

## RISK MANAGEMENT 2006

The IWKA Group conducts business around the globe, which exposes the company to a variety of risks. It is not possible to do business as an entrepreneur without being prepared to accept calculated risks. The goal is to systematically and continually improve shareholder value and achieve our targets while knowingly accepting unavoidable risk. The key is to keep risks that we can influence manageable.

IWKA systematically identifies external and internal risks in all business areas and subsidiaries and evaluates them consistently throughout the Group with respect to their potential level of damage and likelihood of the events occurring. The managers of the divisions and subsidiaries are directly responsible for the early identification, control and communication of risks. Risk coordinators in the business units ensure that the reporting process is uniform. The risk management system is coordinated by an administrator at Group headquarters and is an integral part of the overall budgeting, control and reporting process.

The Group's risk management system makes it possible for executive management to identify material risks at an early stage and take appropriate steps to counter them as well as monitor the mitigating measures. Regular audits of the risk management process by the internal audit department ensure efficiency and continuous improvement. In addition, the external auditors check that the early risk identification procedure integrated into the risk management system is suitable for identifying risks at an early stage that threaten the existence of the company.

### MARKET AND BUSINESS RISKS

IWKA is exposed to the changing investment plans of its regular customers in the various market subsectors. Since it conducts business around the globe, IWKA is also exposed to country risks, exchange-rate fluctuations, financial and technical risks and the risk of substantial price increases of key raw materials.

During the 2006 financial year, the company continued to implement its group-wide cost-cutting and efficiency improvement programs to address the business impact of the general economic conditions. The Group's portfolio restructuring contributes significantly to reducing the Group's business risks. Direct exposure to automotive industry investment cycles was reduced when Boehringer und EX-CELL-O were sold.

### SYSTEMS

A key risk associated with plant construction is the complexity of IWKA's products, the long duration of the project-management phase and the infrequency of the orders received. In addition, revenues and profits are at risk when carmakers' production quantities do not increase, or even decline. In some cases, this also led to an oversupply of bidders. A risk mitigator is the regional diversification introduced by the now significant business activities in the United States (approx. 35

percent of sales). As part of the reshaping of the value chain, carmakers are increasingly attempting to outsource manufacturing activities. This enables subsuppliers to participate in new business opportunities. IWKA limits the risks of the new pay on production business models using structured financing and having appropriate contractual agreements. In addition, the division is building its first systems for customers outside the automotive industry.

#### ROBOTICS

The risks in the robotics markets relate primarily to the continuing price pressure in the automotive industry.

The steadily increasing cost consciousness of major automotive companies is causing them to keep their robots in service longer, which in turn leads to lower spending on replacements. KUKA Roboter can only counter such trends by continually developing new products and applications that offer customers quantifiable financial advantages and have very short paybacks. An effort to expand the customer base in the automotive industry is showing first signs of success (Tata/India, Toledo/USA). The inherent risk of developing and implementing applications for new general industry markets is higher in some areas.

#### PACKAGING

Business in the European companies continues to be dominated by high exports, and is thereby also particularly sensitive to the value of the US dollar versus the euro. In this case, the regional diversification of the sales, of which about 33 percent are generated in the United States, have been working against the division. In addition, rationalization in the marketplace and cyclic capital spending affect the demand for packaging machines. Higher prices for steel, particularly the stainless steel preferred in the packaging industry, also erodes the margins we are able to achieve with our products. As part of its strategy to focus on high-end products, the division sold some smaller subsidiaries.

#### CORPORATE STRATEGY RISKS

The goal of IWKA's divisions is to be among the technology and market leaders in their target markets. Enhancing their technologies through coordinated innovation programs is therefore of key importance. To a large extent, this also entails identifying the opportunities and risks of technical innovations in a timely manner and evaluating their feasibility.

Using efficient quality assurance systems in combination with regular certification programs helps convince our customers that we offer high quality and strengthens our companies' positions in their target markets.

Acquisitions and investments go hand-in-hand with complex risk factors. Acquisitions and integration projects at IWKA are therefore managed using predefined processes. This is monitored by an M&A department based at headquarters.

#### PERSONNEL RISKS

IWKA Aktiengesellschaft relies on qualified specialists and managers to achieve its goals. In today's very competitive marketplace, it is therefore an ongoing challenge to attract these human resources to the Group and ensure they identify with the company long-term. There is a particularly high demand for well educated and motivated workers in growth markets. There is also evidence of an increasing shortage of qualified personnel, particularly in the technical area. Appropriate in-house qualification programs are required to counter this. Centralized and decentralized training and continuing education programs for employees at all levels ensure that the Group's people have the indispensable expert skills they require.

Entrepreneurial thinking and management styles are also encouraged by tying variable incentives to managers' remuneration packages, which are paid according to business performance. This is supported by an employee share program.

#### INFORMATION SYSTEMS RISKS

All business processes are modeled on a modern IT system. The growing information technology-related risk associated with the rapidly increasing integration of IT-supported business processes demands that IWKA continuously analyze and optimize its current information technologies in order to ensure the highest possible level of security.

#### FINANCIAL RISKS/EXCHANGE RATE RISKS

IWKA manages and, if necessary, hedges against, the risks associated with group-wide credit, liquidity, interest and exchange requirements. Risk hedging related to interest and currency exchange rates (price change risks) is done almost exclusively by actively using standard derivatives to hedge the underlying transaction. Both the trading and use of derivatives is regulated by internal guidelines and undergoes continuous internal risk analysis. In addition, it is monitored annually by the public auditors. Transaction-related currency exchange risks are hedged using forward foreign exchange contracts (primarily futures and swap transactions). The risk associated with the volatility of leading currencies and the resulting exchange risk (competitive risk) is mitigated by having production facilities in several countries.

#### SUMMARY

Considering the risks from an overall perspective, it is clear that the IWKA Group is primarily exposed to market risks. In particular, this includes the business cycle and the dependence on important major customers in the automotive and consumer sectors. Risks resulting from value-added processes are controlled by our risk management system, and their potential negative impact is therefore limited.

In summary, there are risks associated with high raw material prices, continued price pressures and exchange rates, which the Group is addressing by implementing numerous performance improvement and cost cutting programs. The IWKA Group's risks are manageable and transparent, and as far as we are able to foresee, do not threaten the company's survival. Neither do we see any risks that could threaten the company's future business or legal existence.