2

Group Management Report

Basic Principles of the Group

Group Business Model

This management report for the first time combines the management reports for KSB SE & Co. KGaA, Frankenthal / Pfalz, Germany, and the KSB Group for the 2019 financial year (Combined Management Report).

The KSB Group's mission is to supply customers around the world with top-quality pumps and valves as well as related systems. It also offers a broad service portfolio to users of these products.

KSB SE & Co. KGaA, as the parent, directly or indirectly holds the shares in the companies belonging to the Group. Besides it, 9 domestic and 76 foreign companies are fully consolidated; 6 other companies are accounted for under the equity method. KSB is currently represented in more than 40 countries with its own subsidiaries.

As well as KSB SE & Co. KGaA 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)
- GIW Industries, Inc., Grovetown / Georgia (USA)
- KSB Limited, Pimpri (Pune), India
- KSB Service GmbH, Frankenthal, Germany
- KSB BRASIL LTDA., Várzea Paulista, Brazil
- KSB Italia S.p.A., Milan, Italy

The basic business model has not changed during the year under review. External economic and political changes, however, have had a partial effect on business. These are – where relevant and material to KSB – described in the following sections.

ORGANISATION, MANAGEMENT AND CONTROL

KSB SE & Co. KGaA was formed from KSB Aktiengesellschaft by entry in the *Handelsregister* [German Commercial Register] on 17 January 2018. The partnership limited by shares (KGaA) [*Kommanditgesellschaft auf Aktien*] is a common legal form in Germany for companies with a family- and foundation-dominated ownership structure. The general partner is KSB Management SE, a European public limited company. The shares in this company are wholly owned (100 %) by Klein, Schanzlin & Becker GmbH, a subsidiary of the non-profit KSB Stiftung [KSB Foundation] and the Kühborth-Stiftung GmbH [Kühborth Foundation]. KSB SE & Co. KGaA and with it the KSB Group are managed via KSB Management SE, which has four Managing Directors and a five-member Administrative Board.

Managers and employees implement the strategy and instructions of the Managing Directors within an organisation that is structured according to responsibilities for product groups, corporate functions and regions.

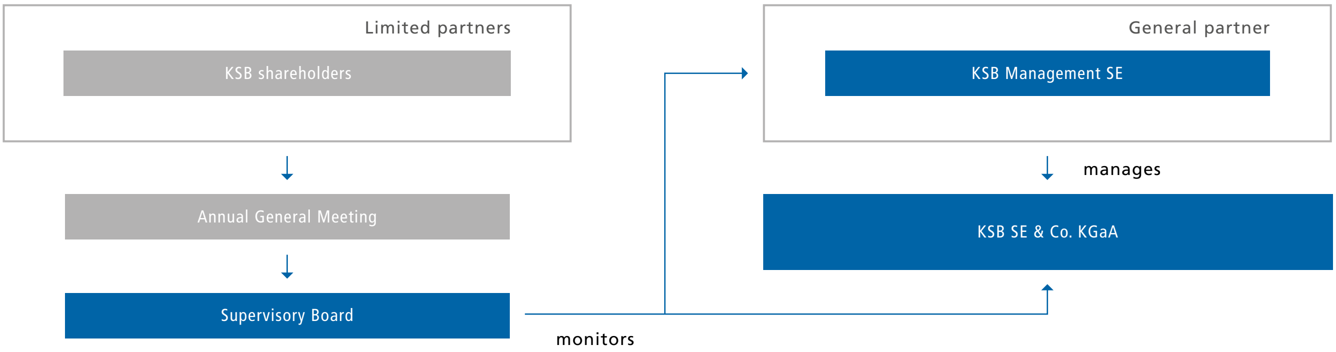
All organisational units in the KSB Group act with the aim of ensuring sustainable, profitable growth to secure both KSB's financial independence and its medium- and long-term future. KSB is monitored by a Supervisory Board consisting of twelve members. The Annual General Meeting of shareholders appoints six members of the Supervisory Board, with the remaining six being delegated by the employees under the terms of the *Mitbestimmungsgesetz* [German Co-determination Act].

The KSB Group organises its business activities in three segments based on product groups: Pumps, Valves and Service. The Pumps segment covers single- and multistage pumps, and associated control and drive systems. Applications are industry, chemicals / petrochemicals, energy supply, water transport and waste water treatment, construction / building services and the hydraulic transport of solids in mining. The Valves segment covers butterfly, globe, gate, control, diaphragm and ball valves, as well as associated actuators and control systems. The applications for these products are essentially identical to those for pumps. The Service segment, for which KSB launched its own brand, KSB SupremeServ, in the 2018 financial year, covers the installation, commissioning, start-up, inspection, servicing, maintenance and repair of pumps, related systems and valves for all these applications, as well as modular service concepts and system analyses for complete systems.

MARKETS AND LOCATIONS

Within the KSB Group, centrifugal pumps account for around two thirds of sales revenue. These pumps, as well as valves, are sold to engineering contractors, OEMs and end users or, in some cases, distributed via dealers.

Bodies / Structure



The former KSB AG is now managed in the legal form of a partnership limited by shares [*Kommanditgesellschaft auf Aktien* – KGaA]. Management is the responsibility of KSB Management SE, the individually liable general partner. The responsibilities of the bodies are governed by law and the Articles of Association. This is the basis for efficient corporate governance, which contributes to sustainable corporate growth.

The same applies to control and monitoring systems, and to package units with pumps and valves.

The largest and best developed sales market for these products is Europe, where KSB operates its main manufacturing facilities in Germany and France. The main plant of the present KSB SE & Co. KGaA in Frankenthal is its largest in Europe, ahead of the production sites in Pegnitz (Bavaria) and Halle (Saxony-Anhalt) in Germany, and La Roche-Chalais in France.

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

KSB manufactures products and components in a total of 17 countries; they are sold through the Group's own companies or agencies in more than 100 countries. With their products, the Group companies serve customers in industry including the chemical and petrochemical industries, in the energy sector, in construction / building services, in water and waste water management, and in mining. In 2019 the largest markets continued to be general industry, energy and water / waste water.

As the largest company in the KSB Group, KSB SE & Co. KGaA serves all the Group's regions and markets.

In order to be able to offer KSB products at favourable prices, the Group's purchasing requirements are combined and affordable suppliers sourced around the world who meet the relevant quality standards. The KSB Group is able to maintain its market position as one of the leading pump and valve manufacturers through its good and long-term relationships with customers and suppliers. Highly trained and motivated employees as well as the high quality of products have also helped cement this reputation.

Control System

Based upon a matrix organisation, KSB determines its key financial performance indicators as follows:

KSB mainly makes management decisions for the Group as a whole and for the Pumps, Valves and Service segments on the basis of the following key indicators: order intake, sales revenue and EBIT. KSB defines EBIT to be earnings before finance income / expense and income tax. When specifying key indicators, KSB is guided on the one hand by developments in the market and on the other by its main competitors. In addition, KSB continues to monitor the key indicators of earnings before income taxes (EBT), pre-tax return on sales and net financial position, which since the 2019 financial year have no longer been considered significant performance indicators.

Management decisions for KSB SE & Co. KGaA are made on the basis of the same control metrics as for the Group.

No non-financial performance indicators are consulted for controlling the Group and for making decisions regarding management issues.

Research and Development

Innovations are a fundamental pillar of KSB's activities and are part of the core elements of its strategy. They are defined as solutions that create added value for customers and translate into new products, services or business models.

Finding creative solutions is the most successful where developers have a high degree of freedom in choosing the approaches or methods. With this objective in mind, KSB has set up the off-site Business Innovation Lab to abandon the traditional paths of research and development. In this think tank, digital natives work with experienced specialists on ideas for the digital transformation of the company and on new paths in the marketing of pumps, valves and hydraulic systems.

Beyond these innovation approaches, the integration of hydraulic and electronic systems is a focus of activities. It opens access to new business models. As many product components come into contact with fluids that are corrosive or abrasive, materials research is another key area of the developers' work.

50.5

Research and development expenses in € millions

In these activities, the KSB Group is primarily drawing on its strong research and development expertise in Europe and India. In addition, it cooperates with external institutes and research facilities. Overall, the Group spent around € 50 million on research and development in the year under review. This equates to about 2 % of our sales revenue. KSB SE & Co. KGaA invested € 34 million in research and development in the year under review, which equates to around 4 % of sales revenue. A large portion of the development work was on customer projects. Across the Group, 512 staff were employed in research and development on average over the year. At KSB SE & Co. KGaA, 271 staff worked in research and development in the year under review.

Economic Review

Macroeconomic Environment and Sector View

The world economy lost further steam over the course of the 2019 financial year. The International Monetary Fund (IMF), whose figures provide the basis for planning, predicted growth of 3.5 % at the start of 2019. Actual growth, at + 2.9 %, failed to meet this forecast and was at its lowest level since the global financial crisis in 2008 / 2009. The ongoing trade policy restrictions on the traffic of goods along with geopolitical tension led to a deterioration in the business climate and acted as a brake on capital investment decisions. Weaker growth affected both developed countries (+ 1.7 %) and emerging market and developing countries (+ 3.7 %).

Europe was once again of primary importance for the KSB business in 2019. However, compared with the IMF forecast, the growth of the economy in the home market weakened more sharply than it did on a global scale. The effects of the global restrictions on trade and a collapse in sales figures in the automotive industry were reflected in significantly weaker demand from abroad and pushed down economic growth in the euro zone to + 1.2 %. Exports declined in Germany in particular. In combination with lower industrial output, this caused the economy to grow by only + 0.5 %, just avoiding recession. France escaped the fall in growth largely unscathed on account of stable domestic demand, and recorded economic growth of + 1.3 %. In Italy, the drop in demand from abroad combined with political uncertainty and lower private consumption meant that the economy weakened to + 0.2 %. In the UK, economic growth slowed to + 1.3 %. Main reasons were the ongoing uncertainty about the consequences of the forthcoming exit from the EU and more circumspect capital investment behaviour as a result. The Spanish economy once again recorded above-average growth in international terms thanks to strong domestic demand. This improved the economic environment for sales in Spain as well as for production and service.

After posting strong growth in recent years, the US economy weakened in 2019. The decline was primarily attributable to higher customs duties and the waning effect of the tax-cutting policy. Overall, the US economy achieved growth of + 2.3 %, putting it slightly below the IMF forecasts at the beginning of the year.

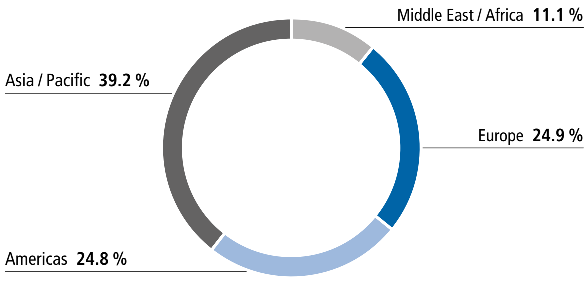
While economic growth in China and India remained above the average for the emerging economies of Asia, the increase was lower year on year, too. Despite stabilising fiscal policy and state infrastructure projects, economic growth in China slipped to + 6.1 %. Weaker exports and a fall in capital investment contributed to the slowdown. In India, economic growth declined to + 4.8 % because of weaker domestic demand.

The five economically most significant countries in South East Asia – Indonesia, Malaysia, the Philippines, Thailand and Vietnam – recorded a growth rate below the previous year's level at + 4.7 % overall. The IMF forecast for these countries – where KSB also has a presence through its own companies – was reduced in the course of the year.

The region South America, which includes important markets for KSB in Argentina, Brazil and Chile, was considerably weaker and well below the expectations at the beginning of the year. Here growth was a mere + 0.2 %. In Argentina, the currency crisis and the outflow of capital were exacerbated following the elections in August. The result was a further decline in the economy. In Brazil, structural reforms and improved conditions on the financial markets, accompanied by expansionary monetary policy, bolstered the economy. However, these measures were unable to prevent a slight slowdown in economic growth compared with the previous year.

The economic performance of the countries in the Region Middle East / Africa was marked above all by international tension and economic sanctions and by a falling oil price overall interrupted only by short-term and supply-driven price shocks. In South Africa, where KSB operates a factory in Johannesburg, political uncertainty, low capital investment and trade restrictions acted as a brake on economic growth.

World market of centrifugal pumps and valves



Source: KSB estimate (February 2020), European Industrial Forecasting

For Saudi Arabia, likewise a large sales market for KSB, the IMF revised its forecast significantly downwards in view of the drop in crude oil production and industrial output.

For Russia, the signs pointed to a further weakening in the economy owing to the continuing sanctions and the lack of foreign investment.

WEAKER DEMAND OVERALL

Over the course of the year, the restrictions on international trade put a brake on capital investment and industrial output worldwide. This meant that in the general industry market, which is important for KSB, growth in demand was also down overall.

The petrochemical industry faced challenges on a number of fronts in view of geopolitical tension, changing international supply chains, volatile crude oil prices and evolving demand. Oil refineries benefited from higher demand and capacity utilisation last year on account of the forthcoming switch to low-sulphur fuels in shipping from 2020. The International Maritime Organisation (IMO) regulation entering into force in 2020 requires a reduction in sulphur oxides from 3.5 % to 0.5 %.

According to estimates from the International Energy Agency (IEA), the consumption of natural gas rose further last year. A number of regionally varying factors contributed to this. In China, political measures to improve air quality took effect, while in the Middle East the efforts to reduce dependency on crude oil had an impact. In 2019, investment in liquid natural gas (LNG) technologies reached a record level.

The chemical industry fared less well. In China, which is the world's largest producer of chemicals, growth weakened in the sector. In the United States, the national trade association for the chemical industry cut its forecast for 2019. In Europe, growth was also down owing to the weakening in the manufacturing sector.

For the water and waste water industry, increasing industrialisation and urbanisation are the driving forces for stable growth. Market observers therefore anticipate a significant increase in capital investment in waste water facilities for 2019. Major capital investment projects were launched in the course of the year as a result of the development of rural regions in Africa and South America and efficiency improvements in countries in the Middle East, particularly Saudi Arabia.

The downward trend of recent years in capital investment in gas-powered and coal-fired power stations continued. In North America and Europe, the generating capacity represented by fossil-fuelled power stations has been continually reduced over recent years. Only Asia and the Middle East have increased capacity. As far as nuclear power stations are concerned, global capacity at the beginning of 2019 was slightly above the previous year's level. Almost all new reactors went on stream in China. Worldwide, more than 50 nuclear power plant reactors remain under construction. The largest expansion in capacity last year was in renewable energy. With regard to total energy consumption, the IEA's monthly statistics for the OECD (Organisation for Economic Cooperation and Development) countries up to and including October 2019 showed a reduction.

In mining the economic slowdown made itself felt. Coal production rose only slightly globally, bolstered by higher demand mainly in China, India and Australia. In the USA, Canada and a number of European countries – among them Germany in particular – the coal industry is facing change in view of emissions regulations. The mining of metals such as iron and copper was also subdued last year. Producers of precious metals benefited from higher prices last year.

The construction / building services industry is at a turning point globally after years of strong growth. As a result, growth rates in energy-efficient building and heating are also down. On the other hand, significant impetus for refrigeration and air conditioning technology had been expected in Asia in particular. With support from public infrastructure projects, growth in the construction / building services industry is expected to be strongest in China. The German construction / building services sector also continued to show strong growth rates across all areas of construction equally, despite the overall economy weakening.

MECHANICAL ENGINEERING IN A DOWNTURN

According to information from the German Mechanical Engineering Industry Association (VDMA), politically motivated upheaval unsettled investors, while the transformation process in the automotive industry hit demand. Global sales revenue in mechanical engineering stagnated in 2019 at prior-year levels in real terms, according to VDMA. Among the top five locations (China, USA, Germany, Japan, Italy), which account for around 70 % of global sales revenue, only China is expected to show growth. Positive sales figures were also achieved in individual countries in the euro zone and in Sweden. In the UK, sales revenue in the mechanical engineering industry showed a negative development.

According to VDMA, sales revenue in the German mechanical engineering sector too dropped by 3.4 %. Real-terms production failed to match the previous year's level, contracting by 3.2 %, according to provisional calculations from the German Federal Statistical Office. Capacity utilisation fell below its long-term average.

In the liquid pumps sector, VDMA recorded real sales revenue growth of 2 % among German pump manufacturers. Industrial valves stagnated with real sales revenue growth of + / – 0 %. Sales revenue growth for building services valves was 1 %.

Business Development and Results of Operations

In the first seven months of the year, business continued to improve because of strong capital investment activity on the part of customers in important sales markets. This applied, in particular, to the energy, water / waste water and construction / building services markets. By contrast, the last five months of the year saw a significant cool-down of the capital goods market.

KSB made the most of market opportunities via the global KSB sales organisation, supported by its global manufacturing network, its service organisation and national dealership networks.

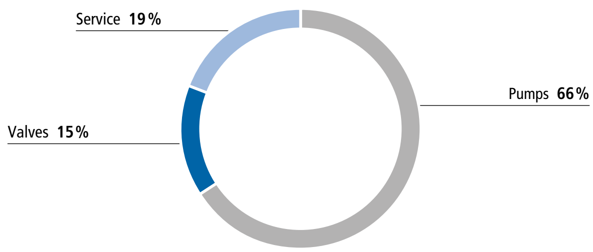
ORDER INTAKE

The volume of incoming orders was increased by a tangible € 150.2 million (+ 6.5 %) to € 2,453.8 million in the financial year.

Notable rises were recorded particularly with customers in the energy (€ + 43.4 million), general industry (€ + 25.4 million), water / waste water (€ + 23.3 million) and construction / building services (€ + 20.8 million) markets. This equates to growth of 6.5 % in total.

At regional level, almost every company posted a significantly higher order intake. The highest growth was achieved by the Region Asia / Pacific at € + 69.5 million (+ 13.6 %) and the Region Americas at € + 44.2 million (+ 12.3 %). Companies in the Region Middle East / Africa were up on the previous year by € 23.4 million (+ 16.3 %), and companies in Europe were up by € 13.1 million (+ 1.0 %) in a generally stagnating market. This growth was underpinned by nuclear orders from China, India, Canada and Northern Europe. The Region Middle East / Africa recorded a considerable recovery from its low position.

Sales revenue by segment



Segment reporting

	Order intake		Sales revenue		EBIT	
€ thousands	2019	2018	2019	2018	2019	2018
Pumps segment	1,617,825	1,506,248	1,562,462	1,469,443	84,823	90,563
Valves segment	361,878	355,618	364,365	340,771	2,266	– 37,373
Service segment	474,060	441,670	456,358	435,734	26,514	21,512
Total	**2,453,763**	**2,303,536**	**2,383,185**	**2,245,948**	**113,603**	**74,702**

Pumps

In the Pumps segment, order intake was € 1,617.8 million, up by a substantial € 111.6 million (+ 7.4 %). The main drivers were the nuclear and water / waste water markets in particular. The energy market grew by € 45.8 million (+ 25.5 %), construction / building services by € 19.1 million (+ 11.3 %), water / waste water by € 16.8 million (+ 5.2 %), mining by € 10.4 million (+ 5.0 %) and general industry by € 9.7 million (+ 2.1 %).

Valves

In the Valves segment, order intake was € 361.9 million, up by a moderate € 6.3 million (+ 1.8 %). The most significant growth came in the oil and gas market with € + 17.6 million (+ 21.8 %), followed by water / waste water with € + 4.2 million (+ 20.7 %). The general industry market also performed positively with growth of € 2.8 million (+ 2.7 %). The construction / building services and mining markets remained almost unchanged, while the energy market declined by € 9.1 million (– 11.4 %).

Service

Order intake in the Service segment totalled € 474.1 million, which was a substantial € 32.4 million (+ 7.3 %) above the previous year. The general industry market in particular recorded notable growth of € 12.9 million (+ 10.9 %). In addition, the energy market grew by € 6.6 million (+ 5.9 %), mining by € 5.6 million (+ 20.3 %), water / waste water by € 2.3 million (+ 4.2 %) and construction / building services by € 1.8 million (+ 5.0 %).

SALES REVENUE

Consolidated sales revenue rose significantly by € 137.2 million (+ 6.1 %) to € 2,383.2 million.

2.4

Consolidated sales revenue in € billions

Europe remains the region with the strongest sales revenue at 54.4 %. The European companies' sales revenue was up by a tangible 3.1 % from the previous year. The largest entity, KSB SE & Co. KGaA, which serves markets both in and outside Europe, improved its sales revenue by € 17.4 million to € 779.4 million. Major projects contributed to this growth. With the exception of the Region Middle East / Africa, where weak order intake from the previous year resulting from political factors made itself felt, all Regions contributed to growth. The companies in the Region Asia / Pacific recorded the strongest growth with an increase of € 59.5 million (+ 12.4 %) followed by the legal entities in the Americas with a gain of € 41.9 million (+ 12.1 %) and Europe with € + 38.9 million (+ 3.1 %). The companies in the Region Middle East / Africa, were down on the previous year with a decline of € 3.0 million (– 1.9 %).

Pumps

Sales revenue in the Pumps segment increased by a significant € 93.0 million (+ 6.3 %) to € 1,562.5 million. Substantial growth compared with the previous year was recorded by the Region Asia / Pacific with € + 40.4 million (+ 11.8 %) and the Region Americas with € + 31.7 million (+ 11.4 %). In the Region Europe sales revenue rose by a significant € 24.4 million (+ 3.4 %). Growth in the Region Americas was supported primarily by the US company GIW with its main business in the mining market. In Asia / Pacific, the business in India and China performed very positively.

Valves

In the Valves segment, order intake growth was translated into significantly increased sales revenue. It rose by € 23.6 million (+ 6.9 %). The financial year closed with sales revenue of € 364.4 million. While in some cases substantial growth was recorded by the companies in the Region Europe at € + 10.8 million (+ 4.9 %), the Region Asia / Pacific at € + 10.6 million (+ 11 %) and the Region Middle East / Africa at € + 2.6 million (+ 39.8 %), the Region Americas was marginally down on the previous year's level by € – 0.4 million (– 2.8 %).

Service

The Service segment saw a tangible upturn in sales revenue of € + 20.6 million (+ 4.7 %) to € 456.4 million. The Region Europe, by far the largest, was approximately level with the previous year at € + 3.7 million (+ 1.1 %), while the Region Americas was well above the previous year's level at € + 10.6 million (+ 20.0 %), as was the Region Asia / Pacific at € + 8.6 million (+ 20.0 %). Only the Region Middle East / Africa recorded a substantial decline of € 2.2 million (– 12.7 %), resulting from the economic and political environment.

EARNINGS BEFORE FINANCE INCOME / EXPENSE AND INCOME TAX (EBIT)

The KSB Group achieved earnings before finance income / expense and income tax (EBIT) of € 113.6 million (previous year: € 74.7 million). The Pumps segment contributed € 84.8 million to this figure, the Service segment € 26.5 million and the Valves segment € 2.3 million.

The previous year was marked by a number of extraordinary transactions, which impacted on EBIT in the amount of € – 22.8 million. After adjustment for extraordinary transactions, EBIT in 2018 would have been € 97.5 million. The significant improvement in EBIT recorded in 2019 was thus attributable both to the extraordinary transactions ceasing to have an effect and to improved operational business activity. Individually, the segments contributed as follows:

Pumps

EBIT in the Pumps segment, at € 84.8 million, was a significant € 5.7 million below the previous year's EBIT figure of € 90.6 million, despite growth in sales revenue of € 93.0 million (+ 6.3 %). The decline was principally caused by the one-off income of € 32.4 million recognised in the previous year as a result of the introduction of a lump-sum option for pension payouts. This option means employees can choose to receive a lump-sum payment, either as a one-time payment or in ten annual instalments, instead of a monthly pension for life. In contrast, EBIT was reduced in the previous year by provisions amounting to € 25.0 million for a legacy project in the UK and for risks in connection with the business in Iran of € 5.4 million. The forecast made in the previous year's report for EBIT (a slight decline) was not met owing to weaker-than-expected sales revenue particularly in the Region Europe and by weaker standard business.

Valves

In the Valves segment the forecast for EBIT (a substantial increase) was met, with an improvement from € – 37.4 million to € + 2.3 million. Like the Pumps segment, the Valves segment also felt the effect of extraordinary transactions in 2018.

113.6

Consolidated earnings (EBIT) in € millions

While the lump-sum pension payment option referred to above added € 5.9 million to EBIT in 2018, EBIT was weighed down in 2018 by a € 20.6 million impairment loss on the goodwill of KSB Seil Co., Ltd., South Korea, and by a write-down on property, plant and equipment in the amount of € 10.6 million. Thus, overall the Valves segment recorded a significant improvement in operational earnings, mainly attributable to the significant rise in sales revenue and higher margins.

Service

In the Service segment, the KSB Group achieved EBIT of € 26.5 million. The substantial rise of € 5.0 million (+ 23.3 %) was in line with the forecast from the previous year. The extraordinary transactions had only a marginal effect of € + 0.5 million on EBIT in the Service segment in 2018. The main factor in the improved earnings in this segment in 2019 was the increase in sales revenue of € 20.6 million. The expansion of the Service business under the KSB SupremeServ brand introduced in 2018 had a positive effect.

TOTAL OUTPUT OF OPERATIONS

The above-mentioned rise in sales revenue was also reflected in a higher total output of operations. This amounted to € 2,381.2 million, after € 2,275.8 million in the previous year, despite a reduction in work in progress and inventories of finished goods of € 9.3 million (previous year: increase of € 22.6 million). Other work performed and capitalised amounts to € 7.4 million and was therefore stable compared with the previous year.

INCOME AND EXPENSES

Other income was almost unchanged on the previous year at € 33.4 million (previous year: € 33.1 million). However, in the previous year the item included income of € 8.5 million from the reversal of provisions; since the 2019 financial year this income has been shown in the expense items in which the original addition to provisions was recognised. Without the effect of this, other income rose by € 8.8 million. This was primarily attributable to higher compensation payments from customers for cancelled orders in the amount of € + 3.5 million, higher income from asset disposals of € + 1.6 million and an increase of € 1.2 million in income from the reversal of impairment losses.

The cost of materials rose slightly in relation to the total output of operations, up from 41.1 % in the previous year to 41.4 % in the year under review. Thus, overall the cost of materials increased in step with the total output of operations to € 984.8 million compared with € 934.5 million in the previous year.

Staff costs rose significantly in the 2019 financial year, from € 765.5 million to € 848.3 million (a rise of € 82.8 million). In the 2018 financial year, staff costs were reduced by € 46.4 million on account of the lump-sum pension payment option referred to above. Without this factor, staff costs would have risen by 4.5 % instead of the actual rise of 10.8 %. On average in the year under review, the KSB Group had 233 employees (+ 1.5 %) more than in the previous year. Just under half the rise in headcount was accounted for by Europe, where on average 103 more staff were employed. Other notable increases were recorded in Asia and in the Region Middle East / Africa. With a 4.6 % increase in the total output of operations and a rise in staff numbers at the same time, the total output per employee increased further from € 148 thousand to € 153 thousand. An average of 15,591 people were employed in the reporting year (previous year: 15,358 employees).

Depreciation and amortisation fell by € 22.6 million to € 81.9 million compared with the prior-year period. In the previous year write-downs totalling € 38.8 million were recognised, comprised of impairment losses on the goodwill of KSB Seil Co., Ltd., South Korea, and of two French service companies, and of impairment losses on property, plant and equipment of the French production company KSB S.A.S., Gennevilliers (Paris). In the year under review, in contrast, depreciation / amortisation of € 15.9 million relating to right-of-use assets was shown under this item for the first time.

Other expenses fell by € 44.7 million to € 372.2 million compared with the prior-year period. The decline was mainly attributable to additions to provisions for a legacy project in the United Kingdom in the previous year as well as to the first-time adoption of IFRS 16 in the year under review. This standard requires that for leases in which KSB is the lessee lease liabilities and right-of-use assets (rights to use leased items) be recognised on the balance sheet. The expenses for rents and leases included in other expenses, which also included operative lease expenses, fell accordingly by € 14.1 million in the year under review. The right-of-use assets now recognised on the balance sheet had the effect of adding to depreciation and amortisation.

Finance income / expense declined by € 1.0 million. This reflects the lower income from equity investments recognised using the equity method.

EARNINGS

The KSB Group generated earnings before income tax (EBT) of € 103.4 million compared with € 65.6 million in 2018. Correspondingly, the return on sales before income tax rose from 2.9 % in the previous year to 4.3 %. The income tax rate fell from 63.5 % in the previous year to 43.4 % in the year under review. The very high income tax rate in the previous year, which remained high in the year under review, was again mainly the result of deferred taxes on loss carryforwards that cannot be capitalised. Overall, KSB more than doubled its earnings after income tax, with an increase from € 23.9 million in 2018 to € 58.5 million.

At € 15.4 million, earnings attributable to non-controlling interests rose by € 2.8 million compared with the previous year. Relative to earnings after income tax, there was therefore a change from 52.8 % to 26.4 %.

Earnings attributable to shareholders of KSB SE & Co. KGaA (€ 43.1 million) were € 31.8 million higher than in the previous year (€ 11.3 million).

Earnings per ordinary share were € 24.47, compared with € 6.26 in the previous year, and € 24.73 per preference share, compared with € 6.64 in 2018.

Financial Position and Net Assets

FINANCIAL POSITION

The KSB Group's financial position remained good. This was reflected in a consistently high equity ratio of 37.1 % (previous year: 38.2 %).

Liquidity

KSB recorded cash flows from operating activities of € 144.9 million, a year-on-year increase of € 83.6 million. The improvement was essentially achieved by a working capital initiative started in 2019. In particular, the increase in inventories usually associated with sales growth was avoided. Higher earnings after income tax also contributed to the sharp increase in cash flows. A reduction in liabilities had a countervailing effect.

The outflows from investing activities fell by € 16.5 million compared with 2018: cash flows from investing activities shrank from € – 90.5 million in the previous year to € – 74.0 million in the reporting year. The repayment of a loan extended to Shanghai Electric-KSB Nuclear Pumps and Valves Co., Ltd., Shanghai, made a major contribution to this.

By contrast, the negative cash flows from financing activities increased, totalling € – 46.4 million compared with € – 9.4 million in the previous year. A key reason was the scheduled repayment on the loan against borrower's note in the amount of € 26.0 million. Furthermore, in the reporting year cash flows from financing activities included the repayment of lease liabilities in the amount of € 16.1 million from the first-time adoption of IFRS 16.

Overall, cash and cash equivalents increased sharply from € 255.5 million to € 280.9 million. Exchange rate effects amounting to € – 0.3 million (previous year: € + 4.6 million) were recorded.

The KSB Group assumes that, in future, it will continue to be able to meet its outgoing payments largely from operating cash flows. From the current perspective, its financial management is meeting the goal of ensuring its liquidity at all times essentially without any additional external financing measures. In addition, there has been a syndicated loan agreement of KSB SE & Co. KGaA and KSB FINANZ S.A., Luxembourg, since December 2018 to hedge liquidity risk and cover the need for bank guarantees of the KSB Group. The credit line can be used at any time and has a fixed term of five years with the option to renew twice by one year each time. In the reporting year KSB made use of this option for the first time and renewed the fixed term early until the end of 2024. For more information on liquidity management (such as credit lines) see the section on Risk Reporting on the Utilisation of Financial Instruments elsewhere in this group management report.

Investments

The additions to intangible assets amounting to € 15.2 million (previous year: € 13.0 million) mainly comprised internally generated intangible assets.

Investments in property, plant and equipment in the year under review, at € 78.9 million, were higher than the prior-year figure of € 66.6 million. The highest additions at € 29.3 million (previous year: € 16.1 million) related to advance payments and assets under construction. Another € 19.8 million related to plant and machinery (previous year: € 21.5 million), while € 19.6 million was accounted for by other plant, operating equipment and office equipment (previous year: € 20.3 million). As in 2018, the focus of capital investment activity was the Region Europe, mainly Germany and France. Outside Europe, the highest additions were made at the plants in the USA, India and China.

246.3

Net financial position in € millions

Net financial position

The net financial position, at € 246.3 million, fell by € 8.7 million after € 255.0 million in the previous year. This reduction was brought about by the first-time adoption of IFRS 16. The lease liabilities included in the net financial position rose by a considerable € 47.1 million. After adjustment for the lease liabilities recognised under IFRS 16, the net financial position in the year under review would have amounted to € 293.4 million (previous year: € 255.0 million).

Contingent liabilities and other financial obligations

The contingent liabilities as at the reporting date totalled € 19.0 million (previous year: € 35.9 million). This decline was mainly the result of the revised assessment of a lawsuit pending in France, for which the likelihood of a conviction was downgraded to remote.

There are no other extraordinary obligations and commitments beyond the reporting date. Further financial obligations arise only within the normal scope from purchase commitments amounting to € 29.5 million (previous year: € 12.4 million).

NET ASSETS

Around 33.6 % of funds is attributable to non-current assets (previous year: 31.1 %). Intangible assets and property, plant and equipment with a historical cost of € 1,507.8 million (previous year: € 1,476.2 million) have carrying amounts of € 608.4 million (previous year: € 587.7 million). Total intangible assets rose from € 91.1 million to € 97.1 million. The main increase, at € 9.2 million, came from internally generated intangible assets, relating primarily to the KSBase sales software, which was made operational in December 2019 as a selection software for the standard pump range, and to the implementation of a project aimed at introducing an end-to-end e-sales process. Property, plant and equipment rose from € 496.7 million to € 511.3 million as a result of capital expenditure (€ 78.9 million) in excess of depreciation of € 61.5 million.

The adoption of IFRS 16, which requires right-of-use assets for leases to be recognised on the balance sheet, resulted in an increase of € 50.1 million.

The carrying amount of financial assets, investments accounted for using the equity method and non-current other non-financial assets rose overall by € 0.5 million to € 29.0 million. The investments accounted for using the equity method made up € + 0.3 million. Deferred tax assets rose to € 95.1 million (previous year: € 80.4 million).

Inventories were recognised in the amount of € 544.7 million, almost unchanged on the previous year (€ 544.4 million) despite a higher volume of business. This reflected the positive effect of the working capital project referred to above. Contract assets edged up from € 74.5 million in the previous year to € 76.4 million.

Trade receivables decreased from € 518.1 million at the end of the previous year to € 504.1 million. This decline was basically the result of measures to reduce receivables in Germany, France and Sweden.

Other financial assets were down from € 103.4 million to € 90.9 million. This change essentially resulted from reduced other receivables (€ – 12.3 million). Other non-financial assets likewise showed a reduction (€ 9.9 million). The main factor was the drop in recoverable taxes, particularly in Germany and India, which were down by € 8.9 million at € 31.2 million.

Cash and cash equivalents account for around 12 % of assets, totalling € 280.9 million (previous year: € 255.5 million).

Assets held for sale in the amount of € 7.8 million relate to the company SPI Energie S.A.S., France, in the Service segment, the shares in which were sold in January 2020.

Total assets increased by 3.8 % to € 2,327.0 million, above all as a result of non-current assets, which since 2019 have also included right-of-use assets for leases pursuant to IFRS 16.

37.1

Equity ratio in percent

EQUITY

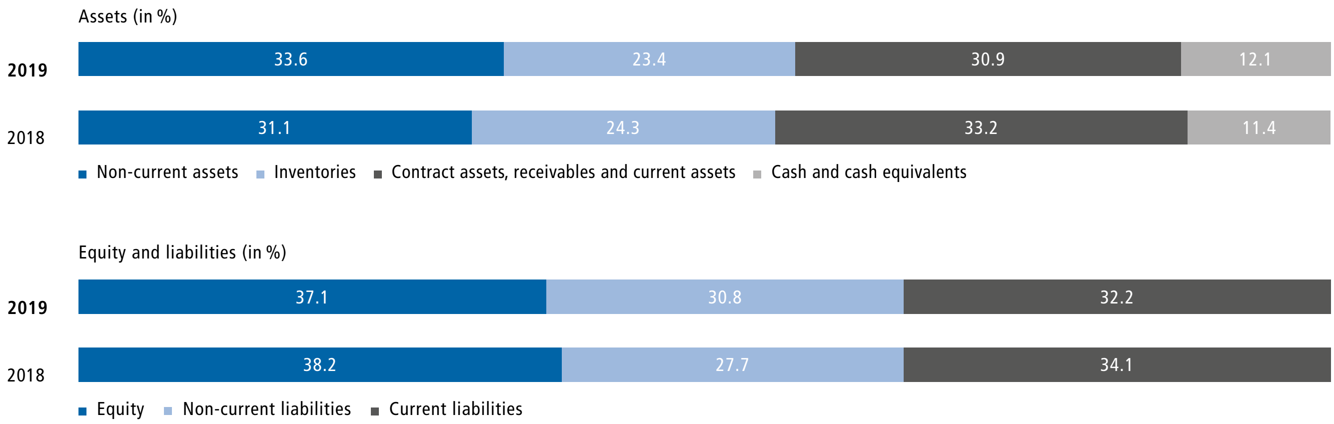
The KSB Group's equity amounts to € 862.6 million (previous year: € 856.8 million). This includes KSB SE & Co. KGaA's subscribed capital of € 44.8 million as in the previous year. The capital reserve remains unchanged at € 66.7 million. Revenue reserves contracted by a total of € 8.8 million. This reflected the effect of the significant increase in earnings after income tax and the fall in discount rates for pension provisions, resulting in actuarial losses after deferred taxes in the amount of € 49.1 million. The revenue reserves include the proportion of earnings after income tax attributable to KSB SE & Co. KGaA shareholders, at € 43.1 million (previous year: € 11.3 million). Out of total equity, € 182.2 million (previous year: € 167.6 million) is attributable to non-controlling interests. Due to the higher total equity and liabilities, the equity ratio contracted to 37.1 % (previous year: 38.2 %).

The non-controlling interests mainly relate to the following companies: KSB Limited, India, and KSB Shanghai Pump Co., Ltd., China, as well as the PAB subgroup. The latter consists of Pumpen- und Armaturen-Beteiligungsgesellschaft mbH, Frankenthal, and its US subsidiaries.

Inflation and exchange rate effects

Of the Group's consolidated companies only the annual financial statements of an Argentinian company had to be adjusted for the effects of inflation. As in the previous year, this did not result in any material impact on the net assets, financial position or results of operations.

Balance sheet structure



The translation of financial statements of consolidated companies that are not prepared in euro gave rise to a difference of € + 3.8 million (previous year: € – 13.8 million). The total of currency translation differences was taken directly to equity.

Liabilities

The largest item under liabilities continues to be provisions for employee benefits, including, also as the largest item, pension provisions, which rose by € 76.0 million, from € 553.6 million to € 629.6 million, of which € 70.5 million (previous year: € 10.7 million) alone was caused by the decrease in discount rates referred to above. Obligations for current pensioners and vested benefits of employees who have left the company account for about 45 % of the amount recognised in the balance sheet. The rest relates to defined benefit obligations for current employees.

Non-current financial liabilities rose by € 26.7 million to € 56.8 million, mainly because of the € 31.2 million in additional lease liabilities resulting from the first-time adoption of IFRS 16. The loan against borrower's note, which still amounts to € 22.0 million, is expected to be repaid in 2021.

The other non-current and current provisions for employee benefits dropped to € 28.9 million (previous year: € 34.4 million) because of the reduction in partial retirement provisions.

Other non-current and current provisions also decreased from € 84.9 million in 2018 to € 69.7 million. This was mainly the consequence of lower provisions for expected losses (€ – 12.7 million).

Current liabilities fell overall by € 16.1 million to € 748.9 million, after € 765.0 million at the close of 2018, following the repayment on the loan against borrower's note. Taking into account the increase in total equity and liabilities, the share of current liabilities in total equity was 32.1 % (previous year: 34.1 %).

Trade payables fell to € 252.7 million (previous year: € 270.2 million). Other non-financial liabilities increased by € 6.8 million. Contract liabilities rose from € 157.4 million in the previous year to € 165.5 million. Current financial liabilities declined by € 4.5 million.

Liabilities in connection with assets held for sale in the amount of € 4.0 million relate to the company SPI Energie S.A.S., La Ravoire, France, in the Service segment, the shares in which were sold in January 2020.

Summary of the Performance in the Financial Year

The order intake forecast in the previous year, expected to be in a range between € 2,350 million and € 2,500 million, was achieved. In the Pumps and Service segments, where a substantial increase was anticipated, the forecast was confirmed. In the Valves segment only a slight increase was recorded. This segment therefore failed to match the tangible increase expected, which was attributable to the energy market.

As with order intake, the forecast for sales revenue, expected to be in a range between € 2,300 million and € 2,450 million, was achieved. Sales revenue in the Pumps segment rose only tangibly rather than substantially, as a result of lower-than-expected growth in the Region Europe. The Valves segment likewise failed to match expectations, with a tangible rise rather than the substantial one forecast. In this segment, too, growth in Europe was weaker than anticipated. In the Service segment the forecast of tangible growth was confirmed.

The range between € 95 million and € 115 million forecast for EBIT was also attained. In the Values segment, the forecast of a substantial rise was met. KSB also recorded substantial growth in the Service segment, as anticipated. By contrast, the forecast for the Pumps segment, where a slight decline was expected, was not matched, as there was a tangible decrease. Detailed information on the reasons for the EBIT performance is provided in the "Earnings before finance income / expense and income tax (EBIT)" section.

The forecasts on ranges for order intake, sales revenue and EBIT reaffirmed in the 2019 half-year report were fulfilled for all key indicators.

The Management of the KSB Group is satisfied overall with business performance in the year under review.

KSB continues to have a healthy financial basis for the future.

Report on Expected Developments

The International Monetary Fund has lowered its forecast for global economic growth in 2020 only slightly to 3.2 % in real terms. Compared with the previous year, growth is expected to pick up on the basis of economic recovery anticipated in a number of emerging economies and developing countries, such as Brazil, Mexico, Saudi Arabia and Turkey. In India, the growth rate is expected to rise to 5.8 %. For the advanced industrialised countries, the expansion in activity is likely to remain level with last year, at 1.6 %. There are prospects of a boost to growth momentum from the phase 1 deal in the trade dispute between China and the USA.

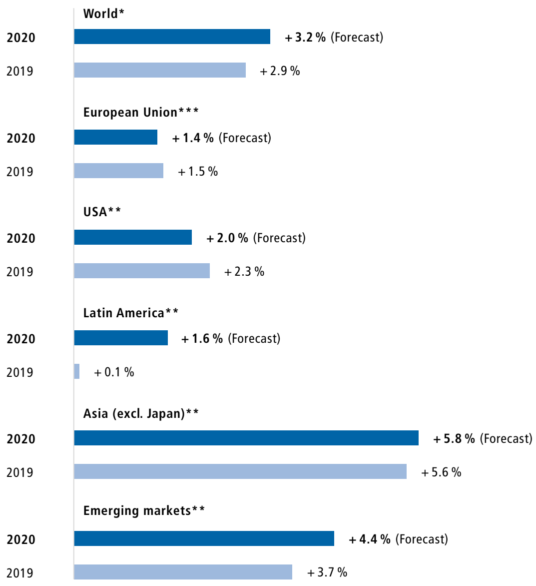
The IMF forecasts a drop in growth for the USA at + 2.0 %. This can be attributed to the waning effect of the 2017 tax cuts, international trade restrictions, falling capital expenditure and lower consumption spending. However, in comparison to the industrialised nations as a whole, growth in the USA will once again be above average. The Canadian economy is also likely to post a slightly above-average performance at + 1.8 %.

For the euro zone, growth of + 1.3 % is expected, which would be a slight improvement on last year. In Germany, economic activity is set to accelerate significantly to + 1.1 %. However, in comparison to other industrialised nations this growth level is once again below the average.

For the emerging markets and developing countries, the IMF is projecting an overall growth rate of + 4.4 %, i.e. well above the previous year's level. Turkey, which suffered a significant drag on growth in the course of 2019, will recover in 2020 and contribute to accelerated growth. In Russia, too, a recovery in growth momentum is to be expected.

For Asia the IMF expects the economy to perform only a little better than last year, which is accounted for both by the stagnation in economically developed countries and by only a slight pick-up in growth in the emerging markets and developing countries. In China, the IMF anticipates a further weakening in momentum to + 5.6 % as a consequence of a further slowdown in industrial production and capital investment activity.

Gross domestic product growth



*Source: International Monetary Fund (February 2020)
**Source: International Monetary Fund (January 2020)
***Source: EU Commission (February 2020);
Additional information: Euro zone +1.2 % (2019), +1.2 % (2020)

However, this forecast does not factor in upward potential from an easing in customs duties or the negative impact on the economy of the spread of the coronavirus at the beginning of 2020. In India, an acceleration in economic growth to + 5.8 % is expected. This is attributable to the after-effects of monetary policy easing and of the cut in corporate taxes. A slight pick-up in growth to + 4.8 % is projected for the ASEAN countries, which also include important KSB sales markets.

In Latin America a significant improvement in growth is anticipated at + 1.6 %. In Brazil, the expectation is that the effect of expansionary monetary policy and of structural reforms will be felt and lead to growth of + 2.2 %.

On the assumption that the current bottoming out of business climate indicators for the manufacturing industry will be sustained, then an initial, though slow, rise in demand for capital goods over the course of 2020 could be expected. However, VDMA expects global sales of plant and machinery to stagnate again in 2020 in real terms. While growth of + 2 % is expected in China, sales in the USA and other industrialised countries will probably shrink by 1 %. In Germany, the decline, at 2 %, will be somewhat more marked.

For manufacturers of liquid pumps in Germany, VDMA foresees a stagnation in sales in nominal terms in the current year (+ / - 0 %). The same applies to industrial valves, for which VDMA likewise anticipates a nominal growth rate of 0 %. Sales of building services valves are expected to rise by + 1 % in nominal terms.

SUMMARY OF EXPECTED DEVELOPMENT

Despite the weaker global economic growth, the economic environment is, generally speaking, expected to be good for an expansion of business in Europe and Asia. In the Middle East / Africa, too, positive growth impetus is expected. Overall, the KSB Group will seek to achieve renewed growth in order intake and sales revenue in the current year.

Expected development

€ millions	Actual 2019	Forecast 2020
Order intake	2,453.8	2,320 – 2,520
Pumps	1,617.8	Up to + 5 %
Valves	361.9	Up to + 5 %
Service	474.1	Down to – 5 %
Sales revenue	2,383.2	2,260 – 2,460
Pumps	1,562.5	Up to + 5 %
Valves	364.4	Up to + 5 %
Service	456.3	Down to – 10 %
EBIT	113.6	100 – 130
Pumps	84.8	Up to + 20 %
Valves	2.3	Up to + 40 %
Service	26.5	Up to + 5 %

The drivers of growth will be standard products, service and spare parts, as well as various major projects. However, a negative impact may be felt from geopolitical risks, such as a continuation in the US-Chinese trade conflict and an exacerbation of the political situation in the Middle East. In addition, this forecast does not take account of the impact of the coronavirus. The scale and duration of any adverse effect on production as well as on KSB's procurement and sales markets both in China and in the Asian, European and American economies are impossible to predict and therefore quantify right now at the time of preparation of the consolidated financial statements. KSB assumes that the spread of the coronavirus will have a negative impact on the Group.

On the basis of these underlying conditions, order intake of between € 2,320 million and € 2,520 million and sales revenue of between € 2,260 million and € 2,460 million are expected for 2020.

Taking into consideration the uncertainties referred to above, KSB anticipates EBIT in a range between € 100 million and € 130 million for the 2020 financial year. This range appropriately reflects the opportunities and risks in the current financial year.

In 2020 and subsequent years, the KSB Group intends to implement its Climb 21 strategic project. This is expected to result in one-off burdens on EBIT. Since the exact impact on EBIT is not known at present, it is not factored into the above forecast for EBIT in 2020.

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements and information that are based upon the assumptions of Management. They express current forecasts and expectations with regard to future events. As a result, these forward-looking statements and information are exposed to risks and uncertainties that lie outside the Management's sphere of influence. KSB wishes to point out that actual events or results may differ materially from the forward-looking statements and information presented, if one or more of the following opportunities or risks, or other opportunities, risks and uncertainties should materialise, or if the assumptions underlying the statements prove to be inaccurate.

Opportunities and Risks Report

As an organisation that operates throughout the world, the KSB Group is exposed to macroeconomic, sector-typical, financial and company-specific risks. The risk policy is designed to enable KSB to grow sustainably and profitably. The KSB Group aims to reduce the risks associated with its business and where possible avoid them completely. At the same time its global alignment and extensive product range offer a wealth of opportunities. This includes but is not limited to any opportunities that arise on the basis of research and development activities, as well as any that are linked to the quality and cost effectiveness of products. KSB's competitive position is also being strengthened by optimising the global sales and production network. KSB always reviews opportunities to expand its global presence and is able to achieve this through start-ups and acquisition projects.

The Group sees opportunities and risks as possible future developments or events that may lead to departures from forecast or targets. The departure can be both positive and negative. In order to manage the varied opportunities and risks professionally and efficiently, the Group aligns its actions accordingly and focuses upon the respective situation when selecting the persons responsible. In doing so, Controlling, Finance and Accounting as well as Internal Audits perform important monitoring tasks.

RISK MANAGEMENT SYSTEM

KSB has implemented a Group-wide risk management system for identifying and assessing relevant risks in the different areas of responsibility and reporting these to Group headquarters. The risk management process of the KSB Group consists of the successive phases of identification, assessment, management, control, documentation and communication of risks. The six phases form a continuous and IT-based closed-loop system. This is documented in KSB's risk management manual as well as the management responsibility and the description of all relevant tasks.

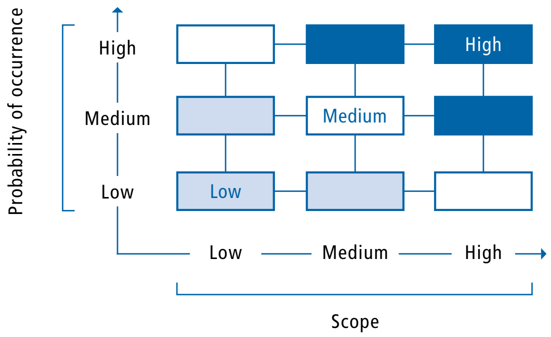
Managers are encouraged to take timely action to define and implement measures to limit or avoid damage that may result from the occurrence of risk events. All corporate and central functions and Group companies, including Group companies that are not consolidated, are included in the risk management system. The responsible managers are required to supply their relevant key business and financial indicators each month. As well as creating quarterly forecasts on business performance, they also report twice a year to the Risk Managers on all recognised risks for the next 24 months from the reporting date for the categories of market and competitive risks, technological risks, project- and product-related risks, financial risks and procurement risks. Other business risks (environmental, human resources, etc.) are also reported in this cycle to the Risk Managers at the Group headquarters. The regular identification and updating of risks in the Group companies and in the corporate and central functions ensure that risk awareness within the KSB Group remains at a high level across the board. A distinction is made between qualitative risks and quantitative risks, not considering any action that has been taken or planned.

Qualitative risks are long-term developments that could have a negative impact on the KSB Group and which cannot or cannot yet be thoroughly quantified due to a lack of precise information. In order to be able to evaluate them all the same, however, estimates of the probability of occurrence and scope are made using defined evaluation categories. With respect to probability of occurrence, the extent to which the information indicating the potential risk is detailed must be determined.

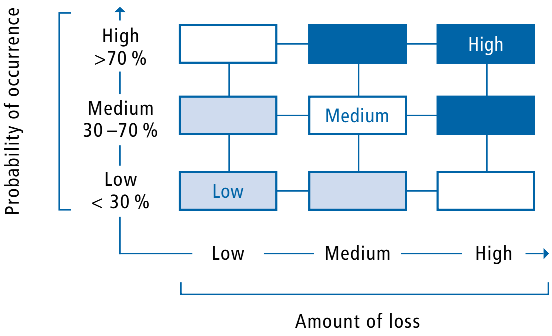
Quantitative risks are risks for which a potential monetary impact on the earnings of the KSB Group or of the respective Group company can be estimated. They are evaluated taking into account the specifically calculated probability of occurrence in combination with the potential amount of loss.

The scope or amount of loss describes the potential influence of the individual risk on the key indicator of earnings before finance income / expense and income tax (EBIT) of the KSB Group or the respective Group company, not considering any action that has been taken or planned.

Qualitative risks



Quantitative risks



Classification of amount of loss

		Amount of loss in € thousands		
Magnitude	**Sales revenue**	**Low**	**Medium**	**High**
Small companies	Up to € 20m	50 – 125	125 – 250	> 250
Medium-sized companies	€ 20m to € 80m	75 – 250	250 – 500	> 500
Large companies, holding companies, organisational units	From € 80m	100 – 500	500 – 1,000	> 1,000

In order to assess whether qualitative and quantitative individual risks are material for KSB, they are classified as low, medium or high risks. All individual risks categorised as medium or high that are detailed in the Individually Assessed Opportunities and Risks section are considered to be material for the KSB Group. The relevant classification can be determined from the above matrices.

→ Qualitative risks – Quantitative risks

In evaluating the amount of loss and the probability of occurrence, KSB limits itself to three possible classifications: low, medium and high. The following criteria apply:

→ Classification of amount of loss

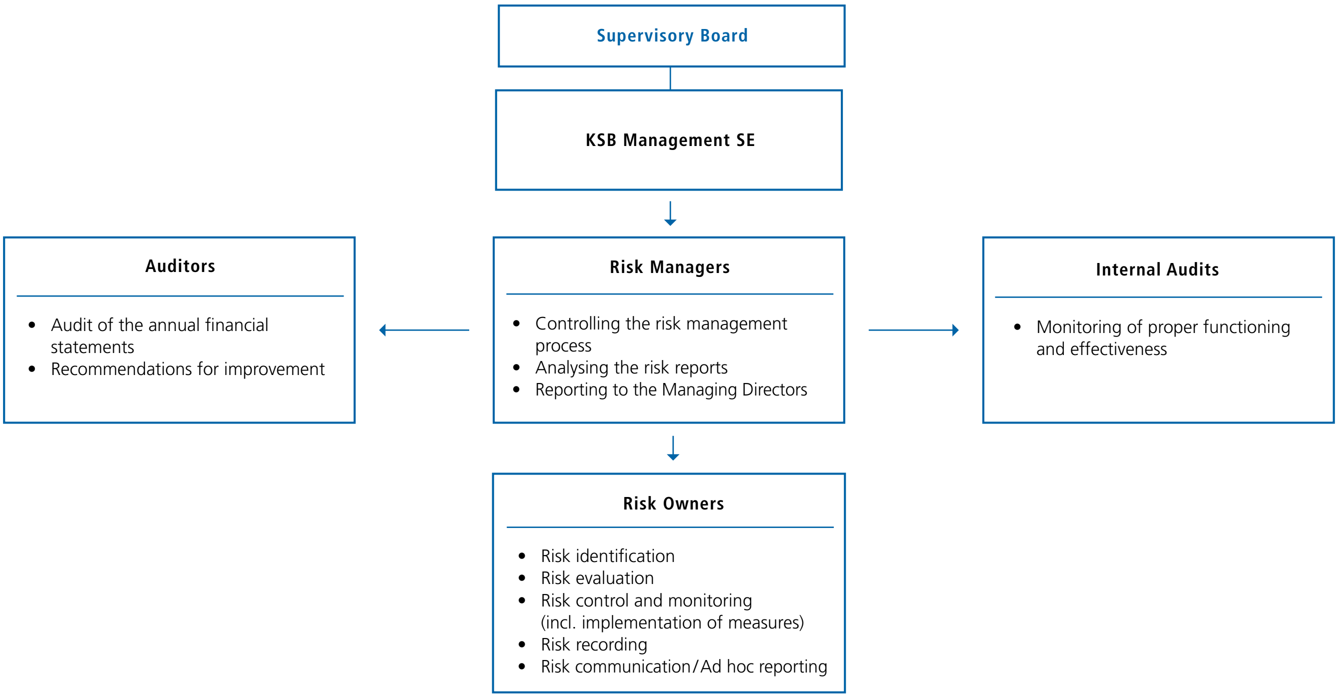
This approach offers the necessary transparency to identify risks in their entirety and to manage them effectively, professionally and in an economically responsible manner.

The bodies to which specific responsibilities and competencies were assigned in KSB's risk management system in the reporting year are shown and explained in the diagram below.

→ Risk management system of the KSB Group

As the legal representative, KSB Management SE assumes overall responsibility for risk management. KSB Management SE reports to the Supervisory Board of KSE SE & Co. KGaA via its Managing Directors during regular Audit Committee meetings and is monitored by the latter. The Managing Directors are supported by the Chief Compliance Officer and the Group Finance and Accounting department of KSB SE & Co. KGaA. The latter coordinates the risk management process at Group level and checks all risks reported for relevance to the preparation of financial statements. This ensures that there is a systematic link with the Group accounting process. The Managing Directors and the Supervisory Board's Audit Committee receive at least two risk reports per financial year. These reports include all the risks that are classed as medium or high that exceed pre-defined threshold values individually or collectively, not considering any action that has been taken or planned (gross risk). Particularly critical topics are reported on an ad-hoc basis by the managers in charge. In contrast, opportunities are not taken into account in KSB's current risk management system. They are reported separately by the Risk Managers of the Group headquarters and regional managers purely in qualitative terms, without further quantification.

Risk management at KSB



With regard to financial risks KSB makes use of additional risk identification, assessment, management and communication. The central Finance department is responsible for this task which is described in further detail later in this section.

Compliance risks are dealt with by the Chief Compliance Officer, who is assigned to the Legal and Compliance, Patents and Trademarks staff function. The Chief Compliance Officer is supported by the members of the Compliance Committee and the Compliance Managers of the individual companies.

The Internal Audits department is integrated into the risk management system as part of the internal 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 identified risks and the countermeasures initiated in response forms an integral part of the reporting to the Managing Directors and to the Audit Committee of the Supervisory Board. The risk management system is updated promptly if need be, for example in the event of relevant legal or organisational changes. In addition, the auditors examine within the scope of the annual audit the early risk detection system, establishing that it is present and checking that it is fit for purpose.

INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT SYSTEM WITH REGARD TO THE GROUP ACCOUNTING PROCESS

The accounting-related internal control system (ICS) contributes towards ensuring proper financial reporting. The aim is to ensure that the consolidated financial statements and group management report comply with all relevant regulations. Key elements of the ICS are – as well as the risk management system described above – guidelines and regulations, which include standard accounting and measurement policies. They must be applied to the full extent by all Group companies. There is a separation of functions and the four-eye principle is applied. This is ensured by the audits carried out by the Internal Audits department.

In addition, Accounting and Controlling carry out regular analytical plausibility checks of time series analyses and actual / budget variance analyses. This enables KSB to identify significant changes early on, which are examined for accounting and measurement discrepancies. The resulting findings are then discussed at management level.

The responsibility for Group accounting lies with the employees in the central Accounting KSB Group department. KSB employs the services of qualified external reviewers for certain calculations as part of financial reporting (such as the calculation of complex pension obligations using actuarial assumptions).

Binding schedules and guidelines apply to accounting within the KSB Group and to accounting at each individual subsidiary. The accounting and measurement methods that must be applied to compile the consolidated financial statements are defined in writing in a manual that is updated and revised on a continual basis. This also includes the guidelines for posting intra-Group transactions. New accounting principles and other official announcements are continually analysed with regard to their relevance and impact on the consolidated financial statements. Guidelines and manual are adapted where necessary and any changes communicated immediately to the companies. Group Accounting likewise monitors compliance with requirements. This reduces the risk of compiling inappropriate financial statements or failing to publish them by the defined deadlines.

The financial statement information for all Group companies is automatically processed using certified and tested standard consolidation software. Systematic checks are implemented to help validate the data. Employees in Accounting KSB Group verify any warning signals that arise before using the data. The sequence of the processing steps is strictly specified through the use of the consolidation monitor within the IT system. This ensures the correct processing of data.

To enable a seamless and accurate accounting process, only employees who have the appropriate specialist know-how are assigned to this task. These employees are trained on a regular basis to make sure that their expert knowledge remains up to date.

Access authorisations have been defined for the accounting-related IT system. This protects the data against unauthorised access as well as improper usage and modification. The data is checked at many stages, helping to ensure the processing quality. Alongside regular system reviews by the auditors, these checks contribute to limiting operational risks.

INDIVIDUALLY ASSESSED OPPORTUNITIES AND RISKS

The categories presented below include the qualitative and quantitative gross risks classed as medium or high and the main opportunities for business development as at 31 December 2019. Where risks are not flagged as high, they are classed as medium risks.

Markets / Competition

▪ Risks

The business opportunities of KSB are again affected by changes in the economic and political environments in the current reporting year. Risks arise for the business model if positive impetus from the world economy and from the markets relevant to KSB fails to materialise and growth rates fail to match the macroeconomic forecasts. The Group manages the risk of fluctuations in the economy and in demand by remaining active in several markets and industries with different economic cycles. Furthermore KSB monitors the development of the economic environment for its markets. If necessary, capacities are adjusted, production facilities relocated and cost-cutting measures implemented.

The outlook for the global economy remains a highly uncertain one. At present, risks arise in particular through geopolitical uncertainty resulting from trade conflicts and a number of global flashpoints. The most important factors in this context are the ongoing trade conflict between the USA and China and the development of relations between the United States and Iran. Owing to the US sanctions against Iran, there are no opportunities to continue ongoing projects in Iran. Consequently, there is a high risk that the costs already incurred for the projects in that country will have to be borne without appropriate consideration. Expected losses have already been recognised through impairment losses and provisions. The protectionist customs policy of the United States is also a drag on business as a result of the associated contraction in world trade. The worsening of the conflict in the Middle East, especially in Saudi Arabia, Qatar, Iran and Israel, as well as the development of the political situation in Turkey, may have a negative impact on business. In addition, the East / West relations that are under considerable strain given the political differences between Russia and the USA, and between Russia and most European countries, continue to be significant. This also becomes apparent in the Russian government’s import substitution programme. Russian companies have been requested to order more products that are made in the country itself or include a high proportion of local value creation.

The coronavirus outbreak may have macroeconomic risks which may entail significant damage to business not just in China and other Asian economies, but also in Europe and North America. Risks to KSB comprise a potential adverse effect on production, the procurement market including the supply industry, and the global sales markets.

The departure of the United Kingdom from the European Union harbours risks both for the local sales and service company and for the other units with business partners in the United Kingdom. Uncertainty still prevails regarding future regulations. This may lead to delays in the trade of goods through increased border controls and have a negative impact on the willingness to undertake capital investment – particularly in the UK but also in the other countries of the European Union.

▪ Opportunities

With an increased focus on the six markets of Mining, Energy, Building Services, General Industry, Chemicals / Petrochemicals and Water / Waste Water in the Pumps segment and the realignment of the Valves segment, KSB expects better market access and thus higher order intake and sales revenue.

In the two large Asian growth markets of China and India, some major infrastructure projects are expected to be commissioned in 2020, particularly in energy and fresh water, areas that are important for KSB. Due to KSB's strong presence in these countries, there is a good chance that it will be involved as a supplier of pumps, valves and services. The expansion of nuclear energy continues in China and India, for which local plant engineering contractors require high-safety pumps. In addition, owing to targeted activities in the service market KSB expects to continue to be able to sell more services and spare parts in China in particular. In India, expansion of the supply of fresh water and the construction of flue gas desulphurisation plants for coal-fired power stations will be factors.

By broadening the portfolio of pumps made to API specifications, the KSB Group has steadily improved its position in the oil processing industry and expects further expansion through its increased focus on the chemicals / petrochemicals market.

From 2020, new regulations from the International Maritime Organisation (IMO) will come into force. According to this specialised UN agency, all ships on the high seas will have to use fuel with a substantially lower sulphur content to reduce air pollution from ships worldwide. Refineries will continue to invest in the technology for the processes to produce this fuel. This is likely to boost demand for refinery pumps. Moreover, ships which continue to use fuel with a high sulphur content will be retrofitted with exhaust gas desulphurisation systems. This would have a correspondingly positive impact on order intake.

Projects / Products

▪ Risks

The markets' requirements for the products of the KSB Group are constantly changing. The Group will only succeed if it meets its delivery deadlines and offers technically advanced products in good quality at affordable prices. To minimise the high risk of delays in delivery, which may lead to a diminished reputation with the customer as well as to penalty payments, KSB keeps a constant eye on its sale and production processes. If it discovers that machinery needs to be renewed or capacities expanded, these investment projects are examined as part of a step-by-step approval process. In this way, KSB counters the risk of schedule and cost overruns.

Regular market analysis and monitoring minimise the risk that products will become technically obsolete or are offered at prices not acceptable in the market. At the same time KSB is exposed to the risk that rival products from countries with lower wage costs, mainly in the regions of eastern Europe and Asia, will compete with KSB's product range. This calls for continuous quality management, which has been introduced across the Group.

In KSB's business, there are special requirements when it comes to the processing of large-scale projects with long contract terms. There are also always associated risks. There may be cost overruns, tighter import regulations, staff shortages, technical difficulties or quality problems – including possible contractual penalties – that reduce margins. KSB therefore trains its employees in project management and equips them with specialist knowledge. This enables them to identify the risks associated with longer-term orders at an early stage. In addition, project managers are provided with appropriate management tools. Decisions are made in conjunction with clearly structured authorisation processes. Furthermore, there is central monitoring of projects exposed to risk across all KSB companies.

There are also technical and financial risks to orders with newly designed products. Technical risks are limited to the extent that intermediate steps for development work are defined and partial solutions are subjected to assessments. Commercial risks are minimised by using appropriate contractual clauses, Care is taken to ensure that advance payments and collateral provided by customers at least cover the costs incurred. Suitable provisions are set aside for warranty obligations and contractual penalty risks. In the 2019 consolidated financial statements, these amounted to € 44 million for the Group, of which KSB SE & Co. KGaA accounted for € 26 million. In the previous year, the total was € 46 million, with € 26 million accounted for by KSB SE & Co. KGaA. Beyond this KSB sees no further material residual risk (net risk).

▪ Opportunities

The increasing integration of hydraulic, drive and IoT solutions for pumps will in future enable innovative business models, such as the activation of chargeable functionalities via app, cloud connections for maintenance, and the use of operational data for the purpose of plant and product optimisation.

KSB uses agile methods. Through interdisciplinary and simultaneous product development, these methods enable customer requirements for ever shorter development times to be met and allow developments to be geared with even greater focus towards market requirements.

At the same time, consistent and intensified use of simulation techniques and engineering methods such as statistical design of experiments and impact analyses enable development risks to be reduced.

Certification by a Chinese customer of the largest seal-less reactor coolant pump ever built for a newly developed reactor type raises the prospect of follow-on orders.

Finance / Liquidity

▪ Risks

The Group's international focus is associated with exchange rate risks. Besides the euro, the most important currencies for KSB are the US dollar, the Indian rupee, the Brazilian real and the Chinese yuan. The liquidity risk arising from foreign currency transactions is hedged by using derivative financial instruments. These hedges are based on fixed contracts and on forecasts about future payment streams the occurrence of which is uncertain. Thus, exchange rate fluctuations may have a negative effect on earnings despite hedging.

Risks regarding margins and liquidity are typical of the project business. As well as the continued pressure on selling prices, which is reducing profit margins, these include unfavourable contract conditions such as reduced advances and tougher contractual penalties. As KSB complies exactly with the approval processes in the quotation phase, this risk is minimised. At the same time, this enables KSB to recognise and avoid liquidity shortages. Where necessary, sufficient liquidity is secured by agreeing appropriate credit lines early on.

Persistent recessions or newly emerging crisis may adversely affect the financial situation of customers. Resulting payment delays and defaults on receivables, which were classed as a high risk in the year under review, would impact on the results of operations. The same effect might occur if the foreign exchange regulations become stricter for individual countries. KSB counters this by means of a strict receivables management system and intensive customer contacts.

Changing market conditions mean that business models need to be fundamentally reviewed and the product range adjusted accordingly time and again. This may lead to inventories losing value, which was classed as a high risk in the year under review. KSB seeks to counter this risk through a working capital initiative started in 2019, with the focus on increasing the turnover rate of inventories and receivables. A further potential consequence of market developments that exert a permanent strain is an impairment loss on goodwill and assets. If impairment testing in accordance with IAS 36 shows a need for impairment, KSB recognises a corresponding expense in the financial year. There is also a residual risk with regard to the development of premises that cannot be controlled and on which the earnings are based. For companies with goodwill, KSB has taken into account the risk assessment through sensitivity analyses to estimate the risk of impairment. Further information is provided in the Notes to the consolidated financial statements in section IV. Balance Sheet Disclosures under "Intangible assets".

As regards tax matters, the global orientation of the activities of the KSB Group must be taken into consideration. Based on its operative activities in numerous countries with varying tax laws and administrative interpretation, differentiated assessment is required for measuring tax obligations. Uncertainty may arise due to different interpretations by taxable entities on the one hand and local finance authorities on the other. These may come to light during audits. By cooperating closely with external local tax specialists, KSB counteracts the risk of having to pay back taxes. As KSB continually monitors unclear issues, it can generally classify the probability of occurrence. Should a need for subsequent payment arise, the corresponding provisions are created in good time. The consolidated financial statements for 2019, as in the previous year, do not include any provision for such matters, which are classed as a medium or high risk. In addition, there are contingent liabilities in the expected amount of € 8.4 million, of which € 0 million is accounted for by KSB SE & Co. KGaA (previous year: € 1.5 million, with € 0 million accounted for by KSB SE & Co. KGaA).

Concentration on a small number of customers entails dependencies which, in the event of the loss of a customer, could result in a material slump in order intake and sales revenue and thus to a burden on earnings for smaller service companies. The pressure which individual customers can exert on the company in these cases rises and may result in increasing concessions having to be made by the supplier. If individual Group entities find themselves in such a situation, losses are in part offset by their parent company. If the situation continues, KSB will consider reviewing the business model of the company affected or selling it.

Procurement

▪ Risks

Commodity prices and procurement times are subject to strong market-related fluctuations. This may adversely affect KSB's earnings situation if it does not manage to make up for cost increases or pass them onto its customers. Delays or bottlenecks in the supply chain for raw materials and components may negatively impact KSB's business operations. If KSB does not benefit promptly from declining procurement prices, the persistent pressure on the selling price of products would have a negative impact on earnings.

In its procurement strategy KSB seeks to prevent dependencies on suppliers and thereby counter the risk of a supplier failing. If local conditions mean that it is impossible to ensure sufficient diversification in this regard, KSB will make use of additional foreign business partners.

▪ Opportunities

In the year under review, a reorganisation of Global Procurement launched in 2018 continued to be developed systematically, and further process adjustments were made. These included, among other things, new reporting guidelines, the elaboration of material group strategies and very early involvement of the procurement team in projects. This enables a clear increase in global transparency, the implementation of a global material group strategy, and cost-optimised procurement, while at the same time improving security of supply.

These changes strengthen KSB's competitiveness while creating the basis for successfully digitalising procurement. In this way KSB secures the opportunities for having permanent access to the best suppliers. It also enhances its appeal to talented buyers who help achieve KSB's corporate goals.

Technology / Research and Development

▪ Risks

It is essential to future success to have a product and service range that is suited to the market in terms of technology, price and delivery time. The changing needs of customers and new standards and regulations – especially in promising markets such as China – require the continuous development and improvement of products and services. Research and development required for adjustments consumes significant financial and human resources, with no guarantee of success in either the medium or the long term.

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

▪ Opportunities

Through a new idea-to-market process, KSB seeks to meet the challenge presented by the fact that the centres of growth have shifted to Asia and South America in particular and will, it is expected, also shift to Africa. For that reason, internal and external actors around the world are connected up on a single platform.

Ideas undergo a stringent process of evaluation, in order to identify new trends and technologies more systematically and more quickly. Direct, personal discussion at all levels also enables us to play an active part in the increasing pace of change in our sector. Through crowd solutions, the experience and skills of employees worldwide can be accessed directly. Decisions are prepared by the experts in a way that is more decentralised than before.

The business decision to digitalise production processes progressively opens up opportunities to optimise manufacturing processes in terms of resource use, to shorten throughput times, to meet customer expectations better and to continue to improve the quality of parts and products.

Through additive manufacturing, cost-intensive, manual processes and production steps can be avoided, particularly for small quantities and complex individual production, and competitiveness in global and regional markets can be increased.

As well as technical innovation, service, application and process innovations are growing in importance. That means that developments need to be closely coordinated with local suppliers, customers and employees. Established innovation methods, business innovation labs, hackathons and start-up events are systematically being rolled out globally in order to strengthen the ability to innovate at the local level.

By this means, KSB is enhancing its abilities in developing forward-looking products, business models and services more quickly and more closely in line with customer requirements.

Other business-specific risks – Environment

▪ Risks

KSB's business activities, primarily in the area of production, are subject to numerous environmental protection laws and regulations. Environmental damage of any kind (for example, groundwater contamination, renovation needed due to outdated construction materials or unpleasant odours arising from the use of chemicals) may result in losses not covered by an insurance policy. Therefore, at all company sites officers monitor compliance with laws and regulations as well as with internal KSB rules. If KSB discovers any contamination, it sets aside provisions to meet the liabilities for the necessary clean-up work. In the 2019 consolidated financial statements, these provisions, as in the previous year, totalled just under € 0.2 million for medium or high risks, of which € 0.2 million was accounted for by KSB SE & Co. KGaA.

As part of acquisition projects, KSB examines properties for possible contamination before purchase. Critical issues are taken into account by way of corresponding contractual regulations with the seller and appropriate measures are implemented in consultation with the seller.

In markets with tightening environmental regulations, there is a general risk that KSB products and its in-house or purchased services might infringe against the regulations and that as a result the necessary authorisation for the relevant business might be lost and KSB's reputation might be damaged. A change in rules on liability in environmental protection can also increase the risks for business success. As a member of national and international professional associations the KSB Group becomes aware of imminent changes in environmental law early on. The legal frameworks that are in place in its Operational Units are continually updated, enabling KSB to ensure that its employees always abide by the applicable law. This is also monitored by external auditors as part of the management certifications.

▪ Opportunities

At KSB, environmental management is combined with an active and forward-looking approach as well as internal processes that enable permanent cost reductions. This applies, for instance, to all measures that reduce energy consumption in production, service and administration. Inversely, the KSB Group offers the users of its products the opportunity to reduce their electricity costs by selecting energy-efficient KSB products.

The successful introduction, maintenance and ongoing development of global environmental and occupational health and safety management systems (ISO 14001 and ISO 45001) open up opportunities for identifying any risks or deviations at an early stage and initiating protective measures. In this way, not only is damage to the environment, to the company's image and to employees' health prevented, but also financial risks are avoided.

Investments in plant and machinery are made on the basis of resource efficiency and environmental and health protection in order to optimise energy costs throughout the entire use phase as well as to prevent any follow-on costs incurred through damage to the environment and/or to health.

With its certified environmental management system, KSB also meets a requirement stipulated by many public sector customers, large companies and entire sectors such as the automotive industry. For them, evidence of an environmental management system is an increasingly important criterion in the selection of suppliers. By ensuring that production and service locations are checked by auditors and certified to international standards, both the KSB Group and its customers attain a high level of certainty that KSB operations are acting with respect for the environment. KSB's commitment to the UN Global Compact also meets the expectations of its customers and improves order opportunities with companies that pick their suppliers with a view to their responsibility for the environment and society, among other things.

Other business-specific risks – Human resources, legal aspects and IT

▪ Risks

To achieve its growth and profitability business objectives, KSB needs qualified employees at all locations, including technical specialists. Due to the demographic change in some countries, the competition for these and other highly skilled professionals is increasing, and will intensify in the course of the economic recovery. KSB counters this risk with demand-oriented measures, systematic human resources planning and international recruitment processes.

Changes to our processes and organisational structure, such as the introduction of shared services centres, require clearly defined project responsibilities and valid project plans, as well as the selection of suitably qualified external partners. This helps to avoid inefficiencies when changing organisational structures and processes, which might otherwise reduce the expected cost benefits.

Other potential risks associated with the activities of KSB's employees include dishonest conduct or violations of laws, which could damage the image of KSB. The KSB Group counters these risks and safeguards its reputation among customers by organising regular compliance training and through individual initiatives in critical regions.

Legal disputes cannot always be avoided within the framework of business activities. These are usually disputes arising from operations, generally involving unclear warranty issues. If as a result of these issues KSB expects negative effects on the success of its business, corresponding provisions are set aside, which cover not only the anticipated amount of loss, but also the costs of proceedings. In order to exclude any net risk, the 2019 consolidated financial statements include about € 2 million for those cases classified as medium or high risks. Of this total, KSB SE & Co. KGaA accounted for € 1 million (previous year: € 2 million, of which € 1 million attributable to KSB SE & Co. KGaA). Furthermore, provisions were created for disputes with authorities and for staff matters, once again totalling just under € 2 million, of which KSB SE & Co. KGaA accounted for € 0 million (previous year: € 2 million, of which € 0 million attributable to KSB SE & Co. KGaA), where these have been classified as medium or high risks in the risk assessment.

The manipulation and loss of electronic data can lead to serious commercial disadvantages. KSB limits this risk by means of adequate security systems and access procedures. An increased centralisation of the IT systems of the various operating units assists KSB in this. In this way, high security standards are implemented and the risk of data loss or corruption is reduced.

KSB seeks to counter increased external fraud activities by raising awareness of fraud attempts. At the same time, KSB is increasing its compliance requirements.

▪ **Opportunities**

At the end of 2019 work began on introducing the "Workday" global HR management system. This will form the basis for strategic personnel planning. The improved transparency of employee-related data will enable KSB to deploy people in an optimum way, taking into account their individual knowledge and skills, and to open new career opportunities for them, including in other countries. At the same time the program harmonises and standardises HR processes across the globe, with due consideration for local legal regimes.

Through investments in IT, particularly through new end devices and broader bandwidths, support is provided for the digital transformation of the company. The expansion of IT security and of cloud-based solutions forms the basis for making the infrastructure and internal processes as well as the processes for dealing with customers, suppliers and partners secure and seamless and thus swifter, more efficient and more uniform.

IMPORTANT OPPORTUNITIES AND RISKS BY SEGMENT

As in the previous year, the opportunities and risks for the Pumps, Valves and Service segments are most influenced by economic development. The future development of China remains important to KSB. Geopolitical uncertainty arising from trade conflicts and a number of global flashpoints remains of material importance for Pumps and Valves and to a lesser extent for Service. A high level of risk for the KSB Group's business continues to be presented by policy decisions in China regarding energy projects, the ongoing trade conflict between the USA and China, the continuation of very strained East-West relations and the US sanctions against Iran. KSB adjusted its strategy accordingly and discontinued its business with Iran. Worsening payment morale also bears corresponding risk potential for future business. The economic development in general continues to be the most significant risk due to the difficulty of assessability. By contrast, the KSB Group continues to hope that the measures intended to foster growth will provide it with considerable support in achieving its goals. KSB's customers are also often affected by recessions and more intense competition, which can decrease their ability to pay in individual cases.

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

RISK REPORT ON THE UTILISATION OF FINANCIAL INSTRUMENTS

Central financial management in the KSB Group performs its duties within the framework of the guidelines laid down by KSB Management SE as the legal representative. The KSB Group bases the nature and scope of all financial transactions exclusively on the requirements of its business. It does not lend itself to business of a speculative nature. The aim is to ensure liquidity at all times and to finance activities under optimal conditions. With respect to the export business, foreign exchange and credit risks are hedged to the greatest extent possible. KSB continuously improves its receivables management methods with the goal of settling outstanding amounts by their due dates.

KSB is exposed to the following financial risks as a consequence of its business activities.

KSB is firstly exposed to credit risk. which is defined as potential default or delays in the receipt of contractually agreed payments. It is 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. In addition, KSB is exposed to market price risk. Exchange rate or interest rate changes may adversely affect the economic position of the Group. Risks from fluctuations in the prices of financial instruments are not material.

Foreign exchange hedges are used to reduce the risks from transactions involving different currencies. These are generally currency forwards, which KSB uses both for transactions that have already been recognised and for future cash flows from orders still to be processed. At year end, the notional volume of currency forwards used to hedge exchange rate risks was € 251.9 million, with KSB SE & Co. KGaA accounting for € 187.9 million (previous year: € 238.3 million, of which € 177.2 million attributable to KSB SE & Co. KGaA). Foreign currency items denominated in US dollars account for the major volume hedged by forwards. A global network of production sites in the local sales markets reduces potential currency risks.

All these risks are limited through an appropriate risk management system, defining how these risks are addressed through guidelines and work instructions. In addition, the current risk characteristics are continuously monitored and the information obtained in this way is provided to the Managing Directors and the Supervisory Board in the form of standardised reports and individual analyses.

For more information on the three risk areas and the impact on the balance sheet, see the Notes, section VI. Additional Disclosures on Financial Instruments.

OVERALL ASSESSMENT OF OPPORTUNITIES AND RISKS

The opportunities and risks for the KSB Group are mainly derived from macroeconomic influencing factors and their effects on the global mechanical engineering markets and the competition.

The overall risk situation on the reporting date 31 December 2019 remains tense. This is due to the political developments described in the risk situation by segment and their impact on the markets. Moreover, geopolitical instabilities, decisions on sanctions and volatile currencies had a negative impact on business volume and on planned earnings. Overall, KSB expects an economic performance in line with the IMF forecast for next year.

In this environment, the KSB Group continues to rely on its ability to match capacities and resources to the changing market conditions. A solid financial position and an efficient cost structure are vital in order to maintain long-term competitiveness. KSB is convinced that it can continue to successfully overcome the risks arising from the above-mentioned challenges.

The potential of opportunities has not changed materially since the previous year.

The risk management system in place as well as the related organisational measures allow KSB Management SE as the legal representative to identify risks in a timely manner and to take adequate measures. In view of the somewhat uncertain situation, the focus of activities in 2020 will continue to be on the management of market risks. The legal representative states that, based on the risk management system established by the KSB Group, at present there are no risks that threaten business continuity and could lead to a lasting and material impact on the net assets, financial position and results of the KSB Group.

Disclosures Relating to KSB SE & Co. KGaA (HGB)

Balance Sheet

Assets

€ thousands	31 Dec. 2019	31 Dec. 2018
Fixed assets		
Intangible assets	50,163	39,141
Property, plant and equipment	117,844	111,605
Financial assets	292,864	288,763
	460,871	**439,509**
Current assets		
Inventories	251,978	248,853
Advances received from customers	– 85,298	– 92,701
	166,680	**156,152**
Receivables and other assets	308,664	322,669
Current financial instruments	–	19,990
Cash and balances with credit institutions	44,864	78,286
	520,208	**577,097**
Prepaid expenses	**1,816**	**2,275**
	982,895	**1,018,881**

Equity and liabilities

€ thousands	31 Dec.2019	31 Dec. 2018
Equity		
Subscribed capital	44,772	44,772
Capital reserve	66,663	66,663
Revenue reserves	136,180	136,180
Net retained profits	67,364	90,179
	314,979	**337,794**
Provisions		
Pensions and similar obligations	415,998	386,489
Miscellaneous other provisions	106,798	123,284
	522,796	**509,773**
Liabilities	**140,080**	**165,014**
Deferred income	**5,040**	**6,300**
	982,895	**1,018,881**

Income statement

Income statement

€ thousands	2019	2018
Sales revenue	**841,693**	**807,142**
Changes in inventories	– 1,262	– 2,007
Work performed and capitalised	6,833	6,871
Total output of operations	**847,264**	**812,006**
Other operating income	27,599	25,396
Cost of materials	– 388,604	– 365,802
Staff costs	– 324,747	– 303,598
Depreciation and amortisation expense	– 17,801	– 17,089
Other operating expenses	– 160,920	– 188,813
	– 17,209	**– 37,900**
Income from equity investments	40,991	281,625
Other financial income / expense	– 38,454	– 61,435
	2,537	**220,190**
Taxes on income	– 1,369	– 1,192
Earnings after taxes	– 16,041	181,098
Other taxes	– 1,191	– 919
Net profit / loss for the year	**– 17,232**	**180,179**
Profit carried forward from the previous year	84,596	–
Transfer to other revenue reserves	–	– 90,000
Net retained profits	**67,364**	**90,179**

Business Model

KSB SE & Co. KGaA, as the parent, directly or indirectly holds the shares in the companies belonging to the KSB Group. The KSB Group is managed via KSB SE & Co. KGaA. The latter is at the same time the Group's largest operative company. The central administrative offices are located at the company's seat (registered office) in Frankenthal; branch operations are located in Bremen, Halle and Pegnitz.

KSB SE & Co. KGaA is associated via control and profit pooling agreements with the three service companies KSB Service GmbH, Frankenthal, KSB Service GmbH, Schwedt, and Uder Elektromechanik GmbH, Friedrichsthal. Thus, these companies are under single management by KSB SE & Co. KGaA. Their annual earnings are transferred to KSB SE & Co. KGaA.

The annual financial statements of KSB SE & Co. KGaA have been prepared in accordance with the provisions of the *Handelsgesetzbuch* (HGB) [German Commercial Code] and the *Aktiengesetz* (AktG) [German Public Companies Act] including the German principles of proper accounting.

Differences between the accounting policies under HGB and the International Financial Reporting Standards (IFRS), which are the basis of preparation of the consolidated financial statements of KSB, arise primarily from the recognition over time of revenue from production contracts under IFRS 15, in the calculation of pension provisions, from the recognition of leases under IFRS 16, and in the capitalisation of deferred taxes. Furthermore, differences arise in the recognition of assets and liabilities and of income statement items; under the German Accounting Directive Implementation Act [*Bilanzrichtlinie-Umsetzungsgesetz* – BilRuG] there is expanded scope for the recognition of sales revenue.

Business Development and Results of Operations

Overall, in the first seven months of the year business further improved for KSB SE & Co. KGaA because of strong capital investment activity on the part of customers in important sales markets. This applied, in particular, to the energy and water / waste water markets. By contrast, the last five months of the year saw a significant cool-down of the capital goods market.

ORDER INTAKE

The volume of orders received by KSB SE & Co. KGaA rose in the year under review by € 29.6 million to € 796.5 million, an increase of 3.9 %.

SALES REVENUE

Total sales revenue under HGB was € 841.7 million (previous year: € 807.1 million), a year-on-year increase of € 34.6 million.

The disclosures below refer only to sales revenue from the sale of pumps, valves and cast products, and from related service. The 2019 sales revenue of € 788.3 million represents an increase over the previous year of € 26.9 million (3.5 %). Pumps accounted for 86 % of the sales revenue (previous year: 86 %), while valves made up 12 % (previous year: 13 %).

Under IFRS, sales revenue rose from € 762.0 million in the previous year to € 779.4 million. The main driver of sales revenue was the engineered pumps project business.

INCOME AND EXPENSES

Other operating income increased from € 25.4 million to € 27.6 million, principally because of higher income from exchange rate gains.

The cost of materials, at € 388.6 million, was well above the previous year's level of € 365.8 million. The cost of materials in relation to the total output of operations rose from 45.0 % in the previous year to 45.9 % in the year under review.

Staff costs increased in absolute terms by € 21.1 million to € 324.7 million. This significant rise resulted from one-off income in the previous year amounting to € 20.4 million because of the introduction of a lump-sum option for pension plans. General staff cost increases also contributed to raising the total. Staff costs as a percentage of total output of operations were 38.3 % (previous year: 37.4 %).

At € 160.9 million after € 188.8 million in the previous year, other operating expenses showed a considerable reduction of € 27.9 million. This was primarily caused by one-off effects in the previous year arising from the recognition of provisions for expected losses and the recognition of the remaining allocation amount for pension provisions under the German Accounting Law Modernisation Act [*Bilanzrechtsmodernisierungsgesetz* – BilMoG]. A large part of other expenses relates to third-party services and other selling costs.

Overall, the income from equity investments, at € 41.0 million, was sharply down on the prior-year level (€ 281.6 million). This includes profit transfers from the three German service companies of € 11.5 million (previous year: € 10.5 million) and dividend income from affiliates and equity investments of € 29.5 million. In the previous year, as well as the usual dividend income, a special dividend and the recognition of hidden reserves as part of the transfer of an equity investment to KSB FINANZ S.A., Luxembourg, at € 262.6 million overall, led to an extraordinarily high level of income from equity investments.

NET PROFIT / LOSS FOR THE YEAR UNDER HGB

Because of the changes to income statement items referred to above, KSB SE & Co. KGaA recorded a net loss for the year in the 2019 financial year of € 17.2 million after a net profit for the year of € 180.2 million in the previous year. This is attributable to a sharp drop in income from equity investments.

EARNINGS BEFORE FINANCE INCOME / EXPENSE AND INCOME TAX (EBIT) UNDER IFRS

The EBIT calculated under IFRS rules was € – 32.5 million in 2019, well below the previous year's EBIT of € – 10.3 million. Higher staff costs made themselves felt in particular. In the previous year the effects of the exercise of a lump-sum option in the pension plans were included here.

Financial Position and Net Assets

FINANCIAL POSITION

KSB SE & Co. KGaA is embedded within central financial management at the KSB Group. The latter works within the framework of the guidelines laid down by KSB Management SE as the legal representative and bases the nature and scope of all financial transactions exclusively on the requirements of the business. The objective of financial management is to guarantee liquidity at all times and to ensure the financing of activities on optimum terms. In financing export transactions, KSB SE & Co. KGaA hedges foreign exchange and credit risks to the greatest extent possible. KSB continuously improves its receivables management methods with the goal of settling outstanding amounts by their due dates.

LIABILITIES AND PROVISIONS

The largest liabilities item, as in the previous year, is pension provisions, which had grown by € 29.5 million to € 416.0 million on the reporting date. This increase is explained by the addition of interest to pension obligations at € 40.4 million. Other provisions amounted to € 106.8 million (previous year: € 123.3 million). The lower figure is mainly attributable to a reduction in partial retirement obligations and in provisions for expected losses.

Of liabilities totalling € 140.1 million (previous year: € 165.0 million), € 22.0 million were accounted for by liabilities from a loan against borrower's note that was placed on the market in 2012 to secure medium-term liquidity. A tranche of € 26.0 million was repaid in 2019. Trade payables at year end were € 0.7 million above the previous year's level. Liabilities to affiliates and equity investments were almost unchanged on the previous year at € 55.1 million. They include € 30.0 million (previous year: € 24.7 million) for intercompany loans and cash investments.

NET ASSETS

Total assets, at € 982.9 million, were 3.5 % below the prior-year figure of € 1,018.9 million. Reductions in receivables and other assets, in financial instruments, in cash and balances with credit institutions contrasted with higher fixed assets.

In the year under review, fixed assets made up 47 % (previous year: 43 %) of total assets. The share accounted for by current assets was 53 % after 57 % in 2018. Inventories including advance payments received totalled € 166.7 million after € 156.2 million in the previous year.

EQUITY

The share capital of KSB SE & Co. KGaA remained at € 44.8 million. The capital reserve was unchanged at € 66.7 million. At year end, € 136.2 million (previous year: € 136.2 million) was assigned to other revenue reserves. Out of the 2018 net earnings for the year of € 90.2 million, a dividend totalling € 5.6 million (dividend of € 3.00 per ordinary share and € 3.38 per preference share) was distributed by resolution of the Annual General Meeting of 29 May 2019. The remaining amount of € 84.6 million was carried forward to new account.

Summary of the Performance in the Financial Year

In the first seven months of the year, business continued to improve because of strong capital investment activity on the part of customers in important sales markets. This applied, in particular, to the energy, water / waste water and construction / building services markets. By contrast, the last five months of the year saw a significant cool-down of the capital goods market.

The forecasts made at the beginning of the year were only partially fulfilled. In terms of order intake, the significant increase anticipated materialised, while sales revenue under IFRS grew only slightly as against the substantial rise forecast. Project business registered increases, while standard business failed to meet expectations. The anticipated sharp drop in EBIT under IFRS did occur.

Opportunities and Risks

The business performance of KSB SE & Co. KGaA depends significantly on the risks and opportunities faced by the KSB Group, which are set out in detail in the Report on Expected Developments and the Opportunities and Risks Report in the Combined Management Report. KSB SE & Co. KGaA generally shares in the risks of its equity investments and subsidiaries in line with its equity interest.

Report on Expected Developments

Despite the weaker global economic growth, the economic environment is, generally speaking, expected to be good for an expansion of business in Europe and Asia. In the Region Middle East / Africa, too, positive growth impetus is expected. Overall, KSB SE & Co. KGaA thus foresees tangible growth in order intake in 2020, largely owing to the energy market. Sales revenue and EBIT under IFRS are expected to rise substantially, owing to good order intake in the energy market in the 2019 financial year.

This forecast does not take account of the impact of the coronavirus. The scale and duration of any adverse effect on production as well as on the procurement and sales markets of KSB SE & Co. KGaA both in China and in the Asian, European and American economies are impossible to predict and therefore quantify right now at the time of preparation of the consolidated financial statements. KSB assumes that the spread of the coronavirus will have a negative impact on the Group.

In 2020 and subsequent years, the KSB Group intends to implement its Climb 21 strategic project. This is expected to result in one-off burdens on EBIT. Since the exact impact on EBIT is not known at present, it is not factored into the above forecast for EBIT in 2020.

The forecast horizon for the above-mentioned information and statements is the 2020 financial year.

Acquisition-related Disclosures

A summary of the acquisition-related disclosures required by section 315a HGB is given below and explanatory information is provided pursuant to sections 175(2) and section 176(1) AktG.

The share capital of KSB SE & Co. KGaA (the company) 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 SE & Co. KGaA's Annual General Meeting. Johannes und Jacob Klein GmbH, Frankenthal, holds approximately 84 % of the ordinary shares; the KSB Stiftung [KSB Foundation], Stuttgart, holds the majority of the shares of Johannes und Jacob Klein GmbH. The preference shares carry separate cumulative preferred dividend rights and progressive additional dividend rights. Detailed information on the share capital and shareholders holding an interest of more than 10 % is provided in the Notes to the Consolidated Financial Statements. Holders of preference shares are entitled to voting rights only in the cases prescribed by law. The issue of additional ordinary shares does not require the consent of the preference shareholders. Similarly, the issue of additional preference shares does not require the consent of the preference shareholders provided that the subscription rights do not exclude newly issued senior or pari passu preference shares.

The company is authorised by a resolution passed at the Annual General Meeting on 6 May 2015 to purchase, until 5 May 2020, company shares of any type totalling up to 10 % of the current share capital or, if lower, of the share capital at the time of this authorisation being exercised. The Board of Management shall be entitled to: (1) sell company shares purchased on the basis of this authorisation either on the stock exchange or by another means that safeguards the rule of equal treatment of all shareholders, for example by means of an offer to all of the company's shareholders; (2) sell the acquired shares of the company with the consent of the Supervisory Board, excluding shareholders' subscription rights, if the shares are sold for cash and at a price that is not materially lower than the market price for company shares of the same type and with the same features at the time of the sale. This authorisation is limited to the sale of shares that overall represent no more than 10 % of the existing share capital on the date on which such authorisation becomes effective or, if the amount is lower, the date this authorisation is exercised. The 10 % limit shall be reduced by the proportional amount of share capital for shares (i) issued within the scope of a capital increase during the term of the authorisation excluding subscription rights pursuant to section 186(3) sentence 4 of the AktG or (ii) to be issued for the purpose of servicing warrants and convertible bonds, provided that the bonds were issued during the term of the authorisation excluding subscription rights pursuant to section 186(3) sentence 4 of the AktG; (3) sell the shares with the consent of the Supervisory Board, excluding shareholders' subscription rights, to third parties for the purpose of acquiring companies, parts thereof and/or financial interests in companies as well as within the scope of corporate mergers or (4) redeem the acquired shares without any further resolution of the Annual General Meeting in full or in part, including in several partial steps. The redemption may also take place without a capital reduction by adjusting the proportional amount of the other no-par-value shares in the company's share capital. In this case, the Board of Management has been authorised by the Articles of Association to adjust the number of no-par-value shares. The company 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 individually liable general partner to increase the share capital (authorised capital).

The company's business is managed by KSB Management SE, which acts through the four Managing Directors.

Amendments to the company's Articles of Association are resolved by the Annual General Meeting. If the amendments only affect the wording of the Articles of Association, they can be made by the Supervisory Board, which operates and is formed in accordance with the regulations of the German Co-determination Act.

Corporate Governance Statement (Section 315d HGB in Conjunction with Section 289f HGB)

The Corporate Governance Statement pursuant to section 315d HGB in conjunction with section 289f HGB [*Handelsgesetzbuch* – German Commercial Code] dated 11 March 2020 is accessible to the public at www.ksb.com > Investor Relations > Corporate Governance / Corporate Governance Statement. In addition to the Corporate Governance Report (including the Statement of Compliance in accordance with section 161 *Aktiengesetz* [German Public Companies Act]), the Corporate Governance Statement includes relevant information on corporate governance practices applied at KSB SE & Co. KGaA that go above and beyond statutory requirements. Also described are the working methods of KSB Management SE as the general partner and of the Supervisory Board, and the composition and working methods of the committees of the Supervisory Board.

Statement on the Non-financial Report (Section 315c in Conjunction with Sections 289c to 289e HGB)

The separate combined non-financial report is prepared in accordance with section 315c in conjunction with sections 289b to 289e HGB and disclosed together with the combined management report in accordance with section 325 HGB. The report can be viewed at:
www.non-financial-report2019.ksb.com

Under the same address the limited assurance report for the separate combined non-financial report is also disclosed.

Remuneration Report

The remuneration report provides information on the principles of the remuneration system for the general partner (KSB Management SE) including its Managing Directors and Administrative Board. It is prepared in accordance with the recommendations of the German Corporate Governance Code in its version dated 7 February 2017.

1. REMUNERATION OF THE GENERAL PARTNER

In accordance with the Articles of Association of KSB SE & Co. KGaA (the "company"), the general partner receives annual remuneration not based on profit and loss in the amount of 4 % of the share capital for the management and assumption of personal liability. Accordingly, € 20 thousand was spent on this by the company in the 2019 financial year.

According to the Articles of Association, the company additionally reimburses the general partner for any expenses incurred in connection with the management of business operations; this relates but is not limited to the remuneration of the members of the governing bodies of the general partner.

2. REMUNERATION OF THE MANAGING DIRECTORS

The general partner is responsible for the management of the company. The Administrative Board of KSB Management SE appoints its Managing Directors and is responsible for the contracts of service of the Managing Directors. This responsibility includes the structure of the remuneration arrangements, the amount of remuneration and their regular review.

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

The remuneration of the Managing Directors 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 normal annual salary and is paid out as a monthly basic remuneration. All Managing Directors 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 Managing Directors in the past financial year.

To ensure the sustainability of the nature of the remuneration, the variable remuneration component includes a long-term component, which accounts for around two thirds of the variable remuneration. It is calculated on the basis of the net profit of the KSB Group plus depreciation / amortisation. Its calculation in the form of a rolling, weighted three-year average essentially includes the effect of the future financial years over the contract term. The short-term variable portion of remuneration is linked to three reference values in equal part. In addition to the Group's key indicators of EBIT margin and sales revenue, the calculation is based on the personal goals of the Managing Directors. These goals are set in such a way that their fulfilment has a positive impact on the relevant performance area beyond the year under review.

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 Administrative Board, of no more than three monthly salary payments per financial year in recognition of any special performance of individual Managing Directors. Such decisions are only made on an irregular basis, meaning that they do not necessarily have to be made annually.

Furthermore, when contracts of service are concluded, care is taken to ensure, in accordance with item 4.2.3 of the German Corporate Governance Code, that payments made to a Managing Director in the event of his or her tenure being terminated prematurely without good reason shall not exceed the value of two years' remuneration including fringe benefits (settlement cap) and shall not exceed the remuneration due for the remaining term of the contract of service. No other payments have been promised to any Managing Director in the event of termination of service; similarly no compensation will be paid in the event of a takeover offer. If the contract of service of a Managing Director is terminated for cause, the company shall not make any severance payments. On 6 May 2015 – using a legally permissible option – the Annual General Meeting resolved not to disclose the details of the compensation for a period of five years.

3. REMUNERATION OF THE ADMINISTRATIVE BOARD

The shareholder of KSB Management SE, Klein, Schanzlin & Becker GmbH, decides on the remuneration of the Administrative Board. The remuneration essentially consists of a fixed sum which covers the time spent attending up to 15 meetings of the Administrative Board. A daily or hourly rate in line with usual market rates is agreed for any extra time spent. Fringe benefits for the Administrative Board have not been agreed and will not be granted. Its members are, however, covered by directors' and officers' (D&O) liability insurance [*Vermögensschaden-Haftpflichtversicherung*] taken out by the company under usual market conditions in favour of the Administrative Board.

Frankenthal, 12 March 2020

KSB Management SE

The Managing Directors