

REPORT OF THE SUPERVISORY BOARD

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

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

In the reporting period, no conflicts of interest arose involving members of the Board of Management or the Supervisory Board that would have been subject to disclosure in the Report of the Supervisory Board.

MAIN FOCUS OF WORK IN THE SUPERVISORY BOARD PLENARY SESSIONS

Core topics of our discussions with the Board of Management were the revision of strategic objectives, and the continued development of the corporate organisation and international production concept. The analysis of business development in the segments and Regions represented an additional focus, as did major investment projects at various sites. We dealt on an ongoing basis with the company's economic position, the progress of the new efficiency improvement programme, and the prospects facing selected markets. Based on the recommendations and suggestions contained in the German Corporate Governance Code, we also looked at fundamental aspects of good corporate governance. Special emphasis was placed on corporate culture because KSB had for the first time recorded and evaluated the employee's views concerning the company by means of a structured global survey.

Four regular Supervisory Board meetings were held in 2016. The performance of KSB Aktiengesellschaft and the Group was the subject of regular discussions in the plenary sessions, primarily with regard to net assets, financial position, employment levels and strategic direction, as well as material investment, divestment and acquisition projects. In a few cases of obvious structural difficulties, we decided to approve the Board of Management's proposals to sell off the units concerned.

The Board of Management regularly explained to us in detail the ways in which KSB can achieve the planned growth for the coming years, including the underlying methodological and strategic considerations. Required investments were subjected to critical analysis before being approved and their implementation was subsequently monitored by us. In this context, the Supervisory Board approved significant financial resources to maintain the high technical level of plants on a Group-wide basis, while at the same time taking into account specific site-related aspects.

We approved major investments, in particular for the expansion of the German head office and our production capacities in Pakistan. We repeatedly examined the status of the expansion work in our French and Indian subsidiaries, which are making good progress at the sites in La Roche-Chalais and Shirwal. In order to obtain a major Chinese order for the supply of pumps we had to expand our local manufacturing facilities, as already reported. We expect the successful implementation of this demanding project to strengthen KSB's market over the long term, and so we ensure that we receive ongoing updates from the Board of Management on the progress made with the contract. In a number of countries, the start or expansion of business activities led to property acquisitions. In each case we discussed the long-term impact of such measures.

Given the ongoing changes in the energy sector, we continued to look at the impact these radical market movements are having on our business operations. The main focus is on the optimisation of manufacturing capacities within our international production network. The current implementation of the concept entails significant changes to in-house logistics, so we are supervising it closely. In some cases this also requires the closing down of unprofitable smaller factories, for example in Bochum, Germany, or the sale of units outside future core areas, such as the business of KSB AMRI, Inc. in Houston (Texas), USA.

Repeatedly on the agenda was the continued development of the corporate organisation. We paid special attention to the reduction of internal administrative costs, for example by reducing the number of Group companies and relocating standardised processes to highly efficient external service providers. The latter has since been contractually agreed upon, so the implementation of the required processes will be of high importance in the current year. These activities to reduce expenditure were rounded off by the continuous application of the programme initiated by the Board of Management at the end of 2015 to enhance efficiency in all Group areas. Another focus of our deliberations continued to be the progress made towards strengthening our value-based corporate culture, with the Board of Management providing regular updates. The results of the Group-wide employee engagement survey, which were presented in this context, revealed interesting findings and also areas where action is needed. The latter have to be addressed in order to continue the constructive dialogue with staff and meet their expectations. By doing this we ensure that the employees' performance and engagement are continually strengthened.

For the September session, the Supervisory Board convened for a meeting at the Halle site in Germany. Based on the relevant reports of the Board of Management, we discussed in detail the status of the strategy revision for various markets that is intended to sustainably promote and secure the company's long-term success. As well as organic growth – for example by working more intensively on certain business areas – the potential for development based on acquisitions was explored. In this context, effective proposals were made which have to be considered in greater depth in the current year. The market opportunities offered by digitalisation were also addressed in some detail. In addition, we familiarised ourselves with local business development and the modern technical facilities at the Halle site.

At the December meeting, one main issue was the approval for the introduction of so-called "Shared Services". The aim here is to collate and outsource some services that were previously performed in-house, especially in the commercial departments. Within the scope of this challenging project, internal processes are to be standardised to a greater extent in future and cost structures are to be optimised. We also looked at business performance during the financial year and planning for 2017. Special attention was also given to the suggestion made by the majority shareholder – Klein Pumpen GmbH, Frankenthal – to change the legal form of the company from a public limited company [*Aktiengesellschaft*] into a partnership limited by shares [*Kommanditgesellschaft*]. After discussing the matter in more detail the Board of Management and Supervisory Board gave their approval to this proposal on 12 January 2017.

COMMITTEES OF THE SUPERVISORY BOARD

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

CORPORATE DEVELOPMENT COMMITTEE

Dr. Martin Auer, Chairman
No. of meetings: 4

NOMINATION COMMITTEE

Klaus Kühborth
Dr. Thomas Seeberg
No. of meetings: 1

PERSONNEL COMMITTEE

Dr. Thomas Seeberg, Chairman
No. of meetings: 8

AUDIT COMMITTEE

Dr. Jörg Matthias Großmann,
Chairman
No. of meetings: 4

MEDIATION COMMITTEE

Dr. Thomas Seeberg, Chairman
No. of meetings: 0

MAIN FOCUS OF WORK IN THE COMMITTEES

In order to perform its duties efficiently, the Supervisory Board worked with five committees in 2016. These prepare the Supervisory Board's resolutions and the special topics to be discussed in the plenary sessions. In addition, they also make their own decisions – to the extent that this is legally permissible – within the scope of their areas of responsibility. This allocation has proved worthwhile in practice. The Chairs of the committees regularly and comprehensively report in the plenary sessions on the content and results of the work carried out in the committees.

In the run-up to the election of Supervisory Board members at the Annual General Meeting, on 11 May 2016, the **Nomination Committee** prepared the Supervisory Board's nominations, convening once during the reporting year for this purpose. In looking for and evaluating suitable candidates with the requisite expertise and experience of the industry, long-term succession planning is a key factor.

The **Corporate Development Committee** deals with the company's strategic development, as well as with annual planning and finance, and technology issues. At four meetings in the year under review, it discussed in particular the areas of strategy controlling, production management and innovation, and – on an ongoing basis – looked at a number of major investments, which require the approval of the Supervisory Board. The development of particular product areas also figured on the agenda, as did tie-in measures during acquisitions and selected projects. The Committee examined in detail the current state of implementation of the aforementioned programme to increase efficiency and the progress of global production networking. Another point of focus was the business opportunities offered by digitalisation, which need to be monitored very closely. The heads of the relevant specialist departments took part in the committee meetings, along with the two members of the Board of Management.

The **Personnel Committee** held eight meetings in the year under review. It primarily addresses topics relating to the Board of Management's remuneration, including the terms of the individual service contracts, as well as other Board of Management issues. Decisions on the Board of Management's remuneration are made in plenary session with the committee acting in a preparatory capacity. In the year under review, the Committee also discussed staff development issues with the aim of ensuring that any need for action in terms of filling Board of Management positions and positions at the management level directly below the Board is identified at an early stage and followed up. The main focus of discussions was the preparation for major staffing decisions in the current year. Following the proposal of the Personnel Committee the Supervisory Board consented to the early resignation of Mr. Werner Stegmüller from the Board of Management – at his own request – effective 31 May 2017. As successor and additional member of the Board of Management, the Supervisory Board appointed Dr. Matthias Schmitz on 22 March 2017, initially for a term of office of three years from 1 June 2017 to 31 May 2020. The term of office of the long-standing member of the Board of Management and Human Resources Director, Dr. Peter Buthmann, was again extended, for six months until the end of 2017, to ensure adequate continuity on the Board of Management. The Supervisory Board approved that the age limit applicable to members of the Board of Management will be moderately exceeded. Additionally, the Committee monitored the internal developments within the company that aim at an increased participation of women in leadership roles.

The four meetings of the **Audit Committee** in the year under review were always attended by a Member of the Board of Management and, on several occasions, by the auditors and the heads of the relevant departments. The Committee primarily discussed the 2015 annual and consolidated financial statements, as well as the corresponding audit reports prepared by the auditors. The Audit Committee also prepared the independent examination by the Supervisory Board of the financial statements, the management reports and the proposal on the appropriation of the net retained earnings. In addition, the 2015 half-year financial report was discussed with the Board of Management. Moreover the Committee presented a recommendation to the Supervisory Board for the election of the auditors at last year's Annual General Meeting. It then assigned to the auditors the audit of the annual and consolidated financial statements for the 2016 financial year and specified the key audit areas. The declaration of independence by the auditors was obtained in accordance with the recommendations of the German Corporate Governance Code (section 7.2.1) and the auditors' continued independence was monitored. The Committee was also involved in monitoring the accounting process, the risk management system – taking into account the relevant reports from Internal Audits – and the effectiveness of the internal control and auditing system, including compliance.

There was no requirement during the financial year under review to convene the **Mediation Committee** required by section 27(3) *MitbestG* [*Mitbestimmungsgesetz* – German Co-Determination Act].

CORPORATE GOVERNANCE AND STATEMENT OF COMPLIANCE

The Supervisory Board continuously monitored developments in corporate governance standards throughout the financial year. The Board of Management and the Supervisory Board report on corporate governance at KSB in accordance with section 3.10 of the German Corporate Governance Code as part of the Corporate Governance Statement pursuant to section 289a HGB [*Handelsgesetzbuch* – German Commercial Code]. On 2 December 2016 they issued a joint updated statement of compliance in accordance with section 161 of the *AktG* [*Aktien-gesetz* – German Public Companies Act] and made it permanently available to shareholders on the company's web site. KSB Aktiengesellschaft complies with the Code's recommendations subject to a few justified exceptions.

AUDIT OF THE 2016 ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS

The Supervisory Board examined the annual financial statements and the management report of KSB Aktiengesellschaft for the year ended 31 December 2016, which were prepared in accordance with the provisions of the *Handelsgesetzbuch* [HGB – German Commercial Code], as well as the consolidated financial statements and the group management report for the year ended 31 December 2016, which were prepared in accordance with the International Financial Reporting Standards (IFRSs), and the proposal by the Board of Management on the appropriation of net retained earnings.

The accounting documentation, in addition to the proposal by the Board of Management on the appropriation of net retained earnings and the audit reports submitted by the auditors, was provided in good time to all members of the Supervisory Board. The documents were examined in detail by the Audit Committee on 21 March 2017 as well as by the Supervisory Board plenary session on 22 March 2017 and explained in depth in both cases by the Board of Management. The auditors attended the meetings of both bodies, reported on the findings of the audit and were available to provide additional information.

The Mannheim office of PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt, also audited the annual financial statements and the management report of KSB Aktiengesellschaft for the year ended 31 December 2016, as well as the consolidated financial statements and the Group management report for the year ended 31 December 2016, and issued an unqualified opinion. The key audit areas assigned to the auditor by the Audit

Committee for the year under review mainly included the recoverability of receivables, and the presence and measurement of finished products and work in progress in the inventory. The auditors reported on their findings on these key audit areas both orally and in writing.

The Supervisory Board concurs with the auditors' findings. Following the final result of the examination by the Audit Committee and its own review, the Supervisory Board raised no objections to the annual financial statements, consolidated financial statements, management report and Group management report. In accordance with the recommendation of the Audit Committee, the Supervisory Board approved the financial statements prepared by the Board of Management; the annual financial statements are thus adopted. After its own examination, the Supervisory Board deems the proposal by the Board of Management on the appropriation of net retained earnings of KSB Aktiengesellschaft, and in particular keeping the dividend at the same level as last year, to be appropriate and concurs with it.

DEPENDENT COMPANY REPORT

The auditors also audited the dependent company report for the 2016 financial year prepared by the Board of Management in accordance with section 312 *AktG* and issued the following unqualified audit opinion on this report:

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

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

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

CHANGES ON THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

The planned resignation of Mr. Werner Stegmüller, the appointment of Dr. Matthias Schmitz as additional member of the Board of Management, and the renewed extension of the term of office of Dr. Peter Buthmann were already mentioned above.

Mr. Günther Koch stepped down from the Supervisory Board with effect from the close of last year's Annual General Meeting after serving for the regular term. The Annual General Meeting elected Dr. Stella Ahlers as his successor and member of the Supervisory Board and confirmed the appointment of Ms. Gabriele Sommer to this office, after she had been appointed by means of an order of the court. Dr. Martin Auer and Dr. Thomas Seeberg resigned from their office as members of the Supervisory Board with effect from 28 February 2017, with Dr. Seeberg also stepping down from his position as Chairman of the Supervisory Board. Dr. Ahlers and Dr. Jörg Matthias Großmann resigned from their office as members of the Supervisory Board with effect from the end of 20 March and 14 April 2017, respectively. Ms. Monika Kühborth, Mr. Oswald Bubel and Dr. Bernd Flohr were appointed members of the Supervisory Board by order of the *Amtsgericht* [Local Court] Ludwigshafen am Rhein on 21 March 2017 to replace the members who had stepped down prior to this date. At the meeting of the Supervisory Board on 22 March 2017, Dr. Flohr was elected Chairman of the Supervisory Board. The Supervisory Board would like to thank the members who have left the Board for their close cooperation. We also thank Dr. Seeberg for his prudent leadership over the past few years.

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

Frankenthal, 22 March 2017

The Supervisory Board