RISK AND OPPORTUNITY REPORT

PRINCIPLES

KUKA Group is a global enterprise with international operations. Its corporate activities open up new business opportunities, but also involve a number of risks. The goal of KUKA AG's Executive Board is to minimize these risks and take advantage of potential opportunities in order to systematically and sustainably improve the value of the company for all stakeholders and shareholders.

Risk management

To achieve this objective, the Executive Board has implemented a comprehensive risk management system within the Group, which is used to systematically and continuously identify, evaluate, manage, monitor and report internal and external risks to which its divisions and subsidiaries are exposed. Identified risks are evaluated throughout the Group for their potential impact on profits and the likelihood that they will occur.

They are categorized according to worst, medium and best case scenarios including the expected risk value. Accruals and write-downs associated with these risks are recognized in the financial statements in accordance with applicable accounting principles. The monthly risk report includes the top ten risks for the divisions and KUKA AG as holding company as well as an overview of the entire Group's risk exposure. These top ten risks are a fixed part of the monthly reporting.

The risk report is also reviewed during Executive and Supervisory Board meetings, especially when the audit committee convenes. The identified risks are presented and explained in more detail to the Executive Board quaterly by the risk management committee. The committee also determines whether the measures already taken to minimize risk are adequate or whether further steps should be initiated. In addition, the plausibility of the reported risks is evaluated and alternative ways of avoiding similar risk in the future are derived.

The direct lines of responsibility for early identification, control and communication of risks are defined and lie with the management of the divisions and subsidiaries. Risk managers in the central and decentralized business units ensure that the reporting process is uniform, with clearly defined reporting channels and reporting thresholds that are in line with the size of the company. Whenever the Group's defined reporting thresholds are exceeded, an internal ad hoc announcement must be made. Responsibility for coordinating the risk management system lies with the head of Group controlling at KUKA AG, who is also the head of risk management and thus reports directly to the CFO of KUKA AG. This ensures that risk management is an integral component of the KUKA Group's overall planning, control and reporting process.

The Group's risk management system enables the Executive Board to identify material risk at an early stage, take appropriate steps to counter such risk, and monitor implementation of the steps. As part of its regular audits, the internal audit department monitors adherence to the KUKA Group's risk management guidelines and thus the effectiveness of the procedures and tools that have been implemented. If necessary, the internal audit involves those responsible for risk management in the audit scope. In addition, the internal audit department regularly audits the risk management process to ensure that it is efficient and continuously improved. Furthermore, external auditors check that the early risk identification system is suitable for timely identification of risk that could threaten the existence of the company as a going concern.

KUKA Group's opportunity and risk-related controlling process ensures that opportunities and risks are taken into consideration by management. Further details regarding the associated opportunities are provided in the description of the various risk categories.

KUKA Group also has an internal controlling system (see p. 87: Internal Control and Risk Management System) that goes above and beyond the risk management system and is used to continuously monitor and support proper adherence to business and accounting processes.

MARKET AND SECTOR RISKS AND OPPORTUNITIES

KUKA is exposed to the cyclic investment behavior of its customers in the various market subsectors. The automotive sector, with its oligopolitical structures and constant price pressure, makes up a major portion of business volumes in the Systems and Robotics divisions. Fluctuations in capital expenditure plans are considered in strategic and operating planning, in part by analyzing public announcements and disclosures. Due to the cyclic nature of the business, the company continuously strives to be as flexible as possible with its own capacities and its cost structure.

KUKA Group is also exposed to country risks, such as risk resulting from inadequate patent and trademark protection in Asia, exchange rate fluctuations, financing risk, technical risk, and the risk of substantial increases in prices for key commodities. To the extent possible and economically viable, value is increasingly added at a local level in order to reduce currency exchange risk. To safeguard its intellectual property, KUKA has developed an independent strategy based primarily on securing patents and trademark rights. New competitors in the market, especially from Asia, are resulting in increased price pressure. We counter this by maintaining strong relationships with our customers, and especially by expanding and protecting our technological competence.

KUKA benefited from high investment activity in both the automotive industry and in the general machinery and plant engineering sector during all of 2012. Additional opportunities exist on the basis of the excellent competitive position that KUKA Group's key automotive customers enjoy in their markets. The advantages of its customer portfolio compared with its competitors gives KUKA Group opportunities to grow its business and, in particular, to gain market share. Further opportunities exist due to the general trend toward greater automation in non-industrial sectors, such as the long-term prospects associated with assisting an aging society.

KUKA works with suppliers that focus on quality, innovation strength, continuous improvement, and reliability so that it can supply its own customers with products of the highest possible quality. Generally, KUKA sources product components from several suppliers, although in a few cases – due to a lack of alternatives – it depends on single-source suppliers that dominate their markets.

Additional risks that could also impact business performance after 2012 are an exacerbation of the sovereign debt crisis, particularly in the Euro zone. Increasing currency fluctuations could also pose a risk, particularly those involving the U.S. dollar, the Hungarian forint, the Japanese yen, and the Chinese yuan. How KUKA manages its currency exchange risk is described in detail in the section on financial risk.

PERFORMANCE RISKS AND OPPORTUNITIES

KUKA Robotics

The key challenges for this division's product portfolio involve ongoing cost sensitivity and demands for continuous product innovation on the part of customers around the world. This applies especially to the automotive industry and its sub-suppliers. The result is permanent price pressure and potentially longer life cycles for the robots in use.

KUKA Robotics responds to such trends by continually developing new products and applications that offer customers in existing markets quantifiable financial advantages driven by very fast paybacks. Launching new products such as the new small robot KR AGILUS or the light-weight robot entails risks associated with product performance and warranties of quality, which could generate reworking costs. To manage such risks or avoid them altogether, KUKA employs a comprehensive quality management system that includes extensive validation and test processes.

KUKA sees an opportunity in continuously expanding its customer base beyond the automotive sector to general industry. This represents a key component of corporate strategy. The process involves developing completely new markets such as medical technology and other consumer-related sectors in which human-machine collaboration will be necessary in the future. The systems used for human-machine collaboration can operate without protective barriers or similar safety measures. One of the division's sections, Advanced Robotics, focuses on technical development of such innovative products and applications. In addition, the company is expediting sales in the Americas region and the BRIC nations. Increasing the distribution of our own value added across several local currencies will make the earnings power of the company less dependent on exchange-rate fluctuations.

KUKA Systems

This division's sales and profits are subject to general business risk due to the length of time it takes to process project orders, the revisions to specifications that are often necessary while processing the orders, the infrequency of the orders received as well as price and competitive pressures. Other risks associated with these projects include inaccurate prediction of the actual costs as well as penalties for late deliveries. The division thus has appropriate risk checklists for individual orders, which are used to assess the associated legal, business and technical risks prior to accepting an order. Insolvency risks in particular are monitored, tracked, and mitigated using a strict project and receivables management process in conjunction with exposure reporting. Other risks are continuously monitored and, if necessary, accounted for by accruals or write-downs on the balance sheet. Opportunities associated with the project business arise mainly when parts can be purchased at a lower cost than originally estimated, and by invoicing the customer for any changes over the course of the project.

Major automakers throughout the world are currently rapidly expanding their global manufacturing capacities. KUKA increasingly carries out joint projects with internal partners, especially in South America and Asia, with several of the division's regional subsidiaries collaborating on a project. In such cases, risks involve the exchange of information, the value-added process, and the IT-based master project management system. There are also organizational risks associated with extraordinarily rapid and strong growth in business volume, particularly in emerging markets. KUKA mitigates these risks by additionally harmonizing its global IT systems and deploying experienced internal and contract employees when establishing and expanding the local organizations.

The increasing variety of models offered by the automotive industry has a positive impact on the potential market volume, since this generates increasing demand for flexible manufacturing systems, which in turn spurs demand for new or revamped assembly lines. This creates new business opportunities for systems integrators and sub-suppliers. Scarce resources are driving demand for smaller and more fuel-efficient vehicles, which will be fueled by alternative energy sources. Going forward, this will make it necessary for automakers, especially U.S. manufacturers, to invest in new production lines or to upgrade their existing production installations.

Pay-on-production contracts such as the one entered into by KUKA Toledo Productions Operations (KTPO) offer additional opportunities, but also risks. The Jeep Wrangler brand continues to present above-average growth prospects compared with other American car models. KUKA participated in this growth again in 2012. Risks in this context involve greater dependence on the volumes produced for the U.S. car market.

Thorough market analyses have shown that KUKA Systems also has long-term business opportunities outside the automotive industry; namely, in general industry. A current example is the aerospace industry, from which new orders were again received in 2012. Although this presents an opportunity to penetrate new markets, it also entails risk, above all in relation to technical requirements, since customers in these sectors often have no experience with automated systems. Using the appropriate risk checklists to review the technical risks is therefore a major instrument to mitigate risk in advance of applying new automation technologies.

STRATEGIC RISKS AND OPPORTUNITIES

The goal of KUKA's business divisions is to be among the technology and market leaders in their target markets. Consistently enhancing their core technologies using coordinated innovation programs is thus of primary importance. A key task is to identify the opportunities and risks involved in technical innovations in a timely manner and to evaluate their feasibility. The company mitigates the impact of faulty market assessment by conducting regular market and competitor analyses, some of which are decentralized. The risk of developing non-marketable products and systems is reduced through application-oriented development, partnerships with systems integrators, and alliances and cooperative research projects with, for example, the German Aerospace Center (DLR) in Wessling near Munich, the RWTH Aachen, and several institutes of the Fraunhofer Society.

Using effective quality assurance systems in combination with regular certification programs helps convince purchasers that the company offers customer-oriented products and solutions and strengthens the positions of KUKA's companies in their target markets.

The corporate strategy is managed by a central KUKA AG department and is regularly reviewed and coordinated with the divisions. The joint Innovation Center develops crossover technologies and concepts in order to take advantage of the synergies arising from uniform procedures and processes and to meet market demand for innovative products and solutions.

PERSONNEL RISKS AND OPPORTUNITIES

The success of KUKA Group, a high-tech enterprise, depends to a great degree on having qualified technical and management staff. Personnel risk arises mainly from employee turnover in key positions within the Group. Improvements in both business and economic prospects enable the company to strengthen the loyalty of its core personnel, train new, highly skilled employees, and entice new recruits to join the Group. This applies to the traditional markets in Europe and the U.S., but especially to recruiting employees in growth markets such as the BRIC countries, in which the need for well-trained employees is steadily growing. Last but not least, in-house continuing education programs such as those offered by KUKA Academy, or employee suggestion programs, generate opportunities resulting from the improved motivation and qualification of the workforce.

Furthermore, in Germany there is evidence of an increasing shortage of qualified personnel, particularly those with technical training. This requires that the company have appropriate in-house training programs and permanently stay in sync with the job market and job seekers. To this end, KUKA works closely with local and national universities and research institutes, such as the University of Augsburg, RWTH Aachen and the German Aerospace Center (DLR).

Centralized and decentralized training and continuing education programs for employees at all levels of the Group ensure that its personnel have the indispensable expert skills required. The in-house and international trainee program offers recruits the opportunity to get to know the various divisions and foreign operations. The 230 apprentices to be trained by KUKA Group as of year-end will be integrated into the company early on, and most of them will be offered a permanent position when they have completed their training. One of the key challenges in the coming years will be to prepare KUKA Group for the future in view of the demographic shift.

In addition to KUKA Group's attractive performance and results-driven compensation system for executives aimed at strengthening entrepreneurial thought processes and management styles, the Group's employee share program encourages employees to remain with the company and participate in its growth over the long term.

IT RISKS AND OPPORTUNITIES

The existing IT security and Business Continuity Management systems as well as guidelines and organizational structures are continuously optimized and reviewed in an effort to predict and minimize possible IT-related risks such as failure of computer centers or other IT systems. One way in which this is achieved is by continuously investing in updated hardware and software. Ongoing optimization of IT-supported processes generates long-term cost reduction potential and leads to continuous quality improvements. By systematically monitoring the associated processes, the company reduces the risks associated with an increasing number of external threats as well as dependence on the ever-expanding digitization of business processes.

IT security is also closely tied to KUKA Group's risk management process. External and internal auditors conduct an annual IT audit as well as spot checks to ensure that the respective processes adhere to legal requirements.

FINANCIAL RISK

One of KUKA AG's primary tasks is to coordinate and control the Group's financing requirements and to ensure that KUKA remains financially independent. With this goal in mind, the holding company optimizes the Group's financing and limits its financial risk via the Group's uniform treasury reporting system. In addition, liquidity risk is reduced for the Group as a whole by closely monitoring the Group's companies and their management of payment flows.

Over the course of the past four years, several measures have been implemented to strengthen the KUKA Group's solvency. One of these was to restructure the company's debt with respect to terms of maturity and the type of financing instruments used. In 2009 and 2010, this included two capital increases, the issue of a corporate bond and the conclusion of new syndicated senior facilities agreements.

In November 2010, KUKA AG was for the first time awarded by ratings agencies Standard & Poor's and Moody's in connection with the launch of the corporate bond. At that time, KUKA AG's bond was rated "B-" by Standard & Poor's and "B3" by Moody's. Based on the good performance of KUKA Group in 2012 and the associated improvement in the Group's financial ratios, both ratings agencies cited a "positive outlook" in 2012. At present, the ratings agencies have given KUKA AG a long-term corporate family rating (CFR) of "B+" (Standard & Poor's) and "B1" (Moody's). Please see the section entitled "Financing" starting on page 136 for more information.

The syndicated senior facilities agreement, which runs until March 2014, contains the usual covenants. A fundamental risk associated with this type of covenant-based financing exists when business performance is significantly below plan and the resulting earnings and financing situation precludes adherence to the defined limits. KUKA monitors adherence to the covenants on a monthly basis. The company complied with all covenants during the course of the 2012 financial year. As of December 31, 2012, all ratios regulated by covenants were well within the contractually defined limits.

In addition to the steps described above, the financing portfolio of KUKA Group is supplemented by agreements on bilateral credit lines with credit insurance companies with a scope of € 62 million along with ABS programs involving the regular sale of receivables with a scope of € 50 million.

Transaction-related currency exchange risks are hedged using currency futures. Details on the central currency management process are provided under "Financial Instruments" starting on page 141 of the notes to the financial statements. Currency translation risks, i. e. valuation risks associated with balance sheet items whose value has been converted from a foreign currency, are not hedged, but are continuously monitored. The risk associated with the volatility of leading currencies and the resulting economic exchange risk (competitive risk) is mitigated by having production facilities in several countries (natural hedging). Internal guidelines govern the trading and use of derivatives, which are subject to continuous internal risk monitoring.

COMPLIANCE RISK

Compliance violations may lead to fines, sanctions, judicial orders regarding future conduct, forfeiture of profits, exclusion from certain transactions, loss of trade licenses, or other restrictions. Furthermore, involvement in potential corruption proceedings could harm the overall reputation of KUKA Group and have a negative impact on efforts to compete for business with customers in both the public and private sectors. Such proceedings could also have a negative impact on the relationship that KUKA Group has with business partners upon which it depends, as well as on its ability to find new business partners. They could furthermore negatively affect the company's ability to pursue strategic projects and transactions of potential importance for the business, such as joint ventures or other forms of cooperation. Ongoing or future proceedings could lead to the suspension of some existing contracts, and third parties, including competitors, could initiate legal proceedings against KUKA Group for substantial amounts of money.

In order to make these risks transparent and controllable, a Corporate Compliance Program was introduced in early 2008. The compliance committee established through this program meets at regular intervals and ad hoc and reports to KUKA AG's CEO, who in turn reports directly to the Supervisory Board's Audit Committee. In financial year 2012, employees all over the world received training via e-learning on the corporate compliance program of KUKA Group.

The CEO is ultimately responsible for the corporate compliance program, which is regularly updated and subject to strict internal controls. The program did not uncover any substantial risks in 2012 due to the active countermeasures taken to mitigate risk at an early stage and to eliminate risk sources, e. g., by realigning business processes.

OTHER RISKS

KUKA Group continuously monitors other risks and mitigates these to the greatest extent possible. Since the company does not use hazardous materials, there is no indication of environmental risk arising from operational activities. The Group makes use of buildings and properties for its business operations, some of which it owns. As a result, the company is exposed to risks associated with any residual pollution, soil contamination, or other damaging substances that may be discovered on its properties. There is currently no evidence of any situations that would have a negative impact on the measurement of balance sheet items. However, it cannot be ruled out that any such situations, which could, for example, require costly cleanup operations to be undertaken, will not occur in the future.

Where possible, legal risks are limited by using standardized master agreements. The Group's legal department supports the operating companies and thereby helps to limit risks. In addition, Group-wide Directors' and Officers' (D&O) liability insurance policies are in place whose coverage includes the managing bodies (Executive Board and managing directors) and supervisory bodies (Supervisory Board, administrative and advisory boards) of the German and foreign Group subsidiaries. Existing insurance policies are reviewed annually in order to weigh the relationship between the insurance protection and deductible amount versus the risk premium. The Executive Board of KUKA Group subsequently decides on any further steps.

The shareholder structure is periodically analyzed to assess the possibility of takeover of the company. Because it has operations around the world, KUKA Group is required to observe numerous international and country-specific regulations, mostly related to the laws of the particular country, as well as instructions from tax authorities. Risks related to financial law exist should the company fail to observe laws and other regulations. Tax audits in particular could have a negative impact on the Group if audit findings result in liability for the payment of interest, penalties, or back taxes. Appropriate provisions have been recognized for such tax risks based on experience.

SUMMARY

From an overall perspective, KUKA Group is primarily exposed to business performance and financial risk. The Executive Board is not aware of any individual or combined risks that could threaten the company's existence as a going concern. Strategically and also financially, the company is positioned to be capable of taking advantage of arising business opportunities.

INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM

PRINCIPLES

Pursuant to section 289 (5) and 315 (2) no. 5 of the German Commercial Code (HGB), KUKA Aktiengesellschaft, as a publicly traded parent company, must describe the key characteristics of its internal control and risk management system in its management report. The description must include the accounting processes of the companies included in the consolidated financial statements.

KUKA regards the internal control and risk management system as a comprehensive system, and uses the definitions provided by the Institut der Wirtschaftsprüfer in Deutschland eV., Düsseldorf, of accounting-related internal control systems (IDW AuS 261 no. 19 et seq.) and risk management systems (IDW AuS 340, no. 4).

An internal control system is accordingly defined as all principles, processes, and measures introduced to the company by management that result in systematic and transparent risk management.
The internal control system focuses on organizational implementation of the management's decisions made to ensure the effectiveness and efficiency of business operations (including the preservation of assets, which includes preventing and exposing asset misappropriation), adherence to generally accepted accounting principles and the reliability of internal and external accounting, and compliance with the legal provisions relevant for the company. This approach allows risk to be better identified, measured, and controlled.

The risk management system comprises all organizational rules and measures related to identifying risk and dealing with entrepreneurial risk.

In the area of financial reporting, the preparation of consolidated financial statements in compliance with the standards must be ensured regardless of possible risk. KUKA meets this requirement through implementation of an accounting-related internal control system at all KUKA Group companies. The internal control system is geared toward assuring early identification of possible sources of error and limiting the resulting risk. Various monitoring measures – both integrated into the process and independent of the process – contribute to the preparation of annual and consolidated financial statements that are in conformity with the legal provisions.

STRUCTURES AND PROCESSES

With regard to the accounting process, the structures and processes described below have been implemented in KUKA Group. The Executive Board of KUKA AG bears full responsibility for the internal control and risk management system as it applies to the accounting process.

The system extends via clearly defined management and reporting structures to all subsidiaries that are included in the consolidated financial statements.

For the Group's German companies, the Shared Service Center of KUKA AG is responsible at a central level for accounting and human resource operations. Intragroup tasks such as treasury, legal services, and taxes are also performed centrally by KUKA AG on the basis of uniform Group processes.

The principles, organizational structures, and processes of the (Group) accounting-related internal control and risk management system are defined in guidelines and organizational procedures. Adjustments based on external and internal developments are integrated on a continuous basis and made available to all employees concerned.

CHARACTERISTICS OF THE INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM

With respect to the accounting process, we regard those characteristics of the internal control and risk management system as material that can significantly impact the accounting and the overall presentation of the consolidated and annual financial statements, including the combined management report. At KUKA Group, these include, in particular:

- Identifying the main areas of risk (see page 81 et seq. of the Risk Report) and control that affect the (Group) accounting process;
- quality controls to monitor the (Group) accounting process and the accounting results at the level of the Group Executive Board, the management companies, and the individual reporting entities included in the consolidated financial statements;
- preventive control measures in the finance and accounting systems of the Group and the companies included in the consolidated financial statements as well as in operating business performance processes that generate key information for the preparation of the consolidated and annual financial statements and the combined management report, including a separation of functions of predefined approval processes in relevant areas;
- measures to ensure proper, IT-supported processing of (Group) accounting-related facts and data. These include, for example, central management of access rights to the bookkeeping systems and automated plausibility checks when data is recorded in the reporting and consolidation system;
- measures to ensure the accounting-related internal control and risk management system by the relevant departments and by internal audit, which monitors adherence to the internal control system by conducting systematic reviews.

In addition, the CFOs of all subsidiaries must provide an internal responsibility statement in the context of external reporting as of June 30 and December 31. Only then do the members of the Executive Board of KUKA AG provide an external statement of responsibility by signing the Group Responsibility Statement at mid-year and year-end, by which they confirm that they have adhered to the prescribed accounting standards of KUKA Group and that their figures give a true and fair view of the Group's financial performance, financial position and cash flows. In its meetings, the Audit Committee of the Supervisory Board regularly reviews the effectiveness of the accounting-related internal control system. The Supervisory Board thus continuously obtains an appropriate view of the Group's risk situation and monitors ICS effectiveness.

In so doing, the Executive Board of KUKA AG presents the risks associated with financial reporting at least once per year, outlines the control measures implemented, and monitors their correct execution.

SUMMARY

The structures, processes, and characteristics of the internal control and risk management system ensure that the accounting processes of KUKA AG and KUKA Group are uniform and are implemented in accordance with the legal requirements, generally accepted accounting principles, international accounting standards, and internal Group guidelines.

They also ensure that transactions are recognized and measured uniformly and accurately throughout the Group and that accurate and reliable information is therefore provided to the internal and external recipients of the information reported.