KSB Group

Annual Report 2012

KSB Group

Annual Report 2012


Cover: High-performance plain bearings for process pumps

GROUP FINANCIAL HIGHLIGHTS

EARNINGS

		2012	2011	2010	2009	2008
Order intake	€m	2,257.4	2,132.3	2,075.0	1,934.0	2,179.0
Sales revenue	€m	2,268.2	2,091.0	1,939.3	1,892.8	1,991.7
Earnings before interest and taxes (EBIT)	€m	150.4	133.4	148.9	185.7	208.2
Earnings before taxes (EBT)	€m	132.8	120.5	135.8	172.8	200.1
Earnings after taxes	€m	90.3	83.3	90.0	122.4	139.5
Cash flow	€m	156.9	137.0	148.5	172.4	183.9

BALANCE SHEET

		2012	2011	2010	2009	2008
Balance sheet total	€m	2,177.0	1,974.1	1,861.3	1,645.4	1,421.4
Fixed assets	€m	602.0	560.5	515.3	469.3	417.6
Capital expenditure	€m	91.4	93.5	72.8	86.6	103.6
Depreciation and amortisation expense	€m	58.6	51.0	48.1	43.4	35.0
Current assets	€m	1,546.2	1,389.2	1,329.2	1,158.6	990.1
Equity (incl. non-controlling interest)	€m	923.0	869.1	825.6	720.6	605.8
Equity ratio (incl. non-controlling interest)	%	42.4	44.0	44.4	43.8	42.6

PROFITABILITY

		2012	2011	2010	2009	2008
Return on sales	%	5.9	5.8	7.0	9.1	10.0
Return on equity	%	14.8	14.2	17.6	26.1	36.0
Return on capital employed	%	7.5	7.4	8.9	12.4	16.1

EMPLOYEES

		2012	2011	2010	2009	2008
Number of employees at 31 Dec.		16,207	15,674	14,697	14,249	14,345
Staff costs	€m	758.2	698.0	649.8	618.3	614.6

SHARES

		2012	2011	2010	2009	2008
Market capitalisation at 31 Dec.	€m	769.4	741.0	1,051.2	707.6	574.3
Earnings per ordinary share (EPS)	€	42.51	40.95	44.09	61.32	70.17
Earnings per preference share (EPS)	€	42.77	41.21	44.35	61.58	70.43
Dividend per ordinary share	€	12.00	12.00	12.00	12.00	12.50
Dividend per preference share	€	12.26	12.26	12.26	12.26	12.76

PRODUCTS AND SERVICES

SINGLE-STAGE PUMPS
Standardised pumps, process pumps, circulator pumps, service water pumps, slurry pumps

MULTISTAGE PUMPS
Boiler feed pumps, boiler circulating pumps, booster pumps, pressure booster pumps, high-pressure pumps for reverse osmosis applications, water transport pumps

SUBMERSIBLE PUMPS
Well pumps, waste water, sewage and drainage pumps, mixers, tubular casing pumps, condensate pumps

AUTOMATION AND DRIVES
Control systems, energy-efficient pump drives, pressure booster systems, fire-fighting systems, lifting units

VALVES
Butterfly valves, globe valves, gate valves, control valves, diaphragm valves, ball valves, actuators and control systems

SERVICE
Installation, commissioning, start-up, inspection, servicing, maintenance and repair of pumps, related systems and valves; modular service concepts and system analyses for entire systems

Technology that drives success. KSB is a leading international provider of pumps, valves and matching service. Wherever fluids need transporting, we offer efficient hydraulic solutions. We owe the success of our technology to our innovative experts. In our worldwide R & D centres, highly qualified engineers and technicians turn new business ideas into reality. They create standard and customised products that combine the very best in hydraulics, automation and materials technology. KSB is at the forefront of all three – and wants to stay that way. Our aim is to make fluid transport more reliable, economical and environmentally friendly than ever before. Because that's what drives our customers' success.

CONTENTS

18 **How can salt be pumped from seawater?**
A new type of compact system ensures drinking water production from seawater is cost-effective.

58 **How do you "bake" the perfect seal for valves?**
A wide variety of ingredients specifically geared to the respective application are used for the in-house production of butterfly valve sealing elements.

126 **How can a magnetless motor generate magnetic forces?**
Patented rotor laminations ensure that KSB's high-efficiency motor does not require magnetic materials from rare earths.

MANAGEMENT AND ISSUES 2012

4 Chairman's Letter
6 Board of Management
8 Report of the Supervisory Board
14 A Look Back at 2012
16 KSB Shares

GROUP MANAGEMENT REPORT

24 Group Structure and Focus of Business
26 Economic Environment
29 Business Development and Events
33 Net Assets, Financial Position and Results of Operations
40 Research and Development
42 Employees
44 Corporate Social Responsibility
47 Risk Management
51 Report on Expected Developments

CONSOLIDATED FINANCIAL STATEMENTS

64 Balance Sheet
65 Statement of Comprehensive Income
66 Statement of Changes in Equity
68 Statement of Cash Flows
69 Notes
- 120 List of Shareholdings
- 123 Supervisory Board
- 124 Board of Management
- 125 Proposal on the Appropriation of the Net Retained Earnings of KSB AG

GENERAL INFORMATION

132 Responsibility Statement
133 Auditor's Report
135 Corporate Governance Declaration
136 Corporate Governance Report / Remuneration Report
143 Glossary
144 Contacts

COVER

Group Financial Highlights
Products and Services
Global Presence
Financial Calendar

LEGEND

Glossary

Dr. Wolfgang Schmitt,
Chairman of the Board
of Management

Dear shareholders and business partners,

The economic downturn in much of Europe has limited the growth of the companies in the region. 2012 was therefore not a year in which our European business expanded significantly. In view of this fact, the strengthening of our presence in recent years in the growth markets of Asia, South America and Africa has proven all the more important. Thanks to this focus, in 2012 we once again succeeded in expanding our business, and achieved a new record sales revenue of € 2,268 million, just under our target of € 2.3 billion. With our consolidated earnings of € 132.8 million, we similarly almost reached our target of € 135 million.

TAKING ADVANTAGE OF GROWING OPPORTUNITIES "IN THE SECOND ROW"

Europe is not expected to lead the way in the growth stakes in 2013 either. So it is imperative that we focus even more strongly on more dynamic markets. These don't just include the economic heavyweights of China, India, Brazil and Russia, but also the "second row" emerging countries and some markets on the European periphery, all of which provide opportunities for lucrative orders.

In 2011 we therefore founded four new KSB companies in Peru and South Eastern Europe, and in 2012 also established subsidiaries in Vietnam, Kazakhstan and Ukraine. In 2013 we are planning to set up subsidiaries in three emerging markets in South America and South East Asia. We also have the Middle East and Africa with its resource-rich countries and growing demand for infrastructure in our sights. We essentially want to ensure that we are everywhere where markets are currently showing or in the future are likely to show above-average growth.

DEVELOPING NEW SALES REVENUE OPPORTUNITIES THROUGH STRATEGIC PROJECTS

Geographic expansion is only one dimension of our current corporate strategy, which will shape our development until 2018. We have launched numerous strategic projects to develop new sources of revenue where we have yet to exploit our strengths in full or at all. This applies in particular to our business with standard products, for which we are expanding our logistical structures, as well as for our service and spare parts business. According to our analyses, we can achieve much higher sales in the aftermarket segment in particular. To this end, we will focus even more strongly in sales and service on providing comprehensive support to our customers, including after they have purchased new products.

HIGH TRUST IN BRAND

How well business develops hinges on the “confidence” factor. This applies first and foremast to the confidence of our customers in their own commercial future as the linchpin for their investment decisions. The lack of confidence in some sectors is currently perceptible in our project business in particular.

But even more important is the trust of customers in our abilities and the KSB brand, which promises them “technology that drives success”. Especially in difficult economic times, customers when investing should be sure that by opting for KSB they have made the best choice and one that will ensure their success.

To confirm this brand promise, in 2012 we once again laid down important foundations in research and development, as you can read in this report. KSB's reputation worldwide is founded on advanced product technology, high quality and safety, as well as our industry-leading consultancy expertise, and we will continue to build on this reputation.

As shareholders too you can trust in KSB. If you have been familiar with our company for some time, you know that we use the capital entrusted to us responsibly and avoid risks that are difficult to assess. Money and trust – we are always eager to earn both. And we will to continue to show you that sustainable and profitable growth does indeed generate reasonable returns.

Yours,

W. Schmitt

Dr. Wolfgang Schmitt,
Chairman of the Board of Management of KSB Aktiengesellschaft

BOARD OF MANAGEMENT

From left to right:

DR. WOLFGANG SCHMITT

joined the Board of Management on 7 April 2006, and has been Chairman of the Board since 15 December 2006. He is primarily responsible for Finance and Accounting, Controlling, Legal & Compliance, Communications, Strategy and the Business Unit Service. Since 1 April 2012, he has also been in charge of the Business Unit Valves.

DR.-ING. PETER BUTHMANN

has been on the Board of Management since 1 January 2007. His main responsibilities include Operations, Human Resources, Central Purchasing, Programme Coordination and the Business Unit Submersible Pumps. He is the Human Resources Director and took charge of Sales and Marketing on 1 April 2012.

PROF. DR.-ING. DIETER-HEINZ HELLMANN

has been a member of the Board of Management since 1 January 2007 and is responsible for Technology, which includes Research, Development and Business Processes (Technology). In addition, he is in charge of the Business Units Single-stage Pumps, Multistage Pumps, and Automation and Drives. On 1 April 2012, he assumed responsibility for Internal Audits.

REPORT OF THE SUPERVISORY BOARD

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

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

In the period under review, no conflicts of interest arose involving members of the Board of Management or the Supervisory Board that would have been required to be reported to the Supervisory Board or the Annual General Meeting.

MAIN FOCUS OF WORK IN THE SUPERVISORY BOARD PLENARY SESSIONS AND IN THE COMMITTEES

Core topics of our discussions with the Board of Management were strategy implementation and the continued development of the corporate organisation. The analysis of the course and impact of the European debt crisis represented an additional focus, as did possible responses to particular developments in some regions and countries, such as the ongoing upheaval in the Arab world. We also closely examined the economic situation and outlook for Asia, particularly China and India.

In 2012, five regular Supervisory Board meetings were held. The performance of KSB Aktiengesellschaft and the Group was the subject of regular discussions in the plenary sessions, primarily with regard to order intake, sales revenue, earnings, assets and employment levels as well as the current economic situation, the strategy, and investment, disposal and acquisition projects. We carefully studied our German and international service activities. Given the large number of acquisitions in recent years, we paid continued attention to their structured integration and management to ensure the desired level of profitability.

The Board of Management comprehensively and regularly explained to us the ways in which KSB can achieve the planned growth for the coming years, including the underlying methodological and strategic considerations. All investments required to pursue these objectives were

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

subjected to critical analysis and subsequently overseen by us. Accordingly, we dealt repeatedly with the status of the modernisation and expansion work at our sites, particularly in Asia and South America. In order to obtain a major Chinese order for the supply of pumps, we had to comprehensively expand our local manufacturing facilities. We received several reports from the Board of Management on the status of the order, which is now being processed and will take several years to complete. In a number of countries, the start or expansion of business activities led to property acquisitions. In each case we discussed in detail the long-term suitability of such measures.

Against the background of our experiences with the global financial and economic crisis, we also discussed how the ongoing European debt problem affects and may continue to affect our business. We subjected the deliberations of the Board of Management on this subject to critical scrutiny, focusing in particular on the development of reliable instruments for detecting market movements at an early stage, which in turn would enable a rapid response.

Repeatedly on the agenda was the development of our corporate organisation. We devoted particular attention in this respect to the structuring of our sales activities. The experiences reported by the Board of Management in relation to measures implemented to date in selected countries highlighted the fact there is still a certain need for modifications in some cases before we can decide on a broader introduction of the revised structures. Another focus of our work was the status – as explained regularly by the Board of Management – of the measures for the development of our corporate culture, which is based on established values.

In October, the Supervisory Board held a meeting at the company's site in Echternach, Luxembourg, where it was able to assess how business was developing there and visit the high-performance production facilities. We also received in-depth information on the situation of selected products and functional divisions of the Group. At the December meeting, we discussed and approved the step acquisition of a Norwegian sales operation in order to use its expertise to expand our own local sales and distribution channels. We have also adopted a concept for optimising the separation between operative tasks and Group management functions at KSB AG. As well as better transparency within the Group, we also expect improved cost structures. Another focus of discussions were the course of the outgoing financial year and the plans for 2013.

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

The **Nomination Committee** looked at the shareholder representative nominations prior to the Supervisory Board elections at the Annual General Meeting. It met seven times for this purpose in the year under review.

The **Planning and Finance Committee** met four times in the year under review. It focuses on corporate and investment planning and the financial situation of the company. Given our strategic objectives and the aforementioned large Chinese order, which required substantial upfront expenditure, determining longer-term liquidity needs and management was a focus of discussion. This was supplemented with an in-depth analysis of the current and expected cost and earnings situation. The committee members also discussed in detail the quality of the corporate planning and its underlying assumptions.

The **Corporate Development Committee** deals with a number of topics of fundamental relevance. It met six times during the year under review. The areas of strategy monitoring, production management and innovation, and repeatedly the strategic direction of the Region Asia were discussed, including a long-term site concept for China and India. The discussions started in 2011 on securing and optimising the provision of castings to our manufacturing facilities were continued, including deliberations about the possible expansion of our own foundry plants in Germany. The heads of the relevant specialist departments often took part in the committee meetings, along with the responsible members of the Board of Management.

In early 2012 we dissolved the Controlling and Sales Management sub-committees and integrated their functions into the work of the Corporate Development Committee.

The **Personnel Committee** held nine meetings in the year under review. It primarily addresses issues relating to the Board of Management's remuneration, including the terms of the service contracts for the individual Board of Management members as well as other Board of Management issues. Decisions on the Board of Management's remuneration are made in plenary session with the committee acting in a preparatory capacity. In addition, the committee discussed staff development issues with the aim of prioritising the recruitment of candidates for the Board of Management and other management positions from within the company's own ranks. Particular emphasis in this context is placed on the selection and development of promising employees. In 2012, the committee members again participated in events with potential candidates from various management levels in an effort to foster a direct exchange of ideas. The committee discussed in detail the consensual and early departure of Mr. Jan Stoop from the Board at the end of March 2012 and the resulting succession issues. Also the subject of careful deliberation was the further extension of the term of office of Prof. Dr. Dieter-Heinz Hellmann on the Board of Management. Given the ongoing discussion on organisational optimisation, he will continue to carry out his duties until 31 December 2013.

The four meetings of the **Audit Committee** were always attended by the Member of the Board responsible for Finance and, on several occasions, by the auditors. The committee primarily discussed the 2011 annual and consolidated financial statements, the audit reports submitted by the auditors and the internal auditors as well as the further development of the risk management system and compliance organisation. In particular, the committee prepared the independent examination by the Supervisory Board of the financial statements, the management reports and the proposal on the appropriation of the net retained earnings. In this context, it also defined key audit areas for the external auditing of the 2012 financial statements. The half-year financial report was also discussed with the Board of Management. The committee submitted a proposal to the plenary sessions for the selection of auditors by the Annual General Meeting on 16 May 2012 and subsequently commissioned them to carry out the audit of the annual and consolidated financial statements for the 2012 financial year. The declaration of independence by the auditors was obtained in accordance with section 7.2.1 of the German Corporate Governance Code and the auditors' continued independence was monitored. The committee also discussed the monitoring of the financial reporting process and the effectiveness of the internal control and auditing system.

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

CORPORATE GOVERNANCE AND STATEMENT OF COMPLIANCE

The Supervisory Board continuously monitored developments in corporate governance standards throughout the year. The Board of Management and the Supervisory Board report on corporate governance at KSB in accordance with section 3.10 of the German Corporate Governance Code on pages 136 ff. of this annual report. On 5 December 2012 they issued an updated Statement of Compliance in accordance with section 161 *AktG* [*Aktiengesetz* – German Public Companies Act] and made it permanently available to shareholders on the company's web site. With just a few exceptions, KSB Aktiengesellschaft complies with the recommendations set out in the Code in the version dated 15 May 2012.

AUDIT OF THE ANNUAL AND CONSOLIDATED FINANCIAL STATEMENTS

The accounting documentation, in addition to the proposal by the Board of Management on the appropriation of net retained earnings and the audit reports submitted by the auditors, was provided in good time to all members of the Supervisory Board. The documents were dealt with in detail by the Audit Committee on 19 March 2013 as well as by the Supervisory Board plenary session on 25 March 2013 and explained in depth in both cases by the Board of Management. The auditors attended the meetings of both bodies, reported on the findings of the audit and were available to provide additional information.

The Supervisory Board examined the annual financial statements and the management report of KSB Aktiengesellschaft for the year ended 31 December 2012, which were prepared in accordance with the provisions of the *Handelsgesetzbuch* [*HGB* – German Commercial Code], as well as the consolidated financial statements and the Group management report for the year ended 31 December 2012, which were prepared in accordance with the International Financial Reporting Standards (IFRS), and the proposal by the Board of Management on the appropriation of net retained earnings.

The Frankfurt am Main office of BDO AG Wirtschaftsprüfungsgesellschaft, Hamburg, audited the annual financial statements and the management report of KSB Aktiengesellschaft for the year ended 31 December 2012, as well as the consolidated financial statements and the Group management report for the year ended 31 December 2012, and issued an unqualified auditors'opinion. The key audit areas defined for the auditors by the Audit Committee for the year under review were: Validity of the measurement assumptions as part of impairment testing for financial investments and goodwill reported, including acquisitions and impairment tests, and validity of the measurement assumptions applied for defined benefit pension obligations. The auditors reported their findings on these key audit areas both orally and in writing.

The Supervisory Board concurs with the auditors' findings. Based on its own final examination results, the Supervisory Board plenary session did not raise any objections to the annual financial statements, consolidated financial statements, management report and Group management report. In accordance with the recommendation of the Audit Committee the Supervisory Board approved the financial statements prepared by the Board of Management; the annual financial statements are thus adopted. After its own examination, the Supervisory Board deems the proposal by the Board of Management on the appropriation of net retained earnings of KSB Aktiengesellschaft to be appropriate and concurs with it.

DEPENDENT COMPANY REPORT

The auditors also audited the dependent company report prepared by the Board of Management in accordance with section 312 AktG and 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."

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

CHANGES ON THE SUPERVISORY BOARD AND BOARD OF MANAGEMENT

Mr. Jan Stoop resigned from the Board of Management and the company at the end of March 2012. The Annual General Meeting elected Dr. Thomas Seeberg to the Supervisory Board as the successor to Mr. Richard Lederer, who following last year's Annual General Meeting on 16 May 2012 left the Supervisory Board, having reached the age limit. Dr. Hermann Nestler and Mr. Werner Stegmüller were re-elected to the Supervisory Board at the same time. Following his assumption of a management role within the company, Mr. Stegmüller resigned as a member of the Supervisory Board on 16 October 2012. Dr. Jörg Matthias Großmann was appointed a member of the Supervisory Board in his place by order of the *Amtsgericht* [Local Court] Ludwigshafen on 9 November 2012 and 3 December 2012. In accordance with the recommendation of the German Corporate Governance Code, the appointment is limited until the end of the next Annual General Meeting. The Supervisory Board would like to thank the retiring members for their many years of close cooperation.

The Supervisory Board would like to acknowledge and thank the Board of Management, the employees and employee representatives of all Group companies for their good work in the year under review.

Frankenthal, 25 March 2013

For the Supervisory Board

Dr. Hans-Joachim Jacob
(Chairman of the Supervisory Board)

A LOOK BACK AT 2012

01

INTEGRATION

The Chinese valve companies KSB Valves (Changzhou) Co., Ltd. and Dalian KSB AMRI Valves Co. Ltd. join the Group together with 7 other companies.

TEST PREMIÈRE

The first full-load test with feed pumps for the Fangchenggang power plant in China is conducted at the Frankenthal test bed facility for large pumps.

RELEASE FOR SALE

The MegaCPK standardised chemical pump is launched on the market. As an innovative development of three proven series, it offers greater energy efficiency and improved operating reliability.

BUILDING SERVICES

KSB AG takes over 80 percent of the shares in Danish company T. Smedegaard A/S near Copenhagen. Some 90 employees produce circulator pumps for heating and cooling systems at the main production facility and at the branch factory in Beinwil am See, Switzerland.

02

03

HIGH-EFFICIENCY MOTOR

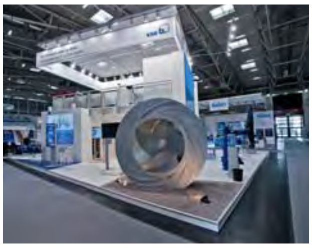
Production of the magnetless SuPremE pump drive begins at the factory in Halle. It is significantly more efficient than conventional energy-saving motors.

NEW COMPANY

KSB Vietnam Co. Ltd. commences operation in new facilities. 80 kilometres north-east of Ho-Chi-Minh City, work starts on a factory complex which will house an assembly facility for standard pumps, a valve warehouse, a service workshop and a test facility.

WASTE WATER

Visitors at the IFAT in Munich are introduced to new energy-efficient products for waste water technology and biogas applications. The highlight is an impeller with a diameter of 2.20 m, as used in specially designed waste water pumps.



SERVICE

KSB acquires the French company ST II (Société de travaux et Ingénierie Industrielle). It specialises in the maintenance and servicing of valves in nuclear power stations.

05

08

INNOVATION
A jury of trade journalists and industry experts votes the KSB SuPremE high-efficiency motor "Best Product of the Year 2012" and the winner of the "Plus X Award". The KSB drive impressed in the "Heating and air-conditioning" product group in the category "Innovation, High Quality, Functionality and Ecology".

NEW COMPANIES FOUNDED
Three new sales companies commence work in Kazakhstan, Ukraine and Belarus, further expanding KSB's sales network in Eastern Europe and Asia.

POWER STATION PUMPS
KSB supplies feed water pumps for the Dutch coal-fired power plant in Eemshaven. With a drive rating of 38 MW, they are among the most powerful units in the world.

AWARD
The MegaCPK wins the "Global Centrifugal Pumps New Product Innovation Award". (Frost & Sullivan).

POLAND
KSB expands its service offering with the new Service Centre South in Przyszowice in Poland. The team there mainly repair pumps for the energy sector.

09

10

CONTINUING EDUCATION
The first 20 graduates of KSB's internal Pump & Applications Professional continuing education programme celebrate their achievements. The distance learning course provides participants with in-depth knowledge of pump technology and the various areas of application.

INFORMATIVE VISIT
Dirk Niebel, the German Minister for Economic Cooperation and Development, visits the factory in Frankenthal. He was informed about innovative projects such as the use of pumps as turbines in developing and emerging countries.

REEL
KSB AG acquires the remaining 20 percent of shares in REEL s.r.l., Ponte di Nanto. The Italian company has been a development partner and component supplier for integrated pump drives for many years.

12

KSB SHARES

- Improved sentiment in the equity markets
- KSB shares up at year end
- Dividend planned at last year's level

In 2012, the world's leading stock exchanges performed much better than in 2011. Although the problems of sovereign debt in Europe and the US still dominated the capital markets, the mood brightened in the second half of the year.

In the euro zone, additional stabilisation measures by the European Central Bank contributed to this improvement. Buy-back programs for government bonds and clear commitments to the euro strengthened the confidence of many investors in European shares and the common currency.

In the US, the budget negotiations and the dispute over the so-called fiscal cliff unsettled market players. However, the more robust economy supported the stable upwards movement in the stock markets compared with Europe.

Finally, the measures taken by the central banks in Europe and the US ensured that there was liquidity in the capital markets, from which shares as material assets also benefited.

The stock exchanges in Europe, the US and Japan all increased against this background. The German DAX rose by 29 % in 2012, and the Euro Stoxx 50 by 14 %. The Nikkei rose by 23 %. The Dow Jones, which in contrast to the aforementioned indices had not fallen in 2011, rose by 7 %.

DAX SEES SIGNIFICANT PRICE GAINS

In 2012, the DAX more than recovered from the price drops seen in the previous year. At the end of 2012 it stood at 7612 points, up 29 % over the 2011 year-end value.

During the course of 2012, investors had to live with large price fluctuations. The increase at the beginning of the year was reversed in April due to the downgrading of the credit-worthiness of several European countries and growing economic worries. In June, the DAX reached its annual low, slightly below its initial level at the beginning of the year. The turnaround started following the decisions taken at the EU summit during the summer. The DAX grew strongly in the second half of the year, supported by stable economic growth in Germany compared with other countries.

DIVIDEND DEVELOPMENT

	2012 (proposed)	2011
Ordinary share		
Dividend	€ 12.00	€ 12.00
Dividend yield	2.6 %	2.6 %
Preference share		
Dividend	€ 12.26	€ 12.26
Dividend yield	3.0 %	3.1 %

	Ordinary share	Preference share
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. 20 %	100 %
Year-end closing price 30 Dec. 2012	€ 464.50	€ 413.55
Market capitalisation 31 Dec. 2012		€ 769.4 million

KSB SHARES GAIN IN VALUE

The KSB shares performed well in this economic environment. The closing price of the preference shares was more than 5 % higher than a year ago, and the price of the ordinary shares grew by around 3 %.

After significant price gains at the beginning of the year, the ordinary shares reached their year-high in February, and the preference shares their year-high in March. Both share classes then came under pressure as a result of declines in the stock markets, and between June and November hardly moved at all. Towards year end, the KSB shares also finally benefited from the positive market sentiment. Both share classes ended the year with overall gains.

The market capitalisation of the company at the end of 2012 was € 769.4 million, just under 4 % higher than at the previous year end.

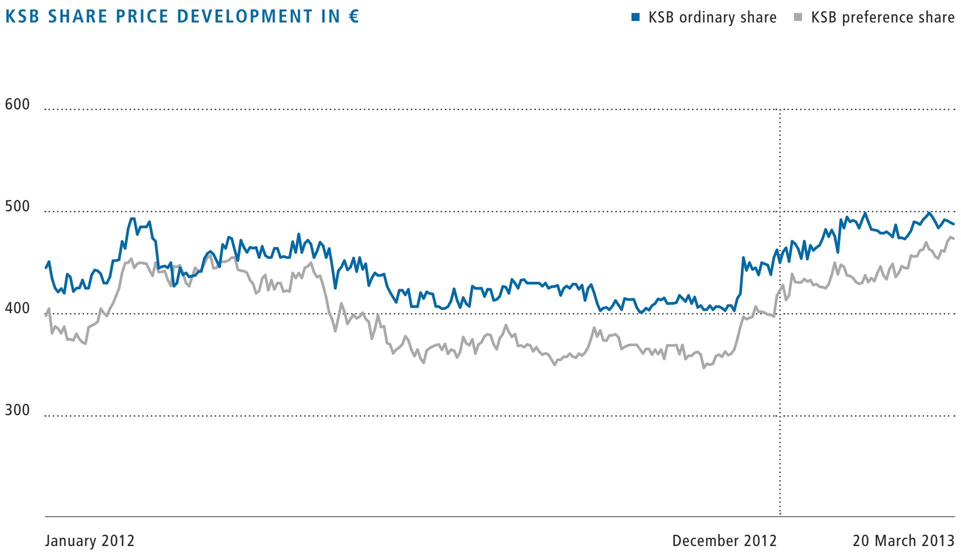
DIVIDENDS UNCHANGED

At the Annual General Meeting on 15 May 2013, the Board of Management and Supervisory Board will propose to pay an unchanged dividend of € 12.26 per preference share and € 12.00 per ordinary share.

IMPROVED EARNINGS PER SHARE

Earnings per share are higher than in the previous year due to higher consolidated earnings. They totalled € 42.51 after € 40.95 in 2011 for the ordinary shares, and € 42.77 after € 41.21 in 2011 for the preference shares.

KSB SHARE PRICE DEVELOPMENT IN €



HYDRAULICS

"How can salt be pumped from seawater?"

Wojciech Golembiewski (l.) and Andreas Wieland of the Start-up Projects team

"Reverse osmosis is the most commonly used process for producing drinking water from the sea. Our unique 4-in-1 technology revolutionises this method. With a pump, motor and energy recovery unit, the new compact system can reduce electricity costs by up to 50 percent."

Wojciech Golembiewski

Scenario: earthquake in Indonesia. In the disaster zone in the Indian Ocean, the German technical relief organisation THW needs to quickly supply the population with sufficient drinking water. This is done with the aid of a mobile seawater desalination system which is based on the principle of reverse osmosis. In this process, seawater is forced through a semi-permeable membrane to remove salt particles.

Small and medium-sized systems for producing water are also used in stationary operation in the hotel industry and in shipping. Extremely high pressure is required to separate the salt from the water. Part of the fluid flow penetrates the desalination system's membrane, while the residual pressurised concentrated brine must be removed from the membrane tank. This pressure is recovered and directly used to drive the axial piston motor – a highly economical procedure. The 4-in-1 technology of the SALINO® Pressure Center is unique on the market, combining the functions of a high-pressure pump and booster pump with an energy recovery unit and drive. Instead of two electric motors only one motor is now necessary. The new SALINO system is energy-efficient and requires only minimal space thanks to its compact design – an advantage not only for mobile use by the THW technical relief organisation in disaster zones.

Hydraulic module | **SALINO® Pressure Center**

The SALINO® Pressure Center is designed for reverse osmosis systems with a capacity of up to 480 cubic metres per day. All components are resistant to seawater and dimensioned with low life cycle costs in mind. In test runs the new compact unit used approximately two kilowatts of electricity per hour for the desalination of one cubic metre of seawater with a salt content of 35,000 ppm.

With sales revenue up € 177.2 million, the KSB Group achieved a new record of € 2,268.2 million.

GROUP MANAGEMENT REPORT

24 Group Structure and Focus of Business
26 Economic Environment
29 Business Development and Events
33 Net Assets, Financial Position and Results of Operations
40 Research and Development
42 Employees
44 Corporate Social Responsibility
47 Risk Management
51 Report on Expected Developments

GROUP STRUCTURE AND FOCUS OF BUSINESS

- 13 newly consolidated companies
- 74 operating companies work in 36 countries
- KSB AG Board of Management manages the Group

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

In the year under review, 74 operating companies in 36 countries were dedicated to achieving this mission. Eight Group companies exercised a holding company function.

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

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

ORGANISATION, MANAGEMENT AND CONTROL

KSB AG's Board of Management manages and controls the KSB Group. The strategy and instructions formulated by the Board of Management are implemented within an organisation that is structured into three areas of responsibility: pumps, valves and service. At the centre of this organisation are the Business Units with their areas of focus, which act as interfaces between Sales and Operations.

All organisational units base their activities on the Group strategy. It aims to ensure sustainable, profitable growth that will secure both KSB's future and financial independence in the medium and long term, in order to achieve and defend a leading competitive position in attractive markets.

Management is monitored by a Supervisory Board consisting of twelve members. The Annual General Meeting of shareholders appoints six members of the Supervisory Board, with the remaining six being delegated by the employees under the terms of the *Mitbestimmungsgesetz* [German Co-determination Act].

MARKETS AND LOCATIONS

Within the KSB Group, centrifugal pumps account for approximately 70 % of sales revenue. These pumps, as well as valves, are sold to engineering contractors, OEMs and end users or, in some cases, distributed via dealers. The same applies to control and monitoring systems, and to package units with pumps and valves.

The best developed sales market for these products is Europe, where KSB operates its main manufacturing facilities in Germany and France. KSB AG's main plant in Frankenthal is its largest in Europe, ahead of those in Pegnitz (Bavaria) and Halle (Saxony-Anhalt) in Germany, and La Roche-Chalais in France.

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

KSB manufactures products and components in a total of 22 countries; they are sold through the Group's own companies or agencies in more than 100 countries. With their products, the Group companies serve customers in the manufacturing sector (industry), the chemical and petrochemical industries, the energy industry and building services, transport equipment manufacturers and operators (e.g. ships, rail vehicles), water supply and waste water utilities and mining companies. The top-selling markets for our products in 2012 were the manufacturing and energy supply sectors.

In terms of sales revenue, the KSB Group is one of the world's leading suppliers of centrifugal pumps, and ranks among the world's top-ten valve manufacturers. We succeed in maintaining this market position through our good, long-term relationships with our customers and suppliers. Our highly trained and motivated employees as well as the high quality of our products have also helped cement our reputation.

MANAGEMENT PARAMETERS WITHIN THE KSB GROUP

The current target variables for managing the Group are the development of order intake and sales revenue as well as profitability, which we primarily measure on the basis of pre-tax return on sales.

When setting our targets, we are guided on the one hand by developments in the market, and on the other by the performance of our key competitors.

DISCLOSURES PURSUANT TO SECTION 315 (4) OF THE HGB AND EXPLANATORY REPORT

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

KSB AG's share capital amounts to € 44.8 million, of which € 22.7 million is represented by 886,615 no-par value ordinary shares and € 22.1 million by 864,712 no-par value preference shares. Each no-par value share represents an equal notional amount of the share capital. All shares are bearer shares. They are listed for trading on the regulated market and are traded in the General Standard segment of the Frankfurt Stock Exchange.

Each ordinary share entitles the holder to one vote at KSB AG's Annual General Meeting. Klein Pumpen GmbH, Frankenthal, holds approximately 80 % of the ordinary shares; the *KSB Stiftung* [KSB Foundation], Stuttgart, holds the majority of the shares of Klein Pumpen GmbH. The preference shares carry separate cumulative preferred dividend rights and progressive additional dividend rights. Detailed information on the share capital and shareholders holding an interest of more than 10 % is provided in the Notes. Holders of preference shares are entitled to voting rights only in the cases prescribed by law. The issue of additional ordinary shares does not require the consent of the preference shareholders. Similarly, the issue of additional preference shares does not require the consent of the preference shareholders provided that the subscription rights do not exclude newly issued senior or pari passu preference shares.

The company is authorised by a resolution passed at the Annual General Meeting on 19 May 2010 to purchase company shares totalling up to € 4,477,196 of the registered share capital by 18 May 2015. The Board of Management shall be entitled to: (1) Sell company shares purchased on the basis of this authorisation either on the stock exchange or by another means that safeguards the rule of equal treatment of all shareholders; (2) Sell the shares with the consent of the Supervisory Board, excluding shareholders' subscription rights, if the shares are sold for cash and at a price that is not materially lower than the market price for company shares of the same type and with the same features at the time of the sale. This authorisation is limited to the sale of shares which overall represent no more than 10 % of the existing share capital on the date on which such authorisation becomes effective or, if the amount is lower, the date this authorisation is used. The 10 % limit shall include the proportional amount for shares issued within the scope of a capital increase during the term of the authorisation excluding subscription rights or for the maximum number of shares that can be issued for the purpose of servicing warrants and convertible bonds; (3) Sell the shares with the consent of the Supervisory Board, excluding shareholders' subscription rights, to third parties for the purpose of acquiring companies, parts thereof and/or financial interests in companies as well as within the scope of corporate mergers or (4) Redeem the shares. KSB AG has not yet made use of this authorisation to purchase treasury shares.

There are no resolutions by the Annual General Meeting authorising the company's Board of Management to increase the share capital (authorised capital).

KSB AG is managed by a Board of Management that, in accordance with its Articles of Association, must consist of at least two persons and in the year under review initially comprised four persons, and from 1 April three persons. The Supervisory Board decides on the appointment and termination of the mandate of members of the Board of Management in accordance with the statutory provisions.

Amendments to the company's Articles of Association are resolved by the Annual General Meeting. If the amendments only affect the wording of the Articles, they can be approved by the Supervisory Board.

ECONOMIC ENVIRONMENT

- Energy sector is reluctant to invest
- Weakening economic momentum in China and India
- Lower growth in mechanical engineering

In 2012, after a positive start, the global economy grew only moderately. Global growth was held back by the problems of the euro zone, which lowered the confidence of many investors in a healthy economic development. Growth also slowed in emerging countries such as China, Brazil and India, not least because of the spillover effects of the European debt crisis. The world's largest economy, the US economy, grew only slightly, with political factors playing a role in this.

SLOWER GROWTH IN INDUSTRIAL AND EMERGING ECONOMIES

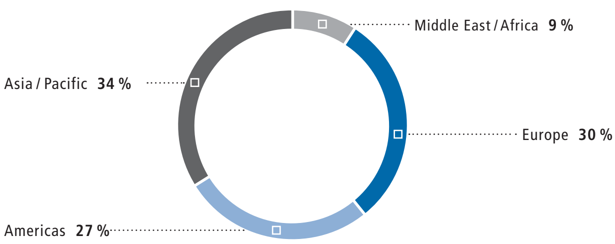
In the euro zone, which is especially important for KSB's business, production declined despite the German economy remaining buoyant. The individual countries were affected in different ways. The necessary consolidation slowed down public sector procurement, especially in southern Europe. Given the uncertainty over the future of the euro zone and its individual members, private companies too were reluctant to invest in new plants and buildings.

The bright spots in Europe were the positive economic trends in Germany, Austria and Switzerland as well as in Sweden and Norway. In Russia, economic growth was slightly above the global average. The expansion in energy supply, investment in the chemicals and petrochemicals industries, as well as measures in the water and waste water industry boosted demand for industrial goods. Across Europe, however, the number of new major projects was lower than in 2011.

In the Middle East, buoyant oil revenues meant that countries had the financial resources to expand their infrastructure and build new residential complexes for their growing populations. Many investors, however, put their plans on hold due to the political tensions in the region. The markets in Saudi Arabia and Qatar nonetheless grew strongly. In Africa, several countries south of the Sahara also recorded positive economic growth.

Weak demand from the industrialised countries of Europe and the US also affected the export-oriented economies of Asia. This was particularly evident in the weakening economic momentum in China. At times, the restrictive monetary policies implemented to fight inflation also slowed growth in the country. Japan's export-dependent economy continued to suffer deflation with falling prices and a strong yen. The South Korean economy too grew only moderately despite considerable demand from the Middle East and Africa.

WORLD MARKET OF CENTRIFUGAL PUMPS AND VALVES



Source: DIW Berlin

India's economy was hampered by high interest rates, domestic problems and inadequate infrastructure. Projects in the construction sector were delayed, and production volumes of capital goods fell sharply.

The economic growth enjoyed by several South-East Asian countries was encouraging and driven mainly by domestic demand. These countries included Indonesia and Thailand, as well as Myanmar, where the growth resulted from the altered political situation. Indonesia, with its mineral and coal deposits, has benefited from the boom in the mining industry, as has Australia.

High-performance components: Sewatec® volute casing pumps and Isoria® butterfly valves used in a bioethanol plant.

In the Americas, the world's largest economy, the US economy, managed only slight growth. The expiry of stimulus measures at the end of the year and the prospect of spending cuts in the public sector dampened the optimism of many investors. Declining gas prices had a positive effect on energy-intensive industries in the country, however. Overall, there was only a slight increase in equipment investment. In Canada the price of crude oil allowed continued investment in the oil sands industry.

The South American markets overall recorded only moderate growth, largely as a result of the significant slowdown in the Brazilian economy. The construction of new refineries in Brazil and the continued growth of the mining sector in Chile both offered opportunities for orders.

LOWER GROWTH IN MECHANICAL ENGINEERING

The mechanical engineering sector continued to grow, albeit at a much lower rate. Worldwide the sales revenue of companies in this sector rose by around 3 %; in the previous year, the growth rate had been in double digits.

In 2012, the production growth rate in China too for the first time in several years fell below 10 percent, while the sales revenue of Japanese mechanical engineering companies actually fell. In the US, mechanical engineering business grew slightly thanks to sales for the continuing re-industrialisation process.

In international comparison, the German mechanical engineering sector performed well. According to the German Engineering Federation (VDMA) it achieved a production value of around € 196 billion and an estimated growth rate of 2 %, matching the record level of 2008. More than 25 % of the mechanical engineering exports went to China, the US and Russia.

LOWER GROWTH IN THE PUMP AND VALVE MARKET

In the pump and valve market, the opportunities in the general and project business varied widely. Demand for standard products in the construction and general industries remained lively, especially in the first half of the year. On the other hand, the lower number of major projects dampened sales of engineered pumps and valves in particular. This was especially true for the energy industry, which planned and constructed very few new power generation plants last year. As a result of generally lower spending, the price war which started last year in relation to power plant pumps and valves continued.

Some special application areas offered good sales prospects. These included new petroleum production and processing plants, as well as loading facilities and tankers for transporting liquefied natural gas to consumers. Due to the high demand for energy and other commodities, capital goods for mining were also in demand, as were pumps for the hydraulic transport of solids. Demand from energy companies for goods to modernise their district heating systems and improve energy use also grew encouragingly.

Against this background, reputable pump and valve manufacturers were largely able to maintain their growth. According to the VDMA, sales of liquid pumps by German companies rose by 3 %, and of industrial valves by just 1 %.

MANUFACTURERS CONTINUE TO ADVANCE INTO THE EMERGING COUNTRIES

The weakness of the European market led the pump and valve manufacturers that are based here to focus even more strongly on non-European countries. Accordingly, the competition in the markets of Asia, Latin America and the Middle East increased. Several companies set up new production facilities for pumps or valves in the regions.

Various pump manufacturers also began to streamline their product portfolio to focus on a narrower range of applications and therefore sold off individual business units. At the same time they tried to consolidate activities in their chosen focus areas through acquisitions. This was especially true of the companies that crowded into the oil and gas market.

The consolidation trend continued in the pump and valve industry. However, the number of valve suppliers is still significantly higher than the number of pump suppliers. Especially for many small- and medium-sized valve suppliers, being too small is increasingly becoming a competitive disadvantage, as more and more customers require products to be supplied close to where they are used.

Companies that produce significant volumes of both pumps and valves are still the exception. In 2012 however, following a merger, a third large company offering both product groups and a wide portfolio emerged in the market alongside KSB and a US manufacturer.

BUSINESS DEVELOPMENT AND EVENTS

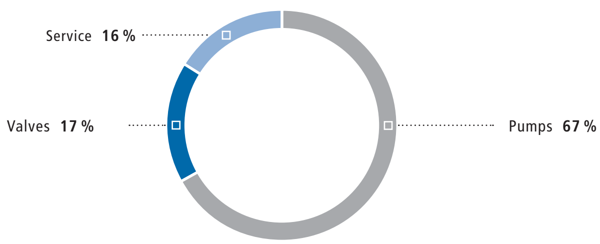
- Order intake growth for pumps, valves and service
- Consolidated sales revenue increases by € 177.2 million
- Realignment initiated in the service market

Our business with pumps, valves and service was characterised on the one hand by regional differences in the development of key sales markets, and on the other by the implementation of strategic projects. Our increased activities in the valves market and in mining, and the intensification of our business with standard pumps had a positive effect on order intake and sales revenue. In the project business, the reluctance of energy companies to invest once again limited new business with pumps and valves for power plants.

HIGHER ORDER INTAKE IN ALL THREE BUSINESS UNITS

Purchase orders received by the Group for our products and services totalled € 2,257.4 million, € 125.1 million or 5.9 % up from the previous year. The volume of new orders increased in all three Business Units – Pumps, Valves and Service. The 13 newly consolidated companies contributed € 44.4 million to this increase.

SALES REVENUE BY SEGMENT



For our main product, pumps, order intake rose by 3.1 % to € 1,490.9 million, with orders for single-stage pumps and for automation products and drives growing strongly. Order intake for multistage pumps, used in power plants, for example, was more subdued. The high pressure on prices in the project business meant that new orders had to be selected with greater emphasis on profitability and returns.

Incoming orders for valves increased by 8.9 % to € 392.0 million. Like last year, marine valve sales drove the increase, as did increased orders from the chemical, petrochemical and water industries. In the power plant sector, sales of high-pressure valves proved as difficult as those of pumps.

The nominally strongest growth was recorded in service, with an order intake of € 374.5 million, 14.6 % higher than in the previous year. The first-time consolidation of seven European service companies contributed in particular to this increase; there was also higher demand for our services from customers outside Europe.

DOUBLE-DIGIT ORDER GROWTH OUTSIDE EUROPE

In our European home market, the-year-on-year increase in order intake was only moderate. Our Group companies received orders worth € 1,345.1 million, 2.7 % up from the previous year. The order intake of the European companies in the Region varied considerably. The strongest growth was recorded by the French company KSB S.A.S., driven by strong exports, and by the Russian company OOO “KSB”. Despite the difficult market conditions in Southern Europe, our three Spanish companies, as well as our Italian sales company all managed to increase their order intake. KSB AG, in contrast, with its relatively high share of power plant business, saw orders decline by 2.1 % to € 801.5 million.

The four operative companies in the Region Middle East/Africa improved their order intake by 12.0 % to € 118.3 million. Higher levels of orders received came especially from the water and waste water industry, the African mining industry and the construction industry in the Middle East.

In the Region Asia/Pacific, the order intake of our local Group companies grew by 11.1 %. This increase to € 398.9 million resulted from the increased order levels recorded by our Chinese companies, the growing business in South-East Asia and the growth of our two South Korean subsidiaries. The two Indian Group companies suffered from weak overall economic growth and the postponement of investment in key customer industries, in particular the energy sector.

Order growth in the Region Americas was primarily attributable to the strong demand in mining. The main beneficiary was our US subsidiary, GIW Industries, Inc., which manufactures pumps for hydraulic solids transport, and our company in Chile. Overall, the American Group companies improved their order intake by 10.5 % to € 395.1 million.

CONSOLIDATED SALES REVENUE INCREASES BY 8.5 %

The sales revenue generated by our Group companies, as anticipated, grew faster than order intake and reached € 2,268.2 million. New business and longer-term project orders billed during the year under review contributed to the increase of € 177.2 million, corresponding to a growth rate of 8.5 %. In addition, the newly consolidated companies added € 44.4 million to overall sales revenue.

Pump sales generated € 1,517.1 million – an increase of 7.7 %. Sales revenue increases were recorded for single- and multistage pumps, submersible pumps, as well as for automation products and drives.

In 2012, the strongest growth in percentage terms was in valve sales, which rose by 14.9 % to € 385.6 million. Significant contributions came from the valves business in Asia, which we strengthened in 2011 by opening a plant in China and acquiring a company in South Korea.

New KSB location: cutting-edge circulator pumps from the Calio range are produced at Smedegaard's factory in Beinwil am See.

The sales revenue we generate with service activities increased in 2012 by 14.0 % to € 368.2 million, thanks to the sales revenue contributed by the newly consolidated service companies and the increased service business outside Europe.

HIGHER SALES REVENUE IN ALL REGIONS

Like in the previous year, consolidated sales revenue increased in all four Regions. In 2012, the Group companies in Europe generated sales revenue of € 1.369,3 million, which was an increase of 4.2 % over the previous year. The strong growth in sales revenue achieved by our French subsidiary KSB S.A.S., especially in the valves business, was outstanding. KSB AG increased its sales revenue by 2.1 % to € 828.2 million, with the billing of several power plant contracts with longer terms contributing significantly to this.

In the Region Middle East / Africa, local Group companies improved their sales revenue by 14.4 % to € 112.7 million, primarily thanks to the significant increase in business recorded by our companies in South Africa and Pakistan.

The highest percentage increase in sales revenue at 19.2 % was posted by the companies in the Region Asia / Pacific, which achieved total sales revenue of € 408.6 million. KSB Shanghai Pump Co. Ltd. and KSB Australia Pty. Ltd. were the main contributors to this increase.

The American subsidiaries increased their sales revenue volume by 12.6 % to € 377.6 million, mainly driven by the business development in the United States and Chile.

ADDITIONAL STEPS IN THE IMPLEMENTATION OF THE GROUP STRATEGY

To ensure that our corporate strategy is successful, we have been implementing a large number of individual projects since the beginning of 2010. During the year under review, these contributed significantly to order intake and sales revenue growth.

At the same time we continued to develop our strategy in some areas, and initiated new measures in order to implement it. In 2012 this applied to three areas in particular: our service and spare parts business, our products and services for the mining industry and our general business with standard pumps and valves.

PUSHING THE SERVICE AND SPARE PARTS BUSINESS

In the year under review we placed a new focus on the so-called aftermarket business, which we plan to strengthen throughout the Group. It perpetuates sales revenue from our customers through consultancy and maintenance contracts, spare parts deliveries, involvement in conversions and performance adjustments. Our strategic goal is to significantly increase the share of this business in our overall sales revenue by 2018.

This requires that we continue to open and expand own service centres as well as provide more intensive post-purchase support to our customers. To achieve the above objective, we will substantially increase the number of our customer contacts and implement further structural measures.

LEVERAGING OPPORTUNITIES IN MINING

For the trouble-free hydraulic transport of solids, our customers in the mining regions need us to provide local support, including spare part stocks and repair and replacement services. For this reason, we set up additional service centres in Australia, Chile, Indonesia and South Africa in the year under review.

These centres also help sell our slurry pumps and the pumps used in the processing cycle for the newly extracted materials. We are seeking to improve the competitiveness of our product range for the mining industry even further by implementing a series of strategic measures.

EXPANSION OF OUR GENERAL BUSINESS

In 2012, due to the difficult market situation in the project business we focused in particular on expanding the general business with standard pumps and valves. We succeeded in increasing the volume of incoming orders in selected countries.

To strengthen the business, we, among other things, expanded our distribution network in Brazil, increased the size of our sales team in Russia, and trained consultants and users of our products in several European countries.

With the acquisition of 80 % of the shares of T. Smedegaard A/S (Smedegaard Group) in February 2012, we also rounded off our range of building services products. The company manufactures circulators for heating and cooling systems in residential, commercial and industrial buildings at its base in Glostrup (Copenhagen) and in Beinwil am See in Switzerland.

CONTINUED EXPANSION IN THE BRIC COUNTRIES

Despite the economic slowdown in several emerging markets, we believe that the prospects of the so-called BRIC countries are still promising. Therefore, in the year under review we opened new facilities in Brazil, Russia and China to manufacture and test our products locally.

In China, where our new valve plant in Changzhou started operations in 2011, the focus of our investment activities was on the development of a test facility for power plant pumps. This is being built at the site of our joint venture in Lingang near Shanghai and will go into operation during the course of the year.

A new plant for standard products was established in Jundiaí in Brazil in 2012. It will initially produce valves and will officially open in April of this year.

In 2012, Russia was the fastest growing market for us in Europe. To make best possible use of the opportunities there, we increased the number of our sales offices from eight to ten. We now also serve our customers from Nizhny Novgorod and Kazan in the Volga region. In addition, our Russian company founded three subsidiaries in the neighbouring states of Kazakhstan, Ukraine and Belarus.

PRODUCTION START IN GERMANY AND INDIA

In the year under review, two innovative products – the MegaCPK standardised chemical pump and the SuPremE high-efficiency motor – went into production and have attracted a lot of interest in the market. They have won several awards and were also the centre of attention at ACHEMA, the world's largest trade fair for the process industry in Frankfurt.

Before starting production of the MegaCPK in Pegnitz and Nashik (India), we thoroughly trained our sales staff so that they are able to provide knowledgeable advice to our customers on the use of the pump.

The new energy-efficient SuPremE magnetless motor is manufactured by our factory in Halle, which also produces submersible motors for waste water pumps.

NET ASSETS, FINANCIAL POSITION AND RESULTS OF OPERATIONS

- Increase in consolidated earnings (EBT) to € 133 million
- Continued solid equity ratio
- Cash flows from operating activities significantly increased

The trend in order intake and sales revenue basically confirmed the forecasts we made in the previous year's report. We also almost reached our earnings target.

RESULTS OF OPERATIONS

Earnings before taxes

The KSB Group generated earnings before taxes of € 132.8 million, compared with € 120.5 million in 2011. We thus achieved a return on sales of 5.9 % (previous year: 5.8 %).

Increase in output of operations

Total sales revenue increased by 8.5 % thanks to improved business development. Work in progress and inventories of finished goods totalled € 23.9 million, € 35.1 million lower than in the previous year. Thus, total output of operations grew more slowly than sales revenue, totalling € 2,293.8 million, or 6.6 % above the 2011 figure (€ 2,151.4 million).

Change in cost structure

Other income rose from € 33.4 million to € 44.3 million. This was primarily attributable to higher income from current assets.

The cost of materials increased by 7.9 % due to factors such as rising purchase prices. We were unable to pass these on fully to our customers due to the continuing pressure on prices. As a percentage of total output of operations, the cost of materials (€ 985.2 million) increased from 42.4 % in the previous year to 42.9 % in the year under review.

Staff costs rose by 8.6 % to € 758.2 million in absolute terms. In relation to total output of operations, this meant an increase of 0.7 percentage points. Reasons for the increase included collectively agreed salary increases and the higher number of employees, especially following the first-time consolidations. But we have also increased staff numbers at our companies in Chile and the US in response to positive business development. The KSB Group employed on average 710 more people than in the previous year. Compared with the previous financial year, average output per employee improved from € 139 thousand to € 141 thousand.

The ratio of other expenses to total output of operations declined from 17.8 % to 16.5 %. In absolute terms, they have changed little, and now total € 377.7 million compared with € 383.9 million in the previous year.

Financial income / expense changed by € – 4.4 million overall. This primarily reflects lower interest income due to declining investment interest rates. This contrasted with lower depreciation / amortisation of financial assets.

Earnings after taxes

The income tax rate increased by 1.1 percentage points, up from 30.9 % in 2011 to 32.0 %. Earnings after taxes at € 90.3 million (previous year: € 83.3 million) have therefore increased less markedly (8.4 %) than earnings before taxes (10.3 %).

Earnings attributable to non-controlling interest increased from € 11.3 million to € 15.6 million, primarily due to the improved results of operations of our companies in India and the US. They also increased relative to earnings after taxes (17.3 % compared with 13.6 % in the previous year).

At € 74.7 million, earnings attributable to shareholders of KSG AG were thus € 2.7 million higher than in the previous year (€ 72.0 million).

Earnings per share

Earnings per ordinary share were € 42.51, compared with € 40.95 in the previous year, and € 42.77 per preference share, compared with € 41.21 in 2011.

Profit situation at parent company KSB AG

KSB AG generated pre-tax earnings (under *HGB*) of € 38.0 million, around € 1.5 million more than the prior-year figure (€ 36.5 million). Taking into account the taxes to be paid, the net profit for the year amounted to € 31.1 million after € 29.4 million in 2011. Sales revenue increased by 2.1 %. Due to significantly lower inventory changes, total output of operations decreased by 0.5 %. Strong price pressure and higher costs, especially material costs, also weighed down on earnings in the parent's annual financial statements as in the consolidated financial statements.

Stable dividend
With earnings after taxes almost unchanged compared with the previous year, we will propose to the Annual General Meeting on 15 May 2013 the distribution of a dividend of € 12.00 per ordinary share and € 12.26 per preference share (including a preference dividend right of € 0.26), as in the previous year.

Segment results
In line with our management and reporting structures, our segment reporting format is by business unit.

In the Business Unit Pumps, sales revenue was 7.7 % higher than in the previous year. From this we generated EBIT of € 91.3 million (versus € 81.9 million in 2011).

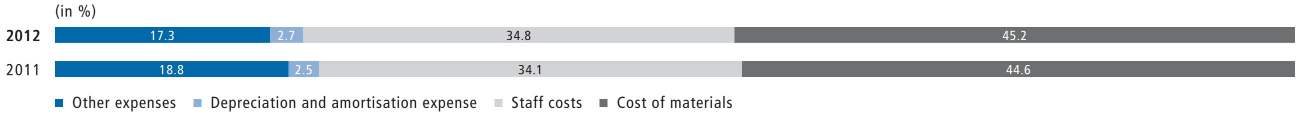
The Business Unit Valves posted an increase in sales revenue of 14.9 %. EBIT, at € 8.8 million, was well above the figure for the previous financial year of € 2.5 million.

The Business Unit Service too posted strong growth, with sales revenue up 14.0 %. EBIT grew from € 42.8 million to € 50.7 million.

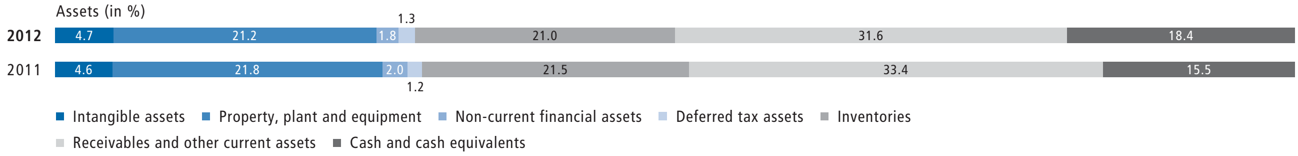
FINANCIAL POSITION

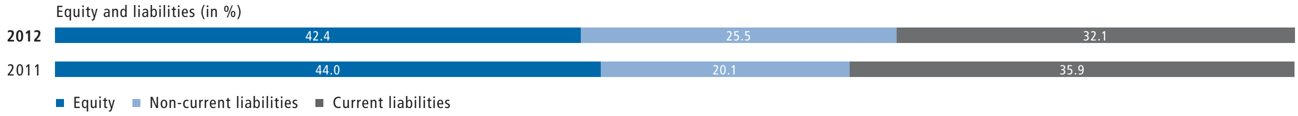
Principles and objectives of financial management
Central financial management in the KSB Group performs its duties within the framework of the guidelines laid down by the Board of Management. We base the nature and scope of all financial transactions exclusively on the requirements of our business. The aim is to ensure liquidity at all times and to finance our activities at optimum conditions. With respect to our export business, we hedge foreign exchange and credit risks to the greatest extent possible. We continuously improve our receivables management methods with the goal of settling our outstanding amounts by their due dates.

COST STRUCTURE IN INCOME STATEMENT



BALANCE SHEET STRUCTURE





Hedging financial risks
Our primary tool for minimising the foreign exchange risks inherent in our export business are currency forwards. This applies both to transactions already recognised and to future cash flows from orders on hand that are still being processed. We transact most of our foreign currency business in US dollars. There is only a relatively low level of foreign currency liabilities.

We regularly monitor the interest rate risks associated with our financing activities. To avoid the negative effects of interest rate fluctuations on the international capital markets, we conclude interest rate hedges (interest rate swaps) where necessary. These are used exclusively to hedge variable-rate loans against rising interest rates.

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

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

By agreeing sufficient credit lines with our banks, we can always respond to fluctuating liquidity needs. In support of this, we use rolling monthly cash flow planning. In selected countries we also rely on cash pooling structures that allow optimised use of the available resources within the Group. In order to be able to provide the necessary collateral in the project business, corresponding guarantee volumes are made available. Adequate proportions are confirmed for a period of more than one year. Our credit and guarantee lines total around € 973 million (previous year: around € 959 million).

Equity
The KSB Group's equity amounts to € 923,0 million (previous year: € 869.1 million). This includes KSB AG's subscribed capital of € 44.8 million as in the previous year. The capital reserve remains unchanged at € 66.7 million. Revenue reserves total € 685.7 million (previous year: € 642.0 million), including the proportion of earnings after taxes attributable to shareholders of KSB AG of € 74.7 million (previous year: € 72.0 million). € 125.8 million (previous year: € 115.6 million) is attributable to non-controlling interest. Due to the significant € 202.8 million (10.3 %) rise in total equity and liabilities, the equity ratio declined slightly (42.4 %; previous year: 44.0 %).

Non-controlling interest mainly relates to the following companies: KSB Pumps Limited, India (€ 39.1 million), PAB GmbH, Germany (€ 18.1 million), KSB America Corporation, USA (€ 14.2 million), GIW Industries, Inc., USA (€ 13.7 million) and KSB Shanghai Pump Co. Ltd., China (€ 12.1 million).

Liabilities
The largest item under liabilities continues to be provisions for employee benefits, including, also as the largest item, pension provisions. These were increased by 5.1 % to € 270.9 million as at the reporting date. A large number of the pension plans currently in use in the KSB Group are defined benefit models. We will be reducing the associated risks, such as demographic changes, inflation and salary increases, for example by introducing defined contribution plans for new employees.

Our obligations for current pensioners and vested benefits of employees who have left the company account for just over half of the amount recognised in the balance sheet. The rest relates to defined benefit obligations for our current employees, who have an average remaining period of service of around 15 years.

The remaining provisions for employee benefits, which, in contrast to pension provisions, are predominantly current, fell slightly from € 133.6 million to € 127.1 million.

Other provisions are virtually unchanged year on year. They include non-current components of € 16.2 million (previous year: € 16.9 million) for warranty obligations. The excess relates to provisions for mainly current uncertain liabilities.

Non-current liabilities increased significantly from € 61.7 million to € 208.0 million. Thus the share of non-current liabilities in total capital also increased from 3.1 % to 9.6 %. Due to the favourable capital market conditions, in December 2012 we took out a new loan against borrower's note in the amount of € 175 million. It is divided into repayment tranches of 3 to 10 years. At year-end, the remaining commitments from the loan against borrower's note placed in 2009 stood at € 6 million. During the year, this total was reduced by € 44 million through early redemption.

Current liabilities remain virtually unchanged (€ 505.0 million compared with € 509.5 million at year end 2011). Financial liabilities decreased by € 12.3 million. Here too the early redemption of the 2009 loan against borrower's note has had an impact; we repaid € 12.5 million before actual maturity. In contrast, other liabilities rose from € 235.7 million to € 245.8 million. Trade payables decreased by € 2.3 million to € 204.0 million. Taking into account the increase in total equity and liabilities, the share of current liabilities in total equity decreased to 23.2 % (previous year 25.8 %).

Contingencies and commitments
The KSB Group's off-balance sheet contingent liabilities totalled € 14.1 million as at the reporting date (previous year: € 10.9 million). These arise mainly from collateral and performance guarantees.

There are no other extraordinary obligations and commitments beyond the reporting date. Other obligations and commitments fall within the scope of what is needed to continue business operations, such as obligations from long-term rental, lease and services agreements (in particular information technology and telecommunications) and from purchase commitments.

Liquidity
The KSB Group's net financial position, i.e. the difference between interest-bearing financial assets on the one hand and financial liabilities on the other, declined from € 187.0 million to € 141.2 million. Contributing factors were increased spending on financial assets and the funds provided to finance working capital following the increase in business volume.

Sources and application of funds
Cash flows from operating activities amounted to € 94.1 million, a year-on-year increase of € 57.8 million. As well as improved earnings and increased depreciation / amortisation, significantly lower amounts tied up in inventories and receivables had a positive impact on cash flows. This contrasted with less funds released from liabilities.

In the year under review, we expanded our investment activities, primarily in property, plant and equipment. In contrast, we spent less on the acquisition of consolidated companies. Accordingly, cash flows were virtually unchanged at € – 99.4 million (previous year € – 102.7 million).

Cash flows from financing activities changed from € – 35.9 million to € + 102.9 million due to the new loan against borrower's note that was taken out. This increase was countered by the early redemption of large portions of the loan against borrower's note from 2009. In the previous year, we repaid more bank loans than we took out.

The KSB Group's cash and cash equivalents from all cash flows together increased from € 305.7 million to € 401.0 million (including € 14.8 million of cash used to secure credit balances for partial retirement obligations, which is available for immediate use at any time, after € 16.6 million the previous year), although this includes changes in exchange rates.

We assume that, in future, we will continue to be able to meet our outgoing payments largely from operating cash flow. From today's perspective, we are therefore not planning any additional external financing measures.

NET ASSETS

Our total assets rose by 10.3 % to € 2,177.0 million. The main reason for this was an increase in cash and cash equivalents due to the liquidity increase following the placement of the new loan against borrower's note. Increased non-current assets, higher inventories and an increase in receivables and other assets also contributed to this change.

Around 28 % is attributable to fixed assets, as in the previous year.

Intangible assets and property, plant and equipment with a historical cost of € 1,160.7 million (previous year: € 1,076.7 million) have carrying amounts of € 563.2 million (previous year: € 520.5 million). Above all the acquisition of the Danish Smedegaard Group and the first-time consolidations of older KSB companies in the year under review resulted in goodwill increasing by € 9.0 million.

Investments in property, plant and equipment amounted to € 81.5 million, above the prior-year figure of € 62.3 million and depreciation (€ 52.1 million after € 45.7 million in 2011). The highest additions at € 23.1 million (previous year: € 15.4 million) relate to technical equipment and machinery. The focus of our investment activities remained the Region Europe, predominantly Germany and France. Outside Europe, the highest additions were again made at our plants in Brazil, China, India and the USA. We maintained our policies for measuring depreciation and amortisation in the year under review.

The investments in financial assets amounting to € 9.8 million related primarily to an additional cash capital increase with our local partner in a company in China where we hold a non-controlling interest and the acquisition of a small service unit in France. Taking into account the opposing effects of the first-time consolidation, the carrying amount of financial assets fell by € 1.3 million to € 38.8 million.

Due to the increased business volume, also reflected in the higher total output of operations, inventories increased by 7.6 % to € 457.2 million. They tied up around 21 % of our resources (previous year: just over 22 %).

As a result of the increased sales revenue, trade receivables were € 20.6 million above the figure at the end of the previous year. The value of customer orders in progress, measured according to the percentage-of-completion method, increased by € 8.6 million, mainly due to declining customer advances for in-process customer orders. As a result, receivables and other current assets made up around 32 % of total assets (previous year: around 33 %), taking into account the change in total assets.

Cash and cash equivalents account for around 18 % of assets (previous year: approx 16 %). The cash inflow associated with the placement of the new loan against borrower's note is reflected here. An even stronger increase was countered by the early redemption of a significant part of the loan against borrower's note, expenditure on non-current assets and the provision of funds to finance working capital following the increase in business volume.

Inflation and exchange rate effects

There were no consolidated companies within the Group whose financial statements were required to be adjusted for the effects of inflation.

The translation of financial statements of consolidated companies that are not prepared in euro gave rise to a difference of € – 13.9 million (previous year: € – 15.2 million). This was taken directly to equity.

SUMMARY OF THE ECONOMIC SITUATION OF THE GROUP

At the end of 2012, the economic situation of the KSB Group was stable at a high level. We consider this a good basis for achieving continued success in the coming years.

REMUNERATION OF THE BOARD OF MANAGEMENT (REMUNERATION REPORT)

The Remuneration Report summarises the principles applied when determining the remuneration arrangements for the Board of Management of KSB Aktiengesellschaft. It is prepared in accordance with the recommendations of the German Corporate Governance Code (item 4.2.5) and explains the remuneration system in place for Board of Management members. This system is geared towards sustainable corporate development. It is adopted by the Supervisory Board plenary session based on the recommendation of the Personnel Committee and reviewed at regular intervals. The same applies to individual Board of Management compensation amounts.

The remuneration arrangements for the Board of Management are structured as clearly and transparently as possible. The total amount of remuneration for the individual Board of Management members is determined based on various parameters. Criteria for assessing the appropriateness of the remuneration include the responsibilities of the individual Board of Management members, their personal performance, the economic situation, the company's performance and prospects as well as customary remuneration amounts when taking peer companies and the remuneration structure used elsewhere within the company into consideration.

The remuneration of the Board of Management consists of fixed and variable components. Fixed components are granted regardless of performance and consist of a fixed sum plus benefits, as well as pension commitments (retirement, disability, widow's or orphan's pension). The fixed sum makes up 60 % of the maximum annual salary and is paid out as a monthly basic remuneration. All Board of Management members are equally entitled to the accompanying fringe benefits which include the private use of a company car, payment of insurance premiums and any payments associated with a post-contractual non-competition clause. No loans or advance payments were granted to members of the Board of Management in the year under review.

To ensure the sustainability of the nature of the remuneration, the variable remuneration component consists mainly of components determined on the basis of a multi-year assessment. They are partly based (60 %) on the degree of implementation of the corporate strategy and its actual market success, and partly (20 %) on the return on investment measured according to the "economic value added" method based on a past average value over a medium-term horizon. The remaining short-term share (20 %) is based on the development of the net financial position in the respective financial year as compared with the planned development. The total amount of the variable remuneration components is limited in order to take extraordinary, unforeseen developments into account.

The weighting factors above do not reflect the additional possibility of a bonus, to be paid out in individual cases at the discretion of the Supervisory Board, of no more than three monthly salary payments per financial year in recognition of any special performance of individual members of the Board of Management. Such decisions are only made on an irregular basis, meaning that they do not necessarily have to be made annually.

Furthermore, when Board of Management contracts are concluded it is agreed that payments made to a Board of Management member in the event of his or her Board of Management tenure being terminated prematurely without good reason shall not exceed the value of two years' remuneration including fringe benefits (settlement cap in accordance with item 4.2.3 of the German Corporate Governance Code). No other payments have been promised to any Board of Management members in the event of termination of service; similarly no compensation will be paid in the event of a takeover offer. If the employment contract is terminated for good reason for which the Board of Management Member is responsible, the company shall not make any severance payments.

On 19 May 2010 – using a legally permissible option – the Annual General Meeting again resolved not to disclose the details of the compensation for individual members of the Board of Management for a period of five years. The total remuneration of the members of the Board of Management for their activities in the 2012 financial year was € 2,620 thousand. No stock options or other share-based payment arrangements are granted to members of the Board of Management. Additional disclosures on the remuneration of the Board of Management can be found in section IX. of the Notes to the Consolidated Financial Statements.

DEPENDENT COMPANY REPORT

Transactions made and measures taken in 2012 were mainly attributable to goods and services supplied to affiliated companies. KSB AG billed a total of € 327.8 million (previous year: € 289.7 million) for these goods and services, and purchased goods and services from affiliated companies for a total value of € 108.2 million (previous year: € 99.8 million).

INTERNAL CONTROL SYSTEM (DISCLOSURES PURSUANT TO SECTION 315(2), NO. 5 OF THE *HGB*)

Our internal control system (ICS) serves to ensure that regular financial reports and consolidated financial statements are properly prepared. Key elements of the ICS are – in addition to the risk management system that is described in detail elsewhere in this management report – guidelines and regulations which include, among other things, standard accounting and valuation policies. They must be applied to the full extent by all Group companies. There is a clear separation of functions and the four-eye principle is applied. Reviews of our Internal Audits departments ensure that this happens.

Our accounting practices also include regular analytical plausibility checks using time series analyses and actual/budget variance analyses. These reviews enable us to identify significant changes early on, which we then examine for accounting and valuation discrepancies. The results are discussed at management level.

Our ICS is subject to a continuous development and improvement process, and we are in regular contact with our auditors. We analyse current financial reporting issues together, such as, for example, announced changes to the accounting principles and regulations. If it becomes necessary to adapt existing codes, guidelines or regulations or issue new ones, this is done promptly and communicated to the entire Group.

Corporate Governance Declaration

The updated Corporate Governance Declaration pursuant to section 289a of the *HGB* will be made accessible to the public from 27 March 2013 at www.ksb.com > Investor Relations > Corporate Governance Declaration.

In addition to the Corporate Governance Report (including the Statement of Compliance in accordance with section 161 of the German Public Companies Act), the Corporate Governance Declaration includes relevant information on corporate governance practices applied at KSB AG that go beyond statutory requirements. Also described are the working methods of the Board of Management and Supervisory Board, and the composition and working methods of the committees of the Supervisory Board.

REPORT ON POST-BALANCE SHEET DATE EVENTS

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

RESEARCH AND DEVELOPMENT

- Compact system reduces the cost of seawater desalination
- Carbon fibre composite materials put to the test
- Electric motors offer savings potential

Commercial success requires technical innovation, and this applies to all European mechanical engineering companies competing on the world market. To maintain our technological lead in pumps, valves and related systems, we therefore continuously invest in our research and development, and in 2012 spent € 45 million on it in the Group. Worldwide, 440 of our employees worked in research and development, seeking to create market-geared standard type series, or to translate the technical requirements of our customers into engineered products.

DRINKING WATER FROM THE SEA

In the year under review, we developed a compact unit for seawater desalination based on the reverse osmosis principle. The process requires very high pressures to separate the salt from the water. However, only a part of the volume flow penetrates the membrane as so-called permeate, while the pressurised concentrated brine has to be discharged from the membrane tank. The new SALINO® Pressure Center uses this pressure to drive an axial piston motor arranged on a common shaft with an axial piston pump. The compact unit combines all the functions pumps can assume in this type of seawater desalination: high pressure generation, pressure loss compensation and energy recovery. A separate booster pump is not needed; in addition, the system requires only a single electric motor and just one frequency inverter. As there is no piping between the individual components, the SALINO® Pressure Center is extremely compact and therefore particularly suitable for mobile use in container systems. Its design means that it can reduce energy costs by up to 50 % compared with conventional recovery systems that use pressure exchangers or Pelton turbines. KSB is the first manufacturer to offer such a compact system for the reverse osmosis process. Since October 2012, several pilot plants have been in operation in the Middle East, and the market launch is scheduled for the middle of this year.

Another example of the work carried out by our hydraulic experts is the further development of the Etanorm® pump series. The improved pumps, which have proven their worth over decades with more than 1.5 million produced, now use even less energy and already fulfill the requirements to be met by water pumps in Europe from 2015 in line with ErP regulations. In overhauling the type series we have also created two additional sizes.

CARBON FIBRE MATERIALS INSTEAD OF METALS

Carbon-fibre-reinforced polymers are primarily used today in the aerospace industry and in high-performance sports. But the application area for these materials is set to expand. Our materials experts are participating in a working group called MAI Carbon that is funded by the Federal Ministry of Education and Research. A total of 73 companies and educational and research institutions are working together in the area of basic research. For us as manufacturers of pumps and valves it is important to determine the extent to which components made of these materials can replace conventional materials. One of the advantages of using carbon fibre materials is the weight; pumps today are mostly made of metal and are therefore relatively heavy. In addition to their low weight, polymers are generally more chemically resistant to aggressive fluids than metallic alloys. In a first step, our specialists check whether bodies, casings or impellers can also be produced using the standard methods used to produce and process carbon-fibre-reinforced polymers.

As reported, in 2011 we started to expand the technical facilities we use to carry out cavitation tests. We continued these measures in the year under review and have thus created an expanded range of test options. Using improved test facilities in Frankenthal and Pegnitz we were able to check in comparative material studies the behaviour of metallic, intermetallic and polymer materials under cavitation conditions. The findings will be included in a newly created database in which we will systematically gather information on the properties of certain materials. This information in turn will help us develop a new cavitation-resistant polymer- or intermetallic-based coating. Every year the physical effect of cavitation causes considerable damage to pump impellers worldwide.

The world's most popular standardised water pump: 43 sizes of the Etanorm® range have been enhanced by KSB engineers (here: Etanorm® equipped with high-efficiency motor, speed control and monitoring system).

ENERGY-EFFICIENT ELECTRIC MOTORS

As almost 100 % of pumps are equipped with an electric motor, KSB began to develop and produce its own drives over 80 years ago. One of its innovation highlights is the highly efficient SuPremE motor. Apart from this drive we also build a whole series of special motors. They are made to order and can have ratings of several hundred kilowatts. They include canned motors for chemical pumps and submersible motors for large boiler recirculation and well pumps. The latter are completely filled with water for technical reasons. This means both the rotor and the stator and its winding are completely surrounded by liquid. The design places high technological demands on the insulation and the manufacturing process, as such drives in some cases need voltages of up to 10,000 volts. In order to be able to offer users such special-design very-low energy pumps, KSB engineers worked on the technological improvement of these motors in the year under review. They investigated the potential of the various synchronous or asynchronous motor operating principles. In cooperation with renowned universities and colleges they designed and calculated new pump drives using computer-based calculation programs. Following extensive simulations of the operating behaviour, they created several prototypes, which they tested in experimental series on test benches in Frankenthal. This work will be continued in the coming years.

Since 1 January 2013, only energy-efficient circulators may be sold in Europe in accordance with the relevant ErP Regulation. For this reason, we have developed a "smart" generation of glandless pumps in close cooperation with the staff of the KSB subsidiaries of the Smedegaard Group. With the Calio type series we have modernised our building services product range, and will present it to our customers at this year's trade fairs.

EMPLOYEES

- First-time consolidations increase Group headcount
- Communication strengthens leadership and values culture
- Distance learning provides in-depth knowledge of pumps

At KSB we need employees at every workplace who, besides having specific knowledge and skills, also bring with them a high level of motivation and a desire for positive change. Finding these people, familiarising them with our corporate culture and promoting their professional skills on an ongoing basis is a key corporate task. It is also part of our effort to be a preferred and competent partner to our customers around the world.

NUMBER OF EMPLOYEES INCREASES

At year-end, the number of employees working on behalf of our customers across the Group was 533 higher than in 2011, bringing the total to 16,207. This growth of 3.4 % is largely due to the first-time consolidation of 13 smaller subsidiaries in Europe and China. 508 employees joined the Group as a result. Individual companies within the Group also increased the size of their workforces, primarily to implement our strategic projects.

LEADERSHIP AND CORPORATE CULTURE

For employees to be motivated in their work, professional and communicative management is required. We provide continuous support to our managers at every level to achieve this. One important tool is standardised leadership feedback, which we carried out simultaneously for 8,203 employees in 2012. They were all asked to give feedback to their direct line manager on their leadership and management skills. 6,280 employees took advantage of this opportunity, and more than 75 % of the participants in the anonymous survey rated the cooperation with their line managers as “very good” overall.

The way we act and interact with each other and with our customers and suppliers is guided by defined KSB values. We consider them part of our corporate culture, which we want to strengthen and develop. To this end, in 2010 we started using so-called value dialogues, in which managers talk with their direct reports about the KSB values and their relevance for day-to-day work. In the year under review, more than 1,000 employees participated in such dialogues.

TRAINING IN SEMINARS AND ONLINE

We offer our employees a varied training programme so that they can develop their skills and adapt to new challenges. It encompasses foreign language and IT courses, technical and business training courses and seminars on personal development and project management. To develop each employee according to their tasks and skills, we determine their individual training needs every two years. The programme, which is tailored to this need, is supplemented with external seminars and training courses.

E-learning is a proven training method, especially for employees not working for one of our large companies. In the year under review, we trained around 3,500 employees via the “KSB E-Academy” Internet platform created in 2011.

DISTANCE LEARNING COURSES FOR KSB ENGINEERS AND TECHNICIANS

KSB is a company driven by technological innovation. Highly specific knowledge of pumps and their applications is required to develop customised solutions. This can only be provided to a limited extent by vocational and higher-education programmes. For this reason, we created the internal “Pump Applications Professional” training in 2011. In the year under review, the first 20 employees in Germany successfully completed the one-year distance learning course. Encouraged by the very good experiences so far, we will continue with this form of teaching, and in October 2012 a second group began their training.

FINDING AND DEVELOPING TALENTS

Globally we look for the best experts and managers. Their work in research and development, production, sales and in other disciplines is expected to contribute to driving KSB forward among top international companies. To achieve new goals, we need committed young professionals with fresh ideas. With our future engineering needs in mind, we have established relationships with universities and colleges in

Europe as well as in Brazil, China and India. We guide students from different disciplines to our company at an early stage through work experience, integrated training programmes and degree project (thesis) placements.

We also teach practical skills and theoretical knowledge to 363 trainees and students at three German plants as part of our company's vocational training programme, which encompasses four dual work / degree programmes. A key element of our training concept is personality development, including social and environmental responsibility.

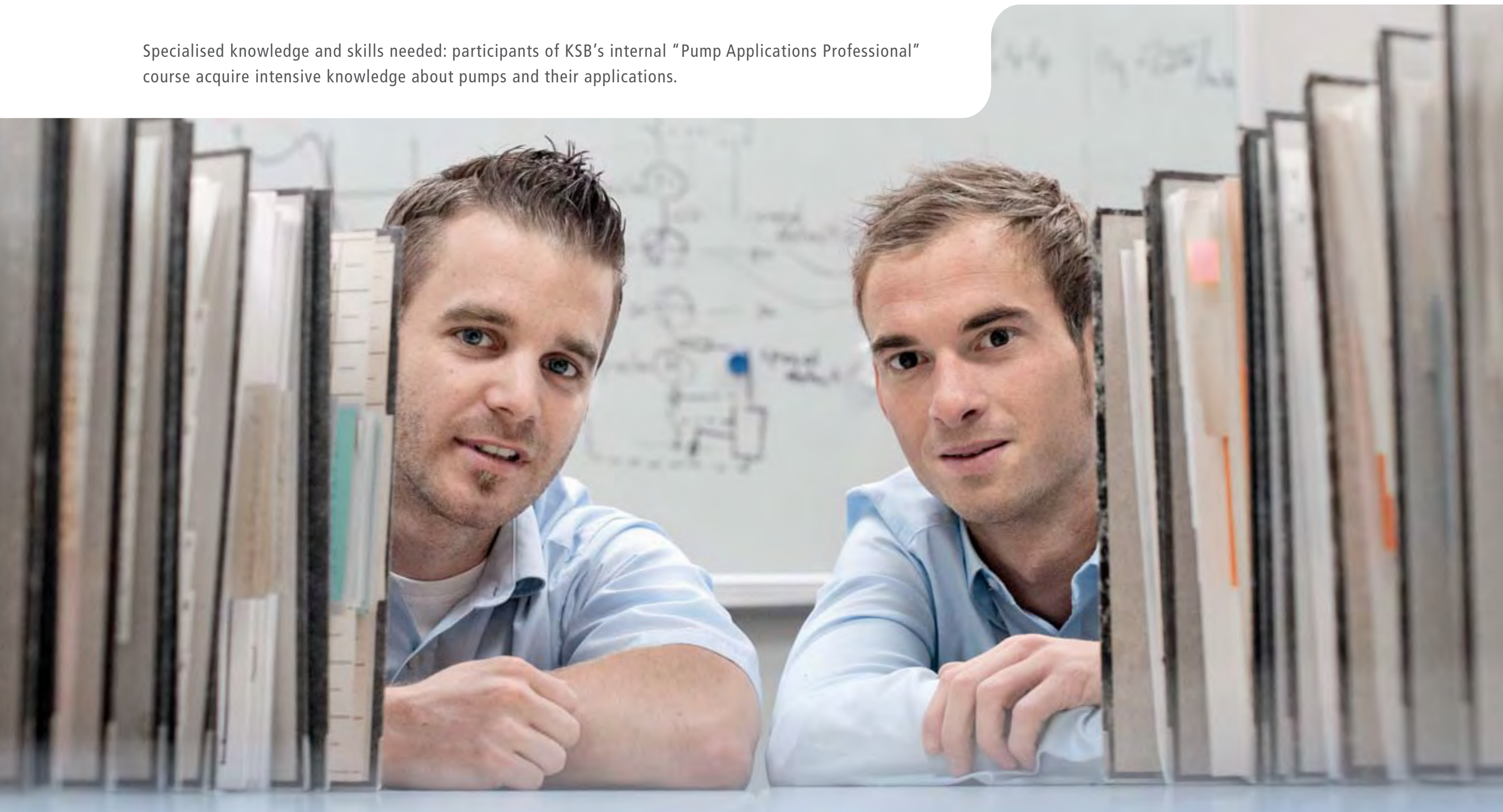
In the year under review, we spent € 9.0 million on vocational training in Germany. We also invested around € 3.0 million at the Halle site in a new social and educational training centre. There our trainees can prepare for their future careers using state-of-the-art machining equipment and manual workstations.

COMMITMENT AND A WILLINGNESS TO ACCEPT CHANGE

In a time in which markets and competition are changing dramatically, we have to adjust to new circumstances. Our employees have succeeded magnificently in many areas in this respect. In their workplaces they achieved large and small process improvements, succeeded in advancing strategic initiatives, and completed their tasks with a high degree of personal responsibility. At the same time they participated in the project teams that have prepared the structural changes that will be implemented this year.

The Board of Management thanks all employees for their achievements and their willingness to contribute to these improvement efforts. Special thanks too go to the members of the employee representative committees, including the Executives' Committee. They showed great commitment and responsibility in protecting the interests of our staff in 2012.

Specialised knowledge and skills needed: participants of KSB's internal "Pump Applications Professional" course acquire intensive knowledge about pumps and their applications.



CORPORATE SOCIAL RESPONSIBILITY

- Innovative products for efficient energy use
- Ecological model plant built in Brazil
- Aid and education projects on four continents

We believe that sustainable management and ongoing success go hand in hand. By acting in an ecologically sound and socially responsible manner, we contribute to the preservation of the environment and the establishment of fair social interaction. As a company that identifies with these types of conduct, we have signed up to the United Nations' Global Compact in 2010. This pact between the UN and companies and organisations aims to bring about a higher level of social and economic justice. By joining, we have committed ourselves to continuously working towards improvements in the areas of human rights, labour standards, environmental protection and business conduct.

EFFICIENT INNOVATIONS FOR CLEAN ENERGY

In the year under review, we launched a number of products onto the market that enable the use of renewable energy or reduce a plant's power consumption. Where customers use these products to save energy, they benefit from lower expenses, we as manufacturers benefit from increased sales revenue, and the environment benefits from reduced pollution.

This applies, for example, to our high-efficiency electric motors, series production of which started in 2012. These innovative drives already surpass the requirements the EU has put in place for the efficiency of electric motors from 2015 onwards. Moreover, our so-called synchronous reluctance motors do not require magnetic materials such as rare earths, whose production has considerable environmental impact in their countries of origin.

FOCUS ON PEOPLE AND THE ENVIRONMENT

As a manufacturing company we try to use natural resources as efficiently as possible and keep the environment clean. We avoid risks to humans and the ecosystem, and strictly comply with the laws and regulations on occupational health and safety and environmental protection, with KSB internal guidelines in many cases imposing even stricter standards on our conduct.

This applies, for example, where we build new manufacturing facilities or refurbish existing plants. At our plant in Nashik in India, where we set up a biogas system in 2011, we have expanded the internal energy supply system to include wind and solar systems. We use these systems to produce clean electricity for our production lines.

In 2012, our Brazilian subsidiary built a plant in Jundiaí that is exemplary in many respects. The production facility, which will be officially inaugurated this year, sets a high standard both in terms of environmental protection and occupational health and safety. In Jundiaí, several tanks collect 100,000 litres of rainwater for use in industrial processes and for sanitation and fire protection purposes. Solar energy heats the hot water for the employees' wash rooms, and before waste water leaves the plant it is carefully filtered. State-of-the-art manufacturing equipment ensures that as little waste as possible is generated.

Production employees in Jundiaí benefit from a pleasant and health-friendly work environment. Natural ventilation creates an optimal environment, with a complete air exchange taking place six to nine times per hour. Transparent roof and wall elements provide natural light while blocking UV rays from entering. Buildings have disabled access, and a rest area for truck drivers with its own sanitary facilities has also been included.

MEASURES THAT SAVE ENERGY

Worldwide we try to use water and energy resources carefully, and make savings wherever possible. To this end, we analysed the electricity and water consumption of our plants in Brazil, Germany, India, Indonesia and South Africa, and on the basis of our analysis defined cost-reducing measures.

We can also save electricity in our production facilities by making greater use of natural light to illuminate the halls. In 2012 we implemented such measures primarily at our site in Ankara, Turkey.

Education programme: young Brazilians extend their school knowledge by acquiring fundamental office communication skills on the job.

We also replace old machines with new, more efficient machines for energy reasons wherever possible. Where this is not economically viable, we use supplementary technology. In India, for instance, various energy-saving devices such as frequency inverters have been integrated into our production machines to reduce electricity costs.

ELECTRICITY AND WATER FOR AFRICA

The collaboration agreement signed by KSB with *GIZ – Deutsche Gesellschaft für Internationale Zusammenarbeit* [German Agency for International Cooperation] in 2012 shows that sustained commitment in developing countries and commercial benefit are reconcilable. Together, we are working on projects for decentralised electrification in Uganda that involve the use of a prototype of our river turbine adapted to local conditions by our experts. From 2013 onwards the small hydropower system will supply a village located on the Nile with electricity. So that local people can later take over operation and maintenance of the system, we involved them in the project right from the start.

In order to also tap the energy potential of mountain rivers and streams, we are planning with GIZ to deploy pumps running in reverse as turbines. They are less expensive than conventional turbines and require significantly less maintenance.

Through our French subsidiary we are supporting a humanitarian project run by an aid organisation that is active in Niger. It involves the local construction of wells, and we have agreed to invest € 45 thousand by 2014. The water extracted from the wells can be used to cultivate fields in the Sahel and also supply schools and hospitals with water.

We are also using our business contacts in France to promote the wells project. In 2012, we presented the project to our customers at the World Water Forum in Marseilles. Some of them took the opportunity to get involved in it themselves, the current aim being to build another 200 wells. Together with the aid organisation, we also presented the project at our French sites in Gennevilliers, Lille and Châteauroux. As a result, a large number of employees decided to support the project either financially or with voluntary work.

FOCUS ON TRAINING AND EDUCATION

Children and young people shape the future if they are well educated. We are therefore committed to providing long-term educational opportunities to young people. As a founding member of the *Wissensfabrik – Unternehmen für Deutschland e.V.* [Knowledge Factory – Companies for Germany] we are committed to educational work, primarily in kindergartens and primary schools. Since 2005 we, together with more than 100 other companies, have supported various projects to awaken children's interest in science and technology. In 2012, we trained teachers to carry out learning experiments and practical exercises in their classes, and supported early language development with a storytelling project.

GLOBAL SOCIAL COMMITMENT

Our social commitment isn't just limited to Europe. Instead we are active in many different places around the world where we can make a difference. Our Asian companies, for example, support several educational institutions through the KSB CARE aid fund. In 2012 we renovated schools in Indonesia and Thailand, and in India we paid for new school uniforms at one school.

In the US, our local companies gave money to charitable organisations that look after young children and the poor. We supplied discarded computers to an anti-drugs programme in Brazil in which members build new computers from still-functioning components. We also continued our programme to introduce Brazilian teenagers from disadvantaged backgrounds to our companies and the working world.

COMPLIANCE WITH LEGAL AND ETHICAL STANDARDS

We believe that the reputation of our company strengthens the confidence customers and business partners have in us. We therefore aim to prevent possible misconduct by individual employees from harming our reputation. In 2012, we implemented a comprehensive e-learning programme on compliance issues such as corruption prevention and cartel/anti-trust law. By providing such specific knowledge to our employees, we protect them from engaging in misconduct. The programme was primarily directed at those who are in direct contact with suppliers and customers, and was offered in seven different languages. In Europe, more than 2,000 employees took part, in the Middle East/Africa, 290, in the Region Asia/Pacific, 620, and in the Americas, 660. The e-learning programme will be continued in the coming years.

The high standards to which we have committed ourselves by signing up to the Global Compact also apply to our suppliers. We expect them too to commit to the social, environmental and economic values defined by the UN. For this reason, in the year under review we analysed as a first step the main suppliers of KSB AG using a guideline to determine the extent to which their business meets the standards of the Global Compact. The answers received provided us with information on companies that supply more than 50 % of the total purchase volume of our parent company. This year we will expand the survey to include the suppliers of all Group sites.

RISK MANAGEMENT

- Increased competition in emerging markets
- Continued price pressure in project business
- Provisions against credit losses and liquidity constraints

As an organisation that operates throughout the world, the KSB Group is exposed to both global and regional risks. Our risk policy is designed to enable us to grow sustainably and profitably. We seek to safeguard our opportunities and reduce the risks associated with our business and where possible avoid them completely. In order to be able to recognise early on all the developments and events that could jeopardise the continued existence of our Group, we use quarterly previews of our earnings and financial situation as well as monthly, Group-wide reporting of key performance indicators. We compare these regularly with our strategic corporate planning.

We have also implemented a system used by our management to continuously identify and record the relevant risks of our business, assess these risks and report them to Group headquarters. All Business Units, corporate departments and Group companies are included in this risk management system. The responsible managers are required to supply the relevant business and financial indicators for their areas each month. As well as creating quarterly forecasts on business trends, they also report recognised risks to Group headquarters twice a year. The Board of Management and Supervisory Board receive a risk report based on this information at least twice per financial year. Particularly critical issues are reported on an ad-hoc basis by the managers in charge.

This process and the responsibilities of management are documented in our Risk Management Manual. Managers are encouraged to take timely action to prevent or limit damage that may result from the occurrence of risk events.

The Internal Audits department is integrated into the risk management system as part of our control system. When planning audits, it prioritises areas according to potential risks and is provided with all the necessary information. The auditors ensure that all audited units adhere to the applicable guidelines, actively participate in the risk management system, and control or avoid their risks. Information obtained by Internal Audits on both the recognised risks and the countermeasures introduced in response forms an integral part of the reporting to the Board of Management and the Audit Committee of the Supervisory Board.

Controlling and Finance and Accounting also perform important monitoring tasks in the management of risks and opportunities. Accounting is responsible for preparing the annual and consolidated financial statements in clearly defined subprocesses.

We assess and communicate risks that could have an adverse effect on our net assets, financial position and results of operations as well as our reputation according to the following categories:

MARKET / COMPETITION

Our business is affected by changes in the economic and political environment. Current economic developments as well as high levels of public debt in the US and some European countries are generating uncertainties in the demand for our products.

In the project business, we are dependent on industries with long investment cycles, and these are still holding back on awarding contracts. Because of the ongoing overcapacity on the supply side, the pressure on our products' selling prices continues. We are countering the risk of short-term business and demand fluctuations by monitoring the development of macro-economic conditions in our markets and, where necessary, adjusting capacity and implementing savings measures.

The success of our pumps, valves and service business for the power generation industry depends on global energy demand as well as on the regulations introduced as part of energy and environmental policy. In Germany in particular the power plant market is currently undergoing change due to the so-called "energy turnaround" initiated by the Federal Government. As the operators of nuclear power plants were large consumers of our products and services, we have lost business volume that needs to be replaced by increasing sales in other countries and in other areas of application for our pumps and valves. If this substitution means higher costs, it may have a negative effect on earnings.

Because of ongoing uncertainties in energy and environmental policy, the construction of new power plants will also be delayed in countries outside Europe. Once the decisions to build new facilities are taken, we can expect improved opportunities in the project business.

Realisation of many major projects is also pending in the markets of the Middle East as well as North Africa. The background to this is the continuing instability in several countries. The current lower number of new orders entails high price and delivery time pressure, to which we must adapt. We see opportunities in some countries such as Saudi Arabia, Kuwait and Oman as well as in the sub-Saharan region, where we offer our pumps and valves for infrastructure projects for water and energy supply as well as for improved waste water treatment. The imposition of export restrictions relating to some countries in the region can in principle put both orders in hand and order opportunities at risk. We do not expect any new political sanctions to be imposed against individual states.

In the growing markets of the BRIC countries, competition is increasing among pump and valve manufacturers. Local suppliers benefit in part from more favourable cost structures. With our strategic measures we are aiming to open up these markets further. The current competitive situation, however, could delay our planned growth.

Overall, our strategic projects aim to increase the number of potential opportunities for sustained profitable growth. It cannot be excluded, however, that in the course of implementation of the strategy, changes in the markets or in technical requirements will necessitate a reassessment of those opportunities. For this reason, it is probable that we will not be able to bring all our strategic projects to fruition as intended and will have to adapt them to new circumstances, if necessary.

PROJECTS / PRODUCTS

Contracts with longer terms, especially in connection with major projects, can involve a variety of risks. There may be cost overruns, staff shortages, technical difficulties or quality problems – including possible penalties – that reduce our margins. We therefore train our staff in project management and enable them to identify risks associated with longer-term contracts at an early stage. Our project managers are provided with appropriate management tools and oversee clearly structured approval processes. Training in project management is also important in order to effectively implement our strategic projects.

Orders including newly designed products involve both technical and financial risks. We limit the technical risks to the extent that we define intermediate steps in product development and subject partial solutions to assessments. This also applies to the pumps that we are supplying as part of a major Chinese order for a new power plant type. We minimise financial risks by using appropriate contractual clauses, and ensure that advances cover our costs.

Acquiring companies or establishing joint ventures forms part of our strategic development and enables us to strengthen our product portfolio. Such steps inevitably also involve risks as we have to integrate new employees and harmonise processes and products into an existing programme. Accordingly, the associated opportunities and risks are carefully considered beforehand.

FINANCES / LIQUIDITY

Acquisitions usually lead to an increase in intangible assets. Adverse changes in the market environment or delayed integration of our acquisitions may affect the commercial and financial development of a new unit. This can lead to an impairment of goodwill.

In the project business we see risks for our margins and liquidity. As well as the continued pressure on our selling prices, which is reducing our profit margins, these include unfavourable contract conditions such as reduced advances and tougher contractual penalties. We counter this risk by paying careful attention to the approval processes in the tender phase, and constantly monitoring our net financial position. In this way we are able to recognise and avoid liquidity shortages. Where necessary, we secure sufficient liquidity by agreeing corresponding credit lines early on.

Litigation, governmental and regulatory proceedings too can affect our business.

We use foreign exchange hedges to reduce the risks from transactions involving different currencies. These are generally currency forwards, which we use both for transactions that have already been recognised and for future cash flows from orders still to be processed. By strengthening our production sites worldwide, we can realise natural currency hedging in currency markets that continue to be volatile.

To prevent the loss of receivables, we have established a strict credit management system and use trade credit insurance.

PROCUREMENT

We have recently been subjected to strong commodity price and procurement time fluctuations due to market volatility. Where we are unable to offset cost increases or pass them on to our customers, this can have a negative impact on our earnings. Shortages or delays in our supply chain for raw materials and components can also lead to the impairment of our business activities.

Therefore, we are actively seeking to identify alternative and better value supply sources, especially in Asia, using the purchasing power that results from pooling the requirements of all KSB plants worldwide.

TECHNOLOGY / RESEARCH AND DEVELOPMENT

It is essential to our future success that we have a product and service range that is suited to the market in terms of technology, price and delivery time. The changing needs of our customers and new standards and regulations make it necessary to continuously develop and improve our products and services. Research and development for innovations consumes significant financial and human resources, and the resulting products are not always successful.

To avoid any negative impact on earnings, it is important to recognise the market-related or technical risks early on. To this end, we are constantly updating our development process, which incorporates various control levels. As sales employees are regularly included in this process, risks arising from changes in markets or applications can also be taken into account in good time in the evaluation.

ENVIRONMENT

Our production activities in particular are subject to numerous environmental protection laws and regulations. There is a risk that losses will result from environmental damage not covered by insurance. Therefore, at all company sites officers monitor compliance with laws and regulations as well as with internal KSB rules, which in some cases exceed the prescribed environmental standards.

As part of acquisition projects, we examine existing properties for possible contamination before purchase. If we discover any contamination, we set aside provisions to pay for the necessary clean-up work.

In markets where environmental regulations are becoming more stringent, there is a risk that our products and own or purchased services may cause infringements that lead to us losing our market authorisation and which damage our reputation. A change in rules on liability in environmental protection can also increase the risks for our business success. Our memberships of national and international professional associations ensure that we become aware of imminent changes in environmental law early on.

STAFF

To achieve our ambitious growth and profitability targets, we need qualified personnel at all our locations, including, for example, technical specialists. Due to the demographic change in some countries, the competition for these and other highly skilled professionals is increasing, and will intensify if economic recovery sets in.

We counter this risk with demand-oriented measures, systematic human resources planning and international recruitment processes.

Changing market conditions can have a negative impact on the funded status of our pension obligations. We are currently developing a model to minimise this risk.

OTHER RISKS

The manipulation and loss of electronic data can lead to serious commercial disadvantages. We minimise this risk through secure access procedures and data backup systems. By centralising the IT systems of our various operating units, we can implement high security standards and thus further reduce the risk of data loss or corruption.

Other potential risks associated with the activities of our employees include dishonest conduct or violations of laws that could damage the reputation of KSB. We counter these risks by organising regular compliance training.

OVERALL ASSESSMENT

Overall, we did not identify any risks in the 2012 financial year that could significantly or permanently impair the net assets, financial position or results of operations.

REPORT ON EXPECTED DEVELOPMENTS

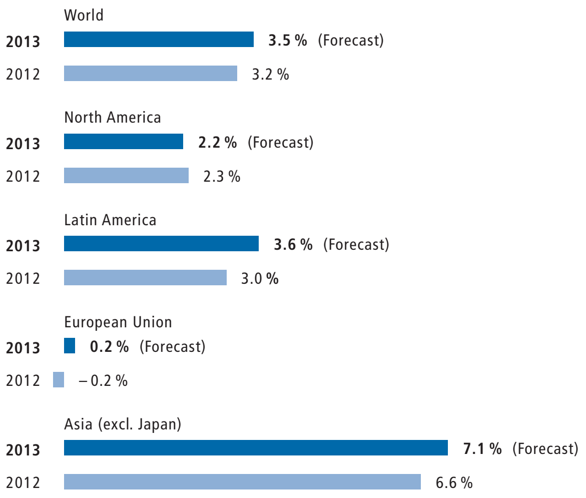
- Overall economic development remains uncertain
- Global expansion of the aftermarket business
- Growth sought in order intake and sales revenue

MARKET DEVELOPMENT AND SALES OPPORTUNITIES

Our planning is based on the assumption that the world economy will continue to grow only moderately, and that the gross domestic product in our European home market will stagnate or increase only slightly. It is therefore imperative that we take advantage to the greatest extent possible of the opportunities present in non-European markets. Our strong presence in these regions and our wide range of globally competitive products will help us in this respect. The economic prospects for the BRIC countries are relatively bright, and economic growth could also well accelerate in other emerging economies.

Overall, however, the economic situation remains plagued by uncertainties that make it difficult to forecast developments. These include the financial problems of the euro zone and the political tensions in the Arab world.

GROSS DOMESTIC PRODUCT GROWTH (WORLD)



Source: International Monetary Fund

Pumps

For pumps and related automation products we expect order intake to once again rise this year. This increase will partly result from the expected market growth, and partly from the fact that we will implement our Group strategy as planned.

We will continue to expand our standard pump business in 2013 and 2014. The European market, however, will only allow us to increase our production volumes to a limited extent. Instead, we aim to expand with these products mainly in the emerging markets of Asia and South America, but also in the Middle East. This year we will have access to improved logistics structures and an expanded network of sales offices and distributors in all those regions.

To strengthen this business, we have also launched a product offensive. This includes the introduction of an improved standardised water pump, which we will manufacture in an identical design on three continents. In February, we started producing this new product in Germany; production starts are due to follow in India, South Africa and China.

Investment activity in the chemical and petrochemical industries suggests that they continue to hold good potential for pump sales. In particular, we aim to take advantage of the opportunities arising from the development and expansion of production facilities in Asia and the Middle East. We also expect, as reflected in our acquisition activities, that the success of Asian plant engineering contractors in this sector is leading to a geographical shift in demand.

In the year under review, we created new sales and service facilities for our customers in the mining industry. As a result, we expect to receive more orders for our slurry pumps and replacement components. As mining companies are currently not expanding their mining capacity to any great extent, we are focusing on their modernisation and replacement needs instead, and will also be strengthening our service organisation to this end.

The market for power station pumps will remain difficult this year. Plans are in place for coal and lignite power plants that will be needed in the coming years. Realisation of these projects in many countries is slow, however. Thus, suppliers of technical equipment still have overcapacity, and there is continued pressure on the prices of feed, condensate and cooling water pumps.

Growing demand is expected for smaller high-pressure pumps, as used in power plants with combined gas and steam turbines. It is likely that new plants of this kind will be build, especially in the USA, now that additional gas sources are being tapped. As well as fossil-fuelled plants, China is planning to build new nuclear power plants with improved safety. There will also be order opportunities this year where energy suppliers modernise their district heating installations or build new ones.

In regions where population growth is placing a strain on drinking water supplies, wells, waterworks and pipeline pumping stations need to be constructed. In the Middle East and Africa new water engineering projects could therefore result in growing demand for appropriate pumps. We also expect increased demand for waste water pumps and waste water treatment mixers and agitators from the Middle East, unless the political situation there deteriorates.

High-level production technology: production of a boiler recirculation pump destined for use in a power plant.

More and more customers are basing their investments on whether they will improve the energy efficiency of their plants. We can benefit from this trend with our systems for continuously variable pump speed control and our magnetless KSB SuPremE high-efficiency motor.

Valves

We foresee growing demand for our valves from general industry and from the chemical and petrochemical industries. There is clear potential for order growth in Asia and the Middle East in particular. In some countries of the Middle East and North Africa there are opportunities to equip new water pipelines with our large valves. For this application area we can offer our Mammouth butterfly valves, which are up to 5 metres in diameter.

The order situation in the Asian shipyards suggests that there will be only modest growth in orders placed with suppliers. However, more tankers and loading facilities are set to be built to transport liquefied gas from the producer to the consumer countries. With our cryogenic valves, we have been the leading supplier for this application for many years. The fact that we are now able to offer marine-grade remote monitoring and control systems for these products has improved our business prospects in this interesting section of the market. The expansion in our product range took place as part of the acquisition of the South Korean company Seil Seres Co. Ltd. in 2011.

We also see good order opportunities for our valves in industrial facilities in which new fire-fighting systems are built. Here sales will be enhanced by the fact that our butterfly valves are certified to meet a number of national fire safety standards in Europe and the Americas.

Growth prospects for power plant valves are moderate due to a low willingness to invest among energy companies. Much the same market conditions therefore apply to our valves as to our pumps.

In 2013 and 2014 we will once again aim to increase the overall volume of our valve orders.

Service

Based on our aforementioned aftermarket strategy, we plan to expand our business with services and spare parts for pumps and valves. New service companies will contribute to this planned expansion.

As well as traditional services such as inspections, maintenance, repairs and installation of new equipment, advising customers about increasing energy efficiency will also gain in importance. The orders for our System Efficiency Service that analyses existing plants for ways of reducing energy consumption have doubled in the past year. Based on such analyses, customers often decide to implement modernisation measures where these will demonstrably reduce operating costs. We plan to expand our System Efficiency Service in the coming years.

Service work in major power plants, which declined in 2012, is expected to increase only slightly this year. Our increased involvement in servicing conventional plants has partially made up for the loss of orders for regular maintenance inspections that used to be carried out at German nuclear power stations until 2011. The growing valves service in French nuclear power plants, which is carried out by currently more than 200 service technicians, is opening up new prospects. The same applies for services in plants that use renewable energy.

More energy efficiency: technical overhauls of pumps by KSB Service help to extend pump service life and reduce electricity costs for pump operation.

When biomass is used as an energy source, our mixers and agitators continuously feed nutrients to the micro-organisms in the fermenters. We have developed a safety concept for inspections and time-saving repairs of such mixers, and plan to launch it onto the market this year. In Germany alone there are around 5,000 biogas production plants that require regular servicing.

This year, we expect a further increase in our service order intake with higher growth rates outside Europe. This trend is set to continue in 2014.

OUTLOOK FOR THE GROUP AND THE REGIONS

The growth prospects of our Group companies are determined by the strong regional differences in market development. We see outstanding business prospects in Asia and the Middle East in particular, as long as the named risks remain manageable.

Higher order intake will depend not just on market development however, but also on how we are able to implement our strategic projects.

Europe

The over-indebtedness and financial problems of the southern European countries and the weakness of the French economy are casting a dark cloud over the economic climate in Europe. This is reflected in the low investment willingness in many European countries at the beginning of the year. In Russia, by contrast, the growth in infrastructure investment and in the modernisation and expansion of industrial facilities is set to continue.

Demand in the general business is expected to remain the same or rise only slightly in the current financial year. Here we are relying on our new products for industrial applications and building services being successful to achieve our growth objectives.

Project business, contrary to initial expectations, is now not expected to significantly recover in 2013. At the same time, the trend for plant engineering contractors, industrial companies and energy suppliers to move their planning and purchasing centres to non-European regions and purchase their equipment there is continuing. This may intensify the competition among pump and valve manufacturers in Europe.

In Service, our new aftermarket concept aims at increasing the number of consultancy and service contracts concluded with customers and at strengthening our spare parts business. Impetus for growth can also be expected from our new service centres in Poland and Italy.

Overall, we expect that our business in Europe will only grow modestly. For our European companies exports to non-European regions will remain important.

Middle East / Africa

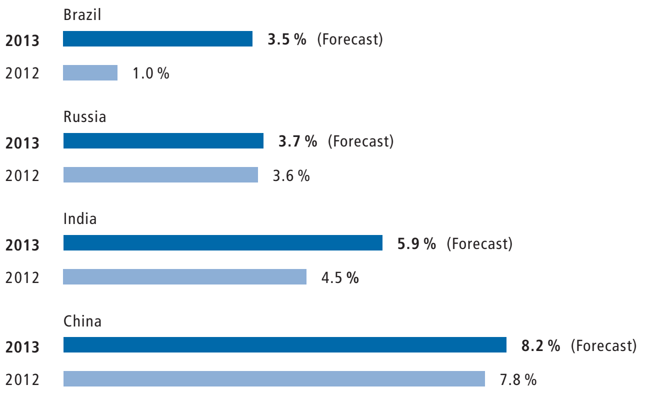
The economic development of this Region is highly dependent on oil revenues. A high crude oil price in the producing countries will create good conditions for further development of the infrastructure. Several of these countries are also confronted with the task of housing a growing population. We can participate in these different projects with our water and waste water engineering products as well as with our pumps and valves for building services. Added to this are the efforts of the oil-producing countries to process their main commodity themselves and to establish new industries in order to reduce their dependency on oil and gas exports. For this they need application-specific pumps and valves.

In Saudi Arabia, which is very important for our regional business, we have restructured our activities. We now have 175 employees in the country to respond to customers' sales, production and service requirements. This year and next will probably see the implementation of several major energy, water supply and waste water treatment projects in Saudi Arabia.

Other centres of activity include the United Arab Emirates, Qatar and Oman, as well as Iraq. There is also demand for our products from African countries as a result of infrastructure projects and investment in the mining industry.

The political situation in the Arab countries, however, remains a source of ongoing uncertainty in the Region. If there is no further deterioration, we expect an increase in order volumes for our Group companies active in the Region.

GROSS DOMESTIC PRODUCT GROWTH (BRIC)



Source: International Monetary Fund

Asia / Pacific

Economic growth in the Region Asia / Pacific is expected to grow slightly this and next year. China as the "engine of the Region" is showing signs of regaining the economic momentum that had recently been waning, and the economic situation in India too is expected to improve, despite many uncertainties.

In China, which remains the most important growth market, we will increase our efforts to become a preferred supplier for industrial clients, including small- and medium-sized companies. We are also seeking to develop the water and waste water market. We are expanding our sales force, strengthening our consultancy activities and improving our dealer and service structures. In doing this we are responding to China's national "Go West" policy, which is aimed at developing new industrial centres. At the same time, we are taking action to cut our costs and shorten the delivery times for our products.

Economic growth in India will depend (in the opinion of the VDMA) on the global economy and on how well the government succeeds in pushing through its reforms. We expect some refineries to be built or expanded, and we also see opportunities in the water industry. In the energy sector, initial decisions have been taken regarding new construction projects.

Our companies in the South-East Asian countries offer us good opportunities for participating in the continued growth there. This is particularly true for industry and the water engineering sector.

With the establishment of a manufacturing and service unit in Vietnam and new joint ventures in the Region, we intend to strengthen our market position in South-East Asia.

We expect our companies in Asia to record the strongest growth in order intake in the Group. Our service strategy for the Asian countries will also contribute to this.

In Australia we want to benefit in particular from the opportunities in the mining industry.

Americas

In the Americas, a slight improvement in the overall economic situation is expected. Falling inflation and an easing of monetary policy in some South American countries, including in Brazil, may help in this respect. In the US, the process of re-industrialisation is expected to result in increased demand for equipment. Its growth will also be determined by the reorientation of fiscal policy, however.

We will expand our business with standard pumps and valves in South America. To this end we have opened new sales offices in Brazil and a large warehouse in Chile, and have also expanded our dealer network. We will also increase our service activities.

Large projects that will involve orders for pumps and valves are imminent in the oil and gas industry, as well as in the mining and water industries. In Canada, the development of the oil sands will require investment in new equipment and replacement equipment. Our US subsidiary, GIW Industries, Inc., could benefit from this development with increased orders for slurry pumps as long as crude oil prices remain high.

In South America, we have our own production and sales companies in Argentina, Brazil, Chile and Peru, which also serve customers in neighbouring countries. We aim to improve our market presence.

The total order intake of our American companies is expected to increase both this year and next.

FINANCIAL OUTLOOK

Based on our strategic measures, we see good potential for achieving higher order intake in all three segments – pumps, valves and service – despite the economic uncertainties. At the same time, we expect our general business to continue to develop positively this year and next. In the project business too we expect a slightly improved market environment. Overall, we expect the Group's order intake to increase in the current financial year. In 2014, this positive trend is likely to continue. However, any significant economic downturn or recession in important customer countries could have a negative impact on our business volumes.

In terms of sales revenues, we expect all three segments to grow in 2013, with the growth primarily driven by the non-European regions. For pumps and services, we expect sales revenue growth to be higher than that for order intake; for valves, we expect sales revenue growth to be comparatively lower. For 2014, we expect consolidated sales revenue to roughly change in line with the development in orders.

Based on this growth in business, we expect an increase in our profit in all three segments this year and next, despite cost increases. However, if on account of an economic slowdown in our markets order volumes or profit quality were to decline, this would have a negative impact on our earnings. In that case we may step up our measures to secure an adequate level of earnings.

Expenditure on property, plant and equipment is likely to rise moderately in 2013 and 2014. Thanks to our continuing sound financial situation and restrictive liquidity management, we expect to be able to finance these investments from equity capital.

We will continue to provide the necessary financial resources and capacities for the implementation of our global strategy projects.

We will only consider acquisitions if they fit our key strategic projects and are likely to prove highly advantageous from a financial and strategic point of view.

FORWARD-LOOKING STATEMENTS

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

MATERIALS TECHNOLOGY

"How do you "bake" the perfect seal for valves?"

Chrystelle Tandonnet,
Elastomer expert from Research and
Pre-development Valves

"Elastomers for valve sealing elements are produced using about 40 different basic formulas. Drawing on a range of about 200 ingredients, we can offer the right sealing solution for all applications our butterfly valves are used in."

Chrystelle Tandonnet

In La Roche-Chalais elastomers are stirred, kneaded, shaped and "baked". Up to 200 different ingredients are mixed in the giant vats of the French "bakery" – to produce elastomer liners. They constitute the core element of a centred disc butterfly valve.

Finding the optimum ratio for producing liners to be used in the food, sugar or steel industry as well as in the transportation of water and oil is a complex task. KSB handles this challenge itself at the French plant. The elastomer's quality is decisive for reliable sealing at the flanged line connections, the seat/disc interface and the stem passage. For every fluid that needs to be handled, the team has a seal version tailored to the customer's needs. The composition, mixing process and vulcanisation play a crucial role in the properties and subsequent functioning of the elastomer. Up to 220 tonnes of synthetic rubber are manufactured every year, producing around 420,000 liners. This includes liners for valves with a diameter of up to five metres. They, too, provide reliable sealing thanks to the materials specially produced at La Roche-Chalais.

Butterfly valves | **ISORIA®**

The maintenance-free ISORIA® centred disc butterfly valve is ideal for use as shut-off and control valve for all industries. Equipped with electric, pneumatic, hydraulic and manual actuators, hundreds of thousands of these valves provide reliable service all over the world. Application areas range from sugar factories to luxury cruise ships and water transport through to process engineering applications.

Consolidated earnings before income taxes (EBT) improved by 10.3 % to € 132.8 million.

CONSOLIDATED FINANCIAL STATEMENTS

64 Balance Sheet
65 Statement of Comprehensive Income
66 Statement of Changes in Equity
68 Statement of Cash Flows
69 Notes
120 List of Shareholdings
123 Supervisory Board
124 Board of Management
125 Proposal on the Appropriation of the Net Retained Earnings of KSB AG

BALANCE SHEET

ASSETS

(€ thousands)	Notes	31 Dec. 2012	31 Dec. 2011
Non-current assets			
Intangible assets	1	102,624	91,697
Property, plant and equipment	1	460,595	428,756
Non-current financial assets	1	38,820	40,073
Deferred tax assets	2	28,729	24,433
		630,768	**584,959**
Current assets			
Inventories	3	457,208	425,056
Receivables and other current assets	4	687,960	658,394
Current financial instruments	5	–	11
Cash and cash equivalents	5	401,031	305,707
		1,546,199	**1,389,168**
		2,176,967	**1,974,127**

EQUITY AND LIABILITIES

(€ thousands)	Notes	31 Dec. 2012	31 Dec. 2011
Equity	6		
Subscribed capital		44,772	44,772
Capital reserve		66,663	66,663
Revenue reserves		685,727	642,075
Equity attributable to shareholders of KSB AG		797,162	753,510
Non-controlling interest		125,807	115,614
		922,969	**869,124**
Non-current liabilities			
Deferred tax liabilities	7	41,236	37,877
Provisions for employee benefits	8	289,023	279,345
Other provisions	8	17,205	17,409
Other liabilities	9	208,041	61,743
		555,505	**396,374**
Current liabilities			
Provisions for employee benefits	8	109,044	111,932
Other provisions	8	84,427	87,180
Liabilities – Taxes	9	22,047	19,947
Other liabilities	9	482,975	489,570
		698,493	**708,629**
		2,176,967	**1,974,127**

STATEMENT OF COMPREHENSIVE INCOME

INCOME STATEMENT

(€ thousands)	Notes	2012	2011
Sales revenue	10	**2,268,211**	**2,091,046**
Changes in inventories		23,871	58,922
Work performed and capitalised		1,755	1,400
Total output of operations		**2,293,837**	**2,151,368**
Other income	11	44,316	33,397
Cost of materials	12	– 985,171	– 912,991
Staff costs	13	– 758,213	– 697,981
Depreciation and amortisation expense	1	– 58,647	– 50,995
Other expenses	14	– 377,712	– 383,879
Other taxes		– 11,260	– 8,572
		147,150	**130,347**
Financial income	15	9,212	14,533
Financial expense	15	– 23,519	– 24,403
		– 14,307	**– 9,870**
Earnings before income taxes		**132,843**	**120,477**
Taxes on income	16	– 42,524	– 37,184
Earnings after income taxes		**90,319**	**83,293**
Attributable to:			
Non-controlling interest	17	15,649	11,343
Shareholders of KSB AG		**74,670**	**71,950**
Diluted and basic earnings per ordinary share (€)	19	42.51	40.95
Diluted and basic earnings per preference share (€)	19	42.77	41.21

STATEMENT OF RECOGNISED INCOME AND EXPENSE

(€ thousands)	2012	2011
Earnings after income taxes	**90,319**	**83,293**
Measurement of financial instruments	4,918	– 3,137
Taxes on income	– 1,425	937
Currency translation differences	– 13,891	– 15,215
Taxes on income	–	–
Other income and expense recognised directly in equity	– 265	– 29
Taxes on income	–	–
Total earnings recognised directly in equity	**– 10,663**	**– 17,444**
Total recognised income and expense	**79,656**	**65,849**
Attributable to:		
Non-controlling interest	12,197	6,939
Shareholders of KSB AG	**67,459**	**58,910**

Also see the relevant explanations in the Notes.

STATEMENT OF CHANGES IN EQUITY

(€ thousands)	Subscribed capital of KSB AG	Capital reserve of KSB AG
1 Jan. 2011	44,772	66,663
Income and expense recognised directly in equity	–	–
Earnings after income taxes	–	–
Total recognised income and expense	–	–
Dividends paid	–	–
Capital increases / decreases	–	–
Change in consolidated Group / Step acquisitions	–	–
Other	–	–
31 Dec. 2011	**44,772**	**66,663**

(€ thousands)	Subscribed capital of KSB AG	Capital reserve of KSB AG
1 Jan. 2012	44,772	66,663
Income and expense recognised directly in equity	–	–
Earnings after income taxes	–	–
Total recognised income and expense	–	–
Dividends paid	–	–
Capital increases / decreases	–	–
Change in consolidated Group / Step acquisitions	–	–
Other	–	–
31 Dec. 2012	**44,772**	**66,663**

Accumulated currency translation differences (€ thousands)	Equity attributable to shareholders of KSB AG	Non-controlling interest	Total equity
Balance at 1 Jan. 2011	– 14,487	– 12,941	**– 27,428**
Change in 2011	– 11,067	– 4,148	**– 15,215**
Balance at 31 Dec. 2011 / 1 Jan. 2012	– 25,554	– 17,089	**– 42,643**
Change in 2012	– 10,196	– 3,695	– 13,891
Balance at 31 Dec. 2012	**– 35,750**	**– 20,784**	**– 56,534**

Also see the relevant explanations in the Notes.

	Earnings recognised directly in equity				
Revenue reserves	Currency translation differences	Measurement of financial instruments	Equity attributable to shareholders of KSB AG	Non-controlling interest	Total equity
617,652	– 14,487	– 604	713,996	111,570	**825,566**
– 3	– 11,067	– 1,970	– 13,040	– 4,404	**– 17,444**
71,950	–	–	71,950	11,343	**83,293**
71,947	– 11,067	– 1,970	58,910	6,939	**65,849**
– 21,240	–	–	– 21,240	– 2,905	**– 24,145**
–	–	–	–	–	**–**
1,844	–	–	1,844	26	**1,870**
–	–	–	–	– 16	**– 16**
670,203	**– 25,554**	**– 2,574**	**753,510**	**115,614**	**869,124**

	Earnings recognised directly in equity				
Revenue reserves	Currency translation differences	Measurement of financial instruments	Equity attributable to shareholders of KSB AG	Non-controlling interest	Total equity
670,203	– 25,554	– 2,574	753,510	115,614	**869,124**
– 265	– 10,196	3,250	– 7,211	– 3,452	**– 10,663**
74,670	–	–	74,670	15,649	**90,319**
74,405	– 10,196	3,250	67,459	12,197	**79,656**
– 21,240	–	–	– 21,240	– 1,858	**– 23,098**
–	–	–	–	–	**–**
– 2,567	–	–	– 2,567	– 155	**– 2,722**
–	–	–	–	9	**9**
720,801	**– 35,750**	**676**	**797,162**	**125,807**	**922,969**

STATEMENT OF CASH FLOWS

(€ thousands)	2012	2011
Earnings after income taxes	90,319	83,293
Depreciation and amortisation expense / Write-ups	59,141	53,102
Increase in non-current provisions	6,196	4,366
Gain / loss on disposal of fixed assets	– 2,010	– 1,520
Other non-cash expenses / income	3,259	– 2,229
Cash flow	**156,905**	**137,012**
Increase in inventories	– 27,435	– 91,211
Increase in trade receivables and other assets	– 18,634	– 50,905
Increase / decrease in current provisions	– 6,537	124
Increase / decrease in advances received from customers	– 8,402	16,855
Increase / decrease in liabilities (excluding financial liabilities)	– 1,832	24,390
Other non-cash expenses / income (operating)	–	–
	– 62,840	**– 100,747**
Cash flows from operating activities	**94,065**	**36,265**
Proceeds from disposal of intangible assets	198	92
Payments to acquire intangible assets	– 8,043	– 6,941
Proceeds from disposal of property, plant and equipment	4,829	4,205
Payments to acquire property, plant and equipment	– 80,232	– 60,361
Proceeds from disposal of non-current financial assets	18	294
Payments to acquire non-current financial assets	– 9,788	– 11,869
Net cash flows from the acquisition and sale of consolidated companies and other business operations	– 6,408	– 28,083
Other non-cash expenses / income (investing)	–	–
Cash flows from investing activities	**– 99,426**	**– 102,663**
Proceeds from additions to equity / Payments related to capital decreases	–	–
Dividends paid for prior year (including non-controlling interest)	– 23,098	– 24,145
Payments for financial liabilities	127,512	– 7,908
Payments resulting from financial receivables	– 1,555	– 3,846
Other non-cash expenses / income (financing)	–	–
Cash flows from financing activities	**102,859**	**– 35,899**
Net change in cash and cash equivalents	97,498	– 102,297
Effects of exchange rate changes on cash and cash equivalents	– 2,828	– 3,253
Effects of changes in consolidated Group	654	3,636
Cash and cash equivalents at beginning of period	305,707	407,621
Cash and cash equivalents at end of period	**401,031**	**305,707**
Thereof term deposits to hedge credit balances for partial retirement arrangements included at the closing date	14,800	16,600

Also see section VII. Statement of Cash Flows in the Notes.

NOTES

I. GENERAL

Basis of preparation

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

KSB AG is a public limited company [*Aktiengesellschaft*] under the law of the Federal Republic of Germany. The company is registered with the *Handelsregister* [Commercial Register] of the *Amtsgericht* [Local Court] Ludwigshafen am Rhein, registration No. HR B 21016, and has its registered office in Frankenthal/Pfalz, Germany. It is a Group company of Klein Pumpen GmbH, Frankenthal.

The consolidated financial statements were prepared on a going concern basis in accordance with IAS 1.25.

The accompanying consolidated financial statements were approved for issue by the Board of Management on 12 March 2012 and are expected to be approved by the Supervisory Board on 25 March 2013.

The consolidated financial statements and the annual financial statements of the Group's parent company are published in the *Bundesanzeiger* [German Federal Gazette].

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

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

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

The main accounting policies used to prepare these consolidated financial statements are stated below. The policies described were applied consistently to the reporting periods presented unless stated otherwise.

The consolidated financial statements of KSB AG therefore meet the requirements of IFRS. They were prepared using the historic cost convention, with the exception of measurement at market value for financial assets available for sale and measurement at fair value through profit and loss for financial assets and liabilities (including derivatives).

New accounting principles

a) Accounting principles applied for the first time in financial year 2012

The following new and revised Standards issued by the International Accounting Standards Board (IASB) were required to be applied for the first time in financial year 2012:

- IFRS 7 Financial Instruments: Disclosures
  (for financial years beginning on or after 1 July 2011)
  The changes involve extended disclosure obligations upon the assignment of financial assets.

b) Newly adopted accounting principles that are not yet binding

The following new Interpretations, Standards and revised Standards were not yet mandatory and were not applied in the 2012 financial year:

- IFRS 1 First-time Adoption of International Financial Reporting Standards
  (for financial years beginning on or after 1 January 2013)
  The changes apply to government loans.
- IFRS 1 First-time Adoption of International Financial Reporting Standards
  (for financial years beginning on or after 1 January 2013)
  The changes relate to severe hyperinflation and the removal of fixed dates for first-time adopters of IFRS.
- IFRS 7 Financial Instruments: Disclosures
  (for financial years beginning on or after 1 January 2013)
  The changes involve disclosure obligations when financial instruments are offset.
- IFRS 9 Financial Instruments
  (for financial years beginning on or after 1 January 2015)
  The additions relate to the accounting treatment of financial liabilities and the transfer, classification and measurement of financial assets and the deferral of first-time adoption.
- IFRS 10 Consolidated Financial Statements
  (for financial years beginning on or after 1 January 2014)
  This standard provides definitions for determining the group of consolidated companies.
- IFRS 11 Joint Arrangements
  (for financial years beginning on or after 1 January 2014)
  The standard applies to companies that share management of a joint venture or activity.

- IFRS 12 Disclosure of Interests in Other Entities
  (for financial years beginning on or after 1 January 2014)
  The standard deals with disclosures to be made in the Notes to the consolidated financial statements on involvements with other entities and joint arrangements.
- IFRS 13 Fair Value Measurement
  (for financial years beginning on or after 1 January 2013)
  The standard deals with the measurement of fair value and the associated disclosures in the Notes.
- IAS I Presentation of Financial Statements
  (for financial years beginning on or after 1 July 2012)
  The changes relate to the presentation of individual items of other comprehensive income.
- IAS 12 Income Taxes
  (for financial years beginning on or after 1 January 2013)
  The changes relate to the measurement of deferred taxes for investment properties.
- IAS 19 Employee Benefits
  (for financial years beginning on or after 1 January 2013)
  The changes relate to the presentation of company pension funds.
- IAS 27 Separate Financial Statements
  (for financial years beginning on or after 1 January 2014)
  IFRS 10 Consolidated Financial Statements supersedes the guidelines in IAS 27 regarding control and consolidation.
- IAS 28 Associates and Joint Ventures
  (for financial years beginning on or after 1 January 2014)
  IFRS 12 Disclosures of Interests in Other Entities supersedes the disclosure obligations currently prescribed in IAS 28.
- IAS 32 Financial Instruments: Presentation
  (for financial years beginning on or after 1 January 2014)
  The changes relate to the offsetting of financial instruments.
- IFRIC 20 Stripping Costs in the Production Phase of a Surface Mine
  (for financial years beginning on or after 1 January 2013)
  The interpretation relates to the accounting treatment of stripping costs incurred in the production phase of a surface mine.
- Annual Improvements 2011
  (for financial years beginning on or after 1 January 2013)

Based on our current state of knowledge, application of the above Standards and Interpretations would not have any material impact on our consolidated financial statements with the exception of the changes in accordance with IAS 19. As the corridor method can no longer be applied as of 1 January 2013, actuarial gains and losses (situation on 31 December 2012: losses of € 123 million; see section 8 of the Notes) will in future be directly recognised in equity, taking into account the relevant tax effect. We expect this to entail increased volatility in pension obligations and equity shown in the balance sheet. This may also affect the equity ratio. In the year under review, the equity ratio would have been 38.5 % (previous year: 43.5 %).

As a matter of principle, we have not voluntarily applied the above-mentioned Standards and Interpretations prior to their effective dates.

II. BASIS OF CONSOLIDATION

Consolidated Group

In addition to KSB AG, 10 German and 75 foreign companies (previous year: 9 German and 62 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 or to determine the business and financial policy (de-facto control). No companies are currently accounted for using the equity method or proportionately consolidated.

To modernise and supplement our product portfolio, we acquired an 80 % stake, i.e. the majority of voting shares, in Danish pump manufacturer T. Smedegaard A/S, based in Glostrup (Copenhagen), on 16 February 2012. The company develops and manufactures circulator pumps for application in building services. The company has three subsidiaries in Bridgwater, UK (Smedegaard Pumps Limited), Västra Frölunda, Sweden (VM Pumpar AB) and Beinwil am See, Switzerland (SMEDEGAARD AG Pumpen und Motorenbau). With the acquisition of these companies (hereinafter referred to as "Smedegaard Group"), KSB is safeguarding its building services project business in the areas of heating, ventilation and air-conditioning.

The difference between the carrying amount of the assets acquired and the cash purchase price was mainly attributable to goodwill (€ 1.4 million), real estate assets (€ 0.4 million) and the customer base and work in hand (€ 0.5 million). The figure for goodwill includes assets that could not be identified separately, such as expected synergies and employee expertise. The share not controlled by KSB has a fair value of around € 1 million, which was determined based on the purchase price of the 80 % interest, and taking the expected future corporate development into account.

These acquisitions have been included in the consolidated balance sheet at the following fair values:

(€ thousands)	Fair value on acquisition	Previous carrying amount
Non-current assets		
Intangible assets	479	–
Property, plant and equipment	3,070	2,707
Non-current financial assets	–	–
Deferred tax assets	513	513
	4,062	**3,220**
Current assets		
Inventories	2,679	2,679
Receivables and other current assets	3,119	3,119
Cash and cash equivalents	192	192
	5,990	**5,990**
	10,052	**9,210**
Equity	**4,200**	**3,569**
Non-current liabilities		
Deferred tax liabilities	248	37
Provisions for employee benefits	–	–
Other provisions	–	–
Liabilities	360	360
	608	**397**
Current liabilities		
Provisions for employee benefits	–	–
Other provisions	82	82
Liabilities	5,162	5,162
	5,244	**5,244**
	10,052	**9,210**

The fair value of the intangible assets includes € 479 for concessions and licences.

The fair value of property, plant and equipment includes € 2,289 thousand for land and buildings, € 505 thousand for plant and machinery, and € 276 thousand for other equipment, operating and office equipment.

It is assumed that the receivables and other assets will be settled in full. The gross amount of trade receivables totals € 2,269 thousand.

From the date of acquisition in February 2012, the Smedegaard Group contributed € 10.2 million of sales revenue to the sales revenue reported in the consolidated income statement. For the financial year as a whole it would have reported € 11.8 million of sales revenue. The contribution to consolidated earnings for the period of consolidation was € – 0.2 million; for the full financial year it would have been € + 0.2 million.

We have also included the following companies for the first time in the consolidated financial statements effective 1 January 2012:

- Pumpen-Service Bentz GmbH, Reinbek, Germany
- Nederlandse Pompservice (N.P.S.) B.V., Velsen-Noord, The Netherlands
- KSB Service Robinetterie S.A.S., Rambervillers, France
- KSB Service Centre-Est S.A.S., Villefranche sur Saône, France
- SPI Energie S.A.S., La Ravoire, France
- VRS Valve Reconditioning Services B.V., Vierpolders, The Netherlands
- Mäntän Pumppauspalvelu Oy, Mänttä-Vilppula, Finland
- Dalian KSB AMRI Valves Co., Ltd., Dalian, China
- KSB Valves (Changzhou) Co., Ltd., Jiangsu, China

Furthermore, six smaller companies that had not previously been consolidated were merged with consolidated companies.

These companies consolidated for the first time were acquired or established in previous years. They contributed around 1 % or € 1.7 million to consolidated earnings.

Our business in Vietnam, which in previous years was managed through a representative office at KSB Singapore (Asia Pacific) Pte Ltd, was transferred to the newly established company KSB Vietnam Co. Ltd. in the year under review. This did not have any impact on the consolidated financial statements.

In the year under review, we acquired the remaining 20 % interest in REEL s.r.l. in Italy (increase to safeguard controlling interest). € 9,722 thousand (previous year: € 11,714 thousand) in payments were made for companies that have not yet been consolidated because this would not have had a material impact. This mainly resulted from a cash capital increase in a company in China in which we hold a non-controlling interest and the acquisition of a service company in France.

Consolidation methods

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

Any excess of our interest in the fair values of net assets acquired over cost remaining after reassessment is recognised in profit or loss.

Those shares of subsidiaries' equity not attributable to KSB AG are reported as non-controlling 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 fixed assets are also eliminated.

The financial statements of all material companies or those required to be audited under local law have been audited, and independent auditors' reports have been issued. 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 (€). Amounts in this report are presented in thousands of euros (€ thousands) using standard commercial rounding rules.

Currency translation is effected on the basis of the functional currency of the consolidated companies. As in the previous year, the functional currency is exclusively the local currency of the company consolidated, as it operates as a financially, economically and organisationally independent entity.

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

When translating financial statements of consolidated companies that are not prepared in euros assets and liabilities are translated at the closing rate; the income statement accounts are translated at average exchange rates for the year. The resulting effects are presented directly in equity.

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

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

	Closing rate		Average rate	
	31 Dec. 2012	31 Dec. 2011	2012	2011
US dollar	1.3194	1.2939	1.2857	1.3917
Brazilian real	2.7036	2.4159	2.5099	2.3260
Indian rupee	72.5600	68.7130	68.6370	64.8646
Chinese yuan	8.2207	8.1588	8.1099	8.9958

III. 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 includes attributable incidental costs (except for costs associated with the acquisition of a company) and subsequent expenditure. Purchase price reductions are deducted from cost. Should borrowing costs pursuant to IAS 23 arise, these will be capitalised from 2009 onwards. As in the previous year, no borrowing costs were incurred in the financial year.

Production cost

In addition to direct material and labour costs, production cost includes production-related administrative expenses. General administrative expenses and selling expenses are not capitalised. Should borrowing costs pursuant to IAS 23 arise, these will be capitalised from 2009 onwards. As in the previous year, no borrowing costs were incurred in the financial year.

Financial instruments

Financial assets and financial liabilities are recognised in the consolidated balance sheet at the time when KSB becomes a party to a financial instrument and when at least one party has fulfilled the agreement. When the contractual right to payments from financial assets expires, these are derecognised. Financial liabilities are derecognised at the time when the contractual obligations are settled or cancelled or have expired. Regular way purchases and sales of financial instruments are recognised at their value at the settlement date; only derivatives are recognised at their value at the trade date. This applies to so-called primary financial instruments such as trade receivables and monetary receivables, as well as to trade payables and financial liabilities (from or to third parties as well as intergroup and associate companies).

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

Classification in measurement categories:

- Financial Assets Held for Trading (FAHfT) / Financial Liabilities Held for Trading (FLHfT): Financial assets and liabilities held for trading and measured at fair value through profit or loss (derivatives not included in hedging relationships)
- Loans and Receivables (LaR): Loans and receivables (loans and primary financial instruments not quoted in an active market)
- Available for Sale (AfS): Available-for-sale financial instruments (non-derivative financial instruments that are not allocated to any other measurement category, such as investments in non-consolidated affiliates or securities)
- Financial Liabilities Measured at Amortised Cost (FLAC): Financial liabilities measured at amortised cost using the effective interest method (liabilities that are not quoted in an active market, such as trade payables)

None of our financial instruments are classified as “held-to-maturity investments”.

Financial instruments are measured at fair value on initial recognition. Subsequent measurement is generally based on fair value. Subsequent measurement of loans and receivables is based on amortised cost using the effective interest method. We do not currently make use of the fair value option. The fair values of the non-current and current assets are based on prices quoted in active markets on the reporting date. The fair values of derivatives included and not included in hedging relationships is determined on the basis of input factors observable either directly (as a price) or indirectly (derived from prices). All our information is obtained from recognised external sources.

Changes in the fair value of "available-for-sale financial instruments" are recognised directly in equity. They are recognised in the income statement when the assets are sold or determined to be impaired.

As in the previous year, we did not make any reclassifications between the individual measurement categories.

Intangible assets

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

Write-downs are charged for impairment if the recoverable amount – the higher of the fair value less costs to sell and the value in use – 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) up to a maximum of amortised cost.

We amortised goodwill originating between 1 January 1995 and 30 March 2004 over a maximum of 15 years. In accordance with IFRS 3, the resulting cumulative amortisation was eliminated against historical cost effective 1 January 2005. Goodwill has been tested for impairment at least once a year since 2005; it is not amortised any longer. A review is conducted as soon as circumstances or events occur that indicate the carrying amount cannot be recovered. The impairment test relates to the "cash-generating units", which at KSB are the legal entities. Occasionally a group of cash-generating units may also serve as the basis, provided these units reflect the lowest level on which we monitor goodwill. If the recoverable amount is lower than the carrying amount, then goodwill must be reduced by the difference in value (reported in the income statement as a component of the write-downs). Reversal of an impairment loss from an earlier period is not possible. Goodwill originating up to and including 1994 has been deducted from revenue reserves. Any excess of our interest in the fair values of net assets acquired over cost originating until 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, after reassessment, immediately recognised in income.

When calculating goodwill we apply purchase price allocations and determine the fair value of the assets and liabilities acquired. In addition to the assets and liabilities already recognised by the selling party, we also assess marketing-related aspects (primarily brands and trademarks, competitive restrictions), customer-related aspects (primarily customer lists, customer relations, orders on hand), contract-related aspects (mainly particularly advantageous service, work, purchasing and employment contracts) as well as technology-related aspects (primarily patents, know-how and databases). To determine values we primarily apply the residual value method, the excess earnings method and cost-oriented procedures.

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

Property, plant and equipment

Property, plant and equipment is carried at cost and reduced by straight-line depreciation. No tax-motivated depreciation is recognised. 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) up to a maximum of amortised cost.

We have applied the component approach under IAS 16.

Government grants relating to property, plant and equipment are transferred to an adjustment item on the liabilities side. This adjustment item is reversed over a defined utilisation period. As far as government grants recognised which are to be held for specific periods of time are concerned, we expect that these periods will be complied with.

Maintenance expenses are recognised 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:

USEFUL LIVES

Buildings	10 – 50 years
Plant and machinery	5 – 25 years
Operating and office equipment	3 – 25 years

Leases

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

Non-current financial assets
Investments in non-consolidated affiliates and associates are carried at fair value. Interest-bearing loans are recognised at amortised cost.

Non-current financial assets are measured at cost if their fair value cannot be reliably determined because they are not traded in an active market.

Inventories
Inventories are carried at the lower of cost and net realisable value. Cost is measured using the weighted average method. Write-downs to the net realisable value take account of the inventory risks resulting from slow-moving goods or impaired marketability. This also applies 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.

Advance payments made on inventories are also presented here because of the correlation and expected realisation of these advances (through conversion into inventories) within the normal business cycle. Advances received from customers are recognised as current liabilities.

Construction contracts under IAS 11
The percentage of completion (PoC) method is applied for construction contracts defined under IAS 11. The stage of completion of contracts is determined on the basis of the proportion that contract costs (excluding indirect material costs) incurred for work performed up to the reporting date bear to the estimated total contract costs (excluding indirect material costs) at the reporting date. The percentage contract revenue less the related advances received from customers is reported – depending on the balance – in receivables and other current assets or in current liabilities. Effects in the period are recognised in the income statement as part of sales revenue. The gross amount due to customers for contract work is included in other provisions.

Receivables and other current assets
For subsequent measurement, receivables and other current assets that are classified as loans and receivables (LaR) are recognised at amortised cost. Low-interest or non-interest-bearing receivables are discounted. In addition, we take account of identifiable risks by charging specific write-downs and experience-based write-downs using allowance accounts. 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 (for further explanations, refer to the Financial Risks – Credit Risk section).

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

Current financial instruments
Financial instruments are carried at their fair values at the reporting date.

Cash and cash equivalents
Cash (cash and sight deposits) and cash equivalents (short-term, highly liquid financial investments that are readily convertible to defined amounts of cash, and that are subject to only immaterial fluctuations in terms of their value) are recognised at amortised cost.

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 recognise 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 utilised. Deferred taxes are also recognised for consolidation adjustments. Deferred taxes are not discounted. Deferred tax assets and liabilities are always offset where they relate to the same tax authority.

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

KSB companies that use a defined contribution pension plan do not recognise provisions. The premium payments are recognised 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 recognised 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. The amount recognised as a provision is our best estimate. Any recourse or reimbursement claims are recognised separately and are not deducted from the provisions concerned.

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

Non-current provisions are discounted if the effects are material.

Liabilities

Liabilities classified as financial liabilities measured at amortised cost (FLAC) are recognised at amortised cost using the effective interest method.

Derivative financial instruments

We only use derivatives for hedging purposes. We hedge both existing recognised underlyings and future cash flows (cash flow hedges) against foreign currency and interest rate risks. The hedging instruments used are exclusively highly effective currency forwards, currency options and interest rate derivatives entered into with prime-rated banks. We hedge currency risks primarily for items in US dollars (USD). Interest rate risks are minimised through 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 currency derivatives used to hedge an existing recognised underlying are recognised in 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 currency derivatives are taken directly to equity until the related hedged item is recognised.

Fair value changes of interest rate derivatives used to hedge against interest rate risks in liabilities are recognised directly in equity.

The carrying amounts equal fair value and are determined on the basis of input factors observable either directly (as a price) or indirectly (derived from prices). Fair values may be positive or negative. Fair value is the amount that we would receive or have to pay at the reporting date to settle the financial instrument. This amount is determined using the relevant exchange rates, interest rates and counterparty credit ratings at the reporting date.

There was no material hedge ineffectiveness that would have been required to be reported.

Derivatives are reported under other receivables and other current assets, and under miscellaneous other liabilities.

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

Contingent liabilities (contingencies and commitments)
Contingent liabilities, which are not recognised, 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 reporting 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 recognised when the deliveries have been effected or the services have been rendered and the significant risks of ownership have been transferred. Effects resulting from application of the percentage of completion method in accordance with IAS 11 are also recognised in the sales revenue.

Expenses are recognised when they are incurred or when the services are utilised.

Estimates and assumptions
Preparation of consolidated financial statements in accordance with IFRSs requires management to make estimates and assumptions that affect the accounting policies to be applied. When implementing such accounting policies, estimates and assumptions affect the assets, liabilities, income and expenses recognised in the consolidated financial statements, and their presentation. These estimates and assumptions are based on past experience and a variety of other factors deemed appropriate under the circumstances. Actual amounts may differ from these estimates and assumptions. We continuously review the estimates and assumptions that we apply. If more recent information and additional knowledge are available, recognised amounts are adjusted to reflect the new circumstances. Any changes in estimates and assumptions that result in material differences are explained separately.

Impairment tests for goodwill, which are conducted at least once per year, require an estimate of the recoverable amounts for each cash-generating unit. These correspond to the higher amount from the fair value less costs to sell and value in use. The earnings forecast on the basis of these estimates are affected by various factors, which may include exchange rate fluctuations, progress in Group integration or the expectations for the economic development of these units. Although management believes that the assumptions used to calculate the recoverable amount are appropriate, any unforeseen changes in these assumptions could lead to an impairment loss.

Estimates and assumptions must also be made to review the value of assets. For each asset it must be verified to what extent there are indications of an impairment of the carrying amount. When determining the recoverable amount of property, plant and equipment, the estimation of the relevant useful life is subject to uncertainty. The measurement of doubtful receivables is based on forecasts about the creditworthiness of customers. A material change in the assumptions or circumstances can lead in future to additional impairment losses or reversals.

For construction contracts with clients in the project business we recognise sales revenue according to the percentage-of-completion method. This requires estimates regarding the total contract costs and revenue, contract risks as well as other relevant factors. These estimates are reviewed regularly by the business units with operative responsibility and adjusted where necessary.

Provisions for employee benefits, especially pensions and similar obligations, are determined according to actuarial principles, which are based on statistical and other factors so as to anticipate future events. Main factors are the reported market discount rates, salary and retirement trends as well as life expectancy. The actuarial assumptions made may differ from actual developments as a result of changing market and economic conditions, and this can have material effects on the amount of provisions and thus on the company's overall net assets, financial position and results of operations.

Other provisions are reported based on the best possible estimate of the probability of future outflows. The later, actual outflow can, however, deviate from the estimate as a result of changed economic, political or legal conditions. This will be reflected in Additional expenses or Income from reversals.

The global scope of our activities must be taken into account for the Taxes on income. Based on our operative activities in numerous countries with varying tax laws and administrative interpretation, differentiated assessment is required for determining our tax obligations. Uncertainty may arise due to different interpretations by taxable entities on the one hand and local finance authorities on the other. Although we believe we have made a reasonable estimate regarding any tax uncertainties, it is possible that the actual tax obligation will differ from our original estimate. With regard to future tax benefits, we assess their realisability as of every balance sheet date. For this reason, we only recognise deferred tax assets if sufficient taxable income is available in future. In assessing this future taxable income it must be taken into account that expected future business developments are subject to uncertainties and are in some cases excluded from control by company management (for example changes to applicable tax legislation). If we come to the conclusion that previously reported deferred tax assets cannot be realised because of changed assumptions, then the assets will be written down by the appropriate amount.

Maturities
Maturities of up to one year are classified as current.

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

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

IV. BALANCE SHEET DISCLOSURES

1 Fixed assets

STATEMENT OF CHANGES IN INTANGIBLE ASSETS

(€ thousands)	Concessions, industrial property and similar rights and assets, as well as licences in such rights and assets		Goodwill		Advance payments		Intangible assets Total	
Historical cost	2012	2011	2012	2011	2012	2011	2012	2011
Balance at 1 January	52,014	40,365	79,977	41,517	1,035	1,303	**133,026**	**83,185**
Changes in consolidated Group	342	3,925	7,075	14,971	–	–	**7,417**	**18,896**
Currency translation adjustments	–410	161	1,403	371	–	–	**993**	**532**
Other	–31	–	–	–	–	–	**–31**	–
Additions	7,807	7,383	1,379	23,310	649	462	**9,835**	**31,155**
Disposals	1,438	788	–	192	–	–	**1,438**	**980**
Reclassifications	494	968	–	–	–497	–730	**–3**	**238**
Balance at 31 December	58,778	52,014	89,834	79,977	1,187	1,035	**149,799**	**133,026**
Accumulated depreciation and amortisation	2012	2011	2012	2011	2012	2011	2012	2011
Balance at 1 January	37,794	31,269	3,535	3,332	–	–	**41,329**	**34,601**
Changes in consolidated Group	120	2,429	547	–	–	–	**667**	**2,429**
Currency translation adjustments	–107	–101	–	–	–	–	**–107**	**–101**
Other	–	–	–	–	–	–	–	–
Additions	6,188	4,985	338	303	–	–	**6,526**	**5,288**
Disposals	1,240	788	–	100	–	–	**1,240**	**888**
Reclassifications	–	–	–	–	–	–	–	–
Balance at 31 December	42,755	37,794	4,420	3,535	–	–	**47,175**	**41,329**
Carrying amount at 31 December	**16,023**	**14,220**	**85,414**	**76,442**	**1,187**	**1,035**	**102,624**	**91,697**

As in the previous year, we did not capitalise any development costs in the year under review because not all of the comprehensive recognition criteria defined in IAS 38 were met.

We conduct our impairment tests once a year. If an additional impairment test is deemed to be required because there is an indication that an asset may be impaired (trigger event), the test is performed promptly. As in the previous year, this proved unnecessary in the year under review.

We apply the discounted cash flow model to determine the recoverable amount (value in use). The future earnings (EBIT in accordance with IFRSs) applied were taken from a multi-year plan (five years max.), the basis of which was approved in December. We carried out this planning based on certain assumptions which were drawn from both forecasts from external sources, e.g. current German Engineering Federation (VDMA) publications, and our own knowledge of markets and competitors. In our calculations we consistently extrapolated the result of the last plan year as a constant; we did not apply any growth rates. Should determination of the recoverable amount reveal a need for write-downs, we additionally calculate the fair value less costs to sell.

The carrying amounts of cash-generating units do not contain any items related to taxes or financing activities.

To determine the discount rate, the weighted average cost of capital (WACC) method is applied in conjunction with the capital asset pricing model (CAPM), taking into account a peer group. Under this method, first the cost of equity is determined using CAPM and the borrowing costs are defined, and then the individual capital components are weighted in accordance with the capital structure. The interest rate for risk-free 30-year Bunds was used as a base rate. This rate was 2.2 % in the reporting year. The market risk premium was 5.5 %, and a beta factor of 1 was used. In addition, country-specific tax rates and country risk premiums are taken into account individually for each cash-generating unit (CGU).

DISCOUNT RATES (AFTER TAXES)

in %	2012
Germany	7.3
The Netherlands	7.3
Italy	9.9
USA	7.1
South Africa	9.5
South Korea	8.3
Other European countries	7.3 – 11.0

The impairment testing on a Group level revealed the need for write-downs of € 338 thousand (previous year: no need for write-downs) for a European service company.

Impairment testing conducted in the separate financial statements did not reveal any need for write-downs (previous year: € 303 thousand).

Of the carrying amount of all goodwill totalling € 85,414 thousand (previous year: € 76,442 thousand), € 24,763 thousand (previous year: € 23,235 thousand) was attributable to the South Korean company KSB Seil Co., Ltd.; € 18,285 thousand (previous year: € 18,285 thousand) to the Dutch Group company DP industries B.V.; € 9,681 thousand (previous year: € 9,681 thousand) to the Italian company REEL s.r.l.; € 3,710 thousand (previous year: € 3,710 thousand) to KSB Italia S.p.A.; € 3,150 thousand (previous year: € 3,150 thousand) to the German company Dynamik-Pumpen GmbH; € 2,980 thousand (previous year: € 2,980 thousand) to the German company Uder Elektromechanik GmbH; € 2,664 thousand (previous year: € 2,839 thousand) to the South African company KSB Pumps (S.A.) (Pty) Ltd.; € 1,764 thousand (previous year: € 1,764) to KSB Finland Oy; € 1,353 thousand (previous year: € 1,353 thousand) to KSB Service Italia S.r.l.; € 1,351 thousand (previous year: € 1,281) to the Norwegian KSB Norge AS; and € 1,077 thousand (previous year: € 1,077 thousand) to KAGEMA Industrieausrüstungen GmbH in Germany.

€ 7,564 thousand was attributable to the companies included in the consolidated financial statements for the first time (of which € 2,609 thousand to KSB Service Centre-Est S.A.S., France; € 1,376 thousand to SPI Energie S.A.S, France; € 1,375 thousand to T. Smedegaard A/S, Denmark; and € 1,335 thousand to Pumpen-Service Bentz GmbH, Germany).

The remaining € 7,072 thousand (previous year € 7,087 thousand) is attributable to another 15 (previous year 15) companies.

KEY GOODWILL ITEMS

Cash-generating unit	Carrying amount of goodwill (€ million)	Percentage of total goodwill	Discount rate after taxes	Underlying assumptions, corporate planning	Method for assessing the value of the underlying assumption
KSB Seil Co., Ltd.	24.8	29 %	8.3 %	■ Business cycle expectations in shipbuilding (liquefied gas tankers) ■ Exchange rates	Consideration of macro-economic key data and external market research.
DP industries B.V.	18.3	21 %	7.3 %	■ Selling prices ■ Procurement prices ■ Market growth rates	Consideration of macro-economic key data and internal estimates of the relevant purchasing and sales departments.
REEL s.r.l.	9.7	11 %	9.9 %	■ Market growth rates ■ Customer focus on energy efficiency ■ Selling prices	Consideration of external market data and macro-economic environment.

For the cash-generating units presented in the table, we determined the value in use or the fair value less costs to sell, based on a five-year plan as a matter of course. There was no impairment requirement.

A 5 % increase in the relevant discount rate as a possible change in a key underlying assumption, on which we have based determination of the recoverable amount of the unit, would require write-downs of approximately € 0.2 million at a German service company and would have an effect of about € 1 million at our South Korean company. No need for write-downs would have arisen in the previous year.

As in the previous year, we did not recognise any impairment losses on other intangible assets in the year under review.

STATEMENT OF CHANGES IN PROPERTY, PLANT AND EQUIPMENT

(€ thousands)	Land and buildings		Plant and machinery		Other equipment, operating and office equipment		Advance payments and assets under construction		Property, plant and equipment Total	
Historical cost	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Balance at 1 January	283,346	254,217	458,337	447,734	182,340	165,503	19,623	17,841	**943,646**	**885,295**
Changes in consolidated Group	8,956	13,965	8,933	3,922	3,267	5,593	136	58	**21,292**	**23,538**
Currency translation adjustments	−2,005	−492	−6,070	−5,128	−2,488	−2,091	−499	−408	**−11,062**	**−8,119**
Other	−460	–	−679	–	–	19	–	–	**−1,139**	**19**
Additions	18,179	10,248	23,149	15,351	21,224	19,547	18,976	17,200	**81,528**	**62,346**
Disposals	508	1,206	7,466	10,265	13,434	7,711	1,987	13	**23,395**	**19,195**
Reclassifications	5,865	6,614	9,472	6,723	1,578	1,480	−16,912	−15,055	**3**	**−238**
Balance at 31 December	313,373	283,346	485,676	458,337	192,487	182,340	19,377	19,623	**1,010,873**	**943,646**
Accumulated depreciation and amortisation	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Balance at 1 January	114,261	107,394	280,366	268,272	120,263	108,769	–	–	**514,890**	**484,435**
Changes in consolidated Group	2,534	754	5,941	1,084	1,708	2,478	–	–	**10,183**	**4,316**
Currency translation adjustments	−721	237	−3,120	−1,944	−1,697	−1,370	–	–	**−5,538**	**−3,077**
Other	−119	–	−679	1	–	18	–	–	**−798**	**19**
Additions	7,098	6,504	25,977	22,439	19,046	16,764	–	–	**52,121**	**45,707**
Disposals	437	628	7,145	9,169	12,998	6,713	–	–	**20,580**	**16,510**
Reclassifications	23	–	82	−317	−105	317	–	–	**–**	**–**
Balance at 31 December	122,639	114,261	301,422	280,366	126,217	120,263	–	–	**550,278**	**514,890**
Carrying amount at 31 December	**190,734**	**169,085**	**184,254**	**177,971**	**66,270**	**62,077**	**19,337**	**19,623**	**460,595**	**428,756**

Assets resulting from finance leases are recognised as fixed assets in accordance with IAS 17, and corresponding financial liabilities are recognised. The carrying amount of these capitalised assets amounts to € 3,524 thousand (previous year: € 3,263 thousand), of which € 1,948 thousand (previous year: € 2,011 thousand) relate to land and buildings, € 433 thousand (previous year: € 167 thousand) to plant and machinery and € 1,143 thousand (previous year: € 1,085 thousand) to other equipment, operating and office equipment.

Disposals of items of property, plant and equipment resulted in book gains of € 2,371 thousand (previous year: € 3,027 thousand) and book losses of € 361 thousand (previous year: € 1,507 thousand). The book gains and losses are reported in the income statement under other income and other expenses.

We did not recognise any impairment losses on property, plant and equipment in the year under review (previous year: € 521 thousand).

STATEMENT OF CHANGES IN NON-CURRENT FINANCIAL ASSETS

(€ thousands)	Investments in affiliates		Other investments		Non-current financial instruments		Loans		Non-current financial assets Total	
Acquisition cost	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Balance at 1 January	34,741	55,056	15,918	13,077	764	754	2,097	11,039	**53,520**	**79,926**
Change in consolidated Group	–12,881	–27,539	–	–	–	6	–1,985	–8,089	**–14,866**	**–35,622**
Currency translation adjustments	11	20	1	–	–	2	–	1	**12**	**23**
Other	–	–	–	–	–	–6	–	–	**–**	**–6**
Additions	3,110	7,214	6,612	4,500	35	13	31	147	**9,788**	**11,874**
Disposals	657	10	–	1,659	15	5	3	1,001	**675**	**2,675**
Reclassifications	–	–	–	–	–	–	–	–	**–**	**–**
Balance at 31 December	24,324	34,741	22,531	15,918	784	764	140	2,097	**47,779**	**53,520**
Accumulated impairment losses	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Balance at 1 January	12,378	10,599	459	1,840	100	94	510	1,548	**13,447**	**14,081**
Change in consolidated Group	–3,819	–379	–	–	–	–	–510	–	**–4,329**	**–379**
Currency translation adjustments	–	19	–	–	–	–	–	–	**–**	**19**
Other	–	–	–	–	–	–	–	–	**–**	**–**
Additions	740	2,139	–	–	1	6	–	–	**741**	**2,145**
Disposals	657	–	–	1,381	–	–	–	1,000	**657**	**2,381**
Reclassifications	–	–	–	–	–	–	–	–	**–**	**–**
Reversal (write-up)	–	–	214	–	29	–	–	38	**243**	**38**
Balance at 31 December	8,642	12,378	245	459	72	100	–	510	**8,959**	**13,447**
Carrying amount at 31 December	**15,682**	**22,363**	**22,286**	**15,459**	**712**	**664**	**140**	**1,587**	**38,820**	**40,073**

Investments in affiliates and other equity investments reported under non-current financial assets are virtually unchanged. Additions, above all from the above-mentioned capital increase and the acquisition of companies in Europe were offset by effects resulting from first-time consolidation.

We currently have no plans for the sale of investments in affiliates and other equity investments.

None of the loans are loans to affiliates (previous year: € 1,521 thousand).

The effect of currency translation adjustments taken directly to equity on fixed assets was a loss of € 4,412 thousand (previous year: loss of € 4,405 thousand).

The list of shareholdings is included at the end of these Notes.

2 Deferred tax assets

Explanations on deferred tax assets are presented under "Taxes on income".

3 Inventories

(€ thousands)	31 Dec. 2012	31 Dec. 2011
Raw materials and production supplies	161,594	149,616
Work in progress	168,172	147,031
Finished goods and goods purchased and held for resale	105,136	102,107
Advance payments	22,306	26,302
	457,208	**425,056**

€ 62,191 thousand (previous year: € 47,771 thousand) of the inventories is carried at net realisable value. The impairment losses recognised as an expense in the period under review amount to € 2,561 thousand (previous year: € 1,460 thousand). We reversed write-downs totalling € 1,364 thousand (previous year: € 1,839 thousand) where the current net realisable value was higher than the prior-period value. Inventories amounting to € 961,300 thousand (previous year: € 854,069 thousand) were recognised as expenses in the period under review.

4 Receivables and other current assets

(€ thousands)	31 Dec. 2012	31 Dec. 2011
Trade receivables	481,900	461,348
Intragroup receivables	8,011	16,025
Associate receivables	8,926	7,566
Receivables recognised by PoC	130,737	122,147
Receivables recognised by PoC (excl. advances received from customers PoC)	230,546	235,194
Advances received from customers (PoC)	– 99,809	– 113,047
Other receivables and other current assets	58,386	51,308
	687,960	**658,394**

Intragroup receivables include loans at the usual interest amounting to € 2,690 thousand (previous year: € 8,400 thousand). Impairment losses on intragroup receivables amount to € 6,374 thousand (previous year: 6,561 thousand) and on associate receivables to € 765 thousand (previous year € 580 thousand). As in the previous year, additions in this respect were not material.

Construction contracts under IAS 11 include recognised profits of € 45,034 thousand (previous year: € 44,257 thousand) and costs of € 185,512 thousand (previous year: € 190,937 thousand). Sales revenue in accordance with IAS 11 amounted to € 535,221 thousand (previous year: € 328,575 thousand). The gross amount due to customers for contract work is included in other provisions.

The other receivables and other current assets include receivables from employees and deferred interest. They also include recoverable taxes (primarily from VAT) in the amount of € 22,909 thousand (previous year: € 16,951 thousand) and other financial assets from currency forwards in accordance with IAS 39 in the amount of € 3,409 thousand (previous year: € 1,207 thousand). As in the previous year, there are no receivables relating to interest rate derivatives.

At the reporting date, the notional volume of all currency forwards was € 196,506 thousand (previous year: € 147,964 thousand), and the notional volume of all interest rate derivatives was € 75,105 thousand (previous year: € 5,052 thousand).

The contractual maturities of payments for currency forwards are as follows:

(€ thousands)	Total	Up to 1 year	1 – 5 years	> 5 years
Notional volume 2012	196,506	166,886	29,499	121
Notional volume 2011	147,964	93,008	54,456	500

€ 30,890 thousand (previous year: € 25,134 thousand) of all receivables and other assets is due after more than one year.

5 Current financial instruments, cash and cash equivalents

There are no current financial instruments (previous year: € 11 thousand).

Cash and cash equivalents are primarily term deposits with short maturities and call deposits. German Group companies use € 14,800 thousand of cash and cash equivalents (previous year: € 16,600 thousand) to hedge credit balances for partial retirement arrangements as required by law. They are available to us at any time due to the underlying contractual structure.

6 Equity

There was no change in the share capital of KSB AG as against the previous year. In accordance with the Articles of Association, it totals € 44,771,963.82 and is composed of 886,615 ordinary shares and 864,712 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 no-par value bearer shares. The individual shares have no par value.

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. These effects resulted in deferred tax assets in the amount of € 174 thousand (previous year: € 1,025 thousand) and deferred tax liabilities in the amount of € 481 thousand (previous year: none).

A total of € 21,241 thousand (dividend of € 12.00 per ordinary share and € 12.26 per preference share) was paid from equity by a resolution of the Annual General Meeting of the Group's parent company KSB AG, Frankenthal, on 16 May 2012.

Equity also includes changes in the fair value of derivatives used to hedge future cash flows amounting to € + 1,008 thousand (previous year: € – 3,882 thousand). They changed as follows:

(€ thousands)	2012	2011
Opening balance at 1 January	– 3,882	– 750
Change in consolidated Group / Currency translation adjustments / Other	26	19
Disposals	2,447	296
Additions	2,417	– 3,447
Closing balance at 31 December	**1,008**	**– 3,882**

Non-controlling interest relates primarily to PAB GmbH, Frankenthal, and the interests it holds, as well as to our companies in India and China. KSB AG holds a 51 % interest in PAB GmbH, while Klein Pumpen GmbH, Frankenthal, holds a 49 % interest.

Details of the changes in equity accounts and non-controlling interest are contained in the Statement of Changes in Equity.

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

CAPITAL DISCLOSURES

Adequate capital resources and sufficient financial independence are key requirements for sustainably increasing KSB's enterprise value and safeguarding the company's continued existence in the long term. Obtaining the necessary funds for ongoing business operations is also extremely important for us. In addition to order intake and sales revenue, our key performance indicators are the return on sales and our net financial position (the difference between interest-bearing financial assets on the one hand, and financial liabilities on the other). The changes in the equity ratio are also relevant for us. We regularly monitor the development of these figures and manage them through active working capital management and by constantly optimising our financing structure, among other things.

We present the development of these indicators in the Group management report.

		2012	2011
Order intake	€ million	2,257.4	2,132.3
Sales revenue	€ million	2,268.2	2,091.0
Return on sales	%	5.9	5.8
Net financial position	€ million	141.2	187.0
Equity ratio	%	42.4	44.0

7 Deferred tax liabilities

Explanations on deferred tax liabilities are presented under "Taxes on income".

8 Provisions

Changes (€ thousands)	1 Jan. 2012	Change in consolidated Group / CTA* / Other	Utilisation / Prepayments	Dissolution	Additions	31 Dec. 2012
Employee benefits	391,277	–431	–102,174	–3,504	112,899	398,067
Pensions and similar obligations	257,717	106	–12,817	–	25,941	270,947
Other employee benefits	133,560	–537	–89,357	–3,504	86,958	127,120
Other provisions	104,589	902	–60,119	–8,011	64,271	101,632
Taxes	12,110	89	–15,488	–27	14,754	11,438
Taxes on income	10,920	–22	–14,654	–27	13,952	10,169
Other taxes	1,190	111	–834	–	802	1,269
Warranty obligations and contractual penalties	50,700	–249	–21,308	–4,387	23,784	48,540
Miscellaneous other provisions	41,779	1,062	–23,323	–3,597	25,733	41,654
	495,866	**471**	**–162,293**	**–11,515**	**177,170**	**499,699**

* CTA = currency translation adjustments

PROVISIONS FOR PENSIONS AND SIMILAR OBLIGATIONS

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

The amounts provided for these defined 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 actuarial assumptions used at German Group companies are as follows: The discount rate applied to the obligations was reduced from 5.4 % to 3.3 %. As in the previous year, the assumed rate of future salary increases is 2.7 %, and the assumed growth rate for the pension trend is 2.0 % per annum. The biometric assumptions are again based on the 2005G mortality tables published by Prof. Klaus Heubeck. A mean fluctuation rate (2.0 %) is still applied to staff turnover. The retirement age used for the calculations is based on the *Rentenversicherungs-Altersgrenzanpassungsgesetz* 2007 [*RVAGAnpG* – German Act Adapting the Standard Retirement Age for the Statutory Pension Insurance System].

In some cases, the valuation parameters used for non-material benefit plans at foreign companies differ from those used in Germany. Discount rates used vary between 2.5 % and 8.2 %, the assumed rate of future salary increase is between 1.0 % and 8.0 % and the assumed increase in pensions is 1.0 % to 2.0 %. Other valuation parameters (for example cost trends in health care) are not significant.

Actuarial gains and losses outside the 10 % corridor around the present value of the DBO are recognised. Where the cumulative gain or loss exceeds the 10 % corridor, the excess amount is spread over the average remaining working lives of the employees and recognised in the profit or loss of future periods.

CHANGES IN DBO (PRESENT VALUE OF THE OBLIGATION)

(€ thousands)	2012	2011
Opening balance at 1 January	**274,189**	**262,093**
Current service cost financed by the employer	8,212	7,387
Current service cost financed by the employees	3,708	3,780
Interest cost	14,623	13,867
Benefit payments	– 13,020	– 11,711
Actuarial gains / losses (–/+)	107,392	– 1,928
Currency translation adjustments	– 158	293
Change in consolidated Group / Other	– 1,083	408
Closing balance at 31 December	**393,863**	**274,189**

The present value of pension commitments amounted to € 262 million for 2010, € 248 million for 2009 and € 217 million for 2008.

RECONCILIATION TO CARRYING AMOUNTS

(€ thousands)	2012	2011
DBO at 31 December	**393,863**	**274,189**
Unrecognised gains / losses (+ / –)	– 122,912	– 16,459
Change in consolidated Group / Currency translation adjustments / Other	– 4	– 13
Carrying amount at 31 December	**270,947**	**257,717**

ALLOCATION OF THE ACTUARIAL GAINS / LOSSES IN THE FINANCIAL YEAR

(€ thousands)	2012	2011
Experience adjustments	– 6	245
Changes in assumptions	107,398	– 2,173
Total gains / losses (+ / –) at 31 December	107,392	**– 1,928**

Experience adjustments for 2010 and 2009 amounted to less than € 1 million each, and to less than € 4 million for 2008.

EFFECTS IN THE INCOME STATEMENT

(€ thousands)	2012	2011
Current service cost	11,920	11,167
Actuarial gains / losses	1,013	379
Interest cost	14,623	13,867
Other	– 954	– 415
	26,602	**24,998**

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

Contributions totalling € 26,948 thousand (previous year: € 26,899 thousand) were paid to state pension insurance funds in the year under review.

OTHER PROVISIONS

Provisions for other employee benefits relate primarily to profit-sharing, jubilee payments, compensated absence, partial retirement and severance payments. Other 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. The provisions for warranty obligations and contractual penalties cover the statutory and contractual obligations to customers. The provisions for miscellaneous other obligations include provisions for expected losses from uncompleted transactions and onerous contracts (primarily from construction contracts with gross amounts due to customers in accordance with IAS 11 in the amount of € 1,383 thousand for 2012 and € 2,665 thousand for 2011), customer bonuses, accrued costs and environmental measures.

€ 35,281 thousand of the other provisions is non-current (previous year: € 39,037 thousand). This relates mainly to provisions for jubilee payments, partial retirement and warranty obligations. As in the previous year, no compounding effects were incurred in the financial year.

9 Liabilities

NON-CURRENT LIABILITIES

(€ thousands)	31 Dec. 2012	31 Dec. 2011
Financial liabilities		
Loan against borrower's note	180,597	50,000
Bank loans and overdrafts	24,638	9,072
Finance lease liabilities	1,352	1,190
Other	1,454	1,481
	208,041	61,743
Total non-current liabilities	**208,041**	**61,743**

CURRENT LIABILITIES

(€ thousands)	31 Dec. 2012	31 Dec. 2011
Financial liabilities		
Loan against borrower's note	–	12,500
Bank loans and overdrafts	54,060	53,164
Finance lease liabilities	703	588
Intragroup liabilities	162	353
Associate liabilities	268	765
Other	14	176
	55,207	67,546
Trade payables		
Trade payables to third parties	193,564	201,578
Intragroup trade payables	1,896	3,475
Associate liabilities	8,554	4,689
	204,014	206,267
Tax liabilities	22,047	19,947
Other liabilities		
Advances received from customers	94,054	84,030
Advances received from customers (PoC)	54,121	61,148
Social security and liabilities towards employees	20,473	17,504
Miscellaneous other liabilities and deferred income	55,106	53,075
	223,754	215,757
Total current liabilities	**505,022**	**509,517**

TOTAL NON-CURRENT AND CURRENT LIABILITIES

(€ thousands)	31 Dec. 2012	31 Dec. 2011
Total liabilities	**713,063**	**571,260**

To safeguard liquidity in the medium term, in 2009 KSB AG took the precaution of placing a loan against borrower's note worth € 100 million with a 3-year and 5-year maturity. This originally served to ensure the solvency of the company even in a protracted crisis situation. € 37.5 million was repaid before maturity in 2011, and € 56.5 million in 2012. Based on the favourable capital market conditions, we decided to place another loan against borrower's note with a total volume of € 175 million in December 2012. This loan is divided into repayment tranches of 3, 5, 7 and 10 years, and the interest rate is in part fixed and in part based on variable interest rate agreements. The residual obligation at year-end 2012 of both loans against borrower's note thus was € 181 million. € 161 million of the liabilities arising from the loans against borrower's note are classified as bank loans and € 20 million as other financial liabilities.

Assets amounting to € 11,353 thousand (previous year: € 16,805 thousand) have been pledged as security in the KSB Group for bank loans and other liabilities on the basis of standard terms and conditions. Of these, € 5,917 thousand (previous year: € 5,771 thousand) relate to property, plant and equipment, € 2,091 thousand (previous year: € 9,191 thousand) to inventories, € 669 thousand (previous year: € 622 thousand) to receivables and € 2,676 thousand (previous year € 1,221 thousand) to cash and cash equivalents, as well as other securities.

€ 2,906 thousand (previous year: € 10,545 thousand) of the liabilities were secured by land charges or similar rights in the year under review.

The weighted average interest rate on bank loans and overdrafts as well as on an open-market credit (loan against borrower's note) was 2.82 % (previous year: 4.49 %). Interest rate risk exists for the major portion of the loan against borrower's note mentioned above.

There were no covenant agreements for loans in the year under review, as was the case the previous year too.

Miscellaneous other liabilities include changes in the fair value of hedging instruments amounting to € 2,134 thousand (previous year: € 6,379 thousand). € 600 thousand (previous year: € 253 thousand) of this amount relates to interest rate derivatives. Deferred income amounts to € 1,298 thousand (previous year: € 1,371 thousand). This also includes investment grants and subsidies totalling € 4,962 thousand (previous year: € 3,003 thousand) received for new buildings in Germany.

V. INCOME STATEMENT DISCLOSURES

10 Sales revenue

KSB Group sales revenue amounted to € 2,268,211 thousand (previous year € 2,091,046 thousand), of which € 2,047,277 thousand was from the sale of goods and goods purchased and held for resale (previous year € 1,897,193 thousand) and € 220,934 thousand from services (previous year € 193,853 thousand).

The breakdown of sales revenue by product group pumps, valves and service is presented in the segment reporting.

The change in the consolidated Group to include the Smedegaard Group had an impact of € 10,199 thousand. Other companies consolidated for the first time accounted for € 34,247 thousand.

There was no material sales revenue from smaller affiliates or associates which have not yet been consolidated.

11 Other income

(€ thousands)	2012	2011
Gains from asset disposals and reversals of impairment losses (write-ups)	2,371	3,027
Income from current assets	7,233	2,904
Currency translation gains	1,218	388
Income from the reversal of provisions	11,488	12,344
Miscellaneous other income	22,006	14,734
	44,316	**33,397**

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

Income from government grants for individual projects (for example research activities) amounted to € 3,386 thousand (previous year: € 529 thousand).

The changes in the consolidated Group did not have any material impact on other income.

12 Cost of materials

(€ thousands)	2012	2011
Cost of raw materials and production supplies consumed and of goods purchased and held for resale	918,594	849,411
Cost of purchased services	66,577	63,580
	985,171	**912,991**

The change in the consolidated Group to include the Smedegaard Group had an impact of € 8,405 thousand. Other companies consolidated for the first time accounted for € 8,891 thousand.

13 Staff costs

(€ thousands)	2012	2011
Wages and salaries	607,241	557,804
Social security contributions and employee assistance costs	129,668	121,254
Pension costs	21,304	18,923
	758,213	**697,981**

Pension costs are reduced by the interest component of provisions for pensions and similar obligations, which is reported as an interest cost in financial income/expense. € 4,427 thousand was spent on defined contribution schemes in the year under review (previous year: € 2,985 thousand)

The change in the consolidated Group to include the Smedegaard Group had an impact of € 4,049 thousand. Other companies consolidated for the first time accounted for € 15,194 thousand.

AVERAGE NUMBER OF EMPLOYEES

	2012	2011
Wage earners	7,171	6,808
Salaried employees	8,458	8,130
Apprentices	585	566
	16,214	**15,504**

The changes in the consolidated Group in the year under review led to the addition of 507 people, of which 82 employees belong to the Smedegaard Group.

14 Other expenses

(€ thousands)	2012	2011
Losses from asset disposal	361	1,507
Losses from current assets	10,075	9,512
Currency translation losses	1,955	502
Other staff costs	22,615	21,248
Repairs, maintenance, third-party services	95,869	97,732
Selling expenses	90,920	89,926
Administrative expenses	92,768	92,321
Rents and leases	27,237	23,506
Miscellaneous other expenses	35,912	47,625
	377,712	**383,879**

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

The change in the consolidated Group to include the Smedegaard Group had an impact of € 2,524 thousand. Other companies consolidated for the first time accounted for € 5,042 thousand.

15 Financial income / expense

(€ thousands)	2012	2011
Financial income	9,212	14,533
Income from investments	3,817	3,693
thereof from affiliates	(2,027)	(2,265)
Interest and similar income	5,088	9,288
thereof from affiliates	(145)	(467)
Write-ups of financial assets	214	38
Income from the remeasurement of financial instruments	1	–
Other financial income	92	1,514
Financial expense	– 23,519	– 24,403
Interest and similar expenses	– 22,668	– 22,193
thereof to affiliates	(– 3)	(– 1)
Write-downs of financial assets	– 740	– 2,139
Expenses from the remeasurement of financial instruments	–	–
Other financial expenses	– 111	– 71
	– 14,307	**– 9,870**

Interest and similar expenses include the interest cost on pension provisions amounting to € 14,623 thousand (previous year: € 13,867 thousand). The decrease in financial income is mainly due to lower interest income as a result of falling interest on investments. Write-downs on financial assets, however, have decreased. A small service company in Europe was affected by impairment due to the difficult economic situation during the year. The previous year saw impairments on two small service companies in Europe.

The changes in the consolidated Group had no material impact in general on financial income/expense.

16 Taxes on income

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

(€ thousands)	2012	2011
Effective taxes	44,555	39,093
Deferred taxes	– 2,031	– 1,909
	42,524	**37,184**

€ 1,525 thousand (previous year: € 150 thousand) of the effective taxes in the year under review related to prior-period tax refunds and € 278 thousand (previous year: € 631 thousand) to tax arrears.

RECONCILIATION OF DEFERRED TAXES

(€ thousands)	2012	2011
Change in deferred tax assets	– 4,296	– 7,609
Change in deferred tax liabilities	3,359	4,173
Change in deferred taxes recognised in balance sheet	**– 937**	**– 3,436**
Change in deferred taxes taken directly to equity	– 1,418	909
Changes in consolidated Group / Currency translation adjustments / Other	324	618
Deferred taxes recognised in income statement	**– 2,031**	**– 1,909**

ALLOCATION OF DEFERRED TAXES

	Deferred tax assets		Deferred tax liabilities	
(€ thousands)	2012	2011	2012	2011
Non-current assets	2,013	1,046	34,659	32,105
Current assets	60,716	55,124	73,189	66,444
Non-current liabilities	15,477	16,903	195	164
Current liabilities	21,014	18,164	9,254	9,758
Tax loss carryforwards	5,570	3,790	–	–
Gross deferred taxes – before offsetting	**104,790**	**95,027**	**117,297**	**108,471**
Offset under IAS 12.74	– 76,061	– 70,594	– 76,061	– 70,594
Net deferred taxes – after offsetting	**28,729**	**24,433**	**41,236**	**37,877**

At the reporting date, deferred tax assets amounting to € 7,032 thousand (previous year: € 6,302 thousand) were recognised, whose realisation exclusively depends on the creation of future profit. Based on the planning figures available, we expect realisation to take place.

As in the previous year, the introduction of new local taxes had no significant material effects in the year under review. Equally, changes in foreign tax rates did not have any significant impact on the total tax expense (€ – 298 thousand), as was the case in the previous year.

In the case of net income from affiliates and other equity investments, withholding taxes incurred in connection with distributions and German taxes incurred are recognised as deferred taxes if these gains are expected to be subject to corresponding taxation, or there is no intention of reinvesting them in the long term.

We did not recognise deferred tax assets from loss carryforwards amounting to € 33,243 thousand (previous year: € 29,626 thousand) because it is unlikely that there will be sufficient taxable profit available in the near future against which these deferred tax assets can be utilised. The same applies to minor deductible temporary differences.

RECONCILIATION OF INCOME TAXES

(€ thousands)	2012	2011
Earnings before income taxes	132,843	120,477
Calculated income taxes on the basis of the applicable tax rate (30 %; previous year: 29 %)	39,853	34,938
Differences in tax rates	320	2,410
Change in write-downs on deferred taxes on loss carryforwards and unused tax loss carryforwards	863	–2,705
Tax-exempt income / non-deductible expenses	–786	979
Prior-period taxes	–1,247	–1,189
Non-deductible foreign income tax	1,597	1,785
Other	1,924	966
Current taxes on income	**42,524**	**37,184**
Current tax rate	32 %	31 %

The applicable tax rate of 30 % (previous year: 29 %) is a composite rate resulting from the current German corporation tax, solidarity surcharge and trade income tax rates. The increase is the result of rising trade income tax rates, which account for € 576 thousand.

Changes in the consolidated Group had no material impact on the taxes on income.

17 Earnings after income taxes – Non-controlling interest

The non-controlling interest in net profit amounts to € 15,802 thousand (previous year: € 11,753 thousand), and the non-controlling interest in net loss amounts to € 153 thousand (previous year: € 410 thousand). These relate primarily to PAB GmbH, Frankenthal, Germany, and the interests it holds.

The changes in the consolidated Group did not have any material impact on the earnings after income taxes attributable to non-controlling interest.

18 Research and development costs

Research and development costs in the year under review amounted to € 45,046 thousand (previous year: € 42,302 thousand).

The changes in the consolidated Group did not have any material impact on research and development costs.

19 Earnings per share

		2012	2011
Earnings after income taxes – Attributable to KSB AG shareholders	(€ thousands)	74,670	71,950
Additional dividend attributable to preference shareholders (€ thousands) € 0.26 per preference share	(€ thousands)	– 225	– 225
	(€ thousands)	**74,445**	**71,725**
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**
Diluted and basic earnings per ordinary share	€	**42.51**	**40.95**
Diluted and basic earnings per preference share	€	**42.77**	**41.21**

The changes in the consolidated Group had no material impact on earnings per share.

VI. ADDITIONAL DISCLOSURES ON FINANCIAL INSTRUMENTS

The changes in the consolidated Group did not have any material impact on below disclosures on financial instruments.

Financial instruments – Carrying amounts and fair values by measurement category:

ASSETS

Balance sheet item / Class (€ thousands)	Category	Initial / subsequent measurement	Carrying amount 31 Dec. 2012	Fair value 31 Dec. 2012	Carrying amount 31 Dec. 2011	Fair value 31 Dec. 2011
Non-current assets						
Non-current financial assets						
Investments in affiliates and other investments	AfS	Fair value / Historic cost	37,968	37,968	37,822	37,822
Non-current financial instruments	AfS	Fair value	712	712	664	664
Loans	LaR	Fair value / Amortised cost	140	140	1,587	1,587
Current assets						
Receivables and other current assets						
Trade receivables	LaR	Fair value / Amortised cost	481,900	481,900	461,348	461,348
Intragroup and associate receivables	LaR	Fair value / Amortised cost	16,937	16,937	23,591	23,591
Receivables recognised by PoC – net –	LaR	Fair value / Amortised cost	130,737	130,737	122,147	122,147
Other receivables and other current assets	LaR	Fair value / Amortised cost	25,740	25,740	28,797	28,797
Derivatives included in hedging relationships	n.a.	Fair value	2,545	2,545	671	671
Derivatives not included in hedging relationships	FAHfT	Fair value	864	864	536	536
Current financial instruments	AfS	Fair value	–	–	11	11
Cash and cash equivalents	LaR	Fair value / Amortised cost	401,031	401,031	305,707	305,707

EQUITY AND LIABILITIES

Balance sheet item / Class (€ thousands)	Category	Initial / subsequent measurement	Carrying amount 31 Dec. 2012	Fair value 31 Dec. 2012	Carrying amount 31 Dec. 2011	Fair value 31 Dec. 2011
Non-current liabilities						
Financial liabilities excluding finance lease liabilities	FLAC	Fair value / Amortised cost	206,689	195,934	60,553	57,570
Finance lease liabilities	n.a.	In accordance with IAS 17	1,352	1,352	1,190	1,190
Current liabilities						
Financial liabilities excluding finance lease liabilities	FLAC	Fair value / Amortised cost	54,504	54,504	66,958	66,958
Finance lease liabilities	n.a.	In accordance with IAS 17	703	703	588	588
Trade payables	FLAC	Fair value / Amortised cost	204,014	204,014	206,267	206,267
Advances received from customers (PoC)	LaR	Fair value / Amortised cost	54,121	54,121	61,148	61,148
Other liabilities – Miscellaneous	FLAC	Fair value / Amortised cost	46,712	46,712	42,322	42,322
Derivatives included in hedging relationships	n.a.	Fair value	1,499	1,499	4,553	4,553
Derivatives not included in hedging relationships	FLHfT	Fair value	635	635	1,826	1,826
Thereof aggregated by category in accordance with IAS 39						
Loans and receivables	LaR	Fair value / Amortised cost	1,002,364	1,002,364	882,029	882,029
Available-for-sale financial instruments	AfS	Fair value	712	712	675	675
Available-for-sale financial instruments	AfS	Fair value / Amortised cost	37,968	37,968	37,822	37,822
Financial assets held for trading	FAHfT	Fair value	864	864	536	536
Financial liabilities measured at amortised cost	FLAC	Fair value / Amortised cost	511,919	501,164	376,100	373,117
Financial liabilities held for trading	FLHfT	Fair value	635	635	1,826	1,826

The carrying amounts and fair values of all financial assets measured at amortised cost are identical. This also applies to finance lease liabilities, trade payables and other liabilities. This is mainly due to the short maturities of these financial instruments.

In the case of financial liabilities excluding finance lease liabilities, the fair values are determined as the present value of the cash flows associated with the liabilities. We apply an appropriate yield curve to arrive at this present value.

The fair values of the current and non-current financial instruments presented in the table above are based on prices quoted in active markets. The fair values of derivatives included and not included in hedging relationships is determined on the basis of input factors observable either directly (as a price, level 1) or indirectly (derived from prices, level 2). Level 3 includes financial instruments whose fair value is determined on the basis of inputs not based on observable market data. Foreign exchange derivatives are measured using forward exchange rates. For interest rate swaps the fair value is determined through the discount rate of future expected cash flows based on the market interest rates and yield curves that apply to the remaining term of the contracts.

PRESENTATION OF HIERARCHY LEVELS OF FAIR VALUE 2012

(€ thousands)	Level 1	Level 2	Level 3	Total
Financial assets recognised at fair value				
Available for sale	712	–	–	**712**
Derivatives	–	3,409	–	**3,409**
Financial liabilities recognised at fair value				
Derivatives	–	2,134	–	**2,134**

PRESENTATION OF HIERARCHY LEVELS OF FAIR VALUE 2011

(€ thousands)	Level 1	Level 2	Level 3	Total
Financial assets recognised at fair value				
Available for sale	675	–	–	**675**
Derivatives	–	1,207	–	**1,207**
Financial liabilities recognised at fair value				
Derivatives	–	6,379	–	**6,379**

NET RESULTS BY MEASUREMENT CATEGORY IN 2012

		From subsequent measurement				
(€ thousands)	From interest and dividends	At fair value	Currency translation	Impairment losses	From disposal	Net results
LaR	5,068	–	–290	–1,581	–	3,197
AfS	3,837	28	–	–526	–	3,339
FAHfT / FLHfT	–	1,271	–	–	–	1,271
FLAC	–6,649	–	161	–	–	–6,488
	2,256	**1,299**	**–129**	**–2,107**	**–**	**–1,319**

NET RESULTS BY MEASUREMENT CATEGORY IN 2011

		From subsequent measurement				
(€ thousands)	From interest and dividends	At fair value	Currency translation	Impairment losses	From disposal	Net results
LaR	9,229	–	549	–3,004	–	6,774
AfS	3,753	–6	–	–2,139	1,394	3,002
FAHfT / FLHfT	–	–543	–	–	–	–543
FLAC	–7,108	–	–280	–	–	–7,388
	5,874	**–549**	**269**	**–5,143**	**1,394**	**1,845**

The interest presented above is a component of financial income / expense; the other gains and losses are partly reported in other income and other expenses.

The AfS measurement category resulted in a remeasurement gain of € 28 thousand (previous year: loss of € 6 thousand), which was recognised directly in equity. As in the previous year, no withdrawals were made from equity and realised in the year under review.

Financial risks
We are exposed to certain financial risks as a consequence of our business activities. These risks can be classified into three areas:

On the one hand, we are exposed to credit risk. We define **credit risk** as potential default or delays in the receipt of contractually agreed payments.

We are also exposed to **liquidity risk**, which is the risk that an entity will be unable to meet its financial obligations, or will be unable to meet them in full.

Finally, we are exposed to **market risk**. The risk of exchange rate or interest rate changes may adversely affect the economic position of the Group. Risks from fluctuations in securities prices are not material for us.

We limit all of these risks through an appropriate risk management system. We define how these risks are addressed through guidelines and work instructions. In addition, we monitor the current risk characteristics continuously and regularly provide the information obtained in this way to the Board of Management and the Supervisory Board in the form of standardised reports and individual analyses.

The three risk areas are described in detail in the following. You will also find additional information in the Group management report, in particular in the Net Assets, Financial Position and Results of Operations and Risk Management sections.

CREDIT RISK

The primary credit risk is that there is a delay in settling a receivable, or that it is not settled in part or in full. We minimise this risk using a variety of measures. As a matter of principle, we run credit checks on potential and existing counterparties. We only enter into business relationships if the results of this check are positive. In addition, we take out trade credit insurance policies primarily through our European companies. In exceptional cases we accept other securities (collateral) such as guarantees. The insurance policies primarily cover the risk of loss of receivables. Moreover, cover is also taken out against political and commercial risks in the case of certain customers in certain countries. For both types of insurance, we have agreed deductibles, which represent significantly less than 50 % of the insured volume. As part of our receivables management system, we continuously monitor outstanding items, perform maturity analyses and establish contact with customers at an early stage if delays in payment occur. In the case of major projects, our terms and conditions provide for prepayments, guarantees and – for export transactions – letters of credit. These also mitigate risk. Impairment losses are recognised for the residual risk remaining in trade receivables. We examine regularly the extent to which individual receivables need to be written down for impairment. Indications of this are significant financial difficulties of the debtor, such as insolvency or bankruptcy. We also cover the credit risk of receivables that are past due by providing for the risk involved on the basis of historical loss experience. Receivables are derecognised if it is reasonably certain that receipt of payment cannot be expected (for example, after completion of insolvency or bankruptcy proceedings).

Impairment losses on “Trade receivables” are the only material impairment losses in the KSB Group. They changed as follows:

(€ thousands)	2012	2011
Opening balance at 1 January	33,513	29,966
Additions	6,988	7,071
Utilised	– 2,802	– 1,758
Reversals	– 5,419	– 2,798
Change in consolidated Group / Currency translation adjustments / Other	– 48	1,032
Closing balance at 31 December	**32,232**	**33,513**

The maturity structure of trade receivables is as follows:

(€ thousands)	31 Dec. 2012	31 Dec. 2011
Receivables that are neither past due nor individually impaired	371,040	353,069
Receivables that are past due but not individually impaired		
1 to 30 days	48,980	41,546
31 to 90 days	29,347	30,150
91 to 180 days	15,953	14,367
180 days	9,114	8,938
Total	103,394	95,001
Receivables individually determined to be impaired	7,466	13,278
Receivables individually determined to be impaired at their principal amount	39,698	46,791
Specific write-downs	32,232	33,513
Carrying amount (net)	**481,900**	**461,348**

With regard to the trade receivables that are neither past due nor individually impaired, there are no indications at the reporting date that our debtors will not meet their payment obligations. This similarly applies to all other financial instruments.

The maximum default risk, excluding collateral received, corresponds to the carrying amount of the financial assets.

There is no concentration of risk because the diversity of our business means that we supply a considerable number of customers in different sectors.

LIQUIDITY RISK

Our liquidity management ensures that this risk is minimised in the Group, and that solvency is ensured at all times. There are no concentrations of risk because we work together with a number of credit institutions, on which we impose strict creditworthiness requirements.

We generate our financial resources primarily from our operating business. We use them to finance investments in non-current assets. We also use them to cover our working capital requirements. To keep these as low as possible, we monitor changes in our receivables, inventories and liabilities regularly using a standardised Group reporting system.

The reporting system additionally ensures that the Group's centralised financial management is continuously informed about liquidity surpluses and requirements. This enables us to optimally meet the needs of the Group as a whole and the individual companies. For our German companies, for example, we use a cash pooling system. We are also in the process of rolling out our receivables netting procedure within the KSB Group so as to minimise the volume of cash flows and the associated fees. In addition, we always ensure that credit facilities are sufficient; we identify the need for these on the basis of regular liquidity plans.

The following tables present the contractual undiscounted cash flows of primary and derivative financial liabilities. Interest payments on fixed-rate liabilities are determined on the basis of the fixed rate. Floating-rate interest payments are based on the last floating interest rates fixed before 31 December. Net payments on derivatives result both from derivatives with negative fair values and from derivatives with positive fair values. Projections for future new liabilities are not included in the presentation. Based on our current state of knowledge, it is neither expected that the cash flows will take place significantly earlier, nor that the amounts will deviate significantly.

CASH FLOWS OF FINANCIAL LIABILITIES 2012

(€ thousands)	Total	Up to 1 year	1 – 5 years	> 5 years
Financial liabilities	291,664	61,314	153,070	77,280
Trade payables	204,014	203,190	824	–
Other liabilities	46,712	42,643	4,069	–
Derivative financial instruments	423	1,307	– 883	– 1
	542,813	**308,454**	**157,080**	**77,279**

CASH FLOWS OF FINANCIAL LIABILITIES 2011

(€ thousands)	Total	Up to 1 year	1 – 5 years	> 5 years
Financial liabilities	138,687	71,384	62,513	4,790
Trade payables	206,267	206,090	177	–
Other liabilities	42,322	41,561	761	–
Derivative financial instruments	– 5,152	– 4,476	– 657	– 19
	382,124	**314,559**	**62,794**	**4,771**

MARKET RISK

Our global business activities expose us primarily to currency and interest rate risk. Any changes in market prices here can affect fair values and future cash flows. We use sensitivity analyses to determine the hypothetical impact of such market price fluctuations on profit and equity. In doing so, we assume that the portfolio at the reporting date is representative for the full year.

Currency risk mainly affects our cash flows from operating activities. It arises when Group companies settle transactions in currencies that are not their functional currency. We minimise this risk using currency forwards and options. You will find further information on this in the “Derivative financial instruments” section of the Notes. As a rule, we do not hedge currency risk from the translation of foreign operations into the Group currency (€).

The most significant foreign currency in the KSB Group is the USD. The volume of trade receivables denominated in USD amounts to around € 52 million (previous year: approximately € 41 million). As in the previous year, the volume of trade payables denominated in USD amounts to around € 13 million.

For the currency sensitivity analysis, we simulate the effects based on the notional volume of our existing foreign currency derivatives and our foreign currency receivables and liabilities at the reporting date. For the analysis, we assume a 10 % increase (decrease) in the value of the euro versus the other currencies.

At the reporting date, equity and the fair value of the derivatives would have been € 12.4 million lower (higher); € 9.7 million results from USD and € 2.7 million from the other currencies.

At the previous year's reporting date, equity and the fair value of the derivatives would have been € 7.6 million lower (higher); € 4.4 million would result from USD and € 3.2 million from the other currencies.

The hypothetical effect on earnings in the year under review would have been a decrease (an increase) of € 0.7 million; € – 1.0 million would be attributable to USD and € 1.7 million to the other currencies.

The hypothetical effect on earnings in the previous year would have been a decrease (an increase) of € 1.5 million; the impact on the dollar would have been very small and there would thus have been no impact on the remaining currencies.

Floating rate financial instruments are exposed to interest rate risk. In the case of long-term loans, we hedge against this risk using interest rate derivatives on a case-by-case basis. Fixed rate financial instruments are not exposed to this risk.

As part of our interest rate sensitivity analysis, we simulate a 100 basis point increase (decrease) in market interest rates, with an interest rate of 0 % being the lower limit, however. This helps us analyse the impact on the floating rate financial instruments. In 2012, the net interest balance would have been € 1.7 million (previous year: € 2.2 million) higher (lower). Changes in the fair value of interest rate derivatives used to hedge floating rate liabilities increase (decrease) equity by € 2.4 (1.8) million (previous year: € 0.1 [0.1] million).

VII. STATEMENT OF CASH FLOWS

In the cash flow statement, cash flows are classified by operating, investing and financing activities. Effects of changes in the consolidated Group and in exchange rates are eliminated in the relevant items. The effect of exchange rate changes (based on annual average rates) and changes in the consolidated Group on cash and cash equivalents is presented separately.

Cash flows from operating activities include a "cash flow" subtotal that merely comprises the net profit for the year; depreciation, amortisation and impairment losses as well as reversals of impairment losses; changes in non-current provisions; and non-cash effects, for example, of the disposal of fixed assets. This subtotal is combined with the changes in the other operating components of assets (including current financial instruments) and liabilities to determine cash flows from operating activities.

Cash flows from investing activities exclusively reflect cash-effective acquisitions and disposals of investments in intangible assets; property, plant and equipment; and non-current financial assets.

In addition to cash flows resulting from equity items (capitalisation measures and dividend payments), cash flows from financing activities comprise cash flows arising from changes in financial receivables and liabilities.

If cash and cash equivalents include restricted cash, this is reported separately.

The funds included in the cash flow statement correspond to the balance sheet item Cash and cash equivalents.

Cash flows from operating activities include cash flows from interest received amounting to € 5,088 thousand (previous year: € 9,288 thousand) and cash flows from income taxes totalling € –45,257 thousand (previous year: € –50,712 thousand). Cash flows from investing activities include cash flows from dividends received of € 3,817 thousand (previous year: € 3,693 thousand). Cash flows from financing activities include cash flows from dividends received of € –6,674 thousand (previous year: € –8,326 thousand).

VIII. SEGMENT REPORTING

	External sales revenue		EBIT	
(€ thousands)	**2012**	**2011**	**2012**	**2011**
Business Unit Pumps	1,517,097	1,408,842	91,340	81,889
Business Unit Valves	385,614	335,586	8,792	2,466
Business Unit Service	368,223	323,088	50,669	42,824
Reconciliation	– 2,723	23,530	– 378	6,203
Total	**2,268,211**	**2,091,046**	**150,423**	**133,382**

€ 662,056 thousand (previous year: € 696,286 thousand) of the sales revenue presented was generated by the companies based in Germany and € 1,606,155 thousand (previous year: € 1,394,760 thousand) by the other Group companies.

At the reporting date, the total non-current assets of the KSB Group amounted to € 477,805 thousand (year-end figure in 2011: € 444,011 thousand), with 190,679 thousand (year-end figure in 2011: € 187,135 thousand) being attributable to the companies based in Germany and € 287,126 thousand (year-end figure in 2011: € 256,876 thousand) being attributable to the other Group companies. The non-current assets include intangible assets and property, plant and equipment. Goodwill, non-current financial instruments and deferred tax assets are not included.

The Smedegaard Group, which was acquired in February 2012 and is part of the Business Unit Pumps, contributed € 10.2 million to external sales; the impact on EBIT was € –0.2 million.

Segment reporting corresponds to our internal organisational and management structure, as well as the reporting lines to the Board of Management and the Supervisory Board. In our matrix organisation, management decisions are primarily taken on the basis of the key performance indicators – external sales revenue and earnings before interest and income taxes (EBIT) – determined for the Pumps, Valves and Service Business Units. Reporting the relevant assets (including depreciation and amortisation, impairment losses / write-downs), number of employees and inter-segment sales revenue for these Business Units is not part of our internal reporting. The managers in charge of the Business Units, which are geared to product groups, have profit and loss responsibility. They identify business opportunities across markets and industries and assess our options based on current and future market requirements. They also proactively encourage the development of new products and improvements to the available range of products. In this context, they work closely with our Sales organisation and Operations.

The **Pumps** product group covers single- and multistage pumps, submersible pumps and associated control and drive systems. Applications include process engineering, building services, water and waste water transport, energy conversion and solids transport.

The **Valves** product group covers butterfly, globe, gate, control, diaphragm and ball valves, as well as associated actuators and control systems. Applications primarily include process engineering, building services, energy conversion and solids transport.

The **Service** product group covers the installation, commissioning, start-up, inspection, servicing, maintenance and repair of pumps, related systems and valves; as well as modular service concepts and system analyses for complete systems

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

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

There were no discontinued operations in the year under review, as in the comparable period of the previous year.

The **external sales revenue of the Business Units by segment** presents sales revenue generated with third parties and unconsolidated Group companies. The effects from measuring construction contracts in accordance with IAS 11 are presented separately as reconciliation effects.

The segment results show **earnings before interest and taxes** (EBIT), including non-controlling interests. The effects from measuring construction contracts in accordance with IAS 11 are also presented separately as reconciliation effects.

IX. OTHER DISCLOSURES

The changes in the consolidated Group did not have any material impact on the other disclosures.

Contingent liabilities (contingencies and commitments)

CONTINGENT LIABILITIES AND COLLATERAL

(€ thousands)	2012	2011
Liabilities from guarantees	5,364	874
Liabilities from warranties	6,813	7,824
Liabilities from the granting of other security for third-party liabilities and other contingent liabilities	1,903	2,191
	14,080	**10,889**

At present, there are no indications that any claims will be asserted under these obligations.

Other financial obligations from rental agreements and other operating leases (minimum lease payments) amount to a total of € 39,205 thousand (previous year: € 30,978 thousand). Of these, € 14,984 thousand (previous year: € 13,783 thousand) is due within one year and € 19,936 thousand (previous year: € 15,399 thousand) due between one and five years. In the year under review, € 13,783 thousand was spent on these agreements.

Operating leases relate primarily to vehicles and real estate. The usual renewal options are available.

FINANCE LEASES

	Minimum lease payments		Present values	
(€ thousands)	2012	2011	2012	2011
Due within one year	769	686	703	633
Due between one and five years	1,202	1,043	1,115	936
Due after more than five years	312	223	237	209
	2,283	**1,952**	**2,055**	**1,778**

Finance leases relate almost entirely to real property. The term of the contract covers most of the useful life of the asset concerned.

The annual obligations from IT services agreements amount to € 44,623 thousand (previous year: € 51,317 thousand) over a term of one to five years.

As in the previous year, there are no purchase price obligations from acquisitions of companies and no payment obligations from capitalisation measures at Group companies.

The aggregate purchase obligation for investments (principally items of property, plant and equipment) amounts to € 11,823 thousand (previous year: € 11,703 thousand). Almost all of the corresponding payments are due in 2013.

Related party disclosures

Pursuant to section 21(1) of the *WpHG* [*Wertpapierhandelsgesetz* – German Securities Trade Act], *KSB Stiftung* [KSB Foundation], Stuttgart, notified us on 21 May 2008 that its voting interest in KSB AG, Frankenthal/Pfalz exceeded the 75.00 % threshold on 5 May 2008 and amounted to 80.24 % (711,453 voting shares) on this date. 0.54 % of the voting rights (4,782 voting shares) were held directly by KSB Stiftung, Stuttgart, and 79.70 % (706,671 voting shares) were attributed to *KSB Stiftung*, Stuttgart, pursuant to section 22(1), sentence 1, No. 1 of the *WpHG*. The voting rights attributed to *KSB Stiftung*, Stuttgart, were held by Klein Pumpen GmbH, Frankenthal.

A rental and services agreement has been entered into between KSB AG and Klein Pumpen GmbH. This resulted in the recognition of expenses of € 24 thousand (previous year: € 33 thousand) and income of € 19 thousand (previous year: € 8 thousand) at KSB AG in the year under review. As in the previous year, no interest was paid on short-term cash deposits by Klein Pumpen GmbH with KSB AG. Short-term deposits by KSB AG with Klein Pumpen GmbH and by Klein Pumpen GmbH with KSB companies carry appropriate rates of interest. Liabilities to Klein Pumpen GmbH as at 31 December 2012 amounted to € 37 thousand (previous year: € 19 thousand).

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* [*Aktiengesetz* – German Public Companies Act].

Disclosures and information on affiliates and other equity investments provided in other section of these Notes refer to relations covering the supply of products and services on an arm's length basis, unless stated otherwise.

The short-term benefits (total remuneration) of members of the Supervisory Board amount to € 1,409 thousand for the 2012 financial year (previous year: € 1,332 thousand) and € 2,620 thousand (previous year: € 3,327 thousand) for the Board of Management. Payments for benefits after termination of work on the Board of Management were made in the amount of € 2,133 thousand (previous year: € 2,172 thousand). € 20,389 thousand (previous year: € 22,195 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 € 1,770 thousand in the year under review (previous year: € 1,714 thousand).

Based on the relevant legal provisions, the Annual General Meeting on 19 May 2010 resolved not to disclose the remuneration of the Board of Management separately for each member and classified by components.

The members of the Supervisory Board and the Board of Management are listed before the presentation of the proposal on the appropriation of the net retained earnings of KSB AG.

Auditors
On 16 May 2012, BDO AG Wirtschaftsprüfungsgesellschaft, based in Hamburg with an office in Frankfurt am Main, were appointed as auditors and group auditors for the financial year 2012 by the Annual General Meeting of KSB AG. The 2012 financial statements include total fees of € 473 thousand (previous year: € 601 thousand). These include € 265 thousand (previous year: € 275 thousand) for audit fees and an additional € 147 thousand (previous year: € 90 thousand) for auditing German subsidiaries. A further € 57 thousand (previous year: € 34 thousand) was paid for other services, € 4 thousand (previous year: € 159 thousand) for other confirmation services, while no costs were incurred (previous year: € 43 thousand) for tax advisory services.

Use of exemption provisions
KSB Service GmbH, Frankenthal and KSB Service GmbH, Schwedt have made partial use of the exemption provision under section 264 (3) *HGB* [German Commercial Code].

Events after the reporting period
There were no reportable events after the balance sheet date.

German Corporate Governance Code
The Board of Management and Supervisory Board of KSB AG issued the current Statement of Compliance with the recommendations of the Government Commission on the German Corporate Governance Code in accordance with section 161 of the AktG [Aktiengesetz – German Public Companies Act]. The Statement of Compliance is published on our web site (www.ksb.com) and has thus been made permanently accessible.

LIST OF SHAREHOLDINGS

Name and seat of company	Country		Capital share %	Equity € thousands	Net profit / loss for the year € thousands	
KSB Service GmbH, Frankenthal	Germany	C	100.00	1,339	PPA	
KSB Atlantic Pump & Valve Service S.L., Las Palmas de Gran Canaria	Spain	N	47.00	223	– 288	■
KSB Service GmbH, Schwedt	Germany	C	100.00	1,686	PPA	
Uder Elektromechanik GmbH, Friedrichsthal	Germany	C	100.00	26	PPA	
Pumpen-Service Bentz GmbH, Reinbek	Germany	C	100.00	1,072	432	
Dynamik-Pumpen GmbH, Stuhr	Germany	C	100.00	970	560	
B&C Pumpenvertrieb Köln GmbH, Cologne	Germany	C	100.00	859	200	
PMS-BERCHEM GmbH, Neuss	Germany	C	100.00	1,033	– 179	
Nikkiso-KSB GmbH, Bruchköbel	Germany	N	50.00	5,336	974	■
KAGEMA Industrieausrüstungen GmbH, Pattensen	Germany	C	100.00	2,602	424	
gear-tec GmbH, Eggebek	Germany	N	51.00	672	– 358	■
KSB Armaturen Verwaltungs- und Beteiligungs-GmbH, Frankenthal	Germany	C	100.00	509	– 21	
OOO “KSB”, Moscow	Russland	C	100.00	1,313	166	
TOV KSB Ukraine, Kiev	Ukraine	N	100.00	250	14	
LLP “KSB Kazakhstan”, Almaty	Kazakhstan	N	100.00	239	– 107	
IOOO KSB BEL, Minsk	Belarus	N	100.00	193	3	
PAB Pumpen- und Armaturen-Beteiligungsges. mbH, Frankenthal	Germany	C	51.00	37,026	2	
KSB America Corporation, Richmond / Virginia	USA	C	100.00	36,281	5,517	
GIW Industries, Inc., Grovetown / Georgia	USA	C	100.00	39,216	6,694	
AMRI, Inc., Houston / Texas	USA	C	100.00	9,808	1,998	
KSB, Inc., Richmond / Virginia	USA	C	100.00	8,497	2,146	
Precision Pump and Machine-KSB, Inc., Bakersfield / California	USA	C	100.00	2,469	159	
Standard Alloys Incorporated, Port Arthur / Texas	USA	C	100.00	2,409	591	
KSB Finland Oy, Kerava	Finland	C	100.00	5,647	1,548	
Mäntän Pumppauspalvelu Oy, Mänttä-Vilppula	Finland	C	100.00	1,037	336	
Kiinteistö Oy Keravan Savirunninkatu 4, Kerava	Finland	N	100.00	1,248	– 6	
KSB Mörck AB, Gothenburg	Sweden	C	55.00	4,360	1,038	
PUMPHUSET Sverige AB, Sollentuna	Sweden	C	100.00	927	197	
KSB Norge AS, Lysaker	Norway	C	89.83	2,685	290	
T. Smedegaard A/S, Glostrup	Denmark	C	80.00	2,720	218	
VM Pumpar AB, Västra Frölunda	Sweden	C	100.00	20	– 120	
SMEDEGAARD AG Pumpen und Motorenbau, Beinwil am See	Switzerland	C	100.00	1,313	472	
Smedegaard Pumps Limited, Bridgwater	United Kingdom	C	100.00	359	166	
KSB Pompy i Armatura Sp. z o.o., Ozarow-Mazowiecki	Poland	C	100.00	7,539	894	
KSB-Pumpy + Armatury s.r.o., koncern, Prague	Czech Republic	C	100.00	3,724	511	
KSB Čerpadlá a Armatúry, s.r.o., Bratislava	Slovakia	N	100.00	255	156	■
KSB Szivattyú és Armatúra Kft., Budapest	Hungary	C	100.00	1,236	154	
KSB črpalke in armature d.o.o., Ljubljana	Slovenia	N	100.00	115	– 185	■
KSB pumpe i armature d.o.o., Zagreb	Croatia	N	100.00	– 90	– 191	
KSB Pumpe i Armature d.o.o. Beograd, Belgrad	Serbia	N	100.00	71	33	■
KSB Zurich AG, Zurich	Switzerland	C	100.00	1,003	– 738	

PPA Profit Pooling Arrangement
C Companies fully consolidated in KSB AG’s consolidated financial statements
N Companies not consolidated in KSB AG’s consolidated financial statements

■ Prior-period figures
* Included

Name and seat of company	Country		Capital share %	Equity € thousands	Net profit / loss for the year € thousands	
REEL s.r.l., Ponte di Nanto	Italy	C	100.00	502	– 21	
Motori Sommersi Riavvolgibili S.r.l., Cedegolo	Italy	N	25.00	6,307	1,470	■
KSB Bombas e Válvulas SA, Rio de Mouro (Lisbon)	Portugal	N	95.00	908	228	■
Hydroskepi GmbH, Amaroussion (Athens)	Greece	C	100.00	1,594	– 18	
KSB TESMA AG, Amaroussion (Athens)	Greece	N	59.74	1,493	169	■
KSB Viosen AG, Patras	Greece	N	60.28	313	– 81	■
KSB Service LLC, Abu Dhabi	U.A.E.	N	49.00	2,162	612	■
KSB Pumps Company Limited, Lahore	Pakistan	C	58.89	6,742	1,358	
MIL Controls Limited, Annamanada	India	C	70.86	11,331	3,293	
KSB Tech Pvt. Ltd., Pimpri (Pune)	India	N	100.00	948	1,238	■
KSB Limited, Hong Kong	China	C	100.00	1,937	788	
KSB Valves (Shanghai) Co. Ltd., Shanghai	China	C	100.00	6,126	482	
KSB Valves (Changzhou) Co., Ltd., Jiangsu	China	C	100.00	3,811	20	
Shanghai Electric-KSB Nuclear Pumps and Valves Co., Ltd., Shanghai	China	N	45.00	15,616	– 5,076	■
KSB Taiwan Co., Ltd., Taipei City	Taiwan	C	100.00	2,200	1,202	
KSB Korea Ltd., Seoul	South Korea	C	100.00	1,118	740	
KSB Seil Co., Ltd., Busan	South Korea	C	100.00	17,225	4,659	
KSB Ltd., Tokyo	Japan	N	100.00	– 1,025	– 90	■
KSB Pumps Co. Ltd., Bangkok	Thailand	C	40.00	4,066	1,256	
KSB Singapore (Asia Pacific) Pte. Ltd., Singapore	Singapore	C	100.00	7,768	1,260	
* KSB Malaysia Pumps & Valves Sdn. Bhd., Petaling Jaya	Malaysia	(C)	100.00	181	316	
* KSB Vietnam Co. Ltd., Tam An Village	Vietnam	(C)	100.00	– 323	– 1,184	
Canadian Kay Pump Limited, Mississauga / Ontario	Canada	C	100.00	5,234	782	
KSB Pumps Limited, Pimpri (Pune)	India	C	40.54	61,899	8,622	
KSB de Mexico, S.A. de C.V., Querétaro	Mexico	C	100.00	3,828	747	
KSB Chile S.A., Santiago	Chile	C	100.00	14,554	2,540	
KSB Perú S.A., San Isidro-Lima	Peru	N	100.00	292	– 249	■
KSB PARS Co. (P.J.S.), Shiraz	Iran	N	100.00	527	29	■
KSB Services Ltd. Co., Al-Khobar	Saudi Arabia	N	70.00	411	–	■
KSB Finanz S.A., Echternach	Luxembourg	C	100.00	126,422	20,985	
KSB Limited, Loughborough	United Kingdom	C	100.00	3,559	122	
Rotary Equipment Services Limited, Loughborough	United Kingdom	C	100.00	682	176	
KSB Finance Nederland B.V., Zwanenburg	Netherlands	C	100.00	27,113	6,382	
DP industries B.V., Alphen aan den Rijn	Netherlands	C	100.00	32,819	10,882	
KSB Nederland B.V., Zwanenburg	Netherlands	C	100.00	3,940	– 655	
Nederlandse Pompservice (N.P.S.) B.V., Velsen-Noord	Netherlands	C	100.00	– 561	– 51	
VRS Valve Reconditioning Services B.V., Vierpolders	Netherlands	C	100.00	132	– 390	
KSB Belgium S.A., Wavre	Belgium	C	100.00	928	422	
KSB Service Belgium S.A. / N.V., Wavre	Belgium	C	100.00	685	– 254	
KSB ON SITE MACHINING BVBA, Wilrijk	Belgium	N	100.00	– 634	233	
VRS Industries SA, Feluy	Belgium	N	100.00	– 319	– 551	■

PPA Profit Pooling Arrangement
C Companies fully consolidated in KSB AG's consolidated financial statements
N Companies not consolidated in KSB AG's consolidated financial statements
■ Prior-period figures
* Included

Name and seat of company	Country		Capital share %	Equity € thousands	Net profit / loss for the year € thousands	
SISTO Armaturen S.A., Echternach	Luxembourg	C	52.86	11,883	908	
KSB Österreich Gesellschaft mbH, Vienna	Austria	C	100.00	16	– 1,851	
KSB S.A.S., Gennevilliers (Paris)	France	C	100.00	107,170	15,821	
KSB Techni Pompe Service S.A.S., Hoerdt	France	C	100.00	1,471	192	
KSB Service Est S.A.S., Algrange	France	C	100.00	1,344	187	
KSB Service EITB-SITELEC S.A.S., Montfavet	France	N	100.00	333	– 98	
Société Berrichonne de Constructions Mecaniques "S.B.C.M" S.A.S., Gennevilliers (Paris)	France	N	100.00	226	6	
KSB Service Robinetterie S.A.S., Rambervillers	France	C	100.00	1,875	924	
KSB SERVICE ETC S.A.S., Montcenis	France	N	100.00	681	242	
KSB Service MEDIATEC S.A.S., Chalon-sur-Saône	France	N	100.00	465	117	
Société de travaux et Ingénierie Industrielle (ST II), Saint Etienne du Rouvray	France	N	100.00	217	821	
SPI Energie S.A.S., La Ravoire	France	N	100.00	1,418	279	
Metis Levage S.A.S., Villefranche sur Saône	France	N	100.00	649	38	■
KSB Service Centre-Est S.A.S., Villefranche sur Saône	France	C	100.00	2,007	– 150	
KSB EXPORT AFRIQUE S.A.S., Gennevilliers (Paris)	France	N	100.00	– 246	– 19	
Techni Pompe Service Maroc (TPSM), Casablanca	Morocco	N	50.00	– 116	96	■
KSB POMPES ET ROBINETTERIES S.à.r.l. d'Associé unique, Casablanca	Morocco	N	100.00	273	135	■
KSB Italia S.p.A., Concorezzo (Milan)	Italy	C	100.00	27,214	2,477	
KSB Service Italia S.r.l., Scorzè	Italy	C	100.00	2,578	1,085	
KSB AMVI, S.A., Madrid	Spain	C	100.00	3,477	115	
AMVI Aplica. Mecánicas Válvulas Industriales, S.A., Burgos	Spain	C	100.00	12,768	1,058	
KSB ITUR Spain S.A., Zarautz	Spain	C	100.00	15,921	366	
KSB Service Suciba S.L.U., Sondika	Spain	N	100.00	620	163	■
KSB-Pompa, Armatür Sanayi ve Ticaret A.S., Ankara	Turkey	C	99.00	8,401	1,743	
KSB Middle East FZE, Dubai	U.A.E.	C	100.00	5,600	630	
KSB Pumps Arabia Ltd., Ryadh	Saudi Arabia	N	50.00	7,600	3,504	■
KSB Shanghai Pump Co. Ltd., Shanghai	China	C	80.00	58,178	2,772	
Dalian KSB AMRI Valves Co., Ltd., Dalian	China	C	100.00	1,407	197	
PT. KSB Indonesia, Cibitung, Jawa Barat	Indonesia	C	100.00	8,781	1,553	
KSB Australia Pty. Ltd., Tottenham (Melbourne)	Australia	C	100.00	16,265	697	
* KSB New Zealand Limited, Penrose / Auckland	New Zealand	(C)	100.00	1,178	309	
KSB Algérie Eurl, Algier	Algeria	N	100.00	685	– 84	■
KSB Pumps (S.A.) (Pty) Ltd., Germiston (Johannesburg)	South Africa	C	100.00	7,261	93	
KSB Pumps and Valves (Pty) Ltd., Germiston (Johannesburg)	South Africa	C	74.99	19,806	5,344	
* Forty-Four Activia Park (Pty) Ltd.	South Africa	(C)	100.00	105	22	
KSB Pumps Inc., Mississauga / Ontario	Canada	C	100.00	1,995	561	
KSB Bombas Hidráulicas S.A., Várzea Paulista	Brazil	C	100.00	61,602	6,348	
KSB Válvulas Ltda., Jundiaí	Brazil	C	100.00	1,413	– 1,427	
KSB Compañía Sudamericana de Bombas S.A., Carapachay	Argentina	C	100.00	3,978	922	

PPA Profit Pooling Arrangement
C Companies fully consolidated in KSB AG's consolidated financial statements
N Companies not consolidated in KSB AG's consolidated financial statements
■ Prior-period figures
* Included

SUPERVISORY BOARD

Dr. Wolfgang Kühborth, Dipl.-Ing., Frankenthal
(Honorary Chairman of the Supervisory Board)

Dr. Hans-Joachim Jacob, Dipl.-Kaufmann, Munich
Auditor, Management Consultant
(Chairman of the Supervisory Board)

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

Dr. Martin Auer, Mannheim[1]
Head of Corporate Legal, Compliance,
Procurement & Logistic Services
MVV Energie AG

Dr.-Ing. Stephan Bross, Erpolzheim
Senior Vice President Business Unit Service

Reiner Euler, Engineering Technician, Grünstadt
Member of the European Works Council,
Chairman of the General Works
Council and the Frankenthal Works Council

Dr. Jörg Matthias Großmann, Dipl.-Kfm., Großhesselohe[2]
(on the Supervisory Board since 9 Nov. 2012)
Management / CFO
Freudenberg Chemical Specialities SE & Co. KG

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

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

Richard Lederer, Dipl.-Kaufmann, Frankenthal
(on the Supervisory Board until 16 May 2012)
Former Member of the Management of the
Energy Pumps Division of KSB AG

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

Dr.-Ing. Hermann Nestler, Regensburg
Former Managing Director of BSH
Bosch und Siemens Hausgeräte GmbH

Dr. Thomas Seeberg, Dipl.-Kfm., Icking
(on the Supervisory Board since 16 May 2012)
Former Managing Director of OSRAM GmbH

Volker Seidel, Electrical and Electronics Installer, Münchberg
1. Delegate of IG Metall Ostoberfranken

Werner Stegmüller, Dipl.-Kfm., Mering
(on the Supervisory Board until 16 Oct. 2012)
Former Partner at Horváth & Partner GmbH
Member of Commercial Management of KSB AG

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

[1] Palatina Versicherungsvermittlungsgesellschaft mbH, Frankenthal, Germany
MVV Energie CZ a.s., Prague, Czech Republic
Stadtwerke Ingolstadt Beteiligungs GmbH, Ingolstadt, Germany

[2] Klüber Lubrication München SE & Co. KG, Munich, Germany
Klüber Lubrication India Pvt. Ltd., Bangalore, India
FCS Holding Inc., Wilmington, USA
Chem-Trend Holding LP, Wilmington, USA
Externa Holding S.R.L., Milan, Italy

BOARD OF MANAGEMENT

Dr. rer. pol. Wolfgang Schmitt, Bad Dürkheim[1]
Chairman, Responsible for Finance and Administration

Dr.-Ing. Peter Buthmann, Frankenthal[2]
Human Resources Director, Responsible for Operations and (since 1 April 2012) for Sales and Marketing

Prof. Dr.-Ing. Dieter-Heinz Hellmann, Frankenthal[3]
Responsible for Technology and Internal Audits

Jan Stoop, Bad Dürkheim[4]
(on the Board of Management until 31 March 2012)
Responsible for Sales and Marketing

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

1 KSB Finanz S.A., Echternach, Luxembourg
KSB Pumps (S.A.) (Pty) Ltd., Germiston, South Africa
KSB Pumps and Valves (Pty) Ltd., Germiston, South Africa
Canadian Kay Pump Ltd., Mississauga / Ontario, Canada
KSB America Corporation, Richmond / Virginia, USA
KSB Pumps Limited, Pimpri (Pune), India
KSB Singapore (Asia Pacific) Pte. Ltd., Singapore
KSB ITUR Spain S.A., Zarautz, Spain

2 SISTO Armaturen S.A., Echternach, Luxembourg
DP industries B.V., Alphen aan den Rijn, Netherlands
KSB Finanz S.A., Echternach, Luxembourg
KSB Shanghai Pump Co. Ltd., Shanghai, China

3 GIW Industries, Inc., Grovetown / Georgia, USA
KSB Shanghai Pump Co. Ltd., Shanghai, China
Shanghai Electric-KSB Nuclear Pumps and Valves Co., Ltd., Lingang, China
KSB Bombas Hidráulicas S.A., Várzea Paulista, Brazil

4 KSB Bombas e Hidráulicas S.A., Várzea Paulista, Brazil
KSB Shanghai Pump Co. Ltd., Shanghai, China
KSB Singapore (Asia Pacific) Pte. Ltd., Singapore
KSB Malaysia Pumps & Valves Sdn. Bhd., Petaling Jaya, Malaysia
KSB ITUR Spain S.A., Zarautz, Spain
KSB Finanz S.A., Echternach, Luxembourg
KSB Pumps Co. Ltd., Bangkok, Thailand

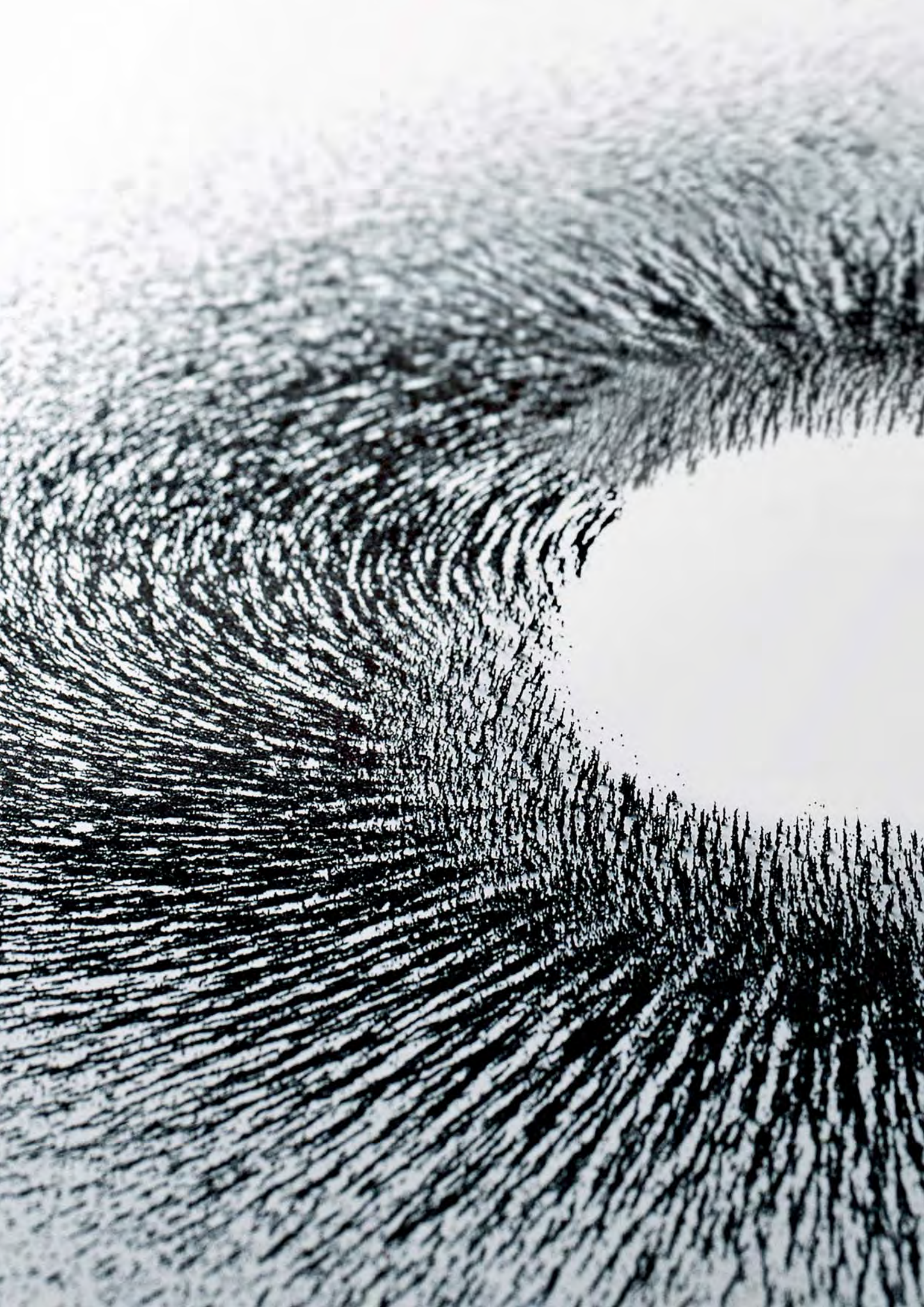
PROPOSAL ON THE APPROPRIATION OF THE NET RETAINED EARNINGS OF KSB AG

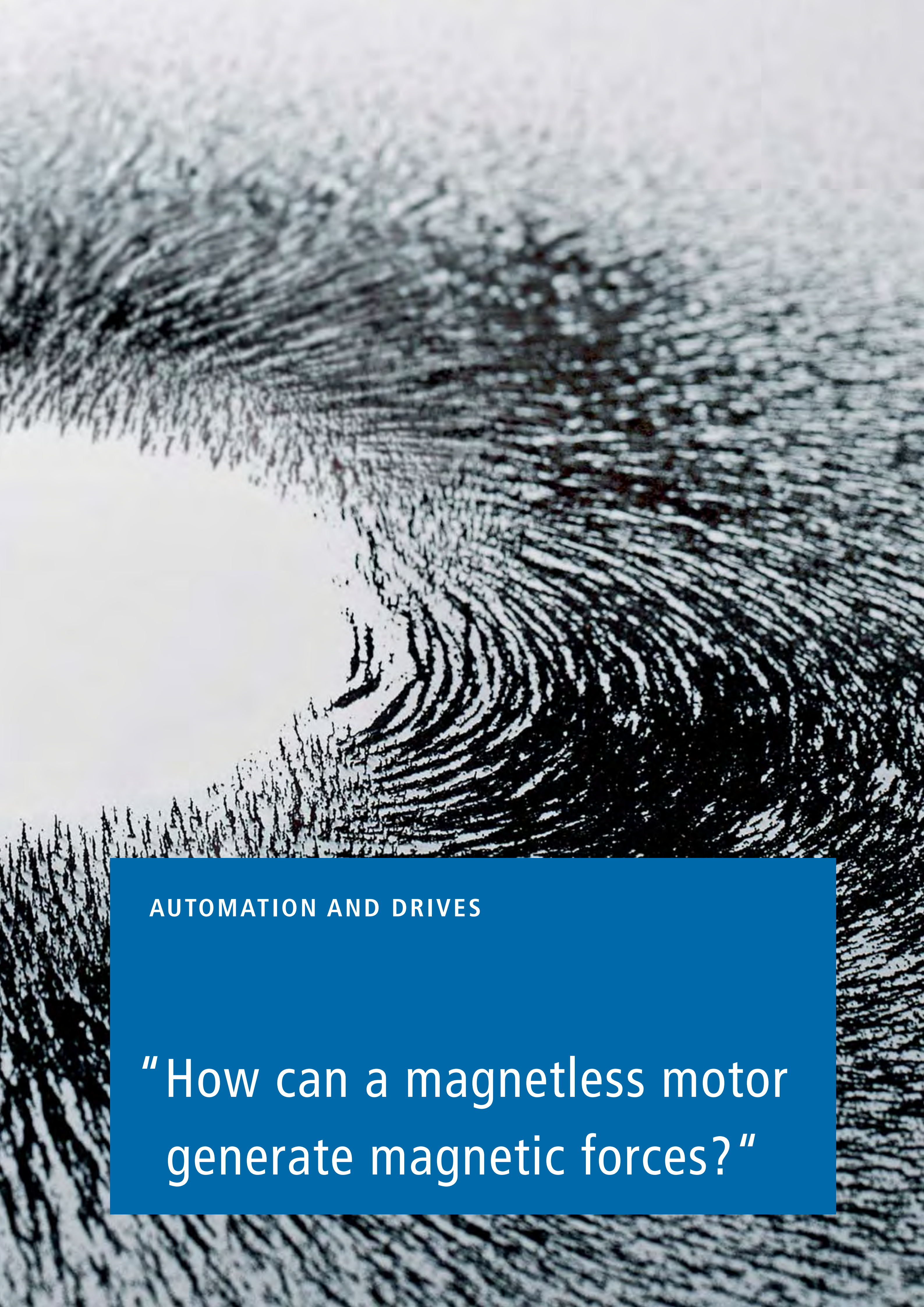
We will propose to the Annual General Meeting on 15 May 2013 to appropriate the net retained earnings of € 31,445,354.22 of KSB AG, containing retained earnings brought forward of € 323,128.16, as follows:

Distribution of a dividend of € 12.00 per ordinary no-par-value share	=	10,639,380.00 €
and, in accordance with the Articles of Association, € 12.26 per preference no-par-value share	=	10,601,369.12 €
Appropriation to revenue reserves		10,000,000.00 €
Total		31,240,749.12 €
Carried forward to new account		204,605.10 €
		31,445,354.22 €

Frankenthal, 12 March 2013
The Board of Management

The annual financial statements of KSB AG were prepared in accordance with German accounting principles. They are published in the *Bundesanzeiger* [German Federal Gazette]. The annual financial statements can also be downloaded from our web site at www.ksb.com, or sent in print form on request.





AUTOMATION AND DRIVES

"How can a magnetless motor generate magnetic forces?"

Boris Janjic (l.) and Michael Könen of the Application and Basic Research / Electric Drives team

"Our high-efficiency electric motor transfers the magnetic force of the electric coils to the drive shaft using patented rotor laminations. We have developed the world's most economic speed-controllable magnetless pump drive by making smart use of the synchronous reluctance principle."

Michael Könen

Electric motors drink electricity, lots of electricity. Extensive research conducted by the European Commission has shown that electric motors are the largest single group of electric consumers, accounting for 49 % of power consumption in industry. In the form of the SuPremE synchronous reluctance motor, KSB has developed the drive of the future: It is currently the most economic speed-controllable magnetless pump drive in the world.

Unlike conventional synchronous reluctance motors, KSB's drive does not use magnetic materials from rare earths, i.e. critical raw materials whose mining causes a considerable impact on the environment. The drive is fitted with a four-pole rotor and consists of a laminated core without a cage. The individual sheet steels are shaped to allow the magnetic lines of flux to be guided in the required direction, thus ensuring that the rotor starts to rotate.

In combination with a PumpDrive speed control system, the SuPremE motor enables up to 70 % of energy savings.

Synchronous reluctance motor | **SuPremE**

Unlike conventional asynchronous motors, KSB's sensorless, magnetless synchronous reluctance motor even achieves good efficiency levels when it is not running at full power. This is a situation frequently encountered in practice as most drives operated in variable speed mode primarily run at reduced speed. In combination with the PumpDrive speed control system, rotational speeds from 0 to 4,200 revolutions per minute are possible.

Cash flows from operating activities increased by € 57.8 million to € 94 .1 million.

GENERAL INFORMATION

132 Responsibility Statement
133 Auditor's Report
135 Corporate Governance Declaration
136 Corporate Governance Report / Remuneration Report
143 Glossary
144 Contacts

RESPONSIBILITY STATEMENT

To the best of our knowledge, and in accordance with the applicable reporting principles, the interim consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the group management report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Frankenthal, 12 March 2013

The Board of Management

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by KSB Aktiengesellschaft, Frankenthal (Pfalz), comprising the balance sheet, the statement of comprehensive income, the statement of changes in equity, the statement of cash flows and the notes to the consolidated financial statements, together with the Group management report for the business year from 1 January 2012 to 31 December 2012. 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 section 315a(1) *HGB* [*Handelsgesetzbuch* – German Commercial Code] 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 section 317 of the HGB and German generally accepted standards for the audit of financial statements promulgated by the *Institut der Wirtschaftsprüfer* [*IDW* – Institute of Public Auditors]. 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 financial reporting information 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 section 315a(1) of the *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.

Frankfurt am Main, 20 March 2013

BDO AG
Wirtschaftsprüfungsgesellschaft

Dyckerhoff
Wirtschaftsprüfer

ppa. Erbe
Wirtschaftsprüfer

CORPORATE GOVERNANCE DECLARATION

STATEMENT PURSUANT TO SECTION 161 OF THE *AKTG* [*AKTIENGESETZ* – GERMAN PUBLIC COMPANIES ACT] (STATEMENT OF COMPLIANCE)

The Statement of Compliance is issued by the Board of Management and the Supervisory Board of KSB Aktiengesellschaft at least once a year. The last statement issued on 5 December 2012 reads as follows:

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 Section 161 *AktG* [German Public Companies Act]

Since the publication of the last statement of compliance on 7 December 2011 KSB Aktiengesellschaft, Frankenthal (Pfalz), has complied with the recommendations of the "Government Commission on the German Corporate Governance Code" as set out in the version dated 15 May 2012 with the exception of the following and continues to comply with the recommendations in this scope:

1. The Chair of the Audit Committee of our Supervisory Board is not "independent" within the meaning of subsection 5.3.2.

Reason: The Chair of the Audit Committee is also the Managing Director of the controlling shareholder. We do not deem the lack of independence resulting from the above situation to be of decisive importance compared with his expertise and extensive knowledge of our company. Nonetheless the Supervisory Board is aiming for a change in the Chair of the Audit Committee in 2013.

2. With the exception of an age limit, the Supervisory Board does not specify concrete objectives regarding its composition (subsection 5.4.1, paragraphs 2 and 3).

Reason: We appreciate the diversity in the composition of the Supervisory Board aimed at by the Code, which will generally be conducive to the interests of the company. To date, we have always followed this principle. However, we take a critical view of detailed specifications, in particular of quota systems, as we believe that this would make it more difficult to ensure an appropriate and adequately flexible composition of this body.

3. The performance-related component of the Supervisory Board remuneration is based on the annual dividend; it is thus not oriented toward "sustainable" growth of the enterprise as defined in subsection 5.4.6, paragraph 2.

Reason: We support the sustainability objective of the Code, but do not consider a change in the well-established remuneration structure for the Supervisory Board to be necessary for achievement of this objective.

4. The total amount of the remuneration paid to the members of the Supervisory Board for their service on the Board, as well as of remuneration or advantages extended for services provided individually, in particular advisory or agency services, is disclosed in the Notes to the Consolidated Financial Statements, but the remuneration is disclosed neither separately for each member nor classified by components (subsection 5.4.6, paragraph 3).

Reason: The remuneration of the Supervisory Board members is governed by the Articles of Association and the supplementary resolution of the Annual General Meeting dated 16 May 2012; these documents provide detailed information on the individual components of the remuneration. Beyond that, we prefer to provide summarised information about the remuneration of the members of the Supervisory Board rather than breaking it down into the compensation paid to the individual members and the components it contains, as we do not believe that the latter would provide any additional benefits for shareholders or the development of the company.

Frankenthal, 5 December 2012

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

CORPORATE GOVERNANCE REPORT / REMUNERATION REPORT

In accordance with section 3.10 of the German Corporate Governance Code, the Board of Management and the Supervisory Board report on the corporate governance of the company as follows:

The term "corporate governance" covers the legal and factual regulatory framework for the management and supervision of companies; it is geared towards responsible management and control with the ultimate goal of sustainable value creation. The principles of corporate governance at KSB are based on the German Corporate Governance Code. This Code provides the basic framework for the management and supervision of listed companies and formulates nationally and internationally recognised standards of good and responsible corporate governance. We welcome the work of the Government Commission on the German Corporate Governance Code as well as the ideas and recommendations contained in the Code. These were last revised on 15 May 2012 and published on 15 June 2012 in the *Bundesanzeiger* [German Federal Gazette].

We are convinced that good, responsible corporate governance will contribute greatly to the company's long-term success. This is why it has always ranked highly at KSB. Even before the Code was introduced, we implemented the core corporate governance and control processes in such a way that they complied with the current key requirements of the Code. We were traditionally guided in this by nationally and internationally recognised standards of transparent, comprehensible corporate governance. During the past financial year, the Board of Management and Supervisory Board of KSB Aktiengesellschaft discussed compliance with the Code's guidelines as well as the relevant legal requirements in detail on several occasions. Our objective is to continue developing the principles of corporate governance in all parts of our company.

Statement of Compliance updated

Pursuant to section 161 of the *AktG* [*Aktiengesetz* – German Public Companies Act], the Board of Management and Supervisory Board of listed German public companies are under the obligation to declare once per year "that the recommendations of the 'Government Commission on the German Corporate Governance Code' published by the Federal Ministry of Justice in the official section of the *Bundesanzeiger* [German Federal Gazette]" were complied with and will continue to be complied with or which recommendations were not or will not be applied and why (Statement of Compliance).

The majority of the recommendations added to the Code in 2012 were implemented, i.e. they were integrated into internal company workflows and pending decisions. The only recommendations not complied with are two of the new recommendations, because we feel that the current practice in our company is preferable. Otherwise, the deviations explained last year remained unchanged. We thus comply with the explicit note in the Code that deviations from the recommendations may well be in the interest of good corporate governance.

The Board of Management and Supervisory Board submitted the current Statement of Compliance on 5 December 2012 and made it available to the shareholders on the company's web site together with statements from previous years. The company complies with the recommendations of the German Corporate Governance Code apart from a handful of exceptions; the Statement is updated at short notice if necessary. With respect to the declared deviations and the reasons for these deviations, reference is made to the exact wording, which is reproduced in full in the above Corporate Governance Declaration.

Members of the Supervisory Board shall as a rule step down at the Annual General Meeting held after they reach the age of 75, and not later than upon reaching the age of 80, in accordance with the provisions of the Rules of Procedure of the Supervisory Board. The appointment of Members to the Board of Management should as a rule not extend beyond their 65th birthday, and shall end not later than upon their reaching the age of 75. These requirements are currently met without exception, although the terms of office of the Chairman of the Supervisory Board Dr. Jacob and Board of Management member Prof. Dr. Hellmann exceed, by way of exception, the age limits recommended in the Rules of Procedure, but in each case will end well before they reach the binding age limits.

Going forward, we will continue to monitor and 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. At the same time we want to foster the trust which investors, financial markets, employees, the public and our customers, in particular, have placed in us.

Shareholders and Annual General Meeting

KSB AG issued both no-par value ordinary shares and no-par value preference shares. The holders of these shares, our shareholders, exercise their co-determination and control rights at the Annual General Meeting which is held at least once a year.

Each shareholder is entitled to attend the Annual General Meeting in accordance with the requirements as stipulated in the Articles of Association and the law. If shareholders cannot or choose not to attend in person, they can opt to appoint a proxy who will exercise their voting rights on their behalf.

In accordance with the Articles of Association, the Chair of the Supervisory Board presides over the Annual General Meeting. The Chair determines the order in which proceedings are conducted as well as the type and form of voting. The Chair may reasonably restrict the time allocated to questions and speeches by shareholders and, at the start of or during the course of the Annual General Meeting, set time limits for the entire proceedings of the Meeting, the discussion of the various items on the agenda as well as on individual questions and speeches.

The Annual General Meeting reaches decisions pertaining to all of the duties and responsibilities assigned to it by law (e.g. appropriation of net retained earnings, amendments to the Articles of Association, election of Supervisory Board members). Each ordinary share authorises the holder to one vote. The preference shares only entitle holders to voting rights as prescribed by law but carry progressive additional dividend rights. Klein Pumpen GmbH, Frankenthal, holds approximately 80 % of the ordinary shares; the *KSB Stiftung* [KSB Foundation], Stuttgart, holds a majority stake in Klein Pumpen GmbH.

Responsible cooperation between the Board of Management and the Supervisory Board

Good corporate governance requires an ongoing development of the dual management system prescribed for German public limited companies in all sections of the business. This begins with independent management by the Board of Management which is monitored and advised by the Supervisory Board. To promote effective management, the Rules of Procedure for both bodies specifically state that business shall be conducted in accordance with the German Corporate Governance Code, with any departure from compliance with the recommendations in justifiable, individual instances being disclosed by the Board of Management and the Supervisory Board.

Continuous dialogue based on mutual trust between the Board of Management and the Supervisory Board provides an important foundation for the success of the company. Their common goal is to generate appropriate, sustainable returns through the systematic pursuit and implementation of these principles. Both bodies thus collaborate closely for the benefit of the company.

The Supervisory Board receives regular, timely, comprehensive updates from the Board of Management regarding all planning, business development, risk position and compliance issues which are relevant to the company. Decisions of fundamental importance must be approved by the Supervisory Board. Any departure in business performance from the formulated plans and objectives is discussed in depth and openly; particular importance is attached to maintaining strict confidentiality towards other persons. The principles of the company's strategic and organisational alignment are defined in close cooperation between the Board of Management and the Supervisory Board and are reviewed constantly. At times the Supervisory Board also convenes without the Board of Management in order to intensify the exchange of ideas within the Board.

Between meetings the Chairman of the Supervisory Board and other Supervisory Board members were in regular contact with the Board of Management, in particular with its Chairman to discuss matters of strategy, planning, business development, risk assessment, risk management and compliance.

Transparency

KSB considers it extremely important to provide capital market participants with regular, comprehensive, consistent and prompt information on the Group's economic situation. Reporting takes place via annual reports, half-year financial reports and interim reports. All publications are published within the time frames specified.

In addition, we provide information by means of press releases and ad hoc statements whenever necessary. All information can be viewed online (web site: www.ksb.com). At the web site, you will also find our financial calendar which contains the scheduled dates for major recurring events and publications.

In the event that any directors' dealings take place which are subject to reporting requirements, you will find the relevant information on our web site at "Investor Relations / Corporate Governance / Directors' Dealings."

KSB AG created an insider directory as required by section 15b of the *WpHG* [*Wertpapierhandelsgesetz* – German Securities Trading Act]. Those persons affected are informed of their current legal obligations and potential sanctions.

The aggregate of all shares in KSB AG held by members of the Board of Management and Supervisory Board, either directly or indirectly, does not exceed a total of 1 % of the shares issued.

Members of the Board of Management and Supervisory Board are under the obligation to act in the company's interests. When making their decisions, they must neither pursue personal interests nor use for their own purposes any business opportunities that present themselves for the company. Any conflicts of interest must be disclosed to the Supervisory Board immediately. Should the need arise, the Annual General Meeting must be informed of any conflicts of interest and how they were dealt with.

When presenting nominations for Supervisory Board members to the Annual General Meeting, the Supervisory Board discloses the personal and business relationships of each candidate to the company, the corporate bodies and substantial company shareholders, provided that – in the opinion of the Supervisory Board – an objective shareholder would consider this information as decisive for his or her voting decision.

Accounting and audit of the financial statements

The consolidated financial statements and interim financial statements of KSB are prepared in accordance with the International Financial Reporting Standards (IFRSs) as adopted by the European Union. After the consolidated financial statements have been prepared by the Board of Management, they are audited by the auditors elected by the Annual General Meeting (BDO AG Wirtschaftsprüfungsgesellschaft) and approved by the Supervisory Board. Prior to the publication of interim reports and the half-year financial report, these are discussed with the Audit Committee.

An agreement has been reached with the auditors that the Chair of the Supervisory Board or the Chair of the Audit Committee shall be notified immediately of any substantial findings or issues which emerge during the audit or of any grounds for exclusion or partiality.

Management parameters and control system

In addition to order intake and sales revenue, our key performance indicators for the management of the KSB Group are the return on sales and our net financial position (i.e. the difference between cash and cash equivalents and interest-bearing investments on the one hand, and financial liabilities on the other). We also attach great importance to managing our activities in accordance with the economic value added (EVA) concept.

Our internal control system is based both on guidelines and regulations that specify standard procedures as well as our Group-wide risk management system. The organisation and implementation of this risk management system are documented in a manual. All Group units are responsible for identifying and assessing risks and reporting these to Group headquarters. They must also initiate countermeasures to avert or limit any damage.

Reporting on identified risks and the countermeasures initiated is an integral part of the planning and controlling process. The Supervisory Board's Audit Committee also looks at the reported risks on a regular basis.

KSB identifies and communicates the risks based on the following categories:

- Market / Competition
- Projects / Products
- Finance / Liquidity
- Procurement
- Technology / Research and Development
- Environment
- Human resources
- Other risks

The Internal Audits department performs regular reviews to establish to what extent the specified guidelines and regulations are observed and whether the operating units are appropriately involved in risk management.

Compliance as a key task of corporate management

Compliance in the sense of implementing measures to ensure observance of applicable law and internal guidelines by Group units is one of the Board of Management's key management tasks. The Board of Management expressed its requirement of professional, honest conduct within our Group-wide Code of Conduct. In addition to internal contact persons, employees can also contact an ombudsman via a whistleblower hotline if they discover that certain laws or company regulations, for instance of criminal or cartel/anti-trust relevance, are being violated. An external law firm is on hand which will promptly forward any information to the Group Compliance Officer.

Some fundamental statements contained in the Code of Conduct are addressed in more detail in other, separate guidelines. This particularly applies to the areas of anti-trust or cartel law and anti-corruption measures. The applicable laws and regulations are explained in greater detail and useful information on proper conduct in concrete situations is provided. The latter is similarly applicable to the guidelines prohibiting insider trading.

A major focus of compliance activities in 2012 was the aligning of our Compliance Management System to the established auditing standards of the *Institut der Wirtschaftsprüfer* [Institute of Public Auditors] in Germany (IDW); the result confirmed the progress made in the last few years as regards securing a structured, integrated approach. This financial year, the optimisation of appropriate organisational structures and processes will be a priority. We will complete the Group-wide training programme began in 2012 on corruption prevention and antitrust risks, and repeat it regularly. The e-learning training sessions will largely replace the previous classroom training. Once again, international projects were randomly audited for compliance with specific compliance issues within the scope of correlated control measures aimed at securing the targeted preventive effects.

Remuneration of the Supervisory Board

The remuneration of the Supervisory Board members is governed by the Articles of Association of KSB Aktiengesellschaft and the supplementary resolution of the Annual General Meeting dated 16 May 2012. According to the provisions of the Articles of Association, Supervisory Board members shall receive lump sum remuneration in the amount of € 6,000 for the financial year. The Chair is entitled to twice this amount and the Deputy Chair is entitled to one and a half times the amount. In addition, the members of the Supervisory Board receive an attendance fee of € 2,000 per meeting of the Supervisory Board and its committees they attend; the attendance fee for committee chairpersons is € 3,000 per committee meeting attended. No attendance fees are paid for meetings of the Committee pursuant to section 27(3) of the *MitbestG* [German Co-determination Act]. The members of the Supervisory Board are also covered by directors' and officers' liability insurance taken out by the company on behalf of the members of the Board of Management and the Supervisory Board at standard market conditions.

Finally, Supervisory Board members receive dividend-dependent remuneration for the financial year. For every 25 cents by which the dividend distributed to ordinary shareholders exceeds the amount of € 1, the remuneration paid out to Supervisory Board members amounts to € 1,200 for the chair, € 900 for the deputy chair and € 600 for the remaining members.

According to the contents of the resolution of the Annual General Meeting dated 16 May 2012, the Supervisory Board members also receive compensation for activities relating to the duties of the Supervisory Board that go beyond the preparation and conduct of meetings of the Supervisory Board and its committees. Compensation for the time invested shall be based on an hourly rate of € 250. The maximum amount of additional remuneration for all Supervisory Board members is € 900,000 per calendar year; for the period from 1 June 2012 to 31 December 2012 the maximum amount is € 525,000.

The representatives of IG Metall on the Supervisory Board declare that they will pay their Supervisory Board remuneration to the *Hans-Böckler-Stiftung* [Hans Böckler Foundation] in line with *DGB* [Association of German Trade Unions] guidelines.

Any additional remuneration is reserved for determination by the Annual General Meeting. The total remuneration paid to members of the Supervisory Board in 2012 amounted to € 1,409 thousand (previous year: € 1,332 thousand).

Remuneration of the Board of Management (Remuneration Report)

The Remuneration Report summarises the principles applied when determining the remuneration arrangements for the Board of Management of KSB Aktiengesellschaft. It is prepared in accordance with the recommendations of the German Corporate Governance Code (subsection 4.2.5) and explains the remuneration system in place for Board of Management members. This system is geared towards sustainable corporate development. It is adopted by the Supervisory Board plenary session based on the recommendation of the Personnel Committee and reviewed at regular intervals. The same applies to individual Board of Management compensation amounts.

The remuneration arrangements for the Board of Management are structured as clearly and transparently as possible. The total amount of remuneration for the individual Board of Management members is determined based on various parameters. Criteria for assessing the appropriateness of the remuneration include the responsibilities of the individual Board of Management members, their personal performance, the economic situation, the company's results and prospects as well as customary remuneration amounts when taking peer companies and the remuneration structure used elsewhere within the company into consideration.

The remuneration of the Board of Management consists of fixed and variable components. Fixed components are granted regardless of performance and consist of a fixed sum plus benefits, as well as pension commitments (retirement, disability, widow's or orphan's pension). The fixed sum makes up 60 % of the maximum annual salary and is paid out as a monthly basic remuneration. All Board of Management members are equally entitled to the accompanying fringe benefits which include the private use of a company car, payment of insurance premiums and any payments associated with a post-contractual non-competition clause. No loans or advance payments were granted to members of the Board of Management in the year under review.

To ensure the sustainability of the nature of the remuneration, the variable remuneration component consists mainly of components determined on the basis of a multi-year assessment. They are partly based (60 %) on the degree of implementation of the corporate strategy and its actual market success, and on the return on investment (20 %), which is measured according to the "economic value added" method based on a past average value over a medium-term horizon. The short-term share (20 %) is based on the development of the net financial position in the respective financial year as compared with the planned development. The total amount of the variable remuneration components is limited in order to take extraordinary, unforeseen developments into account.

The weighting factors above do not reflect the additional possibility of a bonus, to be paid out in individual cases at the discretion of the Supervisory Board, of no more than three monthly salary payments per financial year in recognition of any special performance of individual members of the Board of Management. Such decisions are only made on an irregular basis, meaning that they do not necessarily have to be made annually.

Furthermore, when entering into any Board of Management contract it is agreed that payments made to a Board of Management member in the event that his or her Board of Management tenure is terminated prematurely without good reason shall not exceed the value of two years' remuneration including fringe benefits (settlement cap in accordance with section 4.2.3 of the German Corporate Governance Code). No other payments have been promised to any Board of Management members in the event of termination of service; similarly no compensation will be paid in the event of a takeover offer. If the employment contract is terminated for good reason for which the Board of Management Member is responsible, the company shall not make any severance payments.

On 19 May 2010 – using a legally permissible option – the Annual General Meeting again resolved not to disclose the details of the compensation for individual members of the Board of Management for a period of five years. The total remuneration of the members of the Board of Management for their activities in the 2012 financial year was € 2,620 thousand. No stock options or other share-based payment arrangements are granted to members of the Board of Management. Further disclosures on the remuneration of the Board of Management can be found in section IX. of the Notes to the Consolidated Financial Statements.

GLOSSARY

KEY CORPORATE AND TECHNICAL TERMS

Canned motor
See Glandless pump.

Cavitation
Formation and subsequent implosion of cavities in fluids as a result of pressure fluctuations, causing considerable economic damage.

ERP Directive
The "Eco-design Directive" defines the requirements for the environmentally sound design of energy-related (i.e. energy-using) products (ErP).

***Gesellschaft für internationale Zusammenarbeit (GIZ)* [German Association for International Cooperation]**
GIZ's task field focuses on education, health, energy supply and peace building activities. The organisation's most important customer is the Ministry for Economic Cooperation and Development.

Glandless pump
Pump close-coupled to an electric motor whose rotor chamber is filled with the fluid pumped. The stator is separated from the rotor via a can and remains dry.

Global Compact
A global initiative for businesses and organisations launched by the United Nations with the aim of shaping social and ecological globalisation.

Intermetallic materials
Compounds of two or more materials characterised by hardness, and corrosion and heat resistance. Due to their chemical composition, they are classed in an intermediate category between metal alloys and ceramics.

KSB CARE
Aid fund of Asian KSB companies that supports educational institutions.

Pelton turbine
A water impulse turbine in which a strong water jet impacts against a wheel, or runner, fitted with spoon-shaped buckets. It was designed in 1879 by the American engineer Lester Pelton.

Permeate
The fluid that has penetrated the membrane in a reverse osmosis process.

Polymer materials
Materials which are made up of a multitude of molecules built from one or more types of atoms or atom groups joined together in repeating patterns.

Reverse osmosis
Physical method to remove salt from water. This method is frequently applied to produce drinking water by desalinating seawater.

River turbine
A turbine which generates electricity from water power.

Submersible motor
Electric motor whose rotor and stator are surrounded by fluid.

Synchronous reluctance motor
Highly energy-efficient motors whose specially designed rotor laminations guide the lines of magnetic flux. Rare earths are not required to manufacture these motors.

BRIC countries
Group of emerging countries with high economic growth. BRIC is an acronym of the capital letters of Brazil, Russia, India and China.

CONTACTS

EDITOR

KSB Aktiengesellschaft
Johann-Klein-Straße 9
67227 Frankenthal
Phone +49 6233 86-0
Fax +49 6233 86-3401

ONLINE NEWS

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

Should you need additional information,
please contact:

INVESTOR RELATIONS

Ralf Pfundmaier
Phone + 49 6233 86-2053
Fax + 49 6233 86-3454
E-mail: investor-relations@ksb.com

COMMUNICATIONS

Ullrich Bingenheimer
Phone + 49 6233 86-2138
Fax + 49 6233 86-3456
E-mail: ullrich.bingenheimer@ksb.com

CONCEPT AND DESIGN

KSB Communications (A-CC-G), Frankenthal
3st kommunikation, Mainz

PHOTOS

Robert Kwiatek (A-CC-G), Frankenthal
Getty Images (p. 126 / 127)

PRINTING

Ottweiler Druckerei und Verlag GmbH
Ottweiler, Germany

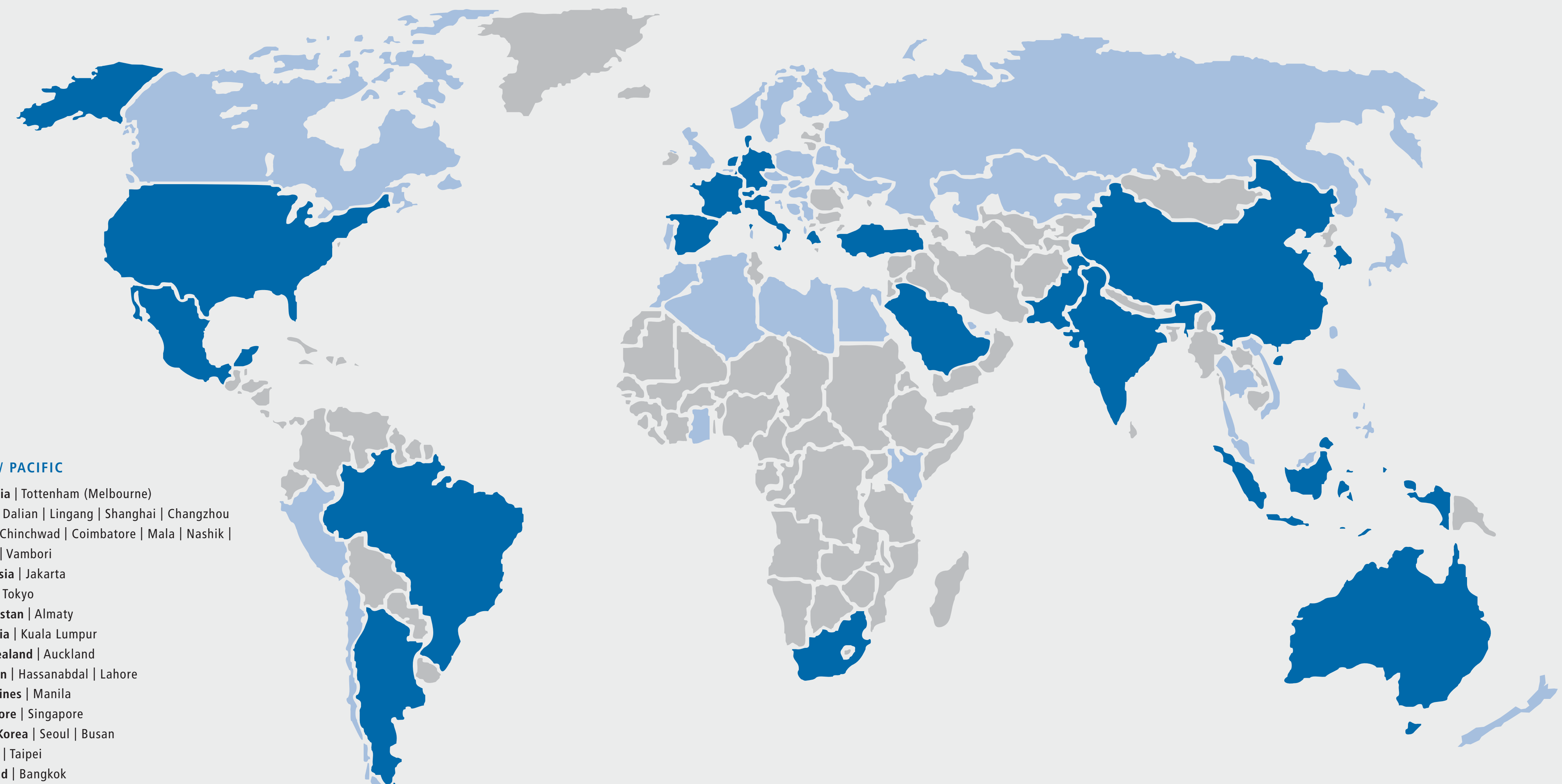
THE GLOBAL COMPACT
WE SUPPORT

As a signatory to the United Nations Global Compact, KSB is committed to endorsing the ten principles of the international community in the areas of human rights, labour standards, environmental protection and anti-corruption.

GLOBAL PRESENCE

KSB manufactures its products on all five continents. With production sites in 22 countries and a tightly knit global sales and service network, KSB staff are always close at hand when customers need to pump or reliably shut off fluids.

- KSB production sites
- KSB sales / service sites



EUROPE

Austria | Vienna
Belarus | Minsk
Belgium | Wavre
Croatia | Zagreb
Czech Republic | Prague
Denmark | Glostrup
Finland | Mänttä-Vilppula
France | Châteauroux | Gennevilliers (Paris) | La Roche-Chalais | Lille
Germany | Frankenthal | Halle | Pattensen | Pegnitz
Greece | Amaroussion (Athens)
Hungary | Budapest
Italy | Concorezzo (Milan) | Vicenza
Luxembourg | Echternach
Netherlands | Alphen | Zwanenburg | Velsen-Noord
Norway | Lysaker
Poland | Warsaw
Portugal | Rio de Mouro (Lisbon)
Russia | Moscow
Serbia | Belgrade
Slovak Republic | Bratislava
Slovenia | Ljubljana
Spain | Burgos | Madrid | Zarautz
Sweden | Gothenburg | Västra Frölunda
Switzerland | Zurich | Beinwil am See
Turkey | Ankara
Ukraine | Kiev
United Kingdom | Loughborough | Bridgwater

MIDDLE EAST / AFRICA

Algeria | Algiers
Egypt | Cairo
Ghana | Accra
Kenya | Nairobi
Libya | Tripoli
Morocco | Casablanca
Qatar | Doha
Saudi Arabia | Riyadh | Al Khobar
South Africa | Germiston (Johannesburg)
United Arab Emirates | Abu Dhabi | Dubai

ASIA / PACIFIC

Australia | Tottenham (Melbourne)
China | Dalian | Lingang | Shanghai | Changzhou
India | Chinchwad | Coimbatore | Mala | Nashik | Pimpri | Vambori
Indonesia | Jakarta
Japan | Tokyo
Kazakhstan | Almaty
Malaysia | Kuala Lumpur
New Zealand | Auckland
Pakistan | Hassanabdal | Lahore
Philippines | Manila
Singapore | Singapore
South Korea | Seoul | Busan
Taiwan | Taipei
Thailand | Bangkok
Vietnam | Ho Chi Minh City

AMERICAS

Argentina | Carapachay (Buenos Aires)
Brazil | Barueri | Várzea Paulista / São Paulo
Canada | Mississauga / Ontario
Chile | Santiago
Mexico | Querétaro
Peru | Lima
USA | Bakersfield / California | Grovetown / Georgia | Houston / Texas | Port Arthur / Texas | Richmond / Virginia

FINANCIAL CALENDAR

27 MARCH 2013
Financial press conference
10:00, Frankenthal

2 APRIL 2013
Invitation to Annual General Meeting

25 APRIL 2013
Interim report
January – March 2013

15 MAY 2013
Annual General Meeting
15:00, Frankenthal

13 AUGUST 2013
Half-year financial report
January – June 2013

13 NOVEMBER 2013
Interim report
January – September 2013

KSB Aktiengesellschaft
67225 Frankenthal (Germany)
www.ksb.com