RISKS

PRINCIPLES

KUKA Group conducts business around the globe, which exposes the company to numerous potential risks that accompany any entrepreneurial venture. The goal of KUKA AG's Executive Board is to minimize these risks and take advantage of potential opportunities, in order to systematically and continuously improve the value of the company for all stakeholders and shareholders.

Risk management

To achieve this objective, the Executive Board implemented a comprehensive risk management system within the Group, which is used to continuously and systematically identify and assess internal and external risks to which its divisions and subsidiaries are exposed. Risks are assessed uniformly throughout the Group for their potential consequences and probability of occurrence. They are also examined for worst, medium and best case scenarios and the resulting expected degree of risk. Appropriate consideration is then given to accruals or revaluations in the balance sheets of the respective divisions or companies. The identified risks are presented to the Executive Board quarterly during risk control meetings and explained in more detail as required. A decision is also made at these steering meetings as to whether the steps to minimize the risk appear to be adequate or whether the responsible parties must initiate additional steps. This steering committee also evaluates the plausibility of the reported risks and derives alternative ways to avoid similar risks in future. The monthly risk report contains among other things the top ten risks faced by the Group, Robotics, Systems and the holding company (AG), as well as a summary of the overall risk situation. In order to keep the importance of the risk management system in focus, the Group's top ten risks are a fixed component of the month-end reports. The risk report is also reviewed at meetings of the Executive Board, the Supervisory Board and especially the Audit Committee.

The direct responsibility for early identification, control and communication of risks is defined and lies with the management of the divisions and subsidiaries. Risk coordinators 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 defined reporting thresholds are exceeded, the responsible parties are obliged to use internal ad hoc announcements for any identified risks. The head of the Group controlling department at KUKA AG is responsible for coordinating the risk management system. This risk management manager position reports directly to KUKA AG's CFO. This ensures that risk management is an integral component of KUKA Group's overall planning, control and reporting process.

The Group's risk management system makes it possible for the Executive Board to identify material risks at an early stage and take appropriate steps to counter them as well as monitor the mitigating measures. The internal audit department regularly audits the risk management process to ensure that it is efficient and continuously improved. In addition, the external auditors check that the early risk identification procedure is suitable for identifying risks at an early stage that threaten the existence of the company.

MARKET AND BUSINESS RISKS

KUKA is exposed to the cyclic investment plans of its customers in the various market subsectors. The automotive sector, with its oligopolistical structures and constant price pressure, represents a major share of the Systems and Robotics divisions' business volumes. In addition, KUKA Group's risk position is affected by country risks, such as patent and brand protection in Asia, exchange rate fluctuations, financial and technical risks and the risk of substantial price increases of key raw materials.

The impact of the economic crisis still had a strong impact in fiscal 2010, especially at the beginning of the year. Thereafter, KUKA benefited primarily from the rise in orders placed by the automotive industry and the plant and engineering sector. Orders received for the year in total thus rose 26.5 percent year-over-year and sales were up 19.6 percent compared to the year prior.

Even though the financial situation of most carmakers has improved dramatically over the course of the last financial year, KUKA continuously monitors the developments at automotive manufacturing companies. An exposure report is created for customers, and if necessary, an upper limit is set for quotation magnitude or order size as a function of the customer's credit rating. The same procedure applies to customers in other market segments; e.g., general industry.

At the present time, the key risks, which could also impact business performance after 2010, are as follows:

- a stronger euro
- expiry of current government incentive programs
- new competitors entering the market, especially from Asia, generating greater price pressure
- a setback in the banking and financial crisis
- political risks, especially in view of current developments in North Africa

PERFORMANCE RISKS

KUKA Robotics

The key challenges for this division's product portfolio are the continuing cost sensitivity of customers around the world and their demands for continuous product innovation. This applies especially to the automotive industry and its subsuppliers. The result is permanent price pressure and potentially longer life cycles for the robots used in the currently served markets.

KUKA Robotics counters such trends by continually developing new products and applications that offer customers in existing markets quantifiable financial advantages driven by very fast paybacks. In addition, the division targets and penetrates new markets; for example, applications in the health care sector and other consumer related areas. In 2010, KUKA Group spent € 29.5 million on research and development. The majority of the spending (95.6 percent) was by the Robotics division.

A key part of KUKA's corporate strategy is to expand into markets other than the automotive sector. This is being done by increasing the size of the customer base in general industry. In addition, the company is expediting sales in the American region and the BRIC nations. Exchange-rate advantages are also benefiting competitors' business in some areas. Increased distribution of our own value added across various local currencies will make the profitability of the company less dependent on exchange-rate fluctuations ("natural hedging").

KUKA Systems

The lead time of Systems' orders are relatively long. Very often, adjustments must be made to meet specifications while orders are being processed. The number of orders can be low due to the higher average order volume and price pressure from competitors is considerable. All of these factors put the revenues and profit from these orders at risk. Other project risks may also arise; e.g., inaccurate estimating when quoting, contractual penalties and project postponement. Exposure reporting includes a stringent project and receivables management process to track and reduce solvency risks. Other risks are continuously monitored and accrued for if necessary. Quotation and order acceptance processes have been optimized and standardized for all worldwide locations.

The regional diversification of activities in Europe and North America and business growth, especially in the Asian region, had a positive impact on the risk situation, as it did last year. There still appears to be significant potential, particularly in the BRIC countries where the automotive industry is planning to substantially expand its production capacity. The increasing model variety in the automotive industry also has a positive effect on orders received, since it results in rising demand for flexible production lines. These must be either newly built or existing lines must be upgraded, which creates new business opportunities for systems integrators and parts suppliers.

The need to build smaller, more fuel-efficient vehicles, some of which are driven using alternative energy sources will make it necessary to invest in new assembly lines or upgrade existing production systems, especially for American carmakers.

Pay-on-production contracts such as the one entered into by KUKA Toledo Productions Operations (KTPO) offer additional opportunities and risks. The Jeep Wrangler brand offers above-average growth opportunities compared to other American car models. Again in 2010, KUKA participated in the growth. The risks herein are the strong dependence on the volume produced for the American car market.

After conducting a fundamental general industry market analysis, KUKA Systems now also plans to tap the long-term business potential outside the automotive industry. Current examples are the aircraft and solar industry, as well as the rail vehicle manufacturing sector, where new orders were received in 2010.

CORPORATE STRATEGY RISKS

The goal of the business divisions is to be among the technology and market leaders in their target markets. Consistently enhancing their technologies through coordinated innovation programs is therefore of primary importance. A key task is to identify the opportunities and risks of technical innovations in a timely manner and evaluate their feasibility. The company mitigates the impact of faulty market assessment by conducting regular market and competitor analyses, some of which are decentralized. This is supported by application-oriented developments, partnerships with systems integrators and alliances and cooperative research projects; for example, with the German Aerospace Center (DLR) in Wessling near Munich, with RWTH Aachen and with the university clinic in Aachen.

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. Uniform procedures and processes generate synergies that help the company meet market demands for innovative products and solutions.

KUKA Group's cost structure was improved in 2010 to optimize its costs and establish more efficient processes. Processes were reengineered and above all, the profitability was increased. A new risk checklist was implemented for major orders, so that it will be easier to assess technical risks.

PERSONNEL RISKS

The success of KUKA Group, a high-tech company, depends mainly on having qualified technical and management staff. Personnel risks arise mainly from employee turnover at key positions within the Group. The challenge KUKA faces as a result of the economic recovery last year is to keep its personnel in the company for the long run and train or recruit new highly qualified employees to fill positions within the Group. This applies both to the traditional markets in Europe and the United States as well as the growth markets; e.g. the BRIC countries, in which the need for highly qualified employees is steadily growing.

Furthermore, in Germany, there is evidence of an increasing shortage of qualified personnel, particularly in the technical area. This requires that the company have appropriate in-house training programs and permanently stay in tune with the job market and job seekers. 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 ensure that the Group's people have the indispensable expert skills they require. The in-house and international trainee program offers recruits the opportunity to get to know various business areas and foreign companies. The 211 apprentices to be trained by the KUKA Group by year-end will be quickly integrated into the company and mostly 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.

KUKA Group has an attractive performance and results-driven compensation system for managers to strengthen entrepreneurial thought processes and management styles and to encourage employees to remain with the company and participate in its growth over the long term. KUKA Group's employee share program is another initiative that serves this purpose.

INFORMATION SYSTEMS RISKS

The company created Shared Service Centers Informationstechnologie (IT) in order to establish a foundation for bundling all IT processes in a single department, simplify and standardize processes and improve the potential to reduce costs. Initially this will be done at the Augsburg location. Among other things, this will be implemented by regularly investing in hardware and software and strictly managing access rights.

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 computer systems related risks such as failure of computer centers and other IT systems. Risks from both the increasing level of external threats and dependence on ever-increasing digitization of business processes are minimized by systematically monitoring the associated processes.

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

The IT systems used also align with the KUKA Group's security and uptime requirements.

FINANCIAL RISKS

One of KUKA AG's primary tasks is to coordinate and control the Group's financing requirements and ensure that KUKA remains financially independent. With this goal in mind, a central department optimizes the Group's financing and limits its financial risks. The standard, group-wide treasury reporting system implemented in 2007 was further enhanced for this purpose. In addition, the Group's overall liquidity risk is reduced by closely monitoring the Group's companies and their control of payment flows.

Over the course of the past year and a half, KUKA Group solvency was strengthened by way of several measures. One of these was to restructure the company's debt in terms of maturity and the type of financial instruments used. It included two capital increases, the issue of a corporate bond and conclusion of a new Syndicated Senior Facilities Agreement.

In November 2009 and June 2010 KUKA AG raised additional capital by issuing new shares, which resulted in gross proceeds of € 27.9 million and € 45.4 million respectively.

In addition to the primary objective, which was to improve the Group's equity position, the funds were used for general corporate purposes. Most importantly, this included implementing further strategic initiatives such as investment and development projects, in addition to financing working capital.

As part of the restructuring of its financing structure, KUKA AG issued a bond, which was purchased by both institutional and retail investors in Germany and abroad. The amount of the bond was € 202 million and a term of seven years, to 2017. The funds generated will be used in part for repayment of the convertible bond issued on May 9, 2006, which comes due on November 9, 2011. € 69 million have been specifically set aside from the proceeds generated by the high yield bond to ensure repayment. The remaining amount will be used for partial repayment of the cash drawn on the credit line that is part of the Syndicated Senior Facilities Agreement and to develop the operating business.

The rating agencies Standard & Poor's and Moody's gave KUKA AG a long-term Corporate Family Rating (CFR) of B and B2 respectively. Both ratings were assigned a stable outlook. KUKA AG's bond was given a rating of B- and B3 respectively.

In March 2010, KUKA AG extended its Syndicated Senior Facilities Agreement to March 31, 2012 and expanded the available credit to € 336 million. This total consisted of revolving cash facilities in the amount € 146 million and guarantee facilities of € 190 million.

After successfully completing its capital increase in June 2010 and placing the corporate bond, KUKA AG signed a new Syndicated Senior Facilities Agreement with the bank consortium in November 2010, which resulted in early release of the Syndicated Senior Facilities Agreement signed in March 2010. The new Syndicated Senior Facilities Agreement for € 200 expires on March 31, 2014. The total amount consists of € 150 million in guarantee facilities and € 50 million in revolving cash facilities. The terms of the new Syndicated Senior Facilities Agreement are better for KUKA than those of the previous loan agreement. It also offers greater flexibility.

The Syndicated Senior Facilities Agreement includes the usual covenants related to debt ratios and interest coverage. The risk with this covenant-based type of financing is that in the event the business substantially underperforms and as a result, earnings and financial parameters come in far below plan, there are no guarantees that these covenants can still be met. In such cases, the continued availability of the financing facilities depends on the extent to which the financing banks agree to the required adjustments. KUKA monitors its covenants monthly and was in compliance as of December 31, 2010.

In addition to the aforementioned steps, agreements on bilateral credit lines with banks and credit insurance companies supplement KUKA Group's financing portfolio. This includes, for example, the ABS program (regular sale of receivables) established in 2006 in the amount of up to € 25 million, which runs until March 31, 2012

Transaction-related currency exchange risks are hedged using currency futures. The goal is to hedge the currency exchange risk on a rolling basis. Details of the central currency management process are provided under Financial Instruments on pages 108 to 110 of the notes to the financial report. As a basic principle, all KUKA Group companies must secure their foreign currency positions as soon as they arise. Translation risks; that is, 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 are used to control the trading and use of derivatives. Associated risks are continuously monitored internally.

COMPLIANCE RISKS

Compliance violations can lead to fines, sanctions, legal directives regarding future business conduct, forfeiture of profits, exclusion from certain businesses, loss of union concessions or other restrictions. Furthermore, involvement in potential corruption proceedings could harm the overall reputation of KUKA Group and could have a negative impact on efforts to compete for business in both the public and private sectors. Such proceedings could also have a negative impact on the relationship KUKA Group has with business partners upon which it depends, as well as its ability to find new business partners. It could also have a negative impact on the company's ability to pursue strategic projects and transactions that may be important for the business; e.g., 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 sums of money.

In order to make these risks transparent and controllable, a Corporate Compliance Program was introduced in early 2008. It applies to all German and international KUKA companies and all managers around the globe have been trained. A compliance committee meets at regular intervals and ad hoc and reports to KUKA AG's CEO, who in turn reports to the Supervisory Board's Audit Committee.

The CEO is ultimately responsible for the corporate compliance program. The program is regularly updated and subject to strict internal controls. The initiative did not uncover any substantial risks in 2010, since the company was able to actively implement countermeasures by mitigating risk at an early stage and striving to eliminate risk sources; e.g., by aligning its business processes.

OTHER RISKS

KUKA Group continuously monitors other risks and mitigates these to the extent possible. There is no evidence of environmental risks from operational activities, since the company does not use hazardous materials. 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 that any situations exist which would have a negative impact on the valuation in the balance sheet. However, there is no guarantee that 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 standard general contracts. The Group's legal department supports the business operations and thereby help to limit risks. A Group-wide Directors' and Officers' (D&O) Liability Insurance policy is in place that covers, among others, the business management bodies (Executive Board and managers) and supervisory bodies (Supervisory, 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. KUKA's Executive Board subsequently decides on further steps.

The shareholder structure is periodically analyzed to assess a possible 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 financial administration rules. There is a risk that countries could implement duties should the company fail to properly observe laws and other regulations. Tax audits in particular could have a negative impact on the Group. Should the auditors find compliance issues, the company could be liable for payment of interest charges, penalties and tax arrears. Appropriate precautions based on experience are taken for such tax risks.

SUMMARY

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