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GROUP MANAGEMENT REPORT

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BASIC PRINCIPLES OF THE GROUP

GROUP BUSINESS MODEL

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

KSB 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 80 foreign companies are fully consolidated; 6 other companies are accounted for under the equity method. An extension of the group of consolidated companies is currently not planned for the current financial year. KSB is 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
- GIW Industries, Inc., Grovetown / Georgia, USA
- KSB Shanghai Pump Co. Ltd., Shanghai, China
- KSB Pumps Limited, Pimpri (Pune), India
- KSB Service GmbH, Frankenthal, Germany
- KSB Bombas Hidráulicas S.A., Várzea Paulista, Brazil

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 2015, 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. Further information on the subject areas of employees, environmental protection and corporate social responsibility can be found in the Management and Issues 2015 section.

RESEARCH AND DEVELOPMENT

The goals of our research and development activities focus on making fluid transport more efficient, more reliable and more cost-effective. Across the globe, our development specialists work in international teams often supported by renowned universities and institutes. Our expenses in this area totalled € 58 million for the year under review (previous year: € 49 million). This equates to an unchanged 2 % of our sales revenue. At 600 (previous year: 588), the number of staff working in research and development has remained almost constant.

€58 million

Research and development expenses in 2015

One focus of our work was on exploring the potential that a future-oriented field such as Industry 4.0 offers for our business. The development of our KSB Sonolyzer app represents the first step towards utilising the possibilities of cyber-physical systems for industrial centrifugal pumps. The application is suitable for smartphones or tablets and helps operators boost the productivity of their systems. The app enables a user to determine the efficiency of a fixed-speed pump in just 20 seconds. This product won KSB the Process Innovation Award in the Pumps and Compressors category at Achema 2015.

Aiming to position ourselves as a full-range supplier for circulators, we expanded our Calio series in 2015. This involved developing additional hydraulic sizes, designing a twin pump variant and extending the performance range by means of a new motor concept. We also integrated the technology acquired via our subsidiary Smedegaard into KSB's existing platforms. Calio's success in 2015 suggests that this work will pay off in the short and medium term.

(Top) Full-range supplier for circulators: The twin pump variant of the Calio series extends our building services product portfolio. (Left) Pump used as turbine: With the KSB PowerHouse, we offer our customers turnkey power generation systems. (Right) Industry 4.0: The KSB Sonolyzer mobile app allows users to analyse the efficiency of fixed-speed pumps in just 20 seconds.

ECONOMIC REVIEW

MACROECONOMIC ENVIRONMENT AND SECTOR VIEW

Our planning for the 2015 financial year was based on slightly stronger economic growth than in 2014. However, this increase in growth, as forecast by the International Monetary Fund (IMF) and other institutions failed to materialise. Rather, as the economy became less dynamic over the course of the year, several corrections to our forecast values were required. Ultimately, the increase in the global gross domestic product, at 3.1 %, was down on the previous year.

A key factor in this regard was the economic situation in several of the major emerging markets. Growth in China dipped slightly in the financial year, which also dampened demand for industrial goods on one of KSB's key sales markets. The economies of Brazil and Russia actually experienced a decline in their gross domestic product. As well as other factors, the situation on the oil and commodities markets played a key role. The collapse in prices for industrial raw materials and fuels also impacted on other countries that export these goods, detracting from their economic strength and reducing the willingness to invest, among both private and government investors.

Indirectly, these developments also had an effect on the industrialised nations, although the economic recovery was maintained overall in the industrialised world. Export-oriented countries in the euro zone, primarily Germany, benefited from the weakness of their common currency. Nevertheless, the economy of the euro zone states lagged a long way behind the US economy.

WEAK GROWTH IN MECHANICAL ENGINEERING

Businesses like KSB that operate in the mechanical engineering sector had limited opportunities for expansion, given the weak state of the economy. The extent of these constraints varied, however, according to production segment and regional market focuses.

While sales of machinery and systems in the EU and in China grew slightly by 2 %, other markets experienced a decline, particularly in South America, where sales figures fell by as much as 12 % compared with the previous year. From a global perspective, mechanical and plant engineering sales only rose by 1 % as a result, a lower level of growth than in 2014.

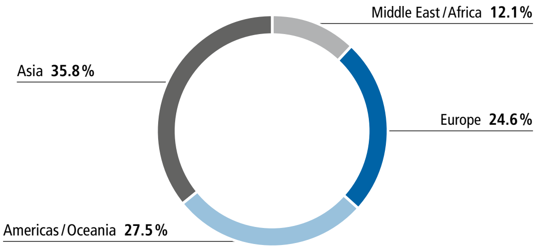
SALES MARKETS RECORD MIXED PERFORMANCES

The main sales markets for pumps and valves developed unevenly again in 2015 across the different sectors. The trend in manufacturing as well as in the chemical industry was positive, which boosted sales of standard pumps. Chemical companies focused on major projects in the Middle East and the USA in particular, looking to exploit the cost benefits during production. Meanwhile, in the water and waste water sectors, demand for pumps for wells and water pipelines, as well as for waste water pumping stations and sewage treatment processes increased. This is a sector that needs to adapt to supplying a growing population in many countries while also complying with stricter environmental protection regulations. The market for shut-off valves used in the water industry was also healthy. The construction sector developed positively in some regions, primarily the Middle East and Asia.

In contrast, a dramatic slump in demand was recorded in the oil and gas industry, as well as in petrochemicals. Hardest hit by the falling levels of demand were the producers of pumps to API standards. They responded to the changing market by restructuring and introducing cost-cutting measures, depending on their main commercial focus.

Mining companies, which as in the previous year suffered from lower demand for raw materials and low prices for their products, were reluctant to invest. Instead, they focused on improving plant efficiency and cutting operating costs. This is reflected in a lower number of new purchase orders, coupled with an increase in service orders. The lack of investment was felt particularly strongly by manufacturers of slurry pumps, among them KSB subsidiary GIW Industries, Inc.

WORLD MARKET OF CENTRIFUGAL PUMPS AND VALVES



Source: KSB estimate, European Industrial Forecasting (February 2016)

In the shipping sector, too, the lower level of demand for goods, including industrial commodities, was tangible. Particularly companies that transport oil and gas by sea slashed their investment levels, limiting the number of contracts that shipyards placed with the supply industry. From KSB's perspective, the marine sector is most relevant as a sales market for cryogenic valves. These are ordered by equipment suppliers and operators of liquefied gas tankers.

Demand from the energy industry for pumps and valves was also down on the previous year, not least due to structural refocussing in the electricity supply market, with the clear trend towards renewable energies. Fossil-fuelled and nuclear power station projects have only accounted for a handful of projects in Europe for many years now. In several emerging markets, however, contracts for fossil-fuelled plants were awarded in 2015. Opportunities also arose in connection with the building of new power stations with combined gas and steam turbines in the USA.

Against this wider economic background, sales by German manufacturers of liquid pumps fell by 4 % in real terms year on year, according to the German Engineering Federation (VDMA) figures. The VDMA had anticipated a stagnating market at the beginning of 2015. Sales by German producers of industrial valves declined by 2 % in real terms, whereas initially 2 % growth had been forecast

COMPETITORS MAKE ADJUSTMENTS

It has mainly been Anglo-Saxon pump and valve companies that have benefited from the boom in the oil and gas sector and in the petrochemical industry over the past few years. In 2015, these companies attempted to compensate for the specific fall in orders by introducing commercial initiatives in other sectors, or by looking to after-sales business. This resulted in greater price pressure, particularly in relation to industrial plant and power station projects.

Several pump and valve producers launched cost-cutting programmes in response to the changes on the market. The measures introduced included long-term capacity reduction also involving the closure of some plants. Sites were closed down in the Americas, Africa and Australia, as well as in Europe.

At the same time, some pump and valve manufacturers turned to acquisitions, mergers and cooperation projects to strengthen their market position. One of the more significant mergers involved two US companies from the oil and gas sector. Current KSB business with its low level of activities in this branch of industry is, however, barely affected by this transaction.

The different fields of application for pumps require specific technical expertise on the part of the manufacturers, as well as a perfectly tailored product and service range. In areas where this has been lacking, or where operations have not developed profitably, some pump suppliers began withdrawing from certain fields of application again in 2015. This improved the sales prospects for their competitors who chose to remain in the market.

BUSINESS DEVELOPMENT AND RESULTS OF OPERATIONS

We focused our business activities on three global and two regional focus markets in 2015. We consider the industrial sector, the water and waste water industry and energy supply to be the key global sales markets. Our regional focus markets are mining in the Americas and construction / building services in Europe.

To serve these markets quickly and cost-effectively, we have embarked on the task of making our global production structures more efficient. This involves closing some of the smaller plants in Europe. At the same time, however, we have invested in a mechatronics centre in Turkey. By setting up a new central spare parts warehouse for standard products in Europe, and by creating eleven additional service centres, we have also extended our logistics base, enabling us to support our customers across the world even more effectively as they make long-term use of our products and service. With this in mind, we contact users of our pumps and valves via our Installed Base sales channel.

At the same time, we used new sales activities and logistics structures to boost sales of our standard products. In this way we were able to offset some of the decline in orders resulting from the fierce competition in the project business against the background of the market situation described above.

It should be borne in mind in the following explanations that the prior-year figures presented include the effects resulting from the adjustment under IAS 8. For more information, see the Notes to the Consolidated Financial Statements.

ORDER INTAKE

Orders received by the KSB Group totalled € 2,261.2 million, which was € 60.0 million or 2.6 % down on the previous year. Large orders from Asia expected during the final months of 2015 were delayed, and a pump order placed for three Egyptian power stations in November was not able to make up the difference. Consequently, the planned “significant increase” in order intake did not materialise. In addition to projects being postponed by customers, the intense price competition was a contributory factor in this regard. The latter made some contracts, which were only awarded by potential customers after protracted negotiations with several providers, unattractive to KSB from a profitability perspective.

Clear regional differences emerged in relation to new orders in 2015. Companies in Asia (+ 9.6 %) and the Middle East / Africa (+ 22.3 %) recorded increases in purchase order levels. Alongside a strong increase in orders from the water and waste water sectors, orders placed by the petrochemical industry in the Middle East and the Asian energy sector contributed to this improvement.

In contrast, order intake of our companies in Europe decreased (– 7.0 %), with a major factor being the poor business situation of energy utility companies. One of the companies hit by the fall in demand was KSB AG, whose order intake fell by 8.0 % to € 780.6 million. New orders also dipped in the Americas and Oceania (– 5.8 %), with a reluctance to invest in the mining sector proving particularly crucial.

Pumps

A 4.7 % decline in orders received for pumps, totalling € 1,452.4 million, can be attributed to the lull experienced in the mining sector, the demand situation in the petrochemicals sector and the change in the basic parameters of European energy supply. We had expected to see a significant increase in order intake.

In light of the situation on the commodity markets, mine operators frequently backed away from ordering new plant components, a reticence that was also felt by GIW Industries, Inc., which predominantly produces and sells pumps for transporting solids. In both Asia and South America, reduced demand for pumps for use in petrochemical plants had an adverse effect on order levels. In Brazil, the lower volume of incoming orders was attributable to the difficulties faced by the country’s major oil company, among other factors. The decrease in orders for power plant pumps can be explained by the situation on the European market, with some energy utilities withdrawing from the fossil-fuelled power plant business.

We recorded strong order intake growth for our pumps in the water and waste water sector. The companies in the Regions Asia and Middle East/Africa in particular expanded their business substantially. Based on orders received to date, they are set to be involved in both new projects and infrastructure modernisation measures. Business with industrial customers also progressed well, with not least the KSB companies in Europe benefiting from this positive development.

Valves

The order intake for valves was € 368.0 million, down 9.7 % on the previous year. In the report on expected developments we had assumed that there would be significant growth in orders. The lack of growth is mainly due to the reduced requirements of energy suppliers in Europe and also to the fact that suppliers of equipment for transport ships in East Asia needed fewer butterfly valves than in earlier years. As with pumps, business with valves used in the petrochemicals sector was adversely affected by our large Brazilian customer halting any investment.

Good success was achieved selling valves to industry in general, particularly in Europe and the United Arab Emirates. This and other increases in order intake in individual sales markets were too low overall, however, to completely offset the decline recorded in relation to power plant and ship valves.

Service

Our Service segment enjoyed very strong growth in 2015. Orders worth € 440.8 million, a year-on-year increase of 13.1 %, came in for our range of services, including retrofit measures. This improvement exceeded our expectation of just moderate growth in this segment. Service orders were placed for pumps and other rotating equipment, as well as for valves, and we also accepted orders for products from other manufacturers.

We recorded considerable increases across nearly all markets. Customers from industry and the energy sector in particular made greater use of our service offering than in 2014, with considerably more orders also being received for work on transport equipment and on water and waste water systems. Not least the setting-up of new service centres in ten countries was a contributory factor.

Our sales channel used to target existing customers, which was expanded further in 2015, also had a positive impact on the sale of services and the related spare parts in many areas. Service orders rose strongly in all four Regions – Europe, Middle East/Africa, Asia and Americas/Oceania. Our efficiency analysis service also played a key role in this regard, enabling us to show customers ways of making savings in their plants, as well as offering possible ways of cutting electricity costs.

SALES REVENUE

Consolidated sales revenue rose as expected during the reporting year, up by € 153.1 million to € 2,334.8 million, which equates to an increase of 7.0 %. This positive divergence from the development in order intake can be attributed to large-scale orders placed in earlier years that we completed on schedule in 2015. This resulted in sales revenue growth in the Pumps and Valves segments, just as the orders received during the year under review had a similar effect in the Service segment.

Sales revenue growth was strongest in the Regions Asia (+ 16.9 %) and Middle East/Africa (+ 12.0 %), but the companies in Americas/Oceania (+ 8.7 %) and Europe (+ 3.4 %) also improved. Performance in our home market of Europe was slightly impeded by the 0.7 % fall in sales revenue recorded by KSB AG (in accordance with the *HGB* German Commercial Code), down to € 809.5 million.

Pumps

In our strongest segment, Pumps, sales revenue grew in line with our forecast, increasing by 5.3 % to € 1,514.0 million. It was mainly performance outside of our home market of Europe that contributed to this growth. Our companies in East and South-East Asia in particular boosted pump sales.

This similarly applies to the companies in North America, with GIW Industries, Inc. fulfilling major contracts placed by customers in Canada for the supply of slurry pumps.

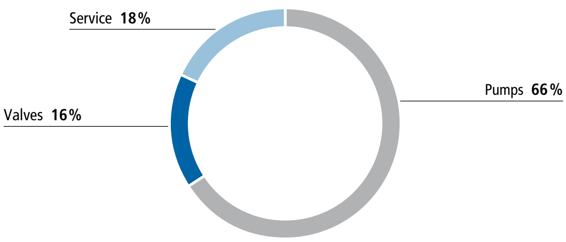
Valves

In the Valves segment, we improved sales revenue by 1.5 % to € 384.6 million. This moderate growth was driven by the development of sales in Asia, where above all our companies in China, India and South Korea invoiced valve orders on a large scale. In the Regions Europe, Americas / Oceania and Middle East / Africa, the sales revenue volume was, however, lower than in 2014. Overall, in our forecast, we predicted that this product group would see a significant increase in sales revenue.

Service

Our strongest sales revenue growth in percentage terms came from the Service segment, in which we initially only anticipated a moderate rise. In fact, we were able to boost sales revenue by 10.6 % to € 413.6 million. Above all, the expansion of our service business in Europe had a very positive impact on volume. However, it was our companies in Asia and the Americas that recorded the strongest growth rates in percentage terms. The companies in North America in particular were able to record far more service contracts than in the previous year.

SALES REVENUE BY SEGMENT



7.0%

Growth in sales revenue in 2015

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 € 101.9 million (previous year: € 102.0 million). The Pumps segment contributed an EBIT figure of € 55.4 million (previous year: € 56.3 million). We were therefore unable to realise our forecast in the previous year's report (considerable increase) and instead had to accept a slight decline. EBIT fell strongly in the Valves segment, reaching € 10.3 million (previous year: € 16.9 million). We therefore did not achieve the marked increase that was forecast. EBIT for the Service segment rose considerably, as planned, reaching € 36.2 million (previous year: € 28.8 million). The reconciliation effect from the measurement of construction contracts under IAS 11 to EBIT changed by + € 16.1 million year on year.

TOTAL OUTPUT OF OPERATIONS

The above-mentioned increase in sales revenue is also reflected in a higher total output of operations, totalling € 2,350.3 million compared with € 2,197.7 million in the previous year. Work in progress and inventories of finished goods increased by € 10.7 million, and was thus € 1.3 million lower than in the previous year. In contrast, other work performed and capitalised rose slightly.

INCOME AND EXPENSES

Other income grew from € 36.3 million to € 50.0 million, partly due to higher income from the reversal of provisions no longer required and also from the reversal of impairment losses on receivables.

The cost of materials rose by 10.4 % and thus at a higher rate than total output of operations. In percentage terms, the cost of materials (€ 979.5 million) increased from 40.4 % in the previous year to 41.7 % in the year under review. As a result of the continued pressure on prices in our pumps and valves business, we were not able to pass on material price effects to our customers in full.

Staff costs increased by 4.4 % to € 819.3 million. In relation to total output of operations, however, this represented a decrease of 0.8 percentage points. Key factors were the collectively agreed salary increases on the one hand and a lower number of employees on the other. Compared with 2014, the number of employees fell by 113, taking the total figure at the end of the reporting year to 16,196. The German companies KSB AG and KSB Service GmbH, Frankenthal, recorded a significant decrease in staff numbers, down by 172 as a result of measures that we have introduced to adapt to new market conditions. In contrast, the size of the French workforce increased, mainly due to the integration of a service unit (126 employees). Consequently, the KSB Group employed on average 138 fewer people than in the previous year. Based on the higher total output of operations and simultaneous decrease in the number of employees, the average output per employee improved from € 134 thousand in the previous financial year to € 144 thousand.

The ratio of other expenses to total output of operations fell from 17.9 % to 17.5 %. In absolute terms, they rose from € 393.0 million to € 411.5 million, however. Higher sales expenses and more third-party services accounted for this change.

The financial income / expense increased by € 6.3 million. This is above all attributable to higher income from investments which we accounted for using the equity method (+ € 2.8 million), and to a reduction of € 2.3 million in financial expenses.

EARNINGS

The KSB Group generated earnings before income taxes (EBT) of € 93.4 million, compared with € 72.8 million in 2014. This meant that we lived up to our prior-year forecast, according to which we were targeting a significant improvement in EBT and a value approaching the three-digit million mark. Correspondingly, the return on sales before tax increased from 3.3 % in the previous year to 4.0 % and is therefore at the lower end of the forecast range. The income tax rate rose, primarily due to prior-period taxes, but also due to more frequent non-tax-effective impairments on goodwill. The rate was 44.1 %, compared with 36.4 % in 2014. As a result, earnings after income taxes, which totalled € 52.2 million (previous year: € 46.3 million) and thus grew by 12.7 %, rose less markedly than earnings before income taxes (EBT) (28.2 %).

€93.4 million

Consolidated earnings (EBT) in 2015

Earnings attributable to non-controlling interests were up from € 7.6 million to € 12.9 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 16.4 % to 24.7 %.

The earnings attributable to shareholders of KSB AG (€ 39.3 million) were € 0.6 million higher than in the previous year (€ 38.7 million).

Earnings per ordinary share were € 22.30, compared with € 21.97 in the previous year, and € 22.56 per preference share, compared with € 22.23 in 2014.

FINANCIAL POSITION AND NET ASSETS

FINANCIAL POSITION

The financial position of KSB Group improved, as expressed in an increase in the equity ratio of 2 percentage points.

Equity

The KSB Group's equity amounts to € 870.2 million (previous year: € 819.7 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 € 609.1 million (previous year: € 578.5 million), including the proportion of earnings after taxes attributable to shareholders of KSB AG of € 39.3 million (previous year: € 38.7 million). € 149.6 million (previous year: € 129.7 million) is attributable to non-controlling interests. Due to the significant increase in equity, which coincided with only a slight rise in total equity and liabilities (+ € 13.1 million or 0.6 %), the equity ratio has also increased (38.0 %; previous year: 36.0 %).

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 € 1.4 million to € 526.0 million as at the reporting date. 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, also only changed slightly and total € 88.8 million (previous year: € 90.3 million).

38.0%

Equity ratio in 2015

The picture with regard to other provisions, which we created almost exclusively for current uncertain liabilities, is more or less stable (€ 99.5 million compared with € 96.7 million in 2014). An increase in warranty obligations and contractual penalties following the growth in sales revenue volume partly offset the decline in miscellaneous other provisions.

Non-current financial liabilities fell significantly, totalling € 133.5 million compared with € 159.4 million at the end of 2014. They include liabilities of € 122 million (previous year: € 140 million) from a loan against borrower's note placed in 2012. It is divided into repayment tranches of 3 to 10 years. The change can be explained by the early repayment of one of these tranches. Furthermore, bank loans and overdrafts decreased by more than € 8 million.

We reduced current liabilities overall by € 15.5 million (€ 558.6 million compared with € 574.1 million at year end 2014). Current financial liabilities fell by as much as € 49.2 million. In addition to the scheduled repayment of a tranche of the loan against borrower's note in the amount of € 35 million, we also reduced bank loans and overdrafts by around € 14 million year on year. In contrast, trade payables rose by € 27.1 million and current income tax liabilities by € 6.8 million. The increase in other non-financial liabilities of € 14.2 million, following a rise in advances received from customers, was offset by the decrease in other financial liabilities (–€ 14.5 million primarily due to lower miscellaneous other financial obligations). Taking into account the increase in total equity and liabilities, the share of current liabilities in total equity is 24.2 % (previous year: 25.1 %).

Investments

The additions to intangible assets amounting to € 8.3 million (previous year: € 7.4 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 € 74.5 million, slightly down on the figure of € 77.7 million for the previous year. The highest additions at € 27.7 million (previous year: € 32.2 million) relate to advance payments and assets under construction, as in the previous year. They are associated with the construction of a foundry at our US mining company GIW Industries, Inc. A further € 19.9 million are attributable to technical equipment and machinery (previous year: € 19.2 million). As in 2014, the focus of our investment activities was Europe, predominantly Germany and France. Outside Europe, the highest additions were again recorded at our plants in the USA as well as Brazil, China and India. We maintained our policies for measuring depreciation and amortisation in the year under review.

Net financial position

The net financial position, at € 211.3 million compared with € 185.5 million in the previous year, developed more favourably than forecast twelve months earlier (€ 180 to 190 million) due to the slightly better earnings and increase in advances received.

€211.3 million

Net financial position in 2015

Liquidity

Cash flows from operating activities amounted to € 116.6 million, a year-on-year increase of € 28.1 million. The key contributory factors, in addition to the improvement in earnings and more write-downs, were an increase in advances received from customers and a higher amount of funds tied down in liabilities. This contrasted with a rise in receivables.

Our investing activities generated virtually unchanged cash flows compared with 2014. The change in term deposits did, however, increase cash flows whereas in the previous year it had resulted in a reduction. Accordingly, cash flows from investing activities declined significantly to € –34.5 million (previous year, adjusted: € –97.9 million).

Cash flows from financing activities changed significantly, primarily due to the repayment of tranches of our loan against borrower's note, but also as a result of our bank loans and overdrafts being reduced, from € –36.9 million (adjusted) to € –87.4 million.

Cash and cash equivalents from all cash flows declined from € 278.6 million to € 273.1 million. Exchange rate effects amounting to € – 0.1 million (previous year: € + 10.8 million) played a role in this.

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

Contingencies and commitments

The KSB Group's off-balance sheet contingent liabilities totalled € 13.4 million as at the reporting date (previous year: € 8.0 million). These arise mainly from collateral and performance guarantees.

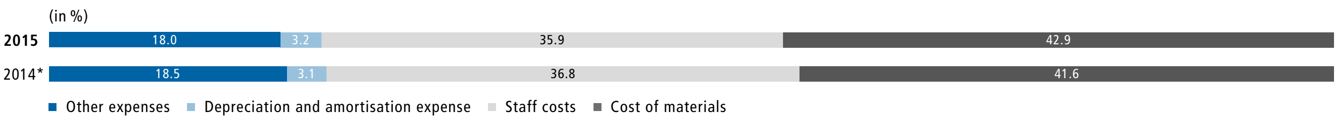
There are no other extraordinary obligations and commitments beyond the reporting date. Other financial obligations arise only within the normal scope from long-term rental, lease and service agreements (in particular IT and telecommunications) necessary for business operations and from purchase commitments amounting to € 20.0 million (previous year: € 17.8 million).

NET ASSETS

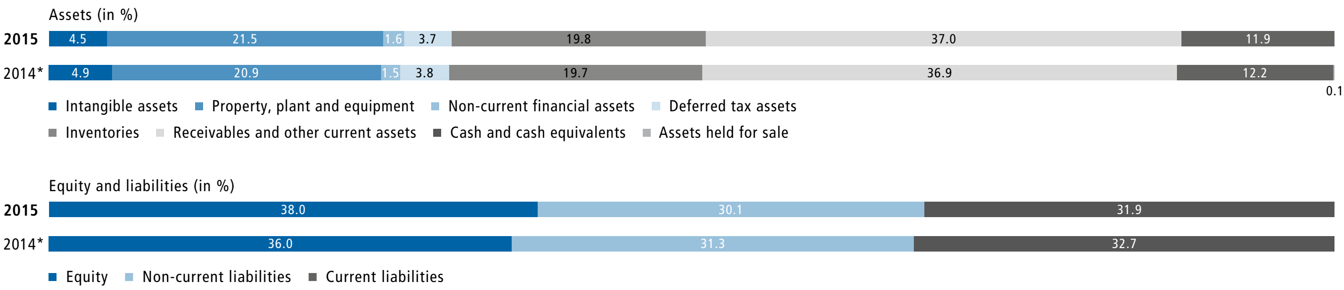
Our total assets increased slightly, rising by 0.6 % to € 2,291.1 million. Considerable increases were recorded for both non-current assets (particularly property, plant and equipment) and trade receivables and PoC. This contrasted with lower other financial assets.

Just under 28 % is attributable to fixed assets (compared with a good 27 % in 2014). Intangible assets and property, plant and equipment with a historical cost of € 1,336.4 million (previous year: € 1,270.4 million) have carrying amounts of € 595.9 million (previous year: € 587.2 million). The goodwill

EXPENSES IN STATEMENT OF COMPREHENSIVE INCOME



BALANCE SHEET STRUCTURE



* Adjustment under IAS 8

impairments recognised in the reporting year resulted in a change of –€ 9.4 million with regard to intangible assets. With investments in property, plant and equipment (€ 74.5 million) once again exceeding write-downs (€ 58.2 million), this balance sheet item increased by € 18.0 million. The carrying amount of financial assets and investments accounted for using the equity method increased by a total of € 1.9 million to € 37.2 million. The investments accounted for using the equity method accounted for € 1.2 million.

Inventories totalled € 454.4 million, up € 4.6 million on the 2014 year end. We recorded a rise in work in progress in particular, while advance payments were down on the previous year. Inventories continued to tie up around 20 % of our resources.

As a result of an increased delivery volume, trade receivables and PoC were € 49.5 million up on the 2014 year-end figure. Overall, taking into account the change in total assets, this balance sheet item accounts for approximately 29 % (previous year: 27 %) of total assets.

Other financial assets were down from € 190.2 million to € 156.2 million as term deposits with a maturity of more than 3 months and up to 12 months decreased by around € 44 million.

As in the previous year, cash and cash equivalents account for around 12 % of assets, totalling € 273.1 million (previous year: € 278.6 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 translation of financial statements of consolidated companies that are not prepared in euro gave rise to a difference of € + 1.2 million (previous year: € + 38.8 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 unexpectedly 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.

Weak demand across the world in several important sectors held back the growth in our business. At the same time, for various products our price flexibility was insufficient for achieving satisfactory margins in a tougher competitive situation. The resulting impact differed across the various segments.

Overall, we achieved the expected significant sales revenue growth in the Group and, consequently, also the considerable improvement in our relevant performance indicators for the Group. Earnings before taxes, at just under € 94 million, approached the three-digit million mark again, and our return on sales, at 4.0 %, was within the lower range of our expectations. Order intake, however, dipped by 2.6 %. We had forecast a significant increase.

Although the Pumps segment lived up to the sales revenue forecast (significant increase), the operating result recorded was slightly down on the 2014 figure due to the basic economic environment parameters, particularly in the power plant sector, and not considerably higher, as had been anticipated. Order intake was expected to rise significantly, but actually fell by 4.7 %.

In the Valves segment too, the difficult market situation clearly affected our energy customers. While we were still able to moderately grow sales revenue by 1.5 %, the planned significant increase was not achieved. One reason for this is the considerable decline in order intake by almost 10 %. A year ago we were still expecting marked improvements. Our operating result was also down on the prior-year figure, as we did not achieve the marked improvement that we had been targeting.

In our Service segment, we posted substantial increases in both order intake and sales revenue, exceeding our target of moderate growth. In terms of the operating result, we recorded considerable increases, as planned.

The net financial position, at € 211.3 million compared with € 185.5 million in the previous year, developed more favourably than forecast twelve months earlier (€ 180 to 190 million).

Overall, therefore, business developed somewhat less favourably than expected in the reporting year due to order intake levels.

On this basis, in 2015 we continued to work on improving the conditions for a return to prosperous business operations. This involves driving forward with the programme underway to redistribute tasks within our global manufacturing network and introducing measures to cut our costs even further. These measures include a gradual reduction in the headcount. We are also reducing the number of KSB companies worldwide and streamlining our product range.

KSB continues to have a healthy financial basis for the future. The measures introduced back in 2014 to make lasting improvements to our cost structures, which we are working to intensify further, will strengthen this basis over the long term.

EVENTS AFTER THE REPORTING PERIOD

No significant events occurred after the balance sheet date that would have a material effect on the company’s net assets, financial position and results of operations.

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 – received adequate compensation for all transactions listed in the dependent company report. No measures required to be reported were taken or not taken at the instigation or in the interest of the controlling enterprise or a company affiliated to it.”

REPORT ON EXPECTED DEVELOPMENTS

The International Monetary Fund (IMF) is forecasting that the global economy will expand by 3.4 % in real terms during the current year. The predicted increase in the industrialised nations is 2.1 %, with weaker growth of only 1.7 % expected in the euro zone. Economic development in Germany will be crucial, accompanied by continued recovery in France, Italy and Spain. In the emerging markets, the IMF expects real economic growth of 4.3 %, which will also improve KSB's sales prospects in these countries.

However, the VDMA expects the mechanical engineering and plant engineering sector to struggle to benefit from this growth, forecasting that the industry will grow by a mere 1 % in real terms. Sales in pumps and systems, and in industrial valves, are actually expected to dip by 1 % in real terms in 2016.

SIGNIFICANT ORDER GROWTH WITH SIGNIFICANTLY WEAKER SALES REVENUE

In this environment, which remains difficult, we expect the Group's order intake in 2016 to be significantly higher than during the reporting year, buoyed by several large-scale contracts.

In terms of consolidated sales revenue, however, we expect to see a significant decrease compared with 2015, based on the lower value of the project contracts in place and scheduled for delivery in 2016.

Pumps

In light of the strong price competition in the project business, combined with a decline in the number of contracts being awarded compared with previous years, we will be focusing during the current business period on promoting sales of our standard pumps. The main areas of growth appear to be industrial standardised and close-coupled pumps, among others. We offer these in combination with our energy-efficient synchronous reluctance motors and our improved variable speed systems, which help our customers to realise energy-saving potential. We also see good sales prospects for our modernised high-pressure and standardised chemical pumps, and for our updated range of pumps for use in heating and air-conditioning systems

We do not expect the market environment for the project business to start improving until 2017. However, the energy sector might prove to be a source of growth momentum during the current year. This particularly applies to China and India, where various contracts are about to be awarded. This could have a key impact on our order intake.

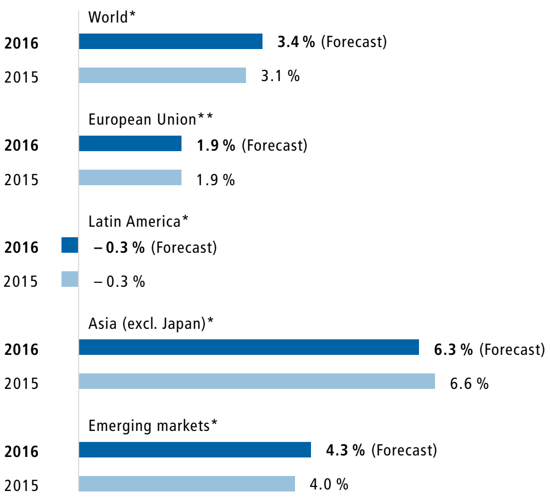
Against this background, we expect the segment to experience significant order growth, while sales revenue from pumps will be significantly down based on weaker order intake in 2015.

Valves

We are forecasting significantly lower growth in orders for our industrial valves. In countries such as Brazil and China, the market environment will be more difficult than in 2015. Specifically, demand from the petrochemicals industry and the oil and gas sector is likely to slow down further, with a corresponding impact on our order levels.

In contrast, we expect to see sales in large-scale butterfly valves pick up, these being the type of valve used in water pipelines for example. There are also signs of tangible growth in valves used in power plants, provided that our customers go ahead as planned with their announced large-scale projects, particularly in China and India. Any recovery on the market for liquefied gas transport is likely to be slow in 2016. However, our triple-offset butterfly valves for tankers are growing in popularity, pointing to the possibility of business growth. In addition, construction projects in the Middle East and Eastern Europe could result in moderate order growth for our valves used in building services.

GROSS DOMESTIC PRODUCT GROWTH



* Source: International Monetary Fund (January 2016)
** Source: European Commission (February 2016);
additional information: euro zone + 1.6 % (2015), + 1.7 % (2016)

Overall, therefore, we expect order intake for our valve business to be stable compared with 2015, while anticipating a substantial decline in sales revenue.

Service

From today's perspective, demand for our service business will remain stable or expand slightly. To achieve our growth targets we will be making greater use of our sales channel aimed specifically at existing customers to offer our service range and related spare parts. As part of this process, we can also base our operations on the additional eleven service centres set up in ten countries in 2015, as well as on the new central spare parts warehouse in Europe.

To grow our business we will be continuing the planned expansion of our service centres, particularly in East and South-East Asia as well as in Eastern Europe.

However, a further considerable decline in the energy sector is to be expected in Germany and other European countries, as capacity in nuclear and fossil-fuelled power stations continues to be reduced. In mining, a second important pillar of our service business, there are not yet any signs of activity picking up again this year.

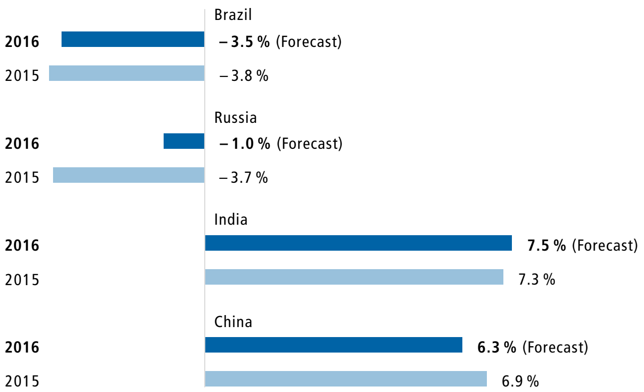
With regard to order intake, we expect the volume of new service orders in 2015 to moderately exceed the previous year's figure. Based on the current situation, sales revenue is expected to grow just slightly.

BOARD OF MANAGEMENT'S SUMMARY OF EXPECTED DEVELOPMENT

For the current business period we anticipate, as detailed above, a significant improvement in order intake, driven primarily by major power plant projects in China and India. In contrast to the positive contributions from the Pumps and Service segments, orders received for valves will remain at prior-year levels. Sales revenue will, from today's perspective, be significantly down on the previous year, as we expect the declines for pumps and valves referred to above and a slight improvement in the Service segment.

We will be significantly stepping up our measures for long-term improvements in our profit situation. These aim to reduce material, staff and other costs. This will also include continuing with our programme to redistribute tasks within our global manufacturing network. We are also creating the framework within which we can increasingly run our power plant engineering business in Asia, using mostly locally manufactured products. In addition, we are reducing the number of KSB companies and streamlining our product range. This means that one-off costs will considerably impact on our performance indicators. The precise amount of these one-off costs is difficult to forecast from today's perspective as some measures are still in the evaluation or discussion phase. The operating result, in other words earnings before interest and taxes (EBIT) excluding the effects from measuring con-

GROSS DOMESTIC PRODUCT GROWTH IN THE BRIC COUNTRIES



Source: International Monetary Fund (January 2016)

struction contracts under IAS 11 will be substantially down on the previous year depending on the level of one-off costs for efficiency enhancement measures. This applies to both the Pumps and Valves segments, while we are expecting to see but a moderate decline in the Service segment. Consequently, earnings before taxes (EBT) will be substantially down on the 2015 figure. This also means that our return on sales will be substantially lower.

With regard to the net financial position, we anticipate only a slight decrease compared with the € 211 million achieved in 2015. This is based on the expectation that the adverse impact on liquidity of the one-off costs to be borne in 2016 will not be felt until 2017 onwards.

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 2016 financial year. Material special factors beyond this period may result from our measures geared towards the long-term improvement of our profit situation, which will involve a reduction of material, staff and other 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.

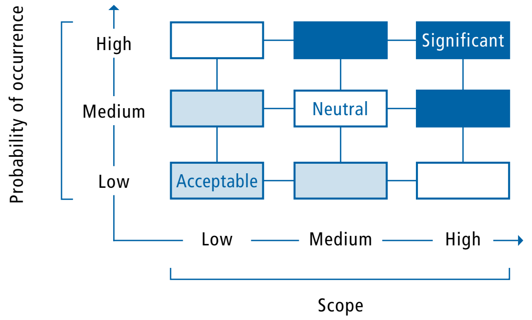
Managers are encouraged to take timely action to define and implement measures to limit or avoid damage that may result from the occurrence of risk events. All corporate and central functions and Group companies, including Group companies that are not consolidated, are included in the risk management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

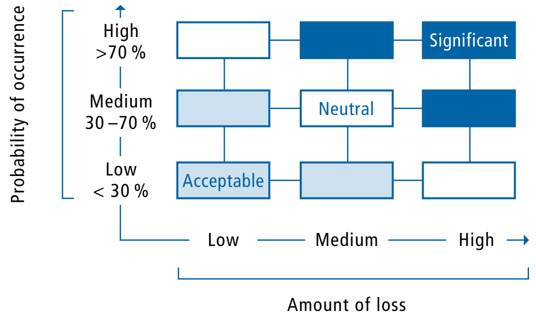
Quantitative risks are those risks with possible monetary impact on the earnings of the KSB Group or the respective Group company. They are evaluated taking into account the probability of occurrence in combination with the potential amount of loss.

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 applies:

		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.

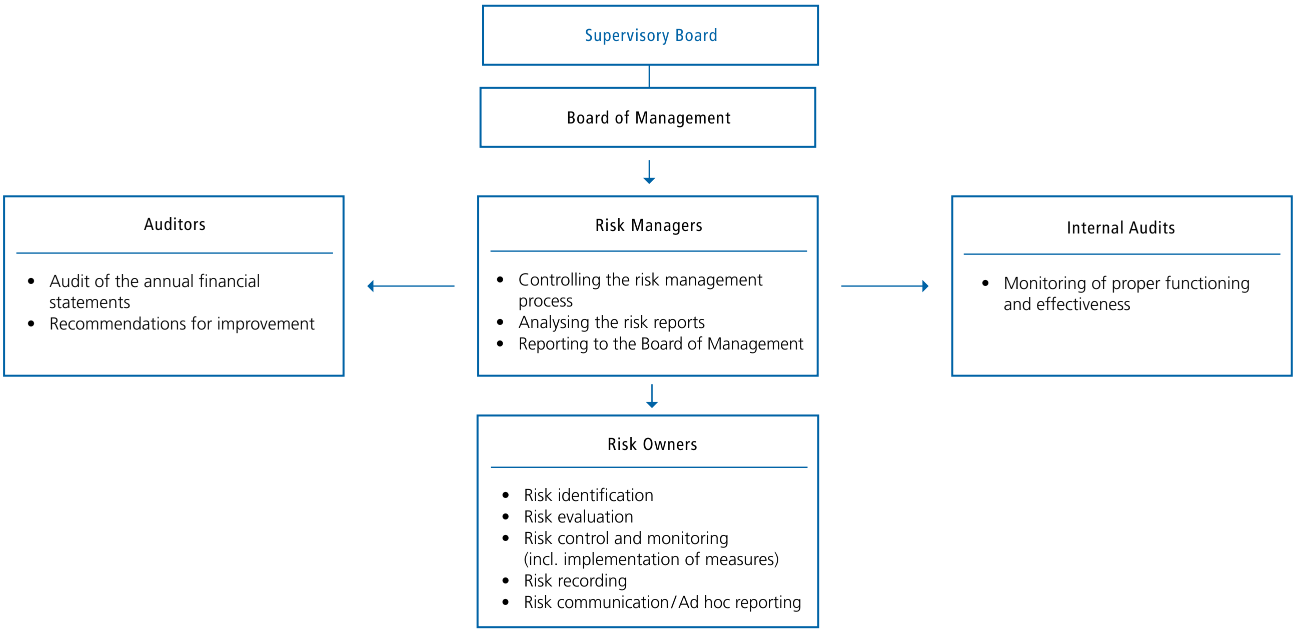
The bodies to which specific responsibilities and competencies have been assigned in KSB's risk management system are shown and explained in the figure below (page 58).

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. This 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 & Compliance, Patents & 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 internal 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 auditors examine 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 regularly and analytically validates the plausibility of time series 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. One of the influencing factors during the current year, from an economic perspective, is the low price of oil. This has a negative impact on the financial strength of the oil-producing countries, limiting their ability to invest. 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 the risk of falling demand in the petrochemical industry in China, which would negatively impact on 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.

Import duties in Malaysia are pushing up the sale price of products from the Eta type series. We are offsetting this risk by optimising our procurement costs there.

The political situation in the Middle East and in North Africa remains critical. The destabilisation of Syria, Libya, Yemen and Iraq following internal and external conflicts is also affecting these countries' neighbours. Both private companies and government institutions are understandably 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, we have seen a clear deterioration in East/West relations. This is also evident in 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 Angola and 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.

Asia remains our most important sales market for power plant equipment, including pumps and valves. Competition in China has, however, continued to intensify, creating greater price pressure for the KSB Group and representing a "significant" risk. In order to tap into the Asian market more widely, we have agreed a strategic alliance with our long-term partner, the Chinese SEC Group, in late 2015. This aims at closer cooperation so that KSB can achieve success in Asian power plant projects outside of China. A first contract, awarded at the end of 2015 to fit out an Indian power plant, will serve as a test case for further joint projects in the future.

▪ Opportunities

Specific opportunities will arise in relation to our valves if large-scale projects for the supply of water are realised in the Middle East, Africa and Asia. These generally relate to the construction or renewal of pipelines that are fitted with butterfly valves with very large diameters.

With regard to sales of slurry pumps to the mining sector, we still see opportunities to acquire market share despite the current difficulties in the sector. Our partnership with a global provider of machinery and systems for the mining industry, agreed during the reporting year, will be beneficial in this area. Furthermore, following the commissioning of a new specialist foundry in the USA, we can now supply large high-quality pumps more quickly than in the past.

The trend towards a greater focus on energy efficiency can result in customers increasingly requesting services for the analysis of existing systems and retrofit measures.

The lifting of the embargo on Iran opens up new sales prospects. Until the political decision to exclude Iran as a trading partner, we primarily supplied customers in the petrochemical and other industrial sectors with pumps and valves, and we were also well represented with our products in water supply facilities. Currently, opportunities are emerging as we increase the size of our team at our Tehran office, and from contacts with Iranian companies that are turning to German products again after their experience with some Chinese producers.

Unexpected sales opportunities may also arise if India accelerates the expansion of its water and waste water infrastructure as a result of improved financing options.

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. For this reason, we specially train our employees in project management. This enables them to identify the risks associated with longer-term orders at an early stage. Our project managers are 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 € 52 million in the consolidated financial statements for 2015 compared with € 45 million in the previous year; beyond this there is no other major residual risk (net risk).

■ Opportunities

In mid-June 2015 we began work on the construction of a new competence centre for mechatronics in Ankara, where we will in future be manufacturing all variable speed glandless pumps used in building services and also system components. The manufacturing programme will include the Calio series, which is still being produced in Switzerland at present. The cost benefits that this relocation will generate can help to improve our competitive position on the heating and air-conditioning market from as early as the second half of 2016. In addition, the expansion of the Calio series, as detailed in the Research and Development section, extends our opportunities for providing customers with state-of-the-art products from our own production.

We also believe that our high-pressure pumps offer additional market opportunities. We now offer these in an extended range of sizes. In 2015 many customers were already ordering this pump set, which offers greater value for money than its predecessors, for use in water engineering or industrial plants.

The world's first measurement and balancing valve using ultrasound technology, which we launched in 2015, is also generating keen interest. It simplifies the task of measuring flow, especially in heating and air-conditioning systems.

The KSB Sonolyzer app, introduced in 2015, is also opening up new opportunities to win contracts. The app helps customers to review the efficiency of their pump system quickly and easily. If a plant frequently operates under low-flow conditions, and thus uneconomically, the link to KSB contact persons provides analysis, consultancy and system optimisation options.

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 deviates from our assumptions, this would have positive or negative effects upon 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 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.

Changing market circumstances mean that our existing business models need to be fundamentally reviewed. During the past financial year we therefore carried out a reassessment of the prospects for canned motor pumps and re-assessed our activities. Our findings were that the current market opportunities are poor, with the result that we will be adjusting 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 2015 consolidated financial statements, we set aside € 1.3 million for circumstances that are classified as a significant or neutral risk.

▪ Opportunities
Every time the US dollar gains in value over our Group currency, the euro, our imported European products become cheaper for our customers in the USA. At the same time, there is the possibility that contracts that we post in US dollars, after conversion to our Group currency, result in higher amounts than if exchange rates had 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.

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
To reduce procurement costs, we continue to look for quality suppliers in Eastern Europe and Asia as part of a targeted process. Where we are able to source products more favourably than in the past, this helps to strengthen our competitive position in sales markets exposed to high levels of price pressure. In cross-functional teams, we look for ways of cutting our material costs, also pursuing technical approaches.

Since 2015 we have been using a supplier portal, which was tried and tested in Germany, to simplify the order process between KSB and its suppliers in Brazil, China, France, South Africa and the USA. We will also be integrating our Indian suppliers into this portal during the current year. By successively expanding our use of this platform, we can reduce the activities in our Group that do not create any value added.

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**

By permanently observing the market and technology, and keenly exchanging ideas and information in our international network with technology partners, customers and suppliers, we identify principles and approaches that enable us to offer new or extended services. In this way, KSB is able to ensure that its products are distinctive in a positive way and to improve market prospects.

In a continuation of our drive system and motor campaign, we are developing appropriate technologies for different individual cases. These can take the form of elementary components that improve the energy efficiency of our customers' systems and lead to us being awarded new contracts.

We are also working on Industry 4.0 projects with our customers and partners. These provide a foundation on which new business models can be developed. By harnessing modern production technologies, and making use of the digital value creation chain in particular, it will be easier for us to provide our customers with the right product at the right time. With this in mind, we are working to devise new logistics concepts and production technologies.

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 2015 consolidated financial statements, these amounted to just under € 1 million for significant or neutral risks, which was unchanged on the previous year.

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**

Based on a global environmental management system, we recognise in good time the hazards for humans and nature that may arise from our activities, and where necessary take protective measures. It gives us great opportunities to prevent damage and the financial consequences thereof. 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.

In 2015 we conducted energy audits at all of our major sites in Europe, complying with the implementation, at national level, of an EU regulation. Ultimately, this analysis revealed new potential for additional energy savings by renovating our production halls, through smart management of our production facilities and through instructions to the operators of the machine tools.

The newly revised ISO 14001 international environmental management standard has been in force since November 2015 subject to a three-year transitional period. As we have already started early in 2016 to have our production facilities certified in line with the new requirements, we have the opportunity to take account of new environmental protection aspects from an early stage and to present us to the public as a company that takes its responsibility for the environment and for society very seriously.

The trend towards greater environmental protection and higher energy efficiency will continue to have a positive influence on demand for our products and services. Customers can use our FluidFuture concept to reduce 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 and legal aspects

- **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.

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 2015 consolidated financial statements include about € 4 million for those cases classified as significant or neutral risks. We have also created provisions for litigation with authorities and for staff matters. These total a further € 1 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

Since 2014, we have made more use of online social media as a means of initiating contact with potential employees. These communication channels will increase our chances of finding a suitable selection of candidates and recruiting professionals internationally. At the same time, using these media we can target young people who are interested in apprenticeships, dual work / degree programmes or executive trainee programmes. We give them an insight via online media into the company's activities including social activities at KSB. This can increase the attractiveness of our company as an employer for key target groups, and improve our chances in the battle for the "best brains".

In 2015, we continued to renew our central infrastructure, as well as further standardising and automating our IT services. This will allow us to provide employees with the required services more cheaply and quickly.

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, for example, is important to KSB. Uncertainty regarding political risk is of great significance to the Pumps and Valves segments, and to a lesser degree to Service. The lack of certainty surrounding future oil prices and worsening payment morale 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. We would always expect benefits from an unexpectedly early recovery of the oil price. Conversely, a continuation of the political uncertainty, combined with persistent depreciation tendencies among some currencies or a permanently low oil price, would have a sustained 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. We see positive signs of this and thus better opportunities for our project business, despite possible currency uncertainties. 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 decrease their ability to pay in individual cases.

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

RISK REPORT ON THE UTILISATION OF FINANCIAL INSTRUMENTS

Central financial management in the KSB Group performs its duties within the framework of the guidelines laid down by the Board of Management. We base the nature and scope of all financial transactions exclusively on the requirements of our business and do not 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 € 254.0 million (previous year: € 235.0 million). Foreign currency items denominated in USD 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: € 60.6 million). Underlyings and hedge transactions share the same variable interest rates and maturities (1 to 3 years).

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, an economic slowdown in the growth markets as well as negative developments that could stem from the regions in Eastern Europe, the Middle East or parts of Africa experiencing political unrest present risks. 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 2016 will continue to be on the management of market risks. The Board of Management states that, based on the risk management system established by the KSB Group, at present there are no risks that could lead to a lasting and significant impact on the net assets, financial position and results of the KSB Group.

ACQUISITION-RELATED DISCLOSURES

A summary of the acquisition-related disclosures required by section 315(4) of the *HGB* [*Handelsgesetzbuch* – German Commercial Code] is given below and explanatory information is provided pursuant to sections 175(2) and 176(1) of the *AktG* [*Aktiengesetz* – German Public Companies Act]. Information is disclosed only to the extent that it applies to KSB AG.

KSB 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 at maximum 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 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 German Co-determination Act.

CORPORATE GOVERNANCE STATEMENT (SECTION 289A OF THE HGB)

The Corporate Governance Statement pursuant to section 289a of the *HGB* [*Handelsgesetzbuch* – German Commercial Code] dated 30 March 2015 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 2016.

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. For the first time, the updated Statement will also include the following information on the gender-specific staffing of executive positions:

The aim of the Act for the Equal Participation of Women and Men in Executive Positions in Private Industry and Public Service, which entered into force in 2015, is to create more equal opportunities in the world of work and to significantly improve the proportion of women in management positions. For KSB AG, in its capacity as a listed company pursuant to section 3(2) of the *AktG* [*Aktiengesetz* – German Public Companies Act] and a company that has co-determination based on parity in accordance with the *Mitbestimmungsgesetz* [German Co-determination Act], fixed gender quotas of 30 % in each case apply to the inclusion of women and men in the Supervisory Board pursuant to section 96(2) *AktG*. To date, two women are on our Supervisory Board, one as a shareholder representative and one representing the employees. This means that the proportion of women on the Supervisory Board is just below 17 % and therefore not yet in line with the quota.

At its meeting on 11 September 2015, the Supervisory Board set its target quota of women for the Board of Management at zero percent by 30 June 2017, which corresponds to the current situation. On 22 September 2015, the Board of Management stipulated the targets for the proportion of women in the two management levels below it, with these also to be achieved by 30 June 2017. Based on these targets, at least the current proportions are to be retained, i.e. zero percent with regard to the top level and 10.4 % in the management level below that.

In order to improve the situation in the interests of promoting women, and to make it easier for employees to reconcile working and family life, KSB has developed various offers. For many years now, KSB AG has provided support in relation to child care for different ages of children. Advisory services are also provided with regard to looking after relatives who are in need of care. Both of these offers are complemented by flexible working time models for men and women.

As part of measures to secure the supply of young talent for executive positions, we make a targeted effort to fill attractive vacancies with women. As a result of these measures, just under 30 % of the new junior managers appointed were women. Like their male colleagues, they receive targeted mentoring from managers immediately below the Board of Management level. Global human resources controlling is used to monitor the development of the proportion of women employed in the different countries.

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 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.

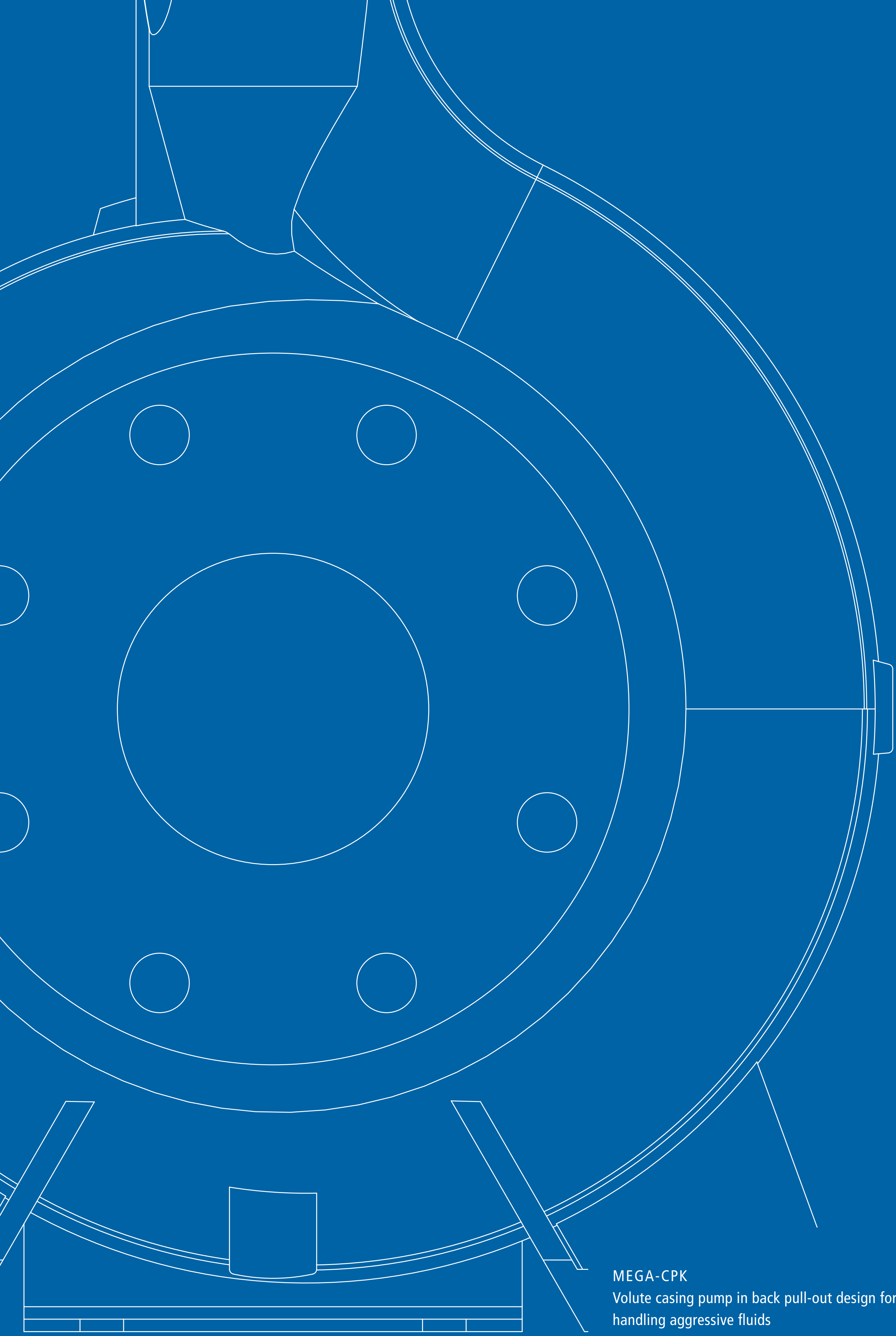
Furthermore, when Board of Management contracts are concluded it is agreed that payments made to a Board of Management member in the event of his or her Board of Management tenure being terminated prematurely without good reason shall not exceed the value of two years' remuneration including fringe benefits (settlement cap in accordance with item 4.2.3 of the German Corporate Governance Code). No other payments have been promised to any Board of Management members in the event of termination of service; similarly no compensation will be paid in the event of a takeover offer. If 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 2015 financial year amounted to € 1,289 thousand (previous year: € 1,427 thousand), and the payments for benefits after termination of work € 1,429 thousand (previous year: € 2,011 thousand). € 4,518 thousand (previous year: € 4,386 thousand) has been provided for pension obligations to current members of the Board of Management, and € 39,387 (previous year: € 41,861 thousand) to former members of the Board of Management and their surviving dependants; total benefits paid to these persons amounted to € 2,246 thousand in the year under review (previous year: € 2,232 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 € 833 thousand for the 2015 financial year (previous year: € 944 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, 17 March 2016

The Board of Management



MEGA-CPK
Volute casing pump in back pull-out design for handling aggressive fluids