Annual General Meeting of Atlas Copco AB

Address given by Gunnar Brock, President and CEO of Atlas Copco on April 24, 2008

Ladies and gentlemen. Let me first welcome you all to our Annual General Meeting. One year has passed since many of us last met here in the lovely Magna Aula – a year that has been quite prosperous for the company. I hope you will feel the same.

The Annual General Meeting is a bit like graduation day for management. We stand here accountable for the decisions we've made, what we have done and perhaps explain why we have not done what we should have.

I highly recommend our Annual Report, our Sustainability Report and the Report on Corporate Governance. While these may not rank among the most popular literature, everything worth knowing about the company and what we have done is detailed in these three reports. Although I am unable to take you through even a fraction of everything that is in the reports, I do intend to present the company's business activities for 2007.

I'll be presenting some figures, not just in terms of financial results but also in terms of our environmental and social commitments. We will also look at our three business areas and developments here. Perhaps the most important issue for us all is what opportunities exist for growth. These opportunities determine the level of our success, and ultimately how successful others feel that we are. Since we are a Swedish company I will also talk about significant events in Sweden during 2007 and finally, finish with two slides about the results for the first quarter 2008.

Today, we have three business areas, all of which have secured very robust global positions: Compressor Technique, Construction & Mining Technique, and Industrial Technique. All three have excellent global presence and in almost all instances rank larger or much larger than their competitors. This is a good starting point.

We are a product-oriented company. The products we design and develop are our core. However, it is increasingly evident that application expertise—which is insight into how companies use our products—is instrumental to our success. This is reflected in the fact that we are building more know-how into our products, like software and control systems, and are subsequently optimizing our products.

However, none of this would be possible without a strong team of service engineers and aftermarket staff to ensure that the installations do in fact function. But I'll get back to this in just a bit.

It is vital that we constantly design and develop new products. In fact, it is the only way we can maintain our high margins. Should we loose this ability, our competitors will soon be at our heels and we will find ourselves competing for the prize. We usually measure this ability in the sale of products that are less than three years old—this is an indicator of how quickly we can manage product development. As you can see, the portion of new products is steadily rising.

We more than doubled our sales figure between 2003 and 2007. Luckily, we managed to almost triple our profits. Moving on, we also see extremely strong growth on the aftermarket which, as I mentioned, is an important part of our operations. It is the most profitable part of our business and in many ways plays an instrumental part in whether our customers are satisfied with us or not. Delivering a product that doesn’t work falls under human error. But our customers are not equally forgiving if we are not immediately onsite to repair the product.

Another way of studying growth over the period is to measure both what we call organic growth—which is what happens in terms of volume and price trends—and that which comes from acquired companies. Our long-term objective is that organic growth will answer for about two-thirds of our growth, and about one-third should stem from acquisitions. This has been the case the past five years and I believe this will continue. Organic growth is normally less risky and considerably more profitable.

I mentioned in the beginning that we would talk about our environmental and social commitments. Environmental issues have figured on the agenda more often than ever before. For us, it is not merely a question of satisfying demands made by our stakeholders – you and others. It is also a question of trying to identify business opportunities within this field. 90% of all our production units have certified environment management systems that conform to truly strict standards. The 9% that lack certification are generally acquired businesses that had previous owners who did not devote as much energy to these matters.

Energy consumption is another way of looking at what is happening in the company. Energy consumption per production unit is dropping while the company’s total energy consumption is rising since the organization is almost twice as large.

Sadly, I cannot claim that our carbon dioxide emission levels have dropped. This is one area where we have not progressed as far as we would like. The reason for the upswing is transportation—both to us and from us to our customers. Our capacity utilization has been extremely high the past 18 months. Customers have wanted products delivered before we had the capacity to deliver which in many cases forced us to use airfreight. This is not an environment-friendly alternative but it has been necessary. I hope that we will see a downswing in this trend next year. Water consumption and waste are two other important areas that we measure and we see a downturn in both respects.
Our approach to production that largely entails buying products and assembling them is a relatively gentle alternative. I want to make it emphatically clear that we are not environmental bad guys. On the other hand, this does not mean that we will in any way cut back on our efforts to improve our image.

We are unfortunately not as progressive in the social sphere in terms of establishing a good balance between men and women in the organization. At present, only about 16% of our employees are women and only 12% of our executives are women. Although these figures are neither better nor worse than for similar companies, this is not good enough. Happily, I can report that one third of all newly recruited employees with academic degrees are women. This gives us a sound foundation on which to build since this means that there will eventually be a greater proportion of women who can aspire to executive positions.

Health and safety are issues we discuss frequently. Our company's sick leave figures are very low. Obviously, we are very proud of this and note that we stand up even in international comparisons.

We can divide our social commitment into three parts. Our employees have a voluntary organization called *Vatten åt alla* (*Water for all*) that the company supports. The organization carries out extensive initiatives to drill for water and provide rural residents with clean water in regions such as Asia, Africa and Latin America. We have large-scale programs in southern Africa, including countries like South Africa and Zambia, to help our employees in the battle against aids. We are recognized as a good example in this respect, something we can be proud over. It is a question of training and supporting young people and children and we also back training programs through an orphanage in India and through our dedication in SOS Children's Villages.

To wind up this rhapsody on our environmental and social commitments, we note that we are included on most of the sustainability lists, or lists of companies that have sustainable environment management plans. This means that we are among the 100 most sustainable companies in the world. We are on FTSE4Good and the Dow Jones' sustainability index. Investors and funds with ethical, environmental and social requirements are constantly intensifying their demands.

Let us now turn to a matter close to all our hearts, namely the share price trend. If we look at an annual yield, which means the past years' price trend, dividends and redemption programs, we have had a yearly yield of 37%, while the Stockholm Stock Exchange has maintained a 23% yield.

Let's jump to our business areas. As I said, we have three business areas. Answering for about 50% of our business, Compressor is the largest. It is a world leader and more than twice the size of its closest competitor. We are the only truly global compressor company with margins and a product development capacity that is unmatched in the industry.

What precisely do you use a compressor for? It can be used as a source of power for a pneumatic hammer. Because that's what we all see in our mind's when we think Atlas Copco—that yellow piece of equipment standing on the street corner. You can also make snow. Sewage treatment plants and water purification are other applications. Clean water is needed for instance in a salmon farm. Fish farming requires compressed air with low pressure for major water flows. We can be found in quarries or on oil platforms. All polyester bottles that we buy filled with bottled water are made by machines that oftentimes use our compressors to increase air pressure. Compressors are also used for electronics manufacturing—plasma screens and micro chips. Steelworks, cement and textile industries are other application areas. Some applications become redundant when other technologies take over—but we find new areas.

Sales more or less doubled in 2007, and margins climbed from about 17% to about 21%.

Two awards will be presented today. One is to representatives for the Compressor division and I want to demonstrate what it is we are rewarding them for. It is a method and a system developed to measure our customers’ air consumption and energy consumption. By constantly measuring these factors we can promise energy and cost savings. Compressors do unfortunately use a lot of power. It is in our interest and that of our customers to be able to identify leakage and use software to control how the compressor works when different revolutions are used. This team has developed a methodical system to measure this, which benefits the customers by enabling tem to cut their energy consumption levels. Let’s watch the movie.

film clip

So, moving on to our next largest business area—Constructing and Mining Technique. We have a very strong global position even here. Perhaps not as strong as Compressor Technique in all markets since we do have a strong competitor in Sweden, but our position is sound in most markets, and in some cases even a few steps ahead.

We have a balanced production and delivery situation since we have production plants on basically all continents which, in these times of fluctuating currencies is not something to take lightly. The business area is called Construction and Mining Technique and supplies products that are used for demolishing and pulverizing buildings, for instance. This is work that must be done quietly in urban conditions, minus the noise and commotion. We see new tunnels being built. Everyone driving into Stockholm can see loads of yellow drilling rigs lining Norra Länken and Norrtull. These yellow rigs make our hearts beat a bit faster when we drive past. I hope yours do, too. On the left we can see the Dynapac equipment. We acquired this road and infrastructure-oriented company just over six months ago. The company has asphalt pavers, rollers and other similar equipment. We also have new, small automatic remote-controlled rock drills.

The other segment, which reports impressive growth, is mining applications, which includes drilling equipment for mines, underground and above ground equipment, loaders that remove debris after blasting as well as drill steel and drill bits.

If we look at history, a tripling in sales figures is quite impressive. This means that over a five year period, the segment has grown to three times its size. Profitability has climbed from around 8% to just over 17%.

I’d now like to present the second award. Our John Munck award will this year be awarded for the development of what we call RCS, a remote computer-controlled steering system for our rigs. We are the only ones who have this system and during the course of the past few years, it has made quite an impact.

film clip

The business area Industrial Technique is our third and smallest, but most profitable business area. Older shareholders will be aware that we also had hand tools and electrical tools a few years ago but we sold this area a while back. Now we only have industrial tools, products that target industrial applications and other manufacturing units. The automobile industry above all has made some major demands which stimulated our product development activities and our ability to be a good vendor.

We offer different types of tightening tools for different types of safety-critical tightening processes in the automobile industry. A little metal bar and a little cable may not look like much, but these are incredibly sophisticated products packed with lots of software. Our competitive strength may not lie in the mechanical aspects, although we do have excellent patented motors. Instead, the decisive factors are the software, the know-how and the application. Were we to talk about relative market shares, this is one area where we far outdistance our competitors.

Industrial Technique has another leg to stand on – the industrial and engineering industry. In fact, half of our turnover derives from this category of customers which is made up of quite a few large-scale, highly focused customer groups. Airplane manufacturers are one category; we have the electronics industry with washing machines and other household appliances, shipyards and other types of metal processing that uses our products, including a lot of grinding machines. Two years ago we also acquired a product that is used for considerably smaller tightening processes and smaller operations. We ship a lot of the equipment that is used in assembling Rolex watches.

If we look at the trend for Industrial Technique over time, sales may not look that spectacular. There are two explanations. One is that we were considerably more dependent on the automobile industry before. And since the car industry had it tough in 2006 and 2007 and did not invest as much, sales were affected. The second factor is that we have not made as many acquisitions as in the other business areas.

I already said that this area is the most profitable. Look here at the journey this business area has made since 2003. Operating margin has moved from 15% to about 22%. That’s quite an achievement.

In recap, the Atlas Copco Group has three legs. Compressor Technique answers for about 50% of the sales and a bit more of the profit, but considerably less than its share in terms of capital requirements. Construction and Mining Techniques is a bit more capital intense and answers for a larger share of the capital. Industrial Technique remains steady.

I’d also like to talk about growth and growth potential. We need to be as good in the future as we have been the past few years. Our idea is that two-thirds of the business should grow organically. We should do more of what we already can. We should sell more of our products to our customers. We should increase our customer shares. We should measure this. We can take Mercedes as an example and look at how much of their total buying of products and services comes from us and how much they use. How much of Nestles’ share of polyester compressors do we deliver? This is *one* part. Organic growth is less risky and more profitable.

We also have an acquisition strategy, because in some instances we need to add products, knowledge, channels or market territories. As I already mentioned, we have a very strong product portfolio that enables us to forcefully drive our organic growth. No one has the global presence we have. We have distribution channels through the Atlas Copco brand

and through our other own brands. We also have a multi-brand strategy and consequently can reach more market segments.

We are investing twice as much in R&D today compared to four years ago. This isn't much in terms of percentage of sales, but since sales have doubled, the absolute amount of money has doubled. It may sound strange, but money isn't the problem. The problem is finding talented people, having the right processes and the right organization.

The aftermarket should actually be called the premarket. When properly managed, the next deal is a given. You're there and you know when the customer needs to invest. You're there and you keep your customer happy. So you might as well call it the premarket.

We also have acquisition opportunities. Each division has to be on the look out for the next opportunities to acquire new companies.

I am going to list what I consider to be the focal opportunities for growth over the next few years. One of the reasons we acquired Dynapac six months ago is the wealth of opportunities all over the world—not just in India, China and Latin America but also in the U.S.A. and in Europe where we have a network of roads and infrastructure in poor condition. Investments in these areas are necessary worldwide. The same also applies to oil, gas and mineral excavation. We are well represented in the mining and mineral excavation areas. Not as much in oil and gas, but we are seeing more and more in these areas particularly through Compressor Technique, but also through Construction and Mining Technique.

Another area for growth lies in improvements in productivity—our products enable our customers to boost their productivity. We deliver more effective tighteners, more effective drills, and so on. This is immensely important to our customers. During the past year, there has been a capacity shortage in many areas. Consequently, it is vital to invest in better equipment to support an already existing production structure. One example of productivity improvements involves cutbacks in power consumption.

We must expand our product range. In recent years, we made two acquisitions aimed at penetrating the natural gas market for vehicle gas. This required compressors that we did not have much of earlier but through acquisitions we have broadened our product range. This market is incredibly interesting. We don't see much of it in Sweden today. I believe there are 140 filling stations for vehicle gas but this is something that is progressing in other countries. I mention this as an example of how we can expand our range of applications and products.

Finally, we have the aftermarket. It is an incredibly important part of our business and one that we will promote even harder in the future.

I want to mention developing countries. During the first quarter this year, and pretty much throughout all of last year, about 45% of our incoming orders stemmed from developing countries. This includes all countries that are not part of Western Europe, North America, Japan, Korea, Australia, and so on. This is where the people are. This is where GNP development will take place. This is the stage for industrialization. We are in an excellent position to be part of this trend. We can see today that the U.S.A. is less prominent in our order book while these countries mean considerably more, securing for us a better spread of incoming orders.

Let us look at the short-term situation in these countries. The U.S.A. is not a developing market but the U.S.A. is part of a group of markets where we are intensifying our focus. It is the world's largest industrial market—the world's largest market for compressors, drilling rigs and so on. We feel that we have work to do here so we have included the U.S.A. Over the past three years, we expanded there by 30% per year. And in Russia, we have grown by 55% the past three years—last year we skyrocketed to 120%. We are growing in India by 40% a year, while the figure for China lands at 30%. Brazil is finally reporting sustainable growth. We've watched Brazil rise and fall many times, but over the past couple of years, the country has reported strong growth.

What we are trying to do here—a tactic that I believe is a bit more aggressive than our competitors—is to expand our presence in the market, or *feet in the street*. It is our sales reps and service engineers who are close to the customers where the deals are done. We have 150 offices all over China today, with Chinese employees who speak the local dialect and comprehend the customers' needs. No other competitor comes even close. In Russia, we have sixty-something offices from Vladivostok to Irkutsk to Saint Petersburg and Jekaterinburg. We are doing business in areas where there is not one single competitor, which is a bit strange. We are trying to drive organic growth by being close to the customer. It is in these developing countries that the growth rate will continue to climb.

Let me wrap things up. I believe that we can maintain growth on the grounds of what I have presented. We have a good approach and we hold a market-leading position. I believe that we can maintain our margins and our prices. We use relatively little capital. Ultimately, this should give us a good return and prove conducive to generating high value.

Let's now jump to Sweden. We have invested quite a bit in Sweden these past years. Sweden is home, it was here it all started in 1873. Soon, we will have more employees in China than in Sweden, which obviously compels us to wonder if we are a Swedish company, a Chinese company, or what are we? Well, there's no doubt that we feel like a Swedish company. We have a strong foundation in Sweden.

Construction and Mining Technique in particular has invested heavily the past years, especially in Örebro but also in Kalmar. The acquisition of Dynapac gave us two large units—one in Karlskrona and one in Ljungby. More than half of the business area's investments are in Sweden. I believe that less than 5% of CMT's sales stem from Sweden; it may be as low as 2-3%, but this is where much of our expertise in many areas is and this is where we have a platform on which we can continue to build.

The same basically applies to Industrial Technique. Investment needs are considerably lower. We invested quite a bit in Hungary in order to move assembly from England to Hungary, but our largest investments are in Sweden.

We also increased the number of employees in Sweden, from 3,200 in December 2006 to 4,500 in December 2007. Unfortunately, we often make very costly investments without this resulting in a major increase in employees since it is often more a question of streamlining production. About half of the increase comes from acquired units, Dynapac in particular.

I want to comment on our most recent quarter. We presented our quarterly report today and recently held an Analyst and Investor Conference. The curves you've been looking at the past years are still there. Obviously, to a certain degree we are chasing our own tail—it is difficult to constantly out perform yourself. But we feel that the first quarter was very strong. We've compared all the figures with the same quarter 2007, which was also a strong quarter. The figures for the 1Q 2008 indicate a very robust quarter and that we are maintaining our growth rate in terms of volume growth.

I want to thank you all for coming to the Meeting. I also want to thank you all for the confidence you demonstrate through your shareholdings in Atlas Copco.