

DIRECTORS' REPORT 2008

About the business

Scana Industrier ASA (Scana) is a Nordic industrial group operating in three business areas: Steel, Marine and Oil & Gas. The main products in the Steel area are the production of customised steel forgings and castings for the oil and gas, energy, marine, machine and tool industries. The Marine area develops and manufactures gears, propulsion systems and valve control systems for ships and offshore vessels, in addition to offering service and after sales services. The main products in the Oil & Gas area are design and production of components and systems, laboratory services and the maintenance and repair of equipment in the oil and gas industry.

The companies in the three business areas provide products and system solutions in four market segments, namely marine, oil and gas, energy and steel and machinery.

Scana's technology, unique expertise in engineering materials and extensive production experience form the basis of our competitive power. Our aim is to be the preferred supplier for leading companies within our market segments.

The group's head office is in Stavanger. The group has operative companies in Sweden, Norway, China, Poland, South Korea, the USA and Singapore. Scana is also represented with its own sales and service companies in a number of countries.

2008 was a record year for the group's turnover and operating profit. This confirms that the industrial choices made by the company in recent years have been right. However, the international financial crisis is affecting Scana's order reserve. The total order intake of NOK 2 477 million is a decline of 23 per cent compared with 2007. The order reserve at the end of 2008 was NOK 2 096 million, which is a decline of 9 per cent compared to 2007.

The group is implementing a number of measures to address the challenges and opportunities as a result of the financial crisis. This includes stepping up the marketing and sales efforts, manpower reductions and cost-cutting, restructuring of businesses and acquisitions/strategic collaborations.

Scana's main products are well diversified, niche-oriented market leaders within their segments. The group is therefore well equipped for the future. Despite this, the international financial crisis is expected to reduce activity somewhat, although the effect for 2009 will be limited since much of the production has already been sold.

Accounts

Going concern

In accordance with section 3-3 of the Accounting Act (Norway), we confirm that the accounts have been prepared on the basis of the going concern assumption, and that this assumption is valid.

IFRS

International Financial Reporting Standards (IFRS) are used as the prevailing accounting principles for the consolidated accounts. The standards are approved by the EU.

Financial performance

The group continued its positive development throughout 2008, and achieved the the highest turnover and operating result in the groups history. Turnover was NOK 2 896 million compared with NOK 2 469 million in 2007, which is an increase of 17 per cent.

The groups profit before depreciation and amortization was NOK 350 million and operating profit was NOK 277 million. This is an improvement of respectively NOK 24 million and NOK 11 million.

The improved result and growth in turnover are largely related to a high utilisation of capacity internally and a good product composition. The turnover growth is evenly distributed between market growth and price increases.

A key customer in the Oil & Gas area went bankrupt and as a result the group made a larger provision for potential losses in 2008. The operating margin was subsequently 10 per cent, compared with 11 per cent in 2007. Without this provision for loss, the operating result would have been more than 11 per cent.

The group had net interest expenses of NOK 23 million. Scana hedges all major contracts in foreign currency. Towards year end 2008 the Norwegian kroner were considerably weakened compared to foreign currency. This led to a temporary change in the value of the group's currency contracts amounting to minus NOK 150 million. This change in value is by year end unrealized but should be expensed according to IFRS, despite it has no cash effect. By a strengthening of the Norwegian kroner compared to foreign currency the change in the value of currency contracts would have led to a positive effect in the finance result.

The result before taxes was NOK 75 million. This year's

expensed taxes were NOK 15 million which is 20 per cent of the result before tax. The tax expense consist of NOK 57 million in tax payable for the group's Swedish and Chinese operations adjusted downwards for changes in deferred tax of minus NOK 42 million. The group still has a loss carry-forward of NOK 189 million linked to the Norwegian operations.

The group's total net profit was NOK 60 million, of which NOK 45 million is assigned to the owners of Scana and NOK 15 million to minority interests. This constitutes earnings per share of NOK 0.27, compared with NOK 1.11 in 2007. Earnings per share before adjustment for temporary changes in value of currency contracts would have been NOK 0.91. As at 31 December 2008, there were 167 333 750 shares issued.

Balance sheet

The balance sheet totalled at 31 December 2008 NOK 2 248 million, which is an increase of NOK 344 million compared with 31 December 2007. The change is due to increased investments and a generally higher level of activity in the group.

At the end of 2008 the group's reported interest-bearing debt net of cash and cash equivalents were NOK 472 million. Book value of the gross interest-bearing debt at the end of 2008 was NOK 611 million which is an increase of NOK 116 million compared with 31 December 2007. Loans and short-term credit facilities were reduced by NOK 45 million. The board believes that the capital structure provides good flexibility for further growth through acquisitions and investments. The increase in the short and long term debt after adjusting for the temporary change in value of the currency contracts were respectively NOK 96 million and NOK 48 million.

The book value of shareholders' equity as at 31 December 2008 was NOK 723 million, which equates to an equity ratio of 32 per cent. Excluding the temporary change in value of the groups currency contracts, the book value of the equity amounts to NOK 4.96 per share and an the equity ratio would have been 38 per cent. At the end of 2007, book value of the equity were NOK 724 million and the equity ratio was 38 per cent.

Financial instruments are valued at fair value. If the change in fair value satisfies the IFRS requirements for hedge accounting, the change in value is recorded against equity. The equity was reduced by NOK 22 million in 2008 as a result of such changes in value and the recognised equity from such changes totalled minus NOK 7 million at the end of the year. Translation differences and exchange effects increased the equity in 2008 by NOK 56 million.

Intangible assets as at 31 December 2008 were recorded at NOK 132 million, of which goodwill amounted to NOK 83 million. The increase in 2008 of NOK 53 million is mainly linked to the acquisition of Scana Offshore Services Inc. and recognised development costs.

Cash flow

The operating profit in 2008 was NOK 277 million after depreciation and amortizations which totalled NOK 74 million. Net cash flow from operations was NOK 147 million. The group works actively to reduce the working capital.

Capitalized expenses and investments in fixed assets totalled NOK 170 million, of which investment in the Swedish steel companies is the most important item. The group purchased Scana Offshore Services in Houston, and the cash effect of the purchase were minus NOK 30 million. The net cash flow from investing activities totalled at minus NOK 199 million.

The net cash flow from financing activities was NOK 5 million, and the group's net cash flow in 2008 was minus NOK 46 million. The group's cash and cash equivalents totalled NOK 139 million at the end of the year.

Capital structure

The group made a large withdrawal on the available credit facilities towards the end of 2008 in order to strengthen the operational flexibility and to finance parts of an ongoing extensive investment program.

No increase in capital was carried out in 2008. A share option programme of up to NOK 1.5 million shares is aimed at senior employees. A net total of 300,000 of the share options were issued in 2008 and 900,000 were issued in 2007. The options can be exercised in 2010. Otherwise, there have been no other circumstances that affect the company's capital structure in 2008.

Change of accounting principle

Until 2007 the group classified exchange gains/losses resulting from operations as operating items. From the first quarter of 2008 the exchange gains/losses are classified as financial items. The corresponding numbers for 2007 and 2006 have for comparison reasons been subject to change. Scana decided early in 2008 to reclassify these items from operating items to finance items in order to reduce fluctuations to the operating result. In 2008 the financial items have a considerable effect on the accounts, and the effect consists mainly of a unrealized temporary change in the value of the groups currency contracts.

Steel area

The steel area companies all specialise in different processes and products. Production takes place at Scana's own production facilities, which include melting plants, forges, rolling mills, foundries, and heat treatment and machining units. Production is of a high standard, and complies with ISO-certified quality assurance systems.

Turnover in 2008 was good, and totalled NOK 1 987 million, up 15 per cent compared with 2007. The operating profit was NOK 317 million, which equates to an operating margin of 16 per cent. Operating profits and operating margins of this magnitude are

very satisfactory and show that the business area is competitive and has succeeded in the efforts of creating the right product mix and the efforts to increase the capacity utilisation.

The prices of scrap steel and electric power fell considerably towards the end of 2008 from the record quotations earlier in 2008. The prices of precious alloys experience a smaller reduction compared with the record quotations early in 2008.

The order intake for 2008 totalled at NOK 1 886 million, down 9 per cent from 2007. The order reserve at the end of 2008 was NOK 1 252 million; an increase of NOK 73 million compared to 2007. The international financial crisis affects the steel and machinery market segment and a downturn is expected for Scana in Europe. However, Scana's activity in China is expected to continue at a satisfactory level since Scana's products are proving successful in relation to the infrastructure expansions initiated by the Chinese state. Only a minor reduction in activity for Scana's steel companies is expected for the marine segment. The oil and gas segment is expected to be reduced somewhat from the second quarter of 2009 as a result of lower oil prices and time lags in projects. The demand and level of activity within the energy area are expected to be extremely good, and energy is therefore regarded as a key market for Scana in the years to come.

Overall, a poorer order intake and reduced profit margins are expected for Scana's steelworks in 2009 and 2010 as a result of the international financial crisis. Investments in Scana's Swedish steel companies will streamline production, reduce risk and increase capacity in the long term with respect to strategically important customers. High demand within the energy segment will offset some of the reduction in other segments.

Marine area

The companies within the marine area develop and manufacture gears, propulsion systems and valve control systems for ships and offshore vessels, in addition to offering service and after sales services. Customers are shipyards, shipping companies, engine suppliers and other system suppliers. The business area is particularly well represented in Asia for sales and service with its own offices and agents, and is also represented in other parts of the world.

Turnover was NOK 636 million in 2008, which is 30 per cent higher than in 2007. The operating profit totalled NOK 74 million compared with NOK 34 million in 2007. The increase is partly due to increased margins on new constructions and a higher share of revenues from service and maintenance. The operating profit is also positively affected by a strengthening of the EUR and USD against the NOK since the majority of contracts are denominated in these currencies.

The market situation has been good throughout the year. However, the financial crisis has also led to cancellations and

delays in the global marine industry. However, Scana's operations have only been affected by cancellations to a limited extent. The part of the market that is most influenced by the market situation is the bulk market, where the group has very little activity. The biggest deliveries are to shipyards in China and Korea with a large degree of state ownership. These shipyards are solid and the group expects the high level of activity to continue. The order reserve fell in 2008, but is still considered to be good. Large parts of Scana's capacity within the business area has been sold for 2009. For 2010, the group has orders which utilize half the production capacity

At the end of 2008, the order reserve was NOK 783 million, which is a reduction of 24 per cent compared with 2007. The order intake in 2008 was NOK 389 million, down 53 per cent compared with 2008. The reduced order intake was anticipated and is related to the reduction in the number of contracts globally. Scana expects the low level of activity on the supply side to continue in the first half of 2009. A certain recovery is expected in Scana's order reserve in the second half of 2009, which will utilize the group's production capacity in 2010. The acquisition of Scana Zamech will enable Scana to offer design, production and installation of tunnel thrusters, shafts and both fixed and manoeuvrable propellers for ships from approximately 1,000 tonnes and up to the largest types of ships. In the long term, this will constitute a positive contribution to Scana's competitive power.

Oil & Gas area

The main products for the Oil & Gas area are design and production of components and systems, laboratory services and the maintenance and repair of equipment for the oil and gas industry. In the second quarter of 2008, Scana acquired the Houston-based BOP Stacking Inc., now known as Scana Offshore Services Inc. The company has extensive expertise within design and project management related to blow out systems, and supplies systems to rig owners and drilling contractors. The company has established an office in Singapore, which gives Scana direct contact with customers in the world's largest market for oil and gas.

The business area had a turnover of NOK 300 million in 2008 compared with NOK 281 million in 2007. The operating result was minus NOK 85 million compared with positive NOK 39 million in 2007. The negative development is due to the development, production and installation of the loading buoy system for FPSOcean's "Deep Producer 1". The project is technologically innovative but also complex.

At the end of 2008 Scana entered into an agreement involving a final settlement for development expenses and outstanding receivables relating to the work on "Deep producer 1". But early in 2009 FPSOcean filed a bankruptcy petition after lacking the financing for the final completion of the ship. Scana consequently

made a provision of NOK 47 million for potential losses in connection with the project. At the same time certain items were reclassified to inventory from receivables as the group expects the underlying values to be realized through a sale to a third party. Scana's remaining work is completed in April 2009 and the remaining risk in connection with the project is limited.

The order reserve at the end of 2008 was NOK 61 million, and the order intake was NOK 203 million. The corresponding figures for 2007 are NOK 96 million and NOK 326 million respectively. The large reduction is due to the "Deep Producer 1" project being almost complete on Scana's part without any new, large projects being started.

With regard to the segment's other companies and projects, the positive growth continues and the operating margin was 15 per cent for the year.

The oil price development in 2009 is likely to influence on Scana's level of activity in 2009 and 2010. In the short term, Scana expects a somewhat reduced level of activity within the business area, both as a result of the general market situation with time lags in projects, and due to the reduced activity of key collaboration partners in recent years. However, a positive development is expected in the long term.

Risk

The group's most critical risk areas are connected to the financial crisis and the consequences this has for the market economy and thereby the demand in Scana's market segments. Scana is implementing a number of measures in order to address the extraordinary market situation as a result of the financial crisis. This includes restructuring operations, increasing marketing and sales efforts, manpower reductions and acquisitions in Poland and strategic collaborations in the marine area. These efforts will increase Scana's competitiveness in which the group works. Scana therefore consider it selves as well positioned and capable to deliver good results in the coming years, despite the fact that the financial crisis also will have a negative effect on Scana's results.

The group is to a limited extent exposed to the development in raw materials as steel scrap, steel alloys and electricity prices, as the group uses a market based and contractual hedging against fluctuations in these risk areas.

The group is also to a limited extent exposed to financial risks in the following areas:

- Currency risk

All sales in foreign currency are hedged against NOK or SEK at the time of entering into the contract. The group is mainly exposed to fluctuations between NOK and SEK through its holdings in subsidiaries in Sweden.

- Liquidity risk

The group aims to have liquid funds and/or credit facilities in order to be able to finance operational activities. Unused credit facilities are described in note 15 in the group accounts. The group has implemented a number of measurements to meet the liquidity risk, especially through closer monitoring of cash flow projections and through programs to reduce the working capital. The group monitor the liquidity situation both on short and long term in cooperation with its subsidiaries. The group also continuously monitor the financial situation so that the group at all times are in compliance with the covenants in the loan agreements.

- Credit risk

The group has guidelines for ensuring that contracts are not entered into with customers who have had or can expect to have payment problems. Parts of the international sales are hedged through customer insurance. Outstanding amounts shall not exceed defined credit limits. The group is of the opinion that it is able to meet the increased credit risk in the marked through monitoring of customers financial performance and through a more cautious practise when considering customers for a line of credit.

See note 23 of the group accounts for further information on financial risk.

Shareholder information

Scana was listed on the Oslo Stock Exchange in 1995. Scana's shareholders consist of institutional investors, small investors and a few key shareholders involved in the company's board and management. The group's largest shareholders are Verket Finans AS and Camar AS, with board member John Arild Ertvåg as owner, each holding around 10 per cent of the shares. Scana's chairman of the board, Frode Alhaug, is the third largest shareholder through his company Fama Invest AS, with 7.4 per cent of the shares.

At the year-end, the ten largest shareholders held a total of 52.8 per cent of the company's shares. The company had a total of 1,940 shareholders, and 7.2 per cent of its share capital was in foreign ownership.

The share price followed the general market trend in 2008 to a large extent. The Scana share declined to a final price of NOK 8.20 compared to NOK 18.90 at the start of the year. The number of shares traded on the Oslo Stock Exchange during the year was approximately 32,8 million, which gives a turnover rate of 0.20.

Organisational and personnel matters

The group had 1,963 employees at the end of 2008, of which 776 in the steelwork in China. The increase of 40 employees in 2008 was linked to the increased scope of the business.

At the end of 2008, Scana reduced manning levels in some of the group companies in Sweden and Norway by approximately 150. This was due to the change in the level of activity. The working environment and collaboration with the employee organisations are considered to be good.

Women representation were 40 per cent in Scana's executive board. Women are also represented in the management teams of the group's subsidiaries. However, Scana consists largely of production units, where there have traditionally been a large proportion of men. Women account for around 25 per cent of the white collar staff in the subsidiaries.

Health, safety and environment (HSE)

The number of lost-time injuries in 2008 was 47 (of which two in China), compared with 39 in 2007. Actual working hours totalled 3 635 242 in 2008, compared with 3 652 864 in 2007. There were no isolated serious industrial accidents at the group's facilities. The board is satisfied that the company has not had any serious industrial accidents and that HSE measures are systematically undertaken in all of the group's activities.

Absence due to illness was 3.0 per cent in 2008 compared with 3.3 per cent in 2007. The absence in the operative subsidiaries varied between 2.1 and 8.4 per cent.

The group has obtained the necessary licences for its activities and does not affect the external environment beyond the discharge permits granted by the authorities. The group is continuously working on limiting discharges to the environment, waste to landfills and other negative environmental effects. The remainder of the waste from the production are sorted and handled in accordance with regulations, in addition to some of it being recycled. Companies in the steel area buy large quantities of scrap for remelting. Scana is therefore also a significant recycling company.

Research and development

Scana spends up to 3-5 per cent of its turnover on research and development. The work is related to product development in oil and gas, marine and steel, and in HSE in order to reduce the company's impact on the external environment.

Outlook

The main aim of the group is to increase the shareholders' value. The following primary strategies have been determined on this basis:

1. Continued organic growth in all business areas
2. Maintain a good operating margin and effective financial management
3. Strengthen the group's strategic position through acquisitions
 - in order to strengthen the market position
 - in order to increase capacity
 - in order to supplement the product range or value chain

4. Develop the repair and service concept within the marine area and to the oil and gas industries

The board believes that the achievement of targets is good in relation to the main strategies. With regard to 2009, the board places special emphasis on ensuring effective sales work, effective operations and financial management in light of the challenges due to the financial crisis. The company expects the strong results in 2008 to be somewhat reduced in 2009 and 2010 due to the global financial turbulence, but also anticipates that the strategy will lead to a positive profit performance once the financial unrest diminishes.

Market development

For Scana, the demand was higher in 2008 than in previous years. On the other hand the financial turbulence in the global market has from the end of 2008 led to a lower level of activity within some of Scana's market areas.

With regard to the marine area a reduced number of contracts is expected, which will lead to a reduced level of activity compared to the recent years very high level of activity. In 2009 Scana expects a temporary reduction in the demand for marine products from the groups steel companies. For Scana's marine companies it is expected a continued high level of activity throughout 2009, but with a decline in the rate of activity for new contracts from mid-2010. Scana's increased efforts towards service and maintenance works may compensate for some of the reduction in new contracts. Through the acquisition of ABB's business in Poland (Scana Zamech) early in 2009, Scana increased its market potential for propulsion systems by being able to offer complete systems and installations for considerably larger ships than before.

Within the oil and gas area Scana has in the recent years developed several advanced products and systems which have created interest in the market. Multidisciplinary experience and considerable knowledge within materials technology and the opportunity for in-house production of special components give considerable future possibilities for both already developed niche products and for products under development. Scana expects a somewhat lower level of activity in the market area oil and gas in 2009 compared to recent years, but expects increased order intake, especially to the steel companies from the second half of 2009. The level of activity for maintenance is expected to be in line with 2008.

Within the business area energy Scana anticipate increased level of activity in 2009. Especially it is expected increased demand for shafts for large windmills. Scana is one of very few manufacturers in the world with the production capacity to supply shafts for such windmills. The company also has considerable competitive power as a supplier of generators and products within power production from a number of energy sources.

Within products for steel and machinery, Scana has concentrated the production on wear-resistant parts, rolls, castings, road clearance equipment, blocks, tool steel, stainless steel and arms for forklift trucks. The financial crisis has led to a considerably lower level of activity within a number of these areas, and the group expects this situation to remain throughout 2009. For some of the products the rate of activity is unchanged. Road clearance equipment and rolls to Chinese steel companies are examples of products which so far has not been influenced negatively by the current market situation.


Scana enters 2009 with a still high order backlog and the order situation for the group's main products is overall satisfactory for 2009. The differences between the groups subsidiaries are on the other hand increasing and it is expected that the financial crisis will lead to lower order intake which throughout 2009 will

gradually result in lower turnover and a lower operating result in 2009. The measurements which the group implements in the different subsidiaries will on the other hand ensure that the group delivers satisfactory results in 2009. The group is also well positioned to meet a future increase in activity.


Appropriation of earnings

The net profit assigned to the owners of the parent company was NOK 45 million, giving earnings per share of NOK 0.27. The result per share after adjusting for the temporary change in value of currency contracts were NOK 0.91. The parent company, Scana Industrier ASA, achieved a net profit of NOK 155 million. The board will propose to the Annual General Meeting to pay a dividend of NOK 0.30 per share; a total of NOK 50.2 million, in addition to the allocation of 3 164 931 own shares. Further it is proposed that NOK 104.5 million is transferred to other equity.

Stavanger, 1 April 2009



Frode Alhaug
Chairman of the board



John Arild Ertvaag
Board member



Mari Skjærstad
Board member



Kristin Malonæs
Board member



Bjørn Dahle
Board member



Rolf Roverud
CEO and Group chief executive