KSB Group

Annual Report 2005

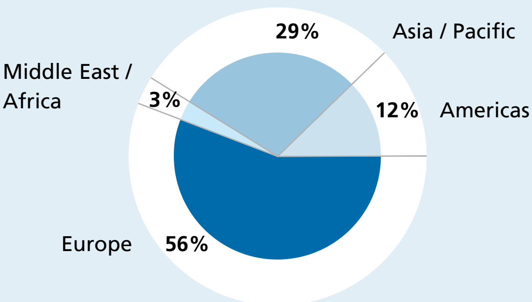
The Brand Lights the Way

KSB

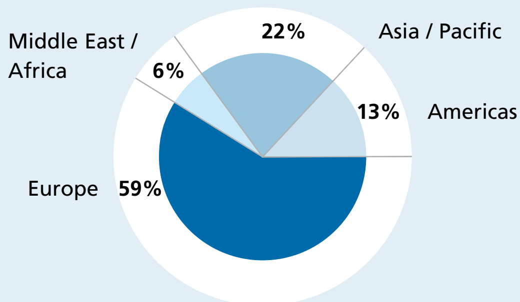
GROUP HIGHLIGHTS

		2005	2004	2003	2002	2001
EARNINGS						
Sales revenue	€m	1,390.3	1,266.8	1,178.1	1,180.2	1,161.9
Earnings before interest and taxes (EBIT)	€m	44.2	33.6	39.7	43.9	36.8
Earnings before taxes (EBT)	€m	32.4	22.1	29.8	34.3	26.9
Net profit for the year	€m	22.6	14.7	18.7	19.6	14.1
Cash flow	€m	73.8	59.5	63.1	60.3	52.8
BALANCE SHEET						
Balance sheet total	€m	1,054.6	982.6	926.5	859.3	909.7
Fixed assets	€m	287.3	261.2	270.1	234.2	248.5
Capital expenditure	€m	45.2	33.7	60.4	31.3	29.0
Depreciation and amortization expense	€m	34.2	33.2	30.2	30.0	32.8
Current assets	€m	737.0	693.8	633.0	604.4	645.7
Equity (including minority interest)	€m	390.0	354.8	346.0	355.8	367.6
Equity ratio (including minority interest)	%	37.0	36.1	37.4	41.4	40.4
PROFITABILITY						
Return on sales	%	2.3	1.8	2.5	2.9	2.3
Return on equity	%	8.7	6.3	8.5	9.5	7.4
Return on capital employed	%	4.7	3.9	4.9	5.5	4.7
EMPLOYEES						
Number of employees at 31 Dec.		12,963	12,467	12,281	11,948	12,071
Staff costs	€m	508.5	477.4	450.5	428.6	420.3
SHARES						
Market capitalization at 31 Dec.	€m	252.9	212.9	211.9	140.2	142.7
Earnings per ordinary share (EPS)	€	7.01	4.16	6.74	8.52	5.19
Earnings per preference share (EPS)	€	8.04	5.19	7.26	8.78	5.45
Dividend per ordinary share	€	–	–	2.50	4.00	4.00
Dividend per preference share	€	1.03	1.03	3.02	4.26	4.26

Employee population by region



Sales revenue by sales region



The KSB World

PRODUCTS AND SERVICES

Industry and process engineering 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 subsystems; installation, commissioning, start-up, inspection, servicing, maintenance and repair services

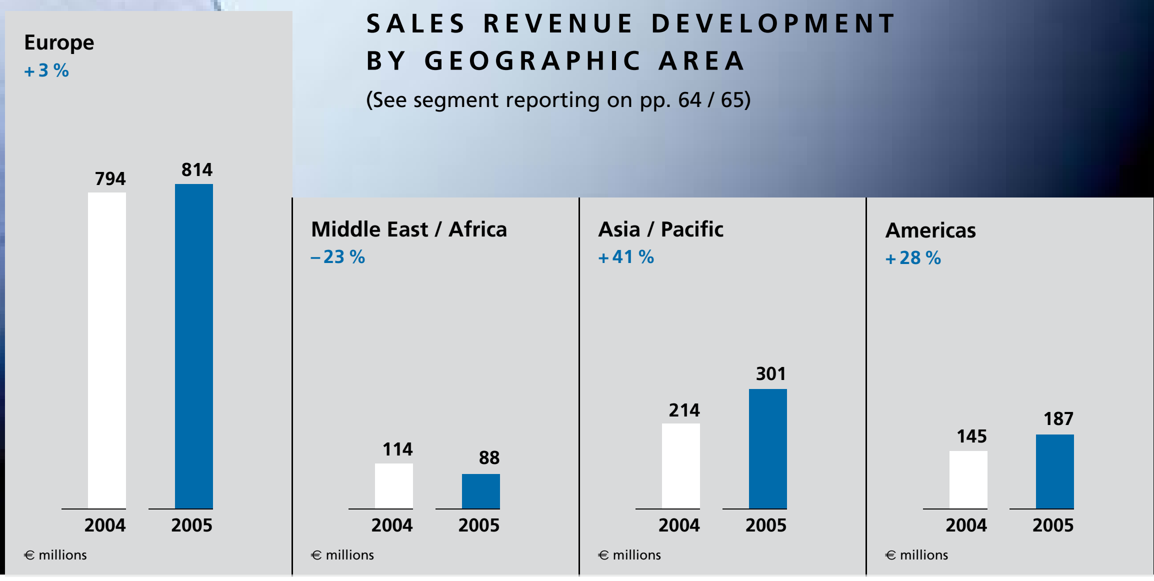
Energy Pumps and valves, as well as associated control and drive systems for use in power stations and district heating systems; installation, commissioning, start-up, inspection, servicing, maintenance and rehabilitation

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

THE KSB GROUP IS ON HAND IN OVER 100 COUNTRIES.
WITH SALES COMPANIES, OFFICES, AGENCIES AND
33 MANUFACTURING SITES.

SALES REVENUE DEVELOPMENT BY GEOGRAPHIC AREA

(See segment reporting on pp. 64 / 65)



OUR 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.

Heinz-Jürgen Otto joined the Board of Management of KSB Aktiengesellschaft on 1 April 2006. He was appointed Chairman of the Board and has taken over the responsibilities previously held by Peter Schubert.

Board of Management of KSB Aktiengesellschaft
(from left to right)

Peter Schubert served as Chairman of the Board of Management of KSB Aktiengesellschaft from 5 July 2005 to 31 March 2006. He was responsible for Sales / Marketing and the Group functions of Corporate Development, Human Resources, Communications and Internal Audits.

Dr. Willi Enderle has been a member of the Board of Management of KSB Aktiengesellschaft since 2001. He is responsible for Research, Development and Engineering, as well as Production, Product Management and Integrated Management Systems. His responsibilities also cover KSB Service GmbH activities.

Dr. Alois Wittmann was member of the Board of Management of KSB Aktiengesellschaft from 1 May 1995 until April 2006. His responsibilities included Purchasing, Controlling, Finance and Accounting. He was also responsible for the Group's IT Management and Corporate Law.

Dear shareholders and business partners,
dear employees,

2005 was a year of progress for KSB. Driving this were our own initiatives, and above all our customers. They displayed more confidence in us than ever before: the Group received orders worth 13.4 percent more than in the previous year. We also enjoyed almost double-digit percentage sales growth, well above the market as a whole. I would like to extend my thanks to all our customers. Their orders enabled us to win back market share in Europe. At the same time, we pursued our expansion in Asia and the Americas.

We also made progress on our Structural Programme. This is designed to improve our working efficiency and cost structure in Europe. The Programme includes, for example, partial retirement arrangements. Initially, therefore, it naturally involves costs. These continued to affect our bottom line in 2005. KSB, however, always puts greater priority on ensuring sustainable business success than on short-term earnings improvements.

Reducing variable costs at our German sites remains an important task, in order to maintain jobs there that are competitive on the world market. One contribution, as already announced, is the new ProSys production system. This is now being introduced at several locations across Europe, with the remainder to follow. In the manufacturing area we have now completed migration to the SAP R/3 software. My thanks go to all employees who have successfully dealt with the tasks involved, and to those who have helped increase our orders and meet the ensuing demand.

2005 was, however, not only a time of progress, but also of change. Several members of the Supervisory Board left KSB, as did the then Chairman of the Board of Management. The Supervisory Board delegated me to the Board of Management for nine months.

During this period, I learned to value the culture and working methods of a company accustomed to achieving top results both in technology and service. KSB is a real innovator. The company set the standard for energy-efficient series pumps, introduced variable speed pump drives, designed a compact valve and has developed a whole number of unique materials for pumps and valves.

We must all work to maintain and extend KSB's ability to innovate. This requires constructive and committed communication throughout all levels of the company. We have several interesting new fields of activity, in which we can make a great deal happen for our customers. Examples include automation and drive technology, fluid transport modules and systems, and the creation of intelligent services. Our declared aim is always to offer the market the best solutions.

To meet this goal, we have intensified internal cooperation within the KSB Group around the world. We have established new competence centres for rapid customer-specific solutions, and a development centre in India. We have also geared our production sites even more strongly towards our global manufacturing network. We are very clear about which markets offer the best long-term volume prospects, and have expanded our capacity in these regions accordingly.

In the years ahead, KSB will continue to grow from its position of strength in the market and in technology. The company will also change. Wherever we implement new business ideas, we shall also be taking some unusual paths. Yet at its heart, KSB will remain the company that stands for the values of quality, reliability, excellence and global perspective, and that also continues to innovate in its traditional spheres of activity. We view the focus on these values as the basis for healthy business development. For you as a business partner, investor or employee, KSB will remain a company that justifies your confidence.

Peter Schubert

Peter Schubert

Richard Lederer,
Chairman of the Supervisory Board
(until 31 March 2006)

The Supervisory Board fulfilled the duties assigned to it by law and the Articles of Association in financial year 2005. 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 all 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. Any departures in business developments from the formulated plans and targets were commented on in detail by the Board of Management. 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.

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

Four 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 discussion included the acquisitions in the past financial year, primarily in Service, discussions on the strategy to be adopted for the Chinese and Russian markets and the development of the current Structural Programme. The latter is intended to help improve earnings in several stages. In this context, the Supervisory Board dealt on several occasions with the introduction of a new production system, which was also inspected on site at the Frankenthal and Pegnitz locations on visits to these facilities. On the occasion of the departure of the long-serving Chairman of the Board of Management, the Supervisory Board discussed the succession arrangements in detail. Other important topics were the implementation of SAP R/3 software at the European production locations and the status of 700UP, a corporate project to promote long-term growth and innovation that has been running for some time now. The core issue in the final meeting of the year under review was the 2006 budget. All of these topics and decisions were discussed in detail with the Board of Management, and were closely scrutinized and reviewed by the Supervisory Board.

The Supervisory Board established four committees, to which shareholder and employee representatives were appointed. The Planning and Finance Committee met once and dealt primarily with planning for the 2006 annual budget. The Personnel Committee, which is primarily responsible for entering into the service contracts with the members of the Board of Management and for other matters relating to the Board of Management, met four times, dealing in great detail with the appointment of a new Chairman of 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.
The main topics of the four 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 the continuous monitoring of the existing risk management system. 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). Detailed reports on the meetings and work of the committees were presented at plenary meetings of the Supervisory Board.

Corporate governance and statement of compliance

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 15 December 2005 and made it permanently 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 2 June 2005 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 page 95 of the annual report.

Audit of the annual and consolidated financial statements

KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Mannheim, audited the annual financial statements of KSB Aktiengesellschaft for the year ended 31 December 2005 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 1 June 2005 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 appropriate application of new and amended IFRSs, the computation of deferred taxes, hedge accounting and the reasonableness of the forecasted 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 2005, 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 16 March 2006 and at the meeting of the Supervisory Board on 6 April 2006. 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 submitted by the Board of Management.

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 in the composition of the Supervisory Board:
In a letter dated 6 May 2005, Dr. Michael Rogowski resigned his office as a member of the Supervisory Board, and Bernd Euler and Bernhard Wild left the Supervisory Board of the Company at the end of the Annual General Meeting on 1 June 2005. Stefan Messer, Dr. Hans-Joachim Jacob and Horst Kuschetzki were appointed members of the Supervisory Board by the court on 27 May and 14 June 2005. Mr. Kuschetzki then resigned office in a letter dated 18 March 2006.
The Chairman of the Supervisory Board until 4 July 2005 was Peter Schubert, whom the Supervisory Board appointed to the Board of Management from 5 July 2005 to 31 March 2006 in accordance with section 105(2) of the AktG. On expiry of his term on the Board of Management, Mr. Schubert also resigned his seat on the Supervisory Board. In his place, Ludwig Udo Kontz was appointed by the court as a member of the Supervisory Board on 23 August 2005 and on 4 April 2006.
Richard Lederer was elected Chairman of the Supervisory Board on 5 July 2005 to succeed Mr. Schubert. On 6 April 2006, Dr. Hans-Joachim Jacob took over as Chairman; Mr. Lederer remained on the Supervisory Board. The Deputy Chairman of the Supervisory Board since 1 July 2005 has been Karlheinz Leitgeb. He took over this position from Hermann Reutter who retired at the end of 2005. Heinrich Dieter Müller became member of the Supervisory Board in his place on 1 January 2006.

The composition of the Board of Management also changed:
Prof. Dr. h.c. Josef Gerstner left the Board of Management of the Company as of 1 July 2005. Peter Schubert took on his duties as Chairman of the Board of Management and Human Resources Director. Mr. Schubert served until 31 March 2006 and was succeeded by Heinz-Jürgen Otto on 1 April 2006.
Dr. Alois Wittmann will leave the Company. His Finance responsibilities will be assumed by Dr. Wolfgang Schmitt who was appointed member of the Board of Management with effect from 7 April 2006.

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.

Frankenthal, April 2006

The Supervisory Board

When they think of the KSB brand, customers see the exemplary quality of our products and services. Maintaining that trust requires innovative technology, top-quality materials and highly trained employees.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The brand lights the way

International corporations and family firms have something in common: their brand is often the most valuable company asset. It is also a crucial factor in business success. Brands are a source of trust, and of customer relationships. Brands provide direction. Underpinning them comes a defined set of goods and services. Companies' task is to show customers the quality of this offering, day after day.

Competition in the modern marketplace is tough. Companies have to vie for business nationally and internationally. The prime beneficiaries are the customers. As global purchasing increases, so does their choice. Customers need to pick exactly the right product from a worldwide range. In their eyes, many products initially seem interchangeable, because so many cover the same basic functions.

As a result, customers look for navigation aids – pointers that help them decide. Strong brands provide exactly that. They light the way to the right company.

What gives the KSB brand its meaning

One way to differentiate oneself from competitors is clear brand positioning. Cars are a good example: "BMWs are fast, Volvos are safe and Smarts are fun". If customers know what they want from a car, the brand will point them to the right dealer. They then expect the brand to deliver on its promise.

The capital goods industry is the same: brands are a promise. When products live up to expectations, customers feel satisfied with their choice. So they come back to "their" brand for the next purchase.

Brand logo, corporate logotype, and prominent capital letters: all three elements add contours to a company's identity. At one level, a logo is just a symbol for a business, brand or product. In the context of Corporate Identity, however, it plays a much more important role. A logo contributes strongly to the creation and communication of an image, internally and externally.

Over the years, the KSB logo has changed in appearance several times. A recurring question was whether it should look timeless or be clearly anchored in a particular era. The results of that debate have determined its varying appearance and feel at different periods. KSB has had a truly distinctive and memorable logo since 1912. The present version dates from 1997, when the temporary additions of a blue band and the words "Pumps Valves" disappeared. The company also modernized the typeface and reworked the fluid circulation symbol.

96 YEARS OF KSB LOGOS

1910	1912	1914	1920

KSB blends innovative technology and first-class service into intelligent solutions.

What does the KSB brand mean? What does it promise customers today and in the future? A company team recently investigated precisely those questions. Its aim was to sharpen the profile of the KSB master brand through clear positioning and by defining its core values.

What values does KSB stand for in the market? Customers know best. Surveys across different sectors and target groups have shown that KSB is a synonym for quality in pump and valve technology. Customers also very strongly associate our brand with reliability, excellence and a global perspective. These four core values form the basis of customers' relationships with KSB.

Historical roots and modern routes

The KSB brand success story begins in 1871, when Johannes Klein files a patent on his "boiler feed apparatus". To manufacture his invention, the German engineer sets up a company called Klein, Schanzlin & Becker. Valve production begins that same year, followed by pumps and compressors in 1874.

Johannes Klein laid the foundation for a company that expanded into Asia and the Americas early on, and today operates around the world. 135 years on, top-quality materials, state-of-the-art technology and highly trained employees continue to guarantee customers the very best products.

Today, KSB is a leading pump and valve manufacturer – and more besides! We are developing from a producer of components into a supplier of "intelligent" systems and extended services as well. This progress is marked by innovations like the new PumpDrive system and the Connectis® coupling module for liquefied gas transport. Another example is the SalTec® desalination module for producing drinking water from the sea. Further new services include pump telemonitoring. So what can customers expect from us? KSB blends innovative technology and first-class service into intelligent solutions. By matching our performance to this ambition, we show customers an important difference between KSB and its competitors.

1961	1978	1986	1997
KSB	KSB	Pumpen Armaturen KSB	KSB

KSB sets yardsticks in quality and reliability

Quality is the result of a continuous process involving people, machinery and material. Total quality only comes when there is total commitment all along the process. We achieve this through advanced quality management, all the way from research and in-house materials development to manufacturing, sales and service. KSB quality begins with our employees. Modern working practices and a high degree of personal responsibility contribute to the strength that their creativity and commitment bring to the brand.

KSB standards of quality apply worldwide, inside and outside the company. We submit all our suppliers to strict auditing. For KSB, meeting global quality standards and international safety requirements is part of daily life.

However, our customers in many fields expect extra quality and reliability. The energy sector is one example, where downtimes cause major knock-on costs. Another is process engineering, in which reliability problems put people and the environment at risk. Our customers in these areas rightly rely on the promise of our brand.

That KSB brand promise stays valid regardless of which site around the world developed or manufactured a particular product. Across our global manufacturing network, we certify all our products to the internal “Made by KSB” standard.

A question of excellence

One of our strengths is solving difficult tasks. New and better products are one way customers expect KSB to respond fast to their wishes. They can rely on us to continue working on innovative answers to future demands, so that their processes run even more economically. Our aim is to manufacture high-performance products that are good value and save energy. Again and again, new departures in materials technology give a boost to development. So do combinations of material designed for specific applications. The KSB brand and innovations have always been inseparable. Our 700UP project is currently giving this tradition new impetus.

We provide individualized services, and constant improvements to our products and technologies. They make KSB a market trend-setter. We develop intelligent pumps, valves and systems. Their sophisticated automation and drive technology takes care of control, regulation and monitoring. We run international collaborations in numerous areas with universities and industrial research units. This joint work always involves the very latest processes and methods. So ideas and excellence turn into technological progress.

Doing business with a global perspective

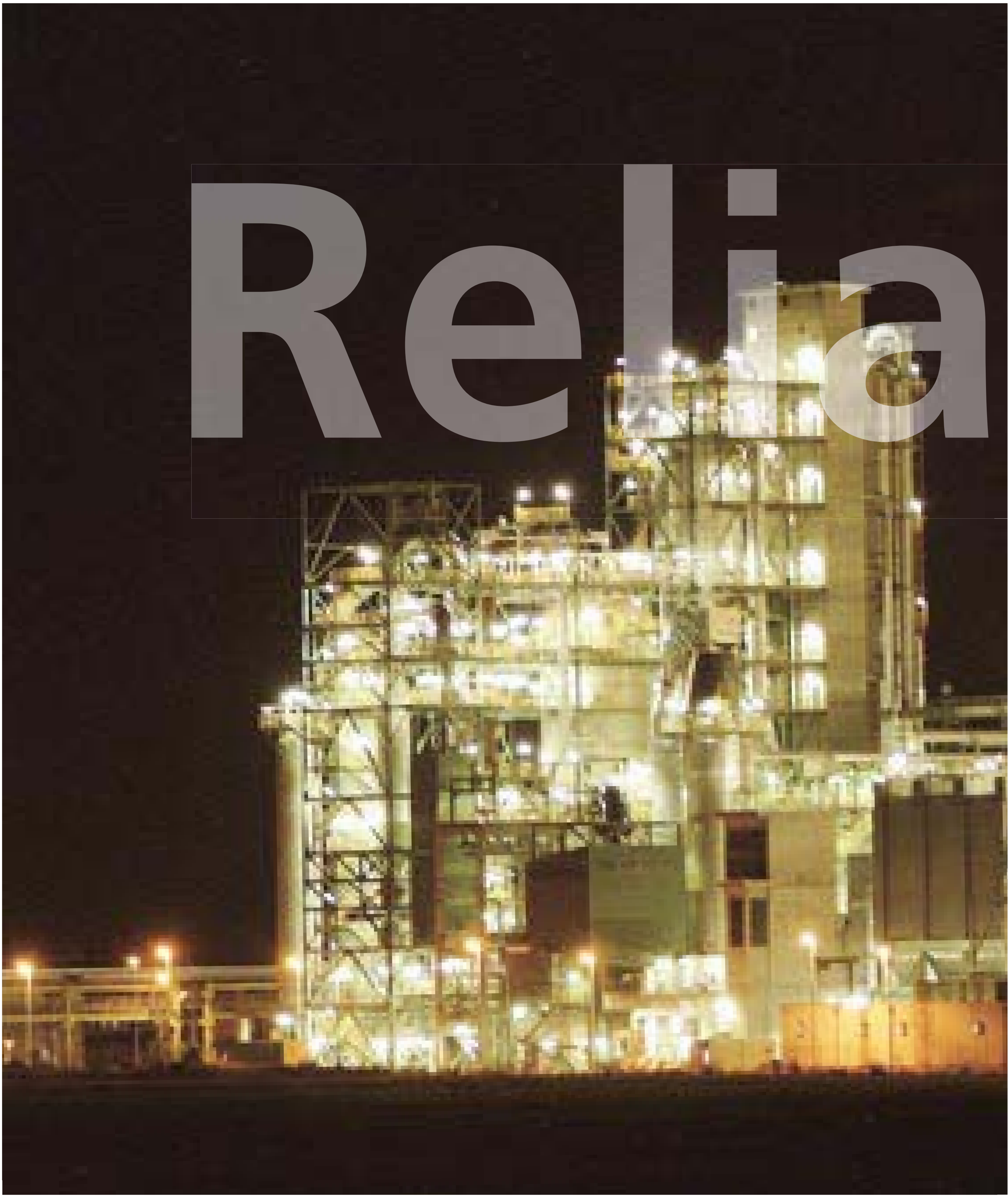
Across the globe, people and markets are coming closer together. Our international structure means that KSB products, services and employees are on hand around the world. We have 33 manufacturing sites, and our sales and service centres span more than 100 countries. From Abu Dhabi to Melbourne, and from Moscow to Johannesburg, KSB is at home worldwide. We continue to extend our global reach, and thus come even closer to our customers.

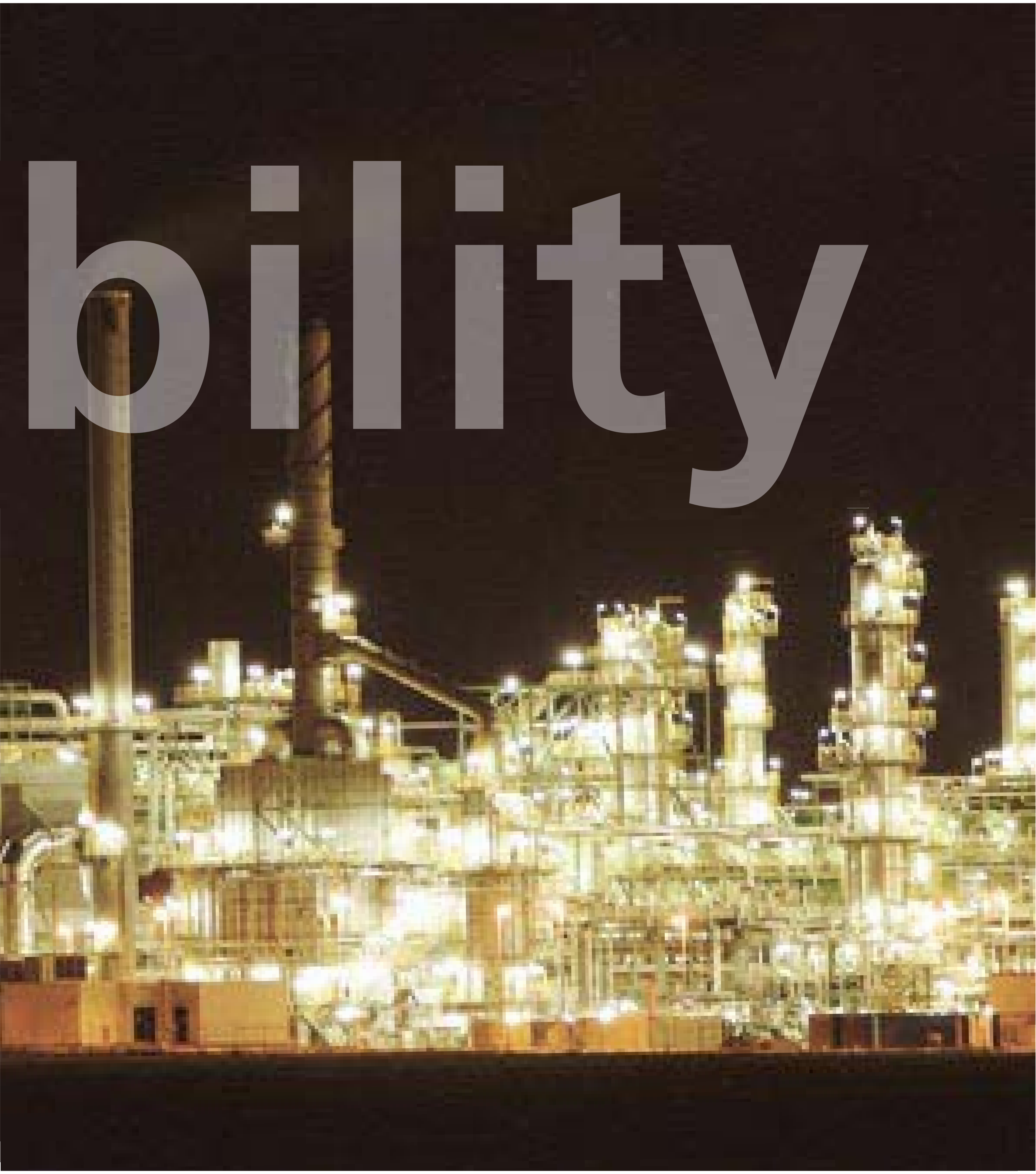
Living the brand

Every company needs a long-term objective. This should be both ambitious and realistic. “KSB provides the best solutions worldwide” is how we sum up our picture of the company’s future. We want to turn our strengths into a clearly visible advantage that will shape its image. We want to confirm and build on the KSB brand, day after day. Every time we prove our quality and excellence, every time we display reliability and a global perspective, then customers will see our brand living up to their expectations. This applies both to the development of a new product, and to service out in the field. We want to be different from our competitors, and better than they are. So we have to prove again and again that we offer “the best solutions worldwide”. When we do so, customers will be happy to have our brand lighting the way.

Shaft and impellers of a stainless steel high-pressure pump. KSB uses state-of-the-art methods and processes to ensure ideal product quality.

High standards of reliability protect plants from damage or breakdown. And they avoid risks to employees and the environment. KSB provides ultra-safe products and rapid service. Customers value a partner who has been a "reliable bet" for 135 years.

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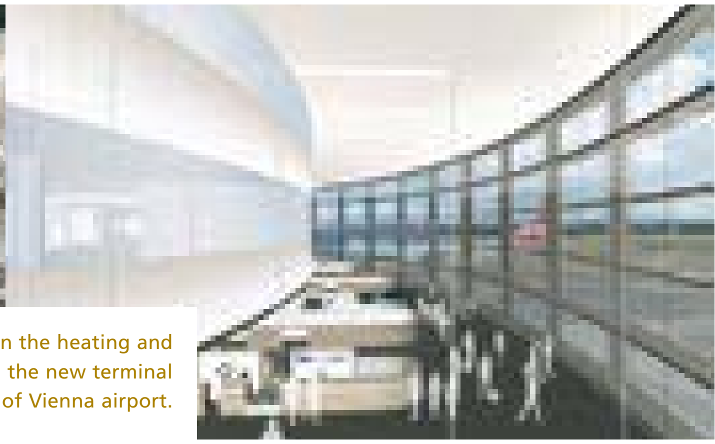


KSB pumps are working in the heating and air-conditioning systems in the new terminal of Vienna airport.

EUROPE

- **Sustained high demand from Eastern Europe**
- **Strong growth of orders in the power plant business**
- **Automation products offer new opportunities**

MARKET DEVELOPMENT AND BUSINESS TRENDS

For KSB, Europe remained far and away the most important market for pumps, valves, systems and services in 2005. But the economy in most European countries continued to show little momentum. The increase in private and public investments was correspondingly restrained. In Germany in particular, foreign demand was once more predominant; the domestic economy offered little stimulus, unlike in Spain or Ireland, for example.

The economy in the new EU member states performed comparatively better. However, the special economic conditions generated by their accession have weakened slightly. The rise in energy costs also had the effect of dampening the economy here, as in most countries. Russia, on the other hand, profited again from the rising prices for oil and gas.

In 2005 the market for pumps and valves only grew by about two percent in Europe. In percentage terms, however, the European Group companies managed to achieve much stronger growth in their order intake: About half the companies even posted double-digit growth rates. KSB in Europe thus succeeded in gaining market share.

PUMPS, VALVES, SYSTEMS

In Europe our customers used the KSB range on offer for equipping industrial plants and power plants, water and waste water facilities and buildings. We serve our European customers through 16 sales and marketing companies, 14 sales houses in Germany and France, as well as through our Web Shop, through wholesalers and through our service organization.

Industry and Building Services

New products for the industrial business

In European industry, KSB enjoys a leading position in pumps and valves engineering. Our portfolio covers almost all industrial needs, including applications in the chemicals, petrochemicals and pharmaceuticals industries. The range of pumps on offer extends from conventional standardized chemical pumps to magnetic drive and canned motor pump sets. This product range is rounded off by cast iron, steel and stainless steel shut-off and control valves.

The air-conditioning system of the „Berliner Bogen" office building in Hamburg is equipped with KSB pumps and valves.

Keen demand for our industrial product range was reported in 2005 from companies in Eastern Europe and from plant engineering contractors with international operations. The latter again profited from demand in strong-growth markets, especially in Asia.

The key areas of our order intake in 2005 lay in the chemicals and petrochemicals sectors. In addition, we received major orders for the equipment of rail vehicles, for fire protection installations and for biofuel production facilities. We also won major orders for valves from the paper and pulp industry and also for a liquefied gas terminal in Northern Europe.

Aiming to meet market requirements and at the same time push ahead with the standardization of our product range, we launched new and improved industrial pumps. These include a standardized chemical pump with a reinforced shaft and bearings for even greater reliability and longer service life. CPK®-N, which can pump aggressive, polymerizing and even gas-laden fluids, supersedes several predecessor models.

Major building projects with KSB involvement

The demand for pumps and valves for building services overall was only just above the level of the previous year. Increased building activities in Eastern European countries offset the weaker development of the market in Central Europe.

The most outstanding orders included equipping Vienna airport with pumps for heating, ventilation and air-conditioning systems, fitting a 194-metre tall office block in Warsaw with water supply and fire protection pumps, as well as providing several hotels and banks with equipment for various supply and waste disposal purposes. In Berlin we were involved in a number of operations, including the building projects of the federal bank, the "Neues Museum", the city's major new shopping mall "Schlossgalerie" and the "Eastgate" shopping and events centre, all of which we completely fitted with pumps, valves and control systems.

In these and other building projects, we offer a persuasive mix of a broad product range and high level of skills in consultancy. Our BOA-Systronic® pump and valve control system, for example, showed a successful sales development. In the business with standard products, most orders came in for domestic water supply and waste water disposal equipment.

1,000 new speed control systems sold

A new product that we launched in the market was our PumpDrive variable speed system. Compared with the predecessor model, this system has a wider range of applications and added functionalities. It also has a special cooling feature that renders it independent of the make of motor, so that the system can be used in universal applications. The new product, which was presented at the Frankfurt ISH Trade Fair, attracted 1,000 orders from customers in building services, industry and other sectors within the space of six months in Germany alone. This investment enables them to reduce pump drive energy by up to 60 percent.

Water and Waste Water

Seawater desalination offers new opportunities

The water market in Europe again showed a varied picture in 2005. Whereas the main focus in countries of Central and Northern Europe was on the rehabilitation of old systems, customers in Eastern Europe built completely new water works. In Southern Europe, the persistent water shortage prompted investments in seawater desalination plants.

Good business opportunities for KSB were also offered by the activities of European companies constructing water extraction, collection and transport systems in North Africa. We received several major orders from these companies in Europe.

Technical advances in reverse osmosis methods have increasingly improved the cost efficiency of obtaining water supplies from the sea. This is opening up a growing field of applications. It is an area where we can cover the whole range of requirements with our pumps and valves, from the extraction of water and the supply of core processes right through to the transport of fresh water to consumers. In addition, KSB has developed a pressure exchanger which allows optimal recovery of a large part of the energy needed for the process. A second pilot plant featuring this module is currently under construction in Malta. Use of the new technology will substantially reduce the operating costs compared with conventional plants.

Finding the right product for waste water applications

We supply operators of municipal and industrial sewage treatment plants with dry-installed and wet-well waste water pumps, as well as with mixers and agitators for clarification processes. Waste water engineering was a key focus of market development in Eastern Europe in 2005. Particularly in Russia we helped to modernize sewage works and equip waste water pumping stations. In addition, we received export orders from Western Europe and from European engineering contractors.

For the design of systems for the transport and purification of waste water, KSB has developed its own software, which is available in 22 languages. Planning engineers thus have a program at their disposal that enables them to select components quickly and easily, as well as solve a large number of technical problems. This tool is now in worldwide use.

Energy and Mining

Boost to investment in European power plants

For the needs of the energy business we supply engineering contractors and power plant operators in Europe with a broad range of pumps, valves, drives and systems. High safety standards, cost efficiency and local service are purchasing factors highly valued by our customers.

The new Etanorm® GPV-W pump for installation in closed tanks has been designed for use in painting and surface treatment applications.

In 2005, the number of orders received by our customers in the plant engineering sector for the construction of power stations outside Europe was well above average. Their demand for pumps and valves for energy generation applications was correspondingly high.

The German energy industry also invested in the construction of new power stations. In line with the Kyoto protocol, which calls for a further reduction of CO_2 emissions, the energy sector stepped up the building of power plants with combined gas and steam turbine cycles. For plants of this kind, which generate only about one-third of the CO_2 emitted by coal-fired power stations, we received orders not only from Germany, but also from Spain and Switzerland.

In addition to these projects, we shall also be supplying boiler feed pumps for a large-scale new lignite-fired power plant in Germany. The highly efficient double-unit plant, each unit having a gross capacity of 1,100 MW, is expected to become operational in 2010. Further major orders in Europe concerned the new construction and modernization of two power plants in Scandinavia.

Slurry pumps for Europe's mines

For the transport of solids, KSB offers hydraulic systems as an alternative to the use of conveyor belts. To supply customers in Europe quickly and reliably with the special pumps they need for this, we have started to establish a competence centre for mining pumps in Frankenthal. The work of this centre has been instrumental in obtaining orders for coal and ore mines in Russia and Ukraine in 2005.

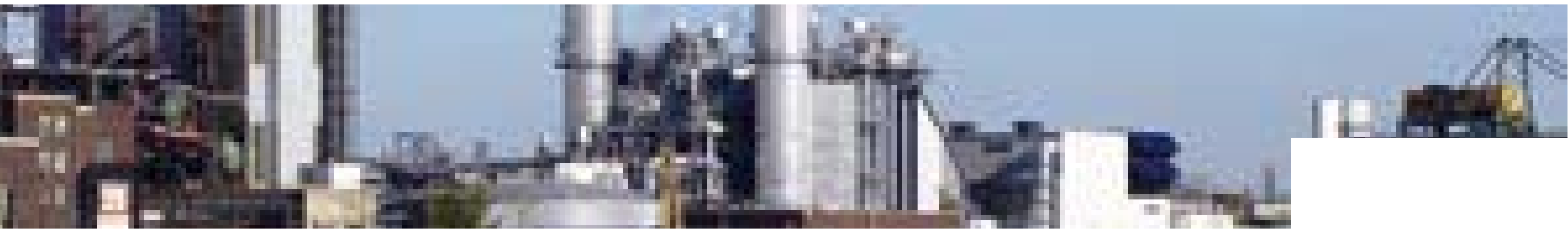
Slurry pump applications place exacting requirements on the equipment's reliability and stability. These requirements are met not only by the use of highly resilient materials, but also by sophisticated design, which we are continually optimizing. In the year under review, for example, we obtained a European patent for a casing element that reduces wear. It protects the susceptible area between the casing wall and impeller and thus increases the stability of these pump components.

The mining sector uses not only the slurry pumps from our US subsidiary GIW, but also pumps and valves from our European manufacturing centres. For example, the operator of one of Sweden's largest iron ore mines ordered high-pressure pumps, butterfly valves and gate valves from us for its processes.

SERVICE

Business with services continued to grow

The service business in Europe is characterized by a tough price war, declining brand loyalty and the production of spare parts by non-original manufacturers. Nevertheless, as the European market leader in the service business for pumps and valves, we succeeded in expanding our business again in 2005 thanks to persuasive quality and fair market prices.



Apart from our competence and performance, a crucial factor behind this growth was our local support to customers. After our acquisition of four additional service companies in Germany, the Netherlands and Spain, our customers in Europe can now turn to around 70 service centres for rapid service. In addition, our authorized service partners look after our customers in building services.

Thanks to the strength of our team, we were able to participate in major overhaul projects in 2005. During scheduled plant outages, we overhauled service-relevant components in chemical and petrochemical facilities and repaired them where necessary. We also received a multimillion-euro order from a German power station operator for an overhaul of the pumps in the operator’s facilities over the next five years.

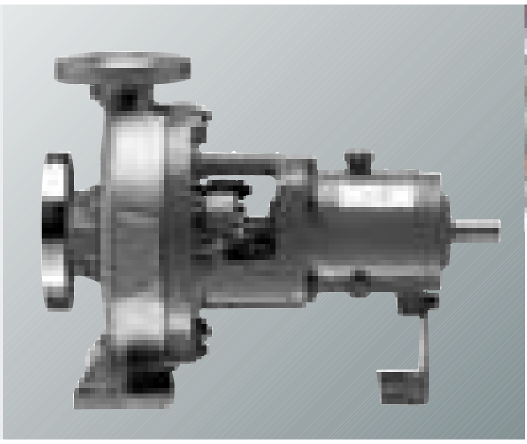
OUTLOOK FOR EUROPE

For 2006, we expect Europe to show a moderate overall growth in the market, which will be above that of the previous year. Demand is likely to be more buoyant in the Eastern European countries than in the rest of the European market. We anticipate a good development in Russia, where we are substantially strengthening our activities. We have also initiated measures in selected Western European countries to increase our market share in sectors of relevance for growth.

We see a growing trend in industry to consider life cycle costs (LCC) as an investment decision-making criterion. This stimulates demand for automation products, which help to save energy costs and avoid unplanned downtime. With our LCC Comparator, we are able to show our customers the profitability of their investments in relation to specific plants and systems.

In building services, we expect demand among customers in Eastern Europe to remain good. Accordingly, we are increasing our market presence there. In Central Europe, demand is likely to be subdued; good opportunities are offered with the sale of energy-efficient systems and controls.

In Southern and Eastern Europe, water supply systems need to be extended and waste water disposal improved. We anticipate that the water and waste water business will be a key focus of orders in this region during the current year.



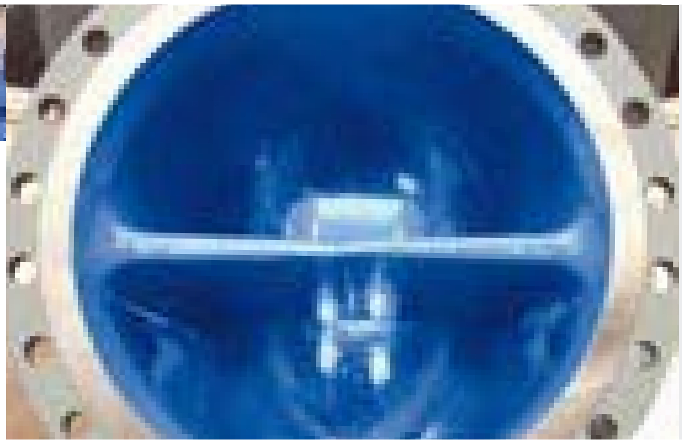
The CPK®-N standardized chemical pump has been improved to achieve even greater reliability and longer life cycles.

In the energy sector, the trend towards building combined cycle power plants with gas and steam turbines will continue in the coming years. This necessitates an increasing standardization of such power plants and related components. In addition, European engineering contractors will continue to share in the boom in power plant construction in Asia and to this extent have a positive influence on the demand for pumps and valves in Europe.

KSB automation products help to save energy costs and avoid unplanned downtime.

We shall continue to expand our mining business as we develop our European competence centre and supply our slurry pumps for the extraction and processing of raw materials to the growing Russian market amongst others.

We shall also continue to strengthen the service sector in 2006. Relevant measures are planned to close gaps in regional supply and to extend our service skills beyond pumps and valves. A particular focus will be on the development of our service business in Eastern Europe.



Suction nozzle of a large pump for water transport systems.

MIDDLE EAST / AFRICA

- **Oil price increases stimulate investments in oil-producing countries**
- **Industrial pumps for new refineries**
- **Collaboration on major water management projects**

In the Region Middle East / Africa we are represented with five of our own companies, as well as sales offices and partner companies. KSB production centres are located in Turkey, Saudi Arabia and South Africa. Our Turkish and South African companies are consolidated in the Group.

As from 2005, our reporting no longer includes Eastern Europe in this Region, because the non-EU countries of Eastern Europe, including Russia, are now covered by our European sales and marketing organization. We are thus keeping in step with their growing economic ties with EU states.

MARKET DEVELOPMENT AND BUSINESS TRENDS

In the year under review, the rise in oil and gas prices facilitated the financing of infrastructure and industrial projects in oil-producing countries. At the same time, several countries in the Region attached high priority to pushing the development of tourism – a further boost to demand for our products. Since Libya has started leaning more towards the west, there has been a change in its restrictive practice in the award of state contracts, so that this market also offered interesting opportunities again for orders.

In 2005 we succeeded in substantially increasing our order intake for direct supplies to the Region. In addition, we won a large number of orders through international plant engineering contractors.

In many projects and requests for quotations, proximity to our customers was also crucial in the past year. For this reason, we strengthened the sales organization in several countries: in Morocco, we opened a sales office, at KSB Middle East FZE in Dubai we increased staff levels, and in the region as a whole we recruited further sales engineers.

Higher demand from South African industry

We have been represented with our own company in South Africa, KSB Pumps (S.A.) (Pty.) Ltd. in Germiston (Johannesburg), since 1959. This company not only produces pumps and valves, but today also coordinates business activities in the whole of Southern Africa. In its home market, the company services its customers through six regional sales offices and a network of 120 distributors.

KSB supplies pumps to Dubai for the cooling water system of what will be the world's tallest building.

Our South African company compensated for a decline in demand for agricultural irrigation equipment through orders from industry and the mining sector. Special attention was paid to securing the return on sales in the mix of project and volume business.

KSB Turkey strengthens competitiveness

Our Turkish company supplies its customers with pumps and systems from its own manufacturing facilities, as well other KSB products. In the year under review, it was particularly successful in the privatized steel industry and in the water business. The company responded to increased competition from local suppliers by cutting costs in its own production and the selective use of products from our global manufacturing network.

PUMPS, VALVES, SYSTEMS

Customers in the Region Middle East / Africa use the full range of KSB products. Pumps, valves and systems manufactured in the Region play a special role in the supply of customers with the products they want.

Industry and Building Services

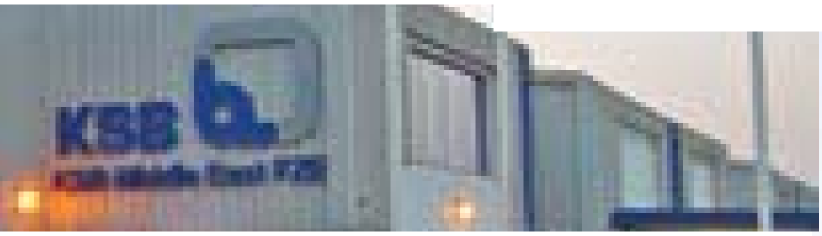
Equipment of refineries in the Middle East

The increase in energy prices has boosted the construction of new refineries in the Region. KSB was able to participate in fitting these plants in several countries with pumps and equipment. In the Middle East, we supplied, amongst other things, 75 process pumps, including accessories and piping for a gas field, and also large tubular casing pumps for the cooling system of a new methanol plant.

Our South African subsidiary added magnetic drive pumps to its product range for use in the chemicals and petrochemicals sectors. The company produces these seal-less pumps for export as part of the global manufacturing network.

Pumps for the world's tallest building

Numerous large-scale building projects are under way in the oil-producing countries of the Middle East and in the tourist destination countries of North Africa. Through the expansion of our distributor network and the logistics centre of KSB Middle East FZE in Dubai we are able to provide even better support to these projects. We extended our local product range with the addition of the Movitec® multistage high-pressure pump, which can be used for domestic water supplies and pressure boosting, and also for irrigation, cooling water circulation and fire-fighting systems.



The logistics centre of KSB Middle East FZE supplies the Region with pumps and valves.

With our extended product range for building services, we succeeded in winning orders for several large projects in the year under review. These included the supply of equipment for high-rise buildings, as well as schools and hospitals.

In Dubai, for example, we are providing pumps to deliver cooling water to what is planned to be the world's tallest building. The Burj Dubai, or "Tower of Dubai", will stand over 700 metres high and offer residential and working areas on 150 floors. KSB pumps also supply coolants for the Dubai Flower Centre, an airport terminal which was built specifically for handling fresh products and which opened at the end of 2005.

Water and Waste Water

New plant projects to tackle water shortage

The rising demand for drinking water and agricultural irrigation necessitates an expansion of water supplies in the Region. In view of the shortage of fresh water, the construction of seawater desalination plants is becoming ever more important. In addition, pumping stations and distribution systems are needed to transport the water to consumer points. With the classic methods of drinking water abstraction, water suppliers are faced with new challenges in the shape of falling groundwater levels and soil salination of well fields.

Our technical expertise and many years of experience in the Region are two crucial factors that persuaded customers to involve us in their new water and waste water projects in Libya, Egypt and Saudi Arabia. Our tasks in Libya include a waste water project in which pumps with ceramic coatings and stainless steel impellers are installed in existing waste disposal stations. Together with KSB control equipment, they enhance equipment reliability and prolong the service life of the systems.

Energy and Mining

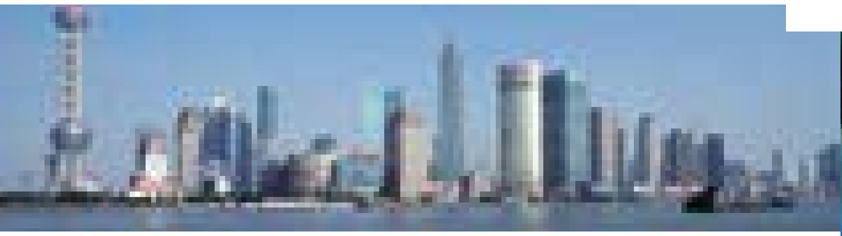
Production of slurry pumps in South Africa

In Southern Africa, too, the increase in commodity prices has boosted investments in the mining sector. In 2005, we therefore stepped up the collaboration of KSB in South Africa with our US subsidiary GIW Industries Inc. Slurry pumps developed in the USA are manufactured locally by our South African company in Johannesburg to serve the needs of the whole continent. There is currently an increased demand for these pump sets.

OUTLOOK FOR MIDDLE EAST / AFRICA

In the current year, there are signs of sustained growth in the areas of energy and water supplies, as well as in industry and building services. We are servicing a lot of projects through international plant engineering contractors, but there is an increasing trend for prospective customers to place inquiries regarding our scope of activities, which ranges from engineering to service, directly with our local subsidiaries.

The further opening of the markets in the Region Middle East / Africa offers new opportunities with the dismantling of trade barriers and the liberalization of agency laws. A key focus of 2006 will therefore be on the expansion of our sales network and of the range of services on offer locally.



ASIA / PACIFIC

- **Strong involvement in the power plant and industrial markets**
- **Record growth with cryogenic butterfly valves**
- **Establishment of new competence centres**

MARKET DEVELOPMENT AND BUSINESS TRENDS

The economy in the Region Asia / Pacific again showed above-average growth in 2005. In some Asian countries with high energy consumption, however, oil price increases slowed the economic momentum. The leading economy and engine of growth in the region remained China with an increase of more than nine percent in its gross domestic product, followed by countries such as India, Pakistan and Indonesia with increases of between five and seven percent. The strongest growth in the sectors serviced by KSB took place in the energy and industry segments in Asia. In Australia, it was above all the mining industry which enjoyed a good development.

The KSB Group companies in the Region improved their order intake in 2005 by more than 40 percent over the previous year. Success factors here were our strong involvement in power plant and industrial projects, the right product mix, as well as local manufacture and supply of pumps and valves.

Key measures taken for growth included the setting up of competence centres in the Region for the areas of water, waste water, energy and industry, the intensification of our business with dealers for standard products and the development of the valves market in China.

PUMPS, VALVES, SYSTEMS

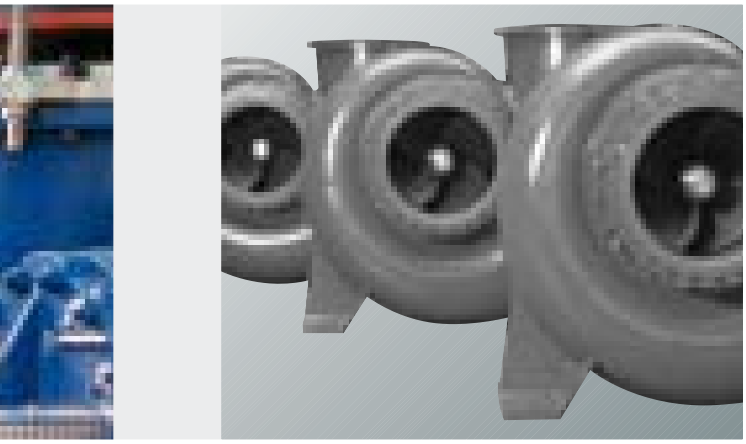
Our production centres in Australia, China, India and Pakistan made an important contribution in supplying our Asia / Pacific customers with high-quality products. In India alone, we currently operate five production centres for pumps and valves.

Industry and Building Services

Vigorous growth in the industrial business

Brisk demand for capital goods for industry boosted our pumps and valves business in 2005. Domestic and international companies invested particularly heavily in China, India, Indonesia, Japan, Pakistan and Singapore. These activities enabled our Group companies in the Region to achieve very strong growth in their business with industrial pumps and valves.

Business development was excellent in China, where we supply industry, for example, with standardized chemical pumps manufactured in Shanghai, as well as cooling water supply pumps. In addition, we offer industrial pumps and valves from KSB's global manufacturing network, which are assembled on the spot together with locally produced components.



KWP® pumps with a special coating for flue gas desulphurization plants in China.

We also won new orders for special pumps for flue gas scrubbers and substantially increased our market share in this important environmental sector.

In India, industry also showed healthy growth. This led to a rise in demand for pumps and valves from Indian engineering contractors and manufacturing companies, above all in the steel and cement industries as well as the paper and pulp industry. Indian refineries implemented quality improvement programmes, which, in turn, resulted in orders for the kind of process pumps KSB manufactures in India to US API standards.

In South Korea we succeeded in persuading local engineering contractors of the qualities of our API pumps for the construction of new petrochemical plants.

Record growth was reported in 2005 for our business with cryogenic butterfly valves. The valves, marketed under the trade name Danaïs®, were needed above all by the South Korean shipbuilding industry for the construction of liquefied gas tankers. We also won major orders in Japan and Taiwan for these special valves, which are used at temperatures as low as minus 250°C.

Further key areas of our industrial activities in the Region were the growth sectors in Indonesia, Pakistan and Thailand.

Water and Waste Water

Flexible pump range for water transport

The supply of drinking water to the growing population is a major challenge in many Asian countries. The authorities are addressing this issue by developing new well fields, building large water pipelines and stepping up efforts to obtain drinking water from the sea.

For a seawater desalination plant in Singapore, for example, KSB delivered more than 40 water extraction and process pumps. The new plant, which operates on the principle of reverse osmosis, is designed to provide around ten percent of the island’s drinking water requirements.

One of the most ambitious projects in the Region is the Chinese north-south aqueduct scheme to divert water from the area of the Yangtse River to the arid north of the country. In the current year, KSB will equip the first pumping station with large pumps of Chinese production. Their adjustable propellers permit the pump output to be matched to varying water levels.

In Pakistan we secured a major order for the overhaul of 350 deep well turbine pumps used to protect against soil salination. At the same time, we successfully introduced our tubular casing pumps onto the irrigation market. Major orders for water pumps also came from Australia.

The Waigaoqiao power station in Shanghai is equipped with KSB boiler feed and cooling water pumps.

Pilot plant for waste water recycling

The waste water market in Asia / Pacific continued to be shaped by the activities of many local and regional suppliers. Nevertheless we managed to achieve a growth in orders in some countries, such as China, India, Pakistan and Singapore. A contribution to this growth came from the introduction in India of a submersible sewage pump with higher power ratings.

We also received orders for the delivery of submersible sewage pumps from customers in Australia – for plants in Brisbane, Melbourne and Sydney – as well as in Singapore. In the Asian city state, waste water is treated using new technology in a pilot plant, which enables it to be used afterwards as fresh water. KSB is involved in the equipment of this plant with 40 waste water pumps from Halle.

Energy and Mining

Largest cooling water pumps to date for China

Our business with pumps and valves for the energy industry saw a very strong performance, with orders from China and India providing major contributions to growth in the Region. An important prerequisite for ensuring that supplies were in keeping with market needs was and remains the local manufacture of pumps for power generation applications.

In China we substantially widened our range of locally manufactured products over the past few years. We today supply both Chinese customers and plant engineering contractors operating in the Region with boiler feed, condensate and cooling water pumps manufactured in Shanghai. Our local offering is rounded off with products from Europe.

In this ambitious emerging economy, the expansion of the electricity supply network remains a focus of technical business developments. As leading pumps manufacturer, KSB Shanghai Pump Co. Ltd. successfully engaged in these expansion projects. On the basis of orders received, we shall be fitting several new power plants with pumps over the coming years. We are also equipping a high-output power plant with electric gate valves, which are designed to meet the special process requirements involved both in terms of their design and selection of materials.

Similarly high technical standards are required for a power plant currently under construction in Yuhuan, for which KSB delivered the first four of eight large cooling water pumps from Germany in December. These are the largest pumps of this type ever built by KSB.

Demand for electricity is also continuing to grow in India, the sixth-largest energy consumer. This growth in demand calls for new captive power as well as cogeneration plants. Our Indian company KSB Pumps Limited is involved in these projects with the provision of power plant pumps and valves: In 2006, KSB will be supplying, amongst other things, twelve large boiler feed pumps to a power station in Sipat in the state of Chhattisgarh. The new plant with the largest unit capacities in the country is due to start operations in the current year.

We succeeded in expanding our business in the energy sector in South Korea, Pakistan, Singapore, Australia and New Zealand. Our company in Taiwan maintained its strong position in the power plant market; in Japan, KSB won its first order for equipment for a local power station.

Fast and reliable service contributes to smooth operation of Chinese plants.

Slurry pumps and fire-fighting systems for the mining industry

Our Australian company in particular was successful in its business with pumps for the mining sector in 2005. Success factors included new offerings for lower-priced slurry pumps used to transport minerals and mine tailings. For selected customers we set up spare parts stores which help minimize downtimes of these heavy-duty pumps.

Containerized fire-fighting systems developed by KSB in Australia also found favour with mining companies. These mobile systems, which are supplied complete with controls, flow meters and lighting, are quick to install and eliminate the need for the operator to build a pump house.

In the countries of Asia, too, order intake for slurry pumps was on the increase. This included orders for mines in South-East Asia and in Mongolia. In Indonesia, we tendered successfully for a drainage project in the mining sector.

SERVICE

Excellent service is a prerequisite for lasting good customer relations not only in the mining business, where pumps are exposed to high stresses and loads resulting from the hydrotransport of hard materials.

In Asia, KSB has therefore extended its service network in all sectors over recent years. In India, for example, we service customers today through four KSB service centres and 76 authorized service partners. In China, we set up a further centre in Inner Mongolia in 2005, in addition to our three existing service centres.

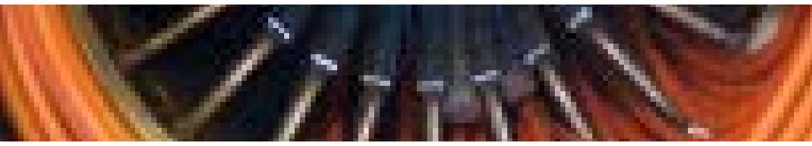
Our Australian company offers its services through five service centres. One outstanding order that was obtained was for the turnkey installation of a sewage treatment plant. Major service contracts were won by the Group companies in Pakistan and Thailand from the industrial, water management and energy sectors.

OUTLOOK FOR ASIA / PACIFIC

The economy in the Region Asia / Pacific is likely to continue its above-average positive development in the years to come. Forecasts assume continued stable growth rates.

We therefore see excellent development opportunities for our business thanks to our good market positioning in the major growth countries, China and India, as well as the intensification of selected activities in important future markets.

We consider such markets to include not only the energy, industry, water and waste water sectors, but also for example marine engineering. New opportunities are emerging in the mining industry, in seawater desalination and in building services. With the production of high-pressure valves in China, we shall also expand our valves business.



KSB Mexico equips pumps for submersible applications with its own motors.

AMERICAS

- New valves company in Brazil
- High demand for slurry pumps
- Further service centres established

MARKET DEVELOPMENT AND BUSINESS TRENDS

In South America, the economy continued to show positive developments in the year under review. Growth opportunities emerged for KSB mainly in industry, including oil production and processing, and in mining. In addition, despite relatively low investment activity in the public sector, a number of major water and waste water project were slated for implementation.

The North American economy in 2005 lost some momentum compared with the previous year. Nonetheless, we registered a greater demand for our products from the industry and mining sectors, whereas the water and waste water market grew only moderately. The recovery in the energy sector continued.

Against this background, the KSB Group companies in the Region succeeded in growing their business well above market. Particularly strong growth in order volume was reported by our companies in Argentina and Brazil, as well as our two large US subsidiaries.

Aiming to improve our competitiveness and market positioning further, we expanded the KSB service activities in 2005, launched new products and modernized production facilities and test fields.

KSB Bombas Hidráulicas S.A. in Brazil, which has been the pump market leader for many years, has started to build up a suitable valves business. To this end, it established the subsidiary company KSB Válvulas Ltda, which acquired the operative business of a Brazilian valve manufacturer. Located in Barueri / São Paulo, the new KSB company produces ball, gate and butterfly valves, as well as actuators.

PUMPS, VALVES, SYSTEMS

The KSB companies in the Region supplied the markets with an extended range of products from their own manufacturing facilities in 2005. In the Americas, pumps and valves are manufactured at seven production sites in Argentina, Brazil, Mexico and the USA. The local offering is supplemented by imports from other regions.

Industry and Building Services

Industrial business grows by more than two thirds

Order intake in the industrial sector developed particularly well in the year under review. In keeping with its strong market position, KSB Brazil was involved in almost all of the country’s important industrial projects. Good demand from the sugar industry, the steel sector and the pulp and paper industry gave a boost to order intake. The company also won important orders from the national oil industry. In this sector, pumps and valves made from special alloys are used on offshore platforms and in refineries.

In Argentina, too, orders from the oil producing and refinery sector helped to drive growth in the industrial business. A major contributory factor was the introduction of pumps built to API standards, as well as valves for oil and refinery applications.

The KSB companies in Canada, Chile and Mexico also stepped up their industrial business activities in 2005. To avoid high import duties, KSB de Mexico, S.A. de C.V. started to assemble industrial pumps locally, adding motors, base plates and other accessories as well.

In the USA, our valves manufacturer AMRI Inc. succeeded in increasing its order intake for butterfly valves in spite of a soft market. The special valves, manufactured in Houston, were mostly ordered by companies in the chemicals and semiconductor industries, as well as in the pulp and paper industry.

Fire-fighting equipment packages were a successful product in industry and building services. The equipment complies with US standards and is supplied to customers above all through our companies in Argentina and Brazil.

Another focus in building services in these countries was on pumping equipment for air-conditioning systems.

Water and Waste Water

Well-filled order books in the water and waste water business

In Latin America, KSB is one of the leading suppliers of water and waste water pumps. In spite of what is currently a low level of investment activity by the public sector, our companies succeeded in expanding their business in this region substantially.

KSB Compañía Sudamericana de Bombas S.A. in Argentina was successfully engaged in the market for irrigation and flood control systems, where the company today is the market leader. In Brazil we received interesting orders for water supply projects and sewage treatment plants.

In Mexico, KSB started production of a new motor for well pumps in Querétaro. Orders for submersible pump sets came from public water companies, irrigation users and dealers. The company also supplied pumps for the country's two most important waste water projects.

KSB valves for the petrochemicals industry are manufactured in Barueri (Brazil).

Energy and Mining

High-pressure pumps for power plants

Our US subsidiary KSB Inc. profited from the recovery of the energy sector in the USA and won a number of orders for high-pressure pumps. Successes in the energy business were also reported by our companies in Argentina and Mexico with the sale of boiler feed pumps.

Expansion of activities in Mining

The commodities market in 2005 was marked by a continuing shortage of metals and high prices of energy sources. As a result, the expansion and reactivation of mines were stepped up, leading to an increase in demand for slurry pumps and the pertinent spare parts, as well as process and auxiliary pumps.

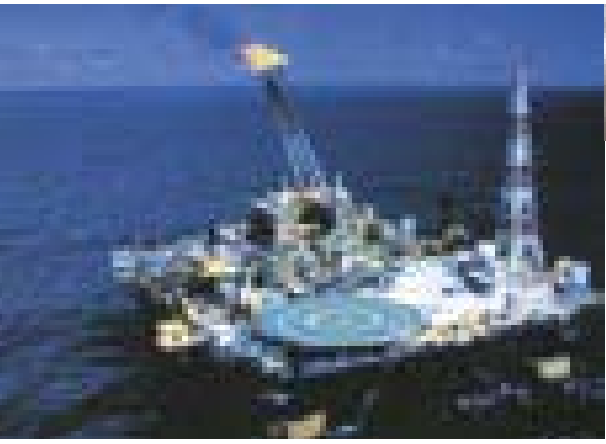
GIW Industries Inc. is one of the world's leading suppliers of slurry pumps. A key focus of its activities in 2005 was on supplying the Canadian oil sands industry and the North American phosphate industry with pumps and spare parts.

To meet the growing demand for slurry pumps, we have continued to invest in manufacturing and testing equipment at the GIW site in Grovetown.

The US American competence centre for slurry pumps has global responsibility for supplying customers with high-quality products and services. Accordingly, it initiated and supported measures aimed at expanding the business with mining pumps in Asia and Australia.

Based on its strong presence in the mining market, our company in Chile secured a number of major orders for the special pumps needed in this sector. Brazil, too, has seen significant progress in its mining business.

Our US subsidiary KSB Inc. profited from the recovery of the energy sector in the USA and won a number of orders for high-pressure pumps.



The acquisitions made in Brazil and the USA will help to strengthen KSB's market positioning in the Americas.

SERVICE

Rapid and reliable service is crucial to justifying and retaining the trust our American customers have placed in KSB. For this reason, we have strengthened our regional service presence. In Argentina we opened a service centre in Rosario City, bringing the number of service centres in the country to three. The new centre will focus on providing the industrial and water sectors with the services they need.

In the year under review, GIW acquired the operative business of Arroyo Process Equipment, Inc. with a site in Mulberry / Florida, which was developed into a service centre. The well-equipped service facility, situated in close proximity to important customers, enables us to repair pump parts which cannot be handled on site because of their size and complexity.

GIW also expanded its service centre in Canada, allowing it to respond rapidly to the needs of the local oil sands industry. To meet demand in the mining sector, KSB Chile S.A. extended its service operations in Antofagasta.

OUTLOOK

In the current year, the economy in North and South America is expected to grow around 3.5 percent. We see good opportunities for the sale of our products, especially in industry, in raw materials extraction and the oil business. In the water supply and waste water disposal sector, some major infrastructure projects are planned to be implemented in 2006. We aim to participate in these as well as in energy engineering projects and some major building services projects.

A particular focus will be on serving the mining industry in Argentina, Brazil and Chile and on developing our activities in this sector in the USA and Canada.

The Brazilian oil industry will offer good business opportunities with the expansion of its capacity. An aggressive approach will be pursued in the waste water business, including the local production of submersible motor pumps.

The acquisitions made in Brazil and the USA in 2005 will help to strengthen KSB's market positioning in the Americas and to implement our growth strategy in the Region.

Transporting and controlling fluids requires the perfect interplay of hydraulics, materials technology and automation. All three are core KSB skills. Every day, we apply them to solving customers' problems and creating a continuous stream of innovations.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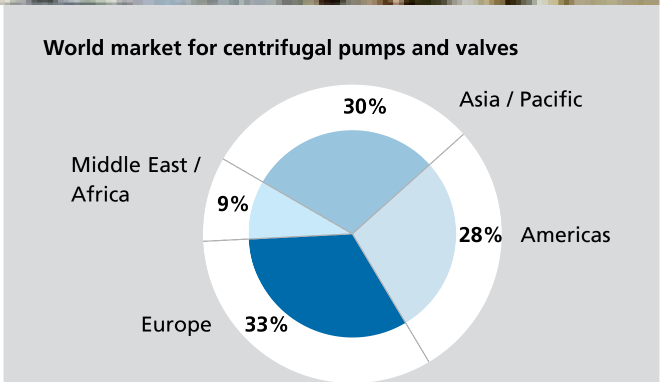


ECONOMIC ENVIRONMENT

- **Good development of global economy**
- **Asia remains strongest growth region**
- **Competitive structure only slightly changed**

Despite the sharply rising price of key raw materials, the global economy developed well with an increase of more than four percent in the year under review. In particular, the economic upturn in the emerging Asian countries, as well as in Eastern Europe and the Middle East, resulted in a recovery in the market for capital goods.

This recovery was also felt in the export-driven industries in Western Europe, which continue to be KSB's most important sales markets. However, in contrast to foreign trade, the domestic economy in most European countries did not perform as well.

Asia / Pacific continued to be the strongest growing region in economic terms. In the business lines relevant for KSB, the energy and industry sectors were dominated by a particularly dynamic development in demand.

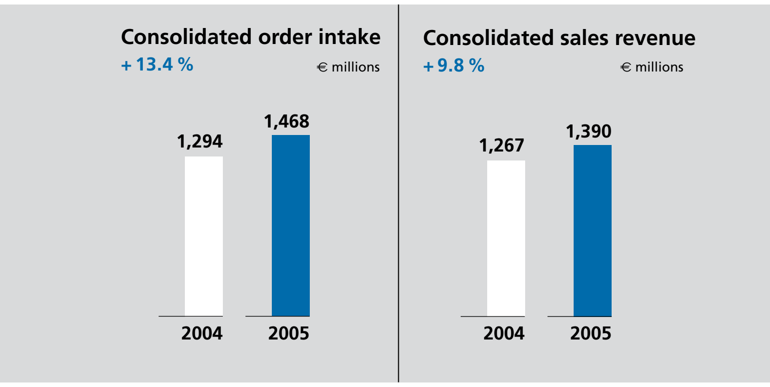
The economy developed encouragingly overall in South America, where KSB has a strong presence in the market. The North American economy lost momentum, but not as much as could have been the case due to the higher energy prices.

In the oil- and gas-producing countries in the Middle East, it was exactly these higher energy prices that facilitated the realization of infrastructure projects and the expansion of industry. The same was true of the growing market in Russia.

Development of our industry

In the pumps and valves sector, 2005 saw growth in order intake and sales revenue. Increased demand particularly benefited companies that supplied products for industrial systems and power plants. There was also new stimulus in regional demand for building services products. In the mining sector, high commodity prices resulted in investments in equipment, including slurry pumps.

There were few changes in the supplier structure, apart from smaller acquisitions, such as KSB also implemented. These acquisitions enabled individual competitors to gain regional strength or penetrate niche market.



BUSINESS DEVELOPMENT

- **Strong growth in order intake and sales revenue**
- **Valves business intensified**
- **New production system for Europe**

Order volume up 13.4 percent

KSB further increased its order intake in all four Regions in 2005. The growth in the Group by 13.4 percent to € 1,467.5 million was characterized mainly by stronger project business in the energy and industry sectors. As well as on contracts to equip and modernize power plants, the focus was on projects in the chemicals and petrochemicals industries. The order intake also developed extremely well in water engineering, with pumps for raw materials extraction and valves for liquefied gas transport.

In comparison with the previous year, the first-time consolidation of seven KSB companies from Europe, Asia and the Americas must be taken into account. Excluding these new additions, the order volume would have risen by 11.0 percent.

The encouraging order growth in Europe was primarily based on increased purchase orders received from the energy industry. These included orders from international plant engineering contractors for indirect exports.

The order intake in the Group rose to € 1,468 million. Group sales improved to € 1,390 million.

Despite the muted development in demand overall, our European sales and manufacturing companies achieved mostly double-digit order intake growth rates. The service organizations in Europe also recorded a double-digit percentage rise in their overall order volume. The German KSB AG generated a 4.5 percent increase in incoming orders despite a persistently weak investment tendency among many customers.

The two consolidated companies in the Region Middle East / Africa increased their order intake only moderately due to the development of domestic markets. By contrast, imports of KSB products to countries of the Region rose significantly.

The Region Asia / Pacific continued to drive economic growth, with the companies in China, India, Indonesia and Pakistan in particular sharply improving their order intake. The primary growth drivers were large projects in the energy and industry sectors.

Strong growth was also generated by the Group companies in the Region Americas. In addition to the industry and energy business, orders focused on the mining sector. Order intake in the water and waste water segments also developed well. With the exception of two smaller companies, all KSB subsidiaries in the Region generated double-digit percentage growth. The Brazilian company KSB Bombas Hidráulicas S.A. increased its order volume by more than 50 percent.

The consolidated volume of orders on hand was € 499.5 million on 31 December 2005. This translates into an average range of coverage of orders received of just above four months at the closing date.

Strong sales revenue growth in three regions

Due to the longer-term nature of some contracts in the project business, consolidated sales revenue did not increase to the same extent as the order intake. At € 1,390.3 million, it grew by 9.8 percent year-on-year. Excluding the first-time consolidations mentioned, the rate of increase would have amounted to 7.7 percent.

The European Group companies improved their sales revenue only slightly overall, despite the high growth rates at some companies. This is primarily attributable to the slight 0.4 percent decline in the sales revenue of KSB AG. The company recorded a particularly high proportion of project business orders that will only generate sales revenue later. In addition, our customers outside Europe are increasingly demanding that part of the products ordered be manufactured locally in the country of destination.

The other Regions also generated double-digit growth rates. The Asia / Pacific companies recorded the strongest increase in sales revenue.

In the Region Americas, very good growth rates were generated primarily by our companies in Brazil, Chile and Argentina, as well as the US subsidiary GIW Industries Inc.

The two Group companies in the Middle East / Africa Region also improved their sales revenue by double-digit percentage increases.

New KSB companies strengthen valves business

KSB's main profile on the market is as a company that manufactures high-quality pumps. In comparison, its valves business is less significant, although the global market for valves – with a volume of around € 22 billion – is even larger than the sales market for centrifugal pumps.

To participate more strongly in the global valves market, we expanded the basis of our business in 2005. Among other things, this involved the establishment of new companies in Brazil and China.

The Chinese valves market in particular is highly attractive due to its fast growth. In China, KSB has a strong presence as the leading pump manufacturer; however, we have not yet leveraged our strength in the valves market to the same extent.

We therefore established a first pillar in the valves market at the end of 2004 with Dalian KSB AMRI Valves Co. Ltd. The newly founded company started assembling standard valves for building services and industry at the beginning of the financial year.

In October 2005, we also formed a second manufacturing company in Shanghai. Since the start of 2006, KSB Valves (Shanghai) Co. Ltd. has focused on the assembly of special butterfly valves and high-pressure valves primarily for the energy sector and industry.

Standard butterfly valve produced by Dalian KSB AMRI Valves Co.Ltd.

KSB is also the largest pump manufacturer in Brazil. With the acquisition of the valves business of IVC S/A Indústria de Válvulas e Controles, KSB has now had a production plant for valves in Barueri / São Paulo since September 2005. Our Brazilian company acquired this facility for the newly established KSB Válvulas Ltda, as well as taking over IVC's employees, products and brand names. The range of ball valves, butterfly valves and actuators is used by the oil and gas industries, among others.

Stronger involvement in China and Russia

As well as forming the new companies already mentioned, we responded to our rapidly growing business in China by increasing our stake in KSB Shanghai Pump Co. Ltd. Since May 2005, we have had an 80 percent stake in this joint venture, compared with the previous 51 percent.

To step up our involvement in the Russian growth market, we founded KSB OOO in Moscow in June 2005. The company focuses on the sale of pumps, valves and systems primarily for the energy sector and industry, as well as for water and waste water management. The building services offering is mostly provided via partner companies.

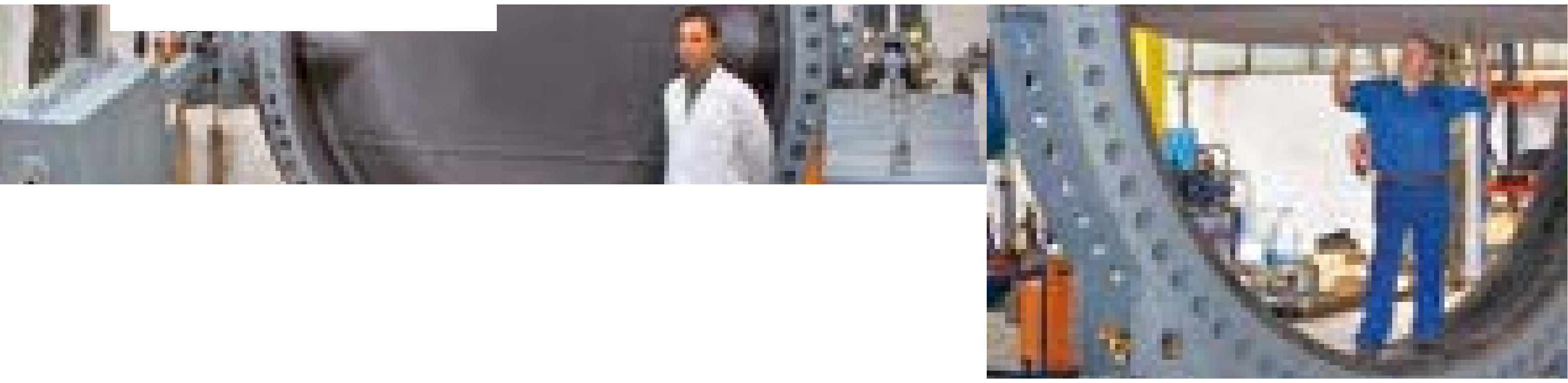
Service business expanded

In addition to the pumps and valves business, the strongly expanded service organization has become an increasingly important pillar of our business in recent years. KSB Service not only provides services today for own products, but also for equipment from other manufacturers. Service is also provided for similar machinery such as motors, ventilators, fans, blowers and feed screws.

Expanded expertise and regional reinforcement were implemented partly through acquisitions. We acquired further service operations in the Netherlands, Spain and Germany in 2005, and integrated them into our service network. In the USA, our subsidiary GIW Industries Inc. acquired Arroyo Process Equipment, Inc., a company in Florida, which will enable it to provide local service to the phosphate industry close to the customer.

Customers use online sales channel

KSB customers have been able to purchase pumps, valves and spare parts via our Web Shop since 2002. We increased our order intake via our online sales channel again by one third in 2005, thus strengthening our industry-wide pioneering role. We now offer the option of electronic ordering in six European countries and in Brazil. In Germany, we already handled more than 50 percent of all spare part orders online in the year under review. Additional country access links and an expansion of the product range are planned.



Sales revenue increase through growth programme

Our 700UP growth and innovation programme, launched at the end of 2002, is aimed at achieving a potential sales revenue of € 700 million. By the end of 2005, we had defined concrete measures for generating sales revenue of more than € 500 million. Part of these have already been initiated. We aim to leverage the full potential by 2010. Relevant measures include, among other things, the expansion of our drive and automation products, offering new services and new products for high growth markets.

Production system increases competitiveness

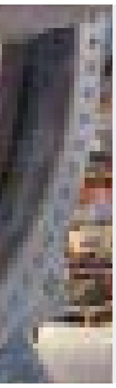
Following a successfully completed pilot phase in 2004, we launched our new ProSys production system in 2005 at four locations in Germany and France. Its focus is on just-in-time production logistics with synchronized manufacturing processes. This eliminates the need for buffer stocks.

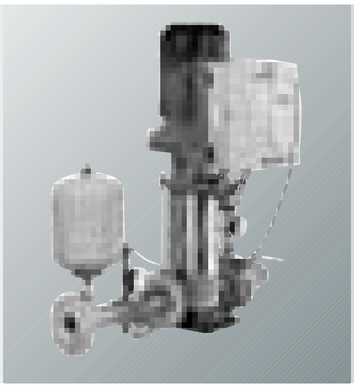
The new production system is aimed at increasing the competitiveness of our European sites by international standards. It ensures that our products can be manufactured at outstanding quality with short cycle times. We will therefore implement ProSys in further areas in the current year. In addition, we are preparing its introduction at sites outside Europe.

Social responsibility

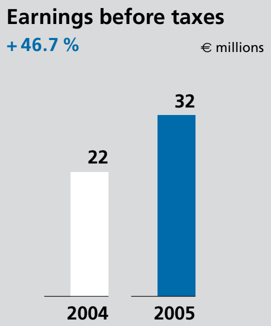
As a company, we have duties to our shareholders, our business partners and our employees. In addition, we also assume social responsibility. In 2005, we therefore committed ourselves as one of the nine founding members of Wissensfabrik Deutschland e.V. (“knowledge factory”). This initiative unites companies that wish to make their own contribution to the future of Germany as an economic location.

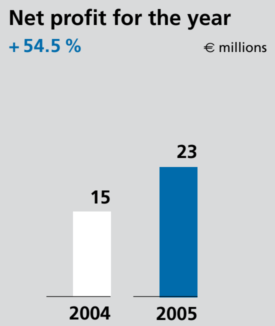
2005 was also a year that made calls on our solidarity for the flood disasters in South East Asia and in the USA, as well as the earthquake in Pakistan. We demonstrated this with cash and non-cash donations, as well as with numerous pumps, which helped to reconnect the drinking water supply and to drain floodwater. Thanks to our global presence, we were able to provide direct local help in coping with the crises.





Hya®-Solo pressure boosting unit with variable speed system for building services.





FINANCIAL POSITION

- **Marked improvement in earnings**
- **Continued stable financial position**
- **Investments financed from cash flow**

RESULTS OF OPERATIONS

Earnings before taxes

The KSB Group achieved earnings before taxes of € 32.4 million, after € 22.1 million in 2004. As in the previous year, earnings were reduced by high restructuring costs (€ 17.4 million; previous year: € 22.8 million).

Both sales revenue (up 9.8 percent) and total output of operations (up 11.4 percent) increased substantially year-on-year. While the cost of materials as a percentage of total output of operations rose by 1.4 percentage points year-on-year, we were able to reduce personnel expenses as a percentage of total output of operations by a further 1.7 percentage points. At 19.3 percent (previous year: 19.6 percent), other operating expenses fell slightly as a percentage of total output of operations.

Although the return on sales rose by 2.3 percent (previous year: 1.8 percent), the impact of the restructuring costs means that it is still clearly short of the Group target.

There was a positive development in the return on equity (8.7 percent following 6.3 percent in the previous year) and the return on capital employed (4.7 percent following 3.9 percent in the previous year).

Earnings after taxes

Due to the lower income tax rate, net profit for the year increased at a comparatively stronger rate than pre-tax earnings (€ 22.6 million following € 14.7 million in the previous year). The principal reason for the reduced tax liability is the negative result at KSB AG.

The minority interest in net profit (€ 9.5 million) rose in line with the rate of increase in earnings before taxes (previous year: € 6.5 million).

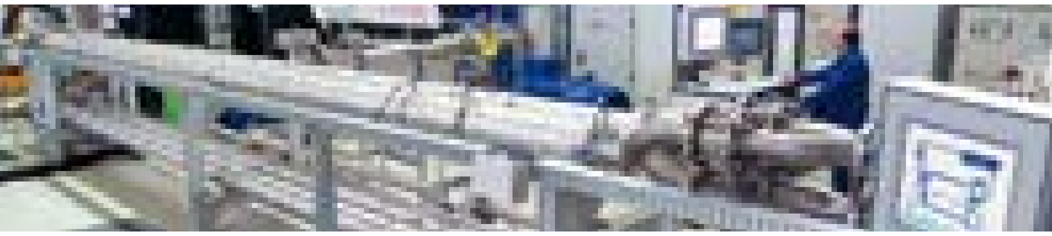
The consolidated net profit of € 13.2 million for the year was € 5.0 million higher than in the previous year (up 61.0 percent).

Earnings per share

Earnings per share amount to € 7.01 for ordinary shares, compared with € 4.16 a year earlier. For preference shares, earnings per share amount to € 8.04, compared with € 5.19 in 2004.

Results of the parent company

KSB AG reported pre-tax earnings of € – 20.9 million. In the previous year, a loss of € 13.8 million was incurred. Both sales revenue (up 5.6 percent) and total output of operations (up 2.8 percent) rose year-on-year. However, this is because KSB Fluid Systems GmbH, Frankenthal, was merged with KSB AG effective 1 January 2005. If KSB Fluid Systems GmbH were also to be included in the previous year's figures for ease of comparison, sales revenue would be 0.4 percent lower and total output of operations 2.9 percent lower.



Hydraulic system for energy recovery in seawater desalination processes.

The profits transferred by KSB AG's German subsidiaries under profit pooling arrangements improved considerably to € 13.8 million. The comparable figure for the previous year – i.e. not including KSB Fluid Systems GmbH, which was merged with KSB AG effective 1 January 2005 – was € 10.7 million.

Dividend possible only on preference shares

In light of the earnings situation, we will be proposing to the Annual General Meeting to distribute, as in the previous year, a dividend of € 1.03 per preference share in accordance with the Articles of Association. This will require the withdrawal of € 23.5 million from the revenue reserves of KSB AG.

Segment results

Our primary segment reporting format is by region. We also report on our secondary format by market.

The companies of the Region Europe were not able to increase their sales revenue overall to the same extent as their order intake. This is due to the increase in the share of project business. The sales revenue resulting from this and, consequently, the impact on earnings, will only arise in subsequent periods. EBIT was € 6.5 million, down 38.5 percent from the previous year. The main reason for this is the earnings situation at KSB AG, which has been outlined above.

The Region Middle East / Africa saw a substantial increase in both sales revenue (up 19.7 percent) and EBIT (up 29.5 percent).

In the Region Asia / Pacific, our sales revenue increased by 48.4 percent as a result of a significantly improved order intake. This, in turn, resulted in an extremely positive development in earnings. The EBIT of € 18.9 million was twice that of the previous year.

The Americas Region also recorded strong growth in sales revenue (up 31.3 percent), with a € 4.1 million improvement in EBIT (up 40.1 percent).

FINANCIAL POSITION

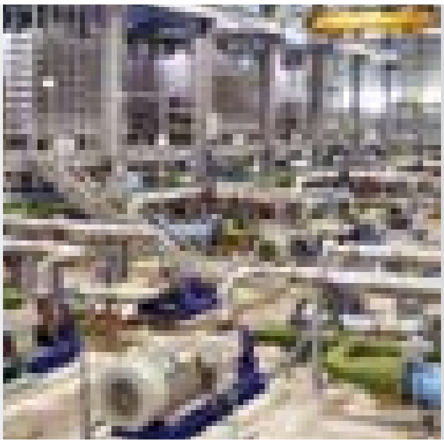
Principles and objectives of financial management

The aim of our financial management is to ensure sufficient liquidity for all Group companies at all times and to finance growth at optimal conditions. Other priorities in this regard are to finance exports while hedging currency risks, and also to reduce the risk of bad debts (default risk).

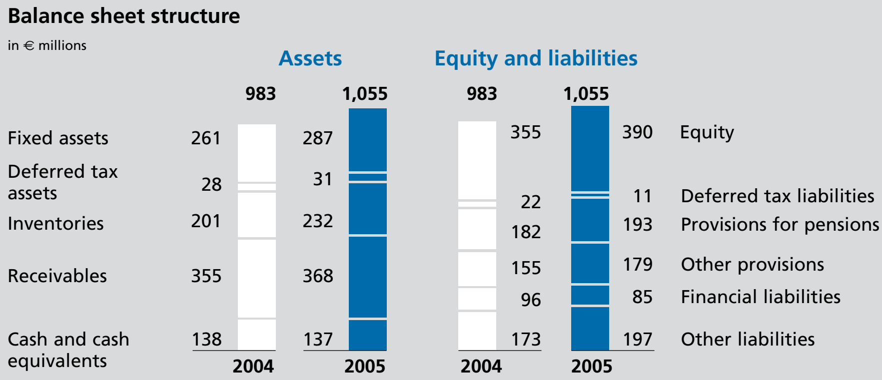
Our financial management serves as a service centre within the framework of the guidelines issued by the Board of Management. The main stipulation is that the nature and scope of all financial transactions should be based exclusively on the requirements of our ordinary business.

Capital structure and sources of finance

Following the increase in total equity and liabilities to € 1,054.6 million (up 7.3 percent), there was a slight improvement in the Group's capital structure. The consolidated net retained earnings generated led to a strengthening of the equity ratio (from 36.1 percent to 37.0 percent). There was a slight increase in the proportion of equity attributable to minority interest.



Singspring seawater desalination plant in Singapore.



Banks were of relatively low significance as an external source of finance, accounting for 6.4 percent of total equity and liabilities (previous year: 7.2 percent). No major financing activities were undertaken in the year under review. The Group generated its funding requirements exclusively from its ongoing business activities.

To protect against liquidity risks, we have access to cash credit lines of over € 110 million worldwide, a significant part of which has been confirmed for over a year.

Financing through trade credit is on a level with the previous year, corresponding to 13.7 percent of total equity and liabilities (previous year: 13.2 percent).

Provisions

At € 371.4 million, provisions account for 35.2 percent of funds (previous year: 34.3 percent). These are primarily provisions for pensions and similar obligations (€ 192.4 million or 18.2 percent of total equity and liabilities). The rise in other provisions is due to obligations from partial retirement agreements and for other personnel costs, such as time credits.

Liquidity

The balance sheet of the KSB Group shows cash and cash equivalents, including current financial instruments, of € 136.8 million. This represents a decrease of € 1.2 million compared with the previous year. At the same time, we reduced our financial liabilities by € 11.2 million. Overall, our net financial position improved from € 45.4 million to € 57.5 million.

Source and application of funds

In the year under review, cash flow amounted to € 73.8 million. This is a marked improvement on last year's figure (€ 59.5 million) and is largely attributable to the increase in earnings.

By contrast, cash flow from operating activities fell slightly short of last year's figure, at € 62.5 million compared with € 64.2 million. The increased share of project business in order intake led to a higher level of orders on hand and a rise in inventories. The increase in advances received from customers and in current provisions could not compensate entirely for this.

Cash flows from investing activities showed an outflow of funds of € 53.2 million (previous year: € 26.4 million). The increase is due to a marked rise in payments to acquire items of property, plant and equipment, and to acquire investments in companies.

Cash flows from financing activities also recorded an outflow, but this is somewhat lower than in the previous year (€ 15.5 million compared with € 17.0 million). This is primarily attributable to lower dividend payments for the previous year.

Welding the stainless steel vanes onto the pump diffuser requires the utmost precision.

NET ASSETS

Amount and composition of assets

The higher total assets of the KSB Group in the year under review (see page 42) are primarily a result of the increased volume of business.

An increase of € 43.2 million (up 6.2 percent) was recorded in current assets alone. This means that current assets represent 69.9 percent of Group assets (previous year: 70.6 percent). The € 31.2 million increase in inventories (up 15.5 percent) is predominantly attributable to the level of completion of customer orders in progress. The increase in advances received from customers is already deducted from this figure. Trade receivables from third parties recorded an increase of € 22.1 million (up 7.3 percent), reflecting the 9.8 percent rise in sales revenue.

Scope and main purpose of investments

In 2005, our investments in property, plant and equipment, and in intangible assets, were substantially greater than the level of depreciation and amortization. In intangible assets, we again capitalized part of the project expenditure incurred in the year under review for the implementation and customization of the SAP system, in addition to software licences.

The main focus of our intensified investment activities in property, plant and equipment was on investments in facility extensions in our non-European manufacturing sites, as well as on rationalization investments in Europe.

Overall, we recorded additions totalling € 51.5 million to property, plant and equipment and non-current financial assets (previous year: € 38.1 million), all of which were financed entirely from cash flow.

Fixed assets now account for 27.2 percent of our total assets, compared with 26.6 percent in the previous year.

Inflation and exchange rate effects

Adjustments to reflect changes in general purchasing power were only applied to eliminate the effects of inflation in the financial statements of two small KSB Group companies. The impact of this on Group figures is not material.

The translation of financial statements of consolidated companies that are not prepared in euros gave rise to a change of € 14.1 million in the difference between assets and liabilities. This amount was taken directly to equity.

Leased assets

We recognized assets resulting from finance leases with a carrying amount of € 9.9 million (previous year: € 9.5 million). These relate principally to buildings in our German and French Group companies.

Etanorm® with PumpDrive control system.

SUMMARY OF THE ECONOMIC SITUATION OF THE GROUP AT THE MANAGEMENT REPORT DATE

Thanks to its global presence and broad range of products, the Group is in a position to benefit from positive market developments in the various regions and segments. This helps the Group to counter the current costs of the Efficiency Enhancement Programme and the new ProSys production system.

Given this background and the positive effects from current projects, we perceive the economic position of the company to be stable and capable of further growth in the light of our stable financial base and the expected continued market growth.

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 depends on the consolidated net profit generated in the relevant financial year. No stock options or other forms of share-based payment are granted to members of the Management Board.

CONCLUDING STATEMENT ON THE 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

Business development after the balance sheet date was in line with management expectations and planning. On 15 February 2006, the Supervisory Board appointed Dipl-Ing. Heinz-Jürgen Otto to the Board of Management and to the positions of Chairman of the Board of Management and Human Resources Director.

No events occurred that would affect the Group’s net assets, financial position, results of operations or risk situation as outlined above.

RISK MANAGEMENT

- **Early identification of risk potential**
- **Evaluation of six risk areas**
- **Purchasing security through strategic partnerships**

Anyone seeking success in the marketplace has to be prepared to take risks. This applies to the development of products as it does to the selection of business partners or entry into promising new markets. What is important is to identify and assess at an early stage the risks that arise from business operations. In this way, appropriate measures can be taken to avoid or limit potential business losses.

KSB has had a risk management system in place for some years in which all the companies of the KSB Group are integrated. Based on a standardized procedure, the local Risk Management Officers in the various companies report to headquarters any events and business processes that may involve risks. After the risk potential and probability of occurrence have been reviewed, the Group Risk Management Officer informs the Board of Management about any important risks.

Risks are identified, assessed and communicated according to the following six categories:

Market / Competition

The market continues to be characterized by overcapacity on the supplier side, which is resulting in a sustained pressure on prices. This is further intensified in our most important markets by the activities of competitors who manufacture in countries with favourable pay structures or who have currency advantages there.

To continue supplying our customers at fair market prices, we use the options provided by our global purchasing and manufacturing network. At the same time, we are improving the competitiveness of our European sites. To this end, we are implementing a number of measures and instruments, including the ProSys production system, and are in the process of integrating elements of our successful efficiency enhancement programme into a continuous improvement process.

Products / Projects

By switching our manufacturing approach gradually from the “job shop principle” to order-driven production in synchronized processes, we are increasing our flexibility and speed. But the introduction of new methods also carries the risk of short-term problems in the coordination of orders or in keeping to specified delivery times. To exclude this as far as possible, we have created a tight project organization. The project team is sensitized to remedy any teething problems that might occur straight away to ensure that customers’ orders can be successfully completed.

As part of our 700UP growth and innovation project, we continue to develop products and services and to make our product range available for new applications. In a multistage filtering process we ensure that only those business ideas are realized which have a high probability of success and whose risks are acceptable.

Finances / Liquidity
We continually analyse the financial situation in the context of our monthly reporting system and take action at an early stage to improve the situation or to avert risks. Our now global early detection system has proved successful as protection against liquidity and default risks. This is supported throughout Europe with the use of SAP software.

KSB Finanz S.A. in Luxembourg uses an efficient credit management that includes all Group companies. Risks are mitigated by credit insurance and, in the project business, by an appropriate specification of payment terms and conditions, including adequate advance payments. We use hedging schemes to minimize foreign currency exposure.

Procurement
As a result of the sustained strong demand for cast iron and steel from the Asian region, relevant commodity prices in 2005 again ranged at a high level. In addition, there was a shortage of copper and aluminium, which also led to price increases.

To offset fluctuations in commodity prices, we have entered into long-term strategic partnerships, which are now easing the burden on the cost side. Furthermore, we are developing new sourcing options in the global context.

The year under review also saw dramatic increases in energy costs. We are taking countermeasures in the form of internal corporate action to save energy and an electricity management system that makes use of lower-cost off-peak tariffs. We can cushion future price increases through long-term contracts for the supply of electricity and gas.

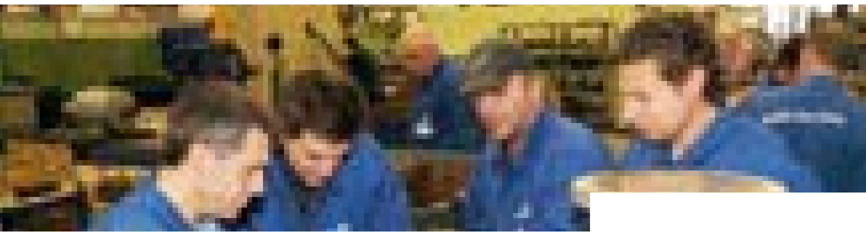
Technology / Research and Development
The creation of innovations in line with the market calls for a clearly structured development process in which customers' requirements give rise to new products. This process is organized at KSB in such a way that technical or market-related risks are detected and eliminated early on. To ensure that a new product sells successfully, the project managers not only accompany it right up to its launch onto the market, but also advise and support sales staff during the first few months after the launch (start-up phase).

The problems of individual players in the market can be very specific. When we develop customized technical solutions, it is agreed with the customers that they pay for these developments, in full or in part, regardless of subsequent use.

The know-how of our technicians and engineers is one of the key assets of our company. When there is a risk of this know-how being lost through the transfer of functions or the retirement of employees, we ensure there is an appropriate knowledge transfer at an early stage.

Environment
To exclude risks to the environment as far as possible, we have developed high safety standards throughout the Group. Since these are aimed at preventive environmental protection, some of these standards go further than the requirements laid down by law. This will enable us avoid the need for costly remediation operations in the future in the interests of a sustainable environmental policy for the company. The local Environmental Protection Officers conduct regular audits, in which they highlight any risk potential and initiate appropriate action. In this way we avoid impacting on the environment as far as possible.

Overall assessment
For the current year, no risks have been identified whose influence on the company's financial position, its results of operations or net assets could jeopardize its continued existence.



EMPLOYEES

- **More employees in growth countries**
- **Systematic fostering of young talent**
- **Family-friendly human resources policy**

A company only achieves sustainable success in the market with first-class specialists. By this we mean employees who are masters of their field, who are continually improving and who do their utmost for their customers in all areas. Owing to the international nature of KSB operations, this calls for an understanding of global demand and the different requirements in technology and service.

More employees in Asia and the Americas

At the end of 2005, there were 12,963 people employed in the KSB Group, 496 more than in the previous year. Most of this increase is attributable to the first-time consolidation of seven companies with a total of 362 employees. In addition, some companies in Asia and the Americas increased their staff levels in sales and production in line with market needs.

By contrast, the number of employees in Europe remained almost constant at 7,225 despite the integration of three companies into the Group. This is mainly explained by a reduction in the number of employees at KSB AG by 75. After the integration of staff from KSB Fluid Systems GmbH, there were 3,800 employees with KSB AG at the end of 2005.

The number of employees in the Region Americas rose by 216 to 1,646 in the year under review. This is largely due to new appointments at KSB in Brazil and at our US subsidiary GIW Industries Inc. These companies responded to a growth in order intake by increasing capacity both in production and in sales and distribution. The acquisition of Arroyo Process Equipment, Inc. and integration of the Californian service company Precision Pump and Machine - KSB Inc. into the Group also added to the headcount in the Region.

Our two Indian companies increased their staff levels by 45 people. In addition, the Region Asia / Pacific saw the addition of 229 employees from newly consolidated companies, so that the number of employees by the end of the year had increased to 3,738.

At the end of 2005 the number of employees in the Region Middle East / Africa stood at 354, unchanged from a year earlier.

Systematic personnel development

Apart from the quantitative adjustment of staff levels to market requirements, we also need to help employees develop their skills and prepare for new challenges.

To this end, we keep a systematic record of the qualification profiles of our employees and develop them according to their individual needs. With a special program in place we are also able to identify suitable candidates for positions both at home and abroad across all sites with a minimal investment of time.

An important tool for identifying and evaluating the potential of promising employees is provided by assessment centres. In these centres, everyday work situations are played out in exercises as realistically as possible. In 2005 about 40 employees preparing for new functions and greater responsibility took part in such exercises in Europe.

Family-friendly human resources policy: KSB cooperates with a municipal day-care centre in Frankenthal.

Fostering the talents of young specialists and graduates

The training of young KSB talent according to the needs of the company is an important part of our human resources policy. 58 school-leavers started their vocational training at KSB AG in 2005. Altogether, 206 apprentices at three German sites are currently in the process of being qualified for later functions. We remain a company that attaches great importance to shaping its own young employee base. In 2005 we therefore invested around € 5 million in vocational training. In addition, we are involved in pre-career education with school partnerships in the context of Germany's knowledge factory (Wissensfabrik Deutschland).

We also provide for qualified young people in the company with trainee programmes for university students and graduates. The international focus of the programmes means that trainees spend at least six months abroad and work in different departments and projects.

350 personnel training and development events in Europe

Targeted training courses get our employees fit for new tasks in their careers. Through our training centre, employees in Europe benefited in 2005 from 350 seminars and training events. Most of them used these events to broaden their skills in sales and marketing or technology, to deepen their knowledge of business administration and computer processing and to improve their communication skills across national and cultural borders.

In Asia, too, we have stepped up training efforts. After an average of three days of training in the previous year, every employee with our Chinese joint venture KSB Shanghai Pump Co. Ltd. devoted 3.5 days on average to training and development in 2005. Our Indian company KSB Pumps Limited offered seminars for managers in which 100 people took part. Our Indian employees also took part in technical seminars, as well as personality development and language courses.

Family-friendly human resources policy

The best performances are achieved by those who can find a good balance between work and private life. In 2005, we dedicated ourselves to this objective especially with regard to the family situation. At our site in Frankenthal, we set an example by improving the conditions for achieving a harmony between family and job. This includes cooperation with a municipal day-care centre which provides all-day care and supervision for the children of employees from the age of one year. In conjunction with a provider for children's and young people's leisure pursuits, provision is also made for accommodating children in the holidays. We are also cooperating with a so-called "family service" which provides support for employees seeking help in the supervision of children or relatives who are in need of care. For our family-friendly initiatives we were awarded the "Job and Family" certificate of the Hertie Foundation in December 2005.

A word of thanks to our employees

Our high order intake in many areas and our involvement in extensive future-oriented projects demanded a great deal from our employees in 2005. They rose to this twofold challenge with enormous commitment. The Board of Management thanks all KSB employees for their efforts, which in many cases went far beyond what was required of them. Special thanks are due to the Works Councils and the Executives' Committee. Their constructive contribution helped to improve our competitiveness and thus to safeguard jobs for the future.

Hydraulic balancing of a virtual impeller model.

RESEARCH AND DEVELOPMENT

- **New approaches in impeller development**
- **Computer-based simulation of materials**
- **Solar power for pumps**

An important element of the KSB business strategy is innovation. It is innovations that help us to reduce costs, increase sales and improve profitability. In an ever more complex environment and in view of the shorter product cycles, research and development have to be guided by our focus on success and financial resources have to be used efficiently.

All this calls for a clear understanding of customer needs, technologies and markets in the coming years and decades. Based on this continual expansion of knowledge, we invested around 2 percent of sales revenue in the research and development of new products in 2005. Major points of focus in development lay in fluid mechanics, materials engineering and automation.

New development for waste water pumps

For the transport of waste water, our customers need pumps that can handle media containing all kinds of substances without any problem. At the same time, the pump sets have to be very economical with precious energy resources. Under hydraulic aspects, this constitutes two diametrically opposed requirements.

To solve this problem, our pump designers have developed sophisticated impeller shapes with just one blade. It is impossible to balance this impeller in the same way that a car tyre is balanced – by simply adding or removing material. To add to the difficulty, pumps are becoming ever larger and more powerful, with impeller diameters of up to 500 millimetres.

To achieve smooth rotation despite the geometrically bizarre shapes, our hydraulic engineers now use a computer model to perform “hydraulic balancing”. This method, in which virtual material is moved around on a virtual impeller, saves considerable time and cost.

Virtual melting pot

The market demand for special stainless steels has increased dramatically since the beginning of the 1970s as a result of increased environmental requirements, new fields of application and not least also for aesthetic reasons. However, the development of new steels in this group of materials often calls for very elaborate experiments and practical tests. We are therefore working in cooperation with well-known partners on the creation of computer-based numerical models. They will enable us to determine the properties of alloys in advance without the need for costly empirical tests. For this purpose a three-dimensional virtual model is used similar to the model applied in fluid mechanics. Using characteristic values for selected comparative materials, it is possible to simulate the expected microstructure of the newly developed steel. Our involvement in this project is aimed at developing low-nickel and thus lower-cost alloys.

Building a global development network

Up to 2005, our research and development activities were predominantly concentrated in Germany, France and the USA. However, it is becoming increasingly apparent that there is a need to develop new products close to the growth markets and at the same time to use the cost-relevant advantages of local sites. For these reasons, we are in the process of linking the development capacity of our companies in India, China and Brazil more strongly into the research and development work of the Group.

In the year under review, KSB Tech Pvt. Ltd., which we founded at the end of 2004, started operations in the Indian city of Pune. The 60 or so technicians and engineers employed in this company are working on independent development projects and are responsible for providing support for a series of water pumps that are in global use. They also support their French and German colleagues for example by taking on CAD design work.

An important element of the KSB business strategy is innovation. It is innovations that help reduce costs, increase sales and achieve a better return on sales.

Pumping with the sun

With the creation of a new solar-powered system in the context of a 700UP project, it will be possible in the future to run a wide range of KSB pumps directly using solar energy. The new development consists of drive electronics that can be used for almost any electric motor with a rating of up to 5.5 kW.

Our photovoltaic pumping system consists of a standard pump with a solar panel plus a special model of the KSB PumpDrive system. In this variable speed system, the direct current supplied by the solar cells is transformed into three-phase or alternating current. An integrated control unit matches the speed of the pump to the operating conditions, which provides for optimum efficiency.

Among other projects in the area of automation, we have also developed a module to regulate the fluid level in tanks or reservoirs. We shall fit our control, drive and monitoring systems with this module in the future. In this way, we shall be able to offer our customers an individual solution with standard components both quickly and at low cost. The various application profiles are being achieved through smart programmable modules.

The South African KSB site in Johannesburg obtained ISO 14001 certification in 2005.

ENVIRONMENTAL MANAGEMENT

- **32 site audits carried out**
- **New moulding plant reduces emissions**
- **Joining the "Bavarian Environment Pact"**

Environmental protection is an active part of our processes. We aim to live up to our corporate and social responsibilities at all times. For the protection of water, soil and air, we are taking measures which go beyond what is required by law and which offer a higher degree of safety.

At KSB AG in Germany and KSB S.A.S. in France, environmental protection is closely linked with health, occupational safety and quality within an integrated management system. This enables us to implement potential improvements in these four areas both simultaneously and efficiently. Management systems in accordance with ISO 9001 (quality), ISO 14001 (environment) and OHSAS 18001 (occupational health and safety) will be introduced in the KSB Group worldwide over the next few years.

KSB invested around € 3 million in 2005 to further improve environmental protection and occupational safety at our sites.

Environmental audits on four continents

Safety has to be regularly checked. In 2005, we carried out 32 internal environmental and occupational safety audits in companies of the KSB Group. Within the scope of these systematic reviews, we audited sites in Australia, Europe, South Africa and the USA for potential hazards to employees and the environment and, where reasonable, initiated measures for improvement. The main emphasis was on preventive action which already takes account of future tightening of environment legislation.

The fact that our activities have produced positive results is reflected in the successful certification of six further KSB sites in 2005 to ISO 14001 for environment standards, ISO 9001 for quality standards and OHSAS 18001 for occupational safety standards. This certification under three standards simultaneously was obtained in Caldicot, Chester and Loughborough (U.K.), Lille (France), Pegnitz (Germany) and Ankara (Turkey). In addition, the site in Frankenthal (Germany) was certified to OHSAS 18001, while Johannesburg (South Africa) achieved ISO 14001 certification.

Investments in environmental protection

To improve environmental protection and occupational safety at our sites further, we invested around € 3 million in new plant and in preventive or restitution measures in 2005. Amongst other things, a new boxless moulding plant has been introduced for increased protection of the environment at our foundry in Pegnitz. This installation enables most of the moulding sand to be re-used, so the used sand no longer needs to be regularly disposed of. By enclosing the shake-out station for the moulds, we have also substantially reduced noise and dust emissions.

Further investments of relevance to the environment involved the deconstruction of empty buildings in Halle and of the foundry in Frankenthal. Remediation work was also carried out to eliminate soil contamination at sites in Germany and Luxembourg.

Reduction of electricity, water and waste disposal costs

The KSB Environmental Protection Officers from Germany, France, Great Britain, Italy and Spain defined site-specific measures in 2005 to reduce the costs of electricity, water consumption and waste disposal. This includes installing additional electricity meters, improving materials sorting processes and checking water and compressed-air systems regularly for leaks.

"Umweltpakt Bayern" – an example of regional cooperation

We also committed ourselves to a "qualified voluntary environmental performance" in the Umweltpakt Bayern (Bavarian Environment Pact) in 2005. Our participation in this regional initiative means that we not only comply with all provisions of environmental legislation, but also improve our ecologically relevant processes. We will replace approved, but hazardous materials and inform the public regularly about our environmental activities. In return, the Pact provides for simplified and accelerated procedures for companies which, like KSB, operate an environmental management system.

The largest cooling water pumps ever built by KSB handle 16,000 litres of fluid per second.

OUTLOOK

- **Continual strong demand in the industry and energy sectors**
- **Broadening the valve range**
- **Further growth planned**

Sustained high growth for the global economy is forecast for 2006. We also expect a slight upturn in the economy for Europe and a correspondingly more favourable investment climate. The Region Asia / Pacific will remain the economic leader, with China continuing to play an outstanding role. In the Region Americas, the development of the USA and the Latin American states may be somewhat weaker than in 2005. The economy in the Middle East is likely to continue to grow, boosted by the high oil prices, although political uncertainties remain.

The pump and valve industries will continue to profit from a boom in the energy sector, from the construction of new chemical and petrochemical plants outside Europe and from an overall friendly investment climate for plant and equipment. In addition, the continued strong demand for raw materials will require additional investments in mining.

Growth in chemicals and petrochemicals industries

Business with industrial pumps and valves will continue to be dominated by the development and expansion of the chemicals industry in China and India in the current year. In addition, the provision of equipment for petrochemical plants in Brazil, India and the Middle East offers good prospects for our business. We are well positioned in the most important demand countries with our own sales and manufacturing companies for customer-focused and rapid servicing of industrial customers.

We anticipate sustained strong growth in liquefied gas transport, where our special valves are used in liquefaction plants and gas tankers. This mainly involves the business in Asia and in the Middle East.

Broadening the valve range

As a result of a shift in the focus of demand, 2006 will see only limited investment by European industrial companies in their domestic markets. Major orders are expected from European plant engineering contractors for their export business. As they increasingly require valve models built to US ANSI standards, we have added new sizes and material variants to our range of valves. In addition, we are starting to integrate the range of our valves company in Brazil into our product portfolio in the current year.

Market development in building services

In building services, we continue to be successful with pumps, valves and systems primarily in Western Europe. Due to the ongoing demand weaknesses there, we are strengthening our sales activities in selected countries outside this sales market. This is particularly true of Eastern Europe. We also expect new stimuli from automation products for pumps and valves.

New projects in water and waste water management

An increasing global shortage of water requires new facilities for extracting and distributing drinking water. We see good prospects here for our range of water pumps and valves. There is currently substantial pent-up demand in Southern Europe, in the Region Asia / Pacific and the Region Middle East / Africa. In the financially strong oil-producing countries in particular, we expect new water supply projects to be implemented in the current year and beyond. These include the construction of seawater desalination plants, for which we have a broad offering of products.

Some countries have a sizeable need for modernization and new equipment in the transport treatment of waste water. This applies both for the municipal sector and for industry, particularly in countries facing an increasing environmental impact. Above-average market growth is expected in the Regions Asia / Pacific and Americas in the current year. We are in the process of expanding our local competence centres for quotation and order processing. There is also a substantial need for new waste water systems in Eastern Europe. In Western Europe, customers are increasingly considering their investments in the light of life cycle costs, which facilitates the decision for KSB products when awarding contracts.

New power plants planned

In the energy sector, 2006 will be dominated by further investments in Asia and Europe. With our end-to-end range of pumps and valves, we will participate as one of the two market leaders in the ongoing boom in equipping and modernizing power plants. In Europe, the construction of new plants with combined gas and steam turbines will play a particular role for reasons of climate protection and efficient energy generation.

Leveraging global opportunities for slurry pumps

With our slurry pumps produced in the USA, we will focus primarily on mining requirements in the growing markets of Asia and North and South America. The need for raw materials will continue to be a growth driver in 2006. We therefore expect sustained high demand for our products in this market. Where necessary, we will strengthen our service activities in Asia. At the same time, we will be building up our competence centre in Europe.

Improving competitiveness still further

To safeguard and increase our competitiveness, we will strengthen our sales presence in growth regions, launch new products on the market and expand service activities in key markets.

We will further improve our efficiency in sales and production. In Europe, this includes the gradual introduction of the new production concept. This project will increase our flexibility and reduce inventories, transport costs and cycle times. Substantial investment and further expenses are necessary for this in the transition phase.

Further growth in order intake, sales revenue and earnings

Following strongly above-average growth in order intake in 2005, our aim in the current year is for growth at least in line with the market. We will continue to examine and evaluate acceptance of new orders based on profitability aspects. Sales revenue, which trailed slightly in the previous year, will pick up, even though not all the orders booked in 2005 will result in revenue in the current year.

We will increase our future pre-tax earnings on the basis of further sales revenue growth and cost reductions from our Efficiency Enhancement Programme. However, consolidated earnings in 2006 will still be impacted by costs for the introduction of the new production system.

From Buenos Aires to Moscow, from Bangkok to Dubai: KSB employees and technology are always close to customers. We have subsidiaries and representatives in over 100 countries, and more than 1,600 service engineers worldwide. So whatever it is, we speak our customer's language.

Global Pe

rspective

CONSOLIDATED BALANCE SHEET

ASSETS

(€ thousands)	Notes	31 Dec. 2005	31 Dec. 2004
NON-CURRENT ASSETS			
Fixed Assets	1		
Intangible assets		39,283	32,377
Property, plant and equipment		224,771	207,834
Non-current financial assets		23,197	20,991
		287,251	261,202
Deferred tax assets	2	30,327	27,541
CURRENT ASSETS			
Inventories	3	232,180	201,016
Receivables and other current assets	4	368,074	354,829
Current financial instruments	5	15,825	2,677
Cash	5	120,957	135,318
		737,036	693,840
		1,054,614	**982,583**

EQUITY AND LIABILITIES

(€ thousands)	Notes	31 Dec. 2005	31 Dec. 2004
EQUITY	6		
Subscribed capital		44,772	44,772
Capital reserve		66,663	66,663
Revenue reserves		201,012	178,182
Consolidated net retained earnings		13,168	8,197
Minority interest		64,363	56,944
		389,978	354,758
NON-CURRENT LIABILITIES			
Deferred tax liabilities	7	10,735	21,729
Provisions			
Pensions and similar obligations	8	192,370	182,062
Other provisions	9	39,425	32,279
		231,795	214,341
Liabilities	10	57,158	67,603
		299,688	303,673
CURRENT LIABILITIES			
Other provisions	9	139,582	122,350
Liabilities	10	225,366	201,802
		364,948	324,152
		1,054,614	**982,583**

CONSOLIDATED INCOME STATEMENT

(€ thousands)	Notes	2005	2004
Sales revenue	11	**1,390,314**	**1,266,755**
Changes in inventories		38,068	13,732
Work performed and capitalized		2,481	3,533
Total output of operations		**1,430,863**	**1,284,020**
Other operating income	12	23,491	23,805
Cost of materials	13	– 584,291	– 506,389
Staff costs	14	– 508,469	– 477,419
Depreciation and amortization expense		– 34,197	– 33,217
Other operating expenses	15	– 276,514	– 251,921
Other taxes		– 7,725	– 6,857
		43,158	**32,022**
Income from investments	16	987	1,357
Other financial income / expense	16	– 11,718	– 11,268
		– 10,731	**– 9,911**
Profit from ordinary activities		**32,427**	**22,111**
Taxes on income	17	– 9,787	– 7,457
Net profit for the year		**22,640**	**14,654**
Minority interest in net profit / loss	18	– 9,472	– 6,474
Consolidated net profit for the year		**13,168**	**8,180**
Retained earnings brought forward		–	17
Consolidated net retained earnings		**13,168**	**8,197**
Earnings per ordinary share (€)	20	7.01	4.16
Earnings per preference share (€)	20	8.04	5.19

STATEMENT OF CHANGES IN FIXED ASSETS

	Historical cost					
(€ thousands)	1 Jan. 2005	Change in consolidated Group / CTA** / Other	Additions	Disposals	Reclassi-fications	31 Dec. 2005
Intangible assets						
Concessions, industrial and similar rights and assets, as well as licences in such rights and assets	21,456	258	3,911	180	110	25,555
Goodwill	29,259 *	894	167	–	–	30,320
Negative goodwill	– *	–	–	–	–	–
Advance payments	214	–	–	–	– 214	–
	50,929 *	**1,152**	**4,078**	**180**	**– 104**	**55,875**
Property, plant and equipment						
Land and buildings	177,451	6,692	6,056	3,675	404	186,928
Plant and machinery	280,371	11,493	15,255	9,935	1,406	298,590
Other equipment, operating and office equipment	119,038	6,693	11,812	6,230	422	131,735
Advance payments and assets under construction	3,425	513	8,031	884	– 2,128	8,957
	580,285	**25,391**	**41,154**	**20,724**	**104**	**626,210**
Non-current financial assets						
Investments in affiliates	20,988	– 5,912	6,013	67	–	21,022
Other investments	2,355	–	300	150	–	2,505
Non-current financial instruments	974	46	–	1	–	1,019
Other non-current loans	63	7	–	6	–	64
	24,380	**– 5,859**	**6,313**	**224**	**–**	**24,610**
	655,594 *	**20,684**	**51,545**	**21,128**	**–**	**706,695**

* Restated in accordance with IFRS 3

** CTA = currency translation adjustments

Accumulated depreciation / amortization							Carrying amounts	
1 Jan. 2005	Change in consolidated Group / CTA** / Other	Additions	Disposals	Reclassi-fications	Write-ups	31 Dec. 2005	**31 Dec. 2005**	31 Dec. 2004
10,535	146	6,086	175	–	–	16,592	8,963	10,921
–*	–	–	–	–	–	–	30,320	29,259
–*	–	–	–	–	–	–	–	– 8,017
–	–	–	–	–	–	–	–	214
10,535*	**146**	**6,086**	**175**	**–**	**–**	**16,592**	**39,283**	**32,377**
80,441	2,558	4,425	1,273	– 5	–	86,146	100,782	97,010
204,554	8,482	13,156	8,250	75	–	218,017	80,573	75,817
87,456	4,795	10,530	5,435	– 70	–	97,276	34,459	31,582
–	–	–	–	–	–	–	8,957	3,425
372,451	**15,835**	**28,111**	**14,958**	**–**	**–**	**401,439**	**224,771**	**207,834**
3,022	– 1,975	–	–	–	–	1,047	19,975	17,966
292	–	–	–	–	–	292	2,213	2,063
74	–	–	–	–	–	74	945	900
1	–	–	1	–	–	–	64	62
3,389	**– 1,975**	**–**	**1**	**–**	**–**	**1,413**	**23,197**	**20,991**
386,375*	**14,006**	**34,197**	**15,134**	**–**	**–**	**419,444**	**287,251**	**261,202**

STATEMENT OF CHANGES IN EQUITY

Including Minority Interest

(€ thousands)	1 Jan. 2004	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	Measure-ment of financial instruments	Adjust-ments taken directly to equity / Other	31 Dec. 2004
Subscribed capital of KSB AG	44,772	–	–	–	–	–	–	–	–	44,772
Capital reserve of KSB AG	66,663	–	–	–	–	–	–	–	–	66,663
Revenue reserves	169,989	–	–	7,659	–	– 966	1,190	2,485	– 2,175	178,182
Consolidated net retained earnings	12,504	8,180	– 4,828	– 7,659	–	–	–	–	–	8,197
	293,928	8,180	– 4,828	–	–	– 966	1,190	2,485	– 2,175	297,814
Minority interest	52,116	6,474	– 1,590	–	–	– 1,369	1,313	–	–	56,944
	346,044	**14,654**	**– 6,418**	**–**	**–**	**– 2,335**	**2,503**	**2,485**	**– 2,175**	**354,758**

(€ 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	Measure-ment of financial instruments	Adjust-ments 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	186,199 *	–	–	7,306	–	10,836	6,122	– 9,961	510	201,012
Consolidated net retained earnings	8,197	13,168	– 891	– 7,306	–	–	–	–	–	13,168
	305,831 *	13,168	– 891	–	–	10,836	6,122	– 9,961	510	325,615
Minority interest	56,944	9,472	– 1,719	–	– 17	3,220	– 4,003	–	466	64,363
	362,775 *	**22,640**	**– 2,610**	**–**	**– 17**	**14,056**	**2,119**	**– 9,961**	**976**	**389,978**

(€ thousands)	31 Dec. 2004	31 Dec. 2005
Accumulated currency translation differences	– 36,534	– 23,858
thereof applicable to minority interest	(– 9,351)	(– 6,842)

* Restated in accordance with IFRS 3

CASH FLOW STATEMENT

(€ thousands)	2005	2004
Net profit	22,640	14,654
Depreciation and amortization expense / write-ups (non-current assets)	34,159	33,217
Increase / decrease in non-current provisions	15,762	18,722
Gain / loss on disposal of fixed assets	1,272	– 6,190
Other non-cash income / expenses	–	– 873
Cash flow	**73,833**	**59,530**
Increase / decrease in inventories	– 40,581	– 29,153
Increase / decrease in trade receivables and other current assets	936	– 21,835
Increase / decrease in current provisions	10,754	9,420
Increase / decrease in advances received from customers	21,380	27,448
Increase / decrease in liabilities (excl. financial liabilities)	1,051	15,284
Other non-cash income / expenses (operating)	– 4,876	3,497
	– 11,336	4,661
Cash flows from operating activities	**62,497**	**64,191**
Proceeds from disposal of intangible assets	5	15
Payments to acquire intangible assets	– 3,911	– 6,292
Proceeds from disposal of property, plant and equipment	4,494	9,874
Payments to acquire property, plant and equipment	– 39,577	– 27,367
Proceeds from disposal of non-current financial assets	223	198
Payments to acquire non-current financial assets	– 6,313	– 4,491
Net cash flows from the acquisition and sale of consolidated companies and other business units (basically successive acquisitions)	– 5,665	– 100
Other non-cash income / expenses (investing)	– 2,439	1,748
Cash flows from investing activities	**– 53,183**	**– 26,415**
Proceeds from additions to equity / payments related to capital decreases	– 17	–
Dividends paid for prior year (incl. minority interest)	– 2,610	– 6,418
Borrowings and loans raised, deferred compensation within the scope of employee pension plans	2,105	2,286
Repayment of financial liabilities	– 9,206	– 16,885
Net cash flows from financial receivables	– 3,367	2,284
Other non-cash income / expenses (financing)	– 2,439	1,748
Cash flows from financing activities	**– 15,534**	**– 16,985**
Net change in cash and cash equivalents	– 6,220	20,791
Effects of exchange rate changes on cash held	– 2,211	1,210
Effects of changes in consolidated Group	7,218	1,948
Cash and cash equivalents at beginning of period	137,995	114,046
Cash and cash equivalents at end of period	**136,782**	**137,995**
Supplemental disclosures:		
Interest received	3,601	3,712
Interest paid	– 15,389	– 15,196
Income taxes paid	– 23,159	– 15,853
Dividends received	987	1,357

SEGMENT REPORTING

BY REGION

(€ thousands)	Region Europe 2005	Region Europe 2004	Region Middle East / Africa 2005	Region Middle East / Africa 2004
External sales revenue of the Group companies by segment	**987,779**	**974,834**	**35,440**	**29,617**
by geographic area				
Europe	811,215	790,494	23	15
Middle East / Africa	50,833	81,385	35,336	29,495
Asia / Pacific	104,672	80,063	30	103
Americas	21,059	22,892	51	4
Inter-segment sales revenue	**52,956**	**28,393**	**627**	**297**
Segment result (EBIT)	**6,466**	**10,519**	**4,545**	**3,511**
thereof depreciation and amortization expense	26,102	25,915	545	565
thereof write-downs of non-current financial assets	–	–	–	–
thereof other non-cash items	17,545	11,195	– 248	– 2
thereof net profit or loss of equity-accounted investments	–	–	–	–
thereof income from investments	880	867	–	–
Segment assets	**734,156**	**753,689**	**22,416**	**19,990**
Segment liabilities	**528,355**	**520,713**	**6,070**	**6,278**
Capital expenditure	**28,964**	**26,090**	**828**	**795**
Number of employees (average)	**7,287**	**7,284**	**356**	**351**

BY MARKET

(€ thousands)	Industry and Building Services 2005	Industry and Building Services 2004
External sales revenue of the Group companies by segment	**734,407**	**682,180**
Segment assets	**541,058**	**514,322**
Capital expenditure	**27,063**	**21,754**

Region Asia / Pacific		Region Americas		Total	
2005	2004	**2005**	2004	**2005**	2004
196,034	**132,058**	**171,061**	**130,246**	**1,390,314**	**1,266,755**
360	393	2,167	2,609	813,765	793,511
1,805	1,347	131	1,813	88,105	114,040
193,859	130,317	2,983	3,259	301,544	213,742
10	1	165,780	122,565	186,900	145,462
6,895	**4,264**	**3,604**	**2,399**	**64,082**	**35,353**
18,869	**9,335**	**14,335**	**10,230**	**44,215**	**33,595**
3,709	3,353	3,841	3,384	34,197	33,217
–	–	–	–	–	–
80	– 76	– 381	542	16,996	11,659
–	–	–	–	–	–
107	403	–	87	987	1,357
145,383	**93,146**	**122,332**	**88,217**	**1,024,287**	**955,042**
72,445	**46,658**	**41,425**	**27,839**	**648,295**	**601,488**
4,946	**3,196**	**10,494**	**3,578**	**45,232**	**33,659**
3,712	**3,484**	**1,558**	**1,404**	**12,913**	**12,523**

Water and Waste Water		Energy and Mining		Total	
2005	2004	**2005**	2004	**2005**	2004
278,005	**270,383**	**377,902**	**314,192**	**1,390,314**	**1,266,755**
204,819	**203,844**	**278,410**	**236,876**	**1,024,287**	**955,042**
10,245	**8,623**	**7,924**	**3,282**	**45,232**	**33,659**

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.

The financial year of the companies consolidated is the calendar year, with the exception of one company that was consolidated on the basis of interim financial statements.

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.

Significant differences between the HGB and the IFRSs

There are certain fundamental recognition and measurement differences between the IFRSs and the German accounting principles. As far as our financial statements are concerned, these include:

- Under the IFRSs, fixed assets are usually measured after deducting straight-line depreciation and amortization, and the economic useful lives are longer than under the HGB. Tax-motivated accelerated depreciation or transfers from the “special reserve with equity portion” are prohibited by the IFRSs. In addition, leased assets are capitalized at the lessee where beneficial ownership is transferred.

- Construction contracts carried under inventories are measured using the percentage of completion method, under which revenue is recognized by reference to the stage of completion. This means that revenue is recognized proportionately prior to completion and billing of the project.

- Foreign currency receivables, cash and cash equivalents, and liabilities, as well as current financial instruments, are translated at the closing rates. This may result in unrealized gains being reported.

- Deferred tax assets and liabilities are accounted for using the balance sheet liability method, rather than by the income statement liability method as used under the HGB. The IFRSs also require deferred tax assets to be capitalized, in contrast to the recognition option under the HGB. The IFRSs require deferred tax assets to be recognized for loss carryforwards under certain conditions; this is prohibited under the HGB.

- In addition to future demographic trends, the IFRSs also require future compensation and pension trends, as well as discounting at a long-term capital market interest rate, to be reflected in the computation of pension provisions.

- The recognition criteria for provisions are much more restrictive under the IFRSs than under the HGB. Provisions for future internal expenses are generally prohibited. Provisions may only be recognized for obligations to third parties if it is probable that the obligation will have to be settled.

- Financial instruments are measured at their fair value, while the HGB requires them to be carried at cost.

First-time application of new and revised standards

We applied those Standards contained in the "Improvement Project" that are relevant to us for the first time in the year under review. In particular, these relate to the new format of the balance sheet under IAS 1 (classification by maturity) and the revised goodwill currency translation rules under IAS 21. The application of IFRS 3 also resulted in changes in the identification and treatment of goodwill and negative goodwill. The applicable transitional provisions were complied with and prior-period amounts restated where necessary. There were no other new or revised Standards required to be applied by KSB for the first time. KSB has not applied IFRS 7 *Financial Instruments: Disclosures* prior to the effective date.

BASIS OF CONSOLIDATION

Consolidated Group

In addition to KSB AG, 4 German and 43 foreign companies (previous year: 5 German and 38 foreign companies) were fully consolidated. 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. 39 (previous year: 38) subsidiaries were not consolidated because of their insignificance, individually and collectively, for a true and fair presentation of net assets, financial position and results of operations on the basis of the relevant consolidation volume. No companies are currently included at equity or proportionately consolidated.

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

The German KSB Fluid Systems GmbH, Frankenthal, was merged with KSB AG, Frankenthal, effective 1 January 2005. However, this did not affect the consolidated financial statements.

Our Danish company KSB A/S, Farum, was deconsolidated effective 1 January 2005 because it discontinued its operating activities. The effects on the consolidated financial statements are not material.

We included the following companies for the first time in the consolidated financial statements effective 1 January 2005:

- Hydraulor Services, France – service company
- KSB Pumpy + Armatury spol.sr.o., Czech Republic – sales / marketing company
- KSB Szivattyu és Armatura Kft., Hungary – sales / marketing company
- KSB SINGAPORE (Asia Pacific) Pte. Ltd., Singapore – sales / marketing company
- PT. KSB Indonesia, Indonesia – manufacturing and sales / marketing company
- KSB Limited, Hong Kong, China – sales / marketing company
- Precision Pump and Machine - KSB, Inc. (PPM), USA – service company

The changes in the consolidated Group described above contributed around 8 percent to consolidated net profit and had the following effects on the consolidated financial statements:

Effects of changes in the consolidated Group in 2005

Assets	€ thousands	Equity and liabilities	€ thousands
Fixed assets	– 953	Equity	6,067
Deferred tax assets	1,054	Deferred tax liabilities	873
Current assets	9,059	Liabilities	2,220
	9,160		**9,160**

In May 2005, we increased our interest in the Chinese company KSB Shanghai Pump Co. Ltd. by 29 percentage points, from 51 percent to 80 percent, and thus reduced the minority interest reported for this company in the consolidated balance sheet.

We acquired and formed the following companies in the year under review:

- We continued to reinforce our service network in 2005. We extended our presence on the German market by buying two new companies and increasing our interest in an existing company. We also acquired a company in Spain, and established new companies in Serbia-Montenegro and the Netherlands.
- We acquired a minority interest in a small German supplier to the pumps and valves industry.
- We established a new sales / marketing company in Moscow to ensure greater market penetration in Russia.
- To strengthen our valves business, we bought a local manufacture in Brazil and established a new company in Shanghai.

The acquisitions or newly formed companies mentioned above were not yet consolidated in 2005.

Overall, we spent € 5,665 thousand (previous year: € 100 thousand) on new acquisitions and successive acquisitions of consolidated companies in the year under review. € 6,313 thousand (previous year: € 4,491 thousand) was spent for companies that have not yet been consolidated. This relates to capital mesures, acquisitions and the formation of companies.

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 the new 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.

In accordance with the new IFRS 3, negative goodwill from previous years was eliminated against revenue reserves directly in equity and thus removed from intangible assets in fixed assets. Any newly arising 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. Because these companies are financially, economically and organizationally independent ("foreign entities"), assets and liabilities are translated at the closing rate. Almost all 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 financial statements of two Group companies are translated by applying the changes in general purchasing power to eliminate the effects of inflation.

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

	Closing rate		Average rate	
	31 Dec. 2005	31 Dec. 2004	**2005**	2004
1 US dollar	0.848	0.734	0.803	0.804
1 Brazilian real	0.364	0.277	0.329	0.275
100 Indian rupee	1.969	1.684	1.904	1.858
100 Chinese yuan	10.504	8.879	9.841	9.874

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.

Intangible assets

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

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. 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.

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), where this accounting treatment is permitted by IFRSs.

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 applicable since 1 January 2005.

Government grants 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. Simultaneously, a liability is recognized for the lease payments. 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. Interest-bearing loans are carried at their principal amount. Low-interest or non-interest-bearing loans are carried at their present value. 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 all 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.

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 is reported in inventories under a separate heading. Gains or losses in the period are recognized in total output of operations in the income statement as changes in inventories.

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 all 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.

Prepaid expenses 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, as they are classified as available for sale.

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 percent corridor rule, under which actuarial gains and losses outside this 10 percent corridor are recognized over the 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 only if the additional criteria set out in IAS 37 are met (detailed restructuring plan that has been announced to those affected by it).

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 (fair value hedges) 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.

Contingent liabilities

Contingent liabilities 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.

Effects on the results from application of the percentage of completion method are recognized in changes in inventories.

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. Prior-period comparative amounts were restated accordingly.

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.

Based on the provisions of IFRS 3, the negative goodwill originating in previous years (€ 8,017 thousand) was eliminated against the revenue reserves effective 1 January 2005, and cumulative amortization of goodwill (€ 11,561 thousand) was eliminated against historical cost. The change in the presentation of negative goodwill results in an overall increase in intangible assets.

The goodwill impairment test is based on a three-year business plan for the cash-generating units, which we have extrapolated into the future. It was performed using the discounted cash flow (DCF) method. The discount rate, which was 6.5 percent in the year under review, 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.

The increase in property, plant and equipment is due to strong investing activities, whereas annual depreciation charges remained more or less unchanged. € 41,154 thousand was invested in the year under review, compared with € 27,367 thousand in 2004.

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 € 9,864 thousand (previous year: € 9,522 thousand).

Disposals of items of property, plant and equipment resulted in book gains of € 1,076 thousand (previous year: € 7,378 thousand) and book losses of € 2,348 thousand (previous year: € 1,188 thousand). The book gains in the previous year are attributable principally to the sale of a property of our Italian company that was no longer required. The book gains and losses are reported in the income statement under other operating income and other operating expenses.

We recognized impairment losses of € 117 thousand (previous year: € 1,032 thousand) on intangible assets and items of property, plant and equipment in the year under review.

The changes in non-current financial assets result from the companies included for the first time in the consolidated financial statements, as well as from the new companies established and acquisitions mentioned earlier.

Currency translation adjustments taken directly to equity in the year under review resulted in a gain of € 7,645 thousand (previous year: loss of € 2,285 thousand).

Details of changes in fixed assets are presented in a separate table (Statement of Changes in Fixed Assets) (pp. 60 / 61).

The list of shareholdings of KSB AG, Frankenthal, has been filed with the commercial register of the Ludwigshafen (Rhine) Local Court, No. HRB 1016.

2 Deferred tax assets

Explanations on deferred tax assets are presented under “Taxes on income” (p. 83).

3 Inventories

(€ thousands)	31 Dec. 2005	31 Dec. 2004
Raw materials and production supplies	99,094	79,774
Work in progress	84,000	68,915
Finished goods and goods purchased and held for resale	65,784	51,291
Inventories recognized by PoC	80,002	68,870
Advance payments	6,100	6,102
Advances received from customers	– 102,800	– 73,936
	232,180	**201,016**

A small volume of inventories is carried at net realizable value. We only reversed write-downs to a minor extent where the current net realizable value is higher than the prior-period value.

Construction contracts under IAS 11 include recognized profits of € 6,034 thousand (previous year: € 6,603 thousand) and costs of € 73,968 thousand (previous year: € 62,267 thousand).

4 Receivables and other current assets

(€ thousands)	31 Dec. 2005	31 Dec. 2004
Trade receivables	322,762	300,709
Intragroup and associate receivables	14,488	20,634
Other receivables, other current assets and prepaid expenses	30,824	33,486
	368,074	**354,829**

Intragroup and associate receivables include loans to unconsolidated KSB companies amounting to € 5,114 thousand (previous year: € 3,028 thousand). Associate receivables amounted to € 1,726 thousand (previous year: € 2,940 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 currency forwards accounted for under IAS 39 amounting to € 688 thousand (previous year: € 14,667 thousand). At the balance sheet date, the notional volume of all currency forwards was € 197,787 thousand (previous year: € 182,985 thousand), and the notional volume of all interest rate derivatives was € 32,633 thousand (previous year: € 34,325 thousand).

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

5 Current financial instruments and cash

The current financial instruments amount to € 15,825 thousand (previous year: € 2,677 thousand). The increase was due to the German Group companies, which are for the first time using securities 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 and minority interest

There was no change in the share capital of KSB AG, Frankenthal, as against the previous year. In accordance with the Articles of Association, it totals € 44,771,963.82. It 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 € 13,324 thousand (previous year: € 14,825 thousand), while deferred tax liabilities amount to € 1,614 thousand (previous year: € 5,083 thousand).

Equity also includes changes in the fair value of derivatives used to hedge future cash flows amounting to € – 5,622 thousand (previous year: € 10,091 thousand). The opening balance as of 1 January 2005 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 percent interest in PAB GmbH, while Klein Pumpen GmbH, Frankenthal, holds a 49 percent interest.

Details of the changes in equity accounts and minority interest are contained in the Statement of Changes in Equity (p. 62).

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 (p. 90).

7 __ Deferred tax liabilities

Explanations on deferred tax liabilities are presented under "Taxes on income" (p. 83).

8 __ Provisions for pensions and similar obligations

More than 90 percent 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 discount rate for discounting the obligations, which is one of the actuarial assumptions, was reduced from 4.75 percent in the previous year to 4.50 percent. The latest "2005G" mortality tables published by Prof. Klaus Heubeck were also used for the first time. All other parameters remained unchanged. The assumed rate of future salary increases is 2.5 percent, and the assumed growth rate for the fixed pension trend and for benefit contributions is 1.8 percent per annum. A rate of 1.0 percent per annum has been applied to future pension trends, and the maximum income threshold for social security contribution assessment is assumed to rise by 2.5 percent. The assumption for pensionable age is governed by the 1999 German Pension Reform Act. A mean fluctuation table was applied to staff turnover. Actuarial gains and losses outside the 10 percent corridor are recognized.

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

(€ thousands)	2005	2004
Opening balance at 1 Jan.	171,379	164,071
Annual pension expense (see below)	14,466	13,002
Contributions by employees	2,390	2,476
Net pension payments	– 8,815	– 8,170
Closing balance at 31 Dec.	**179,420**	**171,379**

The present value of pension commitments amounts to € 207,595 thousand (previous year: € 188,244 thousand). This resulted in a net actuarial loss of € 28,175 thousand (previous year: € 16,865 thousand). The substantial increase is attributable primarily to the reduction in the discount rate. Where the loss exceeds the 10 percent corridor, the excess amount is amortized in the future periods over the average remaining working lives of the employees.

Changes recognized in income statement

(€ thousands)	2005	2004
Current service cost	5,731	3,591
Actuarial gains / losses	– 1	–
Interest cost	8,736	9,411
	14,466	**13,002**

The current service cost is 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 measured using comparable principles and contained in the provisions for pensions and other employee benefits in the amount of € 12,950 thousand (previous year: € 10,683 thousand).

9 __ Other provisions

Changes (€ thousands)	1 Jan. 2005	Change cons. Group, CTA* and other	Utilization	Reversals	Additions	31 Dec. 2005
Taxes	6,175	494	– 4,557	– 679	5,666	7,099
Other staff costs	83,466	1,511	– 45,915	– 819	66,105	104,348
Warranty obligations and contractual penalties	23,508	1,338	– 18,427	– 588	20,177	26,008
Other obligations	41,480	1,739	– 30,823	– 2,995	32,151	41,552
	154,629	**5,082**	**– 99,722**	**– 5,081**	**124,099**	**179,007**

* 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 partial retirement obligations as a consequence of our Efficiency Enhancement Programme.

€ 39,425 thousand of the other provisions is non-current (previous year: € 32,279 thousand). This relates mainly to provisions for jubilee payments, partial retirement and warranty obligations.

10__Liabilities

(€ thousands)	31 Dec. 2005	31 Dec. 2004
NON-CURRENT LIABILITIES		
Financial liabilities		
Bank loans and overdrafts	49,450	57,392
Finance lease liabilities	7,089	7,195
Other	619	3,016
Total non-current liabilities	**57,158**	**67,603**
CURRENT LIABILITIES		
Financial liabilities		
Bank loans and overdrafts	17,697	13,216
Finance lease liabilities	1,142	1,217
Other	9,337	14,448
	28,176	**28,881**
Trade payables		
Trade payables to third parties	142,528	126,247
Intragroup trade payables	2,082	3,311
	144,610	**129,558**
Other liabilities and deferred income		
Taxes	13,840	13,072
Social security	13,077	12,258
Miscellaneous other liabilities and deferred income	25,663	18,033
	52,580	**43,363**
Total current liabilities	**225,366**	**201,802**
TOTAL LIABILITIES	**282,524**	**269,405**

Assets amounting to € 3,744 thousand (previous year: € 3,439 thousand) have been pledged as security in the KSB Group for bank loans and other liabilities.

As in the previous year, liabilities amounting to € 8,648 thousand were secured by land charges or similar rights in the year under review.

Non-current financial liabilities include 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 3 loans that we took out with a residual amount of approximately € 33 million in total at the balance sheet date (previous year: € 36 million). These are long-term loans and bear interest of between three and five percent.

The weighted average interest rate on bank loans and overdrafts was 4.14 percent (previous year: 3.99 percent). 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 € 7,735 thousand (previous year: € 1,305 thousand). € 596 thousand (previous year: € 563 thousand) of this amount relates to interest rate derivatives. Deferred income amounts to € 566 thousand (previous year: € 497 thousand).

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

INCOME STATEMENT DISCLOSURES

11 Sales revenue

The breakdown of sales revenue is presented in the segment reporting (pp. 64 / 65).

Companies that were first-time consolidated in the year under review accounted for € 26,664 thousand of the sales revenue.

12 Other operating income

(€ thousands)	2005	2004
Gains from asset disposals and reversals of impairment losses (write-ups)	1,114	7,378
Income from current assets	3,420	1,643
Currency translation gains	6,497	418
Income from the reversal of provisions	4,529	4,261
Miscellaneous other income	7,931	10,105
	23,491	**23,805**

The book gains in the previous year are attributable principally to the sale of a property of our Italian company that was no longer required.

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

13 Cost of materials

(€ thousands)	2005	2004
Cost of raw materials and production supplies consumed and of goods purchased and held for resale	549,527	473,582
Cost of purchased services	34,764	32,807
	584,291	**506,389**

Companies that were first-time consolidated in the year under review accounted for € 10,327 thousand of the cost of materials.

14__Staff costs

(€ thousands)	2005	2004
Wages and salaries	404,737	382,282
Social security contributions and employee assistance costs	93,293	88,636
Pension costs	10,439	6,501
	508,469	**477,419**

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

First-time consolidation in the year under review accounted for € 9,225 thousand of staff costs.

Average number of employees	2005	2004
Wage earners	6,097	6,014
Salaried employees	6,415	6,150
Trainees and apprentices	401	359
	12,913	**12,523**

362 employees were added from the companies that were first-time consolidated in the year under review.

15__Other operating expenses

(€ thousands)	2005	2004
Losses from asset disposals	2,348	1,188
Losses from current assets	9,889	4,524
Currency translation losses	4,695	4,854
Other staff costs	13,585	15,927
Repairs, maintenance, third-party services	67,663	64,641
Selling expenses	70,864	62,375
Administrative expenses	58,042	51,703
Rents and leases	15,882	13,767
Miscellaneous other expenses	33,546	32,942
	276,514	**251,921**

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

€ 2,097 thousand of the other operating expenses relates to newly consolidated companies.

16 __ Financial income / expense

(€ thousands)	2005	2004
Income from investments	987	1,357
thereof from affiliates	(987)	(1,357)
Interest and similar income	3,601	3,712
thereof from affiliates	(77)	(21)
Interest and similar expenses	– 15,389	– 15,196
thereof to affiliates	(– 205)	(– 177)
Miscellaneous financial income / expense	70	216
	– 10,731	**– 9,911**

Interest and similar expenses include the interest cost on discounted pension provisions amounting to € 9,312 thousand (previous year: € 9,868 thousand). Income from other non-current financial instruments and non-current loans amounting to € 70 thousand (previous year: € 216 thousand) is classified as miscellaneous financial income / expense. As in the previous year, no write-downs were charged on non-current and current financial assets.

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)	2005	2004
Effective taxes	23,159	15,005
Deferred taxes	– 13,372	– 7,548
	9,787	**7,457**

€ 3,797 thousand (previous year: € 791 thousand) of the effective taxes in the year under review related to prior-period tax refunds and € 5,241 thousand (previous year: € 206 thousand) to tax arrears.

Reconciliation of deferred taxes

(€ thousands)	2005	2004
Change in deferred tax assets	– 2,786	– 4,080
Change in deferred tax liabilities	– 10,994	– 6,802
Change in deferred taxes recognized in balance sheet	**– 13,780**	**– 10,882**
Change in deferred taxes taken directly to equity	– 775	– 29
Changes in consolidated Group, currency translation adjustments and other	1,183	3,363
Deferred taxes recognized in income statement	**– 13,372**	**– 7,548**

Allocation of deferred taxes	Deferred tax assets		Deferred tax liabilities	
(€ thousands)	2005	2004	2005	2004
Assets				
Intangible assets, property, plant and equipment	2,331	2,344	34,429	36,590
Inventories	6,317	5,197	10,275	8,927
Receivables and other current assets	1,571	2,925	1,868	5,807
Other assets	19	48	924	9
Equity and liabilities				
Provisions for pensions and similar obligations	12,700	13,847	916	635
Other provisions	15,187	15,371	2,718	3,809
Currency translation differences recognized directly in equity	15,045	20,090	1,797	1,663
Other equity and liabilities	20,918	4,447	1,569	1,017
Gross deferred taxes – before offsetting	**74,088**	**64,269**	**54,496**	**58,457**
Offset under IAS 12.74	– 43,761	– 36,728	– 43,761	– 36,728
Net deferred taxes – after offsetting	**30,327**	**27,541**	**10,735**	**21,729**

The increase in other equity and liabilities for deferred tax assets results primarily from tax loss carryforwards.

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.

Deferred tax assets of € 14,691 thousand (previous year: € 3,237 thousand) were recognized from tax loss carryforwards. The corresponding loss carryforwards amount to € 40,108 thousand (previous year: € 8,899 thousand). They are attributable primarily to the German companies.

We did not recognize deferred tax assets from loss carryforwards amounting to € 10,268 thousand (previous year: € 11,088 thousand) because it is unlikely that there will be sufficient taxable profit available in the near future against which these tax loss carryforwards can be utilized. The same applies to minor deductible temporary differences (“timing differences”).

Reconciliation of income taxes

(€ thousands)	2005	2004
Profit from ordinary activities	32,427	22,111
Calculated income taxes on profit from ordinary activities on the basis of the applicable tax rate (37 percent)	11,998	8,181
Differences in tax rates	– 4,573	– 2,059
Unused tax loss carryforwards	– 303	691
Tax-exempt income / non-deductible expenses	4,347	2,201
Prior-period taxes	– 1,444	585
Other	– 238	– 2,142
Current taxes on income	**9,787**	**7,457**
Current tax rate	30 %	34 %

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 percent 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 € 9,525 thousand (previous year: € 6,773 thousand), and the minority interest in net loss amounts to € 53 thousand (previous year: € 299 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 € 24,733 thousand (previous year: € 24,500 thousand).

20 Earnings per share

		2005	2004
Consolidated net profit for the year	(€ thousands)	13,168	8,180
Additional dividend attributable to preference shareholders	(€ thousands)	– 891	– 891
	(€ thousands)	**12,277**	**7,289**
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	(€)	**7.01**	**4.16**
Earnings per preference share	(€)	**8.04**	**5.19**

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. For the first time, 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 (pp. 64 / 65).

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 minorities.

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)	2005	2004
Segment liabilities	**648,295**	**601,488**
Provisions for income taxes	5,606	4,608
Provisions and liabilities	**653,901**	**606,096**

A reconciliation between the segment result (**EBIT**) and the profit from ordinary activities reported in the income statement is presented below:

(€ thousands)	2005	2004
Segment result (EBIT)	**44,215**	**33,595**
Interest income	3,601	3,712
Interest expense	– 15,389	– 15,196
Profit from ordinary activities	**32,427**	**22,111**

Segments by market

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

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

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

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

OTHER DISCLOSURES

Contingencies and commitments

Contingent liabilities and security granted

(€ thousands)	2005	2004
Liabilities from guarantees	10,984	10,488
Liabilities from warranties	12,628	14,268
Liabilities from the granting of other security for third-party liabilities	14,171	7,644
	37,783	**32,400**

Other financial obligations from rental agreements and operating leases amount to a total of € 12,697 thousand (previous year: € 10,371 thousand), of which € 7,660 thousand is due within one year.

Operating leases relate primarily to vehicles.

Finance leases	Minimum lease payments		Present values	
(€ thousands)	2005	2004	2005	2004
Due within one year	5,931	1,602	5,064	1,217
Due between one and five years	2,813	7,224	2,667	6,636
Due after more than five years	510	593	500	559
	9,254	**9,419**	**8,231**	**8,412**

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 € 18,164 thousand (previous year: € 20,307 thousand) over a term of one to five years.

Payment obligations under capital measures at Group companies amount to € 2,207 thousand (previous year: € 0 thousand).

The aggregate purchase obligation amounts to € 4,059 thousand (previous year: € 4,445 thousand). Almost all of the corresponding payments are due in 2006.

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 € 97 thousand (previous year: € 74 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 € 109 thousand for financial year 2005 (previous year: € 190 thousand), and the total remuneration of the Board of Management amounts to € 2,173 thousand (previous year: € 1,957 thousand). € 18,804 thousand (previous year: € 16,853 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 € 1,344 thousand in the year under review (previous year: € 3,556 thousand).

The members of the Board of Management and the Supervisory Board are listed separately (p. 93).

Auditors

KPMG Deutsche Treuhand-Gesellschaft Aktiengesellschaft Wirtschaftsprüfungsgesellschaft were appointed as the auditors and group auditors for financial year 2005 by the Annual General Meeting on 1 June 2005. The expenses for financial year 2005 include corresponding audit fees of € 225 thousand. A further € 43 thousand was incurred for the audits of the German subsidiaries. In addition, fees of € 13 thousand were incurred for tax advisory services, and of € 6 thousand for other assurance and valuation services.

Events after the balance sheet date

There were no reportable events after the balance sheet date.

German Corporate Governance Code

The Board of Management and Supervisory Board of KSB AG have issued 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 page 97 of the present Annual Report as well as 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 22 June 2006 to appropriate the net retained earnings of KSB AG, Frankenthal, amounting to € 890,653.36 to distribute a dividend of € 1.03 for each of the 864,712 no-par value preference shares in accordance with the Articles of Association.

Frankenthal, March 2006

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. They will be announced in the Bundesanzeiger (German Federal Gazette) and filed with the commercial register of the Ludwigshafen (Rhine) Local Court. These annual financial statements 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, 2005. 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 17, 2006

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Reineke	Benz
Wirtschaftsprüfer	Wirtschaftsprüfer

Investments in affiliates

Name and seat of the fully consolidated companies	Country	Capital share 31 Dec. 2005 %	Equity 2005 € thousands	Net profit for the year/ (Net loss for the year) 2005 € thousands
Direct investments				
KSB Service GmbH, Frankenthal	Germany	100.00	1,534	[1]
KSB Service GmbH, Schwedt	Germany	100.00	1,023	[1]
Uder Elektromechanik GmbH, Friedrichsthal	Germany	100.00	26	[1]
KSB Zürich AG, Zurich	Switzerland	100.00	932	(419)
Hydroskepi GmbH, Amaroussion	Greece	100.00	1,403	(6)
KSB Mörck AB, Askim (Gothenburg)	Sweden	55.00	2,138	458
KSB Finland Oy, Kerava	Finland	100.00	2,914	891
KSB Pumpy + Armatury spol.sr.o., Prague	Czech Republic	100.00	1,704	322
KSB Szivattyu és Armatura Kft., Budapest	Hungary	100.00	1,484	271
KSB Pompy i Armatura Sp. z o.o., Warsaw	Poland	100.00	3,263	711
KSB Chile S.A., Santiago	Chile	100.00	7,176	1,096
KSB de Mexico, S.A. de C.V., Querétaro	Mexico	100.00	616	(167)
KSB SINGAPORE (Asia Pacific) Pte. Ltd., Singapore	Singapore	100.00	3,272	442
PT. KSB Indonesia, Jakarta	Indonesia	6.40	–	–
KSB Limited, Hong Kong	China	100.00	2,836	1,561
MIL Controls Limited, Mala	India	51.00	3,140	536
KSB Pumps Co. Ltd., Lahore	Pakistan	58.89	5,317	1,268
KSB Finanz S.A., Echternach	Luxembourg	100.00	100,275	6,749
KSB S.A.S., Gennevilliers (Paris)	France	100.00	54,549	6,757
Hydraulor Services, Algrange	France	100.00	987	104
Techni Pompe Service S.A.S., Hoerdt	France	100.00	1,739	409
AMRI Inc., Houston / Texas	USA	10.03	–	–
KSB Finance Nederland B.V., Zwanenburg	The Netherlands	100.00	3,641	2,172
KSB Nederland B.V., Zwanenburg	The Netherlands	100.00	4,429	448
DP industries B.V., Alphen aan den Rijn	The Netherlands	100.00	8,971	4,436
SISTO Armaturen S.A., Echternach	Luxembourg	52.86	8,769	311
KSB Italia S.p.A., Milan	Italy	100.00	18,871	1,034
KSB Österreich Ges.mbH, Vienna	Austria	100.00	2,966	461
KSB LIMITED, Loughborough	United Kingdom	100.00	540	(1,600)
Rotary Equipment Services Ltd., Loughborough	United Kingdom	100.00	472	(50)
N.V. KSB Belgium S.A., Wavre	Belgium	100.00	3,459	821
KSB-AMVI S.A., Madrid	Spain	100.00	3,551	325
AMVI S.A., Burgos	Spain	100.00	5,387	516
Bombas ITUR S.A., Zarautz	Spain	90.00	11,003	284
KSB-Pompa, Armatür Sanayi ve Ticaret A.S., Ankara	Turkey	99.00	4,191	772
KSB Ajax Pumps Pty. Ltd., Tottenham (Melbourne)	Australia	100.00	6,983	479
KSB Pumps (S.A.) (Pty.) Ltd., Germiston (Johannesburg)	South Africa	50.00	11,376	2,623
KSB Bombas Hidráulicas S.A., Várzea Paulista	Brazil	100.00	24,469	4,657
KSB Comp. Sudam. de Bombas S.A., Carapachay (Buenos Aires)	Argentina	100.00	3,000	316
PT. KSB Indonesia, Jakarta	Indonesia	93.60	867	237
KSB Shanghai Pump Co. Ltd., Shanghai	China	80.00	14,677	2,128
PAB Pumpen und Armaturen-Beteiligungsgesellschaft mbH, Frankenthal	Germany	51.00	24,018	145
KSB America Corporation, Richmond / Virginia	USA	100.00	21,886	1,992
KSB Inc., Richmond / Virginia	USA	100.00	6,704	584
GIW Industries Inc., Grovetown / Georgia	USA	100.00	20,689	2,155
AMRI Inc., Houston / Texas	USA	89.97	6,336	986
PPM - KSB Inc., Bakersfield / California	USA	100.00	2,050	9
Canadian Kay Pump Ltd., Mississauga	Canada	100.00	6,230	597
KSB Pumps Limited, Pune (Bombay)	India	40.54	33,144	7,433
MIL Controls Limited, Mala	India	49.00	–	–

[1]) Profit pooling arrangement

SUPERVISORY BOARD

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

Richard Lederer, Dipl.-Kfm., Frankenthal
Former Member of the Management of the
Energy Pumps Division of KSB Aktiengesellschaft
(Chairman since 5 July 2005)

Peter Schubert, Dipl.-Kfm., Heddesheim [1)]
(Chairman until 4 July 2005)

Karlheinz Leitgeb, Industrial Foreman, Pegnitz
Deputy Chairman of the General Works Council and
Chairman of the Pegnitz Works Council
(Deputy Chairman since 1 July 2005)

Hermann Reutter, Measurement Technician, Bad Dürkheim
Former Chairman of the General Works Council and the
Frankenthal Works Council
(Deputy Chairman until 30 June 2005 / Member until 31 Dec. 2005)

Dr. Peter Buthmann, Dipl.-Ing., Bayreuth [2)]
Vice President, Service KSB Group

Bernd Euler, Dipl.-Kfm., Buckenhof
Member of the Board in the Industrial Solutions and
Services Division of Siemens Aktiengesellschaft
(until 1 June 2005)

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

Dr. Hans-Joachim Jacob, Auditor, Munich [3)]
Member of the Executive Board of BDO Deutsche Warentreuhand
Aktiengesellschaft Wirtschaftsprüfungsgesellschaft
(since 14 June 2005)

Heinz Köppel, Metalworker, Münchberg
1. Delegate of IG Metall Administration Area
Ost-Oberfranken

Ludwig Udo Kontz, Dipl.-Ing., Königswinter
Owner of Kontz, Network & Group, Bonn
(since 23 August 2005)

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

Horst Kuschetzki, Dipl.-Kfm., Büdingen-Wolf [4)]
(since 14 June 2005)

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

Stefan Messer, Industrial Trader, Sulzbach [5)]
Chief Executive Officer of Messer Group GmbH
(since 27 May 2005)

Heinrich Dieter Müller, Techn. Draftsman, Dannstadt-Schauernheim
Chairman of the General Works Council
and the Frankenthal Works Council
(since 1 January 2006)

Dr. Michael Rogowski, Dipl.-Wirtschaftsing., Heidenheim
Chairman of the Supervisory Board of Voith AG and Vice President
of the Bundesverband der Deutschen Industrie e.V. (BDI)
(German Industry Association)
(until 6 May 2005)

Bernhard Wild, Dipl.-Ing., Königstein
Chairman of the Supervisory Board of Braun GmbH
(until 1 June 2005)

BOARD OF MANAGEMENT

Peter Schubert, Dipl.-Kfm., Heddesheim [6)]
(Chairman and Human Resources Director since 5 July 2005)

Prof. Dr. h.c. Josef Gerstner, Neckargemünd
(Chairman and Human Resources Director until 1 July 2005)

Dr.-Ing. Willi Enderle, Grünstadt

Dr. rer. pol. Alois Wittmann, Frankenthal [7)]

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

[1)] Autohaus NIX GmbH, Wächtersbach, Germany
NIX Auto Group GmbH, Wächtersbach, Germany

[2)] KSB Zürich AG, Zurich, Switzerland
KSB Nederland B.V., Zwanenburg, The Netherlands
SISTO Armaturen S.A., Echternach, Luxembourg
KSB Italia S.p.A., Milan, Italy
KSB Österreich Ges.mbH, Vienna, Austria
KSB LIMITED, Loughborough, UK

[3)] MIRUS AG, Potsdam, Germany (Chairman of the Supervisory Board)
Hypothekenbank in Essen AG, Essen, Germany

[4)] Vacuumschmelze GmbH & Co. KG, Hanau, Germany (Chairman of the Advisory Board)
nie wieder bohren ag, Hanau, Germany (Chairman of the Supervisory Board)
Edscha AG, Remscheid, Germany
Carcoustics International GmbH, Leverkusen, Germany
FRIMO Group GmbH, Lotte, Germany
ASH Automotive Systems Holding GmbH, Rheda-Wiedenbrück, Germany

[5)] 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

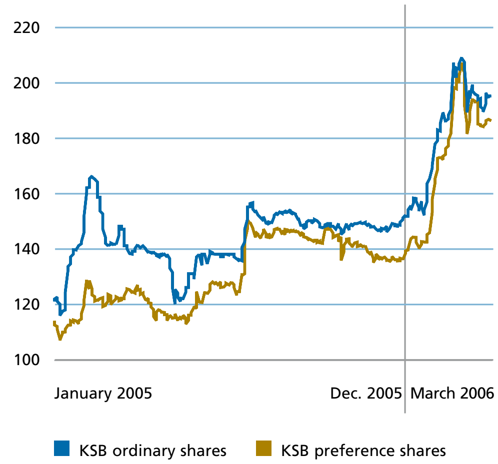
Mandates of KSB AG's Board of Management members in the Board of Directors of KSB companies:

[6)] KSB Finanz S.A., Echternach, Luxembourg
KSB Shanghai Pump Co. Ltd., Shanghai, China

[7)] KSB Finanz S.A., Echternach, Luxembourg
DP industries B.V., Alphen aan den Rijn, The Netherlands
Bombas ITUR S.A., Zarautz, Spain
KSB Bombas Hidráulicas S.A., Várzea Paulista, Brazil
KSB America Corporation, Richmond / Virginia, USA
GIW Industries Inc., Grovetown / Georgia, USA
Canadian Kay Pump Ltd., Mississauga, Canada
KSB Shanghai Pump Co. Ltd., Shanghai, China

	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 30 Dec. 2005	€ 151.43	€ 137.20
Market capitalization 30 Dec. 2005	€ 252.9 million	

Development of KSB shares in €



Dividend development	2005 (Proposal)	2004
Ordinary share:		
Dividend	–	–
Dividend yield	–	–
Preference share:		
Dividend	€ 1.03	€ 1.03
Dividend yield	0.8 %	0.9 %

2005 – a good year for equities

Investors in European and Japanese equities markets profited from positive price growth in 2005. Although the leading indices for these markets recorded only a modest upturn in the first six months, the upward spiral accelerated in the second half of the year. This was propelled by the continued buoyant development of the global economy and an improved macroeconomic climate. Rising commodities and energy prices and the greater political risk in the Middle East were unable to curb this accelerating upward trend. The Japanese Nikkei index grew by approximately 40 percent year-on-year, the EURO Stoxx 50 by approximately 21 percent and the DAX by approximately 27 percent. Only the US markets were unable to report an increase in the index at year-end 2005.

KSB shares record positive growth

KSB shares also recorded encouraging price increases in 2005. The positive development of our preference shares continued, with the third quarter in particular bringing a significant price increase. The year-end closing price was € 137.20, a year-on-year increase of a good 18 percent.

At 19 percent, the increase recorded by our ordinary shares was even higher, closing the year on € 151.43. Following a good start to the first quarter and a price adjustment up to the mid-year point, the price of our ordinary shares recovered in the late summer.

This encouraging share price performance is also reflected in our market capitalization, which improved from € 212.9 million to € 252.9 million.

Unchanged dividend proposal

As in the previous financial year, KSB AG had to absorb considerable restructuring expenses and closed financial year 2005 with a net loss. Because of this continued negative earnings situation, a proposal will be made to the Annual General Meeting on 22 June 2006 to resolve an unchanged dividend provided for by the Articles of Association of € 1.03 per preference share.

The Board of Management and the Supervisory Board report as follows on corporate governance at KSB in accordance with section 3.10 of the German Corporate Governance Code:

Good, responsible corporate governance has traditionally ranked highly at KSB. We therefore welcome the German Corporate Governance Code. Even before the Code was introduced, we implemented the majority of core corporate governance processes in such a way that they complied with the subsequent 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.

KSB AG is an "Aktiengesellschaft" (public company) under German law. The Board of Management and Supervisory Board are therefore responsible for the management and supervision of the Company respectively. The continuous dialogue between these two bodies, based on mutual trust, forms the basis for the long-term success of the Company. At KSB, the Board of Management and Supervisory Board work together closely in the best interests of the Company.

To further improve processes and procedures, the Supervisory Board adopted new rules of procedure in the year under review. These now stipulate explicitly that the Supervisory Board conducts its business on the basis of the German Corporate Governance Code unless the Board of Management and the Supervisory Board have stated that they depart from the Code in justified individual instances.

In addition, we have decided to regularly review the efficiency of the Supervisory Board's activities to safeguard and continuously improve the level already reached. This means that the Supervisory Board will pay particular attention to addressing this issue in future and will critically review its working procedures. In the year under review, the Supervisory Board already met on occasion without the Board of Management and dealt with the structuring of its own processes and procedures for fulfilling its specified duties.

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 15 December 2005 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 2 June 2005 apart from a handful of exceptions. The departures from compliance with the recommendations of the Code are explained below:

- We depart from the recommendations set out in sections 4.2.4 and 5.4.7. We prefer to provide information about the total remuneration of the members of both the Board of Management and 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.
- We also 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 of the Supervisory Board is governed by the Articles of Association. The total remuneration of the Supervisory Board is contained in the notes to the consolidated financial statements on page 89. Peter Schubert was appointed to the Board of Management effective 5 July 2005 in accordance with section 105(2) of the AktG. For his duties on the Board of Management, he was granted a remuneration that is contained in the aggregate remuneration of the Board of Management (disclosed in the notes to the consolidated financial statements on page 89).

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 or responsibility assigned to the member of the Board of Management. The fixed remuneration also includes additional benefits in the form of company cars and health insurance contributions. Benefit commitments (retirement, occupational disability and widow's pensions) have been made to the members of the Board of Management. The variable remuneration depends on the consolidated net profit for the financial year in question. As future additional parameters for measuring the variable remuneration, it is the Supervisory Board's intention to agree both responsibility-related and individual targets with the members of the Board of Management to ensure the more flexible structuring of the variable remuneration. No stock options or other share-based payment arrangements are granted to the members of the Board of Management. Disclosures on the remuneration of the Board of Management are to be found on page 89 of the Annual Report.

The Supervisory Board The Board of Management

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 2 June 2005, with the exception of the following:

1. The total remuneration of the members of the Board of Management is reported in the Notes to the Consolidated Financial Statements, but neither separately for each member nor subdivided according to fixed, performance-related and long-term incentive components (item 4.2.4 of the Code).

2. 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 neither separately for each member nor subdivided according to components (item 5.4.7).

3. 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 15 December 2005

On behalf of the Supervisory Board	On behalf of the Board of Management
Richard Lederer	Peter Schubert

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.

Boiler feed pump Pump which supplies pre-heated water to a steam boiler to allow a continuous evaporation process. Pumps of this kind are used in power plants in particular.

Combined cycle power plant A type of power plant in which the hot exhaust gases from a gas turbine are used for the generation of steam that drives a downstream steam turbine.

Competence centres Organizational units established in the framework of KSB's global strategy whose staff assume regional responsibility for defined product groups, prepare quotations and process orders.

Kyoto Protocol International agreement to reduce worldwide CO_2 emissions.

Life cycle costs Concept that has come to be an important criterion for purchasing decisions: the total costs incurred for equipment over its life span.

Made by KSB A standard which provides for consistent product quality throughout the Group.

Polymerization A process that links relatively simple chemical compounds to form large chain molecules. In this way, for example, the plastic polyethylene is produced from the gas ethylene by polymerization.

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.

Reverse osmosis Mechanical method of filtration to remove salt from water. This process is used in the production of drinking water from the sea.

Structural Programme KSB programme to increase profitability and improve competitiveness.

Abbreviations

ANSI American National Standards Institute

API American Petroleum Institute

IFRS International Financial Reporting Standards (formerly IAS)

ISO International Organization of Standardization

ISO 9001 The certification of quality management systems under ISO 9001 standards warrants that appropriate procedures are in place in a company to ensure not only product quality assurance but also clearly defined processes and work flows.

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

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

20 April 2006, 10:00 h
Financial press conference
67227 Frankenthal

28 April 2006
Invitation to Annual General Meeting

22 June 2006, 15:00 h
Annual General Meeting
CongressForum Frankenthal
Stephan-Cosacchi-Platz 5
67227 Frankenthal

On 23 June 2006
Dividend payment

August 2006
Interim Report January – June 2006

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Online news

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

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Impellers of a KSB high-pressure pump

KSB Group

Annual Report 2005

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