Address by Leif Östling, President and CEO at Scania's 2010 Annual General Meeting in Södertälje, Sweden, 6 May 2010

Dear shareholders,

I would like to tell you a little about Scania's performance during 2009, the most difficult year I have seen during nearly four decades at this company.

Thanks to Scania's core values of always focusing on the customer and respecting all the people who work at the company and use our products, we were able to make it through this difficult year with a continued focus on quality − quality in our products and in the services we provide in the various markets where our trucks, buses and engines operate.

We have a very large number of products, with many different applications, and within these applications are many specific operating requirements. Our products are transport equipment that our customers have at their disposal in order to make a living. They use these products to provide transport services to their own customers.

What we experienced during late 2008 and during practically all of 2009 was that transport activities declined sharply in Europe. On the German railway network, about 25 percent of goods haulage disappeared. Highway tolls in Germany, which are a good indicator of transport flows, fell by about 14-15 percent. We also saw this in our Scania Assistance operations, where we help customers out in the markets to get their vehicles up and back on the roads as quickly as possible if anything should happen. These operations decreased by 9-10 percent.

The declines were very dramatic, and naturally they affected our earnings in 2009. We began the year with excess inventories. As the introductory video mentioned, we had far too many products in stock. Customers were simply unable to take delivery of what they had ordered from us. They had no money. All their money disappeared during one quarter. Our money disappeared too, so we too had major problems financing the company. As a result, our production rate during the first half of 2009 was about 30 percent of what we had during the same period of 2008. Our company was greatly affected.

We had to take a number of steps so we could move back towards profit during the year. We were really close to losing money during one quarter, but during the second half, things slowly got better and better. We managed to end up with positive net income for the year. We were certainly one of the few companies in the transport equipment business to succeed in showing a profit during 2009. Cash flow was good. The reason is that in 2008, we invested a lot in building products that did not come out into the market. These vehicles were left in stock, and they came out into the market in 2009. In other words, we earned money during 2009 on our outlays during 2008 to build these vehicles.

During the first quarter of 2010, we saw an improvement. We knew even before we started the quarter that there would be an improvement. We saw a market upturn during the third and fourth quarters of 2009. Markets stabilised in Europe, and there was a rather sharp recovery outside of Europe. We ended up with an operating margin of nearly 13 percent. Quite a lot of the cost reductions we made in 2009 gradually worked their way through to our earnings and had a full impact in the first quarter of 2010, as we can now see. Consequently, the company began to feel a little better. We were also able to gradually phase out our four-day week, since we need full capacity in order to deliver the vehicles now in demand. So things have become a little better, but the situation is very mixed.

Demand for trucks plunged very sharply early in 2009. In this slide, you see Scania's order bookings in 2008 and early 2009. In South America, there was a free fall. For a few months, we essentially had negative order bookings. Bookings ended up at zero on a quarterly basis. We were very concerned in February and March 2009 and said we would significantly cut back the South American organisation.

But during the second quarter, after strong stimulus measures had been announced by the Chinese government, China began to demand much more iron ore and more agricultural products. As you know, South America is a large producer of ores and agricultural products. We saw how the mining industry sprang into action in Brazil, Chile and Peru. Money began coming in, and our market started taking off.

The Brazilian government unveiled strong incentive programmes for capital spending on durable investment products − among them trucks, but also cars. During the second half of 2009, we thus found ourselves in a completely different situation, with much larger demand in South America. Demand was so strong that we would not have thought it was possible. We have had to put a huge effort into being able to produce enough heavy vehicles to keep pace with South American demand.

This slide indicates how the situation looked in Europe. The figures also encompass eastern Europe, including Russia and Ukraine. From very high levels in 2007 and early 2008, there was a complete free fall during the fourth quarter of 2008, followed by a very arduous recovery during 2009.

Clearly, the recovery in Europe has been very slow. We are still at levels equivalent to the late 1990s. It will probably take some years before we reach the levels we had in 2006 and 2007. This is connected to the heavy indebtedness of many governments in Europe.

Right now we are seeing problems in Greece. There is a risk that these problems will spread to other countries in the Mediterranean area, and they will probably also affect the euro. This means that uncertainty about developments in Europe will continue for another while, until political leaders manage to make the decisions they must make to deal with debts and runaway budget deficits. It has been considerably easier to be a corporate executive and make decisions than to be a political leader and make decisions. The decision making process moves much faster in the corporate world.

In Asia − by which we mean the Middle East, India, Indochina, Thailand, Malaysia, Indonesia, China and Korea, among other countries − demand also fell sharply early in 2009 but returned during the second half. Perhaps the increase was not as dramatic as in South America, but demand still returned in a relatively big way. This also helped keep our factories going, as well as our service market, during the second half. As the slide indicates, the trend in Asia remains favourable.

What is a bit remarkable is that today we are selling more vehicles outside Europe than in Europe. We are more dependent on exports to countries outside Europe than on exports to European countries. This has never happened before in the history of our company.

Let me turn to the demand for buses and coaches, where we have long lead times. Here, too, especially when it comes to city buses in Europe, demand fell sharply in late 2008 and early 2009, but it has gradually returned. We have good prospects of ending up at a relatively good level during 2010.

Looking at service revenue, as you know, Scania has been carrying out forward integration towards customers. We don't sell only vehicles. Customers also need a lot of service hours and parts for their vehicles. These operations are very stable over time. A great majority of vehicles are needed even in tough times. We saw a fairly small volume decline in 2009, about 10 percent, including both parts and service hours. In other words, we were able to continue earning money on these operations, which helped boost our earnings.

The service organisation that we own ourselves covers about 50 percent of the market. Scania's own sales and service organisation employs about 15,000 people. That is about as many as those employed in the production portion of Scania today.

In this slide, you can see the impact of lower demand. The service organisation had a downturn of about 10 percent. In the production network, the downturn averaged 55 percent. This is an exceptionally large downturn in the utilisation of our invested capital − machinery, equipment and buildings. Then we had a downturn in other administrative operations of between zero and 10 percent. The decrease was zero in research and development, since we have to continue our programmes there and develop new products even during tough times. Perhaps we even need more development during tough times, in order to ensure our revenue further ahead.

We have reduced the number of employees. We had a very good working relationship with union representatives during this difficult year. Unfortunately a number of people left our organisation. Granted that many of them were on temporary contracts, but it is still very sad that people have to leave behind their company, livelihood and income and enter the uncertainty of unemployment. But we had no other choice.

In this slide you can see what is left after the reductions. We have nearly 15,000 employees in the sales and service organisation, fewer than 10,000 employees in our production organisation and some 8,000 employees in research, development, financial services and so on around the world.

We introduced a four-day working week. In other words, employee cutbacks were not enough. There was still sizeable overcapacity. In Sweden, this meant 10 percent lower salary expenses, plus postponement of holiday pay and so on, but we introduced a short working week in a number of other European countries as well. Altogether, these measures directly and indirectly saved us around a half billion Swedish kronor.

I must say that all the employees at Scania have been enormously supportive during the difficult year 2009. We have resolved all the tough issues, admittedly with different opinions but still with a good mutual understanding in the end. This is another sign of quality for a company like Scania.

We have invested in new products. Last year we launched a new R-series truck range and a support system that gives drivers information about how they can operate their vehicles with the best possible fuel economy. The savings from using this system can be up to 10 percent of fuel consumption. This may not sound like much, but a vehicle normally consumes perhaps 60,000-70,000 litres of diesel per year. So 10 percent means 6,000-7,000 litres. That is about how much heating oil a modern single-family home in Sweden needs during an entire year. In other words, it represents sizeable savings. The new R-series was named International Truck of the Year, an honour bestowed by a jury of European commercial vehicle journalists.

We launched a partnership with a Chinese company called Higer, which makes bus and coach bodies. We build what is underneath – the engines, gearboxes and so on – but Higer has also received our instructions on how to build a quality body. We have begun to produce a new coach. We have been very restrictive and observant about quality in China. Above all, we have made sure the Chinese understand what we mean by quality. Previously, they did not always mean the same thing as we did, but they have gradually begun to understand us, and we are rapidly moving closer to the goal we had established. We are making an attractive product that is coming out in the market at a very competitive price but with high quality.

Turning to engines: We have developed Euro 5 engines and have also largely developed engines that meet Euro 6 emission regulations, which go into effect in 2014. There will also be equivalent regulations for tractors, rear-loaders and other products found in a construction environment. We have an agreement with Terex, the world's third largest manufacturer of construction machinery after Caterpillar and Komatsu to supply them with engines. We are in discussions with a number of other original equipment manufacturers. This is an important step into the OEM market. Our industrial and marine engine business area has done an outstanding job in entering this market. Our engineers have also done a very good job. These equipment manufacturers say we are better at fuel injection and built-in engines and have a much better concept than Caterpillar or Cummins in the US, a company we also work with. This is encouraging.

A few weeks ago, we unveiled a new V8 engine range. This is the last step in reconfiguring our engines to increase their combustion pressure to 200-210 bar. We have to do this to meet emission regulations, especially Euro 6. We have carried out quite a lot of renovation of our engine range with our inline 5- and 6-cylinder engines, and the last step was our V8 engines.

All Scania engines are based on a 2-litre unit cylinder, whose introduction proved to be a very good decision. We made this decision some years ago so we could optimise our engines, based on the emission regulations that have taken effect and that will take effect, and which will be increasingly demanding in terms of development of new technology.

Our new V8 is the world's most powerful truck. It has 730 horsepower and a torque of 3,500 newton-metres, which is equivalent to an incredible number of car engines.

We are an industry with cyclical demand. We have seen downturns like this one before: in the early 80s, in the early 90s and around 2000. These were downturns of around 35 percent, in 2000 a bit less. This time around, in 2009, we had a downturn of 40 percent. This is not only the largest percentage downturn we have experienced, but also the fastest downturn we have experienced. We normally have a downturn that lasts two or three years, and then it is considerably easier to adjust the organisation than if everything happens all at once. The latest downturn in demand occurred at a brutal pace.

What has enabled us to cope with this, aside from unbelievably fine support from all our employees and the four-day week I have mentioned, is that we have streamlined our production structure in recent years. We were criticised a little here in Sweden because we closed production units in places including Katrineholm, Sibbhult and Falun and concentrated more of our production in Södertälje, while engaging more sub-contractors. As a consequence, our added value has fallen by about 50 percent and now stands at about 30 percent. We see opportunities, in partnership with sub-contractors, to bring down our added value further. This means that we have better flexibility and better risk-spreading, both when our production goes up and when it goes down.

For many years we have worked with a production model that we borrowed from Toyota and refer to as the Scania Production System. In 1993 Bengt Palmér and I were in Kentucky and looked at how Toyota did it there. We have applied a lot of the principles from there. This Toyota model, together with our structural changes and producing less and less ourselves has resulted in shorter lead times at our production units. We eliminated time waste, which contributed to the process. We went from about three vehicles a year to a little over seven per production employee. Given the low production we had in 2009, we are admittedly down to four vehicles per employee, but when volume returns we can increase our output per employee. We should be able to achieve up to ten vehicles per employee without hiring more people at our production units. It will naturally lead to fine leverage in our income statement. This is already starting to happen now. The financial market was a bit surprised when they saw our operating margin of nearly 13 percent in the first quarter of 2010.

We earn a lot of money on our sales and service network. There are about 500,000 Scania vehicles in operation around the world. We know that the number will grow when the market bounces back. Some years from now, we should be up to about a million vehicles. That is a very good number. Today we have about 50 percent of this market in our own hands, and we earn good money on the parts and service sales needed to keep vehicles running. We are unique in our industry in having gone so far in forward integration towards the customer.

Everything we do presupposes motivated employees. It is a continuously ongoing job. Everyone who is employed and works with us feels they are needed at the company and that their capacity, both mental and physical, is well utilised. We work with a number of leadership principles, which have been stable for 15 years. They deal with getting everyone to participate and to feel that they are needed, that they have freedom, getting them to take responsibility, to work with details, to see the overall context and to practise leadership that always focuses on training all employees to a higher level of knowledge. That is what drives productivity growth and the quality of our products forward.

We are also seeing results over a longer time period. In Sweden, healthy attendance − that is, the opposite of absence due to illness − has climbed to 97 percent. I don’t know how much further we can go. Our occupational health physicians say people will catch colds every once in a while and then they should not go to work. So even if we aim at achieving 100 percent, we won’t get there. But 97 percent is very good compared to other Swedish companies.

Accidents have declined, which has to do with leadership and with continuously training the people who work at our production units. The most encouraging thing is that severe accidents and repetitive strain injuries are completely gone today. What we are seeing now is minor injuries and scrapes. Our ambition here is to reach zero accident. We want zero tolerance. Here we still have work to do, but the situation is slowly improving.

Turning to energy efficiency: I have mentioned our Driver Support System. Drivers are just as important as engine development and improvements in vehicle aerodynamics. The difference in fuel consumption between a good and a bad driver can be nearly 15 percent. For professional drivers, who perhaps use 100,000 litres of diesel per year, this means 15,000 litres of diesel. An incredible amount of carbon dioxide emissions can be avoided by providing good training so that drivers use calm, sensible and proper techniques.

We have been working with technical solutions. In principle, we are ready for the Euro 6 emission standards. We have the technology in place. Now we will be testing it in regular operation, so that we know that it really works. The standard for Euro 6 engines is that they must operate for 700,000 kilometres and still meet the emission requirements stipulated by the authorities. This will be checked during annual vehicle tests. It is a challenge.

We are working with hybrids, including buses and coaches, in order to bring down fuel consumption. We have developed engines for all types of fuels − diesel, biodiesel, ethanol and gas. Some time in the future, the next generation of engines will emerge. They will be capable of running on any fuel at all, and the engine will detect what fuel it is running on and readjust the algorithms required to achieve the right mix of fuel and air.

Energy-efficient passenger transport: There are two aspects. The first is to begin working with hybrids and harness braking energy in buses and coaches. The other is simply to persuade a lot more people to take the bus instead of driving. This is because the carbon dioxide load per passenger kilometre in a bus in rush hour traffic is about 6-7 percent of what it would be if he or she drove a car to work instead. To meet the carbon dioxide emission commitments that public authorities and political leaders have established, we must create much better public transport systems. Otherwise these commitments will not be met, in our view.

When we look at environment responsibility in our production network, we can follow a long time-line from the energy crisis of the mid-1970s and see how the number of megawatt hours per Scania vehicle produced has decreased. It has fallen throughout this period, except during 2008 and 2009, which was related to the small number of vehicles we produced during 2009, only 45 percent of what we produced during 2008. We are working to bring down the number of megawatt hours. We are also working in exactly the same way with our suppliers to monitor their energy consumption per unit produced.

We are thus well prepared for an upturn. We have good products and very highly motivated employees in the workshops and offices of the Scania organisation around the world. Now we only need to get out and service, repair and maintain vehicles to the best of our ability, thereby generating good business in our organisation so that we can produce good earnings for our shareholders.

Let us look at the performance of a Scania share – I would like to return to what our Chairman, Martin Winterkorn, said – from 2002 onward. As you know, the stock market fell sharply after 11 September 2001. We see in this slide how a Scania share has performed in relation to the stock exchange index in Stockholm. Both in terms of total return and the price performance of a Series B share, we see very good growth.

We have had the privilege of working with Volkswagen as a major shareholder in Scania since 2000, and it is very important to a company like Scania to have stable, long-term owners − long-term in an industrial sense. The projects and the development work we have in this company are very long-term, both when it comes to developing new products and when it comes to opening new markets. I think that the trend of Scania shares during this period has been very good. It also shows that Scania has very good owners, who work for the benefit of all shareholders when it comes to developing the company.

Then there have been some discussions in the press. On behalf of the Executive Board, I would like to say that the work of Scania’s Board of Directors and Executive Board is based on the Swedish Companies Act and the other rules that apply in Sweden. There is total agreement on the Executive Board and with all of the Board’s representatives. These rules govern the flow of information and also govern mutual projects of various kinds that we may have with Volkswagen. Now MAN is also entering the picture. There is one purpose: making Scania even better and further enhancing the value of Scania shares for all shareholders. There is no other purpose.

This presupposes “arm’s length” cooperation, but cooperation of a very positive nature. So far it has worked very well, and I have every reason to believe that it will also continue to work well and lead to fine future growth in the value of Scania shares.

Finally, I would like to express my sincere gratitude. We as shareholders should say thank you − I too am a fairly large private shareholder in the company − for the fantastic performance of all Scania employees during a very difficult year. For me, it has been a true pleasure to see how closely we have worked together, what great confidence we have had in each other and how incredibly well our employees have performed. That is the best reward the President and CEO of a company can receive. My sincere thanks to all our employees!

Thank you for your attention.