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Business in 2008 and 2009

The pump industry has had continuous strong order growth across most market segments throughout the first three quarters of the year, but FGD and conventional power plants have declined domestically due to changes in atmospheric emissions legislation. Demand internationally has been driven by continued demand for raw materials and equipment, especially from India and China as they continue to build their infrastructure and manufacturing base to export goods globally.

Most pump companies today boast substantial backlogs of work and improved profitability, so the financial turbulence would seemingly have no impact in the operations of this manufacturing segment. The pump industry, however, generally lags behind recessions and their subsequent recoveries by 12 to 18 months, so the full impact of the current economic crisis will not be felt until the first half of 2009. The uncertainty of the leading economies of the world in managing the complex problem of credit and market valuations of companies will make customers and suppliers more cautious in their pursuit of business.

2009 will be challenging for several reasons. The major economies of Asia, which have been driving the demand for commodities such as coal, oil, steel and natural gas, will reduce their projected consumption as their export markets reduce the amount of goods purchased.

Due to the reduction of available credit from banks and other lending institutions, large capital intensive projects for infrastructure will be postponed or cancelled. The subprime mortgage issue has fueled a drop in real estate values nationwide, which will lead to a subsequent drop in tax revenues for many municipalities. This in turn will mean fewer new treatment plants will be built, and the money available will be spent on maintenance and upgrades of existing facilities. The reduction in new residential and commercial construction will also negatively impact pump suppliers for building services.

Customers will examine their suppliers for financial strength. As credit becomes difficult to obtain, companies will have to depend on their own liquidity for cash flow. Those companies that cannot demonstrate their financial strength will be considered at greater risk of not completing orders for goods they have been contracted to produce. As the overall business level declines in 2009, customers will benefit from improved deliveries and better pricing as the pump suppliers vie for the business that is available.

Unfortunately, the downturn in the market is part of a

normal business cycle, and this particular downturn is the worst since World War II. Companies that have pursued growth at all costs will be particularly vulnerable over the next two to three years if their business models were based on continuous growth in the market. Since the pump industry lags behind the general economy by up to 18 months, real growth is not expected until at least 2010. KSB has always taken a fiscally conservative approach to expansion and has focused its resources on product development in established markets, continuous improvement in customer support and employee development. The current business climate does not alter that strategy.

Trends

Much has been written in recent years regarding the continuous improvement in pump technology and the associated applications. While most of the articles center around improved efficiencies, better materials and automation, there are whole new areas of development that were considered impossible only ten years ago.

One area of development is Microprocess technology, in which entire chemical plants for commercial use can be scaled down to fit within a single room. The associated equipment (reactor vessels, pumps, heat exchangers, piping) is measured in micrometers and milliliters. The advantages of this developing technology are apparent when considering the space required, first cost, time to design and build a plant, initial investment, and reduced waste. Certain industries have already started to incorporate this technology into the products they produce and the use of this technology is expected to grow exponentially during the next decade.

Additional Thoughts

The current downward trend in the economy will challenge manufacturers and users alike, but those companies that have focused on building relations with their customers and suppliers will become more prominent as the number of projects decrease. Investing in their representatives and employees will ensure they have the human capital necessary to continue to grow and prosper in the challenging times ahead.