

MACHINERY LTD

**Annual Report
1998**

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Business environment

1998 saw the general economic trends deteriorate world-wide, and risks in the global economy increased sharply. In August, the economic turmoil that had affected the Asian countries escalated into an international financial crisis which USA and Europe are expected to pull through, even though economic forecasts have been revised downwards.

Total output in Finland increased by 5.3 percent last year. Private investments were up by 7 percent while public investments remained on the 1997 level. Sectors that are of key significance to Machinery Ltd saw a positive development: the GNP grew by 7.5 percent in the industrial sector and by 9 percent in the building sector.

Ups and downs in exports

Goods exports picked up in the first half of the year, but then began to slow down gradually and remained at 9.5 percent. In terms of prices, the decrease was 0.5 percent. The decline in growth could be attributed to a deterioration of the general economic development. Exports to Russia halted in September following the devaluation of the rouble and the severe economic crisis. Moreover, the multiplying effects of the Asian crisis further contributed to the decline in exports to Russia.

The electric and electronic industry accounted for the most significant rise in growth with a growth rate of about 30 percent.

Export prices dropped last year and the same trend is expected to continue this year. Despite a slow-down in the growth of exports, foreign trade surplus continued to increase last year.

The fact that Finland joined the European Monetary Union at the beginning of the year will trigger a stronger need to boost trade in the technology sector and focus more heavily on the added value it can generate in the changing common market.

Sharper competitive edge

Exports accounted for more than 30 percent of the overall demand compared to less than 20 percent in the early 1990's. Our success in the exports market was supported by the clearly improved competitiveness of the industry—a key priority in all of Machinery Ltd's activities.

Following structural changes, among other things, profitability of Finnish industry has increased by 7.5 percent during this decade. Labour-intensive industry has, to a large extent, been replaced by new, capital-intensive ones.

New power for growth

Economic forecasts anticipate moderate economic growth prospects in industries of key significance to Machinery in 1999. Towards the year-end, the weakness troubling the industrial sector is expected to come to a halt and growth will gain new momentum. During the period of 1998–2002, the building sector is estimated to grow by 5 percent and the mechanical engineering and metal industry by approximately 10 percent. The level of interest rates is expected to remain rather stable. Once the currency risks have essentially diminished, companies will be able to carry out investments that will boost their competitive ability.



Machinery Ltd's business activities



Machinery Ltd is a family enterprise that passed on to the third generation at the turn of the year as Mr Janne Timonen (left) became Managing Director while his father, Mr Heikki Timonen, assumed a full-time position as the Chairman of the Board. Also pictured is, as a portrait, Mr Hugo Timonen.

The parent company posted a turnover of FIM 237 million (1997: 194 million) while consolidated turnover amounted to FIM 330 million (1997: 290 million). The Group's operating profit, before depreciation, rose to FIM 21.8 million (19.6) and FIM 16 million worth of repayments on interest-bearing liabilities were made during the year. The significant growth of the parent company's turnover proved that the organisational rearrangements had been highly successful. The Machine Tools, Contractor and Construction Machinery departments accounted for the most dramatic growth. All key indicators measuring the efficiency of operations improved over the year as budgeted.

Problems in Russia had an adverse effect on the business environment of our road construction department. As a result, the activities of this non-profitable department were distributed among the other business units during the year.

Our long-standing partnership with the armed forces was expanded through a maintenance agreement that covers the basic repairs of materials handling vehicles.

In terms of clientele, the departments that experienced the most significant changes were the environmental machines department and the electronics and security products department. The environmental machines department modernised its product range to make it better suited for estate management and maintenance purposes, while the electronics and security products department focused on reorganising its acquisition channels to be able to handle larger projects more effectively. Our new business line, generator systems, proved to be functional and successful. Success was further boosted by the quality audit carried out by Cummins Ltd, which showed that our department represented the top international level in its line of business.

We worked in close co-operation with the Finnish Standards Association SFS to expand the scope of ISO 9002 audits to apply to processes rather than functions, as is the case in the more traditional approach.

During the year, Machinery expanded its business activities to Latvia. Machinery Latvia SIA was set up to develop and improve our traditional business operations in the local environment. Over the course of this year, we also intend to bring the operations in Lithuania under a registered company name.

A human resources development project was launched in co-operation with the Institute of Occupational Health. The project is geared at ensuring a high level of motivation among company personnel as we approach the new millennium. The Institute of Marketing provided marketing training to the key personnel of all business units.

Modernisation of the data processing systems continued with the introduction of upgraded financial administration software. Furthermore, the sections designed to support marketing will be completed in 1999. The new system will facilitate the switch-over to euro and eliminate the millennium risk. Materials handling premises in Vantaa became fully operational during the year. Machinery's liabilities decreased dramatically as the redemption obligation, involved in the previous headquarters, was transferred to the new owner.

Machinery's decision to change its fundamental business strategy and to become a systems supplier instead of a distributor played a key role in all business development measures.

The Board of Directors accepted the resignation handed in by Managing Director Heikki Timonen. His resignation was effective as of 1 January 1999. In its meeting on 14 December 1998, the Board appointed a new Managing Director for the company, Mr Janne Timonen, M. Sc. Econ.

Other group companies

	Turnover FIM million	
	1998	1997
Lelumyynti Oy J. Otonkoski	53.2	49.0
Tampereen Konepalvelu Oy	39.1	45.3
Tampereen Työstökonevackraus Oy	0.1	0.3
Oy Scan-Marne Ab	1.1	2.5
A/S Tallmac (50 %)	31.8	35.7

The Group also comprises 7 real estate companies

Personnel and salaries

The parent company, Machinery Ltd, employed an average of 107 (1997:114) people during the financial year, while the entire Group employed 148 (1997:155) people.

Wages and salaries within the Group were paid as follows:

	Group		Parent company	
	1998	1997	1998	1997
Managing Directors and Members of the Board	2,540,827	2,332,484	673,175	706,815
Bonuses	300,000	302,524		
Other wages, salaries and remuneration	27,182,651	26,949,270	20,373,598	19,988,966

Outlook

The balanced growth of the Finnish economy will provide trade in the technology sector with fairly good business potential. In accordance with the management system, each department of Machinery Ltd has prepared an action plan, which they will follow to implement the shared business strategy. The European Quality Award criteria are used as the guideline for drawing up the plans and for monitoring the results. The new organisation, which was introduced a year ago, has proven to be extremely functional. We have budgeted a 5 percent increase in turnover and a 23 percent increase in operating margin for the parent company. In addition, we plan to spend FIM 23 million to repay interest-bearing liabilities during the year.

Board of Directors

At the Annual General Meeting of Machinery, Mr. Carl G. Nordman was elected a new member of the Board.

The following will continue as members of the Board:

Juhani Otonkoski	M. Sc. (Pol. Sc.)	Chairman
Pekka Linnanmaa	M. Sc. (Econ.)	Vice-Chairman
Juhani Suomela	M. Sc. (Econ.)	
Janne Timonen	M. Sc. (Econ.)	
Juha Timonen	Diploma in BA	

Mr. Heikki Timonen (M. Sc. Econ.) acted as the secretary to the Board and as the company's Managing Director.

Auditors

SVH Pricewaterhouse Coopers Oy Accountants

Proposal on the distribution of profits

The Board of Directors proposes that the financial year's profit of FIM 4,030,955.18 be transferred on a profit and loss account, and that no dividend be paid.

Profit and loss account

	Parent company		Group	
	1.1.-31.12.1998	1.1.-31.12.1997	1.1.-31.12.1998	1.1.-31.12.1997
Turnover	237,334,082.06	193,509,028.34	330,180,978.91	290,168,835.39
Other income from business operations	5,405,635.98	8,708,651.22	5,316,194.77	9,069,080.25
Variable costs				
Materials, supplies and goods				
Purchases during the financial year	180,091,063.16	141,777,111.34	247,399,968.60	201,777,682.44
Increase (-)/decrease (+) in stocks	-1,852,415.17	1,112,955.24	-6,385,180.19	7,121,325.33
External services	1,380,955.21	1,663,311.36	1,380,955.21	1,663,311.36
	179,619,603.20	144,553,377.94	242,395,743.62	210,562,319.13
Gross margin	63,120,114.84	57,664,301.62	93,101,430.06	88,675,596.51
Fixed costs				
Personnel costs	26,636,047.73	25,851,905.04	37,578,034.25	36,306,779.90
Rents	6,529,612.93	7,391,182.14	6,743,177.56	8,374,838.29
Other fixed costs	15,383,368.56	15,026,443.20	27,019,052.28	24,417,153.81
	48,549,029.22	48,269,530.38	71,340,264.09	69,098,772.00
Operating profit before depreciation and other long-term expenditure	14,571,085.62	9,394,771.24	21,761,165.97	19,576,824.51
Depreciation on fixed assets and other long-term expenditure	2,487,453.64	2,381,085.23	4,902,182.72	4,648,985.64
Operating profit	12,083,631.98	7,013,686.01	16,858,983.25	14,927,838.87
Financial income and expenses				
Dividend income	192,071.50	14,715.20	1,670.60	16,905.20
Interest income from long-term investments	482,439.99	827,267.97	538,860.14	1,033,011.12
Other financial income	495,871.53	1,151,172.51	825,573.64	1,354,222.44
Exchange rate gains and losses	-18,801.62	1,047,373.87	-18,801.62	1,047,373.87
Share of associated companies' profits			56,398.12	535,787.53
Interest expenses	-10,082,727.14	-12,189,129.46	-10,432,599.84	-12,270,562.75
Other financial expenses	-500,654.32	-488,415.12	-544,784.12	-523,710.92
	-9,431,800.06	-9,637,015.03	-9,573,683.06	-8,806,973.51
Profit/loss before extraordinary items, provisions and taxes	2,651,831.92	-2,623,329.02	7,285,300.17	6,120,865.36
Extraordinary income and expenses				
Extraordinary income				
Group contribution	1,550,000.00	11,528,000.00	0.00	1,015,110.69
Extraordinary expenses				
Group contribution	-610,000.00		-32,600.00	0.00
	940,000.00	11,528,000.00	-32,600.00	1,015,110.69
Profit/loss before provisions and taxes	3,591,831.92	8,904,670.98	7,252,700.17	7,135,976.05
Increase (-) decrease (+) in depreciation difference	1,186,273.10	238,160.50	994,792.66	-384,317.91
Increase (-) decrease (+) in voluntary provisions			0.00	9,611,530.00
Direct taxes				
For the financial year	213,216.94	-96,036.60	-1,694,606.94	-2,513,495.60
For previous financial years	533,932.90	58,643.30	-543,419.90	58,506.30
	-747,149.84	-37,393.30	2,238,026.84	-2,454,989.30
Profit/loss for the financial year before minority interest			6,009,465.99	13,908,198.84
Minority interest of the profit/loss for the financial year			2,228.68	-15,446.08
Consolidated profit for the financial year	4,030,955.18	9,105,438.18	6,007,237.31	13,892,752.76

Balance sheet

	Parent company		Group	
	31.12.1998	31.12.1997	31.12.1998	31.12.1997
ASSETS				
Fixed assets and other long-term investments				
Intangible assets				
Intangible rights	60,040.00	60,040.00	443,942.57	443,287.72
Goodwill			0.00	6,000.00
Group goodwill			535,355.67	1,957,160.28
			979,298.24	2,406,448.00
Tangible assets				
Land and water	133,000.00	133,000.00	7,798,432.11	7,798,432.11
Buildings and constructions			78,362,554.21	78,350,433.56
Machinery and equipment	4,941,609.69	6,064,555.23	8,405,290.15	8,551,342.22
Other tangible assets	1,282,482.74	462,312.52	1,887,680.31	1,045,057.99
Advance payments	414,225.00	758,195.00	414,225.00	758,195.00
	6,771,317.43	7,418,062.75	96,868,181.78	96,503,460.88
Other long-term investments				
Shares in associated companies	874,690.00	874,690.00	10,819,037.21	3,438,785.55
Shares and interests	5,274,027.52	5,310,860.32	6,682,705.22	6,719,538.02
Shares in subsidiaries	60,155,400.00	59,892,702.00		
	66,304,117.52	66,078,252.32	17,501,742.43	10,158,323.57
Current assets				
Inventories				
Goods	26,503,098.85	24,650,683.68	45,072,970.12	38,707,789.93
Advance payments	1,239,268.64	565,393.62	5,140,907.53	913,579.62
	27,742,367.49	25,216,077.30	50,213,877.65	39,621,369.55
Receivables				
Accounts receivable	22,716,946.37	23,497,971.87	37,592,179.12	42,636,604.09
Loan receivables	95,020,644.02	105,023,268.31	3,602,407.80	12,075,937.59
Accrued income and prepaid expenses	1,436,526.53	3,437,999.19	2,029,580.43	3,576,950.59
Other receivables			63,343.20	64,343.20
	119,174,116.92	131,959,239.37	43,287,510.55	58,353,835.47
Cash in hand and at banks	1,044,088.97	1,051,332.90	17,649,739.28	19,409,902.27
	221,096,048.33	231,783,004.64	226,500,349.93	226,453,339.74

	Parent company		Group	
	31.12.1998	31.12.1997	31.12.1998	31.12.1997
LIABILITIES				
Shareholders' equity				
Restricted equity				
Share capital	9,000,000.00	9,000,000.00	9,000,000.00	9,000,000.00
Capital loan	27,000,000.00	27,000,000.00	27,000,000.00	27,000,000.00
Non-restricted equity				
Contingency fund	19,492.80	19,492.80	19,492.80	19,492.80
Profit for the previous financial years	21,774,083.18	12,668,645.00	1,376,748.58	12,516,004.18
Profit for the financial year	4,030,955.18	9,105,438.18	6,007,237.31	13,892,752.76
	25,824,531.16	21,793,575.98	7,403,478.69	1,396,241.38
Minority interests			76,596.33	74,367.65
Provisions				
Accumulated depreciation difference	429,115.95	1,615,389.05	2,242,899.00	3,237,691.66
Liabilities				
Long-term				
Loans from financial institutions	58,030,917.00	67,899,075.65	61,280,917.00	67,899,075.65
Pension loans	29,959,194.09	33,527,090.39	30,856,937.99	34,517,374.69
	87,990,111.09	101,426,166.04	92,137,854.99	102,416,450.34
Current				
Loans from financial institutions	28,857,038.59	31,455,804.98	29,972,116.85	31,592,044.98
Pension loans	3,567,896.30	3,588,060.60	3,660,439.70	3,613,857.90
Advances received	4,957,292.98	3,334,005.34	8,296,626.70	4,159,006.00
Accounts payable	14,870,486.87	19,345,405.63	23,810,410.62	25,210,180.87
Accrued liabilities and prepaid income	18,540,378.41	13,106,367.68	22,525,247.90	18,272,210.32
Other current liabilities	59,196.98	118,229.34	374,679.15	481,288.64
	70,852,290.13	70,947,873.57	88,639,520.92	83,328,588.71
	221,096,048.33	231,783,004.64	226,500,349.93	226,453,339.74