

## Equities

25 January 2011 | 59 pages

# Sandvik AB (SAND.ST)

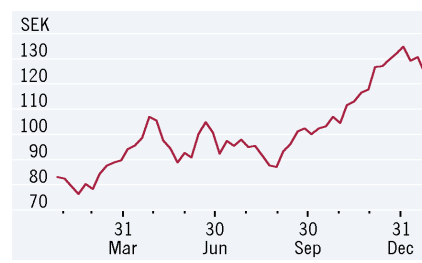
## What Can The New CEO Bring?

- Company Update
- Target Price Change
- Estimate Change

- **New Management Team** — Sandvik will start 2011 under a new, externally recruited, CEO, Olof Faxander (Sandvik have not had an external CEO before). In this report we explore changes that the new CEO can bring to enhance the longer-term value of Sandvik. We are looking for evidence of 1) efficiency improvement; 2) cashflow and balance sheet management and 3) communication improvement. Sandvik has underperformed its peers over the past decade. We believe Sandvik could start to reverse its relative under-performance over the balance of the year if a credible plan for improving operational performance is provided.
- **Tungsten Advantage** — During the downturn Sandvik acquired a Tungsten mine (Feb-09). We see this as a significant strategic advantage to Sandvik's Tooling division as (i) no other competitor owns a tungsten mine and (ii) tungsten price has recently surpassed its previous peak.
- **Nuclear Renaissance** — Sandvik's SMT division is well positioned to benefit from global nuclear expansion (expected to double by 2030). Since the start of 2009, Sandvik received nuclear related orders of >SKr10bn (vs. our 2010E SMT sales forecast at SKr17bn), which is positive for mix given inherently higher margins.
- **EPS Raised** — We raise our 2011E and 2012E EPS by 10% and 14% respectively and also slightly upgrade our 2010E EPS. This reflects an increase in growth estimates (particularly at the SMC and SMT divisions) and EBIT margins (particularly at SMT). We now expect new peak margins of 18% in 2012E; consensus assumes no improvement vs. the prior peak of 17% in 2007.
- **Target Price Raised to SKr175** — We raise our Target Price to SKr175 (from SKr125) based on a higher DCF valuation (with our through-cycle margin assumption raised to 15.5% from 14%). While valuation versus our Mechanicals coverage is high, Sandvik is on just 12.5x 2012E P/E vs. Atlas Copco on 15.6x, Metso on 13.1x and SKF on 12.2x.

<b>Buy/High Risk</b>	<b>1H</b>
Price (25 Jan 11)	SKr126.00
Target price	SKr175.00
	from SKr125.00
Expected share price return	38.9%
Expected dividend yield	1.7%
<b>Expected total return</b>	<b>40.6%</b>
Market Cap	SKr149,472M
	US\$22,705M

### Price Performance (RIC: SAND.ST, BB: SAND SS)



### Sandvik AB (SEK)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (SKrM)	92,654.0	71,937.0	81,858.3	89,652.9	99,113.6
Net Income (SKrM)	7,472.0	-2,653.0	6,524.5	9,342.5	11,933.2
Diluted EPS (SKr)	6.29	-2.24	5.50	7.87	10.05
Diluted EPS (Old) (SKr)	6.29	-2.24	5.32	7.13	8.82
PE (x)	20.0	-56.3	22.9	16.0	12.5
EV/EBITDA (x)	10.4	29.5	11.7	9.2	7.6
DPS (SKr)	3.15	1.00	2.20	3.15	5.03
Net Div Yield (%)	2.5	0.8	1.7	2.5	4.0

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
<b>Valuation Ratios</b>					
P/E adjusted (x)	20.0	nm	22.9	16.0	12.5
EV/EBITDA adjusted (x)	10.4	29.5	11.7	9.2	7.6
P/BV (x)	4.2	5.2	4.4	3.7	3.1
Dividend yield (%)	2.5	0.8	1.7	2.5	4.0
<b>Per Share Data (SKr)</b>					
EPS adjusted	6.30	-2.24	5.50	7.88	10.06
EPS reported	6.29	-2.24	5.50	7.87	10.05
BVPS	30.00	24.44	28.58	34.25	41.16
DPS	3.15	1.00	2.20	3.15	5.03
<b>Profit &amp; Loss (SKrM)</b>					
Net sales	92,654	71,937	81,858	89,653	99,114
Operating expenses	-79,906	-73,310	-70,659	-74,896	-81,220
<b>EBIT</b>	<b>12,748</b>	<b>-1,373</b>	<b>11,199</b>	<b>14,757</b>	<b>17,894</b>
Net interest expense	-2,217	-2,060	-1,714	-1,356	-919
Non-operating/exceptionals	46	-39	0	0	0
<b>Pre-tax profit</b>	<b>10,577</b>	<b>-3,472</b>	<b>9,486</b>	<b>13,401</b>	<b>16,975</b>
Tax	-2,741	876	-2,561	-3,658	-4,685
Extraord./Min.Int./Pref.div.	-364	-57	-400	-400	-357
<b>Reported net income</b>	<b>7,472</b>	<b>-2,653</b>	<b>6,525</b>	<b>9,342</b>	<b>11,933</b>
Adjusted earnings	7,472	-2,653	6,525	9,342	11,933
Adjusted EBITDA	17,702	6,256	15,443	19,273	22,518
<b>Growth Rates (%)</b>					
Sales	7.3	-22.4	13.8	9.5	10.6
EBIT adjusted	-6.9	-87.9	539.5	34.6	21.3
EBITDA adjusted	-3.6	-64.7	146.8	24.8	16.8
EPS adjusted	-18.0	-135.5	345.9	43.2	27.7
<b>Cash Flow (SKrM)</b>					
<b>Operating cash flow</b>	<b>9,671</b>	<b>12,804</b>	<b>10,539</b>	<b>12,128</b>	<b>14,823</b>
Depreciation/amortization	3,481	5,033	4,475	4,516	4,624
Net working capital	-1,348	11,632	-861	-2,130	-2,091
<b>Investing cash flow</b>	<b>-7,631</b>	<b>-6,193</b>	<b>-4,518</b>	<b>-4,752</b>	<b>-5,253</b>
Capital expenditure	-6,788	-4,212	-4,093	-4,752	-5,253
Acquisitions/disposals	-843	-1,981	-425	0	0
<b>Financing cash flow</b>	<b>724</b>	<b>-3,138</b>	<b>-1,186</b>	<b>-2,610</b>	<b>-3,737</b>
Borrowings	6,542	-1,565	0	0	0
Dividends paid	-5,111	-3,926	-1,186	-2,610	-3,737
<b>Change in cash</b>	<b>2,764</b>	<b>3,473</b>	<b>4,835</b>	<b>4,767</b>	<b>5,833</b>
<b>Balance Sheet (SKrM)</b>					
<b>Total assets</b>	<b>103,227</b>	<b>91,575</b>	<b>101,229</b>	<b>109,870</b>	<b>120,253</b>
Cash & cash equivalent	4,998	7,506	12,341	17,108	22,940
Accounts receivable	15,930	11,587	13,365	14,762	16,457
Net fixed assets	26,123	26,519	26,136	26,372	27,002
<b>Total liabilities</b>	<b>66,502</b>	<b>61,618</b>	<b>65,959</b>	<b>67,467</b>	<b>69,297</b>
Accounts payable	7,000	4,730	6,201	6,791	7,508
Total Debt	37,128	36,724	36,724	36,724	36,724
<b>Shareholders' funds</b>	<b>36,725</b>	<b>29,957</b>	<b>35,270</b>	<b>42,403</b>	<b>50,956</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	19.1	8.7	18.9	21.5	22.7
ROE adjusted	23.3	-8.2	20.7	25.1	26.7
ROIC adjusted	16.7	3.7	13.1	16.9	19.3
Net debt to equity	87.5	97.5	69.1	46.3	27.0
Total debt to capital	50.3	55.1	51.0	46.4	41.9

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## Investment Summary

In this report we reiterate our Buy rating on Sandvik and upgrade our target price to SKr175 from SKr 125 based on a higher DCF valuation (with our through-cycle margin assumption raised to 15.5% from 14%). While valuation versus our Mechanicals coverage is high, Sandvik is on just 12.5x 2012E P/E vs. Atlas Copco on 15.6x, Metso on 13.1x and SKF on 12.2x, which is particularly attractive against its relatively higher growth profile than that of Metso or SKF, in our view.

In this report we first look at what the new CEO, Olof Faxander, could bring in and second growth opportunities particularly in mining and nuclear. Overall, we believe despite very hefty upgrades (for more details on consensus upgrades see Appendix- B), the stock is not pricing a potential improvement in operating margins longer-term. Given the relatively low consensus expectations and the prevailing skepticism in the market about Sandvik's ability to surpass the previous peak margins – consensus forecasts 2012 EBIT margins at 17% (in line with the previous peak) compared to over 300bps improvement to the previous peak margins of Atlas Copco and just under 300bps for SKF, we believe a change in the operational approach is needed. We believe the stock could start to reverse some of its relative underperformance in the past decade, over the balance of the year if the new management team can provide a credible plan for improving operational performance of Sandvik.

## New Management Team

Sandvik is starting 2011 under the new, externally recruited, CEO, Olof Faxander (Sandvik have not had an external CEO before) as of February 1. There are many successful examples of turn-arounds with externally appointed CEO including Atlas Copco, Siemens and SKF. As with many companies that undergo external management change, there is likely to be a degree of uncertainty in the near-term as to what the new CEO's strategy will be, but it is possible this may not be unveiled until this year's Capital Markets Day (September 14).

In this report we explore changes that the new CEO can bring to enhance the longer-term value of Sandvik. We are looking for the evidence of

- **Efficiency Improvement** – In particular closing the margin gap between Sandvik's Mining and Construction division and its main competitor Atlas Copco. Despite this being a focus for some time at Sandvik, the prevailing margin gap has widened and the recent downturn's negative earnings momentum suggests not much has changed. In addition, Sandvik needs to show the evidence of the structural changes at SMT in particularly a change in approach of management metal price effects (although we acknowledge the gap is impossible to close full, but any signal of minimizing volatility experienced since 2007, would be well received) as well as evidence of continued improvement in the business mix;
- **Cashflow and Balance Sheet Management** – In particular efficient management of investment relative to the demand environment in order to avoid over-investment as witnessed in the recent downturn (i.e. capex as % of sales peaked at well over 7% in 2008 vs. 2000-2007 average of 5%) and continued improvement of the working capital/sales ratio (despite a notable improvement Sandvik is yet to achieve its targeted 25% and prove its ability to sustain this level). The evidence of the above in our view is far more important than Sandvik's acquisitive activity. We believe the market is overconcerned about Sandvik relatively weaker firepower when it comes to

making acquisitions (compared to Atlas Copco and SKF). While we view further strategic acquisitions as important to Sandvik's growth story, we believe if there is no operational improvement, the shares will struggle to outperform its peers even if Sandvik make further acquisitions. We note the previous management team was very successful in making sensible strategic acquisitions, but the share price underperformed relatively to its peers;

- **Communication Improvement** – We believe the market will welcome a set operational margins targets over the long-term and a well communicated strategy and timing of improving operation efficiency. Despite improving operational efficiency has been on Sandvik's agenda for some time and Sandvik has a set internal targets, which are not communicated to the market, so far the evidence of execution has been somewhat limited and only a margin target for SMT of 12-15% have been communicated. We believe a credit plan for improving operational performance of Sandvik, will be well received by the market.

## Tungsten Advantage

During the downturn (Feb-09) Sandvik acquired a Tungsten mine (WBH). We see this as a significant strategic advantage to Sandvik's Tooling division as (i) no other competitor owns a tungsten mine; ii) independence from China's 70-80% control of the global supply of tungsten; iii) WBH has an unrivaled capability to develop more advanced raw materials which Sandvik can develop even further; iv) WBH also has the capability of recycling – prior to the acquisition Sandvik used 25-30% of tungsten powder supply from recycling, which is much more cost effective; post the WBH acquisition the proportion will increase up to 50% and (v) most recently tungsten price has surpassed its previous peak, up 76% since the beginning of 2010 to date. Sandvik does not disclose the proportion of tungsten of their total cost base of its Tooling division. However, worth noting in the past Sandvik has indicated that raw materials are less than 10% of total Tooling costs.

## Nuclear Renaissance

Sandvik's SMT division is well positioned to benefit from global nuclear expansion (expected to double by 2030) led by planned and proposed nuclear plants in Asia with a particular bias to China. China has recently doubled its previously planned 55 new nuclear reactors to 110 with the first part of expansion planned in 2011, up until 2016. Since the start of 2009, Sandvik received nuclear related orders of >SKr10bn (vs. our 2010E SMT sales forecast at SKr17bn), which is positive for mix given inherently higher margins. Worth noting since 2009, Sandvik has substantially increased its capacity at SMT. Additional capacity will allow Sandvik to manufacture SKr1.5-2bn of SG tubes in Sandviken vs. SKr600m manufactured up until recently.

## Changes to Forecasts

In this report we raise our 2011E and 2012E EPS by 10% and 14% respectively and also slightly upgrade our 2010E EPS. This reflects an increase in growth estimates particularly at SMC - we now forecast 19% LFL sales growth in 2011E (previously 13%) and 12% in 2012E (previously 8%), and SMT divisions. In addition, we raise our EBIT margins across the group especially at SMT. We now expect new peak margins of 18% in 2012E – consensus assumes no improvement vs. the prior peak of 17% in 2007.

Figure 1. Sandvik Forecast Changes

	New 2010E	2011E	2012E	Old 2010E	2011E	2012E	Change 2010E	2011E	2012E
<b>Sales by Division</b>									
Tooling	23,828	24,607	26,083	23,183	23,709	24,894	3%	4%	5%
Mining and Construction	34,872	40,092	44,903	34,872	38,697	41,406	0%	4%	8%
Materials Technology	17,288	18,611	21,403	17,090	17,543	18,420	1%	6%	16%
<b>Net sales</b>	<b>81,858</b>	<b>89,653</b>	<b>99,114</b>	<b>80,855</b>	<b>86,063</b>	<b>91,142</b>	<b>1%</b>	<b>4%</b>	<b>9%</b>
<b>EBIT by Division</b>									
Tooling	4,254	5,413	6,521	4,076	4,979	5,975	4%	9%	9%
Mining and Construction	4,749	6,174	7,364	4,493	5,805	6,625	6%	6%	11%
Materials Technology	1,573	2,233	2,740	1,508	1,754	2,026	4%	27%	35%
<b>EBIT</b>	<b>11,199</b>	<b>14,757</b>	<b>17,894</b>	<b>10,657</b>	<b>13,272</b>	<b>15,628</b>	<b>5%</b>	<b>11%</b>	<b>14%</b>
<b>EBIT Margin per Division</b>									
Tooling	17.9%	22.0%	25.0%	17.6%	21.0%	24.0%	0.3	1.0	1.0
Mining and Construction	13.6%	15.4%	16.4%	12.9%	15.0%	16.0%	0.7	0.4	0.4
Materials Technology	9.1%	12.0%	12.8%	8.8%	10.0%	11.0%	0.3	2.0	1.8
<b>Group Margin</b>	<b>13.7%</b>	<b>16.5%</b>	<b>18.1%</b>	<b>13.2%</b>	<b>15.4%</b>	<b>17.1%</b>	<b>0.5</b>	<b>1.0</b>	<b>0.9</b>
<b>PBT</b>	<b>9,253</b>	<b>13,401</b>	<b>16,975</b>	<b>8,956</b>	<b>11,900</b>	<b>14,627</b>	<b>3%</b>	<b>13%</b>	<b>16%</b>
<b>CIRA EPS</b>	<b>5.50</b>	<b>7.88</b>	<b>10.06</b>	<b>5.32</b>	<b>7.14</b>	<b>8.82</b>	<b>3%</b>	<b>10%</b>	<b>14%</b>

Source: Citi Investment Research and Analysis

## Next Catalyst

Sandvik will report its 4Q10 results on February 2 at 7am GMT followed by the conference call at 12.30 GMT. We forecast sales at SKr22.5bn, slightly above the current consensus and EBIT at SKr 3.3bn, slight above the current consensus as shown in the table below (for more detailed preview see page 45).

Figure 2. Sandvik 4Q10 Results Preview (CIRA and SME Direkt Consensus)

Sandvik	Reported				CIRA 4Q10E	Consensus 4Q10E	CIRA vs Consensus 4Q10E	Reported				CIRA			Consensus		
	4Q09 A	1Q10 A	2Q10 A	3Q10 A				2009A	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
<b>Total Sales</b>	<b>18,211</b>	<b>18,534</b>	<b>20,603</b>	<b>20,241</b>	<b>22,480</b>	<b>21,803</b>	<b>3.1%</b>	<b>71,937</b>	<b>81,858</b>	<b>89,653</b>	<b>99,114</b>	<b>81,181</b>	<b>89,385</b>	<b>96,060</b>			
Sales growth y/y	-25%	-3%	14%	22%	23%	20%	3.7	-22%	14%	10%	11%	13%	10%	7%			
Of which price/volume	-26%	-1%	13%	20%	26%	na	na	-30%	15%	13%	11%	na	na	na			
<b>EBIT</b>	<b>408</b>	<b>1,897</b>	<b>3,471</b>	<b>2,532</b>	<b>3,299</b>	<b>3,238</b>	<b>1.9%</b>	<b>-1,412</b>	<b>11,199</b>	<b>14,757</b>	<b>17,894</b>	<b>11,138</b>	<b>14,348</b>	<b>15,330</b>			
Margin	2.2%	10.2%	16.8%	12.5%	14.7%	14.9%		-2.0%	13.7%	16.5%	18.1%	13.7%	16.1%	16.0%			

Source: Company Reports, Citi Investment Research and Analysis; SME Direkt Consensus

## What Can the New CEO Bring?

Sandvik is starting 2011 under the new, externally recruited, management team

Successful examples of externally brought CEOs include Atlas Copco, Siemens and SKF

Sandvik has previously not had an external CEO

Sandvik is starting 2011 under the stewardship of a new, externally recruited, senior management team. Over the past 17 months Sandvik has made significant changes to its management team, first with the CFO, Ola Salmen effective from September, 1 2009 (previously CFO of Vin & Sprit AB) and most recently announced (December, 14 2010) the new CEO, Olof Faxander, who will assume his responsibilities from February 1, 2011 (previously CEO of Swedish high-strength steel producer, SSAB, since 2006).

As with many companies that undergo external management change, there is likely to be a degree of uncertainty in the near-term as to what the new CEO's strategy will be, but it is possible this may not be unveiled until this year's Capital Markets Day (September 14). In Figure 3 we show a number of successful turn-arounds under new, externally appointed CEOs in our sector (e.g. Gunnar Brock at Atlas Copco; Peter Löscher at Siemens; Sune Carlsson, who started the change at SKF). Worth noting Sandvik has previously not had an external CEO apart from when the major shareholder came in to run the group during 1983-1984 and 1967-1979.

**Figure 3. Management Change at Our Large Engineering Companies since early 1990s**

Company	Announced	Effective	New CEO	External/Internal Replacement?
Atlas Copco	20/01/2009	01/06/2009	Ronnie Leten	Internal
	29/04/2002	01/07/2002	Gunnar Brock	External
	27/01/1997	22/04/1997	Giulio Mazzalupi	Internal
	15/02/1991	25/04/1997	Michael Treschow	Internal
Sandvik	14/12/2010	01/02/2011	Olof Faxander	External
	16/01/2002	07/05/2002	Lars Pettersson	Internal
	08/03/1994	17/05/1994	Clas Åke Hedström	Internal
		1984	Per-Olof Eriksson	Internal
		1983	Göran Ahlström	External – Kinnevik*
		1979	Lennart Ollén	Internal
		1967	Arne Westerberg	External – Kinnevik*
		1958	Wilhelm Haglund	Internal
SKF	04/02/2003	15/04/2003	Tom Johnstone	Internal
	14/08/1998	01/09/1998	Sune Carlsson	External
	23/02/1995	27/04/1995	Peter Augustsson	Internal
		1985	Mauritz Sahlin	
Siemens	20/05/2007	01/07/2007	Peter Löscher	External
	07/07/2004	27/01/2005	Klaus Kleinfeld	Internal
	02/07/1992	01/10/1992	Heinrich von Pierer	Internal
		1981	Karlheinz Kaske	

\* Kinnevik is an investment company that acquired a large stake in Sandvik in 1957 when the founding Göransson family did a capital raising, before Kinnevik finally sold their stake to Skanska in the early 1980s, Skanska then built up a 37% position.

Source: Company Reports, Citi Investment Research and Analysis



### Generation shift in Sandvik may bring changes to the executive management team

What is clear is that the new CEO, Mr. Faxander marks a generation shift in Sandvik and his experience in the intensely competitive high-strength steel industry may prove a major positive for the group, and particularly for Sandvik's Material Technology division, which has struggled to achieve its 12%-15% EBIT margin target (mentioned on several occasions). With regards to the generation shift at Sandvik, we would not rule a possibility of more changes to the executive management team at the divisional head level in the near term, with several members approaching the early retirement age of 62. In Figure 4 we show Sandvik's current executive management team.

**Figure 4. Sandvik Executive Management Team**

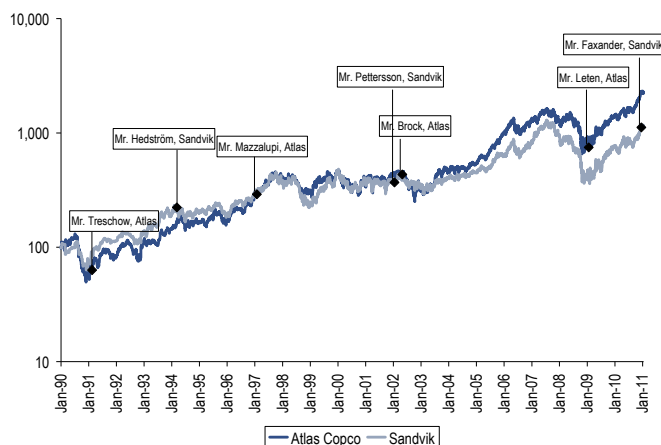
Position	Date	Outgoing	Age	Incoming	Age	External/Internal	Details
<b>Recent Executive Management Changes:</b>							
CEO	14/12/2010	Lars Pettersson	56	Olof Faxander	40	External	CEO at SSAB
CFO	25/02/2009	Per Nordberg	53	Ola Salmen	56	External	CFO at Vin & Sprit AB, 2002-09
<b>Current Divisional Executive Management:</b>							
SMT	Head	Peter Gossas	61	Since 2002		External	Business unit manager positions within Avesta Polarit, Avesta Sheffield and Avesta AB 1986-2001
Tooling	Head	Anders Thelin	60	Since 2000		Internal	Various positions within R&D and the management group of Sandvik Coromant 1976-2000
SMC	Head	Lars Josefsson	57	Since 2003		External	President of ABB STAL/Alstom Sweden AB 1998-2003
SMT	CFO	Jan Öhman	50				
Tooling	CFO	Per-Ove Ehrling	63				
SMC	CFO	Gert Sköld	45				

Source: Company Reports, Citi Investment Research and Analysis

### Management re-rating stories take time

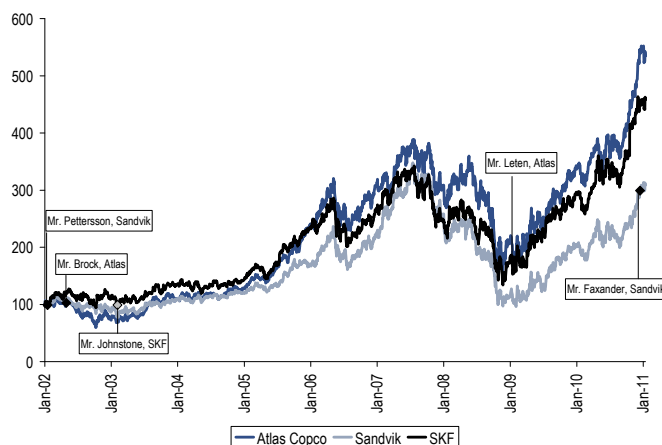
The management change has been welcomed by the market. Typically, management re-rating stories take time; it took Atlas Copco, which was not popular with the market in the 1990s, 4-6 years to be regarded as one of the highest quality companies in our European Engineering Sector. The turning point in the share price performance for Atlas Copco was about 1 year after Gunnar Brock was brought in externally to become the new CEO (announced in late March 2002) - Figure 5. While Sandvik's absolute share price return has been significant since the appointment of Lars Pettersson as the CEO, in relative terms (i.e. vs. Atlas Copco and SKF) the shares have underperformed (Figure 6).

**Figure 5. Sandvik vs. Atlas Copco Share Price Performance & New CEO Announcements since 1990**



Source: Citi Investment Research and Analysis

**Figure 6. Sandvik vs. Atlas Copco and SKF Share Price Performance & New CEO Announcements since 2002**



Source: Citi Investment Research and Analysis



For Sandvik to outperform its peers the market needs evidence of 1) efficiency improvement; 2) communication improvement and 3) cashflow and balance sheet management.

In our view, for Sandvik shares to start to outperform relative to its peers we believe the market would need to see (in addition to the general economic recovery) evidence of a change in approach from Sandvik's new management team in three main areas:

- 1) **Efficiency Improvement** – In particular closing the margin gap between Sandvik's Mining and Construction division and its main competitor Atlas Copco. Despite this being a focus for some time at Sandvik, the prevailing margin gap has widened and the recent downturn's negative earnings momentum suggests not much has changed. In addition, Sandvik needs to show the evidence of the structural changes at SMT, particularly a change in the management of metal price effects (although we acknowledge the gap is impossible to close fully, any signal of minimising volatility experienced since 2007 would be well received) as well as evidence of continued improvement in the business mix;
- 2) **Cashflow and Balance Sheet Management** – In particular efficient management of investment relative to the demand environment in order to avoid over-investment as witnessed in the recent downturn (i.e. capex as % of sales peaked at well over 7% in 2008 vs. 2000-2007 average of 5%) and continued improvement of the working capital/sales ratio (despite a notable improvement, Sandvik is yet to achieve its targeted 25% and prove its ability to sustain this level). The evidence of the above in our view is far more important than Sandvik's acquisitive activity. We believe the market is overconcerned about Sandvik's relatively weaker firepower when it comes to making acquisitions (compared to Atlas Copco and SKF). While we view further strategic acquisitions as important to Sandvik's growth story, we believe if there is no operational improvement, the shares will struggle to outperform peers even if Sandvik make further acquisitions. We note the previous management team was very successful in making sensible strategic acquisitions, but the share price underperformed relative to its peers.
- 3) **Communication Improvement** – We believe the market will welcome a set of operational margins targets over the long-term and a well communicated strategy and timing of improving operation efficiency. Although improving operational efficiency has been on Sandvik's agenda for some time and Sandvik has a set internal targets, which are not communicated to the market, so far the evidence of execution has been somewhat limited and only a margin target for SMT of 12-15% have been communicated.

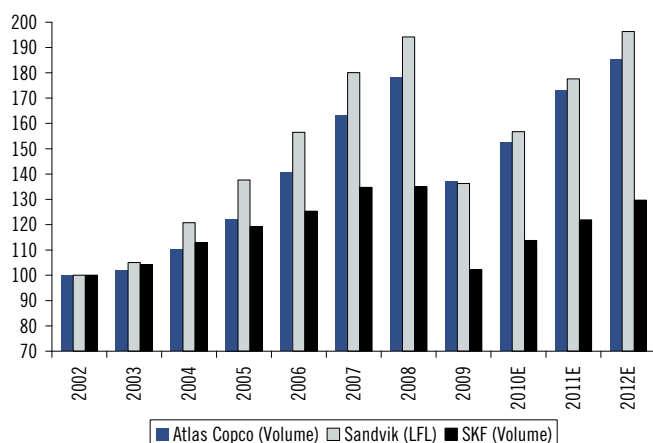
Below we go over 1) and 2) in more detail:

## 1) Efficiency Improvement

Amongst Swedish industrials under our coverage Sandvik saw the sharpest EBIT margin contraction in 2009

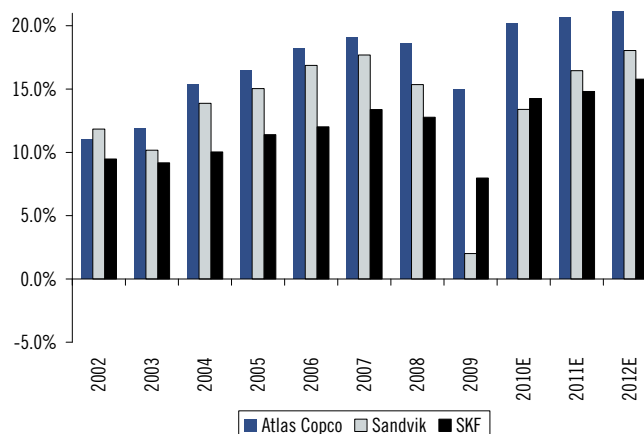
Amongst Swedish industrials under our coverage Sandvik saw the sharpest EBIT margin contraction in 2009, owing to a number of factors: i) volume contraction (Figure 7); ii) high operational leverage (Figure 8) - Sandvik amongst its Swedish engineering peers has a higher fixed cost base owing to its vertically integrated model compared to Atlas Copco which is an assembler and iii) prevailing inefficiencies across the group. For more information on divisional performance since 1990 to date view Appendix-A.

Figure 7. Atlas Copco, Sandvik, SKF - Volumes Indexed at 100 in 2002



Source: Citi Investment Research and Analysis

Figure 8. Atlas Copco, Sandvik, SKF - Underlying EBIT Margins



Source: Citi Investment Research and Analysis

**Despite hefty upgrades, consensus still assumes no improvement in EBIT margins vs. the prior peak and LFL sales still 6% below the prior peak**

Despite hefty upgrades across our Mechanicals coverage (for more information on consensus upgrades in our overall sector and individual Swedish industrial companies see Appendix B), the consensus still does not give Sandvik the benefit of the doubt in particular when it comes to new peak margins. Sandvik believes that its EBIT margin can surpass the previous peak margins (17% in 2008) when volumes recover towards the previous peak level. Sandvik estimates SKr4bn out of SKr8bn of cost savings (annual run-rate reached by the end of 2009) from its aggressive restructuring program implemented during the downturn is sustainable – note Sandvik has reduced its headcount by 18% since September 2008 to date (from 56,000 to 46,000 today) and closed 13% of its total manufacturing sites (=18 plants, 5 in Tooling and 13 in SMC). In 2012E we forecast an EBIT margin of 18% with LFL sales recovering towards the previous peak – consensus assumes no improvement relative to the previous peak EBIT margin and LFL sales still 6% below the previous peak in 2008 (Figure 9).

Figure 9. Mechanical Companies – 2012E Volumes and EBIT margins vs. the Previous Peaks

	CIRA											Consensus*		
Sales (Volume Indexed at 100):	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E	2010E	2011E	2012E
Atlas Copco (Volume)	100	102	110	122	141	163	178	137	153	173	185	149	164	177
Electrolux (LFL)	100	100	103	107	110	115	114	108	109	111	114	105	107	111
GEA (LFL)				100	126	152	163	139	139	147	158	139	148	157
Husqvarna (LFL)		100	107	111	113	117	110	101	101	108	113	95	102	113
Metso (Total Sales)	100	91	77	90	106	133	136	107	116	126	135	117	131	141
Sandvik (LFL)	100	105	121	138	156	180	194	136	157	178	196	154	169	182
SKF (Volume)	100	104	113	119	125	135	135	102	114	122	130	111	123	130
Volume Growth (y/y)														
Atlas Copco (Volume)	-3%	2%	8%	11%	15%	16%	9%	-23%	11%	13%	7%			
Electrolux (LFL)	0%	0%	3%	4%	3%	4%	-1%	-5%	1%	2%	2%			
GEA (LFL)	2%	-6%	6%	8%	26%	21%	7%	-15%	0%	6%	8%			
Husqvarna (LFL)	0%	0%	7%	3%	2%	3%	-6%	-8%	0%	6%	5%			
Metso (Total Sales)	9%	-9%	-15%	17%	17%	26%	2%	-22%	8%	9%	7%			
Sandvik (LFL)	-7%	5%	15%	14%	14%	15%	8%	-30%	15%	13%	11%			
SKF (Volume)	0%	4%	8%	6%	5%	8%	0%	-24%	11%	7%	6%			
EBIT Margins:														
Atlas Copco	11.1%	11.9%	15.4%	16.4%	18.2%	19.0%	18.6%	15.0%	20.2%	20.6%	21.1%	20.2%	21.4%	22.0%
Electrolux	5.0%	4.8%	3.9%	4.0%	4.4%	4.6%	3.3%	5.1%	6.1%	5.1%	4.6%	5.7%	5.8%	6.2%
GEA (Core GEA pre 2009)	8.1%	7.6%	8.2%	8.5%	8.1%	9.2%	9.7%	7.6%	8.0%	9.5%	11.5%	5.4%	8.8%	10.4%
Husqvarna			11.0%	10.2%	10.6%	10.7%	8.3%	5.9%	8.8%	10.5%	11.9%	7.8%	9.6%	11.2%
Metso	3.6%	-5.4%	5.5%	7.9%	9.2%	9.3%	10.0%	7.1%	8.4%	9.6%	10.8%	8.3%	9.5%	10.2%
Sandvik	11.9%	10.2%	13.9%	15.0%	16.9%	17.7%	15.3%	2.0%	13.4%	16.5%	18.1%	13.7%	16.1%	17.3%
SKF	9.5%	9.2%	10.0%	11.4%	12.0%	13.4%	12.8%	8.0%	14.3%	14.8%	15.8%	13.9%	15.1%	15.5%

Source: Company Reports, Citi Investment Research and Analysis. Consensus: SMEDirekt, Vara Research

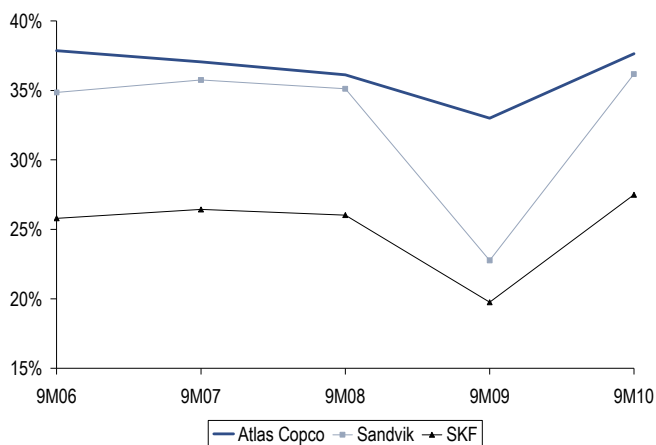
We are looking for evidence of a change in approach related to efficiency improvement from the new management team in the following areas:

### Closing Gross Margin and EBIT Margin Improvement Gap

9m10 gross margins are above previous peak, EBIT margins are still below. Any signals of Sandvik's ability to translate the improvement in gross margins into the EBIT level will be well received by the market.

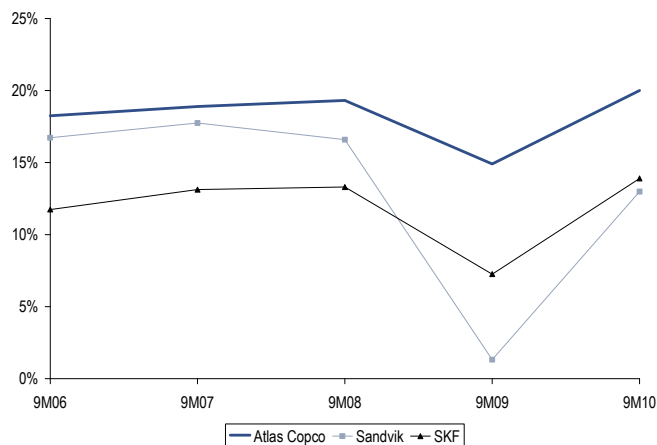
Looking at the first 9 months of 2010, Sandvik gross margins have already reached a new peak level (Figure 10) helped by a stable pricing environment, the positive mix shift in addition to the restructuring, but also the fact that Sandvik's aggressive restructuring was predominantly focused on the COGS level. However, EBIT margins in the first 9 months still remain well below the previous peak (Figure 11) unlike its peers. Consensus is somewhat sceptical in Sandvik's ability to translate the improvement in gross margins into the EBIT level and any signals from the new management team of a change in the approach will be well received by the market, in our view. One factor that we believe explains this differential is Sandvik's vertically integrated model - note that sales costs were kept unchanged. In an environment of a sustained recovery, the market will be looking for evidence of Sandvik's ability to manage volume increases at a proportionally lower cost base, returning to peak volumes without the need to substantially increase SG&A and further increase the permanent employee base.

Figure 10. Atlas Copco, Sandvik and SKF - Gross Margins



Source: Company Reports, Citi Investment Research and Analysis

Figure 11. Atlas Copco, Sandvik and SKF - Underlying EBIT Margins



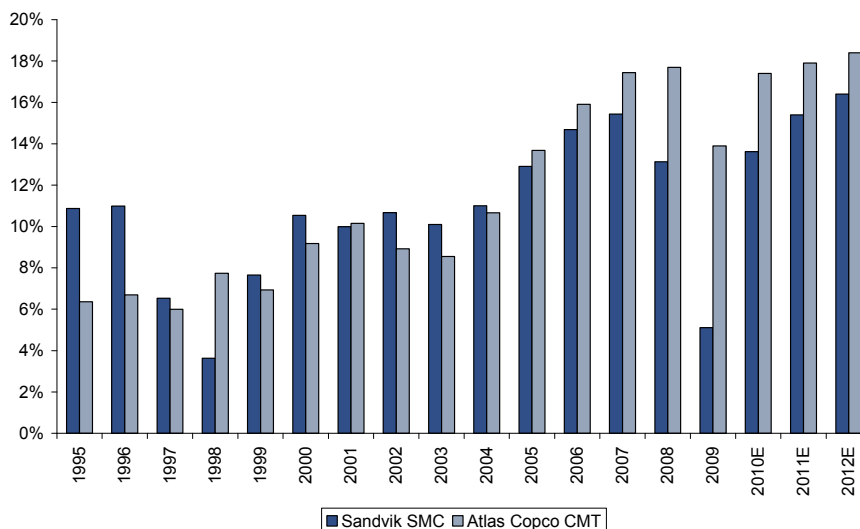
Source: Company Reports, Citi Investment Research and Analysis

## Closing the EBIT margin gap with Atlas Copco

The gap has widened suggesting not much has changed

Despite this being a focus for some time at Sandvik, the prevailing margin gap between Sandvik's Mining and Construction division and its main competitor Atlas Copco has widened (Figure 12) and the recent downturn's negative earnings momentum suggests not much has changed.

Figure 12. EBIT Margins of Sandvik's SMC vs. Atlas Copco's CMT



Source: Company Reports, Citi Investment Research and Analysis

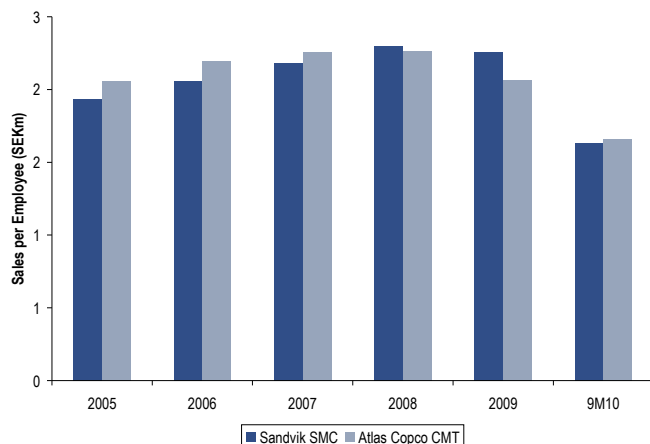
Today 85-90% of Sandvik's Mining & Construction business is comparable to Atlas Copco where we believe the margin gap can be closed

Today 85-90% of Sandvik's Mining & Construction (SMC) business is comparable to Atlas Copco, where we believe the EBIT margin gap can be closed – the other 10-15% is the large project business which inherently has lower margins. Looking at Atlas Copco's Mining and Construction division, CMT, 3Q10 margins of 17.8% and peak margins of 17.7% (in 2008), Sandvik SMC division margins potentially could be c17% vs. the reported 3Q10 of 14.5% and the previous peak of 15% in 2007 – we currently estimate margins to peak at 16% in 2012E.

The margin differential gap between Sandvik's SMC and Atlas Copco's CMT is more of inefficiency related issue rather than a more fundamental issue, in our view

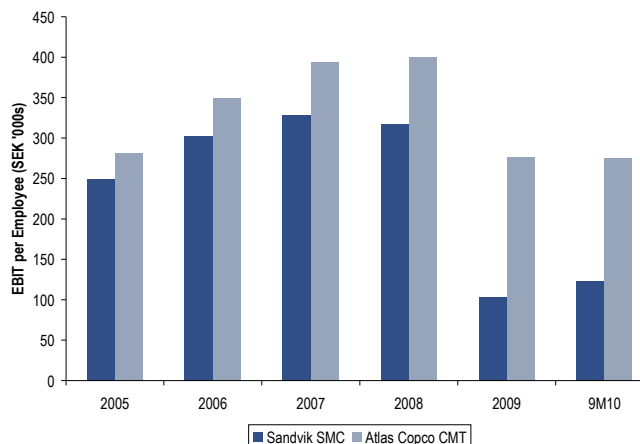
We believe the margin differential between Sandvik's SMC and Atlas Copco's CMT businesses is more of an inefficiency related issue rather than related to a more fundamental issue such as the product offering (with exception of the project business). Looking at the profitability related metrics, while sales per employee ratio of SMC is relatively similar to Atlas Copco's CMT, EBIT per employee is notably poor.

Figure 13. Sales per Employee - Sandvik's SMC vs. Atlas Copco's CMT



Source: Company Reports, Citi Investment Research and Analysis

Figure 14. EBIT per Employee - Sandvik's SMC vs. Atlas Copco's CMT



Source: Company Reports, Citi Investment Research and Analysis

Ways to narrow the margin gap may include: 1) increasing the level of outsourcing; 2) reducing acquired inefficiencies and 3) manufacturing restructuring (fewer but larger in size plants).

We would welcome firm targets/time frame/strategy on how to improve EBIT margins at SMC. Below we highlight some ways of reducing inefficiency and thereby narrowing the gap:

- Increasing the level of outsourcing. Currently Sandvik outsources 60% of its production in SMC compared to 90% that of Atlas Copco;
- Reducing inefficiency as a result of acquisitions by streamlining resources – e.g. lower costs related to components. As a reminder, Sandvik through a substantial number of acquisitions in mining acquired its way up to become a joint No.1 with Atlas Copco in underground mining, having had a limited presence in the past;
- Having fewer but larger in size manufacturing plants. Worth noting SMC closed 13% of its total manufacturing sites during the recent downturn. In 2009 Sandvik has in total across the group 139 manufacturing sites (of which SMC has 36 plants). This compares to 69 total manufacturing at Atlas Copco.

Current consensus EBIT margins forecasts remain below Sandvik's target of 12-15% - we raise our forecasts in this report to 12.8% in 2012E and 15.6% in 2013E from 10% based on improving business mix driven.

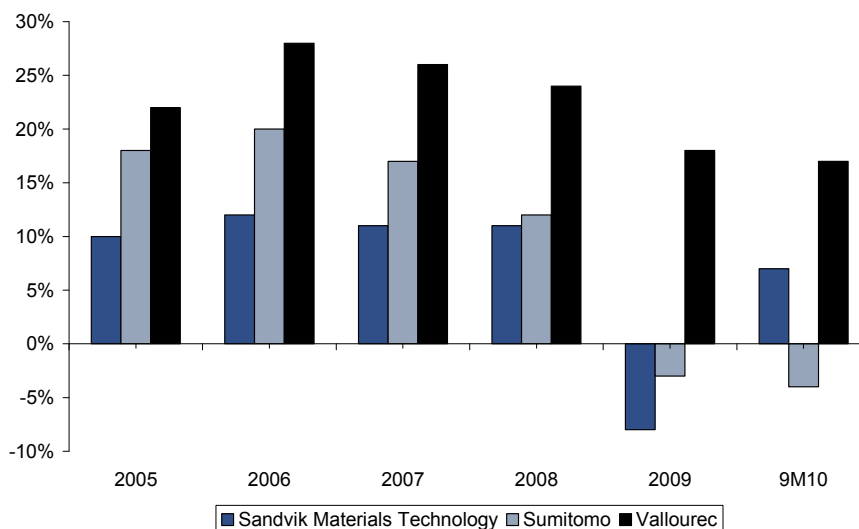
SMT has consistently lagged behind its main competitors (Sumitomo and Vallourec).

## Structural Changes at SMT

Sandvik is targeting a 12-15% EBIT Margin at their SMT division (the only EBIT margin target communicated by Sandvik) "with some help from the markets... when volumes recover in the right product mix". In this report we raise our EBIT margins forecasts to 12.8% in 2012E and 15% in 2013E (from around 10% previously assumed) based on improving business mix driven by nuclear related orders (for more detail see the section in this report entitled SMT: Nuclear Renaissance) – the current consensus estimates continue to remain below the company guidance.

SMT has consistently lagged behind its main competitors (Sumitomo and Vallourec), although the gap has recently narrowed with Sumitomo (Figure 15).

Figure 15. Sandvik – SMT EBIT Margins vs. Peer Group



Source: Company Reports, Citi Investment Research and Analysis

Ways to narrow the margin gap may include: 1) reducing inefficiencies; 2) improving mix; 3) continued exit of non-core businesses; and 4) minimising metal price effects.

This reflects, in our view, two main factors: i) relative inefficiency and ii) relatively poor mix shift - worth noting the highest margin competitor, Vallourec, enjoys a better business mix with energy related end markets accounting for >80% of its sales, which is about 2x the size of SMT. Note since the beginning of 2009, Sandvik received nuclear related orders of more than SKr10bn (this compares to the SMT's total orders received of SKr16.5bn in 2009 and 9m10 of SKr15.7bn). Below we highlight a number of areas in which Sandvik could cut costs and improve margins, any signals of which, in our view, would be well received by the market. These are:

- **Productivity of Employees** – Sandvik does not report COGS and SG&A by division, hence it is difficult to get a better feel for profitability efficiency. Hence we look at sales and EBIT per employee ratios (Figure 16). Both sales per employee and EBIT per employee look poor relative to its main competitors over time. What is encouraging is that Sandvik has cut costs at SMT estimating that SKr800m is sustainable in the context of the SMT EBIT SKr1.2bn in 2008. Out of SKr800m sustainable cost savings 50% is related to permanent personnel reductions.

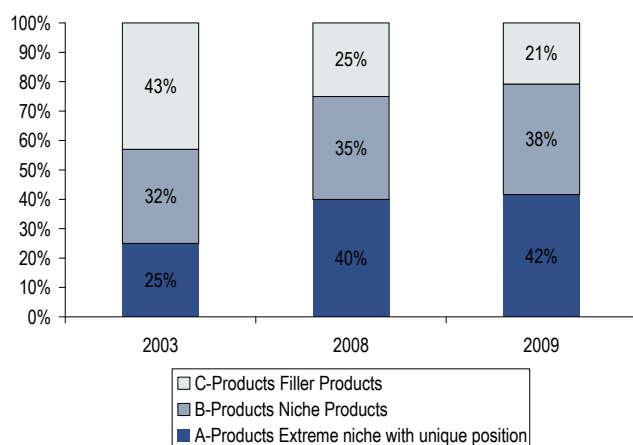
Figure 16. Sandvik – SMT Key Profitability Metrics vs. Peer Group

	2005	2006	2007	2008	2009	9M10
<b>Sales per Employee (SEKm)</b>						
Sandvik Materials Technology	2.0	2.3	2.5	2.3	1.9	1.4
Sumitomo	4.1	4.1	4.0	4.9	4.4	2.4
Vallourec	2.4	3.0	3.6	3.5	2.6	1.6
<b>EBIT per Employee (SEK '000s)</b>						
Sandvik Materials Technology	207	271	268	259	-144	99
Sumitomo	743	832	687	598	-127	-101
Vallourec	534	830	935	835	463	273

Source: Company Reports, Citi Investment Research and Analysis

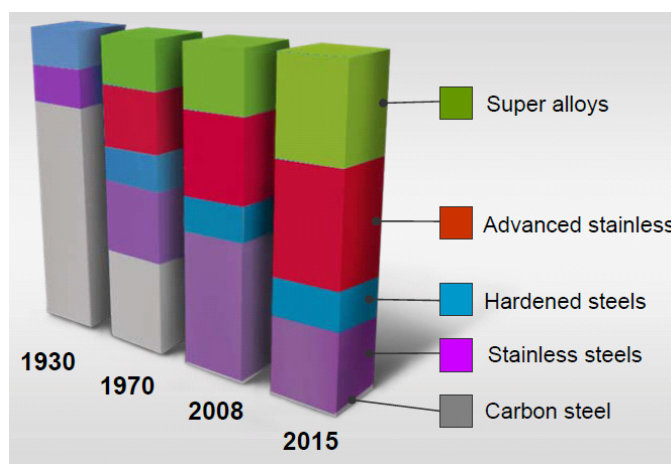
- **Improving Product Mix** – in particular optimising product mix with A-Products, which operate in the extreme niche market and have a unique position and as a result have inherently higher margins. A-Products accounted for 42% of the SMT mix in 2009 compared to 25% in 2003 (Figure 17). Today SMT has a higher degree of unique and specialized materials. The company estimates 75% of its sales in 2009 were from grades unique to SMT (32% of sales) and 'specialty' grades (43%) with 'standard' grades accounting for the balance. The mix is likely to continue to improve as Sandvik materials will continue to evolve further towards higher margins super alloys and advanced stainless (Figure 18). The next generation of materials is ready to be launched in key areas, according to Sandvik, which should improve new sales ratio further (new sales ratio has improved from 5% in 2006 to 20% in 1H10).

Figure 17. Product Mix is Improving



Source: Sandvik CMD 2010

Figure 18. Sandvik Materials Evolution (1930-2015)



Source: Sandvik CMD 2010

- **Exit of Lower Margins Non-Core Businesses** - Sandvik has exited of a number of non-core businesses in SMT, as shown in Figure 19, and has consolidated (i) its Wire and Kanthal into Wire and Heating Technology and (ii) its product units within MedTech and back-offices in the sales organization. There remains a further scope to continue to exit non-core businesses and further consolidate and specialise operations.



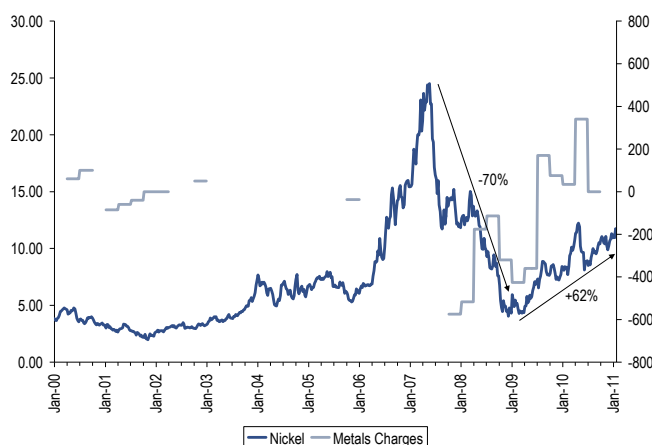
Figure 19. Sandvik – SMT Divestments

Year	Company	Product Area	Location	Division	Sales	Employees
2008	Sandvik Calamo, Sweden	Electro-polished tube products, primarily to the electronics industry	Sweden	SMT	65	36
2007	Sandvik Sorting Systems	Sorting systems for example postal, parcel and baggage handling	USA	SMT	1000	300
2007	Outokumpu Stainless Tubular Products (11.6%)	Stainless welded tubes and pipes with a broad product range of both standard and special grades	Finland	SMT	NA	1400
2003	Eurotungstene Poudres (49%)	Manufactures powder based on cobalt and wolfram mainly for producers of diamond tools	France	SMT	NA	125
2000	Guldsmedshytte Bruk	Castings for use in steel mills, among other applications	Sweden	SMT	90	80

Source: Company Reports, Citi Investment Research and Analysis

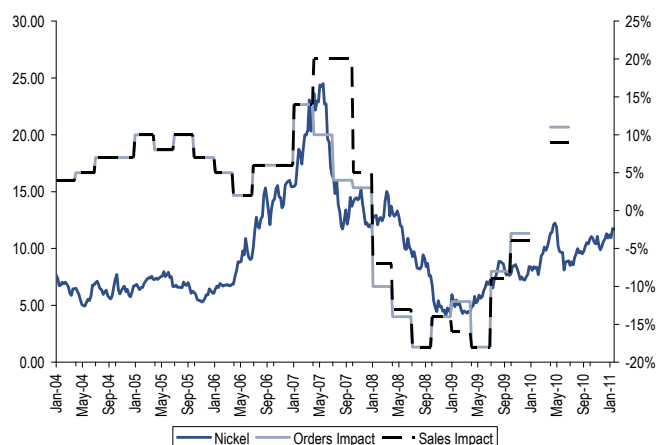
- **Evidence of Minimising Metal Price Effects** – It is impossible in our view to completely close the metal price effects gap (between when SMT is selling price to the customer and input price when SMT is buying the metal) and if there is a dramatic change in metals prices this will lead to fluctuations. In Figure 20 and Figure 21 we show nickel price, metals charges/benefits impact at SMT on EBIT, orders and sales growth over time. We are looking for evidence of the change in the approach of managing metal price effects, in particular minimising metal price effects.

Figure 20. Nickel Price vs Metals Benefits/(Charges) Impact on EBIT



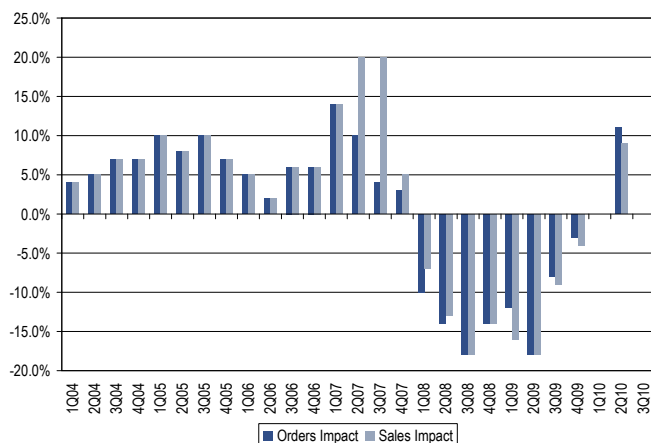
Source: Company Reports, \*Annualised

Figure 21. Nickel Price vs Alloy Charge Impact on Order and Sales Growth



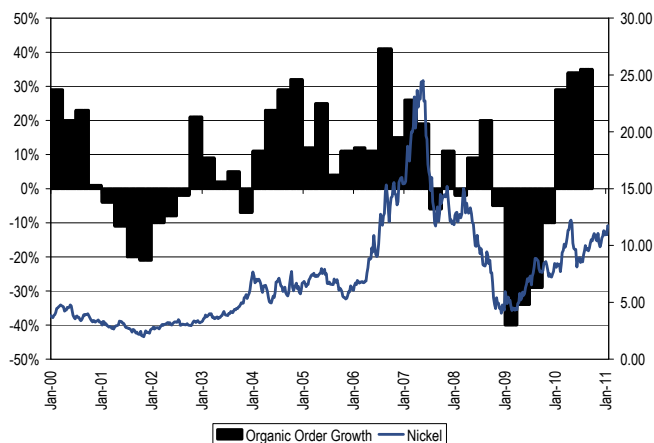
Source: Company Reports, Citi Investment Research and Analysis

Figure 22. Alloy Charge Impact on Order and Sales Growth



Source: Company Reports, \*Annualised

Figure 23. Nickel Price vs Organic Order Growth



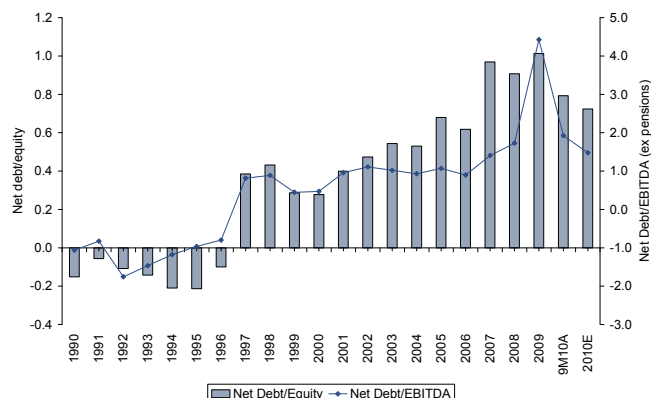
Source: Company Reports, Citi Investment Research and Analysis

## 2) Cashflow and Balance Sheet Improvement

Sandvik is one of the more indebted companies in our Mechanicals coverage, but....

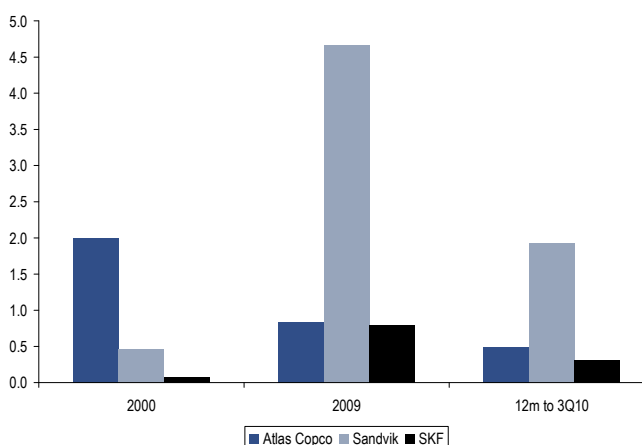
The market is often focused on Sandvik's balance sheet, particularly its relatively weak firepower to make acquisitions compared to the likes of Atlas Copco or SKF. Sandvik is one of the more indebted companies in our Mechanicals coverage – 12 months rolling net debt/EBITDA was 1.9x at the end of 9m10 and we forecast net debt/EBITDA of 1.5x at the end of 2010E (Figure 24) - particularly when comparing to Atlas Copco and SKF (Figure 25) and with net debt/equity (including pensions) at 1x at the end of 2009, which is at the top end of the targeted gearing range of 0.7x-1x. The next big debt maturity is in 2012, but the bigger part is in 2014 (Figure 26).

Figure 24. Sandvik – Net Debt/EBITDA and Net Debt/Equity (1990-2010E)



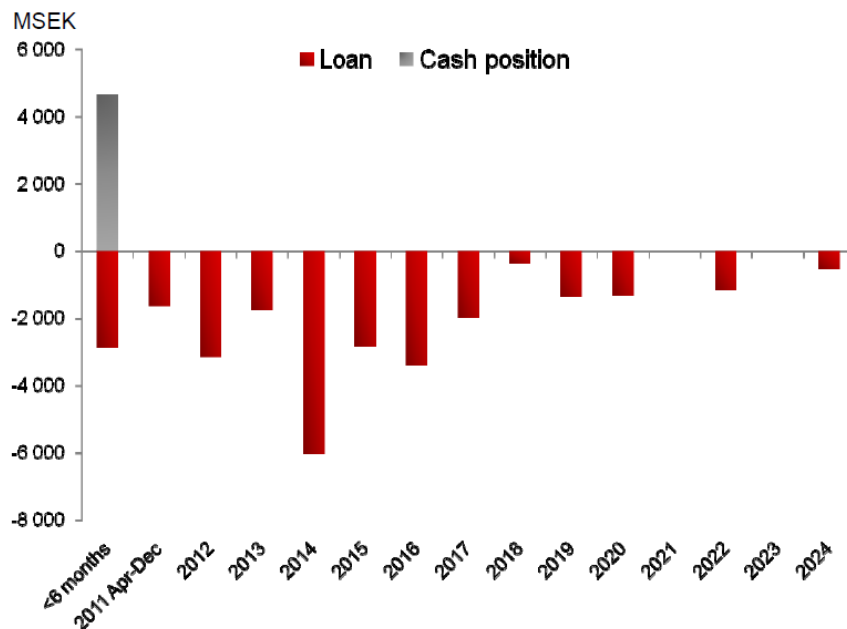
Source: Company Reports, Citi Investment Research and Analysis

Figure 25. Sandvik – Net Debt/EBITDA (ex Pensions) vs. Atlas Copco and SKF



Source: Company Reports, Citi Investment Research and Analysis

Figure 26. Sandvik – Loan Maturity Profile at 3Q10



Source: Company Reports, Citi Investment Research and Analysis

...Sandvik has a strong cash generation history

However, Sandvik has a strong cash generation history. In particular in the last downturn phase in 2008-2009 as well as in the previous downturn in 2000-2003, Sandvik maintained robust FCF/sales ratio as shown in Figure 27. We would treat this data with caution as the data for some companies is impacted by one-offs in specific years, but nevertheless the strong cashflow performance at Sandvik is notable relative to the overall sector.

Figure 27. Free Cash Flow (Pre Interest) as a Percentage of Sales

Company	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2011E
Alstom	na	na	-3%	-5%	2%	5%	6%	10%	8%	2%	2%	7%
Invensys	0%	6%	3%	-10%	-1%	1%	10%	5%	12%	6%	7%	8%
Philips	1%	8%	18%	12%	11%	8%	1%	-5%	8%	10%	12%	7%
Nexans	na	na	na	na	na	-1%	0%	11%	10%	10%	3%	5%
Schneider Electric	3%	7%	8%	12%	9%	8%	8%	11%	11%	16%	10%	10%
Siemens AG	7%	0%	3%	4%	4%	-2%	1%	3%	7%	1%	7%	5%
Atlas Copco	2%	10%	10%	10%	7%	7%	4%	11%	9%	22%	9%	9%
Charter Inter	2%	0%	1%	6%	3%	4%	5%	4%	2%	4%	0%	2%
IMI	5%	6%	8%	6%	7%	7%	5%	7%	8%	11%	8%	10%
MAN	na	na	2%	5%	6%	8%	5%	9%	-6%	8%	4%	4%
Metso	10%	3%	-3%	-6%	5%	2%	7%	3%	0%	14%	6%	4%
RHI	3%	-5%	8%	7%	6%	6%	2%	7%	5%	14%	8%	7%
<b>Sandvik</b>	<b>7%</b>	<b>7%</b>	<b>12%</b>	<b>9%</b>	<b>6%</b>	<b>7%</b>	<b>7%</b>	<b>2%</b>	<b>6%</b>	<b>15%</b>	<b>10%</b>	<b>10%</b>
SKF	9%	11%	7%	7%	5%	5%	5%	6%	2%	11%	12%	8%
Smiths Group	na	na	na	na	na	na	7%	8%	12%	15%	11%	12%
Bodycote	14%	13%	12%	10%	19%	15%	13%	8%	4%	2%	12%	10%
Cookson	6%	5%	6%	3%	5%	4%	4%	3%	4%	10%	3%	6%
Electrolux	2%	5%	6%	2%	4%	0%	2%	2%	2%	6%	3%	2%
GEA	0%	2%	0%	-6%	-2%	7%	3%	3%	5%	11%	6%	5%
Husqvarna	na	na	na	na	na	7%	5%	6%	8%	12%	6%	7%
Morgan Crucible	2%	4%	6%	1%	5%	3%	-7%	-1%	3%	9%	8%	7%
Vestas Wind	-6%	2%	-8%	1%	-5%	1%	11%	10%	-7%	-16%	-10%	1%
Weir Group	na	10%	9%	7%	5%	3%	11%	10%	12%	19%	17%	18%

Source: Company Reports, Citi Investment Research and Analysis

**We believe the market is over-concerned about Sandvik relatively weak acquisition firepower given its more indebted balance sheet compared to Atlas Copco and SKF**

We believe the market is over-concerned about Sandvik's relatively weak acquisition firepower given its more indebted balance sheet compared to Atlas Copco and SKF. We believe where Sandvik has been most successful is in making strategically important acquisitions including the Tungsten mine acquisition in 2009, which we see as a great strategic advantage for Sandvik Tooling division (for more detail see section entitled Tooling - Tungsten Mine Advantage). Since 2000, Sandvik has seen a strong and very sensible portfolio expansion, adding at least SKr17bn in sales over the past decade (equivalent to c24% of 2009 sales) - Figure 28.

While we view further strategic acquisitions as important to Sandvik's growth story, we increasingly think acquisitions are less important to Sandvik's long-term value compared to a much needed improvement in operational performance. We believe if the operational performance of Sandvik does not improve (the margin gap for comparable mining and construction businesses between Sandvik and Atlas Copco is not closed over time; and SMT is not structurally improved), the shares we believe will struggle to outperform its peers even if Sandvik were to be further acquisitive – we note that under the previous management team, although many sensible acquisitions were made, the share price underperformed vs. its peers. With the end markets remaining strong, the key issue in our view continues to be execution (as well as communication) especially given a disappointing 3Q10 results with unexpected by the market one-offs in SMT. We would welcome firm plans from the new CEO of Sandvik to improve operational performance particularly across SMC and SMT. While the message of improving operational efficiency is not new and has been on the agenda of the previous management team for several years, we believe the shares would benefit from a clearly set and communicated to the market targets (today the only communicated target is 12-15% EBIT margins in SMT) and plans to achieve those targets.

**Figure 28. Sandvik – Acquisitions (2000-2010)**

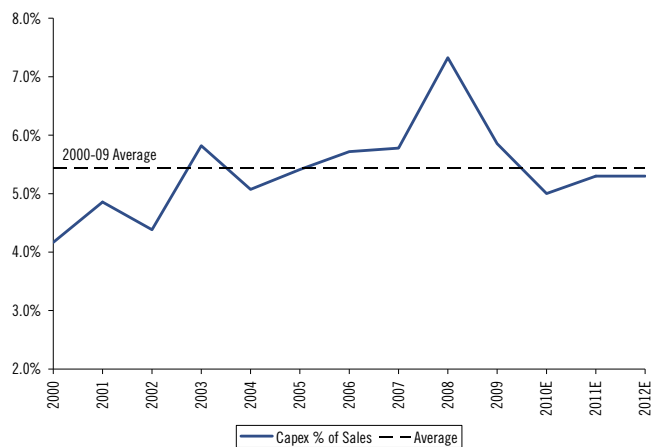
Year	Company	Business area	Sales	Employees
2010	Shanghai Jianshe Luqiao Machinery, China	SMC	1000	1200
2009	Wolfram, Austria (Tungsten Mine)	Tooling	1800	274
2009	BTA Heller Drilling Systems, UK	Tooling	33	12
2008	Precorp, USA	Tooling	140	140
2008	Teeness, Norway	Tooling	200	105
2008	Eurocut, UK	SMT	60	60
2008	Aubema, Germany	SMC	160	80
2008	Corstor International, South Africa	SMC	70	100
2008	JN Precise, Canada	SMC	100	70
2008	Medtronic Inc. (part of), USA	SMT	110	110
2007	JKB Medical Technologies, USA	SMT	90	n/a
2007	Doncasters Medical Technologies, UK	SMT	500	n/a
2007	Fintec Crushing and Screening Ltd, UK	SMC	560	n/a
2007	Extec Screens and Crushers Ltd, UK	SMC	1800	n/a
2007	Hydramatic Engineering, Australia	SMC	330	n/a
2007	Diamond Innovations, USA	Tooling	1000	n/a
2007	Shark Abrasion Systems, Australia	SMC	70	n/a
2006	Metso Powdermet	SMT	90	n/a
2006	Implementos Mineros	SMC	90	n/a
2006	UDR Group	SMC	275	n/a
2006	Hagby-Asahi	SMC	160	n/a
2006	SDS Corporation	SMC	650	n/a
2005	Smith	SMC	n/a	n/a
2005	Walter	Tooling	n/a	n/a
2004	Werner Schmitt PKD-Werkzeug AG	Tooling	88	n/a
2004	Sandvik Gram A/S	SMT	20	n/a
2004	Sandvik MGS S.A.	SMC	399	n/a
2004	Sandvik Smith Asia Ltd	SMC	53	n/a
2004	Technical Tooling Inc	Tooling	36	n/a
2004	Alpen Ferramentaria de Precisão Ltda	Tooling	9	n/a
2004	TI-TEK Pty Ltd	Tooling	n/a	n/a
2003	Walter	Tooling	n/a	n/a
2002	Mazda Earth Technology	SMC	500	n/a
2002	Valenite	Tooling	2000	n/a
2002	Walter	Tooling	2700	n/a
2001	Walter	Tooling	n/a	n/a
2001	Svedala	SMC	1400	n/a
2001	Sandvik Smith	SMC	360	n/a
2001	Sandvik Bafco Servicios S.A.	SMC	80	n/a
2001	Sandvik Hurth-Infer SA	Tooling	65	n/a
2001	Sandvik Choksi Ltd, India	SMT	30	n/a
2000	Beltreco Limited	SMC	450	n/a
2000	Hindrichs-Auffermann Metallverarbeitungs GmbH	SMT	120	n/a
2000	ARAF	Tooling	30	n/a
2000	Titex	Tooling	n/a	n/a
2000	BPI, Neuson	SMC	120	n/a
2000	Qingdao	SMT	n/a	n/a

Source: Company Reports, Citi Investment Research and Analysis

We are looking for evidence of a structural change in the cashflow and balance sheet management to avoid the pitfalls of 2008 – such as over-spending at the peak of the cycle and further reduction in net working capital sales ratio

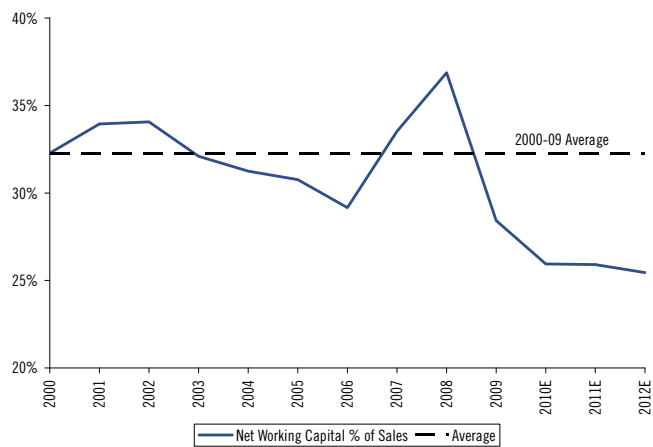
We are looking for evidence of a structural change in the cashflow and balance sheet management to avoid the pitfalls of 2008 – such as over-spending at the peak of the cycle when capex (Figure 29) and net working capital sales ratio (Figure 30) were at record high levels. As a reminder in 2008 capex as % of sales peaked at well over 7% vs. 2000-2007 average of 5% and despite recent improvement the net working capital sales ratio is still above the targeted 25%. During the downturn Sandvik has made structural changing bringing down capex and net working capital as a percentage of sales towards and below their 9-year average respectively. While the low capex is not sustainable and will increase as volumes recover, any signals of improved approach to managing capex and continued improvement in net working capital sales ratio would be well received by the market.

Figure 29. Sandvik – Capex as a % of Sales, 2000-12E



Source: Company Reports, Citi Investment Research and Analysis

Figure 30. Sandvik – Working Capital as a % of Sales, 2000-12E



Source: Company Reports, Citi Investment Research and Analysis

## Tooling - Tungsten Mine Advantage

### No other competitor of Sandvik owns a tungsten mine

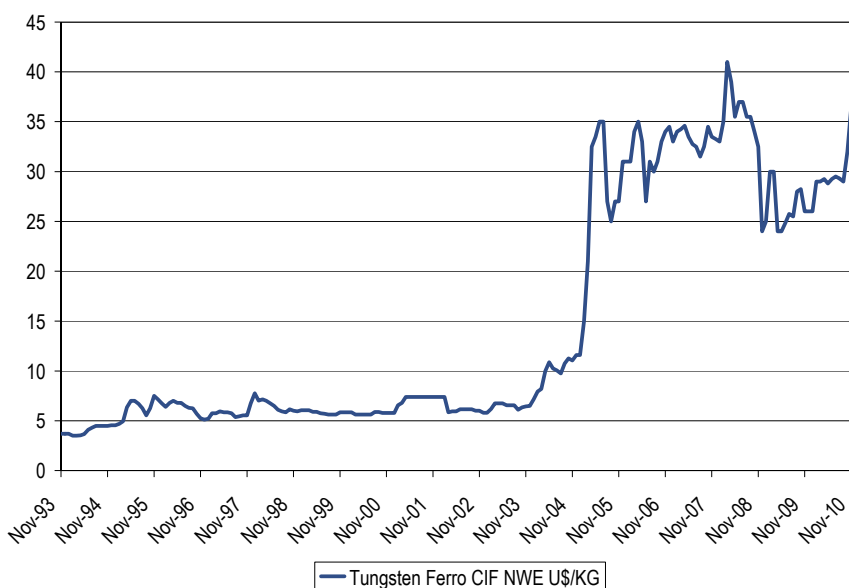
During the downturn (February 2009) Sandvik acquired Austria-based Wolfram Bergbau- und Hütten (WBH), which produces different grades of tungsten powder. In 2008, WBH had sales of SKr1.8bn and 300 employees.

No other competitor of Sandvik owns a tungsten mine, hence we see it as an important competitive advantage for three reasons: 1) independence from China's 70-80% control of the global supply of tungsten; 2) WBH has an unrivaled capability to develop more advanced raw materials which Sandvik can develop even further; 3) WBH also has the capability of recycling – prior to the acquisition Sandvik used 25-30% of tungsten powder supply from recycling, which is much more cost effective; post the WBH acquisition the proportion will increase up to 50%. Worth noting is that Sandvik also sells tungsten powder to most cutting tool manufacturers as it is a profitable business.

In a similar move in 2001, Sandvik invested SKr15m to help finance the reopening of the Can Tung tungsten mine in Canada, which had been closed for 15 years. The investment allowed Sandvik to gain access to significant supplementary supplies of tungsten over the three years, beginning in December 2001.

We believe having a tungsten mine is a significant advantage given the tungsten price has recently surpassed its previous peak as shown in Figure 31. Sandvik does not disclose the proportion of tungsten in the total cost base of its Tooling division. However, worth noting in the past Sandvik has indicated that raw materials are less than 10% of total Tooling costs.

Figure 31. Tungsten Price is Now Above the Previous Peak



Source: Company Reports, Citi Investment Research and Analysis



## SMT: Nuclear Renaissance

Since 2009, Sandvik received orders of more than SKr 10bn for deliveries to nuclear plants during 2012-2017, which is particularly positive for the mix of SMT as margins exceed 24%.

Since the beginning of 2009 Sandvik has received over SKr10bn (\$1.1bn) worth of SG tube orders for deliveries to nuclear plants during 2012-2017 (vs. our forecasted SMT sales in 2010E of SKr17.3bn). Worth noting margins for SG tubes are typically exceed peak margins of the Tooling division which peaked in 2007 at 24%. Sandvik is guiding for a 12-15% EBIT margin for Materials Technology, which we believe is achievable (note consensus estimates peak at 10%). In this report we raise our 2012E forecasts for SMT sales by 16% and for SMT EBIT by 35% increasing our EBIT margins forecasts to 12.8% in 2012E and 15.6% in 2013E (from around 10% previously assumed) based on improving business mix driven by nuclear related orders – the current consensus estimates continue to remain below the company guidance.

Figure 32. Sandvik Materials Technology – Major Announced Orders

Date Announced	Value	Industry	Delivery date	Customer	Summary Details
30/03/2010	SEK 700m	Oil and Gas	2010	Aker Solutions	Seamless tubes for extraction of oil in different projects around the world. The tubes, to be delivered in continuous lengths of up to 30km, will be used in umbilicals, which are employed for such applications as remote operation of oil wells at large depths, down to 1,700 meters in these specific projects.
03/02/2010	SEK 1.5bn	Nuclear	2012-2014	Harbin Electric Corp	Additional multi-year supply agreement for steam generator tubes for nuclear power plants in China
02/07/2009	>SEK 2bn	Nuclear	End 2013	Areva	Multi-year delivery contract for steam generator tubes to be used in nuclear power plants all over the world.
18/06/2009	>SEK 1bn	Nuclear	2013	Shanghai Electric Nuclear Power Equipment	Multi-year delivery contract for steam generator tubes for nuclear power plants in China.
24/09/2001	SEK 100m	Nuclear	2002	Framatome-ANP	The steam generator tubes will be supplied to the French company, Framatome-ANP, for use in a nuclear power plant in the United States.

Source: Company Reports

### Sandvik has substantially increased capacity

Sandvik is increasing capacity (already included in the current capex guidance) to benefit from this trend. Additions to the production capacities of its units were announced for Sweden (2009) and the Czech Republic (2010). Additional capacity should allow Sandvik to manufacture SKr1.5-2bn of SG tubes in Sandviken vs. SKr600m manufactured up until recently. While competition from Chinese competitors (Boosteel) is likely to increase going forward with Baosteel for the first time introducing its nuclear power steam generator 690U-tube (the key special material used in nuclear power plant) in mid December 2010, which will be delivered to Dongfang Electric - worth noting that Chinese companies like Harbin Electric Corporation chose Sandvik Materials Technology as their supplier of SG tubes (an order worth SKr1.5bn, \$210m) with delivery beginning in 2012, until 2014.

Sandvik supplies steam generator (SG) tubes used in nuclear power plants and there are only two companies operating in this segment in addition to Sandvik: Sumitomo Metal Industries (Japan) and Vallourec (France) – all have announced capacity expansion plans over the past 12 months (Figure 33).

Figure 33. Materials Technology Capacity Additions, 2009-2010

Date Announced	Action	Industry	Details
<b>Sandvik</b>			
03/02/2010	Expansion	Nuclear	Investment to expand the production capacity of nuclear steam generator tubes in Sweden and the Czech Republic.
02/09/2009	Expansion	Various	Investment in a dedicated service center in China to provide precision strip. The service centre was opened in 2009.
07/05/2009	Expansion	Nuclear	Investment to significantly increase capacity for the production of high-alloy steam generator tubes for the nuclear power industry. The capacity expansion will be at Sandviken and be progressively implemented with the first phase scheduled to go stream in beginning 2010.
<b>Sumitomo Metals</b>			
08/04/2010	Expansion	Nuclear	14bn yen investment to expand the production of steam generator tubes by c.2.7 times the actual production in 2008. The facility is Sumitomo Metal's Steel Tube Works in Amagasaki and production is scheduled to start in April 2013.
<b>Vallourec</b>			
29/09/2010	Expansion	Nuclear	€55m investment for new steam generator tube facility in China to serve the nuclear industry. Operations will begin in 2012 and increase Vallourec's total capacity to close 7,000km per year from 5,000km. The facility will employ 200 employees.
15/09/2010	Acquisition	Oil & Gas	\$100m acquisition of 19.5% of Tianda Oil Pipe Company Ltd, a Chinese seamless pipe manufacturer. Tianda has manufactured OCTG (oil country tubular goods) for the oil and gas sector since 1993.
28/07/2010	Expansion	Power Gen	€160m investment for the expansion of production capacity of their facility in Chahngzhou, China by 60k tonnes of seamless pipes per year to serve the local needs of the new generation of supercritical and ultra-supercritical power plants.
21/04/2010	Acquisition	Welding	€150m acquisition of 100% of Sermax, a French global leader of fully integrated welding solutions for offshore line pipes. Serimax employs 800 people and in 2009 conducted 50 projects in 20 countries with total sales of €152m.
15/02/2010	Expansion	Oil & Gas	\$650m investment in new small diameter rolling mill in the US to meet demand for production of smal diameter OCTG tubes for unconventional gas production. The new mill will initially produce 350,000 tonnes per year and have total nominal rolling capacity of 500,00 of seamless tube. The project will create 350 new direct jobs, operations are to begin by 4Q11.
24/09/2009	Acquisition	Oil & Gas	Acquisition of DPAL FZCO, a Dubai based supplier of drill pipes to the oil drilling industry in the Middle East. DPAL FZCO has an annual production capacity of 25,000 joints.
16/03/2009	Expansion	Nuclear	€80m investment to expand three production sites to serve the nuclear power industry. Valinox Nucleaire (stainless steel and nickel alloy tubes for steam generators for nuclear power plants) will increase its annual production capacity in France from 1,800km in 2008 to 4,500km in 2011. Valtimet (welded titanium and stainless steel tubes for secondary circuits for nuclear power plant) will double production capacity for nuclear products at its plants in France and the US.

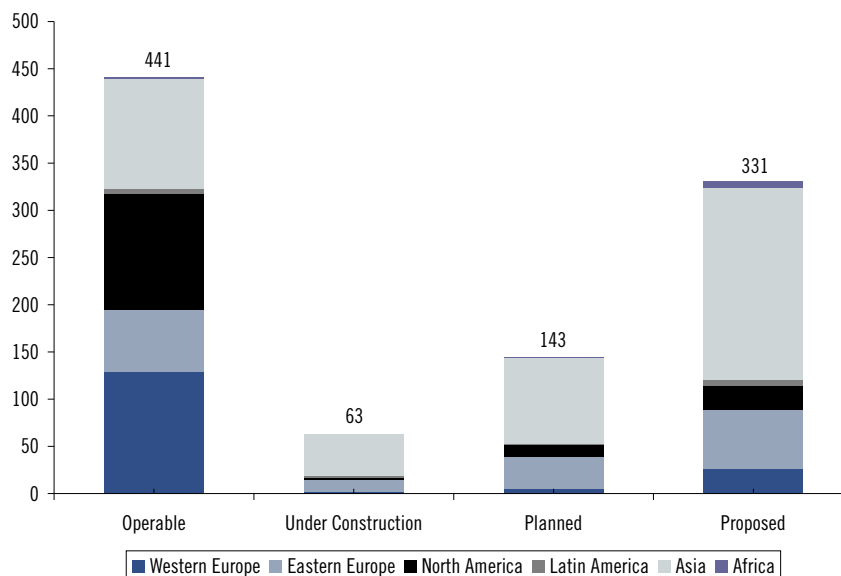
Source: Company Reports

## Nuclear Opportunity

**There is a strong global expansion in the nuclear power industry. The number of global nuclear power plants is set to double by 2030**

There is a strong global expansion in the nuclear power industry, with the number of global nuclear power plants set to double by 2030, led by planned and proposed nuclear plants in Asia (Figure 34), with a particular bias to China. Of the 63 nuclear plants currently under construction globally, 26 are in China, 6 in India and 6 in South Korea. China has recently doubled its previously planned 55 new nuclear reactors to 110 with the first part of expansion planned in 2011, up until 2016.

**Figure 34. Nuclear Power Plants (Global) – Operable, Under construction, Planned and Proposed**



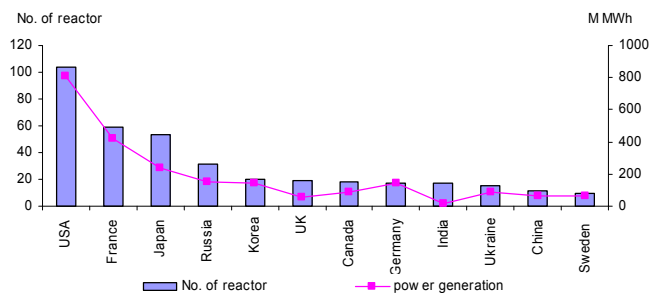
Source: Company Reports, Citi Investment Research and Analysis

## China

### China is to dry growth

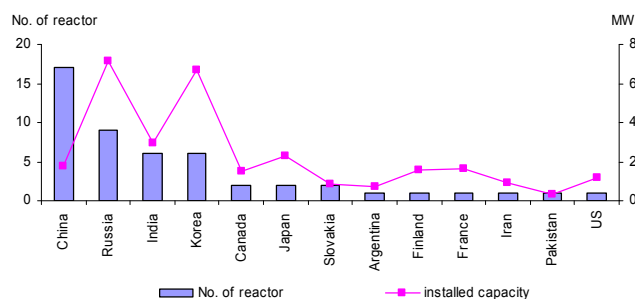
China accounts for 41%, 26% and 36% respectively of the global power plants under construction, in planning and under proposal. Nuclear energy accounts for only 9.1GW, or 1% of Chinese primary energy, well below the global average of 15%. China plans to raise its electricity generation from nuclear power to 7-8% and raising its power generating capacity fueled by nuclear to 5% by 2020. China has approved construction of 34 nuclear power generating units total 36,920MW, including 25 with 27,730MW of capacity under construction.

**Figure 35. Number of reactors in operation (by country)**



Source: WNA, Company Reports and CIRA Estimates

**Figure 36. Number of reactors under construction (by country)**



Source: WNA, Company Reports and CIRA Estimates

While the Chinese Government estimates that Rmb375bn (half of the Rmb700bn budgeted for nuclear power plant capex) could be spent on nuclear power equipment in 2011-20E, Dongfang Electric estimates the investment possibly is as high as Rmb50bn pa in the first 6-7 years, taking the long construction period of nuclear power plants into consideration and assuming the new plants are gradually completed mostly in 2015-20E.

Figure 37. Equipment suppliers of PRC 3<sup>rd</sup> generation nuclear power plants

Project name	Province	Reactor supplier	Pressure vessel	Steam generators
Sanmen	Zhejiang	Westinghouse & Shaw Group	Doosan Heavy & China First Heavy	Doosan Heavy & Harbin Power
Haiyang	Shandong	Westinghouse & Shaw Group	Doosan Heavy & Shanghai Electric	Doosan Heavy & Shanghai Electric
Taohuajiang	Hunan	Westinghouse	China Nuclear & China Erzhong	Dongfang Electric

Source: Company Reports and CIRA Estimates

So far, equipment orders of only three PRC 3<sup>rd</sup> generation nuclear power plants have been placed. Citi China Utilities analysts expect more nuclear power equipment orders to be placed since they forecast that only one-third of the Chinese nuclear power plants to be completed in the next decade have placed their orders so far. The majority of the nuclear power equipment orders for projects to be completed prior to 2020 would be placed in 2011-13E considering that nuclear power plants often take 7-8 years for construction in China.

Figure 38. Chinese nuclear power plants in operation, under construction & in planning

Power plant	Province	Units	Capacity (MW)	Completion	Operators
Daya Bay #1&2	Guangdong	2X984	1,968	1994	China Guangdong Nuclear Power Group
Qinshan #1	Zhejiang	1X310	310	1994	China National Nuclear Corporation
Qinshan #2&3	Zhejiang	2X650	1,300	2002 & 2004	China National Nuclear Corporation
Lingao Ph.1 #1&2	Guangdong	2X990	1,980	2002 & 2003	China Guangdong Nuclear Power Group
Lingao Ph.2 #1	Guangdong	1X1080	1,080	2010	China Guangdong Nuclear Power Group
Qinshan #4&5	Zhejiang	2X700	1,400	2002 & 2003	China National Nuclear Corporation
Tianwan #1&2	Jiangsu	2X1060	2,120	2007	China National Nuclear Corporation, CPI
<b>Subtotal for plants in operation</b>			<b>10,158</b>		
Qinshan #1 - exp	Zhejiang	2X1000	2,000	2010	China National Nuclear Corporation
Lingao Ph2 #2	Guangdong	1X1080	1,080	2010 & 2011	China Guangdong Nuclear Power Group
Qinshan #2 - exp	Zhejiang	2X650	1,300	2011 & 2012	China National Nuclear Corporation
Sanmen #1&2	Zhejiang	2X1250	2,500	2013 & 2014	China National Nuclear Corporation, Huadian
Fuqing #1-2	Fujian	6X1000	6,000	2013-2014	China National Nuclear Corporation, Huadian
Changjiang	Hainan	2X650	1,300	2014 & 2015	China National Nuclear Corporation, Huaneng
Hongyanhe #1-4	Liaoning	4X1000	4,000	2012 & 2014	China Guangdong Nuclear Power Group, CPI
Ningde #1-4	Fujian	4X1000	4,000	2012-2015	China Guangdong Nuclear Power Group, Datang
Yangjiang #1-4	Guangdong	6X1000	6,000	2013-2016	China Guangdong Nuclear Power Group
Fangchenggang	Guangxi	2X1080	2,160	2015 & 2016	China Guangdong Nuclear Power Group
Haiyang	Shandong	2X1250	2,500	2014 & 2015	CPI, China National Nuclear Corporation
Taishan #1&2	Guangdong	2X1700	3,400	2013 & 2014	China Guangdong Nuclear Power Group, EDF
<b>Subtotal for plants under construction</b>			<b>36,240</b>		
Hongyanhe #5&6	Liaoning	2X1080	2,160	2015	China Guangdong Nuclear Power Group, CPI
Sanmen #3&4	Zhejiang	4X1000	4,000	2015	China National Nuclear Corporation, Huadian
Tianwan #3&4	Jiangsu	2X1060	2,120	n/a	China National Nuclear Corporation
Tianwan #5&6	Jiangsu	2X1000	2,000	2015 & 2016	China National Nuclear Corporation
Haiyang #3&4	Shandong	2X1250	2,500	n/a	China National Nuclear Corporation, CPI
Dafan	Hubei	4X1000	4,000	n/a	China Guangdong Nuclear Power Group
Taohuajiang	Hunan	2X1000	2,000	2015	China National Nuclear Corporation
Pengze	Jiangxi	4X1250	5,000	2015	CPI
Shaoguan	Guangdong	4X1000	4,000	n/a	China Guangdong Nuclear Power Group
Lufeng	Guangdong	6X1000	6,000	n/a	China Guangdong Nuclear Power Group
Wuhu	Anhui	4X1000	4,000	n/a	China Guangdong Nuclear Power Group, Shenegy
Nanyang	Henan	4X1000	4,000	n/a	China National Nuclear Corporation
Chengde	Hebei	n/a	n/a	n/a	China Guangdong Nuclear Power Group
<b>Subtotal for plants under planning</b>			<b>41,780</b>		
<b>Total nuclear plants</b>			<b>88,178</b>		

Source: World Nuclear Association and China Electric Power News

Additionally, local content of Chinese nuclear power plants is increasing, with improving production capability of domestic nuclear power equipment makers. However, local Chinese manufacturers lack the technology to manufacture SG tubes, which are provided by the three Western suppliers, including Sandvik.

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**Figure 39. Rising local content of Chinese nuclear power plants**

Power Plant	Local content	Local equipment suppliers	Construction	Completion
Lingao-2	64%	Dongfang Electric, Shanghai Electric, China First Heavy Industries, China National Erzhong	2005	2010-11
Hainan Changjiang	75%	n/a	2010	2014-15
Fangcheng-1	87%	n/a	2010	2015-16

Source: World Nuclear Association and China Electric Power News

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## SMC: Strong Mining Capex To Continue

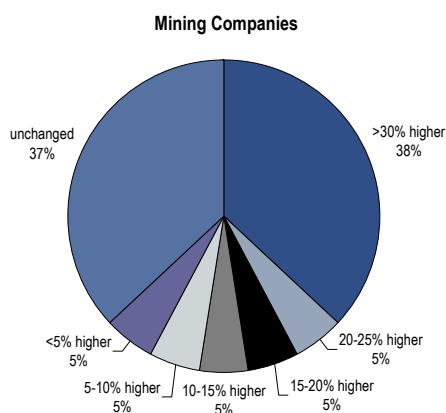
**Strong growth in mining capex continues and pricing bounces back. Sandvik remains our top pick.**

We also publish today the results of our quarterly proprietary Mining & Construction Survey (for more detail refer to report entitled: 4Q10 Global Mining and Construction Report: Strong Growth Continues/Pricing Bounces Back). The survey tracks the 12 month forward looking capex intentions of mining and construction customers. The survey captures >\$140bn in annual sales by customers (including mining and construction equipment dealers, mining, construction and minerals processing companies). In the report we raise LFL sales growth forecasts for the Mining and Construction divisions of Atlas Copco, Metso and Sandvik – now assuming 19% in 2011E (previously 13%) and 12% in 2012E (previously 8%) reflecting continued strong growth and further improved outlook for pricing environment. Sandvik remains our top pick.

Key conclusions from the survey are summarized below:

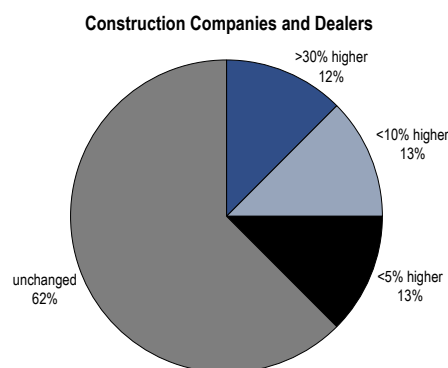
- **Mining Capex: 15% Growth Expected Next 12 Months** — Mining capex is on average set to grow by 15% YoY in the next 12 months (Figure 40) vs. 14% expected at the time of our 3Q10 survey, 20% in 2Q10 and 15% in 1Q10. Our proprietary Mining Capex model (based on CIRA forecasts for over 40 metals and mining companies) shows a 17% YoY increase in capex for the next 12 months. However, a significant increase in spending is now not expected until 2012 (2011 in previous surveys), which we believe reflects a continued growth in capex in 2012 rather than a deferral of spending by mining companies.
- **Construction Capex: Slightly Decline in Sentiment** — Construction capex is on average set to grow by 5% YoY in the next 12 months (Figure 41) vs. an average 7% at the time of our 3Q10 survey and 3% in 2Q10. Worth noting, a meaningful ramp-up in spending is still not expected until 2012 (in line with our past surveys).

**Figure 40. Mining Companies Equipment Purchasing (CAPEX) Intentions Over the Next 12 Months Compared to the Last 12 Months**



Source: Company Reports, Citi Investment Research and Analysis

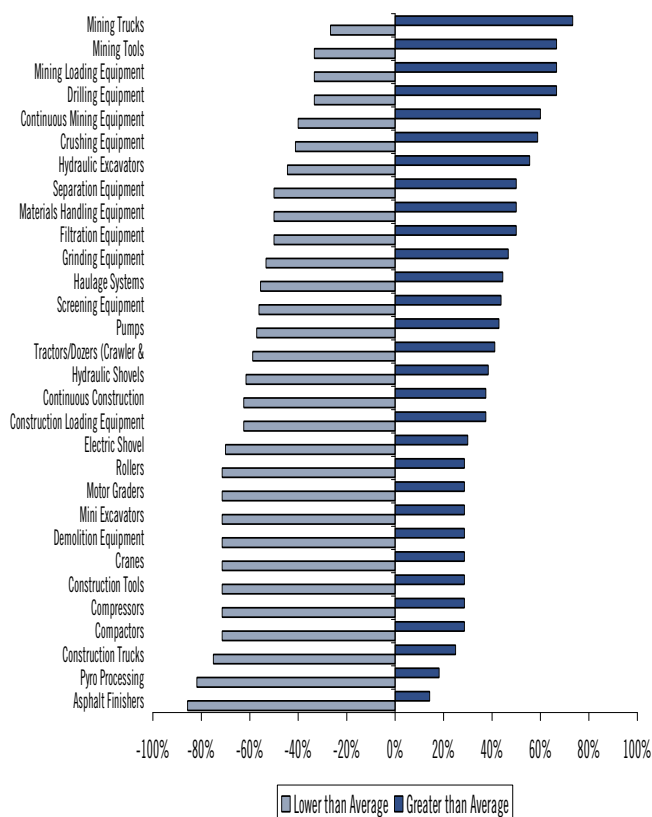
**Figure 41. Construction Companies and Dealers Equipment Purchasing (CAPEX) Intentions Over the Next 12 Months Compared to the Last 12 Months**



Source: Company Reports, Citi Investment Research and Analysis

- **Demand by Type of Equipment** — Over the next 12 months, participants will be spending above the average level on mining trucks, mining tools, mining loading equipment and drilling equipment, the most likely beneficiary being Sandvik and Atlas Copco, and below the average level on asphalt finishers, pyro processing and construction trucks, a potential risk for Atlas Copco and Metso (Figure 42).

**Figure 42. Mining and Construction Survey Participants (Dealers and Direct Customers)**



Source: Company Reports, Citi Investment Research and Analysis

**Figure 43. European Mining and Construction Equipment Suppliers – Key Product Overlap**

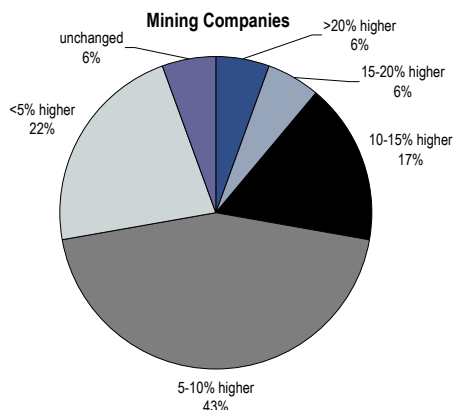
	Atlas Copco	Metso	Sandvik	Weir
Mining Trucks	✓		✓	
Mining Tools	✓		✓	
Mining Loading Equipment	✓		✓	
Drilling Equipment	✓		✓	
Continuous Mining Equipment			✓	
Crushing Equipment	✓	✓	✓	
Hydraulic Excavators				
Separation Equipment		✓		
Materials Handling Equipment		✓	✓	
Filtration Equipment				
Grinding Equipment		✓		
Haulage Systems		✓	✓	
Screening Equipment		✓	✓	
Pumps				✓
Tractors/Dozers (Crawler & Wheel)				
Hydraulic Shovels				
Continuous Construction Equipment	✓		✓	
Construction Loading Equipment				
Electric Shovel				
Rollers	✓			
Motor Graders				
Mini Excavators				
Demolition Equipment	✓			
Cranes				
Construction Tools	✓		✓	
Compressors	✓			
Compactors	✓			
Construction Trucks				
Pyro Processing Equipment		✓		
Asphalt Finishers	✓			

Source: Company Reports

- **Evidence of Purchasers Willing to Buy from Low-Cost Suppliers:** The majority of participants (79%) would consider buying from a low-cost equipment supplier, a marked increase from 53% in 3Q10 and just 15% in 4Q09 (when we first featured this question), this is supportive of our conclusions from our, *Engineering Sector in China: Winners and Losers* (published on October 12, 2010), where we highlighted the increasing threat from Chinese competition, featuring, Atlas Copco and Metso as stocks that in our view have the least to gain, and perhaps more to lose. In the next section entitled Chinese Competition on page 30, we go over in more detail the risks to Sandvik of increasing Chinese competition.
- **Pricing Sentiment Sequentially Strongly Up for Mining** — Pricing for new mining and construction equipment is expected to increase 8.2% and 1.6%, respectively over the next 6-12 months vs. last year (Figure 44 and Figure 45). For mining, this is a significant increase vs. +3.1% expected at the time of our 3Q10 survey and is consistent with the strong rebound in capex demand. Survey participants note that inventory levels for new equipment have fallen below average (Figure 46 and Figure 47), providing further support for higher demand and stronger pricing.

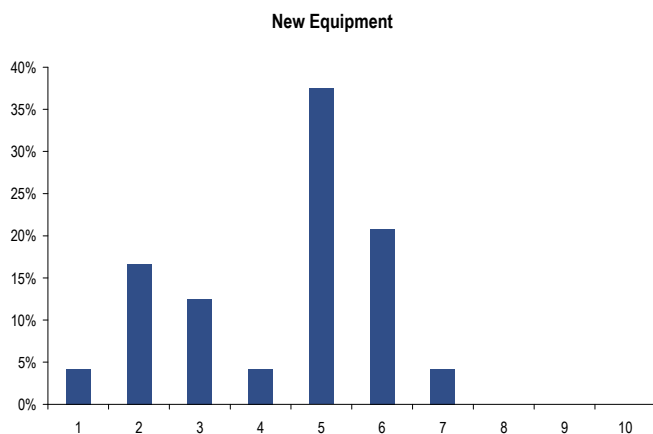


**Figure 44. Mining Companies Prices of New Equipment Purchases Over the Next 6-12 Months Compared to the Last Year**



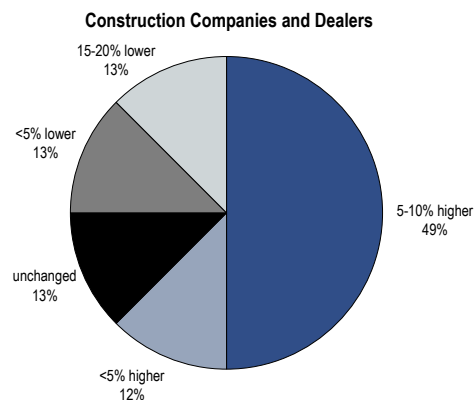
Source: Company Reports, Citi Investment Research and Analysis

**Figure 46. New Mining and Construction Equipment Inventory Level (1 – Too little inventory, 10 - Too much inventory)**



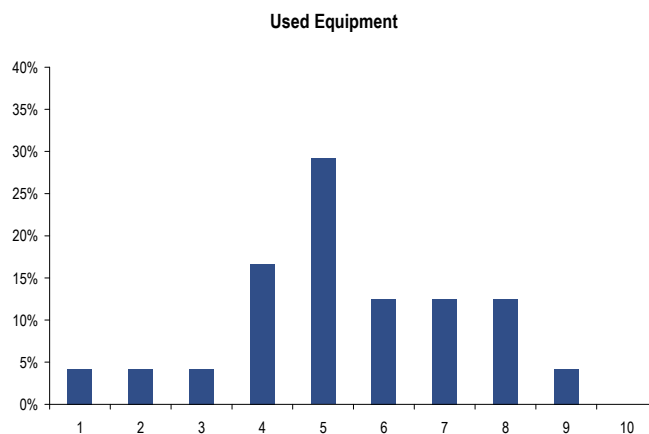
Source: Company Reports, Citi Investment Research and Analysis

**Figure 45. Construction Companies and Dealers Prices of New Equipment Purchases Over the Next 6-12 Months Compared to the Last Year**



Source: Company Reports, Citi Investment Research and Analysis

**Figure 47. Used Mining and Construction Equipment Inventory (1 - Too little inventory, 10 - Too much inventory)**



Source: Company Reports, Citi Investment Research and Analysis

## Chinese Competition

With the exception of construction equipment and crushers (combined c30-40% of group sales), we see Sandvik's business portfolio as being relatively protected from Chinese competition in the medium-term.

With the exception of construction equipment and crushers (combined c30-40% of group sales), we see Sandvik's business portfolio as being relatively protected from Chinese competition in the medium-term. There is less of a presence of Chinese players in under-ground mining than in surface mining and Sandvik sees high barriers to entry for its tooling products (unless there is a consolidation of Chinese tooling manufacturers, we see the tooling industry as being more protected from Chinese competition).

Worth noting Sandvik is one of very few companies under our coverage that have no JVs or R&D partnerships in China (Figure 48). The areas at risk are construction equipment - note Sandvik expects this industry to become more competitive as Chinese companies are moving more rapidly up the value chain, but currently sees no signs of over-capacity in China, and surface mining equipment. In our Engineering Sector in China: Winners and Losers report (published October 12), we favoured Sandvik over Atlas Copco and SKF when it comes to the medium-term threat from Chinese competition.

Figure 48. Current JVs

Company	JVs	WOFEs	How Many	What Business Areas
<b>JVs</b>				
ABB	Yes	Yes	30+ JVs and WOFEs	Power (Switchgears, High Voltage, etc.), Automation
Alstom	Yes	Yes	5 JVs	Power (Thermal, Hydro, etc.), Transport (Rolling Stock, Signalling)
Atlas Copco	Yes	Yes	2 JVs and 14 WOFEs	Industrial Technique
Husqvarna	Yes	Yes	1 JV	Construction Equipment
MAN	Yes		2 JVs	Truck, Diesel Engines
Metso	Yes	Yes	2 JVs and 4 WOFEs	Paper and Fiber and Energy and Environment
Philips	Yes	Yes	30+ JVs and WOFEs	Lighting, Consumer Electronics, Healthcare (Imaging Equipment, etc.)
Schneider Electric	Yes	Yes	14 JVs and 23 WOFEs	Low Voltage, Energy Efficiency
Siemens	Yes	Yes		JV with Shanghai Electric (wind and power generation)
SKF	Yes	Yes	3 JVs and 4 WOFEs	Bearings
<b>No JVs but WOFEs</b>				
Electrolux	No	Yes	2 WOFEs	Domestic Appliances
GEA	No	Yes	15 WOFEs	Heat Exchangers, Process Engineering, Refrigeration Technologies, Mechanical Equipment, Farm Technologies
Sandvik	No	Yes	12 WOFEs	Mining and Construction, Materials, Tools
Vestas Wind	No	Yes	2 WOFEs	Wind Power

Source: Company data, Citi Investment Research and Analysis

## Materials Technology

Worth noting that Baosteel introduced its first nuclear power steam generator 690U-tube in mid-December 2010

Sandvik Materials Technology (SMT) offers a range of unique and specialized materials. The company estimates 32% of its sales are from grades unique to SMT and 43% are 'specialty' grades (Figure 49). The remaining 25% are 'standard' grades where Sandvik faces local Chinese competitors in addition to its main international competitors. However, worth noting that Baosteel introduced its first nuclear power steam generator 690U-tube (the key special material used in nuclear power plant) in mid December 2010 and which will be delivered to Dongfang Electric. Up until this there were only three countries able to supply these nuclear steam generator tubes: Japan (Sumitomo), France (Vallerac) and Sweden (Sandvik). That said, Sandvik has been increasing capacity considerably since 2009, by more than three-fold, and their capacity, including the expansion that comes in to operation in 2011-2013, is fully loaded until 2016-2017.

Figure 49. Sandvik Materials Technology

Materials	Sales 2009	Competitor Comparison					Local Chinese Indian
		Sandvik	A	B	C	D	E
Unique SMT-grades	32%	x					
Specialty grades	43%	x	x	x	x	x	x
Standard grades	25%	x	x	x	x	x	x

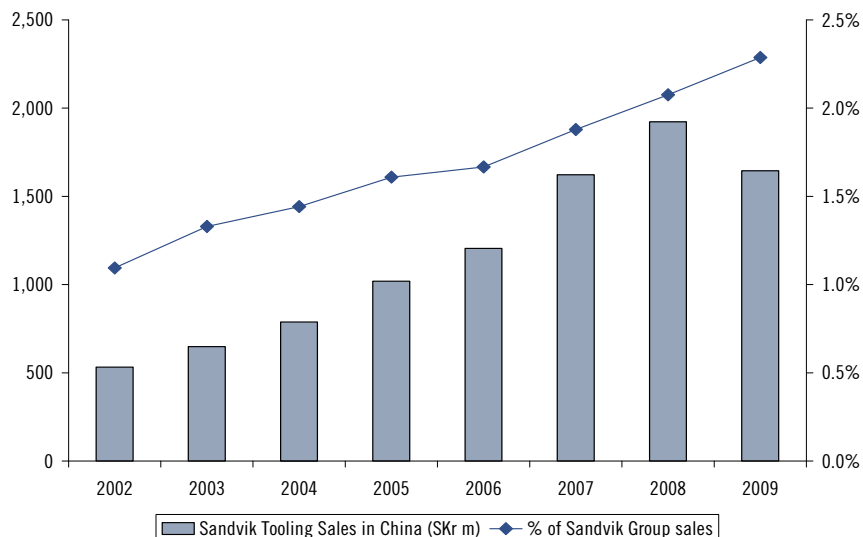
Source: Company Reports, Citi Investment Research and Analysis

## Tooling

Unless there is a consolidation of Chinese tooling manufacturers, we see the tooling industry as being more protected from Chinese competition

Sandvik noted at their recent capital markets day that the supply side in China's low and medium tooling market is fragmented with a high degree of competition. The company has focused its offering in the high end, where local competition is less prevalent. Sandvik Tooling achieved SKr1,645m in China in 2009 (2.3% of group sales), Figure 50. Sandvik's main competitors in the cemented carbide tooling include Zhuzhou Cemented Carbide Group Corp (ZCC) and Zigong Cemented Carbide Company (ZCCC). ZCC and ZCCC are both owned by Hunan Nonferrous Metals Corp Ltd, 100% and 80% respectively.

Figure 50. Sandvik Tooling – Sales in China (SKr m) and as a % of Group



Source: Company Reports and CIRA Estimates

## Chinese Competitor Profiles

- **Zhuzhou Cemented Carbide Group Corp (ZCC):** ZCC is the largest cemented carbide company in China. ZCC was established in 1958 and now has four specialized product divisions at their headquarters, seven holding companies in Hunan, Shenzhen and Hainan, and one 100% owned Import & Export company. ZCC's production units incorporate advanced domestic and foreign equipment and up-to-date technology and the company claims the quality of its products are at an advanced level to compete with global manufacturers. The "diamond brand" cemented carbides, tungsten, molybdenum, cobalt, tantalum and niobium products manufactured by ZCC are widely used in the industries of metallurgy, machinery, mining, electronics, petroleum-chemistry, textiles, national defense and furniture, etc. ZCC sells to 70 countries with an annual export value of over \$120m. ZCC is 100% owned by Hunan Nonferrous Metals Corp Ltd.

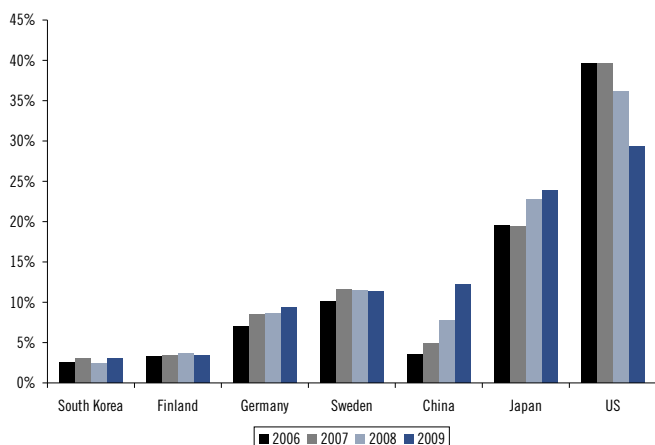
- **Zigong Cemented Carbide Company (ZCCC):** ZCCC was established in 1945 and is the second largest producer of cemented carbide products in China and in the top 10 of the world. Today, the company has operations in several locations employing more than 4,000 people. A fully integrated producer, ZCCC produces a full range of tungsten and molybdenum products starting with concentrates. ZCCC is 80% owned by Hunan Nonferrous Metals Corp Ltd.

## Construction Machinery

We see risk of Chinese competition  
increasing in construction equipment

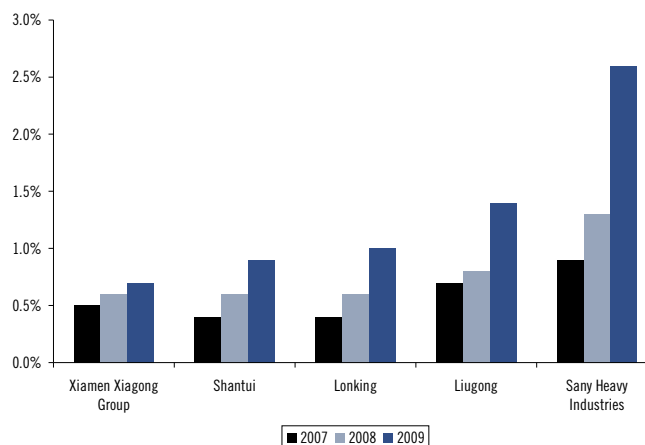
China's major construction machinery companies have seen a rapid development during the last decade, culminating in China's entry last year into the top 3 countries by sales (Figure 51) and Chinese construction equipment manufacturer XCMG's entry into the top 10 companies worldwide (Figure 52).

**Figure 51. Global Construction Equipment Sales – Top Countries by % of Total**



Source: Company Reports, Citi Investment Research and Analysis

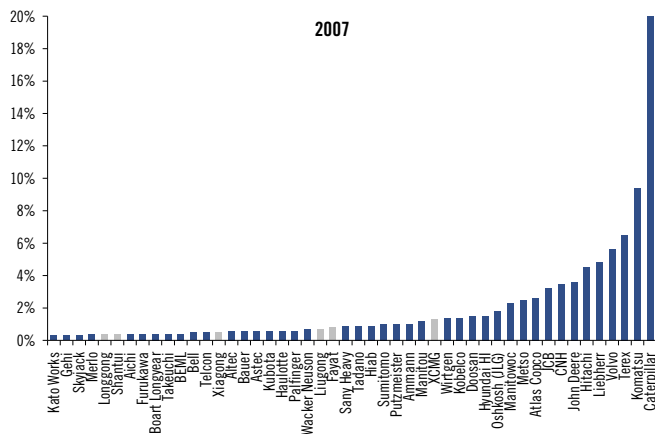
**Figure 52. Global Construction Equipment Sales – Top Chinese Companies**



Source: Company Reports, Citi Investment Research and Analysis

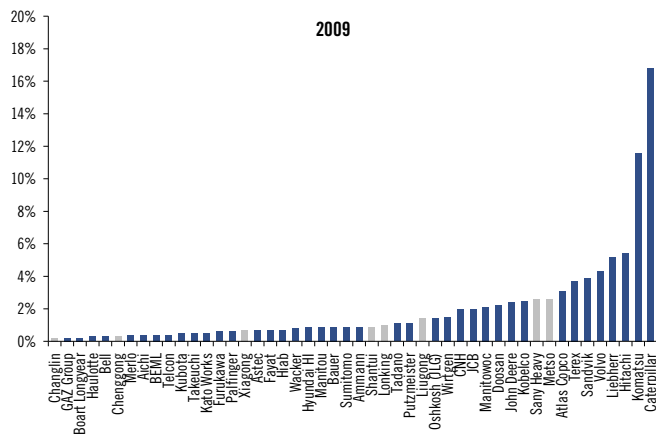
The competitive threat from Chinese construction equipment providers is increasing. Worth noting is that the top three Chinese manufacturers have moved into the top 10-12 in the global market share ranking in 2009 over the space of two years (Figure 53, Figure 54).

Figure 53. Global Construction Equipment – Market Share (2007)



Source: Company Reports, Citi Investment Research and Analysis

Figure 54. Global Construction Equipment – Market Share (2009)



Source: Company Reports, Citi Investment Research and Analysis

## Competitive Landscape

In the table below we show the key product overlap for the main players in the construction equipment market. The Chinese OEMs have a strong offering in concrete machinery, cranes and bull dozers. However, the local market is still dominated by foreign players in certain product areas, such as excavators, compaction/road building and crushing.

Figure 55. Global Construction Equipment Suppliers – Key Products Overlap

	Country	Backhoe Loaders	Mini and/or Midi Excavators	Compact or Skid-steer Loaders	Powered Access	Telescopic Handlers	Cranes	Concrete Equipment	Dozers and/or Crawler Loaders	Compaction/Road Building	Graders	Excavators	Wheeled Loaders	ADTs	Rigid Haulers	Rock Drilling	Hydraulic Breakers/Demolition Attachments	Crushing & Screening
Atlas Copco	SE															X	X	
Caterpillar	US	X	X	X		X			X	X	X	X	X	X	X		X	
Hitachi Construction Machinery	JP		X		X		X					X	X	X	X			X
Komatsu	JP	X	X	X		X			X		X	X	X	X	X			X
Liebherr	DE					X	X		X			X	X					
Liugong	CN	X	X	X								X	X					
Lonking	CN									X	X		X					
Metso	FIN																	X
Sandvik	SE															X	X	X
Shantui	CN								X	X	X							
Terex	US	X	X	X	X	X	X	X		X	X	X	X	X				X
Volvo Construction Equipment	SE	X	X			X				X	X	X	X	X				
XCMG	CN				X	X	X		X	X	X	X	X					

Source: KHL, CIRA

- **Rotary Drill Rigs:** The major Chinese construction equipment suppliers have all complemented their product offering with rotary drill rigs for use in construction applications.

**Main European Competitors:** Atlas Copco, Sandvik

## Chinese Competitor Profile

- **XCMG** has been the leading Chinese construction machinery manufacturer since it was established in 1989. The company ranked 10th globally in 2009 in terms of construction equipment sales (c\$2.825bn or 2.6% of global market share), up from 19th in 2007 (c\$1.861bn or 1.3%). XCMG has a wide offering of construction equipment, the result of numerous joint ventures with leading global manufacturers including Caterpillar, Paccar, Arvin Meritor and Doosan. Its operations involve the development, manufacture and distribution of construction machines. XCMG has 15,000 employees and 16 factories.

## Mining Machinery

With the exception of crushers (combined c10-15% of the Mining business mix), we see limited competition from Chinese competitors in the medium-term

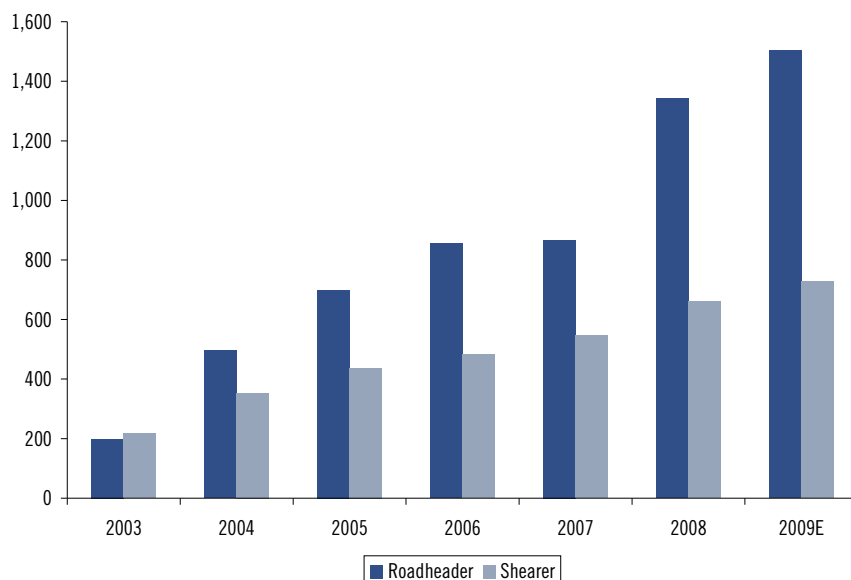
China's major mining machinery companies are strong in coal mining machinery and heavy minerals processing equipment. Dominance in the former industry is the result of the government's focus on the development of the coal mining machinery industry in the 11<sup>th</sup> Five Year Plan. Likewise, the heavy mining industries were a focus of the 1<sup>st</sup> Five Year Plan. Sandvik estimates the accessible equipment market in China to be c.SKr60bn including opportunities in coal, iron ore, non ferrous and aggregates that should deliver double-digit growth for the next five years.

### Coal Mining Machinery - the Key Focus in the 11<sup>th</sup> FYP

The coal mining machinery industry in China is supported by government policies including the Eleventh Five Year Plan's goal of the mechanisation of the coal mining industry in China, encouraging the building of large coal mine bases in China, an import duty tax benefit designed to promote local production of coal mining equipment and the promotion of the R&D for and capital support of the manufacture of major coal technologies and equipment.



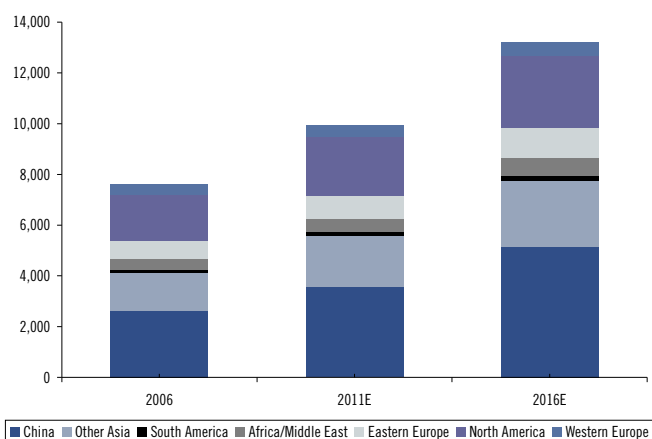
Figure 56. China – Coal Machinery Sales (Units)



Source: China National Coal Machinery Industry Association, CIRA

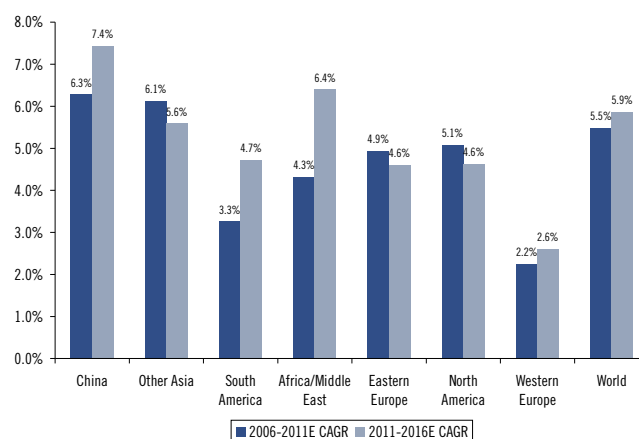
Certain products such as roadheaders are listed in the Catalogue for the Guidance of Foreign Investment Industries (2007) and benefit from preferential foreign investment policies issued by the PRC government.

Figure 57. Global Coal Mining Machinery Market (USD billions)



Source: Freedonia, CIRA

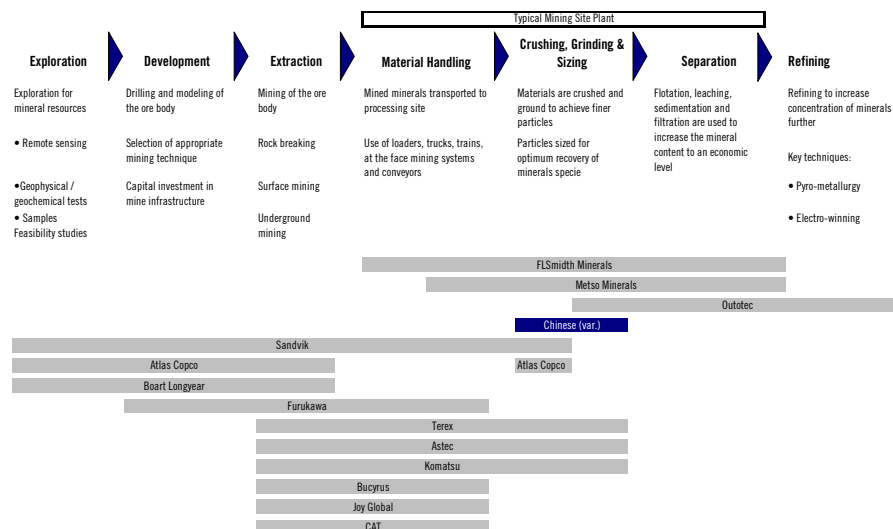
Figure 58. Global Coal Mining Machinery Market (CAGR)



Source: Freedonia, CIRA

## Competitive Landscape

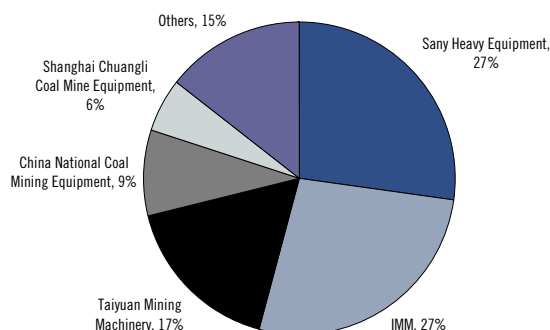
Figure 59. Mining Equipment Suppliers



Source: FLSmidth and CIRA

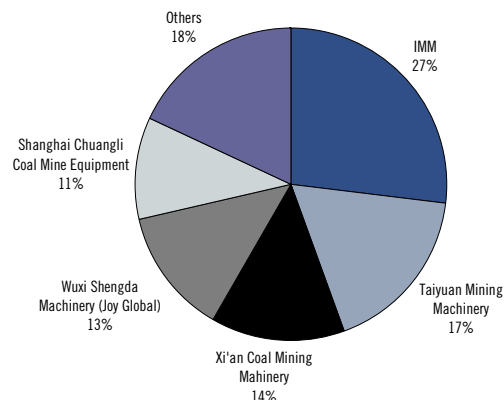
■ **Coal Mining Machinery:** As a result of the relative price competitiveness, continuous improvements in quality and technological standards and also due to advantages in the provision of after-sales services in China, domestically produced coal mining machinery is mainly used in coal mines in China. According to a report by the China National Coal Mining Machinery Industry Association in July 2009, imported coal mining machinery accounted for only approximately 3.0% of the total quantity of domestic coal mining machinery sold in China during 2008. Wide distribution networks, quality aftermarket services and a deep understanding of the needs of domestic coal mining customers have also contributed to the success of domestic manufacturers in the domestic market. Competition is high in the roadheaders industry but not extreme as the combined market share of the four largest manufacturers is 80%, a high concentration characteristic of an oligopoly. In 2008 Sany Heavy Equipment and IMM each achieved a 27% market share of roadheaders (Figure 60) and IMM achieved a 27% market share in shearers in China (Figure 61).

Figure 60. China – Roadheaders Market Share (2008 by unit)



Source: China National Coal Machinery Industry Association, CIRA

Figure 61. China – Shearers Market Share (2008 by unit)

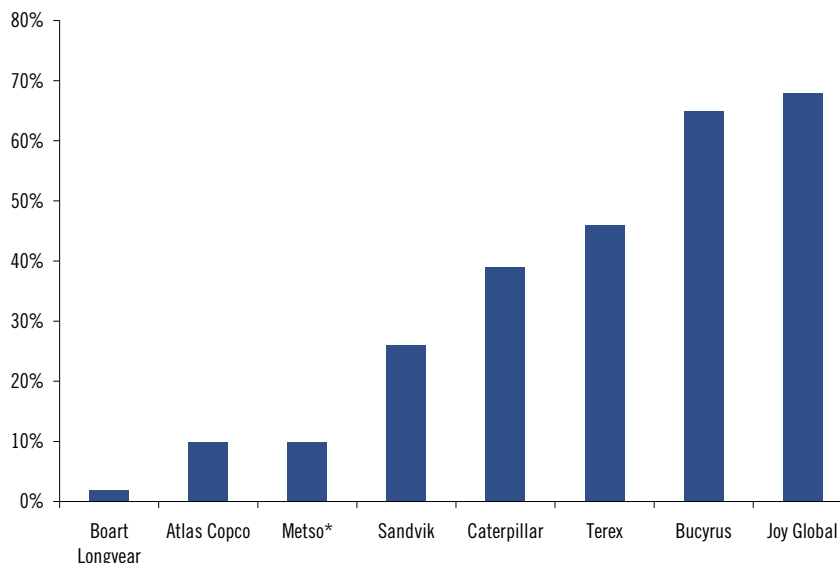


Source: China National Coal Machinery Industry Association, CIRA

Export sales are growing due to increased international demand for coal mining machinery, as well as the competitive pricing and quality improvements offered by PRC products. Domestic manufacturers enjoy significant manufacturing and operating cost advantages, with product prices as low as half the price of imported equipment. In addition, the technological gap between domestic and international coal mining machinery has been narrowing, with PRC products offering improved equipment performance. As the PRC suppliers increase production capacity, exports are estimated to increase significantly. Sany HE products have been exported to Iran, Russia, Ukraine, etc. Domestic coal mining machinery however still lags behind imported products in terms of technology, reliability, service life and level of automation.

**Main European Competitors:** Atlas Copco, Metso and Sandvik. Global mining competitors in coal mining equipment include Joy Global and Bucyrus with 68% and 65% of their mining equipment sales derived from coal, respectively (Figure 62). Sany Heavy Equipment does not provide a breakdown of their sales by commodity. However the company does identify it self as a one-stop coal mining equipment provider, although the equipment does have alternative applications in mining and construction.

Figure 62. Global Mining Equipment Companies – Coal as a % of Mining Equipment Sales



Source: Company reports, Citi Investment Research and Analysis, \*Estimate

- **Crushers/Screening:** Chinese suppliers of crushers/screening equipment include Shanghai Shibang Machinery (SBM), Zenith Mining and Construction Machinery and Shanbao (Shanghai Jianshe Luqiao Machinery). The companies have expanded their sales to overseas including Southeast Asia, East Europe, South America and the Middle East and Africa.

**Main European Competitors:** Atlas Copco (recently entered into mobile crushing and screening via its acquisition of Austria-based Hartl Anlagenbau), Metso, Sandvik (1/3 of Sandvik mining business)

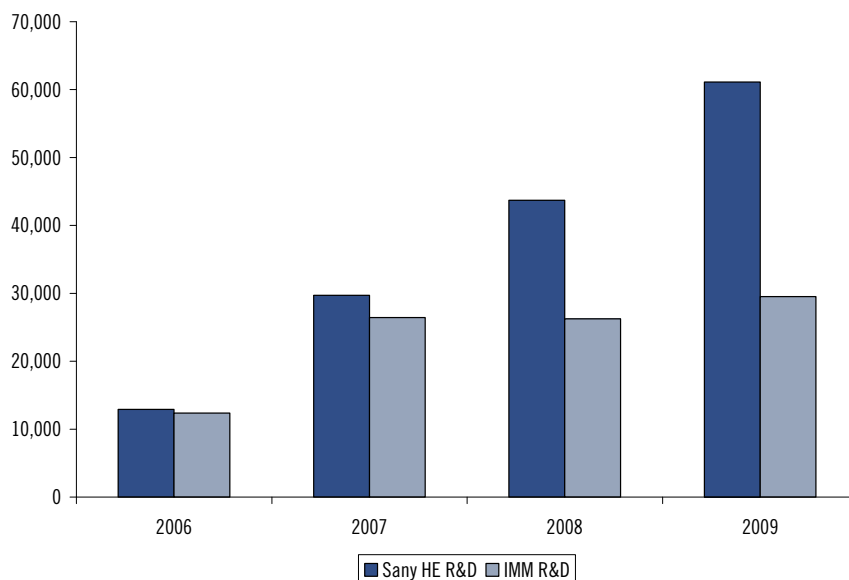
- **Drilling:** The major Chinese mining equipment companies lack a competitive offering in the area of drill rigs (exploration, blast hole, etc.) and the market is fairly fragmented.

**Main European Competitors:** Atlas Copco, Sandvik

## Chinese Competitor Profiles

- **Sany Heavy Equipment** Sany Heavy Equipment (Sany HE) is the coal mining equipment unit of Sany Group and the market leader in roadheaders in China. Its major products include roadheaders, coal mining transportation vehicles and combined coal mining units. Sany's network covers 19 provinces in China, which includes 17 sales centers, 18 service centers and 57 service outlets, as of end of June 30, 2010. Established in January 2004, the company specialises in the R&D (Figure 63), manufacture and sale of coal mining machinery. Sany HE has over 3,000 employees including 600 R&D experts. Sany HE's medium term goals include sales of over Rmb20bn in 2014 (2009: Rmb1.9bn, a CAGR of 60% vs. c.130% CAGR achieved in 2006-2009) and to become one of the top coal machinery manufacturers in the world.

Figure 63. R&D – Sany Heavy Equipment and IMM (RMB thousands)



Source: Company Reports, CIRA

- **CITIC Heavy Machinery** CITIC Heavy Machinery was established as Luoyang Mining Machinery Factory (LMMF) as one of the important 156 projects of the First Five Year Plan (1953-1957). In addition to its own range of mining equipment CITIC HM also manufactures mining equipment components for other OEM suppliers including FLSmidth, Metso, Outotec and others.

The table below lists the announced mining orders for Metso and Sandvik from China. The table highlights the different areas of the market the companies mainly operate in: mills and materials handling (Metso); crushers (Sandvik).

Figure 64. Sandvik Announced Mining Orders in China

Sandvik Orders	Company	Order Details	Value	Delivery
Jul-09	Shenhua Baorixile Energy Industrial Co	Semi-mobile crushing station order with one primary CR610 center sizer and two sets of secondary CR620 side sizers.	nd	1Q 2010
Feb-09	China Metallurgical Group	12 units of CH880 cone crushers (for project in Australia).	nd	2009
Jun-06	Anshan Mining Company	14 H8800 Hydrocone crushers	nd	mid 2007
Oct-04	Gongchangling Mining Co., Angang Group	2 H8800 Hydrocone crushers	nd	nd

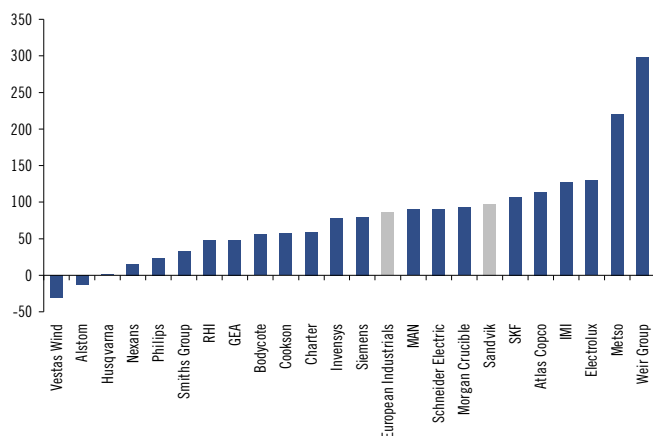
Source: Company Reports, Note Atlas Copco have not announced separately orders from China

## Valuation

Despite very hefty upgrades (for more details on consensus upgrades see Appendix- B), the stock is not pricing in improvement in operating margins longer-term. Given the relatively low consensus expectations and the prevailing scepticism in the market about Sandvik's ability to surpass the previous peak margins – consensus forecasts 2012 EBIT margins at 17% (in line with the previous peak) compared to over 300bps improvement to the previous peak margins of Atlas Copco and just under 300bps for SKF - and a new, externally appointed, management team, we believe the stock could reverse some of its relative underperformance over the balance of the year provided that the new management team can provide a credible plan for improving operational performance of Sandvik.

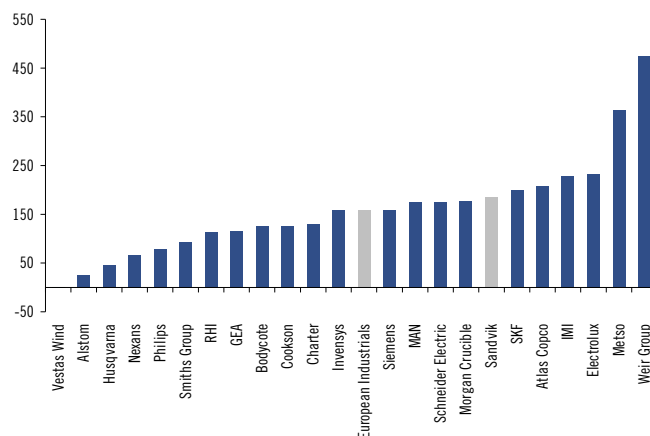
Despite a strong absolute share price performance since the sector troughed in October 2008, Sandvik still underperformed Atlas Copco and SKF relative to the market (DJSTOXX) - Figure 65. In absolute terms, Sandvik is still some 20% below its previous peak share price (Figure 67).

**Figure 65. European Industrials – Share Price Performance Relative to DJSTOXX since Sector Trough**



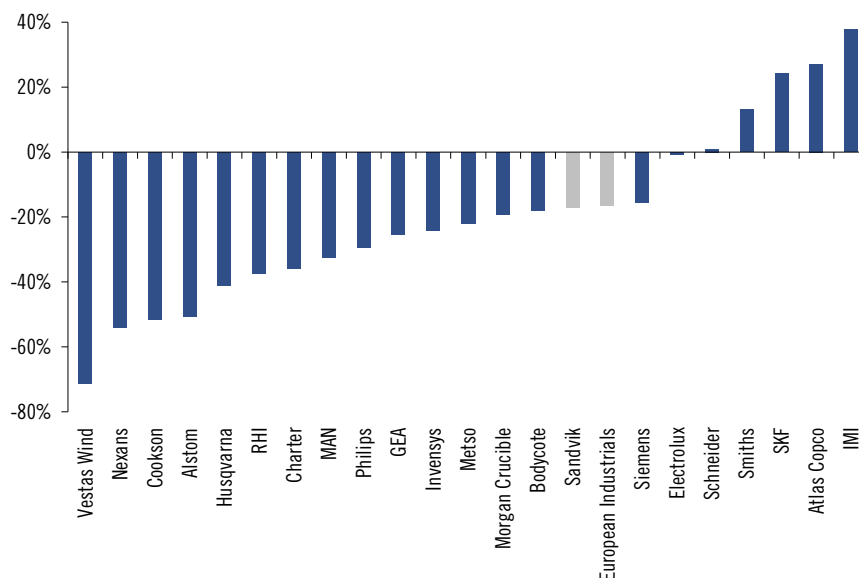
Source: DataStream

**Figure 66. European Industrials – Absolute Share Price Performance since Sector Trough**



Source: DataStream

Figure 67. European Industrials – Share Price, Current vs. Historic Peak



Source: DataStream

## Relative to European Engineering sector

On our revised 2011E forecasts, Sandvik is trading on P/E of 16x (sector is on 13x), EV/EBIT of 12x (sector is on 9.9x) and EV/Sales of 1.9x vs. our conservative through-cycle margin assumption of 15.5%. Sandvik is on just 12.5x 2012E P/E vs. Atlas Copco on 15.6x, Metso on 13.1x and SKF on 12.2x.

Figure 68. European Mechanicals - Valuation

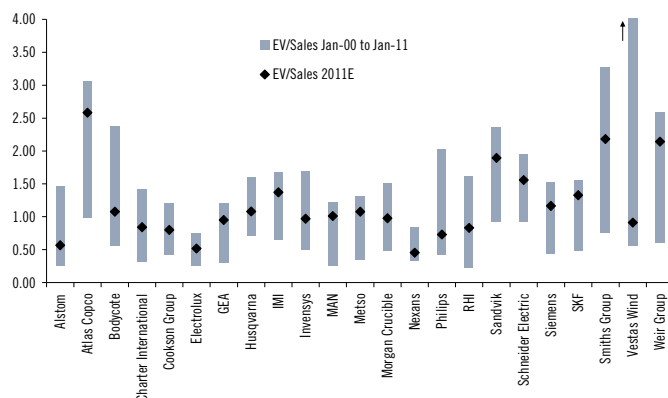
Company	Adjusted PE			EV/Sales			EV/EBITDA			EV/EBIT (Adj)		
	10E	11E	12E	10E	11E	12E	10E	11E	12E	10E	11E	12E
Atlas Copco (ATCOa.ST)	19.9	17.4	15.6	2.9	2.6	2.4	12.3	10.9	9.7	14.4	12.6	11.2
Metso (MEO1V.HE)	22.0	15.8	13.1	1.2	1.1	1.0	11.7	9.1	7.7	15.1	11.3	9.4
Sandvik (SAND.ST)	22.9	16.0	12.5	2.1	1.9	1.7	11.1	8.8	7.3	16.8	12.0	9.4
SKF AB (SKFb.ST)	15.8	14.1	12.2	1.5	1.3	1.2	8.5	7.5	6.4	10.9	9.5	7.9
Electrolux (ELUXb.ST)	11.1	12.7	14.3	0.5	0.5	0.5	6.2	6.6	7.0	8.8	10.2	11.4
GEA (G1AG.DE)	15.8	13.5	10.1	1.0	0.9	0.8	12.3	9.6	7.0	19.6	10.2	7.4
Husqvarna AB (HUSQb.ST)	17.3	12.7	10.4	1.2	1.1	1.0	10.2	7.8	6.6	13.9	10.4	8.5
<b>Averages</b>												
Electrical	13.9	12.0	10.5	1.0	0.9	0.8	7.9	6.4	5.5	11.1	8.5	7.1
Mechanical	16.9	13.6	11.7	1.6	1.4	1.3	9.9	8.2	7.1	13.2	10.6	9.0
UK	14.1	11.9	10.5	1.3	1.2	1.1	8.3	7.0	6.2	10.8	9.0	7.8
Europe	17.5	14.0	12.1	1.2	1.1	1.0	9.3	7.7	6.6	13.2	10.3	8.8
Total Pan Europe	16.0	13.1	11.4	1.3	1.2	1.1	8.9	7.5	6.5	12.4	9.9	8.5

Source: Company Reports, Citi Investment Research and Analysis

## Relative to History

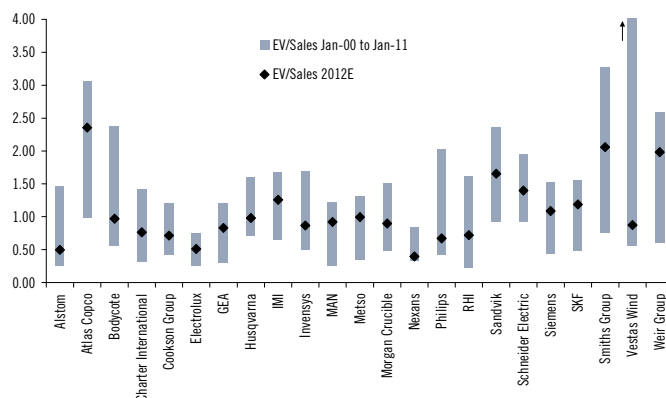
Relative to history, Sandvik is trading above its historic mid-range (based on EV/Sales) but is relatively lower than most of our Mechanicals companies under our coverage (Figure 69 and Figure 70).

Figure 69. European Industrials – 2000-11E EV/Sales



Source: Company Reports, Citi Investment Research and Analysis

Figure 70. European Industrials – 2000-12E EV/Sales



Source: Company Reports, Citi Investment Research and Analysis

## DCF Valuation

Our new TP is set at our DCF fair value of SKr175.

Figure 71. Sandvik – DCF Valuation (SKr millions)

December year end	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Group sales	89,653	99,114	107,558	110,785	114,109	117,532	121,058	124,690	128,430	132,283
growth yoy	10%	11%	9%	3%	3%	3%	3%	3%	3%	3%
Group EBIT	14,757	17,894	20,724	18,938	17,685	18,223	18,777	19,347	19,935	20,540
Margin	16.5%	18.1%	19.3%	17.1%	15.5%	15.5%	15.5%	15.5%	15.5%	15.5%
Depreciation	4,516	4,624	4,781	4,781	4,781	4,781	4,781	4,781	4,781	4,781
Depreciation To Sales	5%	5%	4%	4%	4%	4%	4%	4%	4%	4%
EBITDA	19,273	22,518	25,505	23,719	22,466	23,004	23,558	24,128	24,716	25,321
Change in Working Capital	(2,130)	(2,091)	(1,591)	(987)	(1,016)	(694)	(826)	(469)	(1,106)	(1,140)
Net Working Capital as % of Sales	26%	26%	25%	25%	26%	25%	25%	25%	25%	25%
Capex	(4,752)	(5,253)	(5,701)	(4,781)	(4,781)	(4,781)	(4,781)	(4,781)	(4,781)	(4,781)
Capital Spend to Depreciation	105%	114%	119%	100%	100%	100%	100%	100%	100%	100%
Pre-Tax Operating Profit	12,391	15,174	18,213	17,951	16,669	17,529	17,951	18,878	18,828	19,400
Notional Cash Tax	(3,383)	(4,188)	(5,063)	(5,026)	(4,701)	(4,978)	(5,134)	(5,437)	(5,423)	(5,587)
Tax Rate	27%	28%	28%	28%	28%	28%	29%	29%	29%	29%
NOPAT	9,008	10,986	13,150	12,925	11,968	12,550	12,817	13,441	13,406	13,813
Free Cash Flow	9,008	10,986	13,150	12,925	11,968	12,550	12,817	13,441	13,406	13,813
NPV Of Free Cash Flow	8,303	9,332	10,295	9,326	7,959	7,693	7,241	6,998	6,433	6,109
Summation NPV Of Free Cash Flow	8,303	17,634	27,930	37,256	45,215	52,908	60,149	67,147	73,580	79,689
DCF Valuation:										
NPV Free Cashflows 2011E-2020E		79,689								
Terminal Value		101,822								
Enterprise Value		181,511								
Net cash (debt)		(25,507)								
Equity Value		207,018								
Equity Value Per Share (SKr)		175								

Source: Company Reports, Citi Investment Research and Analysis



Our DCF is based on the following assumptions:

- 3% through-cycle growth;
- 15.5% through-cycle margin assumption – 150bps higher vs. the average margin over 1998-2008 (vs. 500bps improvement assumed for Atlas Copco and 300bps for SKF), providing further potential upside. An improvement of 250bps (all other things being equal) would imply fair value of SKr181 (assuming through cycle sales growth of 3%) as shown in the table below;

Figure 72. Sandvik – DFC Fair Value Sensitivity to Through Cycle Margins and Through Cycle Sales Growth Assumptions

		Through Cycle EBIT Margins								
		13.5%	14.0%	14.5%	15.0%	15.5%	16.0%	16.5%	17.0%	17.5%
Through Cycle Growth	2.0%	161	164	167	171	174	177	180	183	186
	2.3%	161	165	168	171	174	177	180	183	186
	2.5%	162	165	168	171	174	177	180	183	186
	2.8%	162	165	168	171	174	177	180	184	187
	3.0%	162	165	168	171	175	178	181	184	187
	3.3%	162	165	169	172	175	178	181	184	187
	3.5%	163	166	169	172	175	178	181	184	187
	3.8%	163	166	169	172	175	178	181	185	188
	4.0%	163	166	169	172	175	179	182	185	188

Source: Company Reports, Citi Investment Research and Analysis

- Net working capital as a % of sales of 25% (vs. the company guidance of 25% by 2012E) and tax rate of 28-29%;
- Capex/depreciation of 1x over the cycle; and
- 2.5% terminal growth and 8.5% WACC – a table below shows sensitivity of the DCF fair value to WACC and terminal growth rate assumptions, for example, a WACC of 8% (all other things being equal) would yield a DCF fair value of SKr188;

Figure 73. Sandvik – DFC Fair Value Sensitivity to WACC and Terminal Growth Assumptions

Terminal Growth	WACC									
		7.5%	7.8%	8.0%	8.3%	8.5%	8.8%	9.0%	9.3%	9.5%
	1.5%	186	179	173	168	162	157	153	148	144
	1.8%	190	183	177	171	165	160	155	150	146
	2.0%	195	187	180	174	168	162	157	153	148
	2.3%	200	191	184	177	171	165	160	155	150
	2.5%	205	196	188	181	175	168	163	158	153
	2.8%	211	202	193	185	178	172	166	160	155
	3.0%	217	207	198	190	182	175	169	163	158
	3.3%	225	214	204	195	187	179	173	166	161
3.5%	233	221	210	200	192	184	177	170	164	

Source: Company Reports, Citi Investment Research and Analysis

## 4Q Preview

Sandvik will report its 4Q10 results on February 2 at 7am GMT followed by the conference call at 12.30 GMT. We forecast sales at SKr22.5bn, slightly above the current consensus and EBIT at SKr 3.3bn, slight above the current consensus as shown in the table below.

Figure 74. Sandvik 4Q10 Results Preview (CIRA and SME Direkt Consensus)

Sandvik	Reported				CIRA	Consensus	CIRA vs Consensus	Reported	CIRA				Consensus		
	4Q09 A	1Q10 A	2Q10 A	3Q10 A	4Q10E	4Q10E	4Q10E	2009A	2010E	2011E	2012E	2010E	2011E	2012E	
Sales by Division															
Tooling	4,960	5,551	6,122	5,966	6,189	na	na	19,078	23,828	24,607	26,083	na	na	na	
Mining and Construction	8,042	7,588	8,375	8,676	10,233	na	na	32,621	34,872	40,092	44,903	na	na	na	
Materials Technology	3,976	4,019	4,618	4,170	4,481	na	na	15,328	17,288	18,611	21,403	na	na	na	
SECO Tools	1,225	1,367	1,479	1,420	1,568	na	na	4,871	5,834	6,301	6,679	na	na	na	
Total Sales	18,211	18,534	20,603	20,241	22,480	21,803	3.1%	71,937	81,858	89,653	99,114	81,181	89,385	96,060	
Sales growth y/y	-25%	-3%	14%	22%	23%	20%	3.7	-22%	14%	10%	11%	13%	10%	7%	
Of which price/volume	-26%	-1%	13%	20%	26%	na	na	-30%	15%	13%	11%	na	na	na	
Of which structure	0%	2%	3%	1%	0%	na	na	-2%	0%	0%	0%	na	na	na	
Of which FX	1%	-4%	-2%	2%	-3%	na	na	10%	-4%	-4%	0%	na	na	na	
EBIT by Division															
Tooling	-84	834	1,283	961	1,176	na	na	-527	4,254	5,413	6,521	na	na	na	
Mining and Construction	411	623	1,283	1,257	1,586	na	na	466	4,749	6,174	7,364	na	na	na	
Materials Technology	136	312	699	203	359	na	na	-1,137	1,573	2,233	2,740	na	na	na	
SECO Tools	121	220	311	245	298	na	na	307	1,074	1,386	1,670	na	na	na	
EBIT	408	1,897	3,471	2,532	3,299	3,238	1.9%	-1,412	11,199	14,757	17,894	11,138	14,348	15,330	
Margin	2.2%	10.2%	16.8%	12.5%	14.7%	14.9%	-0.2	-2.0%	13.7%	16.5%	18.1%	13.7%	16.1%	16.0%	
Restructuring	-600	34	340	-200	0	-7	nm	-3,126	232	0	0	-107	0	0	
EBIT ex Restructuring	1,008	1,863	3,131	2,732	3,299	3,245	1.7%	1,715	10,967	14,757	17,894	11,245	14,348	15,330	
Margin ex Restructuring	5.5%	10.1%	15.2%	13.5%	14.7%	14.9%	-0.2	2.4%	13.4%	16.5%	18.1%	13.9%	16.1%	16.0%	
PBT	-77	1,502	3,037	2,120	2,827	2,791	1.3%	-3,472	9,486	13,401	16,975	9,449	12,816	10,820	
EPS	-0.11	0.90	1.61	1.33	1.67	1.69	-1.1%	-2.24	5.50	7.88	10.06	5.52	7.59	9.12	
Divisional Breakdown															
Sales Growth (Organic)															
Tooling	-24%	11%	36%	38%	28%	na	na	-40%	15%	8%	6%	na	na	na	
Mining and Construction	-32%	-8%	-2%	9%	30%	na	na	-26%	15%	19%	12%	na	na	na	
Materials Technology	-17%	-4%	14%	17%	15%	na	na	-25%	15%	11%	15%	na	na	na	
Group	-26%	-1%	13%	20%	26%	na	na	-30%	15%	13%	11%	na	na	na	
EBIT Margin by Division															
Tooling	-1.7%	15.0%	21.0%	16.1%	19.0%	na	na	-2.8%	17.9%	22.0%	25.0%	na	na	na	
Mining and Construction	5.1%	8.2%	15.3%	14.5%	15.5%	na	na	1.4%	13.6%	15.4%	16.4%	na	na	na	
Materials Technology	3.4%	7.8%	15.1%	4.9%	8.0%	na	na	-7.4%	9.1%	12.0%	12.8%	na	na	na	
Group	2.2%	10.2%	16.8%	12.5%	14.7%	14.9%	-0.2	-2.0%	13.7%	16.5%	18.1%	13.7%	16.1%	16.0%	

Source: Company Reports, Citi Investment Research and Analysis; SME Direkt Consensus

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# Forecasts

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Figure 75. Sandvik – Income Statement (SKr millions)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
<b>Sales by Division</b>													
Tooling	15,507	16,561	17,840	18,090	19,227	20,847	22,477	24,732	25,975	19,078	23,828	24,607	26,083
Growth %	18%	7%	8%	1%	6%	8%	8%	10%	5%	-27%	25%	3%	6%
Price/Volume	11%	0%	-5%	3%	11%	8%	8%	9%	3%	-40%	15%	8%	6%
Struct. & One-offs									1%	2%	0%	0%	0%
FX									2%	12%	-5%	-5%	0%
Mining and Construction	10,184	13,501	13,842	14,299	16,617	20,560	25,001	33,073	38,651	32,621	34,872	40,092	44,903
Growth %	16%	33%	3%	3%	16%	24%	22%	32%	17%	-16%	7%	15%	12%
Price/Volume	12%	18%	-4%	9%	20%	18%	18%	26%	15%	-26%	15%	19%	12%
Struct. & One-offs									4%	0%	0%	0%	0%
FX									-2%	10%	-4%	-4%	0%
Materials Technology	14,209	14,528	12,970	12,467	14,424	17,003	19,337	22,486	21,480	15,328	17,288	18,611	21,403
Growth %	19%	2%	-11%	-4%	16%	18%	14%	16%	-4%	-29%	13%	8%	15%
Price/Volume	15%	-6%	-8%	3%	18%	16%	15%	20%	8%	-25%	15%	11%	15%
Struct. & One-offs									-12%	-12%	0%	0%	0%
FX									0%	8%	-3%	-3%	0%
SECO Tools	3,785	4,259	4,017	3,902	4,312	4,919	5,436	6,011	6,513	4,871	5,834	6,301	6,679
Growth %	21%	13%	-6%	-3%	11%	14%	11%	11%	8%	-25%	20%	8%	6%
Group activities	65	51	31	52	30	41	38	36	35	39	36	43	46
<b>Total Sales</b>	<b>43,750</b>	<b>48,900</b>	<b>48,700</b>	<b>48,810</b>	<b>54,610</b>	<b>63,370</b>	<b>72,289</b>	<b>86,338</b>	<b>92,654</b>	<b>71,937</b>	<b>81,858</b>	<b>89,653</b>	<b>99,114</b>
Growth %	11.3%	11.8%	-0.4%	0.2%	11.9%	16.0%	14.1%	19.4%	7.3%	-22.4%	13.79%	9.5%	10.6%
Price/Volume	12.0%	3.0%	-7.0%	5.0%	15.0%	14.0%	13.7%	15.1%	7.8%	-29.8%	15.0%	13.3%	10.5%
Struct. & One-offs	-4.0%	1.0%	10.0%	2.0%	-1.0%	-1.0%	1.0%	6.6%	-0.5%	-2.4%	0.0%	0.0%	0.0%
FX	3.0%	8.0%	-3.0%	-7.0%	-2.0%	3.0%	-0.6%	-2.2%	0.0%	9.9%	-3.6%	-3.8%	0.0%
<b>EBIT by Division</b>													
Tooling	3,135	2,964	2,711	2,286	3,864	4,420	5,191	5,989	5,461	-527	4,254	5,413	6,521
Margin %	20.2%	17.9%	15.2%	12.6%	20.1%	21.2%	23.1%	24.2%	21.0%	-2.8%	17.9%	22.0%	25.0%
Underlying Margin %	20.2%	19.0%	15.2%	12.6%	20.1%	21.2%	23.4%	24.8%	21.8%	2.3%	18.3%	22.0%	25.0%
Mining and Construction	1,073	1,348	1,477	1,444	1,829	2,654	3,672	4,979	4,996	466	4,749	6,174	7,364
Margin %	10.5%	10.0%	10.7%	10.1%	11.0%	12.9%	14.7%	15.1%	12.9%	1.4%	13.6%	15.4%	16.4%
Underlying Margin %	10.5%	10.0%	10.7%	10.1%	11.0%	12.9%	14.7%	15.4%	13.1%	5.1%	13.6%	15.4%	16.4%
Materials Technology	980	1,281	1,182	750	1,354	1,729	2,324	2,435	1,187	-1,137	1,573	2,233	2,740
Margin %	6.9%	8.8%	9.1%	6.0%	9.4%	10.2%	12.0%	10.8%	5.5%	-7.4%	9.1%	12.0%	12.8%
Underlying Margin %	6.9%	8.8%	9.1%	6.0%	9.4%	10.2%	12.1%	13.6%	10.8%	-1.6%	7.2%	12.0%	12.8%
SECO Tools	740	787	689	677	840	1,100	1,266	1,491	1,332	307	1,074	1,386	1,670
Margin %	19.6%	18.5%	17.2%	17.4%	19.5%	22.4%	23.3%	24.8%	20.5%	6.3%	18.4%	22.0%	25.0%
Group activities	-261	-277	-288	-190	-309	-371	-385	-500	-182	-521	-450	-450	-400
Items Affecting Comparability	660	340	0	0	0	0	0	0	0	0	0	0	0
<b>Total EBIT</b>	<b>6,327</b>	<b>6,103</b>	<b>5,771</b>	<b>4,967</b>	<b>7,578</b>	<b>9,532</b>	<b>12,068</b>	<b>14,394</b>	<b>12,794</b>	<b>-1,412</b>	<b>11,199</b>	<b>14,757</b>	<b>17,894</b>
Margin %	14.5%	12.5%	11.9%	10.2%	13.9%	15.0%	16.7%	16.7%	13.8%	-2.0%	13.7%	16.5%	18.1%
Underlying Margin %	14.5%	12.5%	11.9%	10.2%	13.9%	15.0%	16.9%	17.7%	15.3%	2.4%	13.4%	16.5%	18.1%
Net Financing Cost	-523	-497	-708	-780	-701	-713	-955	-1,397	-2,217	-2,060	-1,714	-1,356	-919
Total PBT	5,804	5,606	5,063	4,187	6,877	8,819	11,113	12,997	10,577	-3,472	9,486	13,401	16,975
Tax	-1,881	-1,712	-1,431	-1,212	-1,766	-2,427	-3,006	-3,403	-2,741	876	-2,561	-3,658	-4,685
Tax Rate	32.4%	30.5%	28.3%	28.9%	25.7%	27.5%	27.0%	26.2%	25.9%	25.2%	27.0%	27.3%	27.6%
Minority Interest	211	206	196	187	265	371	406	478	364	57	400	400	357
<b>Net Profit</b>	<b>3,712</b>	<b>3,688</b>	<b>3,436</b>	<b>2,788</b>	<b>4,846</b>	<b>6,021</b>	<b>7,701</b>	<b>9,116</b>	<b>7,472</b>	<b>-2,653</b>	<b>6,525</b>	<b>9,342</b>	<b>11,933</b>
Basic EPS	2.87	2.89	2.74	2.23	3.95	4.95	6.49	7.68	6.30	-2.24	5.50	7.88	10.06
<b>Diluted EPS</b>	<b>2.82</b>	<b>2.83</b>	<b>2.69</b>	<b>2.19</b>	<b>3.87</b>	<b>4.92</b>	<b>6.47</b>	<b>7.67</b>	<b>6.29</b>	<b>-2.24</b>	<b>5.50</b>	<b>7.87</b>	<b>10.05</b>
DPS	1.80	1.90	2.00	2.10	2.20	2.70	3.25	4.00	3.15	1.00	2.20	3.15	5.03

Source: Company Reports, Citi Investment Research and Analysis

Figure 76. Sandvik – Cash Flow Statement (SKr millions)

Cash Flow Statement	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
Income after financial items	5,804	5,606	5,063	4,187	6,877	8,819	11,113	12,997	10,577	-3,472	9,486	13,401	16,975
Depreciation & Amortisation	2,336	2,446	2,696	3,346	2,579	2,713	2,976	3,077	3,481	4,541	4,475	4,516	4,624
Other non-cash items	-871	-579	-175	-213	-594	-151	-291	-627	-142	481	0	0	0
Taxes Paid	-1,688	-1,762	-1,449	-1,577	-1,334	-1,828	-2,708	-3,404	-2,897	-870	-2,561	-3,658	-4,685
Changes in working capital	-1,105	-618	1,055	678	-2,206	-2,287	-2,920	-6,567	-1,348	11,632	-861	-2,130	-2,091
Cash Flow from Operations	4,476	5,093	7,190	6,421	5,322	7,266	8,170	5,476	9,671	12,312	10,539	12,128	14,823
Acquisitions	-562	-1,870	-2,570	-107	-311	-285	-1,261	-5,856	-954	-2,036	-726	0	0
Disposals	-306	371	-3	181	468	31	70	363	111	55	301	0	0
Capital Expenditure	-1,823	-2,374	-2,135	-2,840	-2,770	-3,430	-4,133	-4,990	-6,788	-4,212	-4,093	-4,752	-5,253
Growth Capex	0	0	0	0	-191	-717	-1,157	-1,913	-3,307	0	0	-236	-629
Maintenance Capex	-1,823	-2,374	-2,135	-2,840	-2,579	-2,713	-2,976	-3,077	-3,481	-4,212	-4,093	-4,516	-4,624
% of sales	4.2%	4.9%	4.4%	5.8%	5.1%	5.4%	5.7%	5.8%	7.3%	5.9%	5.0%	5.3%	5.3%
Other	0	0	0	0	0	0	0	0	0	0	0	0	0
Total cash flow from operations and investments	1,785	1,220	2,482	3,655	2,709	3,582	2,846	-5,007	2,040	6,119	6,021	7,377	9,570
Dividends paid	-2,266	-2,554	-2,545	-2,659	-2,799	-3,012	-3,533	-4,207	-5,111	-3,926	-1,186	-2,610	-3,737
Cash Flow before financing	-481	-1,334	-63	996	-90	570	-687	-9,214	-3,071	2,193	4,835	4,767	5,833
Equity Issue	0	-1,660	-230	0	-1,931	-3,964	0	-3,559	0	0	0	0	0
Other	963	2,177	1,423	797	-20	4,473	-280	11,816	-707	2,353	0	0	0
Change in Borrowings	147	4,137	341	-1,100	1,814	3,087	1,124	13,052	6,542	-1,565	0	0	0
Net cashflow	629	3,320	1,471	693	-227	4,166	157	12,095	2,764	2,981	4,835	4,767	5,833
Opening net (cash) debt	6,015	6,644	9,964	11,435	12,128	12,487	16,653	16,810	28,905	33,323	30,342	25,506	20,739
<b>Closing net (cash) debt including pension provision</b>	<b>6,644</b>	<b>9,964</b>	<b>11,435</b>	<b>12,128</b>	<b>12,487</b>	<b>16,653</b>	<b>16,810</b>	<b>28,905</b>	<b>33,323</b>	<b>30,342</b>	<b>25,507</b>	<b>20,739</b>	<b>14,907</b>
Pension provision	2,583	1,764	2,044	3,659	3,015	3,538	3,180	3,100	2,735	2,657	2,657	2,657	2,657
<b>Net (cash) debt ex pension provision</b>	<b>4,061</b>	<b>8,200</b>	<b>9,391</b>	<b>8,469</b>	<b>9,472</b>	<b>13,115</b>	<b>13,630</b>	<b>25,805</b>	<b>30,588</b>	<b>27,685</b>	<b>22,850</b>	<b>18,082</b>	<b>12,250</b>
Net debt/equity	0.3	0.4	0.5	0.5	0.5	0.7	0.6	1.0	0.9	1.0	0.7	0.5	0.3

Source: Company Reports, Citi Investment Research and Analysis

Figure 77. Sandvik – Balance Sheet (SKr millions)

Balance Sheet	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010E	2011E	2012E
<b>Non-Current Assets</b>													
Intangible Assets	4,520	4,811	5,898	4,860	5,139	5,874	6,251	11,425	12,472	14,137	14,137	14,137	14,137
Patents and other intangible assets	0	67	265	511	774	953	1,095	2,492	2,641	3,002	3,002	3,002	3,002
Goodwill	4,520	4,744	5,633	4,349	4,365	4,921	5,156	8,933	9,831	11,135	11,135	11,135	11,135
Property, Plant and Equipment	14,265	15,157	15,257	14,992	15,070	16,687	17,677	20,895	26,123	26,519	26,136	26,372	27,002
Financial Assets	371	2,537	1,867	2,500	2,454	3,271	3,653	3,779	4,352	5,698	5,698	5,698	5,698
<b>Total Non-Current Assets</b>	<b>19,156</b>	<b>22,505</b>	<b>23,022</b>	<b>22,352</b>	<b>22,663</b>	<b>25,832</b>	<b>27,581</b>	<b>36,099</b>	<b>42,947</b>	<b>46,354</b>	<b>45,971</b>	<b>46,207</b>	<b>46,837</b>
<b>Current Assets</b>													
Inventories	11,508	12,953	12,849	12,147	13,459	16,440	18,738	25,301	28,614	19,842	22,579	24,280	25,851
Current Receivables	11,147	11,833	12,075	11,926	13,532	15,731	17,837	22,029	26,668	17,873	20,338	22,275	24,625
Trade receivables	0	9,847	9,649	9,252	9,939	11,777	12,574	15,228	15,930	11,587	13,365	14,762	16,457
Due from associated companies	0	68	81	85	165	164	563	186	180	125	142	156	172
Income tax receivables	0	257	497	642	609	627	667	1,429	1,699	1,304	1,304	1,304	1,304
Other receivables	0	1,006	1,006	966	1,324	1,907	3,365	4,179	7,759	4,011	4,564	4,999	5,526
Prepaid expenses and accrued income	0	655	842	981	1,495	1,256	668	1,007	1,100	846	963	1,054	1,166
Cash and cash equivalents	2,097	2,258	2,175	1,972	1,720	1,559	1,745	2,006	4,998	7,506	12,341	17,108	22,940
<b>Total Current Assets</b>	<b>24,752</b>	<b>27,044</b>	<b>27,099</b>	<b>26,045</b>	<b>28,711</b>	<b>33,730</b>	<b>38,320</b>	<b>49,336</b>	<b>60,280</b>	<b>45,221</b>	<b>55,258</b>	<b>63,663</b>	<b>73,417</b>
<b>Total Assets</b>	<b>43,908</b>	<b>49,549</b>	<b>50,121</b>	<b>48,397</b>	<b>51,374</b>	<b>59,562</b>	<b>65,901</b>	<b>85,435</b>	<b>103,227</b>	<b>91,575</b>	<b>101,229</b>	<b>109,870</b>	<b>120,253</b>
<b>Share capital</b>	<b>1,552</b>	<b>1,552</b>	<b>1,552</b>	<b>1,552</b>	<b>1,581</b>	<b>1,424</b>	<b>1,424</b>	<b>1,424</b>	<b>1,424</b>	<b>1,424</b>	<b>1,424</b>	<b>1,424</b>	<b>1,424</b>
<b>Other paid-in capital</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1,057</b>	<b>1,057</b>	<b>1,057</b>	<b>1,057</b>	<b>1,057</b>	<b>1,057</b>	<b>1,057</b>	<b>1,057</b>	<b>1,057</b>
<b>Reserves</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-459</b>	<b>1,184</b>	<b>-512</b>	<b>368</b>	<b>4,651</b>	<b>4,439</b>	<b>4,439</b>	<b>4,439</b>	<b>4,439</b>
<b>Retained earnings including profit for the year</b>	<b>21,467</b>	<b>22,420</b>	<b>21,653</b>	<b>19,888</b>	<b>20,388</b>	<b>19,823</b>	<b>24,177</b>	<b>25,765</b>	<b>28,456</b>	<b>22,067</b>	<b>27,405</b>	<b>34,138</b>	<b>42,334</b>
<b>Equity attributable to equity holders of the parent</b>	<b>23,019</b>	<b>23,972</b>	<b>23,205</b>	<b>21,440</b>	<b>22,567</b>	<b>23,488</b>	<b>26,146</b>	<b>28,614</b>	<b>35,588</b>	<b>28,987</b>	<b>33,900</b>	<b>40,633</b>	<b>48,829</b>
<b>Minority Interest</b>	<b>931</b>	<b>967</b>	<b>964</b>	<b>846</b>	<b>984</b>	<b>1,019</b>	<b>1,052</b>	<b>1,209</b>	<b>1,137</b>	<b>970</b>	<b>1,370</b>	<b>1,770</b>	<b>2,127</b>
<b>Total Equity</b>	<b>23,950</b>	<b>24,939</b>	<b>24,169</b>	<b>22,286</b>	<b>23,551</b>	<b>24,507</b>	<b>27,198</b>	<b>29,823</b>	<b>36,725</b>	<b>29,957</b>	<b>35,270</b>	<b>42,403</b>	<b>50,956</b>
<b>Non-Current Liabilities</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Interest-bearing liabilities	4,840	3,880	6,961	10,963	9,026	10,989	10,370	21,477	25,314	31,807	31,807	31,807	31,807
Provisions for pensions	2,583	1,764	2,044	3,659	3,015	3,538	3,180	3,100	2,735	2,657	2,657	2,657	2,657
Loans from financial institutions	0	0	1,681	2,373	1,840	1,684	2,255	2,682	4,691	5,093	5,093	5,093	5,093
Other liabilities	2,257	2,116	3,236	4,931	4,171	5,767	4,935	15,695	17,888	24,057	24,057	24,057	24,057
Non interest-bearing liabilities	2,686	3,840	3,949	3,885	3,548	3,753	4,187	5,376	5,919	5,507	5,507	5,507	5,507
Deferred tax liabilities	1,467	1,870	1,964	2,109	2,069	2,063	2,029	1,786	1,514	1,242	1,242	1,242	1,242
Provisions for taxes	0	711	858	800	840	1,020	1,413	2,760	3,201	3,311	3,311	3,311	3,311
Other provisions	1,219	1,259	1,127	976	573	528	647	701	806	782	782	782	782
Other liabilities	0	0	0	0	66	142	98	129	398	172	172	172	172
<b>Total Non-Current Liabilities</b>	<b>7,526</b>	<b>7,720</b>	<b>10,910</b>	<b>14,848</b>	<b>12,574</b>	<b>14,742</b>	<b>14,557</b>	<b>26,853</b>	<b>31,233</b>	<b>37,314</b>	<b>37,314</b>	<b>37,314</b>	<b>37,314</b>
<b>Current Liabilities</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Interest-bearing liabilities	3,901	8,342	6,649	3,137	5,181	7,223	8,185	10,469	14,549	7,574	7,574	7,574	7,574
Loans from financial institutions	3,901	8,342	6,192	3,001	5,006	6,059	6,780	9,158	11,324	3,431	3,431	3,431	3,431
Other liabilities	0	0	457	136	175	1,164	1,405	1,311	3,225	4,143	4,143	4,143	4,143
Non interest-bearing liabilities	8,531	8,548	8,393	8,126	10,068	13,090	15,961	18,290	20,720	16,730	21,071	22,579	24,409
Advance payments from customers	0	255	293	330	583	811	1,409	1,795	2,368	1,895	4,093	4,483	4,956
Accounts payable	0	2733	2603	3002	3731	4723	5921	6777	7000	4,730	6,201	6,791	7,508
Due to associated companies	0	43	41	30	57	94	143	103	80	42	42	42	42
Income tax liabilities	0	618	556	363	749	1,041	1,133	1,334	1,301	768	768	768	768
Other liabilities	0	1,318	1,311	1,063	979	1,700	1,966	2,168	3,312	3,428	3,428	3,428	3,428
Provisions	0	0	0	0	194	436	735	569	734	995	995	995	995
Accrued expenses and deferred income	3350	3581	3589	3338	3775	4285	4654	5544	5925	4,872	5,544	6,072	6,713
<b>Total Current Liabilities</b>	<b>12,432</b>	<b>16,890</b>	<b>15,042</b>	<b>11,263</b>	<b>15,249</b>	<b>20,313</b>	<b>24,146</b>	<b>28,759</b>	<b>35,269</b>	<b>24,304</b>	<b>28,645</b>	<b>30,153</b>	<b>31,983</b>
<b>Total Liabilities</b>	<b>19,958</b>	<b>24,610</b>	<b>25,952</b>	<b>26,111</b>	<b>27,823</b>	<b>35,055</b>	<b>38,703</b>	<b>55,612</b>	<b>66,502</b>	<b>61,618</b>	<b>65,959</b>	<b>67,467</b>	<b>69,297</b>
<b>Total Equity and Liabilities</b>	<b>43,908</b>	<b>49,549</b>	<b>50,121</b>	<b>48,397</b>	<b>51,374</b>	<b>59,562</b>	<b>65,901</b>	<b>85,435</b>	<b>103,227</b>	<b>91,575</b>	<b>101,229</b>	<b>109,870</b>	<b>120,253</b>

Source: Company Reports, Citi Investment Research and Analysis

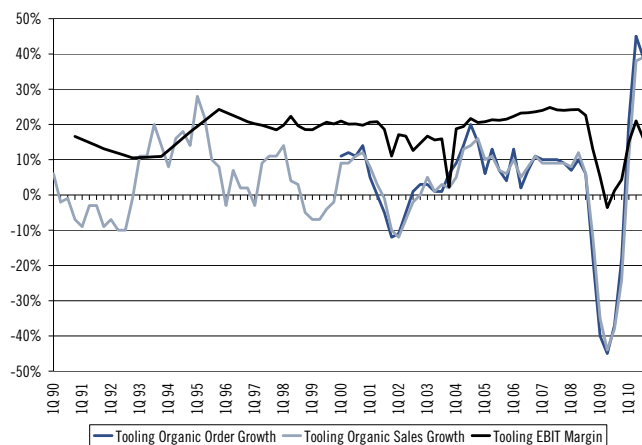
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# Appendix

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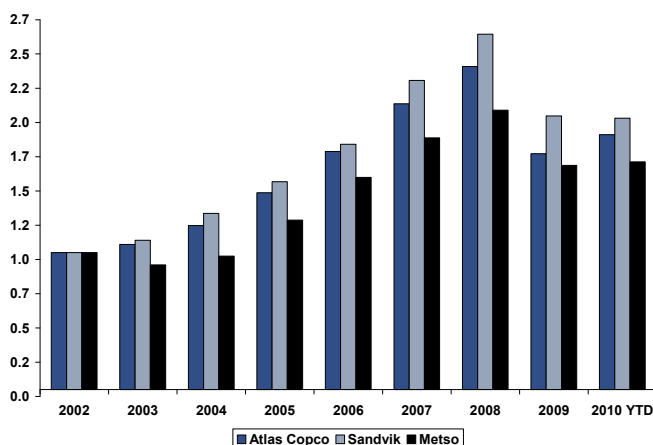
## Appendix A - Sandvik's Divisional Performance Since 1990

**Figure 78. Tooling Organic Growth and EBIT Margin History, 1990-2010**



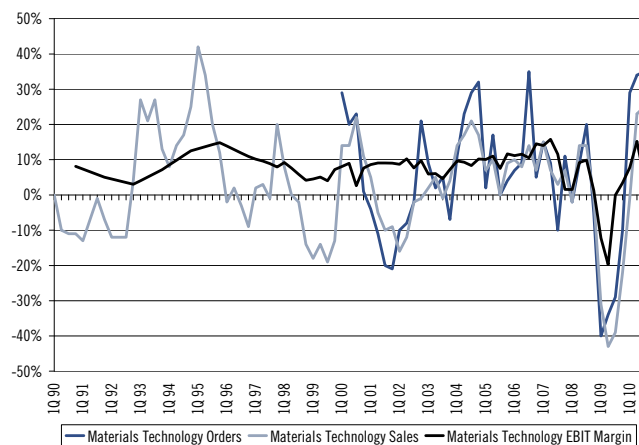
Source: Company Reports, Citi Investment Research and Analysis

**Figure 80. Mining and Construction equipment suppliers – Total Cumulative Volume Growth (2001-9M 2010\*)**



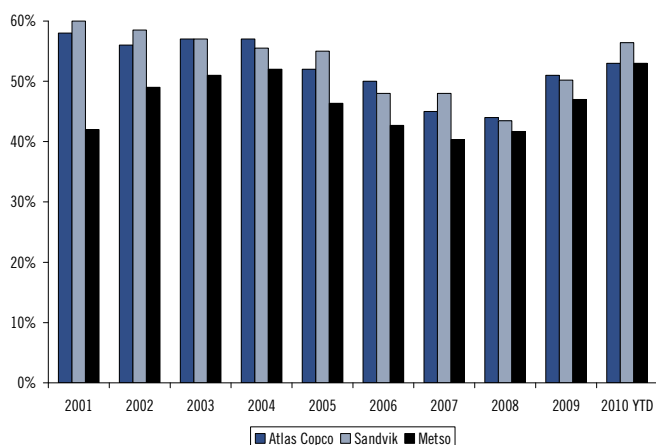
Source: Company Reports, \*Annualised

**Figure 79. SMT Organic Growth and EBIT Margin History, 1990-2010**



Source: Company Reports, Citi Investment Research and Analysis

**Figure 81. Mining and Construction equipment suppliers – Aftermarket revenue mix (2001-9M 2010)**

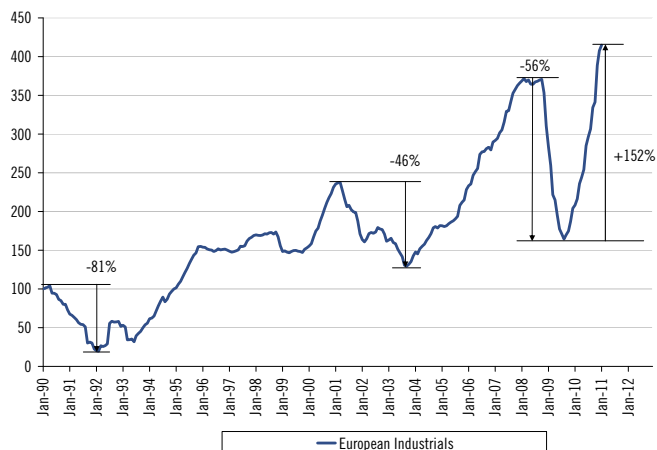


Source: Company Reports, Citi Investment Research and Analysis



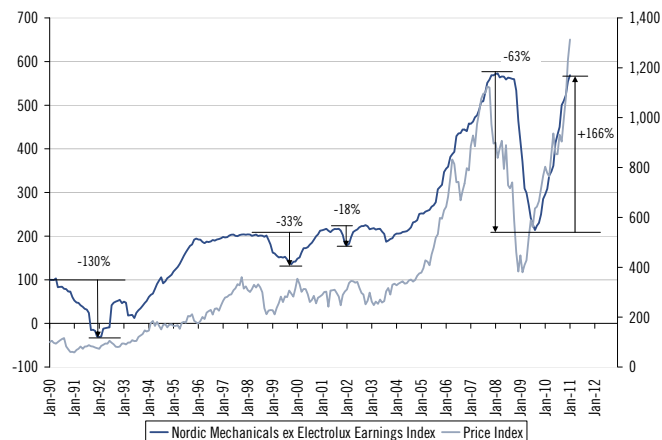
## Appendix B – Consensus Earnings Upgrades

**Figure 82. European Industrials – EPS Index Since 1990 (based on forward 12 month consensus)**



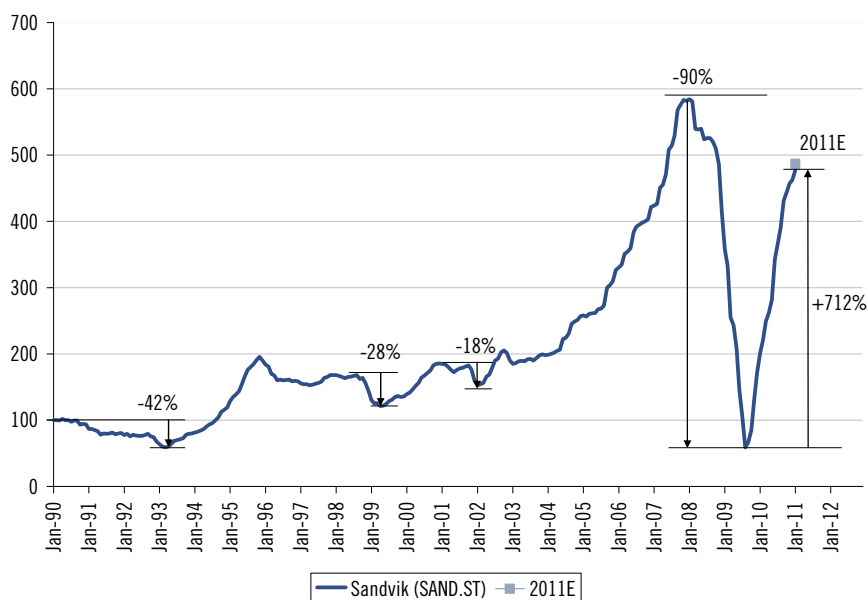
Source: Company Reports, \*Annualised

**Figure 83. Nordic Mechanicals (ex Electrolux) – EPS Index Since 1990 (based on forward 12 month consensus)**



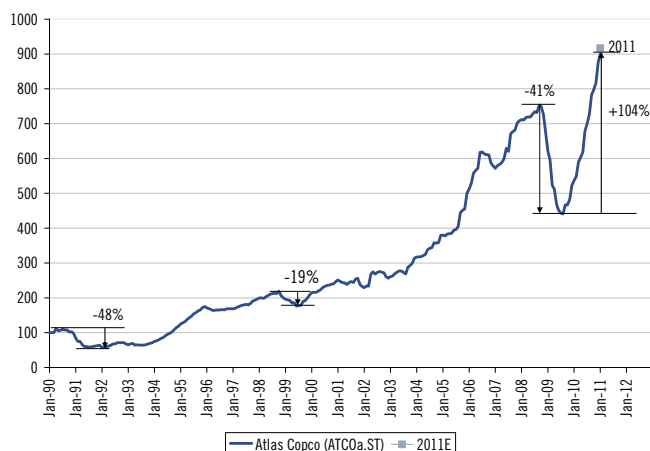
Source: Company Reports, Citi Investment Research and Analysis

**Figure 84. Sandvik – EPS Index Since 1990 (based on forward 12 month consensus)**



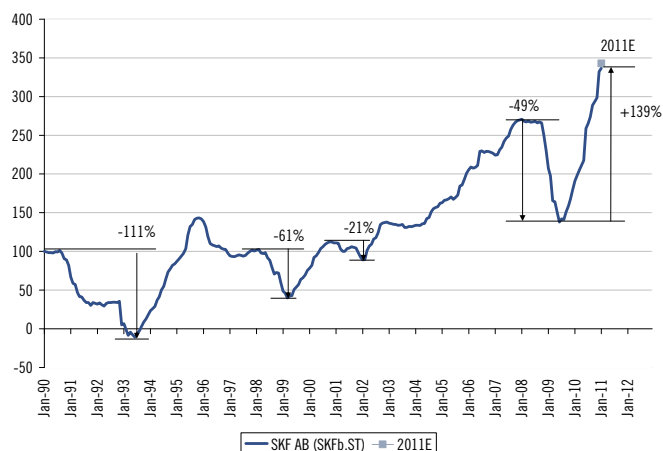
Source: Company Reports, Citi Investment Research and Analysis

**Figure 85. Atlas Copco – EPS Index Since 1990 (based on forward 12 month consensus)**



Source: Company Reports, \*Annualised

**Figure 86. SKF – EPS Index Since 1990 (based on forward 12 month consensus)**



Source: Company Reports, Citi Investment Research and Analysis

**Figure 87. Companies Mentioned**

Company	RIC	Rating	SP	Currency	Share Price
Alstom	ALSO.PA	1 H		EUR	41.12
Atlas Copco	ATCOa.ST	2 H		SEK	159.00
Bodycote	BOY.L	3 H		GBP	2.85
Cookson Group	CKSN.L	1 H		GBP	6.33
Electrolux	ELUXb.ST	3 H		SEK	184.50
Husqvarna AB	HUSQb.ST	1 H		SEK	53.25
IMI	IMI.L	1 H		GBP	8.86
Invensys	ISYS.L	1 H		GBP	3.29
MAN	MANG.DE	2 H		EUR	85.75
Metso	MEO1V.HE	2 H		EUR	38.80
Morgan Crucible	MGCR.L	1 H		GBP	2.55
Philips	PHG.AS	2 M		EUR	23.35
Sandvik	SAND.ST	1 H		SEK	126.00
Schneider Electric	SCHN.PA	2 H		EUR	112.65
Siemens AG	SIEGn.DE	1 H		EUR	93.61
SKF AB	SKFb.ST	3 H		SEK	183.80
Vestas Wind	VWS.CO	3 H		DKK	190.00
Weir Group	WEIR.L	1 H		GBP	16.18
GEA	G1AG.DE	1 H		EUR	21.03
Nexans	NEXS.PA	1 M		EUR	59.30
Charter Inter	CHTR.L	1 H		GBP	7.99
RHI	RHIV.VI	1 H		EUR	26.83
Smiths Group	SMIN.L	2 M		GBP	13.69

Source: Citi Investment Research and Analysis. Priced January 25<sup>th</sup>

## Sandvik AB

### Valuation

Our target price is SKr175 based on our DCF valuation of SKr175. We assume the following key parameters within our DCF valuation: through-cycle growth rate of 3% and a terminal growth rate of 2.5%, a through-cycle margin of 15.5% and WACC of 8.5%. Our other assumptions are net working capital as a % of sales of 25% (vs. the company guidance of 25% by 2012E), tax rate of 28-29% and capex/depreciation of 1x over the cycle.

### Risks

We rate Sandvik as High Risk based on our assessment of industry- and company-specific risk factors. There are a number of specific risks in the case of Sandvik where fluctuations could cause significant changes to our earnings forecasts and valuation and cause the shares to deviate significantly from our target price. Most notably, Sandvik is economically sensitive. High leverage, however, works both ways; when recovery eventually comes, the profit bounce-back should be equally strong. Sandvik's financial leverage could amplify the recovery. Sandvik also has notable currency risk and its Materials Technology business is exposed to metals price fluctuations.

## Appendix A-1

### Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

### IMPORTANT DISCLOSURES

#### Sandvik AB (SAND.ST)

##### Ratings and Target Price History Fundamental Research

Analyst: Natalia Mamaeva  
Covered since July 9 2009



	Date	Rating	Target Price	Closing Price
1	1-Feb-08	1H	*115.00	94.00
2	10-Apr-08	*2H	115.00	105.25
3	29-Apr-08	2H	*100.00	99.00
4	1-Aug-08	2H	*90.00	77.75

\* Indicates change

	Date	Rating	Target Price	Closing Price
5	30-Oct-08	2H	*55.00	49.00
6	21-Nov-08	2H	*45.00	41.80
7	17-Feb-09	2H	*55.00	49.60
8	25-Sep-09	2H	*78.00	76.40

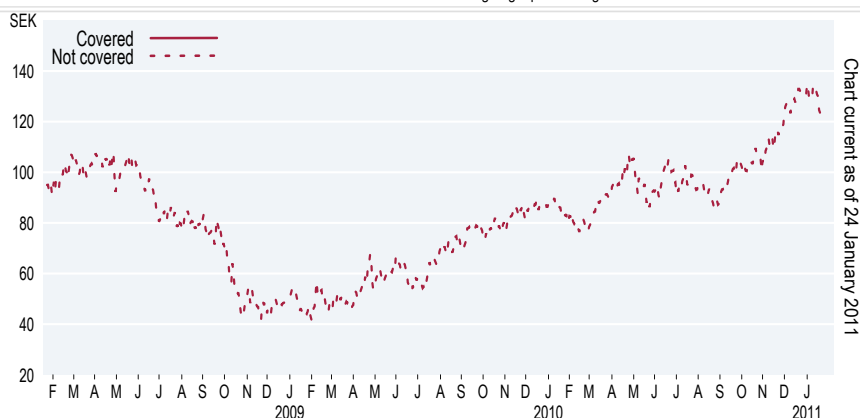
	Date	Rating	Target Price	Closing Price
9	9-Mar-10	*1H	*100.00	84.50
10	22-Apr-10	1H	*120.00	98.85
11	20-Jul-10	1H	*125.00	94.75

Rating/target price changes above reflect Eastern Standard Time

#### Sandvik AB (SAND.ST)

##### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Natalia Mamaeva  
Covered since July 9 2009



\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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##### Data current as of 31 Dec 2010

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
Citi Investment Research & Analysis Global Fundamental Coverage	52%	37%	11%	0%	100%	0%
% of companies in each rating category that are investment banking clients	45%	44%	40%	0%	44%	0%

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Citigroup Global Markets Ltd	Natalia Mamaeva; Martti R Palosuo, CFA; Mark Fielding; Alexandre Werbowy
Citigroup Global Markets India Private Limited	Mallika Shah

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