

## **AB Volvo's Annual General Meeting 2006**

*Speech by the President and CEO, Leif Johansson*

### **Introduction**

Shareholders, ladies and gentlemen

The Volvo Group has completed another successful year. A record year with strong development in largely all markets. The Group grew by 14% to sales of SEK 231 billion. All business areas improved their earnings. In some instances by impressive figures. This is the fruit of the work of many employees with improving the operations and implementing plans we made in recent years. Naturally, without this work we would not be in the position we are in today.

I will present a general description of the development of our business areas and then detail the challenges and the opportunities we face, both in the short and long term.

In a departure from the usual order, let me first begin with our newest business area, Financial Services.

### **Development and earnings of the business areas**

#### **Financial Services**

Our customer financing is expanding and includes Europe, North America, Australia, parts of South America and Asia, and can now be found in 50 countries. The credit portfolio grew by SEK 15 billion to SEK 79 billion in 2005. This was achieved on a market with ever-increasing competition from banks

All regions improved their earnings, the total of which was nearly SEK 2 billion. The return on shareholders' equity amounted to 15%, which is favorable considering the current low interest-rate levels in Sweden.

It is important for the future that we take opportunities to expand our credit operations in growth markets at the same time as we maintain low overhead costs.

#### **Aero**

Volvo Aero lost substantial sales in the crisis that hit the aerospace industry in autumn 2001. The number of airline passengers has increased substantially in recent years and the airlines – primarily in Europe and Asia – have recovered.

This has led to an increase in order bookings for new aircraft. Volvo Aero has fared well and is participating in the development of engines for both Airbus's and Boeing's future aircraft, including the Airbus 380 – which flew for the first time in 2005 – and Boeing's Dreamliner.

In 2005, Volvo Aero increased its sales for the first time since 2001. The figure amounted to SEK 7.5 billion. Earnings doubled to SEK 834 M. The margin of almost 11% was the highest for the Group.

A prioritized target for Aero is to continue working with increasing its volumes and profitability in the aftermarket.

## **Penta**

Volvo Penta has enjoyed strong growth for seven consecutive years and consolidated its position as the world's leading producer of diesel engines for leisure boats. Success with the new Volvo Penta IPS drive system continued in 2005. The system was also launched for commercial boats during the year. The photo shows how by using a joystick, you can maneuver the boat sideways when docking thanks to the fantastic maneuverability of the IPS system. However, we experienced a decline in industrial engines as a result of a reduction in demand in China.

Sales rose by 8% to SEK 9.8 billion. Earnings approached SEK 1 billion. As in 2004, profitability is high, with a margin of around 10%.

An important development is that Volvo Penta is heading toward more integrated cooperation with boat-builders. The intention is to contribute to the more effective manufacture of boats and thereby expand business. IPS, which is simple for boat-builders to install, is a step in this direction.

## **Volvo Construction Equipment**

Demand for construction equipment increased globally. This could also be seen in China where the market has recovered after a downturn. Volvo CE, whose new machines achieved a leading global position in fuel economy captured market shares in several segments. We began the manufacture of our largest ever 70-ton excavator, which you can see in the diagram. This is a broadening of our excavator program, which has been well received by customers. Volvo CE also launched a new series of motor graders in 2005.

Sales increased by 19% to nearly SEK 35 billion and deliveries reached record levels of 33,000 machines. Earnings of nearly SEK 2.8 billion is our best result ever. The margin of 7.9% is the highest in six years.

The continued development of excavators is a high priority since this is the largest product type in the industry. We have now increased our share on the global market from 1% to 7% since 1998.

## **Buses**

The global market for buses rose slightly. The trend of bus customers becoming larger continues, especially for customers purchasing city buses, while there is still scope for small companies in the tourist bus area. Volvo Buses launched six new bus models, adapted for different markets, and captured market shares.

Sales increased substantially for the second consecutive year and with SEK 16.6 billion we have returned to the high sales levels of 2000 and 2001. A large portion of this increase is from the major order for 1,700 buses for the new mass-transit transport system in the Chilean capital, Santiago. Earnings of almost half a billion were the highest in ten years.

Despite these improvements, profitability continues to be unsatisfactory for buses. Work to increase standardization and reduce production costs continues to be a high priority.

## **Trucks**

Demand for trucks was strong in 2005, particularly in North America. **Mack Trucks** increase its deliveries by a total of 42% to just over 36,000 trucks. Mack defended its leading position in the US in trucks for construction operations, regional transport and refuse collection. During the latter part of the year, Mack took its largest step in product renewal in 40 years. This was with the launch of Mack Pinnacle, which you can see on the slide, Mack Granite and the brand new engine program.

**Renault Trucks** launched new versions of Renault Magnum and Renault Premium Route, which is Renault truck's highest selling product. It is pleasing that it received such a positive reception by customers and that we have strong order bookings.

Deliveries increased by 6% to approximately 74,500 vehicles. This also includes solid positions for Renault Trucks' light and medium-heavy trucks.

Like Mack, **Volvo Trucks** enjoyed a positive development in North America, where the manufacture of Volvo trucks reached capacity limits. Europe was at a high level and for the first time more than 100,000 Volvo trucks were delivered worldwide.

During the year the VT880, the flagship on the North American market was launched. Volvo Trucks also launched a new generation of **its** biggest sellers, Volvo FH and Volvo FM, which received a positive reception.

Sales for the Group's total truck operations increased by 14% to a record high SEK 155 billion. Profitability improved for the fourth consecutive year. Income amounted to SEK 11.7 billion and the margin rose from 6.6% to 7.5%.

**The Group's** total sales increased to SEK 231 billion and income amounted to around SEK 18 billion. With this considerable growth, we have grown by a third in two years and at the same time tripled earnings.

The margin rose from 7.3% to 7.9%. This is a favorable level in relation to our long-term target of 5% to 7% over a business cycle.

### **Current situation in the Group**

As we described earlier, the Group is in the midst of an intensive period of product renewal and industrial change. The time schedule is largely governed by legislation on emissions. On October 1, 2006, stricter regulations will be introduced in Europe and new laws will come into effect in the US on January 1, 2007.

The greatest renewal is taking place in Trucks. When we enter 2007, we will have a new and competitive product program for all three brands. For Mack and Renault Trucks, this involves the greatest change in the history of these two companies.

We have a positive view of the stricter environmental legislation, but it also entails negative effects. We know that part of the high demand in North America, and even in Europe, is due to the fact that customers purchase trucks with the old engines since the new generation of engines is more expensive. Therefore, we expect to see a decline in North America in 2007 when all new engines must comply with new statutory requirements.

We have high expectations for our new products and are pleased that the order bookings situation is so strong. Our new engines with up to 5% lower fuel consumption, and new output range, have received a positive response from our customers.

At the same time, we are finalizing the industrial changes that were planned with the acquisition of Renault Trucks and Mack Trucks in 2001. In the last stage, the production of heavy Renault trucks will be concentrated to one factory. This will take place in conjunction with the closure of Villaverde in Spain. After that, all assembly of Renault Trucks' heavy trucks will take place in Bourg-en-Bresse outside Lyon and medium-heavy trucks will be assembled in Blainville.

Engine production will also be made more efficient. We are phasing out the old production systems in France and the US and simultaneously adapting to the new generation of engines.

In conjunction with this, we are moving from 18 to two engine families and are also putting in place an efficient structure for engine production.

### **Integration and corporate culture**

We have learned a great deal during the changes of the past 6-7 years. We have established three new business areas through Mack, Renault Trucks and Financial Services. These business areas have been successful.

We have built up two large, internal units:

Volvo Powertrain for the Group's diesel engines and gearboxes.

Volvo 3P for product planning, product development and purchasing for the truck operations. This unit has also been successful.

We can also mention our acquired companies, with almost 20,000 employees, that have been integrated into our systems for IT, spare parts and logistics.

The development of a common corporate culture has been an important feature of our integration activities. Since 2000, we have worked with The Volvo Way, which is our guide for creating a competitive global culture. It can be described in many ways. One way is by calling in a common language. The Volvo Way helps our employees understand our objectives, work in the same direction and equally as important: understand each other across the world.

An important target in the work with developing our culture is to increase diversity in the organization. When we talk about diversity, we refer to nationality, experience and training. These are areas in which we have been successful. Today, for example, we have five different nationalities in our Group Executive Committee and a significantly broader international mix among our highest managers than compared with only a few years ago.

A total of 83% of employees in the Volvo Group are men. This is manifested not only in the statistics for female managers, but also of course in our corporate culture. Therefore, our diversity activities include the ambition of producing more female managers within the Group.

Several countries have now introduced networks that support women in their professional career.

We train our senior managers and also arrange internal seminars to increase understanding on the advantages of diversity.

We also have introduced the condition to our guidelines for recruiting managers that the final group of candidates should include at least one female applicant –

and that there should be at least one female interviewer during the recruitment process.

For many years, we have also had extra places specifically allocated for women in our internal boards in order to provide training for senior management positions.

Our efforts are beginning to yield results. Last year the percentage of female managers rose from 12.3% to 13.6%. This is the largest increase since our records began. The Group now has approximately 1,000 female managers. The percentage of women holding senior positions is 16%, which rather accurately corresponds to the total percentage of female employees.

Each year we ask all of our employees their opinion about the work climate. This takes place via a survey called the Volvo Group Attitude Survey. Important areas in the survey include respect for the individual, communications, implementation of decisions, teamwork, cooperation between departments and management. These are areas that we know affect our financial results.

A total of 93% of our 82,000 employees participated in this year's survey. The strengths that the survey highlighted include motivation, pride, respect, scope to influence one's own situation, expressing your opinions and knowledge of work objectives.

We created an index, the Employee Satisfaction Index to chart our progress. In simplified terms, it could be described as an index of the most important issues for the work climate and profitability.

As the figures show, the work climate has improved successively since we started, despite the fact that we have had to make many difficult decisions and make sweeping changes during the period.

Our attitude survey provides a clear indication that the integration of our acquisitions and new units are progressing. Our employees enjoy working at our company more and more.

Naturally, we are very proud of this. We want the Volvo Group to be an attractive company to work for.

Although there are areas that require improvement, I would claim that we have been very successful with taking care of our acquired companies.

### **Growth and new acquisitions**

In the long term, we have the target of achieving profitable growth of an average of 10% per year. We have said that this will take place by organic growth and acquisitions. In a cyclical industry like ours, growth is, as a rule, very rapid when there is an upturn in the economy. When there is a downturn, advantageous

opportunities for growth through acquisitions are open, provided that financial resources are in place.

As the diagram shows, we have been very successful in recent years. We have had 50% growth through the acquisition of Renault Trucks and Mack, a sharp downturn in the economy and strong organic growth in the past two years during which we have expanded by a third. With growth of an average of around 14% in the past five years, we have surpassed our target.

In 2005, both the Board of Directors and Group management discussed how we best can grow in the next five to ten years. The main route is clear.

We are strengthening our service network and broadening our product offerings in established markets. We have several examples of this. Volvo Trucks has, together with Mack, strengthened its service network in North America. Volvo CE opened a new distribution channel by starting some 100 rental outlets in North American and Europe, which are operated under franchise agreements. Volvo Buses is marketed and sold through Renault Truck's well-established service network in France and Volvo Aero is focusing on developing its aftermarket services. As I mentioned earlier, Volvo Penta is developing new products together with boat-builders. In so-called soft products, we also have Financial Services' growing financing operations.

In new markets we are primarily going to spread knowledge of our brands, build up distribution and service networks and in certain cases establish new assembly plants.

Eastern Europe and Russia are growth markets in which our brands are already known. Renault Trucks is continuing to focus on Eastern Europe and increasing investments in its service network.

Volvo Trucks has existed in Russia for a long time and as the largest imported truck brand is in a positive position as growth in the Russian economy accelerates. Russia has the prerequisites to become an extremely important market for us.

The two fastest-growing markets, India and China, are very much part of our growth strategy.

In India we have been highly successful at establishing Volvo's brand, primarily through buses. Volvo buses has become a quality concept in India. Passenger pay more to travel in a Volvo bus.

This has led to a number of curious attempts to copy our brand. You may well wonder how successful these attempts were based on this photo, but I can say that we have to work rather hard to keep things clean on this front. In India, we manufacture buses and trucks in Bangalore, but currently on only a small scale.

We also have production in China, with rapidly growing operations in excavators, buses and industrial engines. The Chinese market slowed down in 2005 due to restrictions from the authorities, but we now can see that sales are rising again.

China is the market that was discussed the most by the Board and management. It is not the easiest market to penetrate, but it is indeed one of the world's largest truck markets. Our situation will definitely not improve if we wait and allow our competitors to take advantage of the best opportunities.

One of the difficulties is that there are large and competitive domestic vehicle producers in China, with low cost base. Major manufacturers such as Dongfeng and FAW do not only intend to defend their home market but also have aggressive plans abroad. We want to be there, not just to participate in the growth in China, but also to learn about integrating Chinese operations into our own global systems.

With the settlement we reached with Nissan Motor in March, we intend to strengthen our positions in Japan and Southeast Asia. We have purchased 13% of the listed company, Nissan Diesel, with the option to purchase an additional 6%.

Nissan Diesel is one of Japan's largest manufacturers of heavy and medium-heavy trucks. The company has a fourth of the Japanese market, which in terms of size can be compared with France's market share.

Nissan Diesel produced approximately 38,000 heavy trucks and almost 1,700 buses in 2004.

Sales amounted to SEK 31 billion and earnings to SEK 2.3 billion, giving a margin of 7.2%. That is, profitability that is almost the same as our truck operations.

More than 90% of sales in Japan were made through the company's own dealers. Nissan Diesel also has a well-established distribution network in other parts of Southeast Asia.

These products and the geographical coverage are an excellent complement to the Volvo Group. We see cooperation opportunities in production, sales and aftermarket. We already have engineers and business developers in place in Japan to discuss potential areas of cooperation.

In addition to this, together with Nissan Motor we will investigate the possibility of working with China's largest manufacturer of trucks, Dongfeng – 50% is owned by Nissan Motor.

Dongfeng has approximately a third of the Chinese market in both heavy and medium-heavy trucks. A market that is the same size as the European or North American markets.

In terms of number of vehicles, Dongfeng's market share is equivalent to nearly 70,000 heavy trucks and 66,000 medium-heavy trucks.

Nissan Motor's decision to focus on passenger cars can provide us with the scope to develop extremely strong truck operations in Asia together with Nissan Diesel and Dongfeng.

The medium-heavy truck segment is particularly interesting. The Volvo Group has historically always been small in this segment. With a volume of 60,000-70,000 trucks, Dongfeng is China's largest producer of medium-heavy trucks. If we established a well-functioning form of cooperation with the Chinese authorities and Nissan Motor, we would be able to form a very strong global constellation in the medium-heavy truck segment.

### **Environment and new drivelines**

Another important future issue is alternative fuels and drivelines. As a result of the rapid growth in Asia, we are beginning to approach the point where oil production is reaching its peak and can no longer meet increased demands. We also have to consider the widely-documented political uncertainty surrounding the supply of oil. In parallel, there is also the climate change caused by the burning of fossil fuels.

This means that the interest in fuel-efficient vehicles will become even greater. Therefore, we believe that hybrid vehicles will be a competitive alternative in the future, even for heavy vehicles. Hybrid vehicles preserve energy when breaking, store it and reuse it for propulsion with an electric motor. In our case, this will be done together with a diesel engine.

The diesel engine can be powered by both fossil-fuel diesel and alternative fuels based on biomass. A significant strength of the diesel engine is that it can combust many different types of fuels highly efficiently.

In March we presented our hybrid technology with two demonstration vehicles with very powerful electric engines. The first of this kind among heavy vehicles. With this new technology, we see opportunities to reduce fuel consumption by up to 35%. This applies to buses and trucks operating on short driving distances that brake often, such as in city distribution, refuse collection and mass-transit transport systems.

With our powerful and cost-effective hybrid technology, better batteries and continually increasing oil prices, we believe that our hybrid solutions will soon be commercially viable. Since fuel represents approximately one third of transport costs, customers will be able to compensate higher purchase prices with reduced operating costs in a short period of time. We have seen possibilities for up to a 50% savings in fuel for construction equipment.

We expect to have competitive hybrid vehicles on the market in only a few years and intend to take a leading position in the global market in this segment. With our extensive competence and experience in diesel-engine technology, we have an advantage compared with many other producers. In addition, we are also participating in highly interesting development projects in new battery technology.

### **Performance of the Volvo share**

As I have described, we have been extremely active in 2005. Many highly skilled employees have given exceptional performances in renewing our products.

This is of course extremely pleasing and it is stimulating to see that we will soon have both an entirely new product program – world-class products – and a more efficient industrial system in place.

It is equally as pleasing to be able to issue highly favorable returns to our shareholders. After the economic downturn, we have increased our return on shareholders' equity by nearly 18%. This is a high percentage considering the low interest rate levels in Sweden. Also, earnings per share rose by almost 40% in 2005.

We have also distributed large sums of money. The dividend yield has normally been around 4-5% and substantially above this figure when we paid special payments.

As you can see in the diagram, the total return on the Volvo share, calculated in dividends that have been reinvested, is considerably higher than the index on the Stockholm Stock Exchange. The average return on the Volvo share was 25% per year. I think we can say that this is at a comfortable competitive level. In other word, the Volvo share has been a profitable investment.

### **Conclusion**

I am convinced that in the future we will also be able to create value for our customers and provide our shareholders with favorable returns.

Our positions on the global market are strong in all business areas and we have built up an extremely competitive platform from which to continue our work. We will grow from our own strengths.

We will, with great certainty, see continued consolidation in our industries. Our intention is to participate in such a change, to study potential acquisitions and areas of cooperation. This is the basis from which to broaden our operations geographically and to strengthen and supplement our product segments.

We look forward to continuing our work with developing the Volvo Group as a world-leading global player.

Thank you.