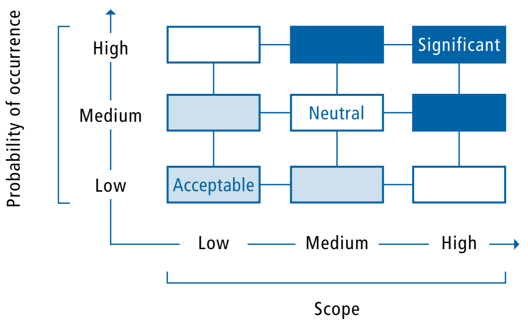
Managers are encouraged to take timely action to define and implement measures to limit or avoid damage that may result from the occurrence of risk events. All corporate and central functions and Group companies, including Group companies that are not consolidated, are included in the risk management 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.

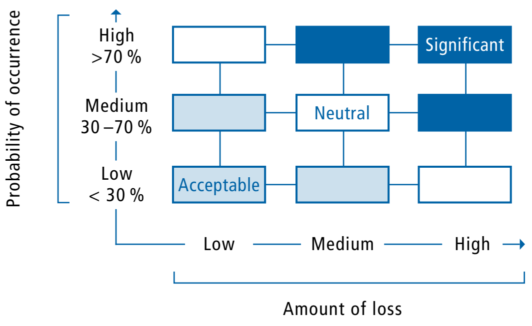
Quantitative risks are those risks with possible monetary impact on the earnings of the KSB Group or the respective Group company. They are evaluated taking into account the probability of occurrence in combination with the potential amount of loss.

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



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

		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

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.

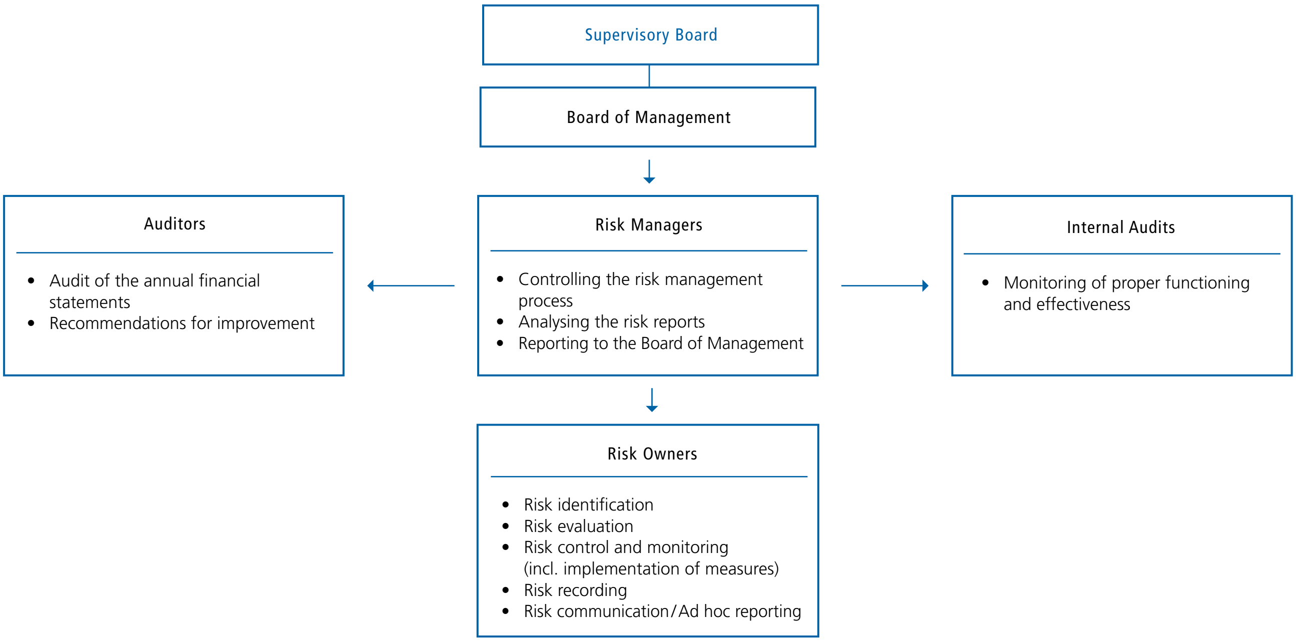
The bodies to which specific responsibilities and competencies have been assigned in KSB's risk management system are shown and explained in the figure on page 72.

The overall responsibility for risk management lies with the Board of Management of KSB AG. It reports to the Supervisory Board during regular Audit Committee meetings and is monitored by the latter. The Board of Management is 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 receive 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.

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.

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.

RISK MANAGEMENT AT KSB



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 and the opportunities available to us are affected by changes in the economic and political environments. The key economic factors, once again in the current year, include oil prices, which have yet to reach a satisfactory level despite climbing in 2016. In the absence of a continued recovery, the oil-producing countries' financial strength would be hampered and with it their options for new investments. We counter this risk, which is classed as "significant" by intensifying our contacts with companies and institutions that are making purchases within the means available to them. In this way we aim to limit the negative impact on our business.

There is still the risk of falling demand in the petrochemical industry in China, which would impair order intake for our pumps and valves. We are responding to this risk by monitoring our orders on hand and by offering the available products for other fields of application.

The political situation in various parts of the world remains critical, not least the general situation in Turkey and Ukraine. The destabilisation of Syria, Libya, Yemen and Iraq following internal and external conflicts is having an impact beyond national borders, affecting these countries' neighbours too.

Both private companies and government institutions are very reticent with regard to investment in new plant. It is possible that the conflicts could spread further, which would place additional constraints on our business opportunities in this region.

Given the political differences between Russia and the USA, and between Russia and most European countries, East/West relations remain very strained. This is also evident from economic life, with Russian companies increasingly ordering products that have been made in Russia or involve a high proportion of local value added. Our KSB company in Moscow has reacted to this development, setting up a local assembly site in leased premises for industrial and water engineering pumps. Additionally, we are also planning to establish our own production site.

In South Africa, political tensions in conjunction with economic shortcomings are hampering progress. This is affecting the business prospects of our local production and sales company. Consequently, it is intensifying its sales activities in other countries in southern Africa, primarily Zambia.

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.

Political relations between various European countries and Iran improved in 2016, providing a foundation for improved business activities but also posing the risk of US business suffering as a result.

Asia remains our most important sales market for power plant equipment, including pumps and valves. However, competition in China has intensified again, not least due to the negative economic development. 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 co-operation so that KSB can achieve success in Asian power plant projects outside of China.

▪ Opportunities

As detailed in the report on expected developments, the water and waste water market is continuing to develop positively, resulting in large-scale project orders in North Africa and the Middle East, as well as in France, China and the USA. With expert staff on the ground, we can provide clients with technical and commercial advice, and therefore see good opportunities to contribute to these and other projects.

In Brazil, the difficult economic situation, particularly in the oil and gas sector, has prompted several of our competitors to scale back their activities. This has extended to the closure of plants and sales offices. From KSB's perspective, there are therefore opportunities to win market share again when the economy starts moving upwards.

The expansion of our service network improves our opportunities in several countries to offer classic services such as inspections, maintenance and repairs. At the same time, however, our new service centres could provide a base from which to offer retrofit services and our energy-saving concepts to a broader range of customers. Where this is successful, we can become involved in the modernisation of existing plant and, in particular, convert inefficient plants to energy-saving operation.

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.

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 terms. There are also always associated risks. There may be cost overruns, tighter import regulations, staff shortages, technical difficulties or quality problems – including possible 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 € 50 million in the consolidated financial statements for 2016 compared with € 52 million in the previous year; beyond this there is no other major residual risk (net risk).

▪ Opportunities

In the course of 2016 we partially renewed our water and waste water product portfolio, improving our offering with energy-efficient components. This provides good opportunities to benefit from the growing demand from the customer industry, particularly as our product's low electricity consumption is increasingly becoming a purchasing argument for operators of waterworks, waste water treatment plants and the connected pumping stations. Our new packaged pump station with integrated solids separation system for pumped drainage applications will open up new sales opportunities in several Eastern European countries this year.

Over the current year we will able to supply equipment suppliers for heating and air-conditioning systems with a full range of our own glandless pumps, covering all needs from detached family homes to large-scale industrial or hotel complexes. This extended range improves our opportunities to sell to original equipment manufacturers and large-scale plant engineering contractors. Where fire protection systems are also needed in industrial applications and building services, we are now able to offer our certified butterfly valves for fire protection.

The successive expansion of our range of mechanical seals produced in-house forms part of our efforts to extend our value added and cut external purchasing costs. With the 25 pump type series that we are now fitting with these components, we can offer our customers a high-quality technical solution that will have a positive impact on their maintenance and repair costs. To this extent there is a good opportunity to record more significant increases in the quantity sold of these seals.

We are supporting plant engineering contractors in the energy and industry sectors as they strive to achieve standardisation and modularisation. Through framework agreements, we can offer the most appropriate system components with short delivery times. In this way, we have the chance to extend and consolidate our business relations with major customers over the long term.

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 and constantly monitor our net financial position, 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 crisis may adversely affect the financial situation of our customers. Delayed payments and credit losses as a result of this can place a burden upon 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. Our Italian company, whose product range includes high-efficiency motors, experienced a deterioration in its financial situation during the reporting year. Some service companies in France also suffered as a result of the persistently difficult economic situation in the country, with an impact on business development and thus on economic and financial solvency, as well as medium-term business prospects. We are therefore reviewing the strategic direction and organisational structures of our service activities there. Where deemed appropriate, we will merge individual units and also exit from any areas from which we do not expect long-term profitability.

Changing market conditions mean that our business models need to be fundamentally reviewed time and time again. This can also mean that we have to 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. 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 2016 consolidated financial statements, we set aside € 1.3 million for circumstances that are classified as a significant or neutral risk. In addition, there are contingent liabilities expected to total up to € 7.4 million.

▪ **Opportunities**

By the end of 2016 the US dollar had reached its highest level for 14 years against other major currencies, based on the expectation that the new government would work to generate economic impetus. If the dollar remains strong against the euro, exporting European products to the US market could become easier, provided that the general trading conditions do not change. Contracts that we post in US dollars would also, after conversion to our Group currency, result in higher amounts than if exchange rates remained unchanged.

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. If local conditions mean that it is impossible to ensure sufficient diversification in this regard, we make use of additional foreign business partners.

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**

In order to make our products more competitive, our global purchasing managers are closely involved in the “design-to-cost” process. Through this process we manage the conception and development of our products to ensure that the resulting market opportunities are optimised, including from a pricing perspective. To this end, Purchasing can influence design considerations in the interests of cost-optimised procurement.

For the purposes of standardising and harmonising our processes, smaller KSB companies are also increasingly making use of uniform ERP systems. This standardisation increases the transparency of our procurement processes and makes it easier to pool the procurement of the same or similar parts, thereby saving costs. Using SAP software, we are also creating end-to-end electronic processes from the placing of an order through to payment, accelerating the entire workflow and reducing the likelihood of errors.

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. This close integration also enables us to respond to new market trends more quickly than our competitors.

▪ **Opportunities**

We are keeping a close eye on our markets and are actively involved in the development of new technologies. In this way, we are able to find appropriate solutions to match our customers' needs at an early stage. By implementing these solutions in the form of innovative products and services, we are able to offer the type of product benefits that our customers value.

In addition to further developments in hydraulics, materials technology and automation, we also monitor the technical options presented by digitally networked systems with a high level of information transparency. Using interdisciplinary teams we are currently looking into the opportunities in relation to serving our customers. In early 2017 we created a special unit which is dedicated to developing and fleshing out new business models on the basis of Industry 4.0 within the scope of four projects.

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 2016 consolidated financial statements, these amounted to just under € 1 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**

Our activities as an industrial company inevitably present risks to humans and to nature. Using a global environmental management system, we recognise any hazards in good time, implementing protective measures as and when required. This puts us in a good position to prevent damage and any resulting financial consequences. By having our production and service plants checked by auditors and certified according to international standards, we and our customers are both assured that KSB companies respect the environment. This is an important prerequisite for many business relations. It offers KSB the opportunity to present itself to the market as an environmentally sound company. Our commitment to the UN Global Compact, too, allows us to meet the expectations of our customers and thus improve our sales prospects.

We also conduct regular energy audits, complying with the implementation, at national level, of an EU Regulation. Ultimately, these analyses reveal potential for additional energy savings by renovating our production halls, through smart management of our production facilities and through instructions to the operators of machine tools.

In some countries, tax incentives are available for companies with an environmental and energy management system. Through our certified systems we have always been able to provide the relevant documentation in this regard.

It is clear to us that the trend towards effective environmental protection and greater energy efficiency among our customers is ongoing worldwide. This will continue to have a positive impact on demand for our products and services. Our customers can, for example, use our FluidFuture concept to cut their electricity consumption. A system analysis is used to ensure that pumps and valves are properly designed and to provide information on the benefits of using high-efficiency pumps, valves and drives.

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.

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 2016 consolidated financial statements include about € 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 € 2 million to cover any cases we classify as significant or neutral within our risk assessment methodology.

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**

In 2016 we carried out a survey of 11,000 employees across ten countries in order to pinpoint the company's strengths and weaknesses. Based on the feedback from approximately 8,700 members of staff, we developed measures that should already be helping to further improve the fundamentals of our work, including customer focus, innovation, cooperation and performance management in the current year. Provided these measures are successful, we can expect to see even greater commitment from our employees, thereby further increasing our company's value for our customers. At the same time, we also expect the measures triggered by our staff's responses to strengthen KSB's reputation as an employer. This will make it easier for us to attract the experts and managers that we need.

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. At the same time, the still comparatively low price of oil and worsening payment morale also harbour risk potential for future business transactions. A quicker-than-expected return to political stability, combined with a calming of the currency turmoil, would probably have positive repercussions. This would also be the case were the oil price to experience another recovery matching that of 2016. Conversely, a continuation of the political uncertainty, combined with persistent depreciation tendencies among some currencies or a permanently low oil price, would have a negative impact on our business. As regards our main influencing factor, the economic situation, we estimate the risk to be slightly higher compared with the previous year. We nonetheless hope that our measures, intended to foster growth, will provide us with considerable support in achieving our goals. Furthermore, the political crises and future development of the oil price mean both opportunities and risks for all segments. Our customers are also often affected by recessions and more intense competition, which can compromise 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 lend ourselves to 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 € 269.8 million (previous year: € 254.0 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 € 39.5 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 BY THE BOARD OF MANAGEMENT

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 has not changed materially in comparison with the previous year, but there has been a change in the assessment of various individual risks as a result of our measures and, in part, of other internal and external aspects.

Overall, we assume there will be moderate economic recovery over the next year. Our structural measures will afford us additional support in achieving our objectives. However, there are risks associated with an economic slowdown in the growth markets, particularly China, as well as with negative developments that could stem from regions in Eastern Europe, the Middle East, Turkey or parts of Africa experiencing political unrest. This similarly applies to future changes in the price of oil, as well as to volatile currencies. Such circumstances would have a negative effect on our business volumes as well as our planned 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 2017 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 operations 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 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. Klein Pumpen GmbH, Frankenthal, holds approximately 80 % of the ordinary shares; the KSB Stiftung [KSB Foundation], Stuttgart, holds the majority of the shares of Klein Pumpen GmbH. 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 is managed by two Board of Management members. The Supervisory Board decides on the appointment and termination of the mandate of members of the Board of Management in accordance with the statutory provisions.

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 *Mitbestimmungsgesetz* [German Co-determination Act].

CORPORATE GOVERNANCE STATEMENT (SECTION 289 a OF THE HGB)

The Corporate Governance Statement pursuant to section 289a of the *HGB* [German Commercial Code] dated 30 March 2016 is accessible to the public at www.ksb.com > Investor Relations > Corporate Governance / Corporate Governance Statement. The updated Statement will be made accessible to the public in the same way from 30 March 2017.

In addition to the Corporate Governance Report (including the Statement of Compliance in accordance with section 161 of the German Public Companies Act), the Corporate Governance Statement includes relevant information on corporate governance practices applied at KSB AG 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.

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 are structured as clearly and transparently as possible. The total amount of remuneration for the individual Board of Management members is determined based on various parameters. Criteria for assessing the appropriateness of the remuneration include 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 consists of fixed and variable components. Fixed components are granted regardless of performance and consist of a fixed sum plus benefits, as well as pension commitments (retirement, disability, widow's or orphan's pension). The fixed sum makes up 60 % of the maximum annual salary and is paid out as a monthly basic remuneration. All Board of Management members are equally entitled to the accompanying fringe benefits which include 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 consists mainly of future-oriented components determined on the basis of a multi-year assessment. They are 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 %) is 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 is 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.

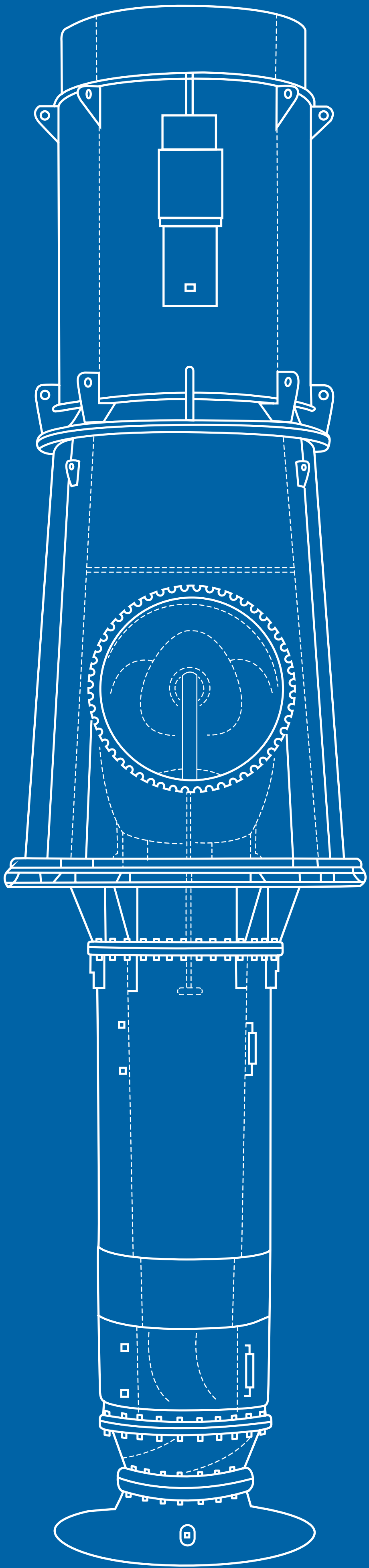
Furthermore, when Board of Management contracts are concluded it is agreed that payments made to a Board of Management member in the event of his or her Board of Management tenure being terminated earlier than agreed without good reason shall not exceed the value of two years' remuneration including 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 the contract of service of a Board of Management member is terminated 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 2016 financial year amounted to € 1,250 thousand (previous year: € 1,289 thousand), and the payments for benefits after termination of work € 1,388 thousand (previous year: € 1,429 thousand). € 5,255 thousand (previous year: € 4,518 thousand) has been provided for pension obligations to current members of the Board of Management, and € 39,309 thousand (previous year: € 39,387 thousand) to former members of the Board of Management and their surviving dependants; total benefits paid to these persons amounted to € 2,244 thousand in the year under review (previous year: € 2,246 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 € 716 thousand for the 2016 financial year (previous year: € 833 thousand). Information on the structure of the remuneration arrangements for the Supervisory Board is provided in the Corporate Governance Statement pursuant to section 289a of the *HGB*.

Frankenthal, 21 March 2017

The Board of Management



SEZ
Tubular casing pump for large water intake structures