

## **Corporate Governance Report**

(including Corporate Governance Declaration)

Good corporate governance is a key factor for long-term corporate success. The Supervisory Board and the Management Board of KHD Humboldt Wedag International AG („KHD“) are committed to the principles of good corporate governance as basis for decision-making and control processes. At KHD, the concept of corporate governance means managing and controlling the Group in a responsible, value-based manner and ensuring long-term success. Promoting targeted and efficient cooperation between the Management Board and the Supervisory Board, paying attention to the interests of our employees and shareholders, employing fair business practices with every party, transparency and accountability when making entrepreneurial decisions and an appropriate management of risks also constitute part of KHD’s corporate principles.

### **I. Corporate Governance Declaration in accordance with Section 289f / 315d of the German Commercial Code („HGB“)**

#### **A. Compliance with the German Corporate Governance Code (the „Code“) and Declaration of Compliance**

The Management Board and Supervisory Board of KHD act according to the recognized principles of responsible corporate governance. KHD sees corporate governance as an ongoing process and will take further development of corporate governance into account.

The Management Board and the Supervisory Board have made the annual declaration of compliance in accordance with Section 161 of the German Stock Corporation Act (“AktG”):

**Declaration of compliance by the Management Board and Supervisory Board  
of KHD Humboldt Wedag International AG  
in accordance with Section 161 of the German Stock Corporation Act ("AktG")  
on the recommendations of the  
“Government Commission on the German Corporate Governance Code”**

The Management Board and the Supervisory Board of KHD Humboldt Wedag International AG hereby declare that since the last declaration of compliance on February 23, 2018 the recommendations of the German Corporate Governance Code (the “Code”) as amended on February 7, 2017 have been complied with and will be complied with in future with the following exceptions:

- The Company has concluded directors’ and officers’ (D&O) insurance for the members of the Supervisory Board but no deductible has been agreed upon (Code item 3.8 para. 3).

The Company and the Supervisory Board are fully aware and fully accept the due care and diligence required from a prudent and conscientious Supervisory Board member, but they do not see the agreement of a deductible as a suitable measure for enhancing the motivation and sense of responsibility with which the Supervisory Board members perform their duties and functions.

- The Supervisory Board has not established any committees as recommended by the Code (Code item 5.3.1).

The issues normally delegated to committees are jointly handled by all Supervisory Board members whereby each member of the Supervisory Board reports to the Supervisory Board as a whole on those topics that are primarily allocated to his/her responsibility based on specific expertise.

- The Supervisory Board has not established an Audit Committee as recommended by the Code (Code item 5.3.2).

Reference is made to the explanation given in connection with item 5.3.1 of the Code. The objective of Code item 5.3.2 is still met as one member of the Supervisory Board, who is not a former member of the Management Board of the Company, has specialist knowledge and experience in the application of accounting principles and internal control processes.

- The Supervisory Board has not established a nomination committee as recommended by the Code (Code item 5.3.3).

Reference is made to the explanation given in connection with item 5.3.1 of the Code. The objective of Code item 5.3.3 is still met, because all members of the Supervisory Board are shareholder representatives.

- The Supervisory Board has neither specified an age limit nor a regular limit of length of membership for the members of the Supervisory Board as recommended by the Code (Code item 5.4.1 para. 2 first sentence).

The Supervisory Board considers extensive business experience from a long business career as beneficial for the competence of the Supervisory Board and the interests of the Company. A long-term membership in the Supervisory Board is also of great advantage for the Company, since this provides for a better understanding in terms of the complexity of the business as well as expert knowledge regarding specifics of the Company. Therefore, the Supervisory Board decided not to specify an age limit and regular limit of length of membership for the members of the Supervisory Board.

- The Company does not publish any information on the business development during the course of the year in addition to the half-year financial report as recommended by the Code (Code item 7.1.1 second sentence).

The Company is no longer obligated to publish interim reports. Due to the long-term nature of the business model as well as significant differences between individual quarters, quarterly information about the course of business does not appear to be expedient. However, the Company reports on the course of business in the first months of a financial year before a general meeting of shareholders.

- The consolidated financial statements and the combined management report for the 2018 financial year will not be made publicly accessible within 90 days from the end of the financial year (Code Item 7.1.2 third sentence 1st half-sentence).

The consolidated financial statements and the combined management report can only be published immediately after the Supervisory Board meeting convened to adopt the financial statements that is scheduled for April 2, 2019.

Cologne, February 22, 2019

For the Management Board

For the Supervisory Board

(s) Yizhen Zhu

(s) Jürgen Luckas

(s) Shaohua Jin

(s) Dian Xie

(s) Tao Xing

The current declaration of compliance with the German Corporate Governance Code is available on the Company's website under [www.khd.com/](http://www.khd.com/).

## **B. Corporate Governance Practices**

KHD places great importance on good responsible management and supervision with the objection of creating sustainable value added. Good corporate governance promotes confidence in the KHD Group among employees, investors, and customers. The basis for successful corporate governance lies in the close and effective cooperation between the Management Board and the Supervisory Board, consideration of the interests of our shareholders as well as open and transparent corporate communication.

### **Code of Conduct**

The Management Board of KHD has compiled and implemented effectively a Code of Conduct (last updated in 2012). The Code of Conduct stipulates that KHD Group's business activities comply with all laws as well as with high ethical standards. The Code of Conduct describes KHD's core values and is binding for all executives and all employees across the KHD Group.

### **Compliance Management System**

Compliance is a key element of KHD's ethical values. Integrity, reliability, honesty and credibility are anchored in our Code of Conduct that is binding for all employees. Measures at KHD to ensure compliance with laws and statutory regulations as well as with the corporate policies of KHD Group constitute a key aspect of management and supervisory tasks, together with a responsible attitude towards risks. In order to ensure that legal regulations and corporate policies are followed, there is a Group-wide system of measures and defined responsibilities in place, which is regularly evaluated for its effectiveness.

An important element of the compliance system in the KHD Group is the whistleblower policy. The whistleblower policy provides employees with the opportunity to report concerns regarding possible violations of laws or KHD Group policies. Informants can remain anonymous if they wish.

### **C. Working Practices of the Management Board and the Supervisory Board**

KHD is governed by the provisions of the German Stock Corporation Act (AktG), capital market regulations, and the rules set out in its Articles of Association. Pursuant to the dual board system, the Management Board is responsible for managing the Company, while the Supervisory Board carries out advisory and monitoring functions. Both boards cooperate closely to the benefit of the Group. Their common goal is creation of sustainable value added, taking into account the interests of the shareholders, employees, and other stakeholders.

#### **Management Board**

The Management Board of KHD currently consists of four members. The members of the Management Board are jointly responsible for the entire management of KHD Group and decide on the basic issues of business policy and corporate strategy. The Management Board determines the strategic alignment of the KHD Group in regular consultation with the Supervisory Board and is responsible for implementing the strategy. Furthermore, the Management Board is responsible for business planning and budgeting, preparing financial statements, implementing an appropriate risk management and risk control system, complying with legal regulations and internal policies ("Compliance"), as well as for providing regular, prompt, and comprehensive reporting to the Supervisory Board.

When filling managerial positions at the Company, the Management Board takes diversity into consideration and, in particular, aims for an appropriate consideration of women and internationality. The Management Board has defined targets for the proportion of women at the two management levels below the Management Board. At least 20-30% of the members of the two senior management levels below the Management Board shall be female. The quota of 20-30% for both senior management levels should be reached by June 30, 2017. KHD is a pure management holding, thus it currently employs only one female employee, but does not have senior management levels below the Management Board.

The Supervisory Board has implemented Rules of Procedure for the Management Board, which amongst others governs the work performed by the Management Board, the assignment of functional responsibilities to each member of the Management Board as well as the procedural rules for Management Board meetings and resolutions. In addition, the Rules of Procedure for the Management Board specify measures and transactions of

fundamental importance that require consent of the Supervisory Board. According to the Rules of Procedure for the Management Board, at least 20-30% of the members of the Management Board shall be female. The quota of 20-30% should be reached by June 30, 2017 and in case this is not achieved, the quota of 20-30% should be reached by June 30, 2020. Currently no woman is member of the Management Board that consists of four members. As KHD is strongly characterized by technology it is a major challenge to identify and recruit suitable female candidates for the Management Board as e.g. the female quota in technical university studies is low.

### **Supervisory Board**

The Supervisory Board appoints the Management Board members and advises and monitors the Management Board in the management of KHD. The Chairman of the Supervisory Board coordinates the work of the full Supervisory Board and chairs the meetings. The Chairmen of both, the Supervisory Board and the Management Board are in regular contact with each other and exchange information. In its Rules of Procedure the Supervisory Board defined, amongst others, terms on its composition, scope of responsibility, passing of resolutions, and on how potential conflicts of interest are to be dealt with.

The Supervisory Board resolves on the adoption of the annual financial statements and the approval of the consolidated financial statements and engages the auditors. More detailed information concerning the activities of the Supervisory Board, as well as its cooperation with the Management Board in the 2018 financial year will be provided in the Group Annual Report under the section "Report of the Supervisory Board".

The Supervisory Board has not established any committees. The issues normally delegated to committees are jointly handled by all Supervisory Board members whereby each member of the Supervisory Board reports to the Supervisory Board as a whole on those topics that were primarily allocated to his/her responsibility based on specific expertise.

The Supervisory Board as a whole handles the issues normally delegated to an Audit Committee. One member of the Supervisory Board has specialist knowledge and experience in the application of accounting principles and internal control processes and in the auditing of financial statements as required by law. The Supervisory Board reaches

agreements with the auditors. In particular, it monitors the accounting process and the effectiveness of the internal control system, of the risk management system and the internal audit system, as well as of the independent audit of the financial statements. Furthermore, it discusses the half-year report with the Management Board prior to publication. The Supervisory Board also deals with questions regarding corporate governance.

### **Objectives for the Composition of the Supervisory Board**

In accordance with Section 10 of the Articles of Association, KHD's Supervisory Board consists of three members. The Supervisory Board of KHD is to be composed in such a way as to ensure that the Management Board is properly supervised and offered competent advice by the Supervisory Board. The full Supervisory Board shall have the expertise, skills, and professional experience necessary to supervise and advise the Management Board of an internationally active Group. When candidates are proposed to the Supervisory Board, particular attention shall be paid to the personality, integrity, commitment, professionalism and independence of each candidate.

In accordance with Section 5.4.1 of the German Corporate Governance Code, the Supervisory Board has prepared a profile of skills and expertise for the entire Supervisory Board and set in its Rules of Procedure concrete objectives regarding its composition, taking into account the international activity of the Group, diversity, and potential conflicts of interest, with due regard to the Group's specific situation. The objectives and the implementation of the objectives are set out below:

- International experience and expertise

In view of the international activity of the KHD Group, at least half of the members of the Supervisory Board should possess international experience and expertise.

Every member of the Supervisory Board has extensive international experience; a short biography of each member of the Supervisory Board is available at [www.khd.com/](http://www.khd.com/).

- Independence

Pursuant to the Rules of Procedure of the Supervisory Board, at least one third of the members of the Supervisory Board shall be independent within the meaning of item 5.4.2



of the German Corporate Governance Code. Supervisory Board members should not have any business or personal relationship with the Company or its Management Board which could cause a conflict of interest. Any conflicts of interest, such as holding an executive role or providing consultancy services, to significant customers or suppliers must be disclosed to the full Supervisory Board. Not more than two former members of the Management Board shall belong to the Supervisory Board.

In the view of the Supervisory Board at least one member of the Supervisory Board, Mr. Gerhard Beinhauer, fulfills the independence criteria within the meaning of Section 5.4.2 of the German Corporate Governance Code. Also for the other members of the Supervisory Board conflicts of interest within the meaning of item 5.4.2 did not occur. There are currently no former members of the Management Board serving on the Supervisory Board.

- Diversity

The Supervisory Board strives for diversity in its composition; in particular it aims for an appropriate consideration of women. Qualified women shall be included during the initial process of selecting potential candidates for new elections or for the filling of Supervisory Board positions that have become vacant, and they shall be given appropriate consideration in nominations. Pursuant to the Rules of Procedure of the Supervisory Board, at least one third of the Supervisory Board members should be non-German. At least 30% of the Supervisory Board members shall be female.

The requirements concerning diversity in the composition of the Supervisory Board have already been fully achieved at KHD due to the international make-up of the Supervisory Board. Currently one woman, Ms. Yiqiong Zhang, is member of the Supervisory Board.

## **II. Additional Information on Corporate Governance**

### **Investor Relations**

Through its investor relations work, KHD informs investors about the development of the KHD Group in an open and comprehensive way. A fundamental aspect of the investor relations policy is that shareholders, analysts, business partners, employees, and other stakeholders are informed equally and promptly about the position of the Group and any

major changes affecting our business. KHD also make extensive use of the internet for reporting purposes. Half-year reports, annual reports, ad-hoc announcements as well as analyst presentations and press releases are published at [www.khd.com/](http://www.khd.com/). In addition, the

financial calendar for the current year, which contains important publication dates for financial reports and the date of the Annual General Meeting of shareholders, is published.

### **Transparency of Accounting and Auditing**

KHD is committed to transparent reporting and informs its shareholders in the financial year about business development as well as the financial position and results of operation. The consolidated financial statements of the KHD Group are prepared in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union, and with the supplementary standards to be applied according to Section 315a Subsection 1 of the German Commercial Code (HGB). Further explanations of the IFRS are provided in the Notes to the Consolidated Financial Statements in the Group Annual Report. The annual financial statements of KHD AG, i.e. the separate financial statements of the parent company that is relevant for appropriation of net retained profit, are prepared in accordance with the accounting standards of the German Commercial Code (HGB). Both sets of financial statements are audited by an independent firm of accountants elected by the Annual General Meeting of shareholders to conduct the external audit.

The half-year financial report for the KHD Group is prepared in accordance with applicable provisions of the German Securities Trading Act (WpHG) taking into consideration relevant IFRS, as adopted by the European Union.

### **Shareholders and Annual Shareholders' Meeting**

The Company's shareholders exercise their membership rights, in particular their voting rights, at the Shareholders' Meeting. Each share in KHD entitles its owner to one vote. The Annual General Meeting of shareholders, at which KHD also reports on business development, is usually held in the first five months of the financial year. The Company facilitates the personal exercise of the shareholders' rights and proxy voting among other things by appointing proxies who are strictly bound by the shareholders' voting

instructions. The reports, documents, and information required by law for the Annual General Meeting of shareholders, including the annual report and Group annual report, are made available online, together with the agenda of the Annual General Meeting of shareholders and any possible counter-proposals or election proposals by shareholders that are required to be disclosed.

The Annual General Meeting of shareholders decides, among other things, on the appropriation of net retained profit, granting discharge to the members of the Management Board and Supervisory Board, and the appointment of the independent auditors. Amendments to the Articles of Association and measures that change the Company's capital stock are approved at the Annual General Meeting of shareholders and are implemented by the Management Board. Shareholders may submit proposals regarding the proposals of the Management Board and Supervisory Board and may contest decisions of the Annual General Meeting of shareholders. Shareholders owning issued capital with an aggregate notional value of € 100,000 or more may also demand the appointment of special auditors to examine specific issues.

### **Management of Risks and Chances at the KHD Group**

Opportunities for sustainable growth and a sustained rise in the Company's value can only be exploited if there is the willingness to undertake calculated business risks. As a result, effective risk management, which identifies and evaluates for both risks and opportunities accordingly, is a core element of corporate governance at KHD. Further details on the risk management system at KHD will be provided in the Group management report in the section titled "Risk and Opportunities Report."