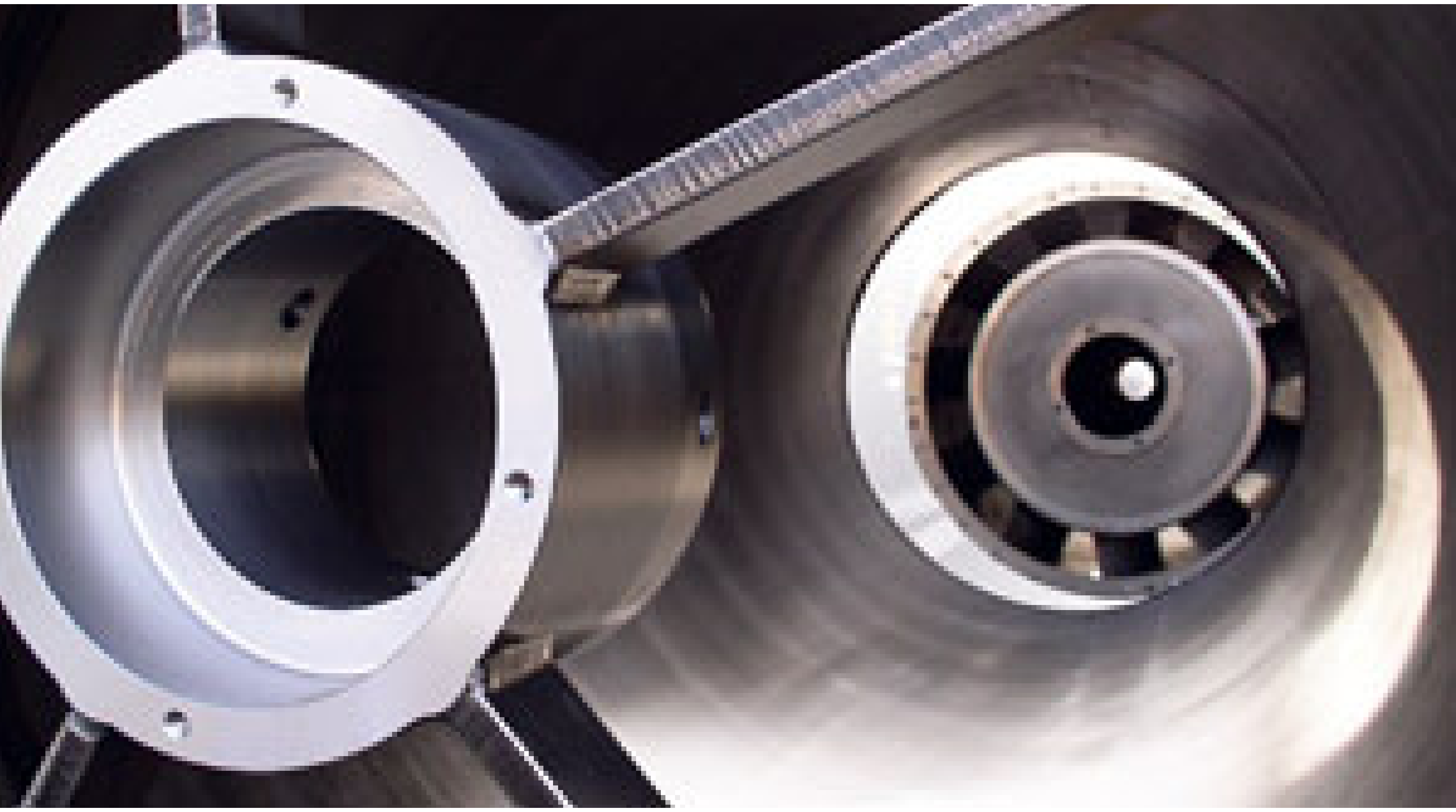
KSB Group

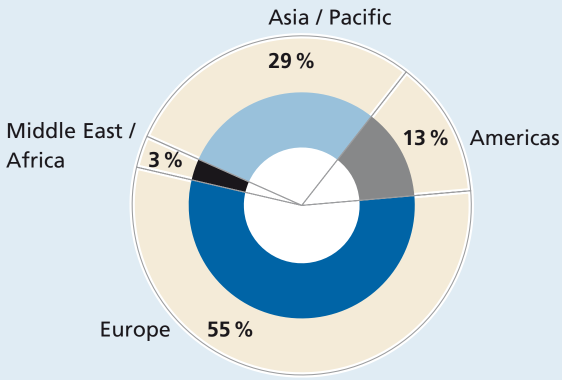
Annual Report 2006



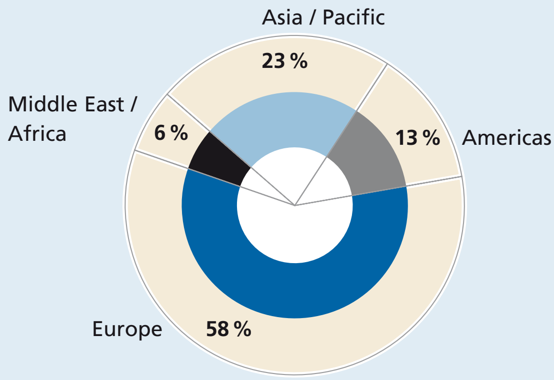
GROUP FINANCIAL HIGHLIGHTS

		2006	2005	2004	2003	2002	2001
EARNINGS							
Sales revenue	€m	1,607.4	1,401.4	1,266.8	1,178.1	1,180.2	1,161.9
Earnings before interest and taxes (EBIT)	€m	100.2	41.4	33.6	39.7	43.9	36.8
Earnings before taxes (EBT)	€m	90.2	29.6	22.1	29.8	34.3	26.9
Net profit for the year	€m	62.4	19.8	14.7	18.7	19.6	14.1
Cash flow	€m	101.2	71.0	59.5	63.1	60.3	52.8
BALANCE SHEET							
Balance sheet total	€m	1,145.8	1,054.6	982.6	926.5	859.3	909.7
Fixed assets	€m	301.2	287.3	261.2	270.1	234.2	248.5
Capital expenditure	€m	46.5	45.2	33.7	60.4	31.3	29.0
Depreciation and amortization expense	€m	33.2	34.2	33.2	30.2	30.0	32.8
Current assets	€m	815.5	737.0	693.8	633.0	604.4	645.7
Equity (including minority interest)	€m	443.8	390.0	354.8	346.0	355.8	367.6
Equity ratio (including minority interest)	%	38.7	37.0	36.1	37.4	41.4	40.4
PROFITABILITY							
Return on sales	%	5.6	2.1	1.8	2.5	2.9	2.3
Return on equity	%	21.7	8.0	6.3	8.5	9.5	7.4
Return on capital employed	%	9.6	4.4	3.9	4.9	5.5	4.7
EMPLOYEES							
Number of employees at 31 Dec.		13,063	12,963	12,467	12,281	11,948	12,071
Staff costs	€m	521.7	508.5	477.4	450.5	428.6	420.3
SHARES							
Market capitalization at 31 Dec.	€m	657.1	252.9	212.9	211.9	140.2	142.7
Earnings per ordinary share (EPS)	€	27.99	5.85	4.16	6.74	8.52	5.19
Earnings per preference share (EPS)	€	28.51	6.88	5.19	7.26	8.78	5.45
Dividend per ordinary share	€	2.00	–	–	2.50	4.00	4.00
Dividend per preference share	€	2.52	1.03	1.03	3.02	4.26	4.26

Employee population by region



Sales revenue by sales region



The KSB World

The KSB Group is on hand in over 100 countries. With sales companies, offices, agencies and 32 manufacturing sites.

Products and Services

Industry

Pumps and valves, as well as associated control and drive systems; installation, commissioning, start-up, inspection, servicing, maintenance and repair services

Building Services

Pumps and valves, pressure boosting and sewage lifting units, associated control and drive systems for use in domestic water supply, drainage, heating, and air-conditioning systems; installation, commissioning, start-up, inspection, servicing, maintenance and repair services

Water

Pumps and valves, pressure exchangers, associated control and drive systems, as well as water transport subsystems; installation, commissioning, start-up, inspection, servicing, maintenance and repair services

Waste Water

Pumps, mixers, associated control and drive systems, as well as waste water transport installations and subsystems; installation, commissioning, start-up, inspection, servicing, maintenance and repair services

Energy

Pumps and valves, as well as associated control and drive systems for use in power stations and district heating systems; installation, commissioning, start-up, inspection, servicing, maintenance, repair and rehabilitation services

Mining

Slurry pumps for use in the mining industry and on suction dredgers, as well as installation, commissioning, start-up, inspection, servicing, maintenance and repair services

SALES REVENUE DEVELOPMENT BY GEOGRAPHIC AREA

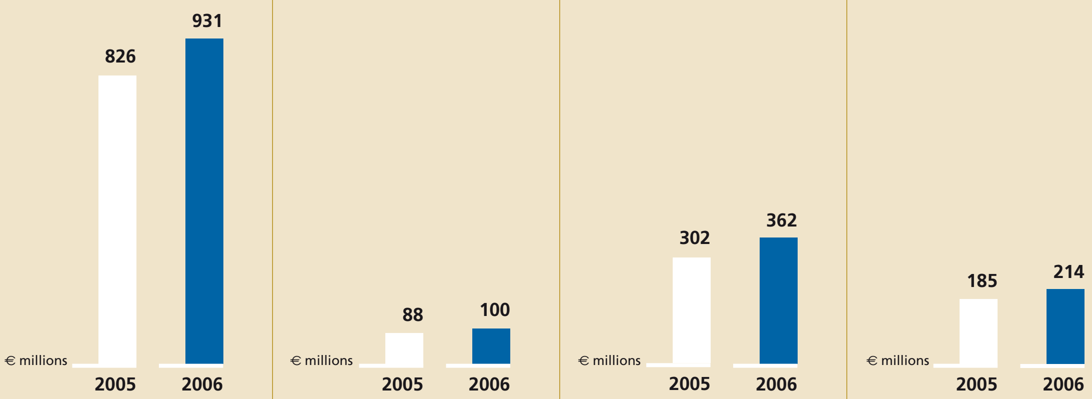
(See segment reporting on pp. 64 / 65)

Europe + 12.7 %

Middle East / Africa + 14.1 %

Asia / Pacific + 19.9 %

Americas + 15.5 %



Company Profile

Reliable and economical fluid transport is our métier. KSB is a leading international supplier of innovative pumps, valves and systems. All around the world, we provide first-class products and excellent service for energy and industrial applications, water and waste water transport, building services and mining.

A Look Back at 2006

New sales centre in Russia

January

- **KSB OOO, Moscow, which was established in 2005,** inaugurates its first sales centre in St. Petersburg. Further branches follow in Novosibirsk and Jekaterinburg in the course of the year.

Company building in Wilrijk (Belgium)

February

- **KSB Service adds to its range of services** in Belgium with the acquisition of On Site Services bvba in Wilrijk (Antwerp). KSB now has 72 service centres in Europe.

Cooling water pump for Chinese power plant

March

- **The largest cooling water pumps the company ever built** are delivered to the Yuhuan power plant in China. The units tower to a height of 18 metres and weigh 130 tonnes.
- **Golden jubilee for KSB Belgium S.A. in Wavre.** Staff and guests celebrate the 50th anniversary of this sales and marketing operation.

June

- **The implementation of a new production system for industrial pumps** in Pegnitz is successfully completed after two years.

Redesigned industrial pumps production

August

- **One of the largest slurry pumps ever built leaves the KSB subsidiary GIW Industries Inc.** in USA for Mongolia. The unit is being used in the Erdenet copper mine to pump sludge and rock at a rate of 15,000 cubic metres an hour.

Slurry pump for Mongolia

September

- **The Chinese valves company KSB Valves (Shanghai) Co. Ltd. starts production.** With a staff of initially 30, it manufactures standardized gate, globe and check valves for the industry segment.
- **For the world's most advanced lignite-fired power plant,** KSB wins an order to supply boiler feed pumps that are among the most powerful of their kind in the world.

Production start-up in Shanghai

Inauguration of new company building in the Czech Republic

KSB at ACHEMA

April

- **New Chairman of the Supervisory Board** is Dr. Hans-Joachim Jacob.
- **Two new members take a seat on the Board of Management:** Heinz-Jürgen Otto is appointed Chairman, and Dr. Wolfgang Schmitt takes over the commercial functions.
- **In the Czech Republic and Finland, new company buildings** are opened by the local subsidiaries.
- **The most powerful water pumps in the history of KSB** are ordered by a customer for flood control in Great Britain. Six units with a drive rating of 1.25 megawatts will each be pumping about 100,000 litres per second from 2007 onwards.
- **With its LevelControl, KSB launches a new system for regulating fluid levels** in industrial applications and building services.

May

- **At the ACHEMA trade fair in Frankfurt,** attended by 180,000 visitors from 98 countries, KSB presents its products for the chemical and petrochemical industries. The stand team makes more than 2,000 customer contacts.
- **In the Pegnitz foundry, Bavaria's Minister for the Environment inaugurates the new moulding plant.** It replaces two old systems and allows fast, low-cost and environmentally acceptable moulding processes.

October

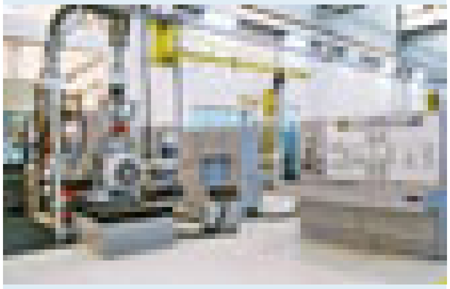
- **KSB S.A.S. wins the largest order for valves in the history of the company.** It involves the delivery of 215 pipeline butterfly valves with diameters of up to 3.5 metres to supply cooling water for an industrial area in Qatar.
- **The most versatile pump test field in Latin America** starts operations at KSB's Várzea Paulista site in Brazil. It has a pumping capacity of 20,000 cubic metres per hour and features nine test stations.

November

- **10,000 valves and 500 pumps** from KSB are used in a building complex in Zurich's new "Sihlcity" district.

December

- **Delivery of pumps and valves for the world's largest multiple effect distillation plant** on the Persian Gulf. The desalination process is designed to produce 270,000 cubic metres of fresh water a day. The largest of the 600 KSB butterfly valves supplied have a diameter of three metres.
- **Dr. Wolfgang Schmitt is appointed Chairman of the Board of Management.** At the same time, the Supervisory Board appoints Dr. Peter Buthmann and Prof. Dr. Dieter-Heinz Hellmann to the Board of Management with effect from 1 January 2007. Dr. Willi Enderle remains a member of this Board. Heinz-Jürgen Otto leaves the company after 9 months.



Pump test field in Brazil

Shopping mall in "Sihlcity"

Butterfly valves for desalination plant

Interview with Dr. Wolfgang Schmitt,
Chairman of the Board of Management

"Act with an eye to the future, and improve every day"

Dr. Schmitt, you joined the KSB Board of Management in April 2006, and took on the Chairmanship last December. Two other members of the four-man Board of Management have also joined within the last few months. Does this herald a major shift in company policy?

KSB definitely does not need to change its business approach abruptly. However, we do see clear potential for positive alterations. We are taking up those opportunities with a Board of Management whose members all have extensive experience at KSB. My colleagues and I know the company's strengths well. Our aim is to use all its resources in the best possible way. That will make KSB sustainably more successful in the marketplace, and more profitable.

The company currently seems to be heading in the right direction. Sales revenue and earnings both leapt up in 2006, and the share price has shot to new heights. Where has this business success come from?

2006 was indeed a successful year. There is no doubt that booming demand in several of our markets contributed to that in large measure. But KSB also worked very hard to be faster, better and more successful. We have, for example, considerably improved our productivity over the last three years. That enabled us to take on a massive increase in orders in 2006, without immediately having to recruit lots of new employees.

Where do you see further potential for success?

In the mid-term, demand from our main markets will continue to rise. At the same time, we shall also need to work in different ways. We want to react to shifting requirements faster than our competitors, and to make even more effective use of our global resources.

What does that mean in practical terms?

More than ever, today's customers work on a global scale. We have to partner with them in several different places. Let's assume Italian engineers are planning a water pumping station in Abu Dhabi. We have to gear ourselves to their needs in a range of countries. An expert from KSB Italia provides technical advice. Then perhaps we get KSB Brazil to produce good-value water pumps. The energy-saving automation technology comes from Germany, while the station operators arrange a suitable service contract with our staff in the Emirates. That is one of the goals that my Board of Management colleagues and I want to achieve: seamless interaction of all our resources around the world in order to perfectly serve our customers' every need.

"KSB has to achieve seamless interaction of all its resources around the world."

“We want to raise our productivity further, continue to streamline the range, and improve our customer orientation.”

Shareholders tend to measure companies more by their numbers than on customer satisfaction. How do you anticipate revenue and return on sales developing now?

Let us be perfectly clear: good business results depend on satisfied customers. Our shareholders will enjoy reading the 2006 Financial Highlights rather more than in previous years. We want sales revenue to be at € 1.9 billion by 2010. Last year, we increased it by € 206 million to more than € 1.6 billion. We also achieved our targeted improvements in efficiency by the end of 2006, right on schedule. Those enabled us comfortably to exceed our projected 5 % return on sales.

Are you happy with that?

As far as 2006 is concerned, definitely. After all, the 2005 return on sales was only 2.1 %. But it’s like climbing mountains: once you’ve stood on top of a “5000” still feeling fit, you wonder if the view isn’t just that bit more rewarding from a 6000- or 7000-metre peak.

You mentioned the Efficiency Enhancement Programme that ran to the end of 2006. This involved considerable restructuring costs. They affected several years’ balance sheets. What is next around the corner?

House owners all know it is better not to postpone repairs too long. Otherwise you suddenly face major renovation, which ends up much more expensive. KSB is factoring in some resources for necessary “repair work” in the near future. The intention is to avoid major restructuring. We have, for instance, identified a number of small areas where we need to “get the builders in”. We will have to lift unprofitable products back into the black, or if necessary discontinue them. Overall, however, we want to take the path of continuous improvement. That means learning from little mistakes and big ones, acting with an eye to the future, and getting better every day. Which is all less spectacular than multi-million restructuring programmes, but twice as effective.

What goals have you set yourself along this path for 2007?

We certainly want to raise our productivity further, continue to streamline the range, and improve several aspects of our customer orientation. We are also putting the company’s full strength behind our overall goal for 2007: profitable growth.

Dr. Wolfgang Schmitt
is Chairman of the Board of Management and Human Resources Director. He took on responsibility for Finance and Accounting, Human Resources, Controlling, Purchasing, IT Management, Communications, Legal Affairs and Corporate Development on 1 January 2007.

Dr.-Ing. Peter Buthmann
joined the Board of Management on 1 January 2007. He is responsible for Production, Service, Internal Audits and Integrated Management Systems.

Prof. Dr.-Ing. Dieter-Heinz Hellmann
became a member of the Board of Management on 1 January 2007. He is responsible for Product Management and Product Development.

Dr.-Ing. Willi Enderle
took charge of Sales and Marketing on 1 January 2007.

Dr. Hans-Joachim Jacob,
Chairman of the
Suvervisory Board

REPORT OF THE SUPERVISORY BOARD

The Supervisory Board fulfilled the duties assigned to it by law and the Articles of Association in financial year 2006. It supervised the management of the Company by the Board of Management and advised it regularly on corporate management issues. The Supervisory Board was directly involved in decisions of fundamental importance. The Board of Management informed the Supervisory Board promptly in comprehensive written and oral reports about relevant corporate planning and strategic development issues. The same applied to the position of the Group, including its risk position, and to business policy and significant business transactions. The Board of Management commented in detail on any departures in business developments from the formulated plans and targets. Between meetings of the Supervisory Board, its Chairman was in regular contact with the members of the Board of Management, and in particular with the latter's Chairman, discussing strategic issues and obtaining information about current business developments and significant transactions.

Where required by law and the Articles of Association, the Supervisory Board voted on any reports and proposals by the Board of Management after studying and discussing them thoroughly. If required, the Supervisory Board adopted its resolutions in writing.

Main focus of work in full Supervisory Board sessions and in the committees

Five Supervisory Board meetings were held in the year under review. The regular plenary meetings dealt with the reports on the business development of KSB Aktiengesellschaft, the Group and the individual business segments, in particular in terms of order intake, sales revenue, earnings, financial and employment trends. The main topics of the discussions in the past financial year included the progress of the current structural programme to improve earnings and the status of the implementation of a new production system. In view of the substantial rise in order intake, the Supervisory Board requested regular reports on the overall production situation and on the measures taken to optimize it. It also intensified consultations with the Board of Management to coordinate fundamental strategic issues and thus provide a basis for updating the requirements and the perspectives for the long-term orientation of the Company. In October, the Supervisory Board met at our French location in La Roche Chalais; members could thus gain an insight into the development of business activities in France, and review selected product development projects. The Supervisory Board devoted time on several occasions to an in-depth examination of acquisition proposals, particularly within the Service area. In the absence of the Board of Management, the Supervisory Board addressed the review of its own efficiency in order to be able to use the results to further improve the quality of its work, as well as personnel issues.

The Supervisory Board established five committees, to which shareholder and employee representatives were appointed. The Committees presented detailed reports on their meetings and their work at plenary meetings of the Supervisory Board.

The Planning and Finance Committee met three times and dealt with preparation of the budget for 2007 and medium-term planning. The Committee discussed at several meetings an investment in the Engineered Pumps section that the Board of Management requested for 2007 and which, in view of its scale, had to be thoroughly discussed in plenary meetings of the Supervisory Board.

The Personnel Committee, which is primarily responsible for arranging the service contracts with the members of the Board of Management and for other matters relating to the Board of Management, met five times, dealing in great detail with new appointments to the Board of Management. In addition to personnel and contractual issues, the Committee also discussed fundamental aspects of the remuneration arrangements and the level of remuneration for the Board of Management. Personnel development issues also formed part of the work of this Committee.

The main topics of the five meetings of the Audit Committee were the selection of the areas of emphasis for the audit of the annual financial statements of KSB Aktiengesellschaft and the consolidated financial statements, the critical scrutiny of the financial statements and of the planning, the continuous monitoring and development of the existing risk management system, and of the work of the internal auditors. The Audit Committee also prepared the efficiency review carried out by the Supervisory Board. The auditors attended these meetings for some of the time.

The Strategy Committee, newly formed in the past financial year, met six times. It coordinates the consultation process between the Board of Management and the Supervisory Board in carrying forward and updating the strategy and prepares the input to be provided by the Supervisory Board for this purpose.

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

Corporate governance and statement of compliance

The Board of Management and the Supervisory Board have closely monitored changes in the German Corporate Governance Code. They issued an updated statement of compliance in accordance with section 161 of the AktG (Aktiengesetz – German Public Companies Act) on 14 December 2006 and made it available to the shareholders on the Company's web site. The Company complies with the recommendations of the Code in the version dated 12 June 2006 apart from a handful of exceptions. The Board of Management and the Supervisory Board report on corporate governance at KSB in accordance with section 3.10 of the German Corporate Governance Code on pages 96 ff. of the annual report.

Audit of the annual and consolidated financial statements

KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Mannheim, Germany, audited the annual financial statements of KSB Aktiengesellschaft for the year ended 31 December 2006 prepared by the Board of Management in accordance with the provisions of the HGB (German Commercial Code), the consolidated financial statements and the management reports on the Company and the Group. The auditors were appointed by a resolution of the Annual General Meeting on 22 June 2006 and engaged to perform the audits by the Supervisory Board. In accordance with section 315a of the HGB, the consolidated financial statements were prepared in accordance with IFRSs (International Financial Reporting Standards). The areas of emphasis of the audit were the correct definition of the consolidated Group, the regularity and propriety of the annual financial statements included in the consolidated financial statements and their compliance with IFRSs, and the uniform accounting policies applied in the Group. Other areas of emphasis included the appropriate application of new and amended IFRSs, the computation of deferred taxes, hedge accounting, the completeness and accuracy of the information provided in the consolidated financial statements and the reasonableness of the forecast information in the Group management report.

The auditors did not raise any objections to the annual financial statements of KSB Aktiengesellschaft, the consolidated financial statements of the KSB Group and the management reports on the Company and the Group for financial year 2006, and issued each of them with an unqualified audit opinion. The accounting documentation and the auditors' reports submitted by the auditors were provided in good time to all members of the Supervisory Board. They were discussed in great detail by the Audit Committee on 23 March 2007 and at the meeting of the Supervisory Board on 12 April 2007. The auditors attended the meetings of both bodies. They reported on the material findings of the audits and were available for supplemental information. Following its own examination, the Supervisory Board concurred with the audit findings and approved both the annual financial statements of KSB Aktiengesellschaft and the consolidated financial statements, in both cases at the recommendation of the Audit Committee. The annual financial statements are thus adopted. The Supervisory Board concurs with the proposal on the appropriation of net retained earnings of KSB Aktiengesellschaft submitted by the Board of Management.

The management reports on the Company and the Group contain information on the disclosures in accordance with section 289(4) and section 315(4) of the HGB; the Supervisory Board has reviewed and adopted the information provided.

Dependent company report

The auditors also audited the dependent company report prepared by the Board of Management in accordance with section 312 of the AktG. The auditors issued the following unqualified opinion on this report:

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

1. the actual amounts and disclosures in the report are correct;
2. the consideration paid by the Company for the transactions listed in the report was not inappropriately high, or disadvantages were compensated;
3. there are no circumstances relating to the measures listed in the report that would indicate an assessment that is materially different from that of the Board of Management."

The reports by the Board of Management and the auditors were provided in good time to all members of the Supervisory Board and were discussed by the Audit Committee and at plenary meetings. The auditors attended the meetings of both bodies, reported on the material findings of the audit and were available for supplemental information. Both at the recommendation of the Audit Committee and following its own examination, the Supervisory Board does not raise any objections to the findings of the audit and the statement by the Board of Management at the end of the dependent company report.

Composition of the Supervisory Board and the Board of Management

A number of changes occurred to the composition of the Board of Management and the Supervisory Board in the year under review:

On 31 March 2006, Peter Schubert left the Company at the end of his fixed-term appointment to the Board of Management by the Supervisory Board. Heinz-Jürgen Otto succeeded him and took over the duties of Chairman of the Board of Management and Human Resources Director. On 6 April 2006, Dr. Alois Wittmann resigned from the Board of Management. His Finance responsibilities were assumed by Dr. Wolfgang Schmitt who was appointed member of the Board of Management by the Supervisory Board with effect from 7 April 2006. Mr. Otto left the Company again on 14 December 2006.

As part of the reorganization of the Board of Management, Dr. Schmitt was appointed Chairman of the Board and Human Resources Director on 14 December 2006; Supervisory Board members Dr. Peter Buthmann and Professor Dr. Dieter-H. Hellmann were appointed to the Board of Management with effect from 1 January 2007 with responsibility for Production and for Product Development and Management; responsibility for Sales was delegated to Dr. Willi Enderle from this date.

On the Supervisory Board, Heinrich Dieter Müller took the seat of the retired Hermann Reutter on 1 January 2006. The term of office of Ludwig Udo Kontz was extended by court order dated 4 April 2006; the Annual General Meeting held on 22 June 2006 appointed Mr. Kontz member of the Supervisory Board until the 2008 Annual General Meeting. As successor to Horst Kuschetzki, who resigned office in a letter dated 18 March 2006, Professor Dr. Dieter-H. Hellmann was appointed member of the Supervisory Board by the court on 14 June 2006.

Owing to their move to the Board of Management, Dr. Buthmann and Professor Dr. Hellmann resigned from the Supervisory Board on 31 December 2006. As representative of the executives, Carl-Wilhelm Schell-Lind succeeded Dr. Buthmann on the Supervisory Board on 1 January 2007. The seat of Professor Dr. Hellmann was taken by Dr. Hermann Nestler who was appointed member of the Supervisory Board by the court on 11 April 2007. Since the fixed term of office of Richard Lederer as Chairman of the Supervisory Board expired on 6 April 2006, Dr. Hans-Joachim Jacob has exercised this role.

No conflicts of interest relating to members of the Supervisory Board were disclosed in the year under review. When selecting new members, attention was paid to ensure that they have neither a personal nor a business relationship with our Company that could give rise to a conflict of interest.

The Supervisory Board extends its gratitude to the retiring members of the Boards for their commitment and constructive work to further the best interests of the Company. The Supervisory Board would also like to thank the Board of Management, all employees and the employee representatives for their commitment and conscientious work during the year under review. They all contributed to KSB’s very successful financial year.

Frankenthal, April 2007

The Supervisory Board

Our technology meets the challenges of tomorrow

Human beings everywhere are finding it harder and harder to ensure the basics of daily life. Drinking water, energy and raw materials all need to be in the right place, in the right quantity, at the right price.

Supplying and disposing of fluids is an increasing challenge, worldwide. KSB products form an important part of the answer. We view that as a long-term opportunity – and obligation. KSB is a global player. Some 13,000 employees in over 100 countries turn customers' needs into reality. We are where they are, committed together.

The challenge of water supplies

Take water supplies, for example. World population is growing rapidly. More than a billion people have no regular access to clean water. Global demand for water supply and disposal facilities is expanding by the day. KSB products and services help get infrastructure in place, and extend it. In many regions, water shortages make seawater desalination a crucial technology. The United Arab Emirates already meet around one third of their fresh water needs this way. Making the Persian Gulf drinkable, however, is a task for experts. KSB supplies pumps and valves, as well as a special system that reuses some of the energy required for desalination.

We also help meet the challenges of the future in other ways. Waterworks, pipeline stations and well networks tap into water sources around the world. KSB then ensures that the water gets to the people who need it – sometimes hundreds of kilometres away. Another key task is to keep the available water clean. Ideal disposal is part of the story. KSB's extensive know-how helps make the world's most important fluid available to more people everywhere, in the quantity and quality they need.

In many regions of the world, supplying fresh water will be just as much a concern for us in the years ahead as disposing of waste water. Expanding efficient energy supply systems will be another key focus of our activities. So will reliable fluid transport in industry and building services. Hydraulic transport of solids will be another priority on our list. We want to be top performers in all these areas. The benefits are three-fold: successful customers, a secure future for KSB and improved living standards for many people across the globe.

Big cities and rural communities have a lot in common: their inhabitants' health depends heavily on clean drinking water and proper disposal of waste water.

Global energy needs are increasing

Water is one vital variable in the complicated equation called "the world's future". Another one, similarly crucial, is energy. Rising population means rising energy needs. The world has to meet that demand as efficiently as possible. Modern life depends on it more than ever. So intelligent use of energy is more important than ever. KSB provides the innovative products and solutions to match. Energy transport, highly efficient components and alternative technologies are all part of our expertise.

High-efficiency pumps can considerably reduce industrial energy consumption. Industry uses about 30 % of its electricity just to run pumps. In Germany alone, experts estimate that pump systems could save about 15 billion kWh every year. KSB keeps developing its pumps, automation technology and service so that plant operators can benefit even more from the savings potential. We shall continue to invest our experience and innovative skills in this area.

Top-range power stations put conventional efficiencies in the shade

KSB subsidiaries provide know-how and products to energy companies all over the world. Huaneng Yingkou is China's first "supercritical" power station. This type of facility offers the maximum efficiency currently possible. KSB is supplying the power station pumps, as well as special corrosion-resistant pumps for the seawater desalination plant. This will provide the necessary fresh water for the power station's circuits. The Huaneng Yingkou desalination unit uses a physical separation process known as reverse osmosis. Multistage pumps generate a pressure exceeding the osmotic pressure and force seawater along a membrane. Part of the water passes through the membrane and is drained off downstream as fresh supplies. The salt remains in the fluid upstream of the membrane.

Tomorrow's drops count double

No fresh water, no life. It's as simple as that. But less than 1 % of the earth's water is actually drinkable. UNESCO predicts that by 2025, global water consumption will reach 2,764 cubic kilometres per year. Today, mankind already needs 12 billion litres every day just to quench its thirst. Nature has distributed fresh water supplies very unevenly. Many parts of the world face shortages. KSB products help to provide water economically, clean it and transport it.

Energy demands are rising. So suppliers worldwide are opening up new natural gas fields. This valuable source of energy travels by pipeline or ship. Key importers include modern combined cycle power stations. They use the gas to drive their turbines. And whether they are taking this fossil fuel around the world or generating energy efficiently, transporters and customers alike use KSB pumps and valves to do so.

Your lungs want clean air

Germany, like many other countries, has shown that "clean air" legislation improves the environment. Energy companies have made a major contribution by fitting coal-fired power plants with flue gas purification units. But what about other parts of the world? China is a case in point. To meet the huge energy needs of 1.2 billion people, the country is building about 30 new coal power stations per year. Together, coal-fired plants generate some 70 % of China's electricity. The booming economy and rapid increase in traffic have drastically raised pollution levels. The Chinese government is endeavouring to limit emissions. Flue gas desulphurization systems have been compulsory in new power stations for several years now. Existing plants have to retrofit them. Equipping power stations with these systems requires highly specialized scrubber pumps. KSB supplies these, and develops some of the special materials in house.

They may be raw, but the world would be cooked without them

When you finish reading this paragraph, the world's population will have increased yet again. The pressure on major conurbations is rising by the minute. They need more and more high-performance pumps and valves to heat buildings, run the air-conditioning, provide drinking water and remove waste water. Population growth also increases the demand for industrial goods. KSB helps customers on every continent build and extend the facilities that manufacture them.

Demand for important raw materials is accelerating worldwide. The resources, however, are finite. To raise their production, mines in Latin America, Asia, Australia or Russia all need pumps for underground water, and for hydraulic transport of solids like ores and tailings. In 2006, the Erdenet copper mine in the Mongolian province of Bulgan took delivery of one of the largest slurry pumps ever built. It can move up to 15,000 cubic metres of tailings every hour. Mining is Mongolia's economic mainstay, and is now increasing its output with modern technologies. The giant slurry pump comes from KSB.

Quality of life is like a breath of fresh air

The environment is under pressure from every direction. Traffic is increasing everywhere and industrial exhaust gases are damaging the world's vulnerable atmosphere. Wherever possible, emissions are to be avoided. Cleaning the flue gases in coal-fired power stations makes a big difference. In many such facilities, KSB pumps transport highly abrasive limestone suspensions, also termed lime milk. These are sprayed into the hot exhausts from the power station and absorb the sulphur dioxide contained in the emissions, forming gypsum as a by-product. In this setting, pump casing and impellers have to cope with highly abrasive and corrosive substances. The KSB answer is pumps made of special alloys like Noridur duplex steel, developed in the company's own labs in Pegnitz, Germany.

Tankers carry liquefied natural gas for modern power stations. Both rely on KSB.

Our pump technology also helps Canada tap its huge oil sand reserves. Extracting and processing the oil both have to be as economical as possible. The sand lies between 30 and 60 metres underground. Instead of unreliable conveyor belts, the oil companies use pipelines. Special highly abrasion-resistant pumps transport the valuable sand, mixed with water, to the extraction plants.

When squeezing resources ensures they get there

By the year 2030, gas power stations will supply almost half the world's electricity needs. Where it is not feasible to transport the gas via pipelines, special tankers deliver it by sea. They carry the natural gas as a liquid, cooled to minus 162 °C and compressed to one six hundredth of its original volume. The liquefied gas is highly explosive. Transporting it safely requires specially designed valves that also shut at extremely low temperatures. KSB supplies these, as well as a new, multi-functional coupling system for filling the tankers out at sea. Terminals on shore then convert the liquefied gas back into gas and feed it into the supply system. By the end of this decade, the energy sector could be transporting about ten billion cubic metres of natural gas this way. As oil reserves decline, gas will gain in importance. Europe, for example, will increasingly use liquefied gas tankers to avoid over-dependence on single suppliers. And that means more use of our special valves, on which this transport method depends.

Filling the tank with renewables

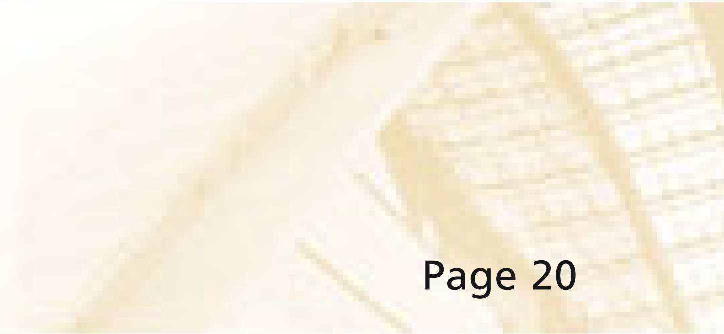
One day, the world will run out of fossil fuels. Fortunately, there are alternatives that make both economic and ecological sense: biofuels. These include biodiesel, rape oil, ethanol and methane from biogas. KSB pumps are hard at work in biodiesel refineries: transporting raw materials, additives and the final product. Biofuels are similar in many ways to petrol and traditional diesel. Engine conversion is straightforward. Apart from biomethane, "green" fuels are liquid. So they are easy to store, move and sell via the existing petrol station network. Another point in their favour is that they produce almost as much energy as conventional fuels. Drivers can thus go virtually as far on the same tank. The European Union's action plan aims to increase renewable fuels' share of overall consumption significantly by 2010.

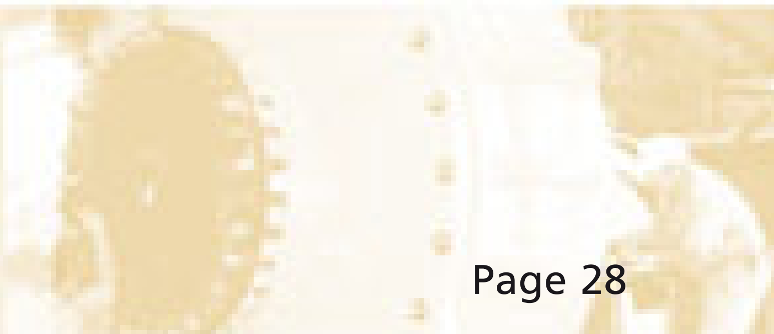
Electricity from biomass protects the environment and resources

As global energy needs increase, fossil fuel reserves dwindle and the climate changes, alternative sources of power are more important than ever. More and more electricity now comes from renewable sources. By 2010, the European Union aims to cover 12 % of its entire energy needs this way. One environmentally friendly alternative to oil is biomass, based on plants. Generating electricity from biomass is still a relatively new approach, compared with plant use for heating. The technique applied is similar to that in coal-fired power stations: the biomass just replaces coal as the fuel to produce steam. And in both cases, KSB has the pump technology to match.

Fuels of the future grow on farms

Oil reserves are finite. "Greenhouse" gases cause increasing global warming. Utilities already generate a sizeable percentage of heat and electricity from renewable energy sources. Industry remains heavily dependent on fossil fuels – but substitution is possible. Biofuels from plant oils, cereals, wood and other renewable materials are a real alternative. They protect the environment, because burning them only releases as much carbon dioxide as the plants bind from the atmosphere. In Germany, for instance, biofuels already account for about 2 % of total fuel consumption. Experts predict that this will rise to some 25 % by 2020. Bioethanol is likely to play a central role. Suppliers extract this from plants rich in starch or sugars. The German state of Saxony-Anhalt is home to a refinery currently producing 260 million litres of bioethanol per year. KSB supplied over 100 pumps and more than 1000 valves to transport ingredients and intermediates for this "green" fuel.





Industry

- Strong demand in the industry market
- Cryogenic valves for liquefied gas transport
- New products for process engineering and flue gas purification

In 2006, the most important market for high-quality KSB pumps and valves was once again the industry segment. Our companies supplied producers as well as engineering contractors and original equipment manufacturers worldwide. Customers ordered our products for a broad range of applications, from general industrial requirements through chemical and process engineering to the oil industry and marine engineering.

In all these market sections, our companies profited in 2006 from a vigorous growth in demand. We posted an increased order intake in all Regions, including our important home market of Europe, where there has been a visible revival of investment activity by industrial companies.

Outside Europe, the construction and expansion of chemical plants and refineries continued. New capacity for chemical production was developed mainly in the growth countries of Asia. The oil-producing countries of the Middle East focused on building new refineries and petrochemical plants or expanding existing ones. We engaged in these projects with the supply of standardized chemical pumps and process engineering valves, as well as refinery pumps to the latest API standard.

Qatar steps on the gas: This small country on the Persian Gulf sits on top of the world's second-richest natural gas reserves. Ras Laffan Industrial City is the heart of the local gas industry. It will soon have one of the largest seawater cooling systems on earth, keeping temperatures securely down in a gas liquefaction plant. KSB is supplying a new unit with more than 200 Mammouth butterfly valves. Their diameters range up to 3.5 metres.

Liquefaction plants cool gas down to minus 162 °C and compress the liquid to one six hundredth of its original volume. Special tankers carry the product to energy importers around the world.

We achieved particularly outstanding results with our industrial products in the transport of fuels and in clean air systems:

New systems for liquefied gas

The steady depletion of oil as a source of energy has led to a growth in demand for natural gas. At the same time, many consumer countries are showing increasing reluctance to become dependent on just a few suppliers for transport through gas pipelines. This has boosted the demand for liquefied natural gas (LNG) transported to consumer countries by tanker. In the year under review, this development led to customers planning and building more tankers and also more loading and unloading points for this fuel.

For the safe containment of LNG in these systems, customers ordered our Danaïs cryogenic valves, which operate reliably in a temperature range down to minus 250 °C. Already 60 % of all LNG tankers worldwide are equipped with these valves from our French subsidiary KSB S.A.S. In addition, our customers needed bronze and stainless steel pumps for filling and draining rock caverns used for storage of liquefied gas in India, Japan and Norway.

Special pumps for flue gas purification

The development of the energy market also strengthened demand for the pumps needed to purify flue gas. Chinese energy producers in particular included numerous flue gas purification systems in their plans for the construction of new power stations. At the same time, many old plants are being modernized and retrofitted for the Olympic Games in 2008. This explains why about 90 % of all orders received for flue gas desulphurization pumps in 2006 came from China. Our customers also ordered butterfly valves and diaphragm valves for their flue gas purification processes.

This kind of demanding application usually requires pumps made of expensive special alloys. At the ACHEMA industry trade fair in Frankfurt, we launched for the first time a polymer-coated scrubber pump for flue gas purification. Thanks to the low cost of the base material used, these pumps can be offered at a comparatively favourable price, which reduces the investment expenditure for plant operators.

New KSB products at the chemical industry's leading trade fair

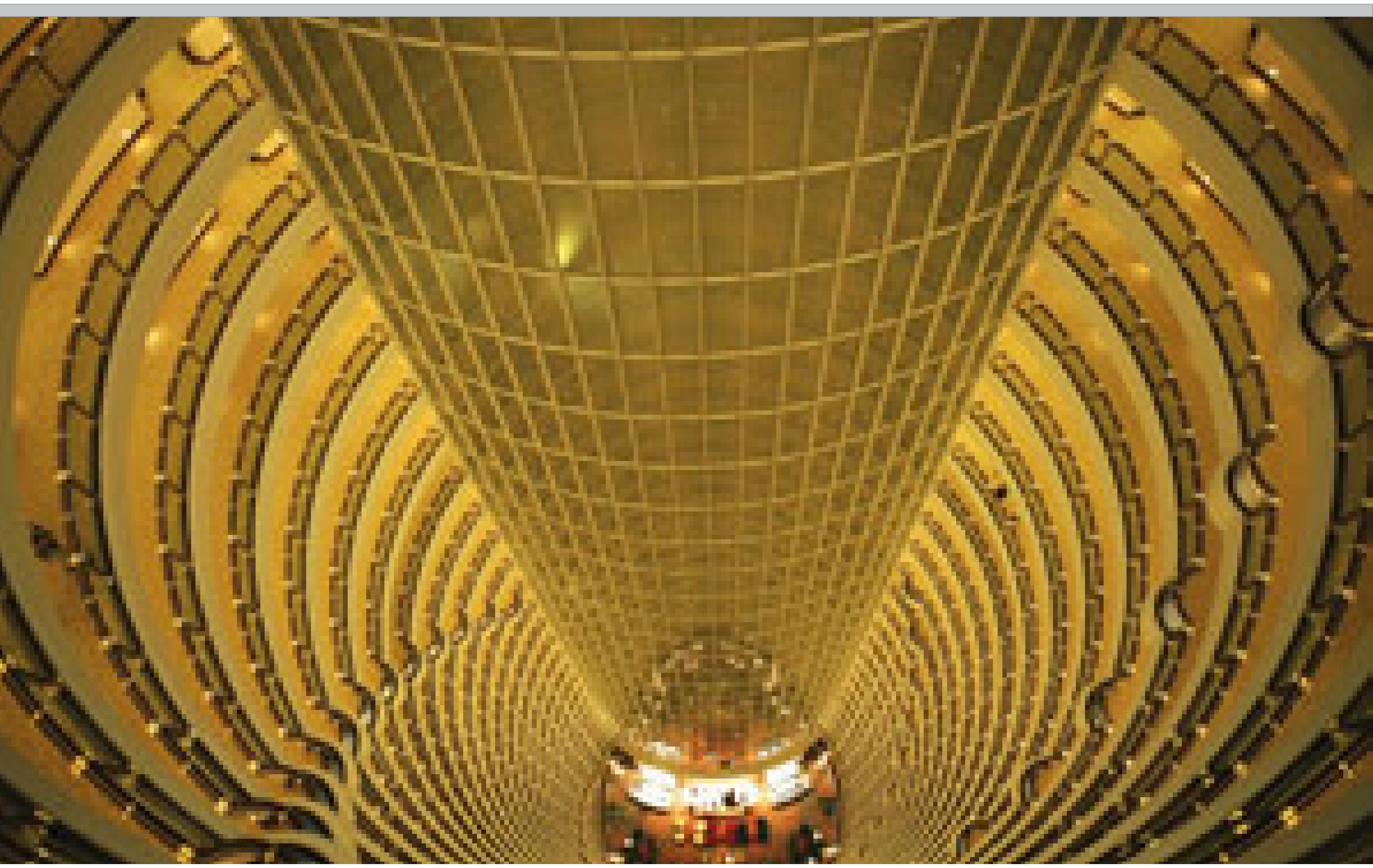
As well as these special pumps, we showcased the latest model of our CPK standardized chemical pump at the ACHEMA fair. This pump, of which more than 200,000 have been sold, is used by process engineers for the production of chemicals, synthetics and crop protection agents. The pump now has stronger shafts and larger sized ball bearings as standard features. These design changes result in a substantially longer service life.

Visitors to the Frankfurt fair also had an opportunity to have a closer look at a ceramic containment shell for our magnetic drive pumps. Available as a retrofittable component, it is characterized by high mechanical strength and good wear properties.

Growing demand for the "classics"

The "classics" in the industry business have for decades included our continually improved pumps from the Eta series. For these products, too, we saw a strong growth in demand in 2006, as we did for industrial pumps from Brazil, China and India in the same fields of application. Our customers ordered these units for use in, for example, paint shops, fire safety installations and heat transfer systems.

A special application for our Eta pumps is the cooling of power electronics in rail vehicles, such as the high-speed German ICE train. In 2006 we received our first-ever order from China to equip a large number of electric locomotives with more than 1,000 Eta pumps over the next few years.



Building Services

- Growth markets offer good prospects
- New pressure boosting and lifting systems developed
- Pump automation allows energy savings

Building services comfort includes state-of-the-art systems for water supplies and drainage, as well as for heating, ventilation and air-conditioning. Where pumps and valves are used in these technical areas, KSB has been one of the leading providers for decades. We advise consultants and engineering contractors, supply distributors and major installation companies and offer our products through electronic sales channels. A major focus of our marketing is on Europe, where KSB traditionally has a large customer base in Germany, France, Italy and Spain, as well as the Netherlands.

Strong growth impetus for building services in 2006 came from China, Russia and countries in the Middle East. In these areas we are in the process of establishing or expanding sales, distribution and warehousing capacity. The aim is to provide customers with the products they need both quickly and competently. An important prerequisite for long-term market success is also a functioning service organization. Along the lines of our European service partner concept with authorized service operations, our companies have therefore started to establish special local service networks for building services products.

Overall, we substantially increased our order intake in 2006 after stagnation in the previous year. We achieved growth both in the volume business through our distributor network and in the supply of products for large building projects. These included airports, sports complexes, hotels, hospitals and company buildings, amongst others.

Shanghai, Moscow, Dubai: New offices and apartments are shooting up everywhere in the big cities of the world's boom economies. Architects and planners also face the challenges of designing giant new skyscrapers, extensive leisure centres and palatial shopping malls. KSB experts are key partners for consultants and equipment suppliers on topics like air-conditioning, heating, water supply and disposal.

The view of the atrium from the top floor of the Grand Hyatt in Shanghai is breathtaking.
The hotel is in China's tallest building, the Jin Mao Tower. KSB technology takes water to all 87 floors.

Technical equipment of large buildings

One of the major orders we worked on in 2006 was for equipping a building complex in Zurich's "Sihlcity", the largest private building construction project in Switzerland. We supplied 500 pumps and more than 10,000 valves for the heating, heat recycling, air-conditioning, ventilation and sanitary facilities of the complex.

Other major order packages included supplying production halls in France with heating and cooling water systems, the rehabilitation of district heating stations in Romania, the equipment of a supermarket chain in Brazil with fire-extinguisher systems and the fitting out of a large hotel complex in Monaco with pumps for pressure boosting, air-conditioning, drainage, seawater extraction and swimming pools.

In the Middle East we provided our water supply products not only for the world's tallest building in Dubai, but also for the new Al Anoud Princess Tower in Saudi Arabia. From Saudi Arabia we also received an extensive follow-up order to equip the schools of the kingdom with pressure boosting systems.

Systems provider for heating and water supplies

In building services, KSB has largely completed the transition from a supplier of components to a module and systems supplier. We have been providing the market with packaged pressure boosting and lifting systems for many years. In the area of heating installations, we offer modules in the form of variable speed pumps and also systems with integrated pumps and valves.

Building services systems with new features

In the year under review, we developed lifting and pressure boosting systems with new performance features and presented them at the ISH 2007 international trade fair for building services in Frankfurt:

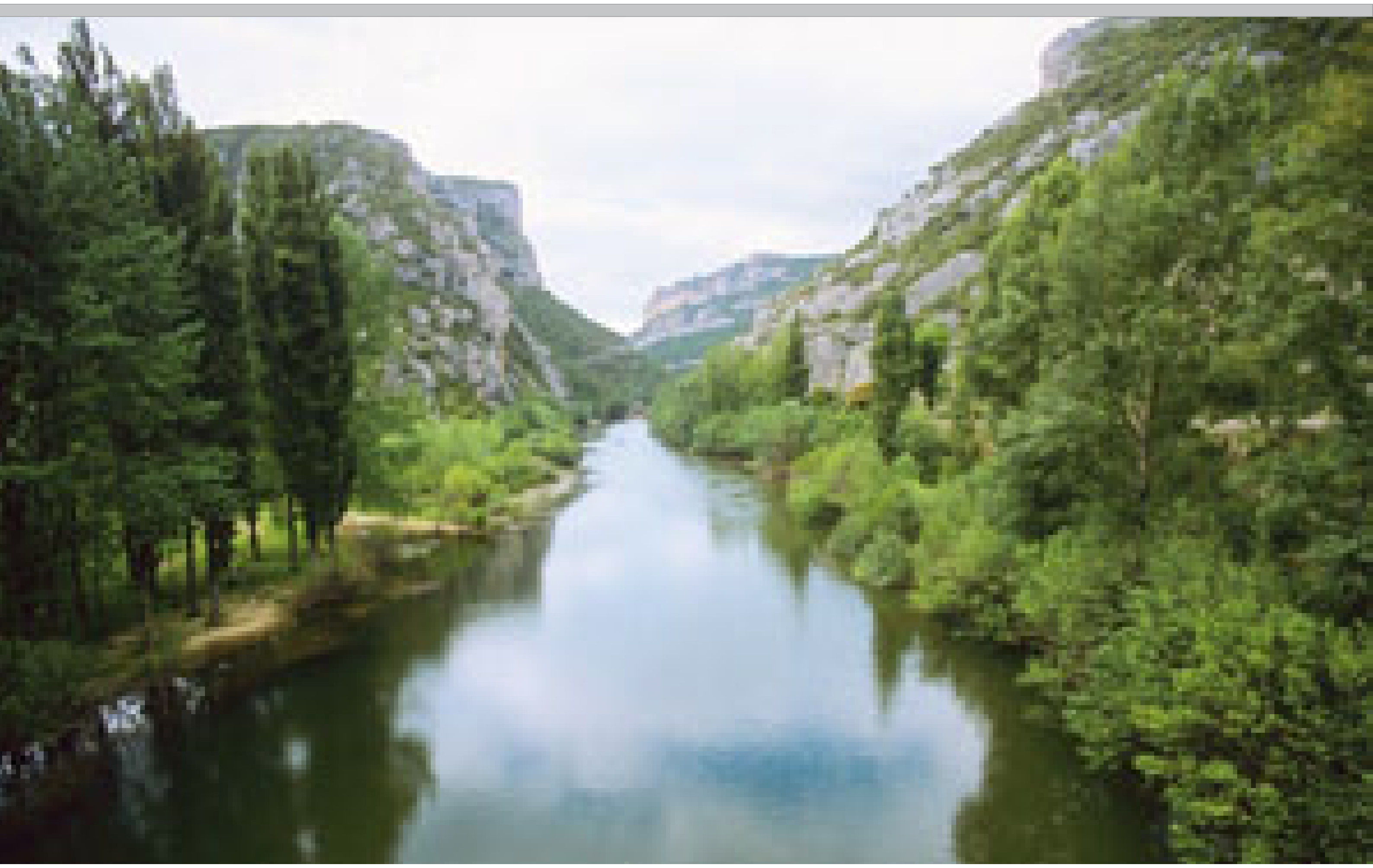
Our lifting systems with intelligent control equipment for building drainage now have fault detection capabilities built in as a standard, which were previously only used for critical applications in industrial environments. This improves protection of the lifting systems against unexpected outages.

We have, among other things, widened the range of applications of our pressure boosting systems by increasing the output of standard sizes. These systems ensure the necessary water pressure is maintained in tall buildings and buildings at high altitudes. A modular design system enables us to tailor the systems to meet national regulations and customers' requirements.

Automation technology helps save energy

In view of rising energy costs, more systematic use is being made of the opportunities for saving electricity in building services. More than 50 % of the automation products provided by KSB is used in building services applications. According to studies conducted by the Germany Fraunhofer Institute, the energy savings potential of pump systems lies at about 60 %. This potential can be tapped by control systems that match pump operation to actual performance requirements.

In 2006, KSB therefore launched onto the market a new model of its motor-mounted speed control system developed especially for building services. Since PumpDrive is independent of the type of motor and the motor brand, it is also suitable for retrofitting on installed pumps in heating and cooling cycles. The further development of our building services product range will continue to have a clear focus on automation technology.



Water

- Growing market for equipment
- Major projects in water transport
- Energy-efficient well pumps

The growth in the world’s population and the progressive industrialization of many emerging markets have led to rising demand for clean water. According to UNICEF figures, there are more than a billion people on the planet today who do not have access to safe drinking water. To ensure an adequate supply of water to populations and companies, € 1,250 billion have to be invested in the necessary infrastructure worldwide over the next five years.

The market for water engineering equipment is growing in line with the demand for water. KSB provides its customers with a range of pumps and valves for obtaining and treating water and supplying it to consumers. These products are currently manufactured at eight sites spread over Europe, Asia and Latin America.

The products range from submersible borehole pumps, such as those installed in wells, through volute casing pumps for waterworks and pipeline stations to large butterfly valves for installation in long-distance water pipelines. With this product portfolio, we managed to achieve a considerably higher order volume in 2006. The strongest growth in the water market was achieved in the Americas and the Region Middle East / Africa.

Reservoir for millions: Dammed lakes form important sources of drinking water. Santander on the northern coast of Spain draws its fresh water from the Ebro Reservoir, 840 m above sea level. KSB pumps extract the water from the lake and transport it about 100 km across the Cantabrian Mountains. Like millions of other people around the world, Santander's citizens owe their drinking water in part to KSB.

The Ebro is Spain's second-largest river. Up in the Cantabrian Mountains it is dammed to create a 35 km long lake. This reservoir provides drinking water for the densely populated north Spanish coast.

Major orders for long-distance water supply systems

Particularly strong growth was seen in the demand for our pumps for water transport. We received several major orders for these pumps:

In Libya, where underground water reservoirs in the Sahara desert are being developed, we equipped two further pipeline stations with a total of 16 pump units late in 2006. These serve to supply "fossil groundwater" to consumers in the country's coastal region. Because the water needs to be chlorinated, all pumps are made of high-grade stainless steel components.

In the future, the Australian city of Sydney is likewise to be supplied with water via pipelines laid over a distance of about 100 km from a dam. KSB will provide large pumps with speed control systems that will match energy input exactly to actual requirements.

A project that has attracted a lot of attention in terms of reliability of supply and ecology is the transport of water to the city of Santander in northern Spain from the Ebro reservoir. KSB pumps with a capacity of 3,000 cubic metres per hour will be extracting water from this reservoir and pumping it across the Cantabrian Mountains to the coastal city. In order not to damage the reservoir's eco-system twelve additional high-performance pumps from KSB, distributed over four stations, will replenish the water during rainy seasons with water from other rivers.

Sales successes with submersible borehole pumps

In water extraction, our submersible borehole pumps come into their own. They convey groundwater from wells up to the surface. In 2006, we were again very successful with these pumps in India, where we supplied the domestic market with about 60,000 of these units.

In Germany we perform well measurements for our customers, which enable us to determine the energy efficiency of the pumps used. Of the wells studied, 37 % showed an overall efficiency rating of less than 40 %, which meant that energy costs were at least one third too high. In these cases, KSB consultants could suggest technical improvements which repaid investment costs in the shortest possible time.

The condition of the drinking water supply system in Cuba calls for a modernization of the infrastructure. A special focus is on energy conservation. In 2006 we received the first part of a major order, in which old pumps are being replaced by energy-efficient units from KSB production.

With the aim of conserving expensive energy, we introduced new 6-inch submersible borehole pumps onto the market in 2006. Thanks to very low-friction flow characteristics, these units achieve above-average efficiency ratings. Laser welding of all hydraulic components also makes them much sturdier than spot-welded designs.

Drinking water production by reverse osmosis

Where there is a lack of fresh water in desert regions close to the coast or where, as in the Mediterranean, fresh water is becoming ever scarcer, seawater desalination is gaining increasing importance. In view of its economic benefits, reverse osmosis is establishing itself as the technology of choice. KSB pumps are provided in the required materials, dimensions and power ratings for the extraction of salt water from the sea, the desalination processes and subsequent transport of the water to the irrigation or water supply systems. In 2006, our customers ordered pumps for plants in Malta, Cyprus, Bahrain and China. A KSB pressure exchanger allows most of the energy used in the process to be recycled.

Waste Water

- Growth in the municipal and industrial waste water market
- Major orders from China, Russia and the Middle East
- Market launch of motors with jacket cooling

Where people use water, it is essential for the environment that it be cleaned afterwards. This applies to waste water from trade and industry and also to domestic sewage. For the transport of this waste to a sewage treatment plant and the purification processes, we manufacture application-specific pumps in all sizes and materials needed. Our customers in this market are engineering contractors and operators of municipal and industrial sewage treatment plants. They use both dry-installed and submersible pumps from our product range. Other equipment needed includes mixers and agitators for recirculation, homogenization and suspension of waste water and sludge.

In 2006, we offered this product range in a market that showed only slight growth overall. Yet we were able to secure a well above average share of this business, with the strongest demand coming from public sewage plants. In addition, we were engaged in a series of major projects in industry.

Important orders came from the Middle East, amongst other regions. In Saudi Arabia, for example, we received orders to equip not only two municipal sewage treatment plants, but also the waste water treatment plant of a refinery with more than 100 high-grade stainless-steel pumps.

Clean water for Asia's peninsular city-state: Visitors to Singapore are always impressed by its cleanliness. The Ulu Pandan NEWater water treatment plant opened in 2006. It is the city-state's fourth such utility employing KSB waste water technology to keep supplies clean.

Singapore is one of Asia's leading business hubs. Excellent infrastructure provides the basis for this metropolis to grow even further.

Strong demand from Russia and China

In Russia, too, we won a major order from the oil-processing industry. We will be supplying highly corrosion-resistant pump units for the disposal of waste water from a hydrocracker. A further multi-million order came in for the waste water treatment plant of a Russian steel works, which involves equally challenging operating conditions.

The increase in demand from China was particularly strong. Where waste water from farming, industry and private households in many places still pollutes water courses, sewage treatment plants are planned to help improve the situation. According to our order books, we shall be engaged in the equipment of ten large sewage plants. For local needs, we are also manufacturing waste water pumps in China. Further production sites for our waste water engineering product range include Brazil, France, Germany and India.

Trend towards large sewage treatment plants in Europe

We continue to enjoy a particularly strong market position with our products in Europe, where we supply customers from our waste water engineering centre in Halle. In European countries, municipal authorities are increasingly concentrating their sewage treatment services in large treatment plants. Waste water has to be transported to these plants over what are sometimes long distances by means of small and large pumping stations. The demand for such pumping stations and the technical equipment needed has risen accordingly. We have recently been profiting from this trend especially in Central and Western Europe.

Automatic tank cleaning

A special application is served with our Amajet systems, which customers use for automatic cleaning of stormwater tanks and storage sewers. The units generate a powerful flow of water and air bubbles, so that solids are kept in suspension and discharged evenly when the tank or sewer is emptied.

These systems help our customers eliminate the need for manual cleaning, which is comparatively time-consuming and costly. In 2006, our orders included equipping a sewage treatment plant in Great Britain with a total of 24 Amajet cleaning systems. The systems prevent pollution of the atmosphere for residents living nearby with the kind of odour emissions that can result from deposits in overflow tanks.

Changing technical requirements

We are continually adapting our pumps to the changing requirements of waste water technology. For our submersible sewage pumps, for example, we launched new motors with ratings of up to 500 kW onto the market. They feature jacket cooling, so that the pump systems can operate both under submerged and under dry conditions. This function is important, for example, if waste water pumps are installed as dry-well units, but also have to work reliably when the system is flooded.

Another technical improvement was implemented in waste water pumps that are used in relatively small municipal plants. Designed for small volumes, the pumps are now also fitted with open single-vane impellers. These so-called D-type impellers combine a high level of efficiency with the ability to cope with waste water containing solids or long fibres.

Further new technical developments for this market are in preparation, as we follow the trend not only towards larger pump systems and high-efficiency motors, but also towards the use of biowaste for alternative energy.

Energy

- Global market leader for power station pumps and valves
- About a third more orders for new plants and extensions
- Major orders for pumps with a drive rating of up to 17 megawatts

As a leading manufacturer of pumps and valves for the energy industry, KSB is profiting from a strong growth in demand for power plant equipment. A major role continues to be played by the development of energy generation capacity in China and India. China aims to build more than 30 large power plants a year by 2010, and in India about 10 to 20 new power stations a year are planned. In both countries, KSB is the leading supplier of power plant pumps.

But 2006 also saw a recovery of the energy market in Europe. The strongest growth was reported in Germany, Italy and Spain. Because of rising energy needs and the targeted reduction of CO_2 emissions, there are numerous power plant projects on the agenda aimed at expanding capacity or replacing old installations. Apart from the construction of power stations with combined gas and steam turbine cycles, there is a trend in Europe towards building new coal-fired power plants. This is associated not least with the rising price of gas supplies.

Further growth markets are Russia and the USA, as well as the Eastern Mediterranean and Middle East. In these regions, new power plants are often combined with seawater desalination plants, for which KSB also supplies a range of products. In countries with a higher acceptance of nuclear technology, a few new nuclear plants are also planned.

India lights up: The world's second most populous country is also one of its fastest growing economies. India plans to meet rising energy needs by building up to 20 new power stations per year. At Barh in the state of Bihar, KSB will supply the new steam generating plant with boiler feed and condensate pumps. The KSB product range also includes cooling water pumps and high-pressure valves for the energy industry.

For Sikhs, the Golden Temple of Amritsar (Punjab / India) is a place of spiritual enlightenment. Every day, thousands of pilgrims come to see the sacred shrine.

Strong increase in orders from the energy sector

We supply the power plant market worldwide with high-performance boiler feed, cooling water and condensate pumps, as well as numerous auxiliary units. The KSB portfolio also includes shut-off globe, gate and butterfly valves for energy engineering applications. The main manufacturing sites for these products are Germany, France, China and India. Overall, we achieved an order intake in 2006 that was about 30 % higher than that in the previous year for our power plant products. Most of the products from India and China were ordered by our customers for their domestic markets.

Trend towards large power plants with outputs of more than 1,000 MW

Operators of steam generating plants are tending to plan for larger capacities today. This increasingly involves the construction of so-called supercritical power stations with outputs of up to 1,100 MW, which are characterized by better efficiencies and thus a lower consumption of primary energy sources.

In 2006, KSB received several orders to equip steam generating plants of this new type with pumps. The high operating pressures and temperatures present in these plants place extreme demands on the design and materials of the units required. There are only a few manufacturers who are fully able to meet these requirements.

A major order that we won in 2006 from this market is for supplying the world's most advanced lignite-fired power plant in Neurath, Germany, with pumps for two new units, each with a capacity of 1,100 MW. By 2008, we shall equip these units with four of the world's most powerful ring-section pumps for boiler feeding, each with a drive rating of about 15 MW. The flow rate of each pump is about 1,400 m^3/h at a discharge pressure of 270 bar.

KSB will also supply more than 40 pumps for the first supercritical coal-fired power plant in China, which is being built in Liaoning province. As well as power plant pumps, the order also includes special corrosion-resistant pumps. These will be used in the seawater desalination system also under construction, which will supply the power plant cycles with the fresh water they need.

Pumps for combined cycle power plants

Despite the growing number of new large power stations, smaller but highly efficient combined cycle power plants are continuing to be built. They are characterized by good efficiencies and relatively low CO_2 emissions. For these power plants, in which the waste heat from gas turbines is used for operating a waste-heat steam boiler, we received a large number of new orders in 2006. These mostly came through European engineering contractors. As well as electricity producers in Europe, the end users also include plant operators in Asia, Australia and the Middle East.

Leading in power plant service

The reliable and low-cost generation of electricity hinges on the efficiency and fail-safe operation of the equipment and systems used. This means that important components of the plant have to be checked and, where necessary, repaired or replaced during scheduled downtimes. Since only a very narrow window of time is available for this work, strong service teams with experienced staff are essential in order to cope with this task. KSB has a total of 400 service staff on hand for this maintenance inspection and rehabilitation service. Of these, up to 70 people will be working in a single plant at the same time during the outages.

KSB is a leading service provider for power plants throughout Europe and again achieved a substantially higher order intake in 2006. The increase in demand was particularly marked in the field of valves service. During maintenance inspections, more than 1,000 valves can be dismantled, serviced and repaired or replaced within two to three weeks.

Mining

- Base metals boom triggers new mining projects
- Important partner to the Canadian oil sands industry
- Leading position in the North American market strengthened

Our primary support of equipment operators of mines is in the supply of extremely long-wearing slurry pumps developed by our US subsidiary, GIW Industries. Customers utilize slurry pumps for example to hydraulically transport extracted ores to mills, or to convey tailings to tailings ponds. For this purpose, solids are mixed with water and pumped through pipelines. Slurry pumps are also used in the oil sands industry and on dredgers.

In 2006, we achieved strong growth for pumps used in hydrotransport applications against a background of increased demand for minerals and energy sources. In line with rising prices for these commodities, mining companies have re-opened “mothballed” plants and planned new mining projects. This promises healthy growth rates in the coming years.

Additional stimulation of the market has come from dredger manufacturers. Dredgers are required to keep waterways free and are used in land reclamation, which is achieved, for example, through the creation of artificial islands.

Copper, ore and oil: Global demand for raw materials increases every year. Chile's Escondida and Chuquicamata mines rely on KSB to help extract valuable copper ore. We supply a special range of slurry pumps, plus those for water supply and drainage. In coal and sand facilities, as well as on suction dredgers, our slurry pumps also transport solids-laden media.

The Chuquicamata copper mine in northern Chile's Atacama Desert is one of the world's largest. Its operators extract more than 600,000 tonnes of copper here every year.

Positive order intake development in North America

Pumps for solids transport are manufactured at our specialized production facilities in Grovetown / Georgia in the USA, as well as in Australia, Brazil and South Africa, and are sold worldwide.

In 2006, we were able to consolidate our leading position in the North American mining market with GIW Industries. Significant impetus came from orders placed by the US American phosphate and the Canadian oil sands industries. GIW has secured supplier of choice agreements with important customers in both sectors.

Major contracts in 2006 were also received for the supply of equipment to a Russian coal plant and a copper mine in South America. Mining projects in the Region Asia / Pacific represented another market focus.

Top technical performance

One supreme technical achievement was the production of a slurry pump with a power rating of 6 MW. The unit is able to pump up to 15,000 cubic metres per hour of a waste sludge / rock mixture resulting from production in a Mongolian copper mine. With this pump, made from a white cast iron material developed by GIW, KSB has delivered one of the largest slurry pumps ever built.

We have also successfully launched pumps with the pioneering slurry diverter into the market. This is a globally patented construction designed to divert solid particles which could otherwise lead to severe wear. Numerous customers have already benefited from this technical innovation which increases pump service life and extends intervals between maintenance.

Swift repair and replacement parts service

Slurry pumps have to cope with the highest levels of wear. In order to ensure their operational reliability, qualified service personnel must be on call and replacement parts quickly available.

To secure the availability of their equipment, many operators make use of our competent service and performance through long-term service contracts. These also provide for our service specialists to help customers improve their processes and minimize the life cycle costs of their slurry pumps.

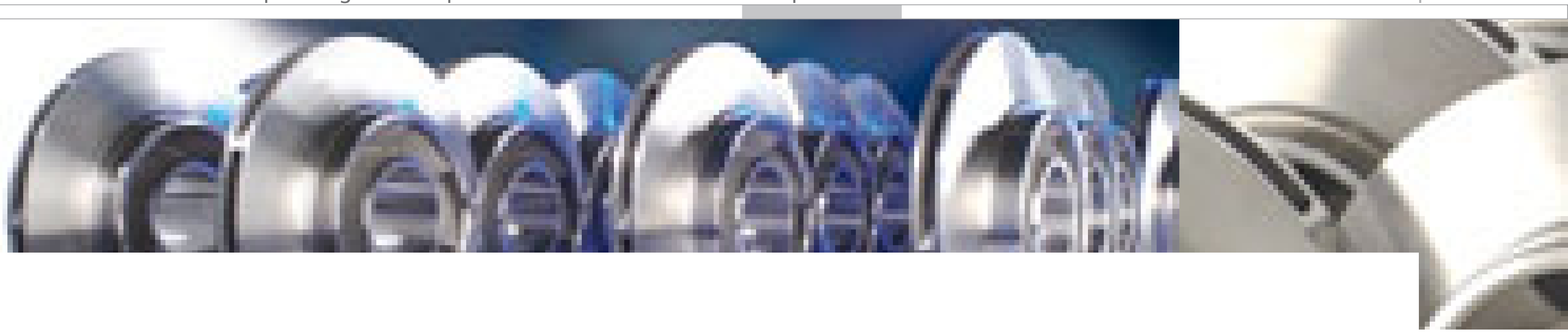
In accordance with rising demand for these and other services, we are in the process of developing our slurry pump service centres worldwide.

Group earnings have tripled

The KSB Group achieved record sales revenue of € 1,607.4 million in financial year 2006. At a return on sales of 5.6 percent, the earnings before income taxes have tripled, from € 29.6 million in 2005 to

€ 90.2 million.

Group Management Report



GROUP STRUCTURE

- 48 companies in the Group worldwide
- Group managed within a matrix organization
- Three primary management parameters

Purpose and organization of the Group

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

42 operating companies in 28 countries were dedicated to achieving this mission in the year under review. 6 Group companies exercised a holding company function.

As the parent company, KSB AG, Frankenthal (Germany), directly or indirectly holds the shares in the companies belonging to the Group. Besides KSB AG itself, the companies in the KSB Group with the highest sales revenues are

- KSB S.A.S., Gennevilliers (France),
- KSB Shanghai Pump Co. Ltd., Shanghai (China),
- KSB Service GmbH, Frankenthal (Germany),
- KSB Pumps Limited, Pune (India),
- KSB Bombas Hidráulicas S.A., Várzea Paulista (Brazil),
- GIW Industries Inc., Grovetown / Georgia (USA).

Shareholder structure and shareholder rights

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 officially listed for trading on German stock exchanges ("General Standard" segment).

Klein Pumpen GmbH, Frankenthal, holds almost 75 % of the ordinary shares. The remaining ordinary and the preference shares comprise the free float.

Each ordinary share authorizes the holder to one vote at KSB AG's Annual General Meeting. The preference shares only entitle holders to voting rights as prescribed by law. The issue of additional ordinary or preference shares does not require the consent of the preference shareholders. The preference shares carry separate cumulative preference dividend rights and progressive additional dividend rights.

There are no resolutions by the Annual General Meeting authorizing the Company's Board of Management to increase the share capital (authorized capital) or to buy back shares.

Organization, management and control

KSB AG is managed by a Board of Management that in accordance with its Articles of Association must consist of at least two persons and currently comprises four persons. The Supervisory Board resolves the appointment and termination of the mandate of members of the Board of Management in accordance with the statutory provisions.

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 Annual General Meeting resolves the Articles of Association. Amendments to the Articles of Association that only affect their wording may be made by the Supervisory Board.

Stainless steel pump impellers

KSB AG's Board of Management manages and controls the KSB Group. The strategy and instructions stipulated by the Board of Management are implemented under a matrix organization. Within this organization, four people responsible for the following Regions:

- Europe,
- Middle East / Africa,
- Asia / Pacific, and
- Americas,

work with those responsible for market-oriented areas of business. The operating business is divided into the following market segments:

- Industry and Building Services,
- Water and Waste Water,
- Energy and Mining.

Markets and locations

The main products of the KSB Group are centrifugal pumps, which account for approximately 60 % of sales revenue. These pumps, as well as globe valves, gate valves and butterfly 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 most significant market for these products from the Group's perspective is Europe, where KSB runs its main manufacturing facilities in Germany and France. KSB AG's main plant in Frankenthal is its largest in Europe, ahead of those in Pegnitz (Bavaria, Germany) and La Roche Chalais (France).

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

KSB manufactures products and components in 19 countries; they are sold through its own companies or agents in more than 100 countries. The Group's companies supply its products to customers from industry and the public sector, the energy industry, building services and mining. KSB is the global market leader in pumps for the energy industry and pumps for process engineering; in other industries, KSB is one of the leading manufacturers of pumps.

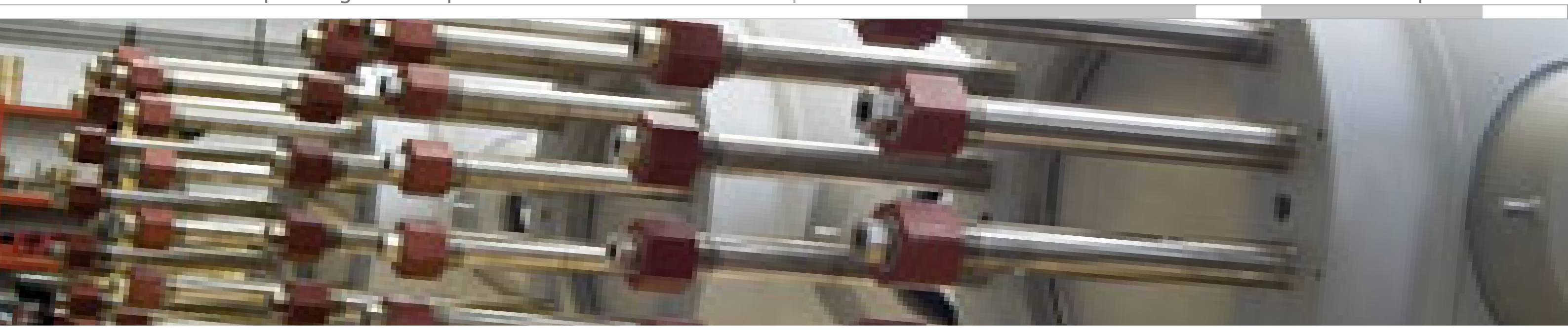
The market generating the highest sales revenue for KSB products in 2006 was once again industry, where KSB is now positioned as the second-largest manufacturer of pumps in the world.

Management parameters within the KSB Group

The current target variables for managing the Group are sales revenue growth and profitability measured in terms of pre-tax return on sales. In determining the required growth in sales revenue, we are governed by a flexible target that takes both general developments in the market and our relative competitive position into account. We have undertaken to grow more quickly than our most successful competitors in each of the strategically important markets.

We exceeded the previous target of 5 % return on sales in the year under review. Based on this, we are aiming over the next few years to improve our performance continuously to approach the 8 % mark by 2010.

We will also be using ROCE (return on capital employed) as a management parameter.



ECONOMIC ENVIRONMENT

- European economy grew faster than expected
- Higher demand around the world
- Easing pressure on prices

Our business benefited from continued strong economic growth in 2006. The economic stimuli were particularly strong in Asia, the Middle East, South America and Eastern Europe.

The upswing also gained momentum in Europe in 2006. Looking at the overall economic picture, the unexpectedly strong growth in Europe made up for the loss of steam in the US and Japanese economies.

There was robust growth in mechanical engineering. New capital expenditure and long overdue replacements by customers played a decisive role in the buoyant growth in demand from the European mechanical engineering sector.

Strong demand from the energy, industry and mining sectors

Demand from the energy industry was very high throughout the world. In particular, the construction of new power stations in Asia lifted demand for equipment, including pumps and valves. In addition, there was growing demand from the European electricity sector, which has started to build new capacity and to modernize old plant.

Capital expenditure by European industrial companies has once again increased, with growth focused in Germany, France, Spain and Eastern Europe. Outside Europe, it was mainly chemicals and petrochemicals companies and refineries that needed considerably more new equipment.

This expansion in the energy and industry sectors was accompanied by growing demand for raw materials and fuels, which gave a new boost to the mining sector.

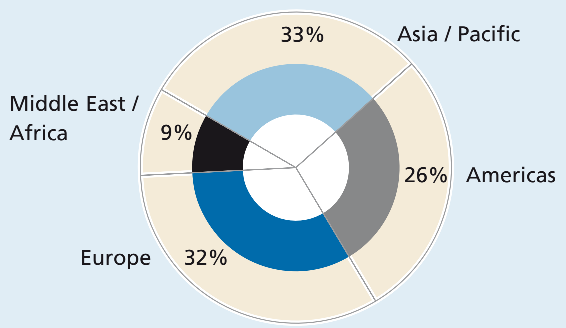
Demand in the water and waste water industry did not grow as strongly. Regions with growing urbanization and those with ambitious major construction projects were the focal points of growth in demand for building services.

Developments in the pumps and valves business

In some cases, manufacturers of pumps and valves were only able to respond to the unexpected surge in demand in 2006 by offering longer delivery times. Like KSB, a number of other manufacturers were working at full capacity, easing pressure on prices, which had been building up for years in some areas. Against the background of higher commodity prices, the market therefore accepted reasonable price hikes.

The structure of the competitive environment remained basically unchanged. There were only takeovers of some of the smaller pump manufacturers.

World market of centrifugal pumps and valves



Casing of a LUV series boiler recirculation pump for high-performance power plants

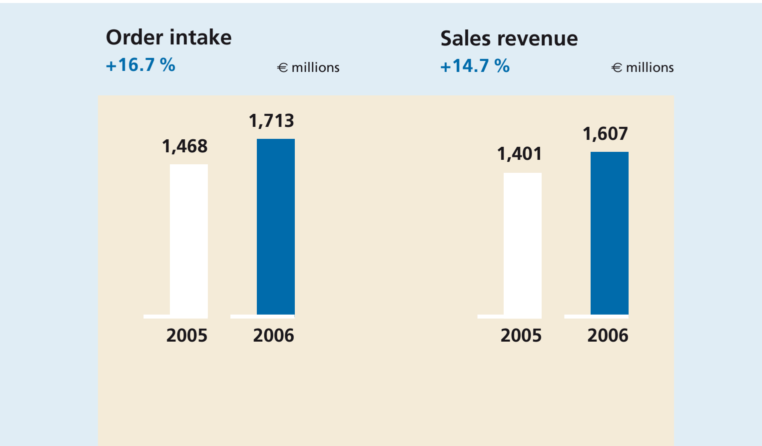
BUSINESS DEVELOPMENT

- Order intake rose by 16.7 percent
- Sales revenue up in all regions
- Efficiency targets met

The KSB Group's business developed extremely successfully in 2006. We increased order intake and sales revenue in all four Regions. This rise in order intake and sales volume benefited Industry and Building Services, Water and Waste Water, and Energy and Mining. This meant that we were more successful than in the previous year in all our markets and in all our Regions.

Record rise in order intake

The KSB Group's order intake rose by 16.7 % in the year under review to € 1,712.8 million, representing year-on-year growth of € 245.3 million, which was the strongest in the last ten years. In terms of volume, the highest order intake was in industry and process engineering, and in energy. Our share in market growth was above average for sales of power station components and products for industrial and process engineering applications. Besides these two markets, the mining business also showed a very steep rise in percentage terms in new orders for slurry pumps.



Orders from the European market dominated the order intake. Demand from builders of power stations and suppliers of equipment for industrial plant provided the main boost to the rise in order intake. The European waste water business also performed well, as did sales of butterfly valves used in transporting water and liquefied gases.

Against the background of a buoyant economy in industry and demand from the power station sector, the Group companies in Europe recorded double-digit percentage growth in their orders. The 20.3 % jump in KSB AG's order intake, where there was a sharp rise in the energy business, was particularly encouraging. The volume of KSB AG's order intake rose to € 718.7 million.

We consolidated our Turkish and South African companies in the Region Middle East / Africa. Both recorded strong growth in their order intake, with KSB Turkey doubling its building services and energy orders. KSB South Africa increased its order intake as a result of the strong demand from the water industry, as well as from the energy generation and mining sectors.

The Asia / Pacific markets also reported high growth rates in 2006. KSB Shanghai Pump Co. Ltd. in China and our companies in India, Pakistan and Singapore were the main beneficiaries. The major contributors to order growth at these companies were industry and the power station sector.

KSB Service engineers install and service pumps on the customers' premises.

The most important factor in China and India was the energy business. In India there was also a steep rise in demand from refineries and the sugar industry. KSB Singapore benefited from projects for the construction of oil and gas storage facilities, while KSB Pakistan received its new orders mainly for water supplies and equipment for industry.

By Region, the Group companies in the Americas recorded the highest growth in orders, with our Brazilian pump manufacturer reporting the largest rise of all. Growth rates at our four operative US companies were also well into double figures. The booming mining business, the recovery in the energy sector and growth in the waste water business were the main factors here. Our company in Houston / Texas received sizeable orders for equipping ships and shipyards with valves.

Orders on hand in the Group totalled around € 600 million as at the closing date of 31 December 2006 (previous year: around € 500 million), corresponding to an order backlog of close to five months.

Sales revenue up in all Regions

Group sales revenue in the year under review rose by 14.7 %, another record, to € 1,607.4 million. This represents a rise of € 205.9 million. Compared with the growth in order intake, growth in sales revenue was two percentage points lower. This is attributable to the high proportion of orders for long-term projects. Especially for power station pumps and valves, for example, but also for industrial products and equipment for the water industry, orders were received that will only be invoiced in 2007 or later.

In Europe, the rise in sales revenue, at about 13 %, was lower than the rise in orders. A major reason for this is the structure of the business. KSB AG increased its sales revenue to € 651.5 million in the year under review. In particular our companies in the Mediterranean countries and in Eastern Europe reported considerably stronger growth.

The two Group companies in the Middle East / Africa Region only increased their sales revenues slightly measured in euros. This was due to negative currency exchange influences.

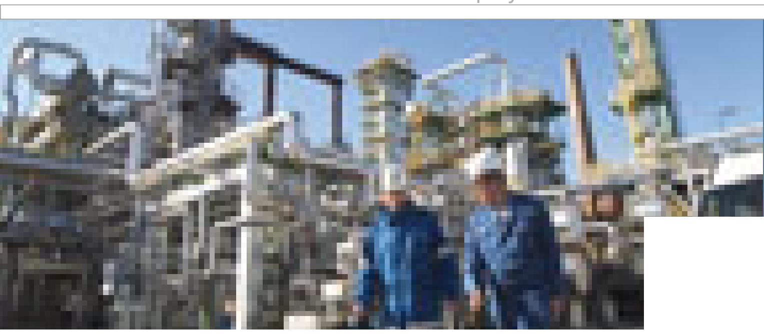
The sales revenue of the companies in the Regions Asia / Pacific and Americas grew particularly strongly, by around 20 %.

In Asia / Pacific, KSB Shanghai in China reported the strongest rise, with sales revenue up by more than 60 %. This figure is attributable above all to billing for power station orders. Sales revenues also grew strongly at our two Indian companies and at KSB Singapore.

In the Region Americas, growth in sales revenue at our Brazilian pump manufacturer deserves particular mention.

Market position strengthened

Overall, sales revenue at the KSB Group developed better than we had initially expected. Besides our own initiatives to increase sales, this was largely helped by strong cyclical stimuli from the industry and energy sectors. Because of this above-average growth in sales revenue, we improved our position in these two most important markets.



In the growth economy of India, for example, we further strengthened our leading position in the energy sector and also became the market leader in industrial pumps. Overall, we are ranked number two pump manufacturer in India.

We see ourselves as general market leader in pumps in the other two important growth markets of Brazil and China, and are gradually improving our position in Russia since setting up a sales and marketing company in 2005. In global terms, KSB is now one of the four largest manufacturers of centrifugal pumps.

"Half-time" for our growth and innovation initiative

In order to continuously increase our sales revenue, we drove forward our growth and innovation programme in the year under review. The aim of the initiative, started in 2002, is to create € 700 million more sales revenue by 2010 compared with 2001. To do this, we are adding to our portfolio of products and services, opening up new markets and taking steps to better leverage existing markets. We are now half-way through the programme and have already defined ways and means of achieving all of the additional sales revenue. These include innovation projects focusing on automation and drive technology, fuel transport systems and energy savings.

Increase in efficiency means decrease in costs

We completed our Efficiency Enhancement Programme, which has been running for three years, on schedule at the end of 2006. It aimed to achieve cost savings of € 100 million, which we just about exceeded. After factoring in the offsetting effects of rising costs due to higher materials and energy prices, wage and salary trends and falling prices in the two previous years, the net effect on earnings in 2006 is approximately € 20 million. The Efficiency Enhancement Programme's "ideas pool" is generating additional savings potential that we shall leverage as part of a continuous improvement process.

By continuing to improve our processes, we aim to enhance our company's efficiency by around 3 % per annum. To this end, we created a project organization in 2006 that will not only consider short-term measures, but also encompass projects of a strategic nature. We want to use faults and obstacles that we discover in our processes as opportunities for sustainable improvement.

Growing popularity for Web Shop offerings

We again expanded our online sales in 2006. Our Web Shop now enables around 1,800 customers in seven countries to obtain pumps, valves and spare parts quickly and easily. We opened up our Web Shop to Swiss customers for the first time in the year under review. Compared with the previous year, the online order intake rose overall by just under 40 %. We are developing Web Shop links for more countries in Europe and the Americas this year.

Service business expanded

Our service for pumps, valves and other plant components again performed well in 2006 and constitutes an important pillar of our business. A major contribution came from a sizeable number of plant rehabilitation projects. This is when teams from KSB use short outages to carry out extensive maintenance and repair work. New installations and the commissioning of power station pumps were also an important area of business.

NET ASSETS, FINANCIAL POSITION AND RESULTS OF OPERATIONS

- Significant improvement in Group earnings
- Parent company KSB AG returns to profitability
- Net financial position further strengthened

In view of sustained market growth and additional contributions to earnings from our Efficiency Enhancement Programme, we forecast a positive performance by the Group in the report for the previous year. The growth in order intake and sales revenue described above and the improvement in earnings have significantly exceeded our expectations.

RESULTS OF OPERATIONS

Earnings before taxes

The KSB Group achieved earnings before taxes of € 90.2 million, after € 29.6 million in the previous year. This generated a return on sales of 5.6 % (previous year: 2.1 %), even more than the target of 5.0 % we had set for 2006.

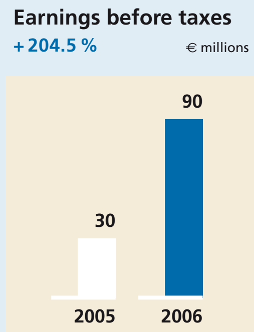
Output up sharply

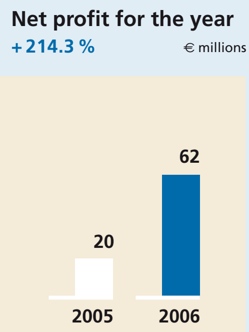
Because of the high proportion of projects with relatively long lead times, sales revenue, as already discussed, did not quite keep up with the order intake. Nevertheless, we achieved a high level of completion of these orders and report the proportionate revenue from them in accordance with the percentage of completion method. The € 51.9 million rise in this item is reported under "Sales revenue recognized by PoC". We reduced work in progress and inventories of finished goods, thus achieving a total output of operations of € 1,585.2 million (up 10.8 % on € 1,430.9 million in the previous year).

Restructuring measures lower costs

A structural improvement to our income statement is evident in the staff costs. Although these rose by 2.6 % in absolute terms to € 521.7 million, they fell to 32.9 % of total output of operations (after 35.5 % in the previous year). This is where the measures under our Efficiency Enhancement Programme are starting to take effect. Despite the year-on-year rise in output, the number of employees has hardly changed. Above all as a result of the many partial retirement agreements concluded over recent years, overall headcount at KSB AG dropped, as the employees involved have now come to the end of the working phase of their agreements and have moved into the release phase. On the other hand, both at KSB AG and especially at our companies in the Americas and South Africa, we have taken on new staff to build up the capacity required for our growth. The average output per employee in the KSB Group rose year-on-year from € 111 thousand to € 122 thousand.

The ratio of other operating expenses to total output of operations also declined (18.4 % compared with 19.3 % in the previous year). Here, too, the effects of our structural measures to cut costs are evident.





In 2006, more than 60,000 Eta series standard pumps left our production facilities in Frankenthal, Germany.

We spent an additional € 14.6 million in 2006 on our Efficiency Enhancement Programme. The amount incurred for financial year 2005 was € 17.4 million.

Cost of materials rose by 11.3 %, close to the rise in total output of operations (up 10.8 %). The figure of € 650.2 million is equivalent to 41.0 % of total output of operations (previous year: 40.8 %). Rising prices on our procurement markets hampered efforts to reduce the cost of materials, as did the increased use of purchased services. This was necessary in order to add to our own well-utilized capacity.

Earnings after taxes

The income tax rate hardly changed year-on-year (30.9 % compared with 33.0 % in 2005). The net profit for the year of € 62.4 million (previous year: € 19.8 million) rose in line with pre-tax earnings. The minority interest in net profit rose to € 12.9 million (previous year: € 8.7 million) as, without exception, all the companies with significant minority interests generated better earnings than in the previous year. The ratio to net profit for the year, however, fell from 43.9 % to 20.7 %, as earnings growth was predominantly generated at companies without minority interests.

Consolidated net retained earnings of € 49.5 million are several times higher than in the previous year (€ 11.1 million).

Earnings per share significantly improved

Earnings per ordinary share were € 27.99, compared with € 5.85 in the previous year, and € 28.51 per preference share, compared with € 6.88 in 2005.

Parent company returns to profitability

KSB AG reported pre-tax earnings of € 5.9 million (under HGB accounting standards). In the previous year, a loss of € 20.9 million was incurred. Both sales revenue (up 6.5 %) and total output of operations (up 10.1 %) rose year-on-year. The positive effects of our restructuring measures that have already been mentioned were reflected to a substantial degree at KSB AG and contributed to the improvement in earnings.

The profits transferred to KSB AG by German subsidiaries (KSB Service GmbH, Frankenthal, KSB Service GmbH, Schwedt, and Uder Elektromechanik GmbH, Friedrichsthal) under profit pooling agreements hardly changed compared with the previous year.

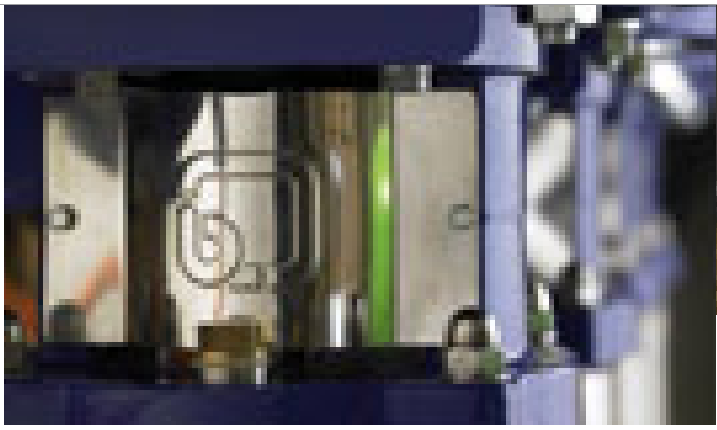
Dividends to be paid for both share classes

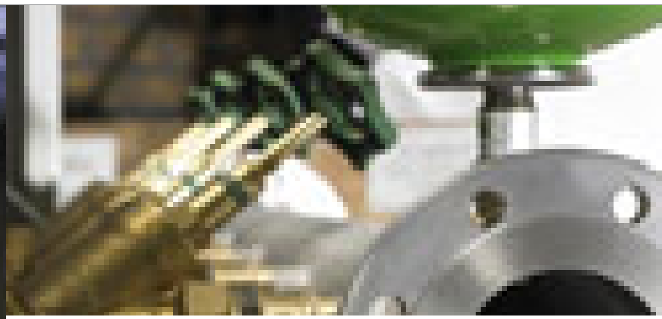
In the two previous years, we had to restrict our distributions to the preference dividend right of € 1.03 per preference share prescribed under the Articles of Association. The improved earnings at KSB AG now permit us to pay a dividend on both the preference shares and the ordinary shares. We will be proposing to the Annual General Meeting to distribute a dividend of € 2.00 per ordinary share and € 2.52 per preference share (including a preference dividend right of € 0.52).

Segment results

In line with our management and reporting structures, our primary segment reporting format is by region; we also report on our secondary format by market segment.

At the companies in the Region Europe, sales revenue growth and the implementation of measures under the Efficiency Enhancement Programme led to a significant improvement in earnings. As outlined above, KSB AG was responsible for a





substantial proportion of this improvement. However, most of the other companies were also more successful than in the previous year. Overall, the Region increased EBIT to € 47.6 million (previous year: € 6.4 million).

The Region Middle East / Africa increased its EBIT, despite only a slight improvement in sales revenue, by € 1.0 million to € 5.2 million.

With an insignificantly higher average headcount (up 0.9 %), the Region Asia / Pacific succeeded in achieving the growth in sales revenue already mentioned. It generated EBIT of € 28.0 million, 56.7 % higher than in the previous year.

The Region Americas also recorded a jump in earnings with a similarly high growth in sales revenue. At € 19.4 million, the figure for EBIT is 50.3 % higher than for the previous year. To cope with the volume of orders, average headcount was increased by 9.0 %.

FINANCIAL POSITION

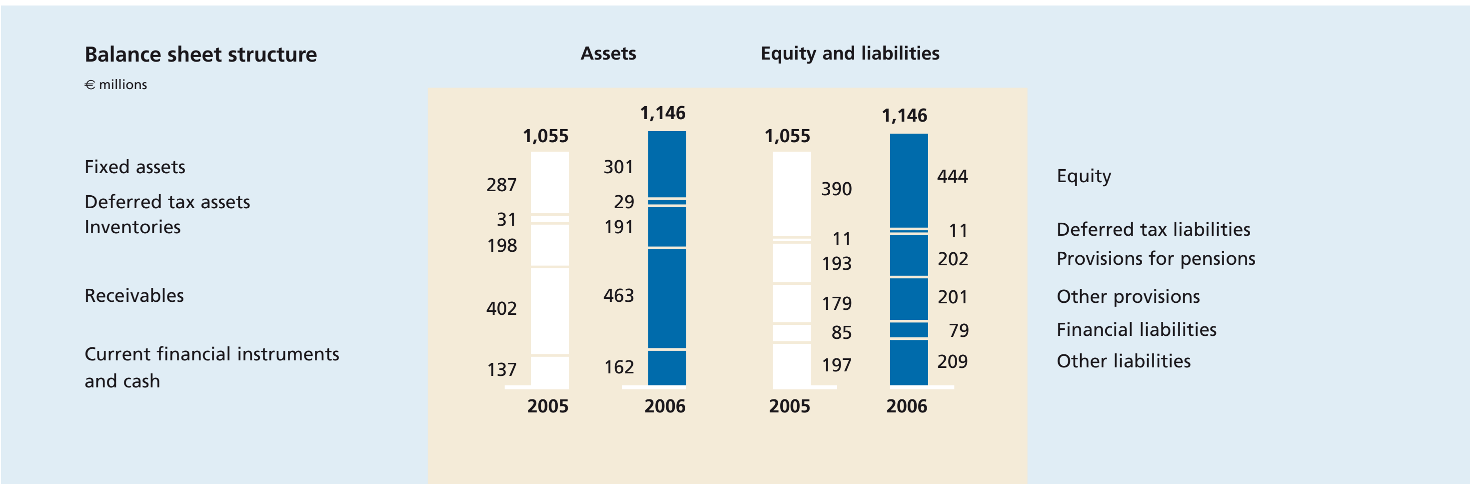
Principles and objectives of financial management

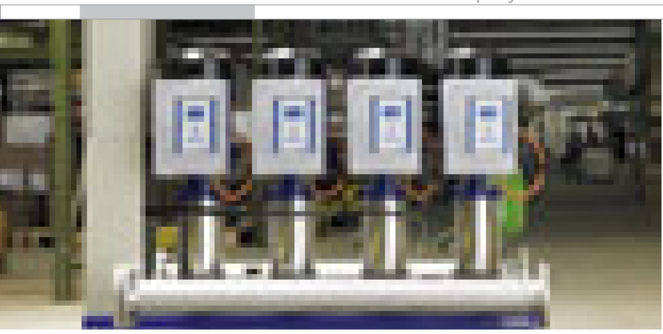
Central financial management in the KSB Group works within the framework of the guidelines laid down by the Board of Management. These include the rule to base the nature and scope of all financial transactions exclusively on the requirements of our business. The aim of our financial management is to ensure sufficient liquidity at all times and to finance growth at optimal conditions.

Hedging financial risks

Our primary tool for hedging the foreign exchange risks inherent in our export business are currency forwards. This applies both to transactions already recognized and to future cash flows. We transact most of our foreign currency business in US dollars and pound sterling. There is only a relatively low level of foreign currency liabilities.

We counter the risks of changes in prices on the procurement side for orders with extended delivery dates by agreeing cost escalation clauses or, in the case of fixed-price contracts, by including the forecast rate of cost increases in our sales price.





Hyamat VP pressure boosting system with continuously variable speed control

We minimize the risk of default by taking out credit insurance, agreeing advance and partial payments, and requiring bank guarantees. To ensure continuous liquidity, we agree payment terms and conditions with our customers in the project business that reflect the cost trend curves of order completion as far as possible.

We take account of the risks from short-term fluctuations in cash flows by agreeing sufficient lines of credit. We have cash credit lines amounting to around € 150 million. A large proportion of this is confirmed for a period of more than one year. For the collateral required in the project business, we have guarantees amounting to approximately € 279 million.

Equity

The KSB Group's equity amounts to € 443.8 million. This includes KSB AG's subscribed capital of € 44.8 million. The capital reserve amounts to € 66.7 million. € 211.4 million was allocated to revenue reserves. The financial statements show consolidated net retained earnings of € 49.5 million and minority interest of € 71.4 million. Despite the € 91.2 million (8.7 %) rise in total equity and liabilities, the equity ratio improved to 38.7 % (previous year: 37.0 %).

Minority interest relates mainly to KSB Pumps Ltd. / India (€ 25.4 million), PAB GmbH / Germany (€ 11.9 million), KSB America Corp. / USA (€ 6.9 million), KSB Pumps Ltd. / South Africa (€ 6.6 million) and GIW Industries Inc. / USA (€ 3.8 million).

Liabilities and provisions

The biggest item under liabilities and provisions is that for pension provisions. They grew by 4.8 % to € 201.6 million as at the reporting date. A large number of the pension plans currently in use in the KSB Group are defined benefit models, with employees at the German companies, for instance, also having the opportunity to convert parts of their pay into pension benefits. To reduce the risks of defined benefit plans – such as demographic changes, inflation or salary increases – we intend to make increased use of defined contribution plans in future.

At present, somewhat more than half of our liabilities relate to current pensioners and vested benefits of employees who have left the company. The rest relate to defined benefit obligations for our current employees, who have an average remaining working life of just under 14 years.

The other provisions also have long-term components (totalling € 36.5 million), mostly for obligations under partial retirement plans and for jubilee payments. The excess relates to provisions for short-term uncertain liabilities.

Liabilities that relate mainly to purchased goods and services are also exclusively short-term. Financing through trade credit is on a level with the previous year, corresponding to 13.8 % of total equity and liabilities (previous year: 13.7 %). At 5.6 % (previous year: 6.4 %) of total equity and liabilities, bank loans and overdrafts are relatively insignificant.

Contingencies and commitments

The KSB Group's off-balance-sheet contingent liabilities amounted to a total of € 29.0 million as at the reporting date (previous year: € 37.8 million). These arise from collateral and performance guarantees.

Other obligations and commitments extending beyond the reporting date fall within the scope of what is normal to carry on the business, such as from long-term rental, leasing and services agreements (in particular IT and telecommunications agreements) and the usual purchase obligation.

Heating valves for building services

Liquidity

At € 93.3 million (previous year: € 57.5 million), the KSB Group's net financial position, that is the difference between interest-bearing monetary assets on the one hand and financial liabilities on the other, is clearly positive.

Source and application of funds

Cash flows from operating activities of € 77.2 million were higher than in the previous year (€ 46.6 million). This is mainly the result of the sharply improved net profit, which was partially offset by outflows due to the increase in receivables, particularly for work commenced on orders with long delivery periods (percentage of completion measurement). These are in line with the increase in the volume of business, and were cushioned by the increase in advances received from customers.

The extent of our investing activities hardly changed compared with the previous year, resulting in slightly lower cash flows of € – 50.9 million (previous year: € – 53.2 million).

Cash flows from financing activities fell to € – 5.1 million (previous year: € – 15.5 million), primarily as a result of lower repayments of financial liabilities.

The KSB Group's cash and cash equivalents arising from all cash flows together rose to € 142.1 million (previous year: € 121.0 million), although this includes minor changes in exchange rates.

We assume that we shall continue to be able to meet our payment obligations out of cash flow. External funding measures are thus not currently viewed as necessary.

NET ASSETS

Total assets rose by 8.7 % to € 1,145.8 million, which is also a result of the expansion in our volume of business. The growth is predominantly in current assets.

Around 26 % is attributable to fixed assets (previous year: 27 %). Intangible assets and property, plant and equipment with historical costs of € 697.9 million have carrying amounts of € 270.9 million. Investments in property, plant and equipment in the year under review amounted to € 42.0 million, considerably in excess of depreciation (€ 29.0 million). This is, however, due to a sharp increase in advance payments and assets under construction. As in the previous year, we invested mainly in technical equipment, machinery and operating and office equipment at our European production facilities. However, the Region Asia / Pacific recorded the strongest absolute and relative increase. We modernized and expanded our factories there, in particular in India and China.

We did not change our principles for measuring depreciation and amortization in the year under review.

Non-current financial assets increased by € 7.2 million or 30.8 %. This is primarily the result of loans and capitalization measures.

The inventories are partially financed by advance payments from customers. After offsetting advance payments, inventories tie up around 17 % of our funds (previous year: 19 %).

As a result of the strong growth in our business, especially in the project business, the amount of customer orders in progress has increased significantly. This rise, measured at € 51.9 million using the percentage of completion method, is reported under sales revenue and therefore increases the reported receivables (see the comments on total output of operations on page 38). The receivables and other current assets account for around 40 % of total assets (previous year: around 38 %). They are primarily the outcome of the Group's current deliveries of goods and services.

14 % of the assets (previous year: 13 %) comprise current financial instruments and cash.

Inflation and exchange rate effects

There are no 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 euros gave rise to a difference of € – 12.0 million. This was taken directly to equity.

SUMMARY OF THE ECONOMIC SITUATION OF THE GROUP

The KSB Group's economic situation improved significantly over the financial year under review. Overall economic conditions were favourable around the world. We made good progress with our structural improvement measures, especially at the parent company KSB AG. The growth and the simultaneous improvement in our cost position led to the net profit for the year almost trebling. The resulting positive effects on the financial situation and net assets are a visible sign of this development.

The Group funds itself internally; the net financial position is clearly positive.

BASIC ELEMENTS OF THE REMUNERATION SYSTEM FOR THE BOARD OF MANAGEMENT

The compensation of the Board of Management consists of fixed and variable components. The amount of the fixed remuneration is primarily determined by the function and responsibility of the Management Board member in question. The variable remuneration component mainly depends on the consolidated net earnings generated in the relevant financial year. No stock options or other forms of share-based payment are granted to members of the Management Board.

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) AktG (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 or the measures were either taken or not taken – received adequate compensation and was not disadvantaged by the fact that the measures were either taken or not taken."

REPORT ON POST-BALANCE SHEET DATE EVENTS

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

RESEARCH AND DEVELOPMENT

- Neural network as design aid
- Ceramic coatings for shaft bearings
- New control systems

In research and development, we use the global resources available to us to secure sustainable success for the company. The technological strengths of KSB lie above all in the complex interplay between hydraulics, materials engineering and automation. We therefore devote particular attention to these three areas. The results of our research and development work are translated into advanced products, strengthen our portfolio and help us to develop new markets.

The expenditure on research and development amounted to € 27.9 million in the year under review; this corresponds to around 2 % of Group sales revenue. In the KSB Group companies, 295 people were employed in Research and Development, mostly in Germany, France, India and the USA.

Pioneering system supports pump design work

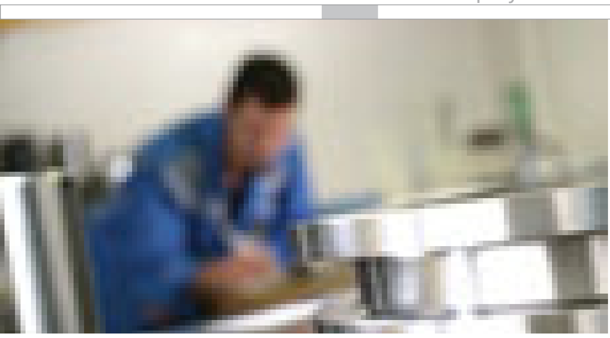
An essential factor for business success is the speed with which our engineers create new products or design application-specific machines to customers' specifications. To step up the pace even further, we have started to establish an artificial neural network incorporating data from more than 130 years of experience in KSB pumps manufacture. The system will support the work of our experts, enabling them to draw on the accumulated engineering and development know-how for solving problems. The findings and experience gained can then be transferred to other issues and tasks, so that faster results will be possible.

New temperature limits for high-pressure pumps and valves

Aiming to push the thermal limits of our high-pressure pumps, we have developed our own test rigs, on which we test the seal elements of these units under varying loads. In the process, we take materials to the limits of what they can withstand and determine which of the various materials are both technically the best and cost-efficient. Thanks to such tests, we can now substantially extend the operating limits for our products. This will enable our customers to run systems at relatively high pressures and temperatures even more efficiently than before. For energy engineering applications, we are also developing designs for high-pressure valves that can be used at up to 720 °C. These are intended to be employed in the next generation of power plants.

New materials engineering developments to combat corrosion and wear

Pumps that operate at times without the intake of liquid are highly susceptible to failure. This is especially true of seal-less chemical pumps, whose plain bearings are lubricated by the pumped liquid itself. For the first time, we have used innovative ceramic materials for this application which are far superior in terms of corrosion and wear to conventional silicon carbide materials. Using pump bearings made of these materials, we shall also be able to cover those applications for which no technically satisfactory solutions have been found to date.



We use special measuring methods to check the surface quality of seal elements.

The aim of a second materials engineering development project was to produce a corrosion- and wear-resistant functional surface on parts subject to high levels of stress through coating with a high-alloy layer. This project was prompted by applications in which our customers use aggressive seawater as a cooling medium. For pumps that are able to cope with this task, designers need a corrosion-resistant metal material with good sliding properties. For this reason, our materials experts investigated the possibilities of using laser technology to apply an alloy layer directly on to a workable metal base material. The results of the coatings obtained are highly promising, so we are now testing their use in our seawater pumps.

Pressure boosting systems with shorter response times

Pressure boosting systems are used wherever the available mains pressure is too low to ensure an adequate water supply. Our automation experts developed a new control device for these systems in 2006. This device responds more quickly to changes in the volume of water consumption, which helps to save energy. The newly developed module will be launched in the current year and will replace automation products used so far.

Since the use of intelligent valves can likewise reduce electricity consumption, we have further improved our BOA-Systronic electronic control system for use in ventilation and cooling applications. In this way, the energy needed for a recirculation pump can be reduced by up to 70 % in these installations.

Added plant reliability through monitoring systems

The failure of a pump very often brings a complete production plant to a standstill. To counteract disruptions of this kind, we are working on a project sponsored by the German Federal Ministry of Education and Research to develop a software program for pump operators. This allows the causes of failures to be analysed and conclusions to be drawn on the reliability of pump systems under a variety of plant conditions. The program is based on the mathematical principles of our “PumpExpert” monitoring system. Once the program is completed by the project team, plant operators will be able to use it to optimize their operations and to develop strategies for low-cost maintenance.

We are pursuing the same idea with the development of our quarter-turn pneumatic actuators. Here, too, the primary aim is to avoid the failure of shut-off or control butterfly valves and thus prevent plant stoppages. We are therefore working on smart actuator systems that are able to detect risks of potential breakdowns and transmit the information to a control room.

EMPLOYEES

- More than 13,000 employees worldwide
- Involving employees in our success
- Training secures our skill base

Our global corporate objectives can only be achieved with employees and managers who are well-qualified and have experience in depth. Innovative personnel development concepts and continuing education help KSB employees to keep adapting to the new challenges they are constantly faced with. These come from the development of advanced technologies, the change in our markets and the growing internationalization of our business relations.

Moderate increase in number of employees

As a result of our improved efficiency, we managed to cope with the increase in orders during the year under review without major increases in the number of personnel. At the end of 2006, the KSB Group had 13,063 employees, 100 more people than a year earlier. This slight increase is largely attributable to recruitments in two American companies and in our company in South Africa. These companies expanded their production in the year under review and in some cases took on new functions.

In the European companies, the number of employees fell slightly by 31 people to 7,194, while in the Region Asia / Pacific it remained unchanged at 3,738. The headcount in the Region Americas increased by 99 in the year under review to 1,745, with the largest growth being posted by KSB Bombas Hidráulicas S.A. in Brazil. In the Region Middle East / Africa, there were 386 employees at the end 2006, 32 more than in the previous year.

Human resources policy with global perspective

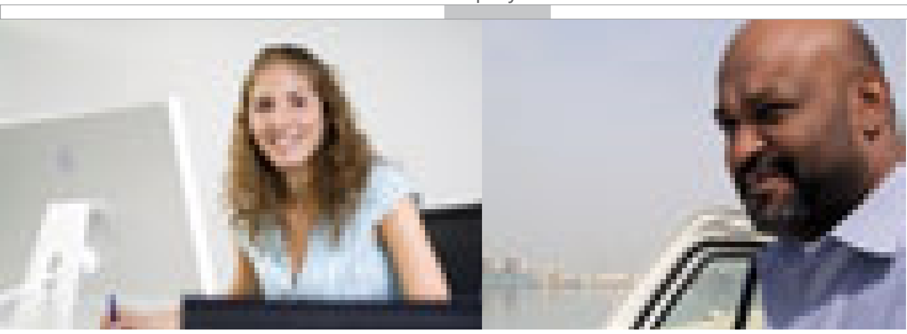
The global nature of the Group calls for a human resources policy that not only remains focused on our corporate objectives, but also has the flexibility which enables it to respond to company and country-specific developments. In 2006 we initiated Group-wide projects on this issue aimed at standardizing job evaluation procedures, implementing systematic succession planning and ensuring adequate continuing technical education, while at the same time taking into account the various national concerns.

Through variable components of pay, the Group companies are increasingly endeavouring to involve employees in the success of the company and to motivate them with added incentives. In 2006, we introduced a system of variable compensation for the sales staff of our Chinese KSB Shanghai Pump Co. Ltd. In Germany, apart from the annual bonus, employees are also receiving for the first time an additional “pension building block” for 2006, which improves their retirement pensions. The level of this benefit depends on the return on sales and is paid to employees who also have a private benefits scheme.

In the year under review, the German companies also prepared for the changeover to a standardized remuneration system for all employees. The pay scheme formulated according to the metal and electrical industry’s new framework compensation agreement comes into force in the current year.

Continuing education increases the level of qualification

To keep their knowledge and skills at the required high level, our employees are continuously broadening their qualifications. This includes training and development in engineering,



KSB employees ensure the company's success worldwide – with dynamism and technical expertise.

business administration, data processing and languages as well as the acquisition of intercultural skills and new creativity methods. An important focus of the continuing education on offer is the range of seminars provided by the KSB training centre, which in the year under review organized around 500 internal events throughout Europe for 2,214 employees.

The range of training offered also included integration seminars for new employees, who had the opportunity to familiarize themselves, amongst other things, with the fundamental principles of our pumps, valves and systems at the International KSB Pumps & Valves Training event. This three-week training event was attended by 68 employees from 29 countries.

Vocational training helps to safeguard the future

KSB will also need well-qualified specialists in the future. To this end, we invested € 5.4 million in our vocational training in Germany and are currently preparing 228 young people for their later careers. In addition to their technical and methodological qualification, we also set great store by the personal and social development of these young people. And we offer additional training to foster this development. In the framework of our "Young Business Center" we also familiarize trainees with the principles of entrepreneurial thinking in their own projects.

To enable young people to enjoy practice-based learning already at school, we cultivate close contacts with the educational institutions at our various locations. In the context of cooperation agreements we support schools in project work and teaching.

Measures to tackle staff shortages

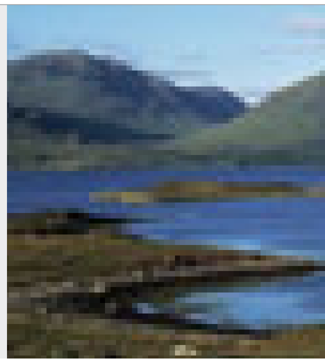
The past year was marked by a high level of capacity utilization. To cope with the sharp increase in the volume of orders, we used flexible working time models in particular. We also recruited new qualified personnel and project engineers.

To eliminate staff shortages at our German production facilities, we developed a shift model with the Works Councils which ensures better utilization of machines. This is based on a 35-hour week, but in principle allows work to be carried out in three shifts on six days of the week on key machines.

Thanks to the staff

In 2006, our employees coped with the largest growth in orders for more than a decade. This was only possible thanks to the high level of flexibility and commitment of everyone involved and the huge efforts made to improve and speed up work processes. The Board of Management thanks all the company's employees, who managed to ensure that our customers were provided with good service despite the increased workload.

A special word of thanks is due to the employees' representatives and the Executives' Committee. They made a substantial contribution towards creating efficient structures and working time models which enabled our staff to cope efficiently with the additional workload.



The new Amarex N submersible motor pump has been designed for energy efficiency and low environmental impact.

ENVIRONMENTAL MANAGEMENT

- CO_2 emissions and electricity costs reduced
- Environment-friendly design of pumps
- Certification processes simplified

As a responsible company, we remain focused on the future. This includes safeguarding the basis of our existence and being economical in the use of natural resources for power generation and for production.

Investments in environmental protection

In the year under review, we invested around € 3 million in preventive and restorative activities. These included the closure of our in-house landfill for foundry waste sand in Pegnitz, which will be sealed and recultivated by June 2007. The relinquishment of this landfill became possible because in Pegnitz today we recycle almost all the sand needed for the casting process.

We continued the groundwater purification started in 2005 at the former site of SISTO Armaturen S.A. in Mersch, Luxembourg. The restoration work will last a total of ten years and will cost around € 500 thousand.

Climate protection and conservation of resources

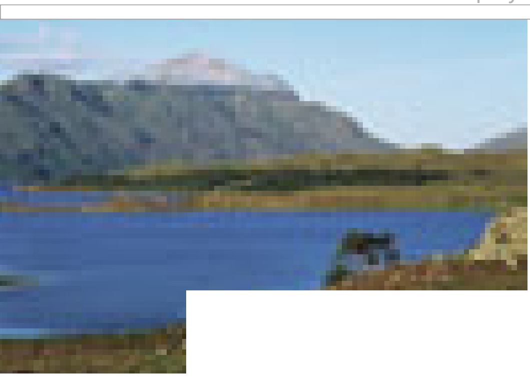
Our environmental protection activities are aimed at helping to achieve the objectives of the Kyoto protocol signed in 1997. Being economical in our use of energy resources is just as important as using fuels which cause relatively few emissions.

A massive reduction of CO_2 emissions was achieved in 2006 at our Pakistani site in Hassanabdal. We switched our fuel supplies from diesel oil to natural gas. The positive effect of this measure was particularly marked at our site foundry, where until then we had needed large quantities of diesel oil for drying the sand and heating the casting moulds.

At all KSB sites, we are seeking to keep energy consumption and costs as low as possible. At our Pegnitz site, we implemented a lighting system in 2006 designed to conserve energy by using only half the fluorescent tubes we used before. This has reduced our local electricity costs by about € 160 thousand per annum.

"Eco-design" for submersible motor pump

To protect the environment, we also take care to ensure that our products are made of recyclable materials, consume as little energy as possible and offer a high degree of safety. We are therefore one of the first manufacturers to develop a submersible motor pump that is fully compliant with the European Directive 2005/32/EC, which provides a framework for the eco-design of energy-using products. The directive encourages manufacturers to minimize the environmental impact of new products from development right through to later waste disposal. It also provides rules intended to improve energy efficiency in operation and simplify maintenance. By means of structural changes, our designers managed amongst other things to increase the pumps' efficiency by up to 10 % compared with previous models.



Improved processes and cost reduction

In our companies in Germany, France, Italy, Pakistan and Spain, we brought environmental protection, quality management and also occupational health and safety together in a single integrated management system. In this way, we have established a basis for comparing our sites in terms of their consumption data, volume of waste, accident rates and quality. This highlights approaches for improvement and reduces the cost of documentation.

At the same time, we concentrated the certification of our sites worldwide on ISO 19001 for quality, ISO 14001 for environmental protection and OHSAS 18001 for occupational health and safety. Accordingly, we succeeded in achieving a cost-effective reduction in the number of certification companies involved and the necessary audits.

Voluntary environmental performance

Environmental laws vary from country to country. It goes without saying that we comply with these laws. However, to meet our own ambitious goals, we do substantially more than meet the minimum legal standards in the countries concerned. In 2005, we had already committed to greater environmental protection within the scope of the "Bavarian Environment Pact". We underlined our commitment in 2006 by joining the "Saxony-Anhalt Environmental Alliance" in 2006. We are thus committed not only to applying our environmental management system according to ISO 14001, but also to making additional voluntary contributions. These are aimed at reducing the use of hazardous substances, improving water and soil protection and conserving energy.

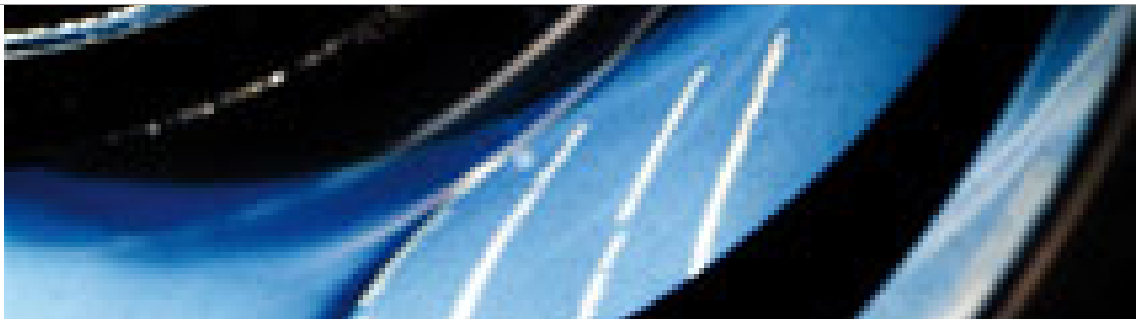
SOCIAL RESPONSIBILITY

- Cooperation with regional schools
- Donation campaign for social projects
- Collaboration in *Wissensfabrik Deutschland e. V.* ("knowledge factory")

KSB lives up to its responsibility for helping to find solutions to social problems and tackling community tasks in the region. This includes collaboration with educational institutions, active assistance in careers counselling for young people and cooperation in regional initiatives to improve local conditions.

In addition, we support institutions and initiatives in our local regions with an annual campaign of donations for the benefit of the socially disadvantaged and of children or young people.

As a founding member of *Wissensfabrik Deutschland e.V.*, we take an active part in this "knowledge factory". With a membership today numbering 50 companies, this association is engaged in educational projects throughout Germany and sponsors start-up companies. As part of this initiative, KSB is currently active in six school partnerships, supports a scientific education project and is involved in consultancy work for young entrepreneurs.



RISK MANAGEMENT

- Effective measures to eliminate delivery bottlenecks
- Strict management of payments and costs
- Strategic partnerships extended

Corporate risk management at KSB is aimed at identifying business risks at an early stage, initiating appropriate countermeasures and thereby averting risks to the prosperity and continued existence of the company.

The corporate guidelines on the organization and implementation of risk management are documented in a manual. According to the requirements laid down in this manual, all KSB companies have a responsibility to identify and assess risks and to report them to headquarters, as well as to initiate countermeasures. The internal auditor undertakes audits to establish the extent to which all operative units are observing these guidelines and meeting their obligations to play an active part in risk management.

Risk reporting is integrated in the planning and controlling process. We inform the Audit Committee of the Supervisory Board about the risk status at its regular meetings.

Risks are registered and communicated according to the following categories:

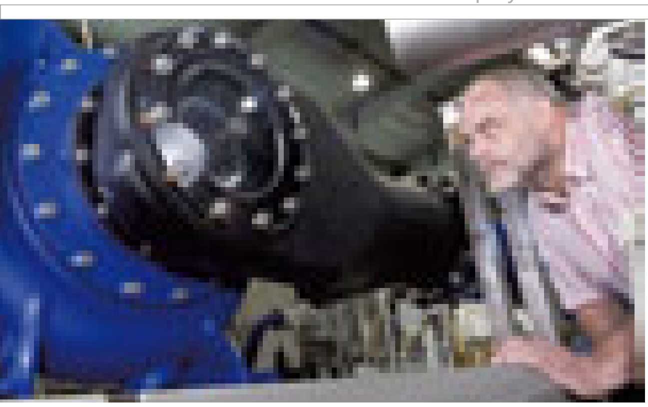
Market / Competition

The situation on our markets underwent major changes in 2006. The strong demand for pumps, valves and associated systems eliminated the overcapacity in some segments which had influenced the market in the previous years. This is especially the case for the equipment of large plants in the energy, industry and water segments and also for the mining sector.

This rapid change on the demand side led to capacity bottlenecks throughout the industry with corresponding delays in delivery. We too had to adjust to the change in delivery requirements and expanded our capacity for processing orders and production. We are also making increasing use of our global manufacturing network to complete our customers' orders on time. We are eliminating the bottlenecks that still exist through our continuous improvement process.

On the market for standard products that are used in the industrial sector, in building services and in waste water treatment plants, the competition remains very strong. Labour cost and currency advantages play an important role in some production countries. To counter the risk of competitive disadvantages, we are expanding our purchasing and manufacturing network worldwide. In Europe we are continuing to improve our business processes. We are also reducing the cost of order processing by making increased use of online sales systems.

We do not see any major risks to the economic development in the current year. In particular, we feel the growth in the Region Asia / Pacific provides a very workable basis for the planned expansion of our business in this increasingly important market.



Hydraulic experts design impellers with high mechanical strength to avoid damage from vapour bubbles.

Products / Projects

There were no significant risks that could result from any technical problems of our products.

The switch in various units of production to a synchronous manufacturing system and the introduction of SAP R/3 software initially made the supply situation difficult. We are combating the teething problems encountered in some areas with solution-oriented project management. Bottlenecks have also compromised delivery capability on our procurement markets. In our continuous improvement process, we are on course to ensure further stabilization of our production processes in 2007 and to reduce the risk of delivery bottlenecks.

To identify and act on market opportunities in good time, we continue to engage in our 700UP growth and innovation initiative. In this programme, we are exploring applications for our existing product range that were not hitherto served and identifying market potential for new products and services. In the process, we set strict standards in terms of both the anticipated market success and the risks associated with these innovations.

Finances / Liquidity

Both Controlling and the Finance and Accounts departments report on the company's financial position once a month to the Board of Management and the Supervisory Board, analyse current trends and define suitable measures for avoiding or limiting financial risks.

Our standardized global reporting system helps to identify profit and liquidity risks promptly. To avoid payment defaults, we run a strict payment management system, especially in our large-scale projects business. This system provides, amongst other things, for advances and payments in instalments. We use hedging schemes to minimize foreign currency exposure.

We also operate intensive cost management to provide long-term safeguards for the results of the Efficiency Enhancement Programme that finished at the end of 2006.

Procurement

As a result of the strong growth in global demand for goods, we saw further increases in prices for the raw materials we need, especially copper. In view of the sustained favourable demand situation we believe it is possible to pass on these price increases to the market. However, the shortage of raw materials associated with the high capacity utilization of our sub-suppliers may also lead to bottlenecks in deliveries of materials and thus to longer delivery times.

Aiming to reduce this risk, we reserved capacity with our suppliers early on, extended our strategic partnerships and tapped new sources of supply. We have further refined our planning instruments to ensure that we can perform material requirements planning at an even earlier stage in the future.

Standardized Eta series pumps in the cooling system of a trade fair hall

Against the background of the continued strong demand for oil and gas, 2006 saw a dramatic rise in energy costs. Further cost increases cannot be excluded. Thanks to long-term supply contracts with electricity and gas suppliers we are able to cushion the effect of these increases to some extent. We have also taken action at our sites to increase energy efficiency. This includes in Germany, for example, improved heat insulation of buildings.

Technology / Research and Development

Our process for the development of new products is designed in such a way that we can identify technical and market-related risks at an early stage and mitigate them by taking appropriate action. Interdisciplinary teams also include sales staff in all the important phases of product development.

The increasing number of customized solutions to problems results in product developments that can only be used in very limited fields of application. To exclude financial risks, we endeavour to ensure that customers compensate us for such developments, regardless of their later use.

In the market of flue gas desulphurization we assume that, apart from pumps made of special materials that offer high levels of wear resistance, there will be increasing demand in the future for lower-cost systems with plastic linings. In 2006 we therefore acquired the rights to use a new process in order to meet this growing demand with suitable technology.

Environment

Our standardized corporate environment and safety standards are aimed at excluding environmental risks as far as possible. At all KSB sites, specially appointed officers ensure compliance with our strict environmental standards.

Measures intended to clean up contaminated sites are backed by appropriate financial resources.

Other risks

We reduce risks that may occur as a result of the manipulation or loss of data by using high-performance hardware and software and securing our systems against misuse.

Overall assessment

There are currently no risks that could jeopardize the continued existence of the company. On the basis of the good net worth of our company, any financial risks that could occur beyond the current year are not deemed to be jeopardizing the company’s existence.

REPORT ON EXPECTED DEVELOPMENTS

- Ongoing favourable market developments
- Increase in sales revenue at a high level
- Aiming for another improvement in earnings

Market developments and sales opportunities

From today's perspective, it appears that the global economy will continue to perform well. We therefore expect continued high demand in 2007 and the following year from the markets that are most important to us. A general slowdown in the economy may, however, lead to a decline of our order intake for products with short sales cycles, such as in Building Services. However, this does not look likely before 2008.

Despite some cooling down of the economy, we are basically expecting growth in Industry and Building Services, Water and Waste Water, and in Energy and Mining until at least 2010.

Demand for industrial goods is likely to increase further in 2007 and 2008, with producers expanding their capacity accordingly. Important areas of growth will include chemical and process engineering, where we aim to maintain our good market position around the world and gradually extend it. In the chemicals industry, the substantial need for investments in the Region Asia / Pacific will be ensuring ongoing high demand for pumps and valves. In Europe, indirect exports via plant and equipment engineering contractors will remain strong.

In the building services sector, we see a trend towards more air conditioning related to rising expectations of comfort and growing urbanization in warmer climate zones. We also perceive opportunities in the fitting out of wellness and water sports facilities. Counter to this, the trend towards low-energy buildings in the industrialized countries may lower the growth rates for heating pumps.

In many countries, new water extraction and infrastructure projects are needed to supply growing populations with the most vital resource of them all. Desalination of seawater, for which we offer a special product range, is gaining in importance. It is also becoming increasingly necessary to transport water over great distances to supply it to consumers. This will favour the business in large pipeline pumps and valves. We consider Asia to be the market with the best growth prospects. However, the demand for water equipment is also growing in Eastern Europe, where water supply systems need to be modernized, and in the Middle East. The supply of fresh water there needs to keep pace with the growth in the population and of industry.

To treat the waste water from households and from industry, waste disposal utilities are increasingly relying on large-scale water treatment plants. This trend will increase demand for pumping stations to bring the waste water to these plants. This is where we currently see the largest potential for growth. In some growth markets, there is also an urgent need to intensify the treatment of industrial waste water, for which we are very well equipped.

Global consumption of energy is rising, and with it the need to build and equip power stations. Plans in China indicate a very strong expansion in power plant capacity over the next few years. This will ensure strong demand for energy generation

For the Erdenet copper mine in Mongolia, KSB supplied one of the largest slurry pumps ever built.

equipment until at least 2010. Our power station pumps and valves can also benefit from the rising energy requirements in other growth markets, such as India and Russia. There are a large number of new projects and expansion projects on the agenda in Europe, too.

In the mining industry, the commodities boom has led to our customers planning new mines and reopening ones that had been shut down. We expect business for our slurry pumps and associated spare parts to be buoyant here over the next few years. The same applies to oil sands extraction in Canada. Experts believe that output here will double within six years. However, this depends on how oil prices develop.

Outlook for the Group and for the Regions

In view of this market situation, we intend to further add to our order intake in the Group in this year and the next. Increased business in standard pumps and valves, which in some countries is not as strong as the project business, should help us achieve this.

As our capacity is extremely well-utilized and there are continued bottlenecks on our procurement markets, sales revenue in 2007 may again lag behind the order intake. In this case it is only expected to catch up in 2008.

In order to increase our order volume, we shall take advantage of the opportunities being offered in the four Regions as follows:

In Europe, we intend to improve our order intake above average this year. To this end, we shall be implementing the findings from a customer survey we carried out in eight countries and will align our sales and service activities with market requirements even more systematically. We will also improve our market position with a new logistics concept for standard pumps and valves.

As a result of the high prices for oil, gas and raw materials, our customers in the Region Middle East / Africa have sufficient funds to implement major projects for water supply, waste water treatment, industrial and urban development. We shall improve our market penetration by establishing new competence centres and a greater presence in terms of sales and service.

In Asia / Pacific, we continue to see above-average potential for growth. We can take advantage of this based on our strong market position there, especially for our Industry and Energy segments. We see a particularly favourable outlook for equipping large-scale power stations, transporting liquefied gases, in petrochemicals and in the general process industry. State and municipal projects to protect the environment also offer opportunities. This is why we shall become more involved in waste water treatment and flue gas desulphurization in this region.

In the Americas, we are expanding our sales network to boost our standard business. With the manufacturing facility acquired in 2005 in Barueri / São Paulo, we shall also be intensifying our valve business in South America. Good market prospects also result from the introduction of new products for the industrial and water engineering sectors and the very positive growth in demand in the mining industry. The opportunities for selling European products may, however, worsen if the US dollar, the real, or other American currencies further weaken against the euro.

The Iskenderun Bay coal-fired power plant in Turkey is equipped with KSB boiler recirculation pumps.

Moreover, economic institutes are forecasting an economic downturn in the USA, which might slow down investments.

Measures to safeguard the future of the Company

We shall drive forward our growth and innovation initiative throughout the Group. This will leverage additional revenue potential. At the same time, we remain committed to further enhancing efficiency. This includes a continuous process of improvement, in which we analyse mistakes and develop measures for leaner and more cost-effective processes.

To safeguard KSB's growth markets of the future, we already reinforced our commitment to key markets such as Brazil, China, India and Russia in 2005 and 2006. Over the next few years, we are planning additional measures to safeguard and expand our position in these markets.

In research and development, we are focusing our efforts in 2007 on the development of new product series for energy generation applications, the automation of pumps and valves, and the creation of additional sizes for our pressure exchanger, which is needed for seawater desalination plants. In addition, we are working on reducing the complexity of our range of products, which involves consolidating related series and standardizing components.

Financial outlook

Cost-cutting, accompanied by continued productivity increases and the volume growth, will lead to another improvement in earnings. Both in 2007 and 2008, we aim to draw closer to our medium-term goal of a pre-tax return on sales of 8 %. The risks that we see here are excessive collective wage agreements and commodity prices rising faster than we had planned.

We are planning for capital expenditure of around € 75 million in 2007. The priority is on the expansion and renovation of our production facilities, with a particular focus on our capacity in the Energy segment. We are adding larger sized machine tools and more powerful test facilities to our large pump production area. These measures will take account of both the growing volume of orders and the trend towards rising power station output, and accordingly towards larger and more powerful pumps. We plan on financing the necessary expenditure from cash flow. Our net financial position will remain stable in 2007.

We expect the parent company KSB AG to develop in line with the overall Group and continue to improve its earnings.

Forward-looking statements

This report contains forward-looking statements. We wish to draw attention to the fact that actual events may differ materially from our expectations of developments if one of the uncertainties described, or other risks and uncertainties, should materialize, or if the assumptions underlying the statements prove to be inaccurate.

Efficiency improved

Our measures to increase the efficiency of our work took effect. Staff costs fell to 32.9 percent of total output of operations, down 2.6 percentage points from the previous year. The average output per employee rose year-on-year from € 111 thousand to € 122 thousand, by almost

10 percent.

Consolidated Financial Statements

BALANCE SHEET

ASSETS

(€ thousands)	Notes	31 Dec. 2006	31 Dec. 2005
NON-CURRENT ASSETS			
Intangible assets	1	39,353	39,283
Property, plant and equipment	1	231,501	224,771
Non-current financial assets	1	30,349	23,197
Deferred tax assets	2	29,093	30,327
		330,296	317,578
CURRENT ASSETS			
Inventories	3	191,035	198,268
Receivables and other current assets	4	462,801	401,986
Current financial instruments	5	19,597	15,825
Cash	5	142,115	120,957
		815,548	737,036
		1,145,844	**1,054,614**

EQUITY AND LIABILITIES

(€ thousands)	Notes	31 Dec. 2006	31 Dec. 2005
EQUITY	6		
Subscribed capital		44,772	44,772
Capital reserve		66,663	66,663
Revenue reserves		211,390	203,051
Consolidated net retained earnings		49,476	11,129
Minority interest		71,468	64,363
		443,769	389,978
NON-CURRENT LIABILITIES			
Deferred tax liabilities	7	11,515	10,735
Provisions for pensions and similar obligations	8	201,641	192,370
Other provisions	9	36,477	39,425
Liabilities	10	49,445	57,158
		299,078	299,688
CURRENT LIABILITIES			
Other provisions	9	164,482	139,582
Liabilities	10	238,515	225,366
		402,997	364,948
		1,145,844	**1,054,614**

INCOME STATEMENT

(€ thousands)	Notes	2006	2005
Sales revenue invoiced		1,555,454	1,390,314
Sales revenue recognized by PoC		51,937	11,131
Sales revenue	11	**1,607,391**	**1,401,445**
Changes in inventories		– 24,148	26,937
Work performed and capitalized		1,950	2,481
Total output of operations		**1,585,193**	**1,430,863**
Other operating income	12	18,080	20,697
Cost of materials	13	– 650,225	– 584,291
Staff costs	14	– 521,694	– 508,469
Depreciation and amortization expense		– 33,239	– 34,197
Other operating expenses	15	– 291,342	– 276,514
Other taxes		– 8,226	– 7,725
		98,547	**40,364**
Income from investments	16	2,200	987
Other financial income / expense	16	– 10,501	– 11,718
		– 8,301	**– 10,731**
Earnings before income taxes		**90,246**	**29,633**
Taxes on income	17	– 27,878	– 9,787
Net profit for the year		**62,368**	**19,846**
Minority interest in net profit / loss	18	– 12,892	– 8,717
Consolidated net profit for the year		**49,476**	**11,129**
Retained earnings brought forward		–	–
Consolidated net retained earnings		**49,476**	**11,129**
Earnings per ordinary share (€)	20	27.99	5.85
Earnings per preference share (€)	20	28.51	6.88

STATEMENT OF CHANGES IN FIXED ASSETS

	Historical cost					
(€ thousands)	1 Jan. 2006	Change in consolidated Group / CTA* / Other	Additions	Disposals	Reclassi-fications	31 Dec. 2006
Intangible assets						
Concessions, industrial and similar rights and assets, as well as licences in such rights and assets	25,555	– 163	1,316	139	19	26,588
Goodwill	30,320	– 111	764	–	–	30,973
Advance payments	–	–	2,348	–	–	2,348
	55,875	**– 274**	**4,428**	**139**	**19**	**59,909**
Property, plant and equipment						
Land and buildings	186,928	– 3,083	4,531	3,066	2,485	187,795
Plant and machinery	298,590	– 6,440	16,060	4,497	5,422	309,135
Other equipment, operating and office equipment	131,735	– 3,102	12,355	9,301	89	131,776
Advance payments and assets under construction	8,957	– 562	9,099	158	– 8,015	9,321
	626,210	**– 13,187**	**42,045**	**17,022**	**– 19**	**638,027**
Non-current financial assets						
Investments in affiliates	21,022	– 19	5,571	661	–	25,913
Loans to affiliates	–	–	2,262	–	–	2,262
Other investments	2,505	–	47	–	–	2,552
Non-current financial instruments	1,019	– 29	–	–	–	990
Other non-current loans	64	– 1	–	1	–	62
	24,610	**– 49**	**7,880**	**662**	**–**	**31,779**
	706,695	**– 13,510**	**54,353**	**17,823**	**–**	**729,715**

* CTA = currency translation adjustments

Accumulated depreciation / amortization						Carrying amounts	
1 Jan. 2006	Change in consolidated Group / CTA* / Other	Additions	Disposals	Reclassi-fications	31 Dec. 2006	31 Dec. 2006	31 Dec. 2005
16,592	– 128	4,228	135	– 1	20,556	6,032	8,963
–	–	–	–	–	–	30,973	30,320
–	–	–	–	–	–	2,348	–
16,592	**– 128**	**4,228**	**135**	**– 1**	**20,556**	**39,353**	**39,283**
86,146	– 1,591	5,933	2,208	–	88,280	99,515	100,782
218,017	– 5,304	13,185	3,620	15	222,293	86,842	80,573
97,276	– 2,664	9,893	8,538	– 14	95,953	35,823	34,459
–	–	–	–	–	–	9,321	8,957
401,439	**– 9,559**	**29,011**	**14,366**	**1**	**406,526**	**231,501**	**224,771**
1,047	–	–	660	–	387	25,526	19,975
–	–	500	–	–	500	1,762	–
292	–	169	–	–	461	2,091	2,213
74	–	8	–	–	82	908	945
–	–	–	–	–	–	62	64
1,413	**–**	**677**	**660**	**–**	**1,430**	**30,349**	**23,197**
419,444	**– 9,687**	**33,916**	**15,161**	**–**	**428,512**	**301,203**	**287,251**

STATEMENT OF CHANGES IN EQUITY

(€ thousands)	1 Jan. 2005	Net profit / loss for the year	Dividends paid	Transfer to / from revenue reserves	Capital increases / decreases	Currency translation changes	Change in cons. Group / Successive acquisitions	Measurement of financial instruments	Adjustments taken directly to equity / Other	31 Dec. 2005
Subscribed capital of KSB AG	44,772	–	–	–	–	–	–	–	–	44,772
Capital reserve of KSB AG	66,663	–	–	–	–	–	–	–	–	66,663
Revenue reserves	185,380 *	–	–	8,125	–	12,875	6,122	– 9,961	510	203,051
Consolidated net retained earnings	9,016	11,129	– 891	– 8,125	–	–	–	–	–	11,129
	305,831 *	11,129	– 891	–	–	12,875	6,122	– 9,961	510	325,615
Minority interest	56,944	8,717	– 1,719	–	– 17	3,975	– 4,003	–	466	64,363
	362,775 *	**19,846**	**– 2,610**	**–**	**– 17**	**16,850**	**2,119**	**– 9,961**	**976**	**389,978**

(€ thousands)	1 Jan. 2006	Net profit / loss for the year	Dividends paid	Transfer to / from revenue reserves	Capital increases / decreases	Currency translation changes	Change in cons. Group / Successive acquisitions	Measurement of financial instruments	Adjustments taken directly to equity / Other	31 Dec. 2006
Subscribed capital of KSB AG	44,772	–	–	–	–	–	–	–	–	44,772
Capital reserve of KSB AG	66,663	–	–	–	–	–	–	–	–	66,663
Revenue reserves	203,051	–	–	10,238	–	– 7,875	–	5,377	599	211,390
Consolidated net retained earnings	11,129	49,476	– 891	– 10,238	–	–	–	–	–	49,476
	325,615	49,476	– 891	–	–	– 7,875	–	5,377	599	372,301
Minority interest	64,363	12,892	– 1,697	–	754	– 4,122	– 1,136	–	414	71,468
	389,978	**62,368**	**– 2,588**	**–**	**754**	**– 11,997**	**– 1,136**	**5,377**	**1,013**	**443,769**

(€ thousands)	31 Dec. 2005	31 Dec. 2006
Accumulated currency translation differences	– 27,751	– 39,748
thereof applicable to minority interest	(– 8,629)	(– 12,751)

* Restated in accordance with IFRS 3

CASH FLOW STATEMENT

(€ thousands)	2006	2005
Net profit for the year	62,368	19,846
Depreciation and amortization expense / write-ups	33,916	34,159
Increase / decrease in non-current provisions	5,968	15,762
Gain / loss on disposal of fixed assets	– 1,076	1,272
Cash flow	**101,176**	**71,039**
Increase / decrease in inventories	6,907	– 30,298
Increase / decrease in trade receivables and other assets	– 92,555	– 22,495
Increase / decrease in current provisions	25,097	10,754
Increase / decrease in advances received from customers	15,921	21,380
Increase / decrease in liabilities (excl. financial liabilities)	17,964	1,051
Other non-cash income / expenses (operating)	2,718	– 4,876
	– 23,948	– 24,484
Cash flows from operating activities	**77,228**	**46,555**
Proceeds from disposal of intangible assets	4	5
Payments to acquire intangible assets	– 3,664	– 3,911
Proceeds from disposal of property, plant and equipment	3,239	4,494
Payments to acquire property, plant and equipment	– 42,045	– 39,577
Proceeds from disposal of non-current financial assets	2	223
Payments to acquire non-current financial assets	– 7,880	– 6,313
Net cash flows from the acquisition and sale of consolidated companies and other business units (basically successive acquisitions)	– 1,900	– 5,665
Other non-cash income / expenses (investing)	1,359	– 2,439
Cash flows from investing activities	**– 50,885**	**– 53,183**
Proceeds from additions to equity / payments related to capital decreases	754	– 17
Dividends paid for prior year (incl. minority interest)	– 2,588	– 2,610
Deferred compensation within the scope of employee pension plans	2,681	2,105
Net cash flows from financial liabilities	– 3,331	– 9,206
Net cash flows from financial receivables	– 3,926	– 3,367
Other non-cash income / expenses (financing)	1,359	– 2,439
Cash flows from financing activities	**– 5,051**	**– 15,534**
Net change in cash and cash equivalents	21,292	– 22,162
Effects of exchange rate changes on cash held	– 134	583
Effects of changes in consolidated Group	–	7,218
Cash and cash equivalents at beginning of period*	120,957	135,318
Cash and cash equivalents at end of period*	**142,115**	**120,957**
Supplemental disclosures:		
Interest received	5,162	3,601
Interest paid	– 5,668	– 6,077
Income taxes paid	– 24,957	– 23,159
Dividends received	2,200	987

* Current financial instruments are no longer reported as part of the cash and cash equivalents as from 2006. They are included in the other assets. For reasons of compatibility, the relevant prior-period amounts have been restated.

SEGMENT REPORTING

BY REGION

(€ thousands)	Region Europe 2006	Region Europe 2005	Region Middle East / Africa 2006	Region Middle East / Africa 2005
External sales revenue of the Group companies by segment	**1,128,618**	**1,000,753**	**35,951**	**35,440**
by geographic area				
Europe	928,766	823,689	48	23
Middle East / Africa	63,168	50,750	35,900	35,336
Asia / Pacific	124,870	105,422	–	30
Americas	11,814	20,892	3	51
Inter-segment sales revenue	**51,746**	**52,956**	**423**	**627**
Segment result (EBIT)	**47,622**	**6,414**	**5,199**	**4,227**
thereof depreciation and amortization expense	25,640	26,102	525	545
thereof write-downs of non-current financial assets	677	–	–	–
thereof other non-cash items	5,645	17,545	38	– 248
thereof net profit or loss of equity-accounted investments	–	–	–	–
thereof income from investments	1,665	880	169	–
Segment assets	**800,956**	**734,156**	**23,782**	**22,416**
Segment liabilities	**558,309**	**528,355**	**6,617**	**6,070**
Capital expenditure	**30,785**	**28,964**	**1,216**	**828**
Number of employees (average)	**7,138**	**7,287**	**379**	**356**

BY MARKET

(€ thousands)	Industry and Building Services 2006	Industry and Building Services 2005
External sales revenue of the Group companies by segment	**827,173**	**737,412**
Segment assets	**574,687**	**541,058**
Capital expenditure	**28,476**	**27,063**

Region Asia / Pacific		Region Americas		Total	
2006	2005	**2006**	2005	**2006**	2005
234,799	**196,034**	**208,023**	**169,218**	**1,607,391**	**1,401,445**
31	360	2,329	2,167	931,174	826,239
1,186	1,805	143	131	100,397	88,022
233,548	193,859	3,938	2,983	362,356	302,294
34	10	201,613	163,937	213,464	184,890
7,706	**6,895**	**5,413**	**3,604**	**65,288**	**64,082**
27,978	**17,857**	**19,428**	**12,923**	**100,227**	**41,421**
3,060	3,709	4,014	3,841	33,239	34,197
–	–	–	–	677	–
– 20	80	– 771	– 381	4,892	16,996
–	–	–	–	–	–
193	107	173	–	2,200	987
166,474	**145,383**	**125,539**	**122,332**	**1,116,751**	**1,024,287**
76,963	**72,445**	**42,621**	**41,425**	**684,510**	**648,295**
8,536	**4,946**	**5,936**	**10,494**	**46,473**	**45,232**
3,747	**3,712**	**1,698**	**1,558**	**12,962**	**12,913**

Water and Waste Water		Energy and Mining		Total	
2006	2005	**2006**	2005	**2006**	2005
307,467	**277,782**	**472,751**	**386,251**	**1,607,391**	**1,401,445**
213,617	**204,819**	**328,447**	**278,410**	**1,116,751**	**1,024,287**
10,584	**10,245**	**7,413**	**7,924**	**46,473**	**45,232**

NOTES

GENERAL

Basis of preparation

The accompanying consolidated financial statements of KSB AG, Frankenthal, were prepared in accordance with the International Financial Reporting Standards (IFRSs) as adopted by the EU and the additional requirements of German commercial law under section 315a(1) of the HGB (German Commercial Code). We applied the Framework, as well as all Standards and the Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) in force at the reporting date. For the purposes of this document, the term IFRS includes applicable International Accounting Standards (IASs).

The consolidated financial statements are published in the electronic *Bundesanzeiger* (German Federal Gazette).

The financial year of the companies consolidated is the calendar year.

All material items of the balance sheet and the income statement are presented separately and explained in these notes.

The income statement has been prepared using the nature of expense method.

First-time application of new and revised standards

There were no new or revised Standards required to be applied by KSB for the first time in the year under review. KSB has not applied IFRS 7 *Financial Instruments: Disclosures* prior to the effective date.

BASIS OF CONSOLIDATION

Consolidated Group

As in the previous year, 4 German and 43 foreign companies were fully consolidated in addition to KSB AG. We hold a majority interest in the voting power of these companies, either directly or indirectly, or we have the power to appoint the majority of the members of the companies' management. No companies are currently included at equity or proportionately consolidated.

The following changes relating to the consolidated companies occurred in the year under review:

- In December 2006, we acquired the remaining 10 % interest in our Spanish Group company Bombas ITUR S.A., Zarautz, and are now the sole proprietor.
- In December, we also effected – together with our partner – an increase in the capital of the Chinese company KSB Shanghai Pump Co. Ltd., Shanghai, in which we hold an 80 % interest. This serves to strengthen the company's good market position and provide the financial basis for further growth in the coming years.

Overall, we spent € 1,900 thousand (previous year: € 5,665 thousand) on new acquisitions and successive acquisitions of consolidated companies in the year under review. € 5,618 thousand (previous year: € 6,313 thousand) was spent for companies that have not yet been consolidated. This relates mainly to capital measures.

Consolidation methods

Capital consolidation uses the purchase method of accounting, under which the acquisition cost of the parent's shares in the subsidiaries is eliminated against the equity attributable to the parent at the date of acquisition. Any goodwill arising from initial consolidation is accounted for in accordance with IFRS 3 in conjunction with IASs 36 and 38. It is measured at the relevant current closing rate, presented in intangible assets and tested for impairment once a year. An impairment loss is recognized if any impairment is identified.

Any excess of our interest in the fair values of net assets acquired over cost is recognized directly in the income statement.

Those shares of subsidiaries' equity not attributable to KSB AG are reported as minority interest.

All intercompany receivables, liabilities, provisions and contingent liabilities, as well as sales revenue, other income and expenses, are eliminated. Intercompany profits contained in inventories and non-current assets are also eliminated.

The financial statements of all material companies or those required to be audited under local law have been audited and approved by auditors. This audit also extended to the correct reconciliation of the financial statements prepared under local GAAP to the uniform Group IFRS accounting policies.

Currency translation

The consolidated financial statements have been prepared in euros (€).

Transactions denominated in foreign currencies are translated at the individual companies at the rate prevailing when the transaction is initially recognized. Monetary assets and liabilities are subsequently measured at the closing rate. Currency translation gains and losses are recognized in net profit or loss.

Financial statements of consolidated companies that are not prepared in euros are translated using the functional currency principle. These companies are financially, economically and organizationally independent ("foreign entities"). Assets and liabilities are translated at the closing rate; the income statement accounts are translated at average exchange rates for the year.

Gains and losses from the translation of items of assets and liabilities compared with their translation in the previous year are taken directly to equity.

The exchange rates of our most important currencies to the euro are:

	Closing rate		Average rate	
	31 Dec. 2006	31 Dec. 2005	**2006**	2005
1 US dollar	0.759	0.848	0.796	0.803
1 Brazilian real	0.356	0.364	0.365	0.329
100 Indian rupees	1.791	1.969	1.840	1.904
100 Chinese yuan	9.728	10.504	9.995	9.841

Since we adopted IASs / IFRSs, replacing the HGB, for our consolidated financial reporting starting with the opening balance as at 1 January 2001, we have in coordination with the auditors translated the financial statements of foreign companies that are not prepared in euros using the modified closing rate method. In doing so, we recognized in the income statement (under other operating income or other operating expenses), as we already did under the HGB, any currency exchange differences resulting from the different translation rates used for the consolidated net profit for the year in the income statement (average exchange rates for the year) on the one hand and the consolidated net retained earnings (year-end closing rate) on the other. This approach differs from the treatment described in IAS 21 (IAS 21.39 [c] and 21.41), which requires exchange differences to be taken directly to equity.

As recognition in equity was effected with a delay of one year, the earnings we reported in the years 2001 to 2004 were lower. The earnings before income tax would have had to be higher by the following amounts: in 2001 by € +0.2 million, in 2002 by € +2.8 million, in 2003 by € +1.9 million, and in 2004 by € +1.8 million. Only in 2005 would the earnings have had to be reported € 2.8 million lower. In 2006, this effect again had a positive impact, amounting to € +2.1 million, on the earnings before taxes.

As the necessity of changing our approach was recognized, we have included the corrections required in the present consolidated financial statements for the year ended 31 December 2006 and adjusted the prior-period comparative amounts.

a) Balance sheet (€ thousands)	**2005 after adjustment**	2005 before adjustment
Revenue reserves	203,051	201,012
Consolidated net retained earnings	11,129	13,168

b) Income statement (€ thousands)	**2005 after adjustment**	2005 before adjustment
Other operating income	20,697	23,491
Earnings before income taxes	29,633	32,427
Net profit for the year	19,846	22,640
Minority interest in net profit / loss	– 8,717	– 9,472
Consolidated net profit for the year	11,129	13,168
Consolidated net retained earnings	11,129	13,168

c) Earnings per share (€)	**2005 after adjustment**	2005 before adjustment
Earnings per ordinary share	5.85	7.01
Earnings per preference share	6.88	8.04

d) Statement of changes in equity (€ thousands)	**2005 after adjustment**	2005 before adjustment
Revenue reserves		
• 1 Jan. 2005	185,380	186,199
• Transfer to revenue reserves	8,125	7,306
• Currency translation changes	12,875	10,836
• 31 Dec. 2005	203,051	201,012
Consolidated net retained earnings		
• 1 Jan. 2005	9,016	8,197
• Net profit for the year	11,129	13,168
• Transfer to revenue reserves	– 8,125	– 7,306
• 31 Dec. 2005	11,129	13,168
Minority interest		
• Net profit for the year	8,717	9,472
• Currency translation changes	3,975	3,220
Accumulated currency translation differences at 31 Dec. 2005	– 27,751	– 23,858
• thereof applicable to minority interest	(– 8,629)	(– 6,842)

e) Cash flow statement (€ thousands)	**2005 after adjustment**	2005 before adjustment
Net profit for the year	19,846	22,640
Cash flow	71,039	73,833
Cash flows from operating activities	46,555	49,349
Net change in cash and cash equivalents	– 22,162	– 19,368
Effects of exchange rate changes on cash held	583	– 2,211

We have also adjusted the relevant disclosures for 2005 in the Notes and the 2005 EBIT values given under Segment Reporting by Region.

ACCOUNTING POLICIES

The accounting policies have generally not changed as against the previous year and apply to all companies included in the consolidated financial statements.

Acquisition cost

In addition to the purchase price, acquisition cost also includes attributable incidental costs and subsequent expenditure. Purchase price reductions are deducted from cost. Borrowing costs are not capitalized.

Production cost

In addition to direct material and labour costs, production cost also includes production-related administrative expenses. General administrative expenses, selling expenses and borrowing costs are not capitalized.

Financial instruments

Financial assets and financial liabilities are recognized in the consolidated balance sheet at the time when KSB becomes a party to the contract creating a financial instrument. When the contractual right to payments from financial assets expires, these are de-recognized. Financial liabilities are de-recognized at the time when the contractual obligations are settled or cancelled or have expired. The acquisition and sale of financial instruments on an arm’s length basis are recognized as per the date of settlement. This applies to so-called primary financial instruments such as trade receivables and monetary receivables, as well as to trade payables and financial liabilities.

Derivatives, which we use to hedge against foreign currency and interest rate risks, are also financial instruments.

Classification in measurement categories:

- Financial assets and liabilities recognized in income at their fair value (derivatives, current financial instruments and cash quoted in an active market)
- Loans and receivables (loans and primary financial instruments not quoted in an active market)

None of our financial instruments is classified as “held-to-maturity investment” or “available-for-sale financial asset”.

On initial recognition, financial instruments are carried at cost. Subsequent measurement is based on market values or fair value. Financial intruments with fixed maturities for which current market prices are not available or fair values cannot be reliably measured are accounted for at amortized cost using the effective interest method.

We have not effected any significant re-classification of financial instruments between the individual measurement categories in the year under review.

Intangible assets

Intangible assets are carried at cost and reduced by straight-line amortization. The underlying useful lives are two to five years.

Write-downs are charged for impairment if the recoverable amount is lower than the carrying amount. If the reasons for an impairment loss charged in a previous period no longer apply, the impairment loss is reversed (write-up).

We amortized goodwill originating between 1 January 1995 and 30 March 2004 over a maximum of 15 years. In accordance with IFRS 3, the resulting cumulative amortization was eliminated against historical cost effective 1 January 2005. Goodwill is tested annually for impairment. This impairment test relates to the "cash-generating units", which at KSB are the legal entities. Write-downs are charged for impairment if the recoverable amount is lower than the carrying amount. Goodwill originating up to and including 1994 has been deducted from revenue reserves. Negative goodwill originating prior to 30 March 2004 was eliminated against revenue reserves directly in equity. Any excess of our interest in the fair values of net assets acquired over cost arising after 30 March 2004 is recognized directly in the income statement.

Development costs

Development costs are capitalized as intangible assets at cost and reduced by straight-line amortization where the criteria described in IAS 38 are met. Research costs are expensed as incurred. Where research and development costs for a project cannot be reliably distinguished, no costs are capitalized.

Property, plant and equipment

Property, plant and equipment is carried at cost and reduced by straight-line depreciation. No tax-motivated depreciation is recognized. Write-downs are charged for impairment if the recoverable amount is lower than the carrying amount. If the reasons for an impairment loss charged in a previous period no longer apply, the impairment loss is reversed (write-up).

We have applied the component approach under IAS 16.

Government grants relating to property, plant and equipment are deducted from the assets concerned.

Maintenance expenses are recognized as an expense in the period in which they are incurred, unless they lead to the expansion or material improvement of the asset concerned.

The following useful lives are applied:

Buildings	10 – 60 years
Plant and machinery	7 – 25 years
Operating and office equipment	3 – 25 years

Leases

Lease payments that are payable under operating leases are recognized as expenses in the period in which they are incurred. In the case of finance leases, the leased asset is recognized at the time of inception of the lease at the lower of fair value and the present value of future minimum lease payments. A liability is recognized in the same amount for the future lease payment. The asset's carrying amount is reduced by depreciation over its useful life or the shorter lease term.

Non-current financial assets

Investments in unconsolidated affiliates and associates are carried at cost or the lower fair value. If the reasons for an impairment loss charged in a previous period no longer apply, the impairment loss is reversed (write-up). Interest-bearing loans are recognized at amortized cost. Non-current financial instruments are carried at their fair values at the balance sheet date.

Inventories

Inventories are carried at the lower of cost and net realizable value. Cost is measured using the weighted average method. Write-downs to the net realizable value take account of the inventory risks resulting from slow-moving goods or impaired marketability. This also applies to write-downs to fair value if the selling price is lower than production cost plus costs still to be incurred. If the reasons for an impairment loss charged in a previous period no longer apply, the impairment loss is reversed.

Advances received from customers are deducted in full from inventories unless they relate to construction contracts under IAS 11.

Construction contracts under IAS 11

The percentage of completion (PoC) method is applied for construction contracts defined under IAS 11. The stage of completion of the contracts is determined on the basis of the total estimated contract costs and the actual contract costs up to the balance sheet date. The percentage contract revenue less the related advances received from customers is reported in receivables and other current assets under a separate heading. Effects in the period are recognized in the income statement as part of the sales revenue. In previous years, these items were reported in the balance sheet in inventories and in the income statement as part of the changes in inventories. For reasons of comparability, we have restated the relevant prior-period amounts.

Receivables and other current assets

Receivables and other current assets are generally carried at their principal amounts. Low-interest or non-interest-bearing receivables are discounted. We take account of identifiable risks by charging specific write-downs and experience-based write-downs. If the reasons for an impairment loss charged in a previous period no longer apply, the impairment loss is reversed.

We hedge part of the credit risk exposure of our receivables.

The prepaid expenses reported relate to accrued expenditure prior to the balance sheet date that will only be classified as an expense after the balance sheet date.

Current financial instruments

Current financial instruments are carried at their fair value at the balance sheet date.

Cash

Cash items are carried at their principal amounts.

Deferred taxes

We account for deferred taxes using the balance sheet liability method on the basis of the enacted or substantively enacted local tax rates. This means that deferred tax assets and liabilities generally arise when the tax base of assets and liabilities differs from their carrying amount in the IFRS financial statements, and this leads to future tax expense or income. We also recognize deferred tax assets from tax loss carryforwards in those cases where it is more likely than not that there will be sufficient taxable profit available in the near future against which these tax loss carryforwards can be utilized. Deferred taxes are also recognized for consolidation adjustments. Deferred taxes are not discounted. Deferred tax assets and liabilities are always offset where they relate to the same tax authority.

Provisions for pensions and similar obligations

Provisions for pensions and similar obligations are calculated on the basis of actuarial reports. They are based on defined benefit pension plans. The reports are prepared using the projected unit credit method. We apply the 10 % corridor rule, under which actuarial gains and losses outside this 10 % corridor are recognized over the average remaining working lives. The actuarial demographic assumptions and the definition of compensation and pension trends, as well as interest rate trends, are best estimates. The interest component is reported as an interest cost in financial income / expense.

KSB companies that use a defined contribution pension plan do not recognize provisions. The premium payments are recognized directly in the income statement as pension costs in the staff costs. These companies have no obligations other than the obligation to pay premiums.

Other provisions

A provision is recognized only if a past event results in a present legal or constructive external obligation that the company has no realistic alternative to settling, where settlement of this obligation is expected to result in an outflow of resources embodying economic benefits, and the amount of the obligation can be estimated reliably. No provisions are recognized for future internal expenses. The amount recognized as a provision is our best estimate. Any recourse or reimbursement claims are recognized separately and are not deducted from the provisions concerned.

Provisions for restructurings are recognized if the criteria set out in IAS 37 are met.

Non-current provisions are discounted if material.

Liabilities

Liabilities are carried at their redemption amount.

Derivative financial instruments

We only use derivatives for hedging purposes. We hedge both existing recognized underlyings and future cash flows (cash flow hedges) against foreign currency and interest rate risks. The hedging instruments used are exclusively highly effective currency forwards, currency options and interest rate derivatives entered into with prime-rated banks. We hedge currency risks primarily for items in USD and GBP. Interest rate risks are minimized for long-term borrowings at variable rates of interest. Group guidelines govern the use of these instruments. These transactions are also subject to continuous risk monitoring.

Fair value changes of derivatives used to hedge an existing recognized underlying are recognized in net profit or loss, as are changes in the fair value of the related hedged items.

In the case of cash flow hedges, changes in the fair value of derivatives are taken directly to equity until the related hedged item is recognized.

The carrying amounts reflect fair values.

Derivatives are reported under other receivables, other current assets and prepaid expenses, and under miscellaneous other liabilities and deferred income.

The maturities of the currency derivatives used are mostly between one and two years, and those of interest rate derivatives are between six and eleven years. The maturities of the hedging instruments are matched to the period in which the forecast transactions are expected to occur. In the year under review, all hedged forecast transactions occurred as expected.

Contingent liabilities (contingencies and commitments)

Contingent liabilities, which are not recognized, are possible obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of uncertain future events. Contingent liabilities may also be present obligations that arise from past events where it is possible but not probable that there will be an outflow of resources embodying economic benefits.

Contingent liabilities correspond to the extent of liability at the balance sheet date.

Income and expenses

Sales revenue consists of charges for deliveries and services billed to customers, and licence income. Sales allowances reduce sales revenue. Sales revenue is recognized when the deliveries have been effected or the services have been rendered and the significant risks of ownership have been transferred to the buyer. Effects resulting from application of the percentage of completion method are recognized in sales revenue.

Expenses are recognized when they are incurred or when the services are utilized.

Estimates

Any estimates necessary for preparation of these consolidated financial statements are based on cautious assumptions. Actual amounts may differ from these estimates.

Any changes in estimates that result in material differences are explained separately.

Maturities

Maturities of up to one year are classified as current.

Assets that can only be realized after more than 12 months, as well as liabilities that only become due after more than 12 months, are also classified as current if they are attributable to the operating cycle defined in IAS 1.

Assets and liabilities not classified as current are non-current.

BALANCE SHEET DISCLOSURES

1 _ Fixed assets

We did not capitalize any development costs in the year under review because not all of the comprehensive recognition criteria defined in IAS 38 were met.

The goodwill impairment test is based on a three-year business plan for the cash-generating units, which we have extrapolated constantly into the future. It was performed using the discounted cash flow (DCF) method. The discount rate, which was 6.75 % in the year under review (previous year: 6.50 %), is based on the interest rate for risk-free 10-year Bunds, increased by a company-specific risk premium. All goodwill was determined to be recoverable, and no impairment losses on goodwill were required to be charged.

Both investments in and depreciation charged on items of property, plant and equipment were recognized at previous year levels. € 42,045 thousand was invested in the year under review, compared with € 41,154 thousand in 2005. Depreciation amounted to € 29,011 thousand (previous year: € 28,111 thousand).

Assets resulting from finance leases (almost exclusively real property) are recognized as fixed assets in accordance with IAS 17, and corresponding financial liabilities are recognized. The carrying amount of these capitalized assets amounts to € 9,382 thousand (previous year: € 9,864 thousand).

Disposals of items of property, plant and equipment resulted in book gains of € 2,260 thousand (previous year: € 1,076 thousand) and book losses of € 1,183 thousand (previous year: € 2,348 thousand). The book gains and losses are reported in the income statement under other operating income and other operating expenses.

We recognized impairment losses of € 1,393 thousand (previous year: € 117 thousand) on intangible assets and items of property, plant and equipment in the year under review. These related to our cash-generating unit in Great Britain, which is part of the “Region Europe” segment. The reason was the difficult economic situation.

The changes in non-current financial assets result mainly from the above-mentioned capital measures and new loans granted to non-consolidated companies.

Currency translation adjustments taken directly to equity resulted in a loss of € 4,908 thousand (previous year: gain of € 7,645 thousand).

Details of changes in fixed assets are presented in a separate table (Statement of Changes in Fixed Assets).

2 Deferred tax assets

Explanations on deferred tax assets are presented under “Taxes on income”.

3 Inventories

(€ thousands)	31 Dec. 2006	31 Dec. 2005
Raw materials and production supplies	103,627	99,094
Work in progress	63,934	84,000
Finished goods and goods purchased and held for resale	59,851	65,784
Advance payments	10,007	6,100
Advances received from customers	– 46,384	– 56,710
	191,035	**198,268**

Part of the inventories (approx. 10 %) is carried at net realizable value. As in the previous year, the impairment losses recognized in the period under review as an expense are not significant (less than 2 % of the inventories). We only reversed write-downs to a minor extent where the current net realizable value is higher than the prior-period value.

Write-downs of € 572 thousand related to the cash-generating unit in Great Britain mentioned above.

4 Receivables and other current assets

(€ thousands)	31 Dec. 2006	31 Dec. 2005
Trade receivables	348,535	322,762
Intragroup and associate receivables	19,284	14,488
Receivables recognized by PoC (excl. advances received from customers by PoC)	131,829	80,002
Advances received from customers (PoC)	– 68,340	– 46,090
Receivables recognized by PoC	63,489	33,912
Other receivables, other current assets and prepaid expenses	31,493	30,824
	462,801	**401,986**

Intragroup and associate receivables include loans to unconsolidated KSB companies amounting to € 8,184 thousand (previous year: € 5,114 thousand). Associate receivables amounted to € 1,631 thousand (previous year: € 1,726 thousand).

Construction contracts under IAS 11 include recognized earnings of € 5,856 thousand (previous year: € 6,034 thousand) and costs of € 125,973 thousand (previous year: € 73,968 thousand).

The other receivables, other current assets and prepaid expenses include recoverable taxes, receivables from employees and deferred interest. They also include other assets from hedges in accordance with IAS 39 amounting to € 4,735 thousand (previous year: € 688 thousand). € 356 thousand (previous year: € 0 thousand) of this amount relates to interest rate derivatives. At the balance sheet date, the notional volume of all currency forwards was € 174,071 thousand (previous year: € 197,787 thousand), and the notional volume of all interest rate derivatives was € 28,160 thousand (previous year: € 32,633 thousand).

The fair values of receivables correspond to the carrying amounts reported.

5__Current financial instruments and cash

The current financial instruments amount to € 19,597 thousand (previous year: € 15,825 thousand). They are mostly held by the German Group companies, which use these financial instruments for hedges of credit balances prescribed by law for partial retirement arrangements.

Cash relates primarily to term deposits with short maturities and call deposits.

6__Equity

There was no change in the share capital of KSB AG as against the previous year. In accordance with the Articles of Association, it totals € 44,771,963.82 and is composed of 886,615 no-par value ordinary shares and 864,712 no-par value preference shares. Each no-par value share represents an equal notional amount of the share capital. The preference shares carry separate cumulative preferred dividend rights and progressive additional dividend rights. All shares are bearer shares.

The capital reserve results from the appropriation of premiums from capital increases in previous years.

In addition to revenue reserves from previous years, the revenue reserves primarily include currency translation adjustments and consolidation effects taken directly to equity. The deferred tax assets resulting from these adjustments amount to € 13,517 thousand (previous year: € 13,324 thousand), while deferred tax liabilities amount to € 2,244 thousand (previous year: € 1,614 thousand).

Equity also includes changes in the fair value of derivatives used to hedge future cash flows amounting to € + 2,739 thousand (previous year: € – 5,622 thousand). The opening balance at 1 January was almost completely withdrawn from equity and included in the measurement of the hedged items. The ending balance at 31 December results primarily from derivatives entered into in the year under review.

The minority interest relates primarily to PAB GmbH, Frankenthal, and the interests it holds, as well as to our companies in India and South Africa. KSB AG holds a 51 % interest in PAB GmbH, while Klein Pumpen GmbH, Frankenthal, holds a 49 % interest.

Details of the changes in equity accounts and minority interest are contained in the Statement of Changes in Equity.

The proposal on the appropriation of the net retained earnings of KSB AG calculated in accordance with HGB is shown at the end of these notes.

7 _ Deferred tax liabilities

Explanations on deferred tax liabilities are presented under “Taxes on income”.

8 _ Provisions for pensions and similar obligations

More than 90 % of the provisions for pensions result from defined benefit plans of the German Group companies. These relate to direct commitments by the companies to their employees. The commitments are based on salary and length of service. Contributions from employees themselves are also included.

The amounts provided for these benefit obligations and the annual expense for pension benefits are measured and calculated each year on the basis of actuarial reports using the projected unit credit method (IAS 19).

The underlying actuarial assumptions were almost unchanged as against the previous year. The discount rate applied to the obligations was 4.5 %. The assumed rate of future salary increases is 2.5 %, and the assumed growth rate for the pension trend is 1.8 % per annum. The biometric assumptions are based on the “2005G” mortality tables published by Prof. Klaus Heubeck. A mean fluctuation rate was applied to staff turnover. The assumption for pensionable age was adjusted to reflect that a minimum age of retirement of 63 years is to be applied as from 2012. Actuarial gains and losses outside the 10 % corridor are recognized. Where the cumulative gain or loss exceeds the 10 % corridor, the excess amount is spread over the average remaining working lives of the employees and recognized in the income statements of future periods.

Change in pension provisions from the above-mentioned benefit plans of the German Group companies

(€ thousands)	2006	2005
Opening balance at 1 Jan.	179,420	171,379
Annual pension expense (see below)	16,977	14,466
Contributions by employees	2,682	2,390
Net pension payments	– 9,299	– 8,815
Closing balance at 31 Dec.	**189,780**	**179,420**

The present value of pension commitments amounts to € 218,402 thousand (previous year: € 207,595 thousand). This resulted in a net actuarial loss of € 28,622 thousand (previous year: € 28,175 thousand). Changes in the underlying personnel data have resulted in additional losses of € 2,002 thousand. Changes in measurement have resulted in a reduction of losses by € 969 thousand. Actuarial losses of € 586 thousand outside the 10 % corridor were recognized in the income statement.

Changes recognized in income statement

(€ thousands)	2006	2005
Current service cost	7,247	5,731
Actuarial gains / losses	586	– 1
Interest cost	9,144	8,736
	16,977	**14,466**

The current service cost as well as actuarial gains and losses are recognized in staff costs under pension costs, and the interest cost is recognized in financial income / expense under interest and similar expenses.

There are smaller benefit plans at certain foreign Group companies. At the US companies, there are post-employment medical care obligations for employees. These are partly funded, measured using comparable principles and contained in the provisions for pensions and similar obligations in the amount of € 11,861 thousand (previous year: € 12,950 thousand).

One Group company with about 300 employees in the Netherlands has a multi-employer defined benefit plan in place, which has been accounted for as if it were a defined contribution plan.

9 _ Other provisions

Changes (€ thousands)	1 Jan. 2006	Change cons. Group/ CTA*/ Other	Utilization	Reversals	Additions	**31 Dec. 2006**
Taxes	7,099	– 240	– 3,024	– 93	3,814	7,556
Other staff costs	104,348	1,218	– 60,417	– 306	78,280	123,123
Warranty obligations and contractual penalties	26,008	– 375	– 15,539	– 1,729	19,877	28,242
Other obligations	41,552	– 5,415	– 27,123	– 1,234	34,258	42,038
	179,007	**– 4,812**	**– 106,103**	**– 3,362**	**136,229**	**200,959**

* CTA = currency translation adjustments

Provisions for taxes contain amounts of tax still payable for the year under review and for previous years for which no final tax assessment has yet been received. Provisions for other staff costs relate primarily to profit-sharing, jubilee payments, compensated absence, partial retirement and severance payments. The provisions for warranty obligations and contractual penalties cover the statutory and contractual obligations to customers. The provisions for other obligations include provisions for expected losses from uncompleted transactions and onerous contracts, customer bonuses, accrued costs and environmental measures.

The increase in the provisions for other staff costs is attributable, among other things, to higher working time accounts and increased profit-sharing and profit bonus obligations.

€ 36,477 thousand of the other provisions is non-current (previous year: € 39,425 thousand). This relates mainly to provisions for jubilee payments, partial retirement and warranty obligations.

10 Liabilities

(€ thousands)	31 Dec. 2006	31 Dec. 2005
NON-CURRENT LIABILITIES		
Financial liabilities		
Bank loans and overdrafts	43,717	49,450
Finance lease liabilities	5,381	7,089
Other	347	619
	49,445	57,158
Total non-current liabilities	**49,445**	**57,158**
CURRENT LIABILITIES		
Financial liabilities		
Bank loans and overdrafts	20,041	17,697
Finance lease liabilities	1,323	1,142
Other	8,493	9,337
	29,857	28,176
Trade payables		
Trade payables to third parties	155,214	142,528
Intragroup trade payables	2,976	2,082
	158,190	144,610
Other liabilities and deferred income		
Taxes	17,112	13,840
Social security	7,123	13,077
Miscellaneous other liabilities and deferred income	26,233	25,663
	50,468	52,580
Total current liabilities	**238,515**	**225,366**
TOTAL LIABILITIES	**287,960**	**282,524**

Assets amounting to € 4,924 thousand (previous year: € 3,744 thousand) have been pledged as security in the KSB Group for bank loans and other liabilities. Of these, € 762 thousand relate to property, plant and equipment, € 2,126 thousand to inventories and € 2,036 thousand to receivables.

€ 8,655 thousand (previous year: € 8,648 thousand) of the liabilities was secured by land charges or similar rights in the year under review.

Financial liabilities include long-term loans that we used to partly debt-finance acquisitions in previous years so as to exploit the low level of interest rates. These relate in particular to three loans that we took out with a residual amount of approximately € 30 million in total at the balance sheet date (previous year: € 33 million). € 3 million of these is due within one year, € 22 million between one and five years and € 5 million after more than five years. They are long-term loans and bear interest of between three and five percent.

The weighted average interest rate on bank loans and overdrafts was 4.12 % (previous year: 4.14 %). Interest rate risk is limited to overdrafts and to a long-term redeemable loan with short-term variable interest lock-ins.

Taxes classified as other liabilities also relate to taxes that Group companies must remit for third-party account.

Miscellaneous other liabilities and deferred income include changes in the fair value of hedging instruments amounting to € 872 thousand (previous year: € 7,735 thousand). € 89 thousand (previous year: € 596 thousand) of this amount relates to interest rate derivatives. Deferred income amounts to € 468 thousand (previous year: € 566 thousand).

The fair values of liabilities correspond to the carrying amounts reported.

INCOME STATEMENT DISCLOSURES

11 Sales revenue

Sales revenue includes € 51,937 thousand (previous year: € 11,131 thousand) recognized by PoC. The breakdown of sales revenue is presented in the segment reporting.

12 Other operating income

(€ thousands)	2006	2005
Gains from asset disposals and reversals of impairment losses (write-ups)	2,260	1,114
Income from current assets	2,461	3,420
Currency translation gains	2,548	3,703
Income from the reversal of provisions	3,323	4,529
Miscellaneous other income	7,488	7,931
	18,080	**20,697**

Miscellaneous other income relates primarily to services income, commission income, rental and lease income, insurance compensation, grants and subsidies.

Income from government grants for individual projects amounted to € 607 thousand (previous year: € 366 thousand).

13 Cost of materials

(€ thousands)	2006	2005
Cost of raw materials and production supplies consumed and of goods purchased and held for resale	605,931	549,527
Cost of purchased services	44,294	34,764
	650,225	**584,291**

14 Staff costs

(€ thousands)	2006	2005
Wages and salaries	412,910	404,737
Social security contributions and employee assistance costs	97,628	93,293
Pension costs	11,156	10,439
	521,694	**508,469**

Pension costs are reduced by the interest component of provisions for pensions, which is reported as an interest cost in financial income / expense.

Average number of employees	2006	2005
Wage earners	6,177	6,097
Salaried employees	6,442	6,415
Trainees and apprentices	343	401
	12,962	**12,913**

15 Other operating expenses

(€ thousands)	2006	2005
Losses from asset disposals	1,183	2,348
Losses from current assets	10,586	9,889
Currency translation losses	1,010	4,695
Other staff costs	20,664	13,585
Repairs, maintenance, third-party services	70,872	67,663
Selling expenses	74,080	70,864
Administrative expenses	58,987	58,042
Rents and leases	17,319	15,882
Miscellaneous other expenses	36,641	33,546
	291,342	**276,514**

Miscellaneous other expenses relate primarily to warranties, contractual penalties and additions to provisions.

16 — Financial income / expense

(€ thousands)	2006	2005
Income from investments	2,200	987
thereof from affiliates	(1,782)	(987)
Interest and similar income	5,162	3,601
thereof from affiliates	(263)	(77)
Interest and similar expenses	– 15,143	– 15,389
thereof to affiliates	(– 218)	(– 205)
Miscellaneous financial income / expense	– 520	70
	– 8,301	**– 10,731**

Interest and similar expenses include the interest cost on discounted pension provisions amounting to € 9,475 thousand (previous year: € 9,312 thousand). Income from other non-current financial instruments and non-current loans amounting to € 157 thousand (previous year: € 70 thousand) is classified as miscellaneous financial income / expense. Amortization and write-downs amounting to € 677 thousand (previous year: € 0 thousand) were charged on non-current financial assets and current financial instruments.

17 — Taxes on income

All income-related taxes of the consolidated companies and deferred taxes are reported under this heading. Other taxes are reported in the income statement after other operating expenses.

(€ thousands)	2006	2005
Effective taxes	25,619	23,159
Deferred taxes	2,259	– 13,372
	27,878	**9,787**

€ 0 thousand (previous year: € 3,797 thousand) of the effective taxes in the year under review related to prior-period tax refunds and € 381 thousand (previous year: € 5,241 thousand) to tax arrears.

Reconciliation of deferred taxes

(€ thousands)	2006	2005
Change in deferred tax assets	1,234	– 2,786
Change in deferred tax liabilities	780	– 10,994
Change in deferred taxes recognized in balance sheet	**2,014**	**– 13,780**
Change in deferred taxes taken directly to equity	1,075	– 775
Changes in consolidated Group, currency translation adjustments and other	– 830	1,183
Deferred taxes recognized in income statement	**2,259**	**– 13,372**

Allocation of deferred taxes	Deferred tax assets		Deferred tax liabilities	
(€ thousands)	2006	2005	2006	2005
ASSETS				
Intangible assets, property, plant and equipment	2,994	2,331	32,780	34,429
Inventories	6,641	6,317	15,004	10,275
Receivables and other current assets	2,494	1,571	2,703	1,868
Other assets	179	19	1,510	924
EQUITY AND LIABILITIES				
Provisions for pensions and similar obligations	13,204	12,700	693	916
Other provisions	12,315	15,187	2,581	2,718
Currency translation differences recognized directly in equity	18,575	15,045	1,368	1,797
Other equity and liabilities	2,638	6,227	2,663	1,569
TAX LOSS CARRYFORWARDS	17,840	14,691	–	–
Gross deferred taxes – before offsetting	**76,880**	**74,088**	**59,302**	**54,496**
Offset under IAS 12.74	– 47,787	– 43,761	– 47,787	– 43,761
Net deferred taxes – after offsetting	**29,093**	**30,327**	**11,515**	**10,735**

The corresponding loss carryforwards, for which deferred taxes were recognized, amount to € 49,421 thousand (previous year: € 40,108 thousand). They are attributable primarily to the German companies.

As in the previous year, changes in existing local tax rates or the introduction of new local taxes had no material effects in the year under review.

We did not recognize deferred tax assets from loss carryforwards amounting to € 14,063 thousand (previous year: € 10,268 thousand) because it is unlikely that there will be sufficient taxable profit available in the near future against which these deferred tax assets can be utilized. The same applies to minor deductible temporary differences.

Reconciliation of income taxes

(€ thousands)	2006	2005
Earnings before income taxes	90,246	29,633
Calculated income taxes on the basis of the applicable tax rate (37 %)	33,391	10,964
Differences in tax rates	– 6,650	– 4,573
Unused tax loss carryforwards	1,404	– 303
Tax-exempt income / non-deductible expenses	– 1,724	487
Prior-period taxes	381	1,444
Non-deductible foreign income tax	1,214	1,361
Other	– 138	407
Current taxes on income	**27,878**	**9,787**
Current tax rate	31 %	33 %

We have adjusted the prior-period comparatives because of the change in the tabular presentation compared with last year's report.

The applicable tax rate of 37 % is a composite rate resulting from the German corporation tax, solidarity tax contribution and trade income tax rates.

18__Minority interest in net profit / loss

The minority interest in net profit amounts to € 13,160 thousand (previous year: € 8,816 thousand), and the minority interest in net loss amounts to € 268 thousand (previous year: € 99 thousand). It relates primarily to PAB GmbH, Frankenthal, and the interests it holds, as well as to our companies in India and South Africa.

19__Research and development costs

Research and development costs in the year under review amounted to € 27,948 thousand (previous year: € 24,733 thousand).

20__Earnings per share

		2006	2005
Consolidated net profit for the year	(€ thousands)	49,476	11,129
Additional dividend attributable to preference shareholders	(€ thousands)	– 450	– 891
	(€ thousands)	**49,026**	**10,238**
Number of ordinary shares		886,615	886,615
Number of preference shares		864,712	864,712
Total number of shares		**1,751,327**	**1,751,327**
Earnings per ordinary share	(€)	**27.99**	**5.85**
Earnings per preference share	(€)	**28.51**	**6.88**

There were no dilutive effects.

SEGMENT REPORTING

Segment reporting corresponds to our internal organizational and management structure, as well as the reporting lines to the Board of Management and the Supervisory Board. Geographical regions form the primary reporting format, while market segments form the secondary reporting format.

As in the previous year, there were no discontinued operations in the year under review.

The amounts disclosed for the individual segments have been established in compliance with the accounting policies of the underlying consolidated financial statements. The amounts have been consolidated within the individual segments.

Transfer prices for intercompany sales are determined on an arm’s length basis.

The amounts disclosed for the individual segments are presented in separate overviews attached to these notes.

Segments by region

The regional segments presented include the development, production and marketing of pumps and valves by our Group companies, as well as the corresponding service business.

The **external sales revenue of the Group companies by segment** presents sales revenue generated from third parties and unconsolidated Group companies.

The **external sales revenue of the Group companies by geographic area** presents the sales revenue of the segments generated from third parties and unconsolidated Group companies by customer location. Customer locations are allocated to the following Regions: Europe, Middle East / Africa, Asia / Pacific and Americas.

Inter-segment sales revenue relates to all sales revenue between the segments.

The segment result shows the earnings before interest and taxes (**EBIT**), including minority interest in net profit / loss.

Segment assets correspond to the entire assets reported on the balance sheet, excluding recoverable income taxes; **segment liabilities** consist of all liabilities and provisions, net of provisions for income taxes.

Capital expenditure relates to intangible assets, property, plant and equipment.

A reconciliation between the **segment liabilities** and the provisions and liabilities reported in the balance sheet is presented below:

(€ thousands)	2006	2005
Liabilities	**684,510**	**648,295**
Provisions for income taxes	6,050	5,606
Provisions and liabilities	**690,560**	**653,901**

A reconciliation between the **result** (EBIT) and the earnings before income taxes reported in the income statement is presented below:

(€ thousands)	2006	2005
Segment result (EBIT)	**100,227**	**41,421**
Interest income	5,162	3,601
Interest expense	– 15,143	-15,389
Earnings before income taxes	**90,246**	**29,633**

Segments by market

The **Industry and Building Services** segment covers pumps, valves and associated control and drive systems for industrial and process engineering applications, domestic water supply, drainage, heating and air-conditioning, as well as service activities.

The **Water and Waste Water** segment covers pumps, valves, mixers, pressure exchangers and associated control and drive systems for use in water and waste water transport installations and subsystems, as well as service activities.

The **Energy and Mining** segment covers pumps, valves and associated control and drive systems for use in power station applications and district heating systems, as well as service for these products. It also covers slurry pumps and service activities for applications in the mining industry and on suction dredgers.

The information on **external sales revenue by segment, segment assets** and **capital expenditure** in the presentation of segments by region applies correspondingly.

OTHER DISCLOSURES

Contingent liabilities (contingencies and commitments)

Contingent liabilities and security granted

(€ thousands)	2006	2005
Liabilities from guarantees	10,170	10,984
Liabilities from warranties	15,567	12,628
Liabilities from the granting of other security for third-party liabilities	3,223	14,171
	28,960	**37,783**

Other financial obligations from rental agreements and operating leases amount to a total of € 13,395 thousand (previous year: € 12,697 thousand). Of these, € 7,745 thousand is due within one year and € 5,650 thousand (previous year: € 4,897 thousand) due between one and five years. In the year under review, € 7,660 thousand were spent on these agreements.

Operating leases relate primarily to vehicles.

Finance leases	Minimum lease payments		Present values	
(€ thousands)	2006	2005	2006	2005
Due within one year	1,366	5,931	1,323	5,064
Due between one and five years	5,673	2,813	4,942	2,667
Due after more than five years	444	510	439	500
	7,483	**9,254**	**6,704**	**8,231**

Finance leases relate almost entirely to real property. There is a purchase option on one property in Germany.

The annual obligations from IT services agreements amount to € 44,371 thousand (previous year: € 18,164 thousand) over a term of one to six years. The increase is attributable to a long-term IT services agreement entered into in the year under review in Europe.

There are purchase price payment obligations for financial year 2007 from acquisitions made in the amount of € 1,900 thousand (previous year: € 0 thousand).

Payment obligations under capitalization measures at Group companies amount to € 85 thousand (previous year: € 2,207 thousand).

The aggregate purchase obligation for investments amounts to € 13,096 thousand (previous year: € 4,059 thousand). This includes € 3,525 thousand for new software to be implemented in Europe. Almost all of the corresponding payments are due in 2007.

A multi-employer defined benefit plan in place at a Group company with about 300 employees in the Netherlands poses a low risk of increased contribution payments, if the number of employers involved is reduced.

Related party disclosures

Klein Pumpen GmbH, Frankenthal, holds a majority interest in the voting power of KSB AG.

A rental and services agreement has been entered into between KSB AG and Klein Pumpen GmbH. KSB AG paid € 66 thousand (previous year: € 97 thousand) under the terms of this agreement in the year under review. Short-term deposits by KSB AG with Klein Pumpen GmbH and by Klein Pumpen GmbH with KSB companies carry appropriate rates of interest.

All transactions are entered into on an arm's length basis. This is also demonstrated by the dependent company report prepared in accordance with section 312 of the AktG (German Public Companies Act).

The total remuneration of members of the Supervisory Board amounts to € 418 thousand for financial year 2006 (previous year: € 109 thousand), and the total remuneration of the Board of Management amounts to € 3,769 thousand (previous year: € 2,173 thousand). € 18,660 thousand (previous year: € 18,804 thousand) has been provided for pension obligations to former members of the Board of Management and their surviving dependants; total benefits paid to these persons amounted to € 1,347 thousand in the year under review (previous year: € 1,344 thousand).

Based on relevant legal provisions, the Annual General Meeting on 22 June 2006 decided not to disclose the remuneration of the Board of Management separately for each member and subdivided according to components.

The members of the Board of Management and the Supervisory Board are listed separately.

Auditors

KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft were appointed as the auditors and group auditors for financial year 2006 by the Annual General Meeting on 22 June 2006. The expenses for financial year 2006 include corresponding audit fees of € 240 thousand (previous year: € 225 thousand). A further € 31 thousand (previous year: € 43 thousand) was incurred for the audits of the German subsidiaries. In addition, fees of € 1 thousand (previous year: € 13 thousand) were incurred for tax advisory services, and of € 7 thousand (previous year: € 6 thousand) for other assurance and valuation services.

Events after the balance sheet date

At the beginning of 2007, we increased our interest in our South African Group company by 24.9 % and now hold a 74.9 % interest.

German Corporate Governance Code

The Board of Management and Supervisory Board of KSB AG issued in 2006 the statement of compliance with the recommendations of the "Government Commission on the German Corporate Governance Code" in accordance with section 161 of the AktG (German Public Companies Act). The statement of compliance is published on our web site (www.ksb.com) and has thus been made permanently accessible to our shareholders.

PROPOSAL ON THE APPROPRIATION OF THE NET RETAINED EARNINGS OF KSB AG

We will propose to the Annual General Meeting on 13 June 2007 to appropriate the net retained earnings of KSB AG, Frankenthal, of € 4,070,028.21, as follows:

Distribution of a dividend of		
€ 2.00 per ordinary no-par-value share	=	€ 1,773,230.00
and, in accordance with the Articles of Association,		
€ 2.52 per preference no-par-value share	=	€ 2,179,074.24
Total		€ 3,952,304.24
To be carried forward to new account		€ 117,723.97
		€ 4,070,028.21

Frankenthal, March 2007
The Board of Management

The annual financial statements of KSB AG, Frankenthal, were prepared in accordance with German accounting principles. KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Mannheim, has audited these annual financial statements and issued an unqualified audit opinion. The annual financial statements are published in the electronic *Bundesanzeiger* (German Federal Gazette). They can also be downloaded from our web site at www.ksb.com, or sent in print form on request.

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by the KSB Aktiengesellschaft, Frankenthal (Pfalz), comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from January 1 to December 31, 2006. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB are the responsibility of the parent company`s management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB (*Handelsgesetzbuch* "German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

March 16, 2007

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Kern	Benz
Wirtschaftsprüfer	Wirtschaftsprüfer

LIST OF SHAREHOLDINGS

Name and seat of company	Country		Capital share %	Equity € thousands	Net profit / loss for the year € thousands	
KSB Service GmbH, Frankenthal	Germany	C	100.00	1,534	Profit pooling	
Pumpen- und Motoren-Service GmbH, Neuss	Germany	N	100.00	455	151	
KSB Atlantic Pump & Valve Service S.L., Las Palmas	Spain	N	47.00	268	– 83	
KSB Service GmbH, Schwedt	Germany	C	100.00	1,023	Profit pooling	
Uder Elektromechanik GmbH, Friedrichsthal	Germany	C	100.00	26	Profit pooling	
Pumpen-Service Bentz GmbH, Reinbek	Germany	N	100.00	927	290	
Motoren-Jacobs GmbH, Heide	Germany	N	100.00	369	221	
Dynamik-Pumpen GmbH, Stuhr	Germany	N	100.00	260	159	■
NOMIG GmbH, Reken	Germany	N	49.00	307	84	■
KSB Mörck AB, Askim (Gothenburg)	Sweden	C	55.00	2,930	1,185	
Motori Sommersi Riavvolgibili S.r.l., Berzo Demo	Italy	N	25.00	4,571	939	■
KSB Pompy i Armatura Sp. z o.o., Warsaw	Poland	C	100.00	4,181	894	
KSB Szivattyu és Armatura Kft., Budapest	Hungary	C	100.00	1,575	353	
KSB Pumpy + Armatury sr.o., Prague	Czech Republic	C	100.00	2,116	286	
KSB Bombas e Válvulas S.A., Algés (Lisbon)	Portugal	N	95.00	808	171	■
KSB Čerpadlá a Armatúry, spol.sr.o., Bratislava	Slovak Republic	N	100.00	401	160	■
KSB Finland Oy, Kerava	Finland	C	100.00	2,091	64	
Hydroskepi GmbH, Amaroussion (Athen)	Greece	C	100.00	1,350	– 2	
KSB TESMA AG, Amaroussion (Athen)	Greece	N	57.00	666	74	■
KSB Viosen AG, Patras	Greece	N	60.28	621	– 48	■
KSB Zürich AG, Zurich	Switzerland	C	100.00	636	– 266	
KSB Service LLC, Abu Dhabi	UAE	N	49.00	620	– 2,769	■
KSB Pumps Co. Limited, Lahore	Pakistan	C	58.89	5,829	1,576	
MIL Controls Limited, Mala	India	C	70.86	4,054	1,290	
KSB Singapore (Asia Pacific) Pte. Ltd., Singapore	Singapore	C	100.00	3,240	1,169	
KSB Limited, Hong Kong	China	C	100.00	1,884	718	
KSB Pumps Co. Ltd., Bangkok	Thailand	N	40.00	1,485	235	■
KSB Taiwan Co. Ltd., Taipei	Taiwan	N	100.00	693	127	■
KSB Tech Pvt. Ltd., Pimpri (Pune)	India	N	100.00	322	53	■
KSB Korea Ltd., Seoul	South Korea	N	100.00	169	47	■
KSB Valves (Shanghai) Co. Ltd., Shanghai	China	N	100.00	352	– 12	
KSB Ltd., Tokyo	Japan	N	100.00	– 112	– 76	■
KSB Chile S.A., Santiago	Chile	C	100.00	6,779	906	
KSB de Mexico, S.A. de C.V., Querétaro	Mexico	C	100.00	655	91	
KSB Mexicana, S.A. de C.V., León	Mexico	N	100.00	145	– 83	■
Bombas Pleuger de Mexico, S.A. de C.V., León	Mexico	N	88.57	60	– 30	■
KSB Armaturen Verw.- und Beteiligungs-GmbH, Frankenthal	Germany	N	100.00	574	– 2	
KSB OOO, Moscow	Russia	N	100.00	431	– 95	■
KSB Finanz S.A., Echternach	Luxembourg	C	100.00	104,650	4,375	
KSB S.A.S., Gennevilliers (Paris)	France	C	100.00	62,266	9,444	
TPS Techni Pompe Service S.A.S., Hoerdt	France	C	100.00	1,743	406	
Hydraulor Services, Algrange	France	C	100.00	1,135	247	
SEME S.A.S., Forbach	France	N	100.00	1,423	52	
EITB Entrepr. Industr. de Traveaux de Bobinage, Avignon	France	N	100.00	1,109	26	
Société Beri. de Constr. Mec. S.à r.l., Gennevilliers (Paris)	France	N	100.00	202	0	
KSB Export Afrique S.A.S., Gennevilliers (Paris)	France	N	30.00	73	– 1	
Techni Pompe Service Maroc (TPSM), Casablanca	Morocco	N	15.00	239	12	■

Name and seat of company	Country		Capital share %	Equity € thousands	Net profit / loss for the year € thousands	
KSB Finance Nederland B.V., Zwanenburg	The Netherlands	C	100.00	6,777	3,136	
DP industries B.V., Alphen aan den Rijn	The Netherlands	C	100.00	10,652	5,181	
KSB Nederland B.V., Zwanenburg	The Netherlands	C	100.00	4,809	746	
Nederlandse Pompservice (N.P.S.) B.V., Velsen-Noord	The Netherlands	N	100.00	– 183	– 167	
KSB Italia S.p.A., Milan	Italy	C	100.00	19,728	1,357	
Velmec S. r.l., Scorzé	Italy	N	100.00	127	45	■
KSB Belgium S.A., Wavre	Belgium	C	100.00	4,150	1,100	
KSB Mechanical Services On Site N.V., Antwerp	Belgium	N	100.00	850	686	■
KSB On Site Machining BVBA, Wilrijk	Belgium	N	100.00	•	•	
AMVI Aplica. Mecánicas Válvulas Industriales, S.A., Burgos	Spain	C	100.00	6,064	677	
Bombas ITUR S.A., Zarautz	Spain	C	100.00	11,701	699	
Suciba S.L., Sondika	Spain	N	100.00	330	32	■
SISTO Armaturen S.A., Echternach	Luxembourg	C	52.86	9,187	607	
KSB Österreich Gesellschaft mbH, Vienna	Austria	C	100.00	2,685	106	
KSB SRB d.o.o. Beograd, Belgrade	Serbia	N	100.00	20	8	■
KSB-AMVI, S.A., Madrid	Spain	C	100.00	3,461	– 46	
KSB Limited, Loughborough	United Kingdom	C	100.00	261	– 289	
RES Rotary Equipment Services Ltd., Loughborough	United Kingdom	C	100.00	690	207	
KSB Pumps (S.A.) (Pty.) Ltd., Germiston (Johannesburg)	South Africa	C	50.00	10,495	2,152	
KSB-Pompa, Armatür Sanayi ve Ticaret A.S., Ankara	Turkey	C	99.00	4,431	1,133	
KSB Pumps Arabia Ltd., Riyadh	Saudi Arabia	N	50.00	2,612	597	■
KSB Middle East FZE, Dubai	UAE	N	100.00	513	124	■
KSB Shanghai Pump Co. Ltd., Shanghai	China	C	80.00	23,261	5,854	
KSB Ajax Pumps Pty. Ltd., Tottenham (Melbourne)	Australia	C	100.00	7,379	644	
PT KSB Indonesia, Jakarta	Indonesia	C	100.00	994	261	
Dalian KSB AMRI Valves Co., Ltd., Dalian	China	N	100.00	272	– 400	■
KSB Bombas Hidráulicas S.A., Várzea Paulista	Brazil	C	100.00	26,737	5,594	
KSB Válvulas Ltda., Barueri	Brazil	N	100.00	367	11	■
KSB Comp. Sudamericana de Bombas S.A., Carapachay	Argentina	C	100.00	2,902	339	
KSB Pumps Inc., Mississauga / Ontario	Canada	N	100.00	1,089	296	■
PAB Pumpen- und Armat.-Beteiligungsgesell. mbH, Frankenthal	Germany	C	51.00	24,231	213	
KSB America Corporation, Richmond / Virginia	USA	C	51.00	21,060	1,471	
GIW Industries, Inc., Grovetown / Georgia	USA	C	51.00	19,683	3,473	
AMRI, Inc., Houston / Texas	USA	C	55.91	6,303	1,269	
KSB, Inc., Richmond / Virginia	USA	C	51.00	6,270	574	
PPM-KSB, Inc., Bakersfield / California	USA	C	51.00	1,823	– 12	
Canadian Kay Pump Ltd., Mississauga / Ontario	Canada	C	100.00	4,390	632	
KSB Pumps Limited, Pimpri (Pune)	India	C	40.54	37,904	9,054	

C = Companies fully consolidated in KSB AG's consolidated financial statements
N = Companies not consolidated in KSB AG's consolidated financial statements
■ = Prior-period figures
• = No data available, as company has been newly established / acquired

SUPERVISORY BOARD

Dr. Wolfgang Kühborth, Dipl.-Ing., Frankenthal
(Honorary Chairman)

Dr. Hans-Joachim Jacob, Auditor, Munich
Member of the Executive Board (until 31 Dec. 2006) of BDO Deutsche Warentreuhand Aktiengesellsch. Wirtschaftsprüfungsgesellsch.
(Member until 5 April 2006 / Chairman since 6 April 2006)

Richard Lederer, Dipl.-Kaufmann, Frankenthal
Former Member of the Management of the
Energy Pumps Division of KSB AG
(Chairman until 31 March 2006 / Member since 1 April 2006)

Karlheinz Leitgeb, Industrial Foreman, Pegnitz
Deputy Chairman of the General Works Council and
Chairman of the Pegnitz Works Council
(Deputy Chairman)

Dr.-Ing. Peter Buthmann, Dipl.-Ing., Bayreuth
Vice President, Service KSB Group (until 31 Dec. 2006)

Sigrid Feldmann, Insurance Trader, Neustadt / Weinstraße
Trade Union Secretary of IG Metall Ludwigshafen / Frankenthal

Prof. Dr.-Ing. Dieter-Heinz Hellmann, Dipl.-Ing., Kaiserslautern
Head of the Institute for Fluid Machinery and Fluid Mechanics,
Kaiserslautern Technical University
(from 14 June 2006 to 31 Dec. 2006)

Heinz Köppel, Metalworker, Münchberg
1. Delegate of IG Metall Administration Area Ostoberfranken

Ludwig Udo Kontz, Dipl.-Ing., Königswinter
Owner of Kontz, Network & Group, Bonn
(until 31 March 2006 / since 4 April 2006)

Klaus Kühborth, Dipl.-Wirtschaftsing., Frankenthal
Managing Director of Klein Pumpen GmbH

Horst Kuschetzki, Dipl.-Kaufmann, Büdingen-Wolf
(until 18 March 2006)

Alois Lautner, Lathe Operator, Kirchenthumbach
Deputy Chairman of the Pegnitz Works Council

Stefan Messer, Industrial Trader, Sulzbach [1)]
Chief Executive Officer of Messer Group GmbH

Heinrich Dieter Müller, Techn. Draftsman, Dannstadt-Schauernh.
Chairman of the European Works Council, the General Works
Council and the Frankenthal Works Council

Carl-Wilhelm Schell-Lind, Dipl.-Ing., Wirtsch.-Ing., Freinsheim [2)]
Vice President, Regional Sales Europe (since 1 Jan. 2007)

BOARD OF MANAGEMENT

Dr. rer. pol. Wolfgang Schmitt, Bad Dürkheim [3)]
(Member since 7 April 2006 / Chairman and Human Resources Director since 15 Dec. 2006)

Heinz-Jürgen Otto, Mutterstadt
(Chairman and Human Resources Director from 1 April 2006 to 14 Dec. 2006)

Peter Schubert, Heddesheim
(Chairman and Human Resources Director until 31 March 2006)

Dr.-Ing. Peter Buthmann, Bayreuth [4)]
(since 1 Jan. 2007)

Dr. Ing. Willi Enderle, Grünstadt [5)]

Prof. Dr.-Ing. Dieter-Heinz Hellmann, Kaiserslautern
(since 1 Jan. 2007)

Dr. rer. pol. Alois Wittmann, Frankenthal
(until 6 April 2006)

Mandates of KSB Supervisory Board members in the Supervisory Board / Board of Directors of other companies

[1)] Wiethoff Immobilien AG, Schmallenberg, Germany
Elme Messer Gaas A.S., Tallinn, Estonia
Messer Gases del Peru S.A.C., Callao, Peru
Messer Italia S.p.A., Collegno, Italy
Messer Schweiz Verwaltungs AG, Dällikon, Switzerland
Messer B.V., Moerdijk, The Netherlands
Messer Schweißtechnik AG, Dällikon, Switzerland
Messer Schweiz AG, Lenzburg, Switzerland
Messer Tehnogas AD, Belgrade, Serbia

[2)] KSB Pumpy + Armatury sr.o., Prague, Czech Republic
KSB Pompy i Armatura Sp. z o.o., Warsaw, Poland
KSB Finland Oy, Kerava, Finland
KSB Limited, Loughborough, United Kingdom
KSB Belgium S.A., Wavre, Belgium
SISTO Armaturen S.A., Echternach, Luxembourg
KSB Italia S.p.A., Milan, Italy
KSB-AMVI S.A., Madrid, Spain

Mandates of KSB AG's Board of Management members in the Board of Directors of KSB companies

[3)] Hydroskepi GmbH, Amaroussion, Greece
KSB TESMA AG, Amaroussion, Greece
KSB Viosen AG, Patras, Greece
SISTO Armaturen S.A., Echternach, Luxembourg
KSB-AMVI S.A., Madrid, Spain
KSB-Pompa, Armatür A.S., Ankara, Turkey
KSB Bombas e Válvulas S.A., Algés, Portugal
KSB Finanz S.A., Echternach, Luxembourg
KSB Pumps (S.A.) (Pty.) Ltd., Germiston, South Africa
Canadian Kay Pump Ltd., Mississauga, Canada
KSB America Corporation, Richmond / Virginia, USA

[4)] KSB Italia S.p.A., Milan, Italy
KSB Nederland B.V., Zwanenburg, The Netherlands
SISTO Armaturen S.A., Echternach, Luxembourg

[5)] KSB Tech Pvt. Ltd., Pimpri (Pune), India

KSB SHARES

2006 – an encouraging year on the financial markets

The performance of the international equity markets was encouraging overall in the year under review. The DAX rose by some 22 % year-on-year, the Dow Jones in the US by a good 16 % and the EURO Stoxx 50 by around 15 %. Japan's Nikkei was up by almost 7 %.

After a good start to the year, concerns about interest rates and inflation led to a massive correction in spring. At the mid-year point, the indices stood even lower for a while than at the end of 2005. Significant price gains then marked the second half of the year on the financial markets. These were mainly triggered by a continuing robust global economy, with rising corporate profits and more favourable expectations about inflation.

KSB share price at a record level

KSB shares posted record gains in 2006. In the first half of the year, both our ordinary and preference shares rose continuously. This development gained momentum in the second half of the year, with the share price reaching all-time highs of around € 380 for each class in the last quarter of 2006. Our preference shares closed the year at € 378.50, a 176 % rise as against the end of 2005. KSB ordinary shares recorded a year-on-year rise of 146 %, closing the year at € 372.00.

The steep rise in our share prices is also reflected in our market capitalization: at the end of 2005, this still stood at € 252.9 million, but then improved significantly by € 404.2 million to € 657.1 million.

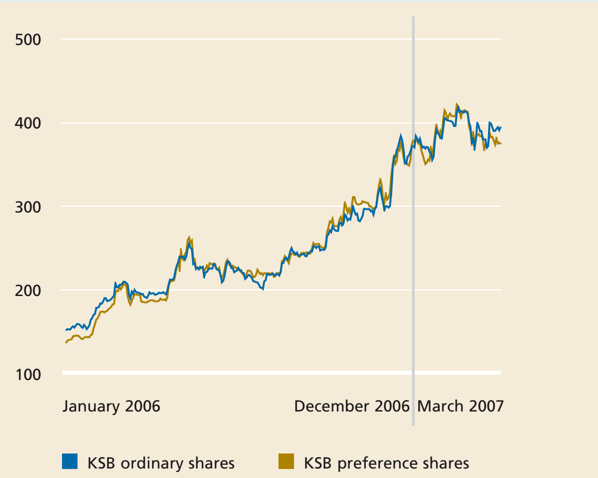
Higher dividend proposed

After bringing KSB AG back into profit in the year under review, we are now again in a position to propose the payment of a dividend to ordinary shareholders at the Annual General Meeting on 13 June 2007, as well as an increase in the dividend to preference shareholders. The proposal would see ordinary shareholders receiving a dividend of € 2.00 per share (previous year: € 0) and preference shareholders € 2.52 per share (previous year: € 1.03).

Dividend development	2006 (Proposal)	2005
Ordinary share		
Dividend	€ 2.00	–
Dividend yield	0.5 %	–
Preference share		
Dividend	€ 2.52	€ 1.03
Dividend yield	0.7 %	0.8 %

	Ordinary shares	Preference shares
ISIN	DE0006292006	DE0006292030
Reuters symbol	KSBG	KSBG_p
Bloomberg symbol	KSB	KSB3
Share capital	€ 22.7 million	€ 22.1 million
Shares in free float	approx. 25 %	100 %
Year-end closing price 31 Dec. 2006	€ 372.00	€ 378.50
Market capitalization 31 Dec. 2006	€ 657.1 million	

Development of KSB shares in €



CORPORATE GOVERNANCE REPORT / REMUNERATION REPORT

The Board of Management and the Supervisory Board report as follows on corporate governance at KSB as well as on the remuneration principles for the Board of Management in accordance with sections 3.10 and 4.2.5 of the German Corporate Governance Code:

Good, responsible corporate governance has traditionally ranked highly at KSB. We therefore welcome the principles set out in the German Corporate Governance Code. Even before the Code was introduced, we implemented the majority of core corporate governance and control processes in such a way that they complied with the current requirements of the Code. In doing so, we were guided by generally accepted national and international standards of good and responsible business conduct and management. We endeavour to be worthy of the trust placed in us by investors, the financial markets, our staff, the general public and particularly by our customers, and to further increase this trust.

KSB AG is an "Aktiengesellschaft" (public company) under German law. The Board of Management and Supervisory Board are therefore responsible for the management of the Company. The members of the Supervisory Board are selected according to the rules of the German Co-determination Act and the German Public Companies Act. At KSB, the Board of Management and the Supervisory Board cooperate closely for the benefit of the Company. The continuous dialogue between these two corporate bodies, based on mutual trust, forms the basis for the long-term success of the Company.

In pursuit of transparency in the management of the Company, it is explicitly stated in the rules of procedure for both the Board of Management and the Supervisory Board that the Company is to be run according to the standards of the German Corporate Governance Code, unless the Board of Management and the Supervisory Board have agreed to an exception being made in justifiable, individual instances. Corporate Governance plays a major role for both Boards, covering all areas of the Company. The development and positioning of a group-wide code of conduct have a particular significance in the current financial year. The Board of Management will establish a set of binding rules which set standards for lawful behaviour and which must be observed by all employees.

In addition, the Supervisory Board has decided to regularly review the efficiency of its activities to safeguard and continuously improve the level already reached. The Supervisory Board is putting particular emphasis on this subject and is supported by the Audit Committee set up from among its members.
The way the Supervisory Board works was critically examined by extensively interviewing its members. The results of these interviews were then discussed in a full plenary meeting. The Supervisory Board will make use of the opportunities for improvement which resulted from the interviews to better structure the processes to carry out the work that has to be done. In the financial year under review, the Supervisory Board has also worked intensively on reviewing the rules of procedure for the Board of Management, and to redefine the list, included in these rules, of the transactions which are only permissible with the agreement of the Supervisory Board. At times, the Supervisory Board met to discuss this and other subjects without the Board of Management being present.

In the current financial year, one focus of the Board of Management's activities will be on carrying forward a consistent strategy for the Company. The Board of Management will work closely with the Supervisory Board on this. To optimize the coordination process, the Supervisory Board has set up a Strategy Committee from among its members, which will prepare the necessary contributions for the plenary meeting.

The Board of Management and Supervisory Board issued an updated statement of compliance in accordance with section 161 of the AktG (*Aktiengesetz* – German Public Companies Act) on 14 December 2006 and made it available to the shareholders on the Company's web site. The Company complies with the recommendations of the German Corporate Governance Code in the version dated 12 June 2006 apart from a handful of exceptions. The departures from compliance with the recommendations of the Code are explained below:

- We depart from the recommendation on disclosing details of the remuneration for individual members of the Supervisory Board (section 5.4.7). We prefer to provide information about the total remuneration of the members of the Supervisory Board, rather than breaking it down into the compensation of the individual members and the components it contains, as the latter would not provide any tangible benefits for shareholders or the development of the Company. The remuneration of the Supervisory Board members is governed by the Articles of Association. The total remuneration of the Supervisory Board is contained in the notes to the consolidated financial statements.
- We depart from the recommendation in section 7.1.2 to the extent that the consolidated financial statements are not published within 90 days of the end of the financial year. The interim report is published within 45 days of the end of the second quarter. KSB already publishes its annual financial statements well ahead of the statutory deadlines, so we do not believe there is any need to further accelerate their publication.

Going forward, we will continue to respond quickly to further developments in the German Corporate Governance Code to ensure that suggestions and recommendations that are applicable to KSB are implemented in the interests of sustained transparency and growth in our enterprise value.

No transactions in shares of the Company or in financial instruments on these shares were notified to the Company in accordance with section 15a of the WpHG (*Wertpapierhandelsgesetz* – German Securities Trading Act) in the year under review. The members of the Board of Management and the Supervisory Board do not hold shares of KSB or financial instruments on these shares that in the aggregate exceed an interest of one percent of the shares issued by the Company.

The remuneration arrangements for the Board of Management are structured as transparently as possible. The remuneration of the Board of Management consists of fixed and variable components.

The amount of the fixed remuneration is governed primarily by the function and responsibility assigned to the member of the Board of Management. The fixed remuneration consists of a fixed sum plus benefits as well as pension commitments (retirement, occupational disability and widow's pensions). The fixed remuneration is independent of performance and is paid monthly as a salary; the benefits include the use of a company car as well as covering insurance premiums. No credit or advance payments were granted to members of the Board of Management in the year under review. With some members of the Board of Management, for certain cases of premature termination of the mandate, an agreement has been made from the outset to pay a fixed amount of severance compensation, so as to keep the costs predictable which would arise for the Company in such a situation.

The variable remuneration component is linked to the consolidated net retained earnings for the financial year in question as well as to responsibility-related and individual targets agreed with the members of the Board of Management to ensure a more flexible structuring of the variable remuneration. Apart from that, the total amount of the variable components is limited, to take account of extraordinary, unpredictable developments.

On 22 June 2006 – using a legally permissible option – the Annual General Meeting agreed that it will not be necessary to disclose the details of the compensation for individual members of the Board of Management for a period of five years. The total remuneration for the members of the Board of Management for their activities in the 2006 financial year was € 3,769 thousand. For this period, additions of € 1,392 thousand were made to the pension provisions for active and for retired members of the Board of Management. No stock options or other share-based payment arrangements are granted to members of the Board of Management. Further disclosures on the remuneration of the Board of Management are to be found on pages 43 and 89 of the annual report.

The Supervisory Board

The Board of Management

CORPORATE GOVERNANCE: STATEMENT OF COMPLIANCE

Statement by the Board of Management and the Supervisory Board of KSB Aktiengesellschaft on Compliance with the Recommendations of the Government Commission on the German Corporate Governance Code pursuant to § 161 AktG (German Public Companies Act)

Since the publication of last year's statement of compliance KSB Aktiengesellschaft, Frankenthal (Pfalz) has complied and continues to comply with the recommendations of the Government Commission on the German Corporate Governance Code as set out in the latest version dated 12 June 2006, with the exception of the following:

1. The total remuneration of the members of the Supervisory Board for their service on the Board, as well as remuneration or advantages extended for services provided individually, in particular advisory or agency services, are disclosed in the Notes to the Consolidated Financial Statements, but in the Corporate Governance Report they are disclosed neither separately for each member nor subdivided according to components (item 5.4.7).

2. KSB publishes the Consolidated Financial Statements well before expiry of the periods of time provided by law. However, the time frame provided by the Code, i.e. within 90 days of the end of the financial year, is not met (item 7.1.2).

Signed in Frankenthal on 14 December 2006

On behalf of the Supervisory Board	On behalf of the Board of Management
Dr. Hans-Joachim Jacob	Dr. Wolfgang Schmitt

Key corporate and technical terms

700Up A Group-wide growth and innovation programme with the aim of developing and evaluating business ideas and successfully taking them to market.

Artificial neural network A computer program whose architecture is modelled after the biological "network" structures of the human brain.

Boiler feed pump Pump which supplies preheated water to a steam boiler to allow a continuous evaporation process.

Cooling water pump A pump that is used to remove process heat in a cooling system.

Hydrocracker A system in which complex hydrocarbons are broken down into simpler molecules under very high pressures, using a catalytic process.

Kyoto Protocol International agreement to reduce worldwide CO_2 emissions.

Pressure exchanger A system in which the high pressure of one medium is transferred to another medium. KSB manufactures these pressure exchangers for energy recovery in seawater desalination plants that work on the principle of reverse osmosis.

Quarter-turn pneumatic actuator A mechanical device that converts energy in the form of compressed air into motion to operate quarter-turn ball or butterfly valves.

Supercritical power plant A power station, in most cases coal-fired, that works with high temperatures and pressures. It is up to 50 % more efficient in producing electricity than conventional power plants.

Abbreviations

API American Petroleum Institute

EBIT Earnings before interest and taxes

ISO 14001 International standard under which companies can obtain certification for the integration of environmental protection in their management system.

ISO 19001 Standard governing quality and environmental management system audits.

OHSAS 18001 OHSAS stands for "Occupational Health and Safety Assessment Series" and is a certification system relating to safety at work and health management.

PoC Percentage of completion

ROCE Return on capital employed

SHAREHOLDER INFORMATION

25 April 2007, 10:00 h
Financial press conference
67227 Frankenthal

3 May 2007
Invitation to Annual General Meeting

13 June 2007, 15:00 h
Annual General Meeting
CongressForum Frankenthal
Stephan-Cosacchi-Platz 5
67227 Frankenthal

14 June 2007
Dividend payment

August 2007
Interim Report January – June 2007

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Online news

You will find the latest news on KSB at www.ksb.com

Concept and design:
HGB Hamburger Geschäftsberichte GmbH & Co. KG, Hamburg

KSB Communications (V5), Frankenthal

Lithography / Printing:
Ottweiler Druckerei und Verlag GmbH, Ottweiler

Photos:
D. W. Schmalow, Mannheim
Horst Kirsch, Frankenthal
Werner Schäfer, Frankenthal

Cover:
View into the tubular casing of a cooling water pump type SEZ

Annual Report 2006

KSB Group

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