

SCANIA'S 2009 ANNUAL GENERAL MEETING

Address by Leif Östling, President and CEO

Ladies and gentlemen, honoured shareholders,

I would like to say a few words about our operations during 2008 and look briefly at where we are today. It is a pleasure to see so many new faces here, as well as to see many of you who are familiar from previous AGM's and so many current or past Scania employees.

Scania's core values do not include *shareholder value*. Instead they focus on the **customer** – who always comes first – **respect for the individual** – the people who work at the company – and the **product** – the quality and performance of our products and services. In the long term, these are the three factors that are absolutely crucial to Scania's further development. They are the three factors that, in smooth collaboration with each other, generate what is called shareholder value – a much misunderstood term. Many people believe that you begin with shareholder value and then seek something else. But the customer, respect for the individual and product quality are where it all starts. If we don't get these three things right, there will be no shareholder value either.

This is what we are fighting for, and it is what our Chairman, Martin Winterkorn, just said: We are building a long-term Scania around these three core values, in order to create a company that is of long-term value to you as shareholders.

Our products are very well known. You see them often out on the roads. When you want to overtake them, sometime you are not thrilled that they are so frightfully long. But they fulfil an important function. They help hold together our societies.

Without transport services there can be no growth, and the higher the living standard of a society, the more transport services it needs. This is why, in a way, we have a very secure market ahead of us. People all over the world want a higher living standard. That means increased consumption of various products, which must be transported. People themselves must also be transported. That is where our trucks and buses, but also our industrial and marine engines, come into the picture.

Even in tough times like these, we are producing product innovations. For many years, we have worked with ethanol-powered buses, but we have now also developed ethanol-powered trucks for urban distribution services. Despite the hard times, we are continuing to invest in new products. We have launched new engines to meet the even stricter emission level standards that take effect starting this year, and we are in the starting blocks for the next set of emission rules, which will take effect in 2013.

Two thousand eight was the strongest year in the company's history. Unprecedented growth during 2007 continued into 2008, until about the end of September. That's when things started falling apart. The financial market found itself in very big trouble because of bankruptcies in the US banking sector. When Lehman Brothers went bankrupt in September, the banking market stopped functioning all over the world, and that affected us directly.

The fourth quarter of 2008 was bad. If we had instead had a good fourth quarter, the year would have been even better. But in spite of this, 2008 was the best year ever in Scania's history, with very good net income and a very good return on shareholders' funds – as shareholders, you provide the equity in the company – and on all the capital that we

employ. I believe that few engineering companies can show such good profitability.

During the first quarter of 2009, the effects of what we had experienced late in 2008 continued, and there was much lower demand. In principle, the market disappeared completely for a couple of months in November and December last year. Big order books simply melted away, just like a spring snow. We entered a period of very sharp adjustments of our organisation, so that we could continue to run the company profitably. We succeeded, just barely. As I mentioned, business has been poor during the first quarter, but we are still proud – when we compare ourselves to our colleagues and competitors in the heavy vehicle industry, and also with other companies in the engineering industry – that we have achieved an operating margin of just above 3 percent.

What exactly has happened? When the financial crisis struck, quite a lot of goods haulage ceased. Consumption fell drastically. This was especially true of electronic products, such as various kinds of home electronics, and passenger cars. Construction activity fell sharply, because financing completely ceased. Some of the newer European Union member countries such as Poland, the Czech Republic, Slovakia and the Baltic countries ran into major problems, as did Russia, where things almost came to a halt.

We can see this in the demand for transport services. Trade activity can be measured in the flows of goods, that is, the quantity of container shipments arriving via Rotterdam in the Netherlands, but also via Antwerp, Belgium – where the downturn is more than 50 percent. It is quite clear that countries outside Europe, including India and China, have also been hard hit by lower demand.

Highway tolls in Germany are a good measure of heavy vehicle movements on the Autobahn network. During January-February this year, volume has dropped by 19 percent, and probably even more, since certain toll increases are apparently part of the picture.

The overall outcome of this is that during the first quarter, Scania's total truck deliveries in western Europe fell by 45 percent, and in central and eastern Europe by 77 percent. Latin America held up relatively well. It was mainly Brazil, but to some extent Argentina, that helped. But many of our Asian markets have also been severely affected.

Looking at buses and coaches, however, we see a somewhat different trend. Scania is a rather large market player here. We are one of the biggest makes in the world when it comes to heavy buses and coaches. We have experienced a slight downturn, but people must still continue travelling, and municipal authorities must keep their bus fleets in shape. As a result, such purchases have continued at a relatively high level in various parts of the world. Meanwhile the market for tourist coaches – which is about one third of the total – has shrunk rather dramatically. We expect that market to continue shrinking during the rest of this year.

Where does Scania stand today? In September 2008, we had about 15,000 employees in our sales and service organisation – in offices, workshops and parts warehouses. The sales and service organisation represents the largest single group of our employees, since we own a large proportion of this organisation.

In our production organisation the number of employees is smaller; in 2008 they numbered about 12,000. In development, administration and financial services in our markets in the form of finance companies, we have about 8,700 employees. Almost one third of them are involved with development work.

The different branches of company operations have been affected in different ways by the economic downturn. If we compare the level of activity in the first quarter of 2008 to the first quarter of 2009, in the service network particularly the downturn was no more than about 10 percent. In production, things look totally different. Invoiced sales fell 41 percent, but we sold off a lot of our inventories – surplus inventories that had built up during the fourth quarter of 2008. As a result of the 70 percent decrease in order bookings during the first quarter, workload at our production units fell dramatically compared to the same period of last year. That is an incredibly big decline. I have been at this company for a long time, and I have never seen such a big decline in such a short period.

In light of this, I think our production organisation has performed very well by managing to adjust as quickly as it has to this drastic change.

Some 2,100 people in our global organisation have left our production units – in Sweden, the Netherlands, Brazil, France, Poland and Russia – and these were mainly people who were on temporary contracts and who have served as a buffer to absorb these shocks. It is naturally sad that so many people who were so eager to work at our company, and who are enthusiastic about our technology and our products, can no longer earn their living by working for us.

In administrative and development departments, we have cut back the level of activity by about 10 percent. In particular, a number of consultants in both development and IS/IT have left the company. This was done in a short time and has naturally also created a lot of tensions in the company. At the same time, however, I think we have had outstandingly smooth cooperation with employee and union representatives during this difficult period.

But more challenges lie ahead, and we have to respond. In Sweden we need to take further action. Out of a total of 34,000 employees, we have 12,000 in Sweden in all categories. We have made proposals that we are now discussing with union representatives. There has been some discussion about this in the press, as there always is. Our proposal is based on postponing the wage and salary increase that is already part of the three-year collective agreement between employer and employees – in its third year in 2009, and the increase is about 4 percent – for one year. In addition, we are proposing roughly a 10 percent cut in labour costs and the introduction of a four-day week for all employees including the management for a certain period until the situation begins to clarify. We hope to have a better view of how things are going by early next year. If we don't have that view after the six-month period that we have proposed, we will try to discuss an extension of a further six months.

This is what we think is needed. We want to avoid lay-off notices, because we want to protect the collective competence of our company.

Our proposal would result in significant savings. About 70 percent of these savings are on the white collar side, and 30 percent on the skilled worker side.

We work in an industry characterised by cyclical demand, and we have seen downturns before. They usually come about once per decade. I usually say that we have seven fat years and three lean years. According to another book, it should be seven lean years; in any case, it's better with three lean years than seven.

We have previously seen downturns of 30-35 percent. This time around, so far we have

actually seen a downturn of a full 40 percent, and we are not entirely sure that we have reached the bottom. Our Chairman was saying that perhaps we are in a tunnel, but I don't see any light at the end just yet. It may be a long tunnel. But we know far too little today. There is great uncertainty.

Naturally we at Scania will be successful in our struggle to make it through this difficult downturn. We have always managed to do so before. I am completely convinced that through a concerted effort at our company, involving all categories of employees, we can make it through this period in a positive way – even strengthening our competitiveness in the marketplace.

The restructuring steps that we have taken over the years have given us a flexible cost structure. As a result, our own added value in production today is no more than 30 percent, with 70 percent provided by suppliers. I want to mention here that our suppliers are having just as hard a time as we are. They are small and medium-sized companies and are struggling for survival, and we must help them survive in a number of cases. But we can also handle that, and it gives us many new experiences. It isn't so often that a company like ours ends up in this kind of situation.

We have focused on efficiency in our production network. Since 1990 we have had roughly the same number of production employees, 12,000. By focusing on quality, by continuously streamlining and improving our working methods, with the help of a favourable volume trend during that period, but also thanks to a number of structural changes that we have implemented – closing a number of production units and selling off parts of them to other stakeholders, thereby lowering our added value – we have managed to increase our output per production employee from about three vehicles per year to nearly seven in 2008. Our target is to achieve 15 vehicles per employee by 2015, and we are completely convinced that we will be able to do this. But we need to have the market with us. We believe that this will happen, sooner or later. We hope it will happen sooner, but I am not sure – perhaps it will be a little later than we wish.

Out in our sales and service organisation, we have a major efficiency-raising programme under way, which has borrowed all its ideas from the Scania Production System (SPS). It covers all 14,900 employees. Here, too, significant efficiency improvements are possible. Greater efficiency always results in better product quality. Efficiency and quality go together. High quality automatically means higher efficiency. In the sales and service organisation we are also concentrating a number of support functions, so that we can take advantage of the economies of scale that exist in this structure.

Our sales network is global – with one exception, North America. Over the years I have been asked many times why we are not there. I reply every time, with the same gusto, that it's great not to be there. There is so much to do in other parts of the world, in the Near and Far East, in Africa, in South America. Our company can expand in those markets, without entering the extremely difficult and highly competitive North American market.

We are continuing our efforts to refine our engines and make them more energy-efficient, regardless of what fuel they use. We see it as our task to supply customers with good engines – engines that run on ethanol, gas or synthetic diesel. As we say, anything in gaseous or fluid form that is combustible should be possible to burn in our diesel engines, generate a high output and do it in an efficient way.

We are also continuing to work with environmental standards, and we have interesting

developments in the pipeline. Not even in these hard times have we been stingy with these efforts. Instead we have persisted with our development work. The same is true of vehicles with hybrid drive. We will soon be putting a number of new buses in operation for Stockholm Transport, and they will be ethanol hybrid buses.

Since the first oil crisis in the 1970s, we have been measuring the environmental impact of our production. The number of megawatt hours per vehicle consumed by our production network has fallen from around 40 to 8. That is good progress, but there is a lot left to do. When you look at our long period of improvements, all you can say is that it will never end. The energy efficiency of our production network can always be improved, and it is our task to make it better and better every year.

As for alternative fuels – ethanol, synthetic diesel, biodiesel, biogas – today we have engines for all of these. They reduce net carbon dioxide emissions by between 70 and 100 percent. We have part of the responsibility for this. Those who produce these alternative fuels bear a large part, usually most, of the responsibility for reducing carbon dioxide emissions, compared to what we can contribute in our engines.

It will be possible for Scania to halve carbon dioxide emissions during the period 2000 to 2020, but this will require a number of stakeholders – our customers, road traffic authorities, logistics operators – to act in such a way that logistics systems become even more efficient that cargo capacity to be utilised better, and perhaps even by means of slightly longer vehicles. We know that the driver and driver training are of the highest importance in being able to keep carbon dioxide emissions down. In addition to that comes the further vehicle improvements we are making and the supply of the various kinds of non-fossil fuel that can be used to run our vehicles.

All these things that we are doing at Scania, as well as the continuous improvements that we have achieved, begin with people. They begin with the leadership of our organisation. The leadership model we use, which we call the Scania Production System, is actually a leadership model that we first learned from Toyota in Japan. During the first four or five years, we understood almost nothing about it, but we understood that there was something there that was very important, that was crucial to the long-term profitability of our company. By now we understand it better, and we can summarise this leadership model with the following five principles:

- Co-ordinate but work independently – take responsibility
- Work with details and understand the context
- Act now – but think long term
- Build know-how through continuous learning
- Stimulate commitment through involvement

As President and CEO of the company, I would like to express my sincere thanks to all our employees – and I know that some of you who are here at the AGM are, or have been, employees of the company – for their extremely fine performance during 2008, which was a red-hot year up until September, but then changed abruptly into a gloomy night. It was quite a ride.

With that, I will conclude my look back at Scania during the past year, so that the AGM can continue according to the agenda.