

# Industrivärden's Annual General Meeting, May 5, 1998

I would like to start out by saying that it is with great pleasure about our business performance that Industrivärden's board and management today present the 1997 accounts for adoption by the Annual General Meeting.

Our reported earnings before taxes amounted to SEK 2.4 billion – the highest ever. At the same time, the surplus in our portfolio of listed stocks rose by a full SEK 5.6 billion. Applying the accounting principles used by insurance companies, you could say our total earnings were as high as SEK 8.0 billion. Holding companies have special tax rules which entail, among other things, exemption from capital gains tax. Therefore the effective tax, including deferred tax on unrealized growth in value, was a modest SEK 46 million, and essentially the entire profit was added to the company's and thus the shareholders' net wealth.

## **Total Return of 48 percent**

This favorable development was appreciated by the stock market. Industrivärden's share price rose by 43 percent, compared with 25 percent for the General Index. More relevant, however, is a comparison with the Findata yield index, which also takes dividends into account. This applies especially for Industrivärden, which has the goal of paying a dividend – or direct yield – that exceeds the average of listed companies. Industrivärden's shareholders thus received a total return of 48 percent, or a full 20 percent more than the market average.

The trend during the first quarter of this year has also been positive. The growth in value of the listed portfolio was somewhat better than the index, and all subsidiaries are showing earnings improvements. As of April 30 our Class A shares had risen by 21 percent, slightly more than the index.

Historic triumphs are no guarantee for future success, however. Therefore in Industrivärden's management we put 1997 behind us long ago. Instead, we are concentrating fully on the business and investments whose financial outcome will affect future earnings reports. Nevertheless, it is appropriate today to briefly comment on some of the business events during 1997.

## **High Quality Portfolio of Listed Stocks**

At previous annual meetings I have emphasized the very high quality of our listed portfolio. It consists of stock in companies that are among the most successful in their respective industries. As I now summarize the trend in 1997 I have no reason to regret my previous assertions. The value of the portfolio rose by 30 percent, that is, by 5 percentage points, or 20 percent more than the General Index.

Now and then I hear the comment that this is not so strange, since Industrivärden is a major shareholder in Ericsson – the uncontested star of the Stockholm Stock Exchange in recent years. Therefore it can be justified to compare the performance of our portfolio with the General Index, with Ericsson excluded in both cases. Such a comparison shows that our performance still would have been five percentage points better than the index. I happily take that fact as a further indication of the high quality of our portfolio.

In 1997 we made new, net investments of more than SEK 5 billion in stocks. The largest acquisition was 22 million shares in Sandvik for SEK 4 billion. This means that we are a new major owner in the company. The return on this investment was good in 1997. However, Sandvik's stock has performed more poorly in the current year. Some may therefore think that our investment decision was questionable and/or hasty. But I don't share that view. Our decision was based on thorough analysis of Sandvik – a study whose basic conclusions we believe we have had no reason to reconsider. A few characteristic findings of this analysis are that Sandvik has

an appealing strategy of growth and shareholder stewardship, including a progressive dividend policy. In the opinion of our and many other prominent market analysts, the current valuation does not fully reflect the company's potential. Moreover, the acquisition of shares in Sandvik complements Industrivärden's holding of engineering stocks, giving us a better balance in our portfolio composition.

In 1997 we also increased our holdings in the financial sector through additional purchases of stock in Handelsbanken and Skandia. Our positive view on interest rates and the generally positive view of bank and insurance companies were two key motives for the purchases. Handelsbanken's stock, moreover, was considered to be attractive in view of the anticipated positive impact on the bank's income of the acquisition of Stadshypotek. Concerning Skandia, what should be stressed in particular is its successes in the rapidly growing global savings market. Skandia has been one of the Stockholm Stock Exchange's absolute best investments since Industrivärden began buying its stock in 1996. Our unrealized growth in value is currently about 1.1 billion kronor.

### **AGA and PLM**

Two investments that did less well during the year were AGA and PLM. In both of these cases the weak development was largely related primarily to the European stock markets' view of the gas and packaging markets. Concerning both AGA and PLM, however, it must be said that neither company is in any crisis situation. Thus AGA reported pretax earnings amounting to more than 11 percent of revenues, while PLM posted an earnings improvement of 21 percent for 1997. This has been appreciated by the market, and this year the PLM stock has performed better than the index.

Even though AGA's earnings level is high, the company reported a lower profit in 1997 than in 1996, due to rising price competition, among other things. Strong measures have been taken, however, to reinstate earnings to the previous levels. In 1997 a new, customer-oriented organization was adopted and the work force was cut by 500 persons. Another extensive program to enhance competitiveness has been started. It entails, among other things, major cost savings by reducing the number of production facilities from 350 to 290 by concentrating production in larger, more cost-effective units. In addition, a new logistics system is being set up which will increase efficiency as well as customer service. Altogether the program is expected to lead to yearly earnings improvement of approximately SEK 800 million after a three-year period. However, no major earnings impact is expected in the current year since achieved earnings improvements will be offset by costs for implementing the program.

With respect to AGA it should also be mentioned that 1997 earnings were charged with future-oriented investments and marketing costs, primarily in eastern Europe. This has entailed, among other things, that AGA today is the market-leading gas company in Russia. Investment activities have thus been high in recent years, but the focus now is to return to the level that applied previously. Naturally, we have not been satisfied with AGA's stock price during the last two years. In view of the ongoing measures, however, my judgment is that AGA's earnings and thus, reasonably also its stock price in the future, will meet the demands we are entitled to make.

### **Subsidiary Values Realized**

At last year's Annual General Meeting I made reference to plans to list our subsidiary Thorsman on the stock market at the same time that we would remain as a major shareholder. In connection with preparations for a stock market listing we also took up contact with a number of conceivable industrial buyers. These contacts eventually led us to shelve our plans for a market listing, since we learned that an industrial sale would lead to higher value for our shareholders. In September a sales agreement was signed with the Finnish–Danish electrical components company Lexel.

As a result of this agreement we received cash payment of SEK 2.0 billion and a capital gain of SEK 1.4

billion. Within Industrivärden's management, we viewed the high purchase price clear proof of the effects of Thorsman's merger with its sister company Wibe, as well as of the fact that the product and market development work conducted in recent years had led to the desired result.

With one exception, activities of Inductus and Indutrade developed entirely in line with our expectations in 1997. Profitability remained high. All companies except Hydrauto achieved the profitability target of 20 percent on capital employed. Isaberg had the highest return as it began reaping the harvest following recent years' investments in a new production organization and a new line of patented, electric staplers. Its return was fully 39 percent.

Industrivärden's involvement in the real estate sector has been greater than what we have considered desirable. In 1997 Fundament was divested, and the shares in Närkebro were sold in March of this year. The sale of Fundament – which we announced long ago – was drawn out over time. The reason for this was the glut of properties that arose in the wake of the real estate crisis. Natural buyers were real estate companies, which generally preferred to carry out an acquisition through payment with their own stock. This would entail an unchanged exposure in the real estate sector and thus would not have met our set demands. In May 1997, however, we managed to carry out a cash sale of Fundament at a price we considered to be satisfactory.

Skanska's annual meeting resolved a week ago to distribute the real estate company Drott to its shareholders. The decision was preceded by a debate over whether Drott would have the same share structure as Skanska, with vote-strong Class A shares plus B-shares, or if the company would have only one class of stock with equal voting rights. The decision of Skanska's board – which Industrivärden's representative made reservation against – was that Drott would have only one class of stock. Putting a reservation on record in the minutes of a listed company's board meeting is rare. The reason in this case, however, was to safeguard the interests of Industrivärden's shareholders, since vote-strong Class A shares as a rule have a higher value. Skanska's annual meeting decided in accordance with Industrivärden's wishes.

## **Discount Halved**

From what I've said thus far, much is going our way. On one point, however, I feel a disappointment – namely, that we are still burdened with quite a high holding company discount. The discount in recent years has amounted to just over 20 percent. However, as a result of our own measures and the trend in general, the discount has essentially been halved compared with the situation three years ago.

The discount is naturally a problem not least because it is often perceived by the market as a below-average grade. I must assert, however, that the discount is a general phenomenon. Practically all holding company stocks – in Sweden as well as abroad – are valued below their net asset value. This indicates that the discount has a number of fundamental causes. At the same time that I see it as a problem, in my view it has been the focus of too much interest with respect to views of holding companies. Studying only the discount while simultaneously disregarding a holding company's overall development is like judging a company only according to its costs, without taking into account its income development.

To avoid misunderstanding I want to stress that at Industrivärden we do not nonchalant the problem in any way. Therefore we will continue our efforts at reducing the discount with undiminished intensity. By far the most important measure we can take is to actively contribute to the favorable development of the companies in which our capital is invested. Other important measures are continued active management of our portfolio, including decisions to reinvest when a stock's anticipated development so requires and/or investments in new stocks which are expected to outperform the index.

One item of business for today's annual meeting is to decide on the Board's proposal for a stock split, whereby the par value of our stock would be changed from twenty kronor to five kronor. This entails that our shareholders would receive four new shares for each existing share held. The aim of the proposal is to facilitate trading in Industrivärden shares and to increase the stock's liquidity. Our hopes are that this measure will also lead to a reduction in the discount.

### **Continued Strong Stock Market**

During the past two years the trend on the Stockholm Stock Exchange, like most other bourses in the Western world, has been exceptionally good. This trend continued through the first four months of 1998. As CEO of a holding company I am often asked how long the strong rise can continue. Every time I'm asked the question, the words of wisdom of an old Swedish satirist ring in my ear: "It's difficult to prophesy, especially the future." They are well worth keeping in mind when trying to predict the future of the stock market.

The most important factors for the favourable trend on the Stockholm Stock Exchange during the past two-year period have been falling interest rates and a strong liquidity flow. Long interest rates have fallen by roughly 3 percentage points during the last two years. The Swedish rates have neared the German, and the interest rate gap today is just under 0.5 percentage points, down from about 2 percent in 1995. The current general view in the market is that Swedish interest rates will remain essentially unchanged in the year immediately ahead. Therefore, the stock market is not likely to get a boost from further interest-rate cuts.

However, there is every indication that the strong liquidity flow will continue in Sweden as well as the Western world in general. In recent years there has been a sharp rise in long-term savings, and several factors point to continued growth. In pace with the rising average age of the population, the number of retirees is increasing. At the same time, concern for cuts in pensions and other social security systems is leading to greater personal savings.

On average the Stockholm Exchange is currently valued at 19–20 times 1998 forecast earnings after taxes, which is somewhat high from a historic perspective. However, this valuation is somewhat lower than for Europe in general, where the corresponding P/E multiple can be calculated to just over 22, or in the U.S., where the valuation translates to a P/E multiple of about 24. Thus in an international comparison the value of the Stockholm Stock Exchange can hardly be called challenging.

During the first quarter this year the stock market rose by 18 percent. April was characterized by alternate rises and falls. The final result for April was a rise of one percent. In view of the strong liquidity flow, I do not think the outcome in April should be interpreted as the start of an impending strong recoil. On the other hand, we hardly have reason for the rest of the year to believe in monthly gains of 5 percent as during the first quarter. My main scenario, instead, is that during the rest of the year we will see a limited but positive trend in the market as a whole. After making this judgment, however, it would be appropriate to recall those words of wisdom, since many events which affect the stock market's development come fast and unforeseen. The effects last fall of the economic crisis in Asia are the most recent reminder of this.

### **The Stock Market and EMU**

In summary I would like to briefly touch upon one factor which in the future will have an impact on Industrivärden's operations as well as the Stockholm Stock Exchange, namely, EMU. Accurately predicting how we will be affected by Sweden's exclusion from European Monetary Union is not possible. What is certain, however, is that we and the stock market will be affected.

At Industrivärden we have a policy – with a few exceptions – to invest only in Swedish equities. We have thereby avoided the direct problems that arise through exposure to businesses conducted in several currencies. This will now be changing in pace with a situation in which several of the companies in which we are a shareholder will most likely be quoted in euros. Naturally, such a situation is not impossible to handle in terms of risk, and we are currently conducting an internal investigation into how and to what extent we will protect ourselves and our shareholders from a change in our currency exposure.

Major players in the stock market – especially international institutions – have in recent years made it a matter of policy to diversify their investments by distributing them in various national markets. This pattern is now starting to break up. The thinking in these institutions today is leaning largely toward allocating investments

among various sectors within the European Union, but independent of country. More and more, their performance comparisons will be made against a common European index. Like the impact of other EMU factors, how and to what extent this will affect the trend on the Stockholm Stock Exchange is difficult to predict. However, I do not believe there will be any immediate or drastic changes on January 1, 1999, but instead a gradual impact.

From the perspective of Sweden and Swedish business, it is unfortunate that Sweden did not align itself with EMU from the start. This does not mean, however, that I am pessimistic about Industrivärden's future development. At Industrivärden we are aware that changes will occur, but our readiness to deal with a changed situation is high. We have a good starting point with a well positioned portfolio of listed stocks and a profitable wholly owned operation. Therefore, Mr. Chairman, I will take this opportunity to conclude my report to the Annual Meeting the same way as last year, that is, by asserting my belief that I have reason to look positively on Industrivärden's future development.

## Decisions at Industrivärden's Annual General Meeting

Industrivärden's Annual General Meeting was held at Grand Hôtel in Stockholm on May 5 under the direction of Board Chairman Bo Rydin.

- Industrivärden's Annual General Meeting resolved to raise the dividend by SEK 2 to SEK 15 per share. CPN interest is thus SEK 17.25 per CPN. The record date for the dividend was set at May 8, and thus the dividend and CPN interest are expected to be paid through the Swedish Securities Register Center (VPC) on May 15.
- The Meeting also resolved to change the par value of the shares from SEK 20 to SEK 5, whereby for each existing share held, shareholders will receive four new shares of the same class. The conversion price per CPN will thus be changed from SEK 92 to SEK 23, and for each existing CPN held, four new CPNs of the same class will be received. The record date is planned for May 29. May 26 will thereby be the last day for trading in Industrivärden's shares and CPNs prior to the change in par value and conversion price, respectively (split).
- Directors reelected to the Company's board were Dr. Bo Rydin (Chairman), Ms. Inga-Britt Ahlenius, Mr. Carl-Erik Feinsilber, Dr. Tom Hedelius (Vice Chairman), Mr. Lennart Nilsson, Mr. Clas Reuterskiöld (President and CEO) and Mr. Björn Wolrath.
- Mr. Bertil Edlund and Mr. Ulf Pernvi were reelected as auditors. Ms. Margareta Essén was reelected as deputy auditor, and Mr. Ingvar Pramhäll was elected to his first term as deputy auditor. All auditors are with Öhrlings Coopers & Lybrand AB.