VALMET

Annual Report

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Key Figures

Millions, except per share data	FIM 1996	FIM 1997	**FIM 1998**	**EUR[1] 1998**	**USD[2] 1998**
Orders booked	10 486	10 609	**10 686**	**1 797**	**2 110**
Order backlog, December 31	8 086	7 126	**5 813**	**978**	**1 148**
Net sales	11 764	12 313	**11 649**	**1 959**	**2 300**
Net sales change, %	37.2	4.7	**–5.4**	**–5.4**	**–5.4**
Operating profit	921	939	**761**	**128**	**150**
Income before extraordinary items and taxes	1 056	1 018	**866**	**146**	**171**
Income before taxes	1 020	1 137	**866**	**146**	**171**
Net income for the year	806	863	**675**	**114**	**133**
Exports and international operations	7 891	9 799	**9 791**	**1 647**	**1 933**
Exports and international operations, % of net sales	67.1	79.6	**84.0**	**84.0**	**84.0**
Capital expenditures	632	1 376	**516**	**87**	**102**
Depreciation and amortization	437	432	**501**	**84**	**99**
Research and development	493	498	**500**	**84**	**99**
Number of personnel, December 31	12 871	13 480	**12 680**	**12 680**	**12 680**
Shareholders' equity and minority interests	3 283	3 949	**4 278**	**720**	**845**
Balance sheet total	8 302	10 073	**9 886**	**1 663**	**1 952**
Net debt / equity, %	–9.5	18.8	**6.8**	**6.8**	**6.8**
Equity ratio, %	42.8	40.3	**46.1**	**46.1**	**46.1**
Return on net assets, %	23.4	20.6	**15.8**	**15.8**	**15.8**
Return on equity, %	26.6	22.4	**16.8**	**16.8**	**16.8**
Earnings / share	10.26	10.08	**8.64**	**1.45**	**1.71**
Dividend / share	3.00	3.50	**3.50**[3]	**0.59**[3]	**0.69**[3]
Market value of shares, December 31	6 326	5 873	**5 311**	**893**	**1 049**

[1] Translated from Finnish markkas ("FIM") into euros using the irrevocable conversion rate of EUR 1.00 = FIM 5.94573 adopted by the European Union Council.

[2] Translated from Finnish markkas ("FIM") into United States dollars ("USD") using the December 31, 1998 Noon Buying Rate of the Federal Reserve Bank of New York of USD 1.00 = FIM 5.0645.

[3] Proposal by the Board of Directors

Valmet in Brief

The Valmet Group is a leading world supplier of paper and board machines, and process automation systems. The Group operates in five business groups – Paper and Board Machinery, which makes paper, board and finishing machines, Converting Equipment, which supplies machinery for the packaging and printing industries, Valmet Automation, which makes applications and solutions used for the measurement, control and information management of industrial processes, Valmet Power Transmission, which makes industrial gears and hydraulic motors, and Valmet Automotive, which specializes in the production of cars.

Valmet Group net sales for 1998 were FIM 11.6 billion, of which exports and international operations accounted for 84 per cent. The Group had 12,680 employees at the end of the year.

Valmet's shares are listed on the Helsinki (HEX) Exchanges and New York (NYSE) Stock Exchange.

Due to the merger between Valmet and Rauma, the companies have published a joint Valmet-Rauma Review for 1998, containing detailed information on the merger, the pro forma figures and the businesses of the new company.

Contents

A Period of Consolidation after Strong Growth

Valmet Group's income before extraordinary items and taxes for 1998 was FIM 866 million - a result which, although good, does not meet the level achieved in the best years. The decline in profit is a consequence of the worldwide economic malaise which began in Southeast Asia and has spread to other markets. This development has had a negative impact on Valmet, despite the taking of appropriate adaptation measures in good time. Valmet's order backlog fell to FIM 5,813 million as a result of the postponement of several significant deals.

Innovation is the stepping stone to growth

Valmet aims to achieve sustained growth through improved competitiveness and cost effectiveness. Improvements in competitiveness are dependent on technological progress and innovation. Innovative product development allows us to constantly launch new solutions, which incorporate new concepts and improve the customers' processes. The bold questioning of old ways has been reflected in the growth of innovative thinking among the personnel. Last year, nearly 900 employee inventions were registered in Valmet.

Valmet is increasingly focusing on mastery of the whole papermaking process. The Group is being developed into a center of technological competence, supported by the RTD centers that have been established for the most important markets. A good example of Valmet's integrated RTD work is the new generation OptiConcept papermaking line, which creates even better opportunities to receive orders of new paper machines and machine rebuilds. Another major aim of Valmet's RTD is the reduction of the environmental impact of paper industry processes.

Development of product structure seen as challenge

Sustaining growth and leveling out changes in the business cycle are seen as challenges in Valmet. The corporate acquisitions made last year support the Group's growth targets, while giving better opportunities to provide customers with new products and serve them in new markets. The establishment of the Converting Equipment group shows our dedication to identifying new customer groups, in this case the packaging industry. Valmet's position as a leading supplier of roll handling equipment and systems was strengthened by a corporate acquisition, and printing houses are now also our customers.

Even though Valmet has primarily focused on the papermaking process, the Group is continually searching for other interesting future growth areas and products. There are new possibilities particularly in automation and power transmission. Valmet Automation has broadened its expertise in the wood processing industry for a long time already. The Sage unit, which specializes in SCADA systems for oil and gas networks has grown into the leading supplier of automation for the oil and gas industry in North America. The wind power station turbine gears developed by Valmet Power Transmission are a good example of our specialization in environmental technology. The demand for wind power is growing strongly, particularly in Central Europe.

Service operations, the Group's global outreach and strong financial structure, act to level out the effects of cyclical variations in the forest industry. New service centers have been established in different market areas and the existing ones have been renewed. Paper machine service is a significant growth area for Valmet. Service operations are estimated to grow at about 15 per cent per year.

Merger of Valmet and Rauma

The merger of Valmet and Rauma will take effect on July 1, 1999. The new company will be a global market leader in all of its main product groups supplying machinery and processes to the forest products industry. The product range of the new company will cover all areas of the treatment of wood-based fiber from forest machinery to finishing and converting machinery. The new company will have a strong base of

machinery and equipment that will provide a platform for further growth in the areas of service and spare parts. I believe that the synergetic advantages of the merger will strengthen the new company's market position, creating added value for shareholders in the long term.

I would like to take this opportunity to thank our employees, and our sub-contractors and suppliers, for their excellent work during the past year. I would also particularly like to thank our customers and shareholders for the faith they have continued to place in Valmet.

Helsinki, February 16, 1999

Matti Sundberg

Shares and Shareholders

Valmet Corporation's share capital totals FIM 851 million. According to Valmet's Articles of Association there is one series of shares. The total number of shares issued and outstanding is 78,100,000. No shareholder can vote with more than 80 per cent of the total votes represented at the General Meeting. According to the Corporation's Articles of Association a shareholder whose total shareholding or voting rights reach or exceed 33 1/3 per cent or 50 per cent, shall, upon demand, acquire the shares held by other shareholders at a price specified in the Articles.

The Corporation's shares have been quoted on the Helsinki Exchanges since 1988. The shares have been joined to the book entry securities system, in which shareholdings are registered in book entry accounts held by various book entry registrars. Foreign shareholders may alternatively register their shares in nominee accounts administered by a custodian. Nominee-registered shares have no voting rights. Valmet's American Depository Shares (ADS) representing two ordinary shares each, have been listed on the New York Stock Exchange since 1996 and traded under a sticker VA.NYSE.

During 1998, 44.6 million Valmet shares were traded on the Helsinki Exchanges at an average price per share of FIM 77.29. The number of ADSs traded on the New York Stock Exchange was 1.0 million, and the average price was USD 30.74 per ADS.

On November 17, 1998, the Boards of Directors of Rauma and Valmet announced a plan, under which Rauma and Valmet will merge to create a new combined company. In the merger each outstanding share of Rauma will be converted into 1.08917 shares of Valmet-Rauma and each share of Valmet will be converted into one share of Valmet-Rauma. Since November 17, 1998 the share prices of Valmet Corporation and Rauma Corporation have moved in relation to each other in accordance with the proposed conversion ratio.

The 1994 Annual General Meeting approved an issue of bonds with warrants, valued at FIM 500,000, to members of Valmet Corporation's senior management. The bonds are valid for five years, carrying an interest rate of five per cent and an issue price of 100 per cent. The warrants entitle the holders to subscribe to a maximum of 1,000,000 shares from December 1, 1998 to January 31, 2001, at a subscription price of FIM 60.00. The bonds with warrants were completely subscribed. In connection with the approval of Valmet-Rauma's merger plan on November 17, 1998, the Board of Directors of Valmet determined that warrant holders would be eligible to subscribe for Valmet shares during the period from December 1, 1998 to May 31, 1999 and for Valmet-Rauma shares from the completion of the merger until January 31, 2001, at the original subscription price and in accordance with the original terms of warrants. The subscription rights of warrants had not been used by February 16, 1999.

The 1998 Annual General Meeting approved an issue of two series of warrants to persons belonging to the management of the Group and certain other key persons. The warrants entitle the holders to subscribe to an aggregate of 2,000,000 shares in the Company (1,000,000 shares in each series). The subscription period for the new shares will commence on April 1,

Share Data	1994	1995	1996	1997	**1998**
Share capital, Dec 31, MFIM	851	851	851	851	**851**
Number of shares					
Number of shares, Dec. 31	85 101 430	85 101 430	78 100 000	78 100 000	**78 100 000**
Average number of shares	79 079 512	85 101 430	81 130 756	78 100 000	**78 100 000**
Trading volume, Helsinki Exchanges	26 552 340	24 751 770	44 980 204	53 648 851	**44 584 487**
Share issues, MFIM					
Increase in share capital	140				
Surplus over nominal value	505				
Number of shares redeemed and cancelled	–	–	7 001 430	–	**–**
Dividend, MFIM	43	149	234	273	**273** [1)]
Dividend / share, FIM	0.50	1.75	3.00	3.50	**3.50** [1)]
Dividend yield, %	1.1	3.2	3.7	4.7	**5.1**
Earnings / share, FIM	2.50	6.74	10.26	10.08	**8.64**
P/E ratio	18.02	8.09	7.89	7.46	**7.87**
Cash flow / share, FIM	8.22	11.35	15.88	15.32	**15.25**
Equity / share, FIM	29.45	36.03	41.57	49.85	**54.06**
Nominal value, FIM	10	10	10	10	**10**
Highest quotation, FIM	64.50	72.50	83.50	98.00	**102.00**
Lowest quotation, FIM	34.50	39.50	52.00	69.00	**48.00**
Quotation, Dec 31, FIM	45.00	54.50	81.00	75.20	**68.00**
Market value of shares, Dec 31, FIM millions	3 830	4 638	6 326	5 873	**5 311**

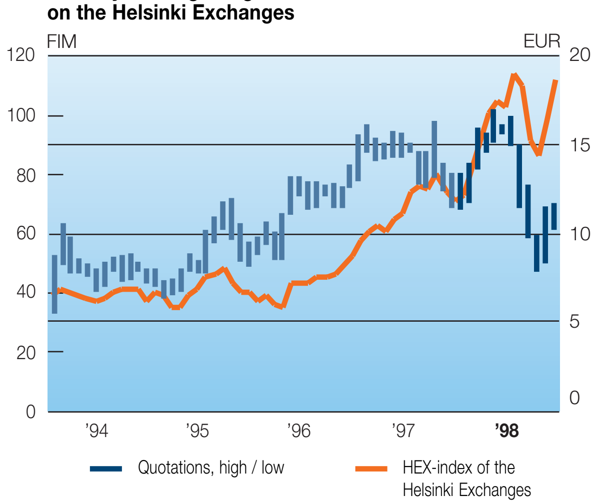
[1)] Proposal by the Board of Directors

The two-for-one share split has been taken into account in the table above for all years presented.

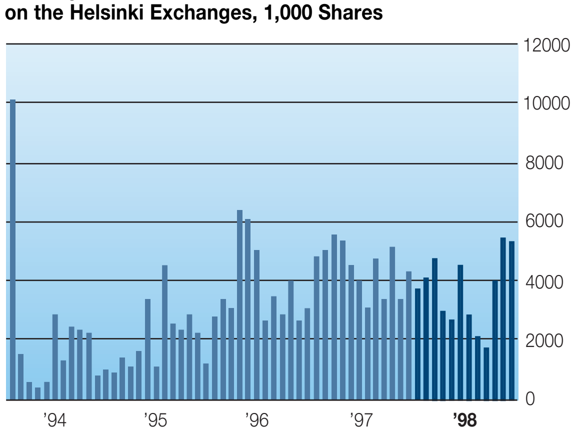
2001 for the first series, entitling holders to subscribe for new shares of Valmet at a price of FIM 108 per share, and on April 1, 2003 for the second series, entitling the holders to subscribe for new shares of Valmet at a price of FIM 113 per share. The subscription period for both series will close on March 31, 2005. The share subscription price for both series will be adjusted by dividends distributed after May 1, 1998 and before the date of subscription. In connection with the approval of Valmet-Rauma's merger plan on November 17, 1998, the Board of Directors of Valmet determined that warrant holders would also be eligible to subscribe for Valmet shares during the period from April 1, 1999, to May 31,1999. Following completion of the merger the options will entitle holders to subscribe for shares of Valmet-Rauma at the original subscription price and in accordance with the original terms of options.

No other bonds with warrants or convertible bonds have been outstanding during 1998. Valmet Corporation does not currently have an authorization to issue shares or warrants, or to buy back its own shares.

Monthly Trading Range of Valmet Shares on the Helsinki Exchanges



Monthly Turnover of Shares on the Helsinki Exchanges, 1,000 Shares



ADS Data

(Each ADS represents two shares)	1997	**1998**
Trading volume, New York Stock Exchange	521 522	**928 034**
Earnings/ADS, USD	3.70	**3.41**
Highest quotation, USD	38.50	**36.31**
Lowest quotation, USD	26.50	**18.88**
Quotation, Dec 31, USD	27.50	**26.31**

Shareholders by Category Dec 31, 1998	Number of shareholders	% of shareholders	% of shares
Companies	366	3.7	1.3
Financial institutions and insurance companies	87	0.9	19.5
Public institutions	12	0.1	23.0
Foundations and associations	229	2.3	4.5
Private individuals	9 260	92.6	4.0
Foreign shareholders	44	0.4	0.1
Registered shareholders, total	9 998	100.0	52.4
Nominee registered			47.6
Shares not converted into book entries			0.0
Shareholdings, total			100.0

Shareholders Dec 31, 1998	Number of shareholders	Number of shares	% of shares
The Finnish Government		15 695 287	20.1
Ilmarinen Mutual Insurance Company		3 192 400	4.1
Varma-Sampo Mutual Pension Insurance Company		2 507 032	3.2
The Local Government Pensions Institution		1 709 300	2.2
Pohjola Life Assurance Company Ltd.		1 061 500	1.4
Industrial Insurance Company Ltd.		975 000	1.2
Pohjola Non-Life Insurance Company Ltd.		865 000	1.1
Suomi Mutual Life Assurance Company		680 000	0.9
Sampo Assurance Company plc		500 000	0.6
Valmet Corporation Personnel Fund		466 700	0.6
Mutual insurance company Pension-Fennia		456 068	0.6
Kaleva Mutual Insurance Company		434 000	0.6
Tapiola General Mutual Insurance Company		422 200	0.5
Social Insurance Institution		372 200	0.5
Sampo Enterprise Insurance Company Limited		370 000	0.5
Sampo Life Insurance Company Limited		360 000	0.5
	16	30 066 687	38.6
Other shareholders, shares / shareholder			
100 001 – 359 999	18	3 236 227	4.1
10 001 – 100 000	103	3 408 525	4.4
5 001 – 10 000	83	611 138	0.8
1 001 – 5 000	823	1 547 024	2.0
501 – 1 000	978	744 850	0.9
101 – 500	4 814	1 085 929	1.4
1 – 100	3 163	176 168	0.2
Nominee registered		37 199 052	47.6
Shares not converted into book entries		24 400	0.0
Total	9 998	78 100 000	100.0

Members of the Company Board of Directors own a total of 5,390 shares, that is 0.007 per cent of the total votes carried by all stock. Additionally they hold warrants to subscribe for up to 0.31 per cent of the outstanding shares.

Valmet Group's income before extraordinary items and taxes was FIM 866 million, still a good result in the prevailing market situation. The Group's net sales were FIM 11,649 million. Valmet's operating profit for 1998 was FIM 761 million. New orders worth FIM 10,686 million were gained during the year, and the order backlog was FIM 5,813 million at the end of the year.

Year of Stable Development

Merger of Valmet and Rauma

The Boards of Directors of Valmet Corporation and Rauma Corporation proposed on November 17, 1998 that the two companies be merged. Extraordinary general meetings of the respective companies approved the merger plan on January 31, 1999. The European Commission, the Bureau of Competition of the Federal Trade Commission, USA and the Bureau of Competition Policy, Canada have announced that they will not oppose the merger of Valmet and Rauma.

The new company to be created by the combination merger will begin operations on July 1, 1999. In the merger, Valmet shareholders will receive 57.5 per cent of the shares of the new company and Rauma shareholders 42.5 per cent. As a merger consideration, each Valmet Corporation share will give entitlement to one Valmet-Rauma share, while each Rauma Corporation share will give entitlement to 1.08917 Valmet-Rauma shares. More detailed information on the merger and the new company has been given in the prospectus of Valmet and Rauma published on January 6, 1999.

Main market developments

Paper consumption has grown at a steady two to three per cent for some years already. This growth has been greater than average in more highly processed paper grades and in tissue.

The capacity utilization of pulp and paper mills has been high throughout the world for the whole year. The supply of market pulp exceeded demand and prices declined in 1998, with the price of short-fiber pulp falling particularly steeply. Paper price levels also decreased slightly during the year, mainly due to weak demand in Asia and increased supply in the European and North American markets. In order to balance the markets, pulp and paper companies have been restrained in making investment decisions or have aimed at postponing them.

The development of paper and board machinery markets has been according to expectations. In a departure from general market developments, Europe has had a relatively large number of investment projects. Investments in North America are still mainly machine rebuilds. The turmoil in Southeast Asia has reduced paper industry investments in the region and, consequently, the volume of orders of Valmet's Paper and Board Machinery Group has fallen. Although no significant project in the Group's order books has been cancelled, delays in timetables have occurred due to financing arrangements, among others. A substantial part of new orders received in Asia are being delivered to China where the investment level of the paper and board industry has remained relatively stable.

The volume of paper industry rebuild projects continues to grow and has simultaneously leveled out variations in the business cycle.

Group Net Sales and Income

Valmet Group's 1998 net sales were FIM 11,649 million (FIM 12,313 million in 1997), or 5.4 per cent less than the previous year. New orders worth FIM 10,686 million were booked (10,609), and the order backlog at year-end was FIM 5,813 million (7,126). Exports and international operations accounted for 84 per cent of net sales. 28 per cent of Valmet's net sales were from the Nordic countries, 28 per cent from other European countries, 27 per cent from North and South America, 16 per cent from Asia-Pacific and the remainder from other market areas.

The Group's gross profit was FIM 2,864 million (3,147), or 24.6 per cent of net sales.

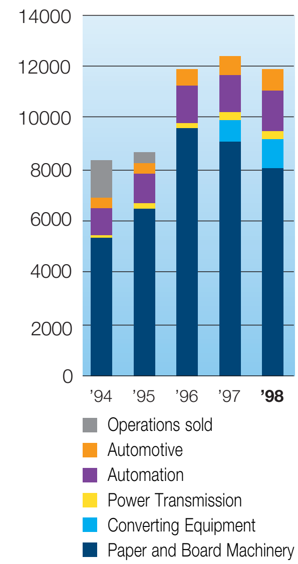
Operating profit was FIM 761 million (939). The 19 per cent decline in operating profit was due mainly to tighter competition and a fall in prices, particularly in converting equipment and automation. The Group's marketing and sales expenses were at the previous year's level, i.e. FIM 928 million (933). Research and development expenses were FIM 468 million (472). Administrative expenses were FIM 707 million (803). The drop was due to the rationalization of administration and a decrease in pension costs. As the Group's profit did not meet the targets set for profit and performance bonuses, the personnel did not receive any bonuses based on Group operating profit or on the performance of specific business units in 1998. In the previous year, bonuses worth FIM 190 million had been paid. The amortization of goodwill was FIM 58 million (38). The increase was due to the goodwill included in the purchase of Atlas Converting Equipment plc.

Income before extraordinary items and taxes was FIM 866 million (1,018). The Group's net financial income was FIM 86 million (66), of which net foreign exchange gains accounted for FIM 32 million (62) and profits on the sale of shares in listed companies FIM 54 million. The share of the profits of associated companies was FIM 19 million (13).

The net income for the year was FIM 675 million (863). Income taxes were FIM 176 million (253). The tax amount was affected by utilization of tax loss carryforwards in non-Finnish units.

Consolidated earnings per share were FIM 8.64 (10.08) and cash flow per share FIM 15.25 (15.32). Net income for the year under U.S.GAAP was FIM 659 million (857) and earnings per share FIM 8.44 (10.97). In calculating earnings per share under U.S. GAAP, extraordinary items are included in income.

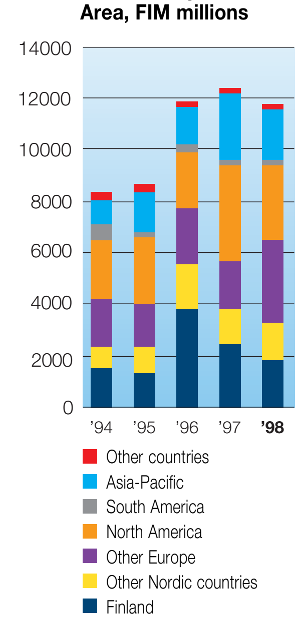
Net Sales by Business Group, FIM millions



The Converting Equipment Group was established at the beginning of 1998 and comprises the converting operations of the Atlas Converting companies and Rotomec companies. Converting Equipment was previously included in the Paper and Board Machinery Group. In the tables presented in the Board of Directors report, however, Converting Equipment has been removed from the Paper and Board Machinery Group figures for 1997, and the figures have been stated as if Converting Equipment had been a separate group in 1997.

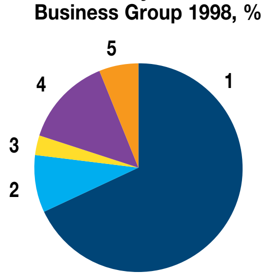
Net Sales by Business Group, FIM millions	1994	1995	1996	1997	**1998**
Paper and Board Machinery	5 470	6 560	9 602	9 130	**8 063**
Converting Equipment				860	**1 101**
Power Transmission	194	267	369	395	**405**
Automation	1 023	1 253	1 581	1 625	**1 627**
Automotive	381	388	477	583	**715**
Sub total	7 068	8 468	12 029	12 593	**11 911**
Operations sold	1 452	290	–	–	**–**
Less inter-business eliminations	–192	–184	–265	–280	**–262**
Group total	8 328	8 574	11 764	12 313	**11 649**

Net Sales by Market Area, FIM millions



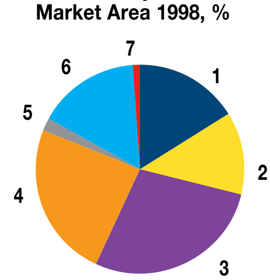
Net Sales by Market Area, FIM millions	1994	1995	1996	1997	**1998**
Finland	1 575	1 365	3 873	2 514	**1 858**
Other Nordic countries	841	1 068	1 722	1 370	**1 465**
Other European countries	1 831	1 642	2 132	1 788	**3 245**
North America	2 310	2 558	2 246	3 710	**2 815**
South America	537	175	274	228	**288**
Asia-Pacific	937	1 532	1 465	2 588	**1 907**
Other countries	297	234	52	115	**71**
Group total	8 328	8 574	11 764	12 313	**11 649**

Net Sales by Business Group 1998, %



1	Paper and Board Machinery	69%
2	Converting Equipment	9%
3	Power Transmission	3%
4	Automation	13%
5	Automotive	6%

Net Sales by Market Area 1998, %



1	Finland	16%
2	Other Nordic countries	13%
3	Other Europe	28%
4	North America	24%
5	South America	2%
6	Asia-Pacific	16%
7	Other countries	1%

Group's Financial Performance, FIM millions	1994	1995	1996	1997	**1998**
Operating profit					
Business Groups:					
Paper and Board Machinery	235	425	705	714	**572**
Converting Equipment				6	**–55**
Power Transmission	22	21	41	44	**35**
Automation	80	101	140	100	**87**
Automotive	92	94	105	112	**149**
Others	5	4	–5	–	**3**
Subtotal	434	645	986	976	**791**
Operations sold	17	–7	–	–	**–**
Total	451	638	986	976	**791**
Less unallocated corporate overhead and inter-business eliminations	–80	–108	–65	–37	**–30**
Operating profit, total	371	530	921	939	**761**
Financial income and expenses	–220	27	115	66	**86**
Share of profits or losses of associated companies	52	80	20	13	**19**
Income before extraordinary items and taxes	203	637	1 056	1 018	**866**
Extraordinary income and expenses	–25	82	–36	119	**–**
Income before taxes	178	719	1 020	1 137	**866**

GROUP FINANCING AND BALANCE SHEET STRUCTURE

The Group's liquidity remained good throughout the year. Liquid assets, i.e. cash and short-term investments, were FIM 1,533 million (1,581) at the end of the year, and the ratio of current assets to current liabilities was 1.6 (1.4).

Valmet's principal source of liquidity is the cash generated from operations. The Group's most important liquidity requirements are related to investments, the repayment of debt and working capital.

The net cash provided by operating activities was FIM 430 million (418). Delivery delays due to the Southeast Asian situation still affect the need for working capital somewhat.

The net cash used in investment activities was FIM 146 million (1,266). The total of capital expenditures on property, equipment and business acquisitions was FIM 516 million (1,376). Cash proceeds from sale of property and equipment, sale of subsidiaries and holdings in associated companies and other shareholdings were FIM 370 million (110).

The net cash used by financing activities in 1998 was FIM 302 million. The net cash provided by financing activities of FIM 827 million in 1997 was materially affected by the finance raised to purchase the Atlas Converting companies. Valmet issued a bond in the USA with an aggregate principal amount of USD 200 million in December, 1997.

Moody's Investors Service has given Valmet a long-term loan rating of Baa2. Standard & Poors' corresponding rating for long-term loans is BBB+ and for short-term loans A-2.

A substantial part of the Group's cash flow is in currencies other than the Finnish markka, the main currency in sales income being the US dollar. Future foreign currency cash receipts, arising primarily on long-term contracts, net of any matching foreign currency payments, are hedged principally through the forward foreign exchange market. In determining the extent of current foreign exchange exposures, account is taken of the hedging provided by foreign currency denominated loans and currency swap agreements.

Consolidated Balance Sheet, FIM millions	1994	1995	1996	1997	**1998**
Paper and Board Machinery	5 242	5 038	4 568	6 052	**5 651**
Converting Equipment				1 313	**1 276**
Power Transmission	188	213	239	262	**284**
Automation	804	877	818	918	**981**
Automotive	638	387	493	668	**543**
Others	1 644	2 691	2 184	860	**1 151**
Subtotal	8 516	9 206	8 302	10 073	**9 886**
Operations sold	389	435	–	–	**–**
Group total	8 905	9 641	8 302	10 073	**9 886**

Valmet generally hedges its future net cash flows over a period typically not exceeding two years. In accordance with this policy, the majority of Valmet's future net cash flows related to its order backlog are hedged. Valmet has partly hedged its foreign currency denominated net assets of foreign subsidiaries through borrowings and through certain financial instruments.

The Group's balance sheet total was FIM 9,886 million (10,073), the equity ratio was 46.1 per cent (40.3), and net interest-bearing debt FIM 293 million, or 6.8 per cent (18.8) of equity.

The Group's unrestricted equity was FIM 2,033 million (1,644). The distributable funds of the Group were FIM 1,939 million (1,578) and of the parent company FIM 1,443 million (1,338).

Development by Business Group

The Paper and Board Machinery Group's net sales for 1998 were FIM 8,063 million (9,130), or 11.7 per cent less than the previous year. The operating profit was FIM 572 million (714). Lack of equilibrium in pulp and paper markets, and especially the fluctuations in the price of pulp, caused large pulp and paper manufacturers to postpone their investments, leading to a lower volume of orders for new projects. Paper and Board Machinery received new orders worth FIM 7,331 million (7,565), which was three per cent less than the previous year. The order backlog at the end of the year was FIM 4,687 million (5,720). In 1998, Valmet gained orders for nine new paper and board machines, as well as numerous extensive rebuilds of paper and board machines. Most of the orders for rebuilds, air systems, paper finishing machines and service products came from Europe. The year saw the start-up of 14 complete paper and board machines supplied by Valmet, which was three more than in 1997.

The net sales of the Service product group stabilized at the previous year's level, after several years of growth and was FIM 1.8 billion in 1998. The measures taken in response to the Asian turmoil have not yet yielded the planned sales increase. A new service and technology center was opened in Thailand and the service scope was developed in Australia. The greater investments in the service network will increase net sales and income in the long term.

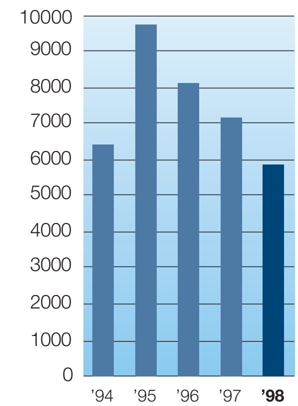
The Converting Equipment Group's net sales were FIM 1,101 million (860). The growth of 28 per cent mainly reflects the addition of the acquired Atlas Converting companies to the Valmet Group on July 1, 1997. The operating loss was FIM 55 million (operating profit was FIM 6 million in 1997), of which amortization of goodwill accounted for FIM 37 million. The operating loss resulted from smaller delivery volumes, tighter competition in Asia as well as in other markets, and the strength of the pound sterling. Converting Equipment gained new orders worth FIM 902 million (816), and the order backlog at the end of the year was FIM 406 million (622). The order backlog for new sheeters and printing presses for the packaging industry supplied by the Group remained good, but was weaker for converting slitters and vacuum metallizing equipment.

Valmet Power Transmission's net sales were FIM 405 million (395), or 2.6 per cent higher than the previous year. The operating profit was FIM 35 million (44), which was 20 per cent down on the previous year, due primarily to research and development expenditure on wind turbine gears. Power Transmission gained new orders worth FIM 417 million (383), or nine per cent more than in the previous year. The demand for hydraulic motors, marine gears and wind power station gears grew in particular. The order backlog at the end of the year was FIM 162 million (150).

Valmet Automation's net sales were FIM 1,627 million (1,625). Net sales growth was limited by unsatisfactory demand at the end of 1997 and the consequent low work loads in early 1998. The operating profit was FIM 87 million (100), or 13 per cent less than in the previous year. Profit weakened because of low capacity utilization at the beginning of the year, non-recurring costs due to restructuring and tight price competition. Invoicing and profit for the last four months of the year were good, however. Automation gained new orders worth FIM 1,677 million (1,483), up by 13 per cent on the previous year. The order backlog at the end of the year was FIM 744 million (726).

Valmet Automotive's net sales were FIM 715 million (583). The growth of 22.7 per cent was primarily due to the growth in the number of specialty cars and the positive effect of revenue recognized from certain discontinued assembly contracts.
In practice, the net sales of Valmet Automotive are comprised of the value added by the assembly of cars, as the payment from principal does not include material costs. Automotive's operating profit was FIM 149 million (112), or 33 per cent greater than in the previous year. Porsche Boxster production, begun in September 1997, was bigger than expected due to growth in demand. Production of the Saab 9-3 Convertible was commenced at the beginning of 1998, replacing the Saab 900

Order Backlog, Dec 31, FIM millions



Convertible. Euro-Samara production was terminated in July due to poor demand. In late 1998, preparations were made at the automotive plant to start producing a special high-performance model of the Saab 9-3 in spring 1999. The total production of cars in 1998 was 31,400 (33,700).

Changes in Business Structure

The printing paper machine businesses were combined and concentrated in Jyväskylä, Finland. The Karhula unit continues within the Group's production and service operations. Some of the released personnel transferred to the Jyväskylä unit.

The concentration of the board machine business in Karlstad, Sweden has been completed. The relocation of the personnel went well and restructuring costs were less than forecast. The labor force released from the Tampere unit transferred almost completely to companies acting as subcontractors to Valmet.

A new business group, Converting Equipment, was established in Valmet Group at the beginning of 1998 by joining the Atlas Converting companies, acquired in Great Britain the previous year, with the Rotomec companies from Italy which were earlier a part of the paper finishing systems.

The production of paper machine suction and tube rolls was closed down at Valmet's Montreal unit during the fall of 1998. In the future this unit will focus on paper and board machine sales, service and maintenance operations in Canada. It will also continue to make special roll covers for the North American markets.

In August, Valmet Corporation and Raisio Chemicals Oy, a part of the Raisio Group, established a joint venture, Valmet Flootek Oy, to specialize in paper industry water treatment. Valmet Corporation owns 51 per cent of its share capital and Raisio Chemicals 49 per cent.

In November, Valmet bought the total shares of Von Roll Handling Systems Ltd. in Switzerland. The company specializes in roll handling systems for printing houses. As a result of this acquisition, Valmet's position as a leading supplier of roll handling machinery and systems has been strengthened and the customer segment has been expanded to include printing houses as well as paper mills.

Valmet acquired the total shares of the Swiss company Farros Blatter AG in November. This company is the leading manufacturer of belt grinding machines for the paper industry. In addition, its product range includes the on-site grinding of rolls and cylinders. The acquisition facilitates the more effective development and marketing of specialized grinding machinery and services, and the improvement of service capabilities in different market areas.

In December Valmet sold to the Finnish State its 49.9 per cent stake in Patria Finavitec Oy which assembles aircraft. The State had already earlier acquired 50.1 per cent of Patria Finavitec's shares.

Year of New Technological Concepts

The attempt to simplify the papermaking process and the bold questioning of old concepts has been reflected in new innovations. The OptiConcept technology, covering the whole papermaking line, was launched in June at Valmet's Paper Technology Days. OptiConcept technology makes it possible to raise paper machine production speeds to over 2,000 m/min. Industrial design was also considered in developing OptiConcept. In recognition of successful, ergonomic design which strengthened the product image, the OptiConcept papermaking line was awarded an honorable mention in the Pro Finnish Design competition at the beginning of 1999.

A new paper machine stock preparation system, OptiFeed, is an example of an invention exploiting process boundaries in a new way. OptiFeed has boldly simplified the paper machine's approach system and short circulation. As a result the process achieves better stability and dynamics with smaller running and investment costs. The new measuring technology and multivariable predictive control developed by Valmet Automation has decisively affected the development of OptiFeed.

The OptiLoad multi-nip calender, designed for the calendering of paper, has been adapted in connection with OptiConcept development into an online version, integrated with the paper machine. For a few paper grades this means not only a considerable simplification of the production process, but also significant savings in investment costs.

In rebuilds, OptiConcept components such as the OptiFlo headbox, the OptiFormer wire section and the OptiLoad calender significantly improve production efficiency and paper quality. In 1998, numerous rebuilds and two complete papermaking lines incorporating OptiConcept components were sold. Altogether, the sales of OptiConcept have exceeded FIM 2 billion in half a year.

Significant innovations have been made in Valmet's board machine technology during the year, including gap former technology in the design of high speed liner board machines. A prototype built for SCA's Obbola mill produces extremely strong board at high speeds and utilization ratios. The Condebelt drying technology, which gives completely new properties to board, was introduced first in Stora Enso's Pankakoski Board Mill. At the beginning of 1999 a production application also started up on Dong Il Paper's board mill in South Korea.

In 1998, 871 invention announcements were made in Valmet Group and 620 patent applications were filed. At the end of the year, Valmet had about 3,000 valid patents.

Investments

The importance of technological leadership is reflected in considerable investments in research, technology and development. In 1998, Valmet invested FIM 500 million in research and development, or 4.3 per cent of net sales, an amount which is at the previous year's level. Capital expenditure accounted for FIM 100 million of this amount.

Modern and efficient research centers are crucial to the development of new concepts. The most significant research center investments in 1998 were a new technology center at Järvenpää, Finland focused on finishing systems and a research center at Karlstad, Sweden focused on tissue and board. Karlstad's new pilot tissue machine contains TAD technology which will allow the large scale commercialization of this technology in the future.

The Group's investments in 1998 totaled FIM 516 million (1,376), or 4.4 per cent of net sales. The 1997 figure had included the acquisition of the Atlas Converting companies. In addition to the investments in developing new technology other capital expenditure in 1998 was FIM 416 million (651), targeted mainly on information systems, service operations and power transmission technology.

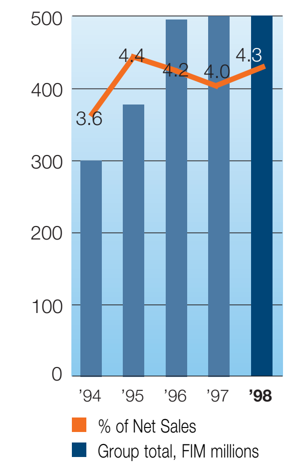
In order to develop the total quality of operations, efforts have been made as in previous years to maintain ISO 9000 certificates and to use the Malcolm Baldrige criteria as an evaluation tool in surveying areas for development.

The building of environmental systems in Valmet units was continued in accordance with ISO 14000 standards, and development work was supported by self evaluations within the Group. The environmental systems have been integrated with the quality system and Valmet's total operational quality program. The first ISO 14001 certificate was granted to Valmet-Raisio in February, 1998.

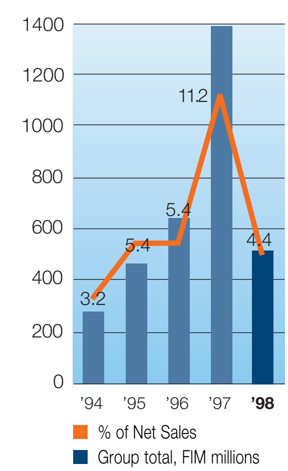
Research and Development, FIM millions	1994	1995	1996	1997	**1998**
Paper and Board Machinery	199	256	329	313	**312**
Converting Equipment				5	**6**
Power Transmission	2	6	6	7	**16**
Automation	80	99	113	135	**131**
Automotive	16	13	17	17	**17**
Others	3	–	28	21	**18**
Subtotal	300	374	493	498	**500**

Investments, FIM millions	1994	1995	1996	1997	**1998**
Paper and Board Machinery	165	326	374	355	**303**
Converting Equipment				765	**36**
Power Transmission	14	21	51	40	**25**
Automation	31	35	42	55	**38**
Automotive	9	23	103	103	**50**
Others	36	47	62	58	**64**
Subtotal	255	452	632	1 376	**516**
Operations sold	11	9	–	–	**–**
Group total	266	461	632	1 376	**516**

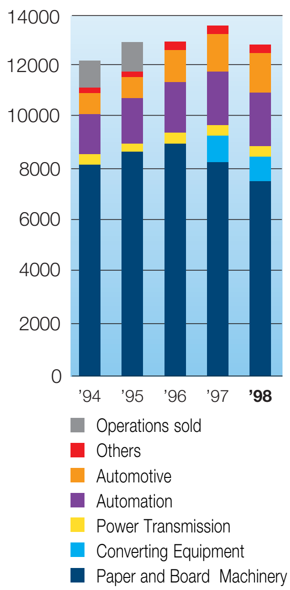
Research and Development/ Net Sales, FIM millions



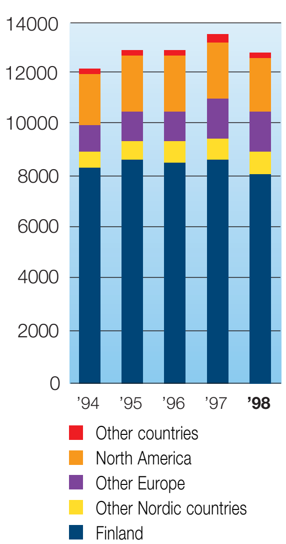
Investments, FIM millions



Personnel by Business Group



Personnel by Region



HUMAN RESOURCES

The average number of employees in the Group during 1998 was 13,230 (13,536), with 12,680 (13,480) on the payroll at the end of the year. The employee decrease resulted from the continued focus on core operations and adaptations to the market situation.

Almost 800 employees work principally in research and development, and about 1,200 in marketing and sales. There are over 3,100 technical professionals working in project management and engineering tasks.

Open communication and employee commitment is encouraged by a broad participation system. This is represented by the Valmet Forum, comprising employee representatives from the main units in the EU countries and senior corporate management. It met twice in 1998.

All of Valmet's employees are included in the incentive pay system, consisting of two parts – a joint profit bonus for all, determined on the basis of the profit of the Valmet Group, and a unit-specific performance bonus. Work motivation and well-being is monitored at the Group level by means of the Malcolm Baldrige quality system criteria.

About 80 per cent of Valmet's employees have completed at least a two or three year program at a trade or technical college, and 15 per cent have a university degree. In the future, the proportion of those with university education in technical fields will increase.

About 1.6 per cent of the Group's total wages and salaries, or FIM 41 million excluding the participants' pay expenses, is invested in training. Each employee undergoes an average of five days' further or advanced training annually.

The Valmet Academy, an in-house doctoral program, is being implemented in close cooperation with the Helsinki and Tampere Universities of Technology and the University of Jyväskylä in Finland. 20 students enrolled for the first program, with 14 more starting in the fall of 1998. Two doctors of technology and one licentiate of technology graduated in 1998. From four to five new doctors are expected to graduate in each of 1999 and 2000.

The Valmet Leadership Program (VLP) and Valmet Edge continued as the main Group-wide programs for general management development. Special attention has been paid to the long-term development of young employees at the beginning of their careers.

Personnel by Business Group	1994	1995	1996	1997	**1998**
Paper and Board Machinery	8 193	8 674	9 042	8 318	**7 547**
Converting Equipment				1 009	**961**
Power Transmission	361	364	416	422	**421**
Automation	1 560	1 711	1 931	2 058	**2 074**
Automotive	867	876	1 258	1 467	**1 476**
Others	208	213	224	206	**201**
Subtotal	11 189	11 838	12 871	13 480	**12 680**
Operations sold	957	970	–	–	**–**
Group total	12 146	12 808	12 871	13 480	**12 680**

Personnel by Region	1994	1995	1996	1997	**1998**
Finland	8 349	8 729	8 614	8 690	**8 008**
Other Nordic countries	628	689	768	811	**907**
Other Europe	1 058	1 094	1 173	1 585	**1 519**
North America	2 007	2 182	2 191	2 191	**2 074**
South America	–	–	–	8	**11**
Asia-Pacific	104	114	125	195	**161**
Group total	12 146	12 808	12 871	13 480	**12 680**

Year 2000 Challenges

Valmet has established a Year 2000 task force which is organized into separate teams to cover: (i) internal systems, (ii) machine, tools and facilities; (iii) customer deliveries, (iv) suppliers and (v) legal issues. Valmet's task force is being coordinated by a Year 2000 steering group at Valmet headquarters. Based upon available information, Valmet estimates that its Year 2000 project expenses will be less than FIM 70 million, approximately one-third of which was incurred in 1998, with the remainder due in 1999. The cost of the year 2000 project is being expensed as incurred.

Valmet commenced its program to renew its internal enterprise resource planning systems two years ago. The new software system is expected to be year 2000 compliant. Valmet expects to run its business operations and production control systems on the new system by the year 2000. In addition to that, some existing computer systems of Valmet units are being updated to become Year 2000 compliant. Programs are also underway to ensure the compliance of machine tools, real estate and other internal systems. Valmet's target date for the completion of Year 2000 corrective measures to its internal systems and its machine tools and facilities is June 30, 1999.

Valmet has also implemented procedures to identify products that it has delivered to customers which may require Year 2000 modification and to arrange for the necessary modifications to such products. Valmet periodically sends out updated information concerning the Year-2000 issue to its customers. Valmet currently estimates that its customers use approximately 300 to 500 Valmet products under warranty that have been previously delivered and which will require Year 2000 modification. Valmet expects to complete the modification of its products under warranty by June 30, 1999.

Valmet has approximately 500 key suppliers and subcontractors, all of whom are being audited under the Year 2000 program. Valmet has also implemented procedures to access the Year 2000 readiness of its key suppliers. These procedures include the testing of critical components and obtaining confirmation from key suppliers. Valmet currently expects its key subcontractors and suppliers will be Year 2000 compliant in all material, respects by midyear 1999.

Valmet is in the process of developing Year 2000 contingency plans. The basic principles of these plans are that critical components of Valmet's products will be manufactured or bought into stock during the last quarter of 1999 if the renovation of old systems, the implementation of new internal systems or the renovation of machine tools is delayed. Valmet will also follow up carefully during the first half of 1999 to determine how suppliers of critical components are proceeding in their Year 2000 programs. Valmet expects to finalize these contingency plans by March 31, 1999.

In Valmet's current understanding, the year 2000 problem will not have a significantly harmful effect on the company's business operations or profit performance.

Introduction of the Euro

The introduction of the euro will necessitate changes in Valmet's IT and other systems, to accommodate the use of the euro in corporate transactions and in financial reporting. Two years ago, Valmet initiated a project to analyze and implement the changes to information technology and other systems required to convert to a euro operating environment. The implementation of such systems is expected to be completed during the transitional period between 1999 and 2001. Valmet expects that the introduction of the euro will cause it to incur incremental expenses of less than FIM 10 million, of which approximately one-third was incurred in 1998, with the remainder due in 1999.

Valmet introduced the euro as a reporting currency for financial accounting purposes effective from January 1, 1999. Valmet is also able to provide customers with price quotations and invoices in euros, in addition to other currencies, beginning on January 1, 1999. The operating systems of Valmet's various business units are expected to become capable of operating in a euro environment during the transitional period.

In Valmet's understanding, the introduction of the euro will not have a significant effect upon Valmet's business or competitive position. In particular, management does not expect cross-border price transparency stimulated by the euro to affect the market for Valmet's principal products and services, which consist of large paper machines or major rebuild projects typically ordered and delivered pursuant to specific customer specifications.

Introduction of the euro, and the consequent elimination of the currency exchange rate risk between the national currencies of the participating member states and the Finnish markka, will eliminate the need for currency exchange transactions and hedging transactions with respect to such currencies, resulting, according to the present understanding, in transaction cost savings to Valmet.

Outlook

The global demand for paper and board products is forecast to continue growing. The economic situation in Asia has decreased the willingness of the region's paper industry to invest, and has postponed the projects being planned. Valmet has been able to partly replace the drop in Asian demand, especially in the European and South American markets. On the other hand, there is still no clear sign of the long-awaited significant investments by the North American industry.

The market situation continued to be tight in 1998, which will affect profit performance in the early part of 1999 in particular.

The merger of Valmet and Rauma will provide an excellent opportunity to increase efficiency. The resulting annual synergy benefits, estimated at approximately FIM 400 million, are expected to be realized in full from the year 2001. Costs can be saved by combining distribution networks, by benefits of scale in procurement and component production and by rationalizing the administration. The joint development of service and spare parts resources, and automation and flow control operations, is also expected to result in synergy benefits. The company can also benefit from improved utilization of the results of research and development.

The actions required to achieve these synergy benefits are expected to result in one-time expenses in the order of FIM 150 million.

Board of Directors' Proposal for Distribution of Profit

The Board proposes to the Annual General Meeting that dividends of FIM 3.50 per share be paid for the fiscal year ended December 31, 1998. The record date for this purpose will be April 7, 1999. Dividends will be paid to all shareholders who, on the record date, are recorded in Valmet Corporation's register of shareholders held by the Finnish Central Securities Depository Ltd. Dividends will be paid on April 14, 1999.

Helsinki, February 16, 1999

Paavo Rantanen
Chairman of the Board

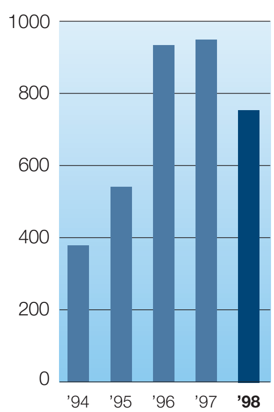
Teuvo Kinnunen
Jaakko Rauramo
Juhani Yli-Paavola

Jarmo Leppiniemi
Matti Sundberg

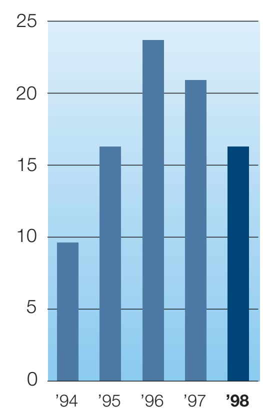
Consolidated Income Statement

(Millions)	1997 FIM	**1998 FIM**	**1998 EUR**
Net sales	12 313	**11 649**	**1 959**
Cost of sales	–9 166	**–8 785**	**–1 477**
Gross profit	3 147	**2 864**	**482**
Marketing and selling expenses	–933	**–928**	**–156**
Research and development expenses	–472	**–468**	**–79**
Administrative expenses	–765	**–649**	**–109**
Amortization of goodwill (2)	–38	**–58**	**–10**
Operating profit (1, 2)	939	**761**	**128**
Financial income and expenses (3)	66	**86**	**15**
Share of profits or losses of associated companies (4)	13	**19**	**3**
Income before extraordinary items and taxes	1 018	**866**	**146**
Extraordinary income (5)	200	**–**	**–**
Extraordinary expenses (5)	–81	**–**	**–**
Income before income taxes	1 137	**866**	**146**
Income taxes (6)	–253	**–176**	**–30**
Minority interests	–21	**–15**	**–2**
Net income	863	**675**	**114**

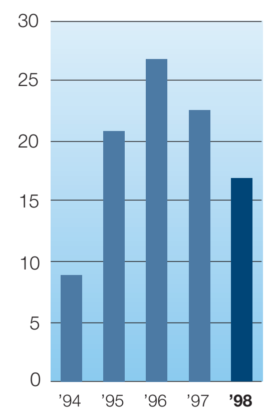
Operating Profit, FIM millions



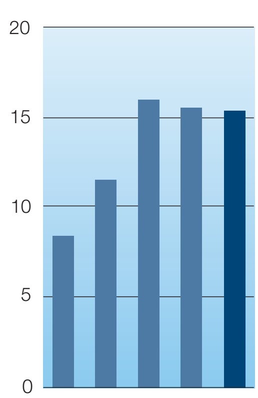
Return on Net Assets, %



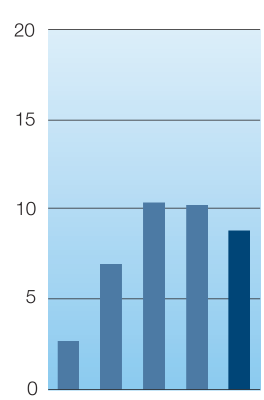
Return on Equity, %



Cash Flow per Share, FIM



Earnings per Share, FIM



Consolidated Balance Sheet

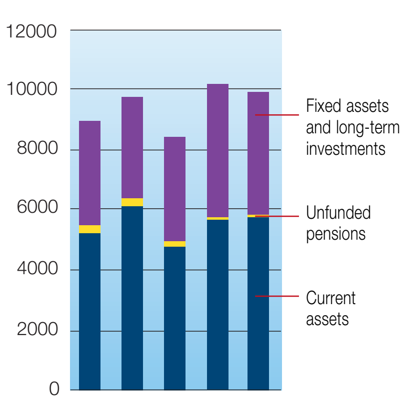
ASSETS

(Millions)	Dec 31, 1997 FIM	**Dec 31, 1998 FIM**	**Dec 31, 1998 EUR**
FIXED ASSETS AND LONG-TERM INVESTMENTS			
Intangible assets (7)			
Goodwill (9)	526	**485**	**82**
Other intangible assets	161	**168**	**28**
	687	**653**	**110**
Tangible fixed assets (7)			
Land and water areas	248	**227**	**38**
Buildings	878	**847**	**143**
Machinery and equipment	1 155	**1 063**	**179**
Other tangible assets	25	**32**	**5**
Assets under construction	167	**244**	**41**
	2 473	**2 413**	**406**
Long-term investments			
Shareholdings and other securities (8)	1 087	**905**	**152**
Other long-term assets	51	**58**	**10**
	1 138	**963**	**162**
	4 298	**4 029**	**678**
UNFUNDED PENSIONS (10)	108	**71**	**12**
CURRENT ASSETS			
Inventories			
Materials and supplies	344	**334**	**56**
Finished products	104	**103**	**17**
	448	**437**	**73**
Receivables (11, 12, 21)			
Trade receivables, interest-bearing	84	**322**	**54**
Trade receivables, non-interest-bearing	1 890	**1 887**	**317**
Cost and earnings of projects under construction in excess of billings (12)	887	**1 068**	**180**
Loans receivable	29	**18**	**3**
Accrued income and prepaid expenses	589	**469**	**79**
Other receivables	159	**52**	**9**
	3 638	**3 816**	**642**
Cash and short-term investments (13)	1 581	**1 533**	**258**
	5 667	**5 786**	**973**
TOTAL	10 073	**9 886**	**1 663**

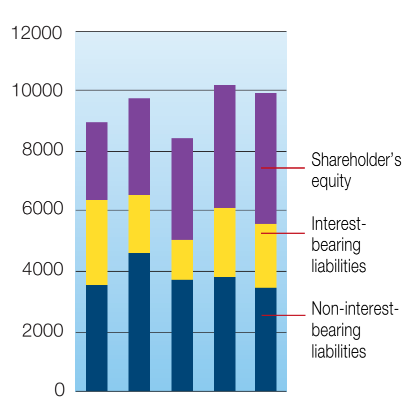
LIABILITIES AND SHAREHOLDERS' EQUITY

(Millions)	Dec 31, 1997 FIM	**Dec 31, 1998 FIM**	**Dec 31, 1998 EUR**
SHAREHOLDERS' EQUITY (14)			
Share capital	851	**851**	**143**
Restricted funds	1 351	**1 351**	**227**
Cumulative translation adjustment	–114	**–187**	**–31**
Retained earnings	942	**1 532**	**257**
Net income for the year	863	**675**	**114**
	3 893	**4 222**	**710**
MINORITY INTEREST	56	**56**	**10**
LIABILITIES (15)			
Long-term debt			
Bonds	1 445	**1 359**	**229**
Loans from financial institutions	350	**360**	**61**
Other long-term debt	155	**115**	**19**
	1 950	**1 834**	**309**
Other long-term liabilities			
Deferred tax liability (16)	71	**73**	**12**
Accrued expenses (10), (17)	191	**151**	**25**
	262	**224**	**37**
Current liabilities			
Short-term portion of long-term debt (15)	219	**186**	**31**
Other interest-bearing short-term liabilities (18)	154	**147**	**25**
Non-interest-bearing current liabilities			
Accounts payable	877	**768**	**129**
Billings in excess of cost and earnings of projects under construction (12)	267	**599**	**101**
Accrued expenses and prepaid income (19)	2 314	**1 783**	**300**
Other current liabilities	81	**67**	**11**
	3 539	**3 217**	**541**
	3 912	**3 550**	**597**
	6 124	**5 608**	**943**
TOTAL	10 073	**9 886**	**1 663**

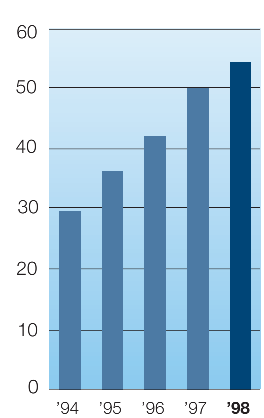
Assets, FIM millions



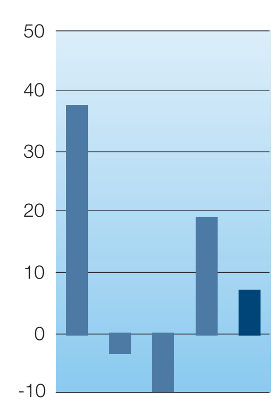
Liabilities and Equity, FIM millions



Equity per Share, FIM



Net Debt / Equity, %



Consolidated Statement of Cash Flow

(Millions)	1997 FIM	1998 FIM	1998 EUR
Cash flows from operating activities:			
Net income	863	**675**	**114**
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	432	**501**	**84**
(Gain) loss on sale of property and equipment	–12	**–21**	**–4**
(Gain) loss on securities	25	**–1**	**–**
Gain on sale of shares in listed companies	–	**–54**	**–9**
(Gain) loss on sale of subsidiaries and associated companies	–200	**3**	**–**
Foreign exchange (gains), losses	74	**–92**	**–16**
Deferred income taxes	14	**–2**	**–**
Share of profits or losses of associated companies	–13	**–19**	**–3**
Dividends from associated companies	7	**17**	**3**
Other non-cash items	21	**15**	**3**
Changes in assets and liabilities, net of effects of dispositions of businesses:			
Receivables	–309	**–105**	**–18**
Inventories	17	**–6**	**–1**
Accounts payable	–26	**–91**	**–15**
Billings in excess of cost and earnings of projects under construction	–575	**132**	**22**
Accrued expenses and prepaid income	325	**–486**	**–82**
Other current liabilities	–225	**–36**	**–6**
Net cash provided by operating activities	418	**430**	**72**
Cash flows from investing activities:			
Capital expenditures on property and equipment	–639	**–497**	**–84**
Cash proceeds from sale of property and equipment	28	**83**	**14**
Business acquisitions, net of cash acquired	–727	**–19**	**–3**
Investments in associated companies	–10	**–**	**–**
Proceeds from sale of subsidiaries and associated companies	–	**51**	**9**
Proceeds from sale of shares	82	**236**	**40**
Net cash used by investing activities	–1 266	**–146**	**–24**
Cash flows from financing activities:			
Dividends paid	–234	**–273**	**–46**
Proceeds from issuance of debt	1 465	**150**	**25**
Principal payments on debt	–404	**–164**	**–28**
Other	–	**–15**	**–2**
Net cash provided (used) by financing activities	827	**–302**	**–51**
Effect of changes in exchange rates and market values of cash and short-term investments	–	**–30**	**–5**
Net decrease in cash and short-term investments	–21	**–48**	**–8**
Cash and short-term investments at beginning of year	1 602	**1 581**	**266**
Cash and short-term investments at end of year	1 581	**1 533**	**258**

Supplemental cash flow information:

The following is a summary of non-cash financing and investing activities:

	1997 FIM	1998 FIM	1998 EUR
Acquisitions:			
Assets acquired	997	**37**	**6**
Liabilities assumed	–270	**–18**	**–3**
Cash paid, net of cash acquired	727	**19**	**3**
Disposals:			
Non-cash assets disposed of	–	**11**	**2**
Less liabilities disposed of	–	**–4**	**–1**
Net non-cash assets sold	–	**7**	**1**
Loss on sale	–	**–3**	**–**
Cash received from sale, net of cash disposed	–	**4**	**1**

Parent Company Income Statement

(Millions)	1997 FIM	**1998 FIM**
Net sales	6 751	**5 460**
Cost of sales	–5 311	**–4 285**
Gross profit	1 440	**1 175**
Marketing and selling expenses	–380	**–361**
Research and development expenses	–281	**–260**
Administrative expenses	–349	**–258**
Operating profit (1, 2)	430	**296**
Financial income and expenses (3)	273	**155**
Income before extraordinary items and taxes	703	**451**
Group internal contributions	–10	**114**
Extraordinary income and expenses (5)	157	**–**
Income before income taxes	850	**565**
Allocations to untaxed reserves	–65	**–29**
Income taxes	–196	**–157**
Net income	589	**379**

Parent Company Statement of Cash Flow

(Millions)	1997 FIM	**1998 FIM**
Cash flows from operating activities:		
Net income	589	**379**
Adjustments to reconcile net income to net cash provided by operating activities	66	**230**
Changes in assets and liabilities, net of effects of dispositions of businesses	–1 006	**–705**
Net cash used by operating activities	–351	**–96**
Cash flows from investing activities	–801	**120**
Cash flows from financing activities	995	**–307**
Net decrease in cash and short-term investments	–157	**–283**
Cash and short-term investments at beginning of year	1 150	**993**
Cash and short-term investments at end of year	993	**710**

Parent Company Balance Sheet

ASSETS

(Millions)	Dec 31, 1997 FIM	**Dec 31, 1998 FIM**
FIXED ASSETS AND LONG-TERM INVESTMENTS		
Intangible assets (7)	117	**133**
Tangible fixed assets (7)	1 067	**1 038**
Long-term investments		
Shareholdings and other securities (8)	2 850	**2 440**
Loans receivable (21)	447	**861**
	3 297	**3 301**
	4 481	**4 472**
UNFUNDED PENSIONS (10)	108	**71**
CURRENT ASSETS		
Inventories	121	**108**
Receivables (11, 21)	2 471	**2 350**
Cash and short-term investments (13)	993	**710**
	3 585	**3 168**
TOTAL	8 174	**7 711**

LIABILITIES AND SHAREHOLDERS' EQUITY

SHAREHOLDERS' EQUITY (14)		
Share capital	851	**851**
Legal reserve	1 281	**1 281**
Revaluation reserve	200	**200**
Retained earnings	749	**1 064**
Net income for the year	589	**379**
	3 670	**3 775**
UNTAXED RESERVES	70	**99**
LIABILITIES (15)		
Long-term debt	1 786	**1 677**
Other long-term liabilities		
Accrued expenses (10, 17)	116	**76**
Current liabilities		
Short-term portion of long-term debt (15)	10	**14**
Other interest-bearing short-term liabilities (18)	497	**472**
Non-interest-bearing current liabilities (19)	2 025	**1 598**
	2 532	**2 084**
	4 434	**3 837**
TOTAL	8 174	**7 711**

Notes to the Financial Statements

(1) PERSONNEL COSTS

The information regarding personnel costs is as follows:

(FIM millions)	Group 1997	Group **1998**	Parent Company 1997	Parent Company **1998**
Wages and salaries	2 639	**2 611**	1 090	**993**
Pension costs	391	**354**	226	**192**
Other indirect employee costs	432	**386**	181	**127**
Total	3 462	**3 351**	1 497	**1 312**

Other information:				
Salaries for members of Boards of Directors and Chief Executive Officers of Group Companies	37	**34**	3	**3**
Bonuses for members of Boards of Directors and Chief Executive Officers	4	**2**	1	**1**

The President and CEO of the Parent Company is entitled to retire at the age of 60.

(2) DEPRECIATION AND AMORTIZATION

Depreciation and amortization expenses are allocated in the Income Statement as follows:

(FIM millions)	Group 1997	Group **1998**	Parent Company 1997	Parent Company **1998**
Cost of sales	252	**292**	93	**85**
Marketing and selling	18	**18**	4	**4**
Research and development	63	**67**	52	**57**
Administrative	61	**66**	26	**27**
Goodwill	38	**58**	–	**1**
Total	432	**501**	175	**174**

Depreciation and amortization expenses consist of the following components:				
Consolidation goodwill	38	**56**	–	**–**
Other goodwill	2	**2**	1	**1**
Other intangible assets	29	**39**	18	**22**
Buildings	53	**61**	29	**28**
Machinery and equipment	302	**334**	121	**118**
Other tangible assets	8	**9**	6	**5**
Total	432	**501**	175	**174**

(3) FINANCIAL INCOME AND EXPENSES

The following information provides a summary of financial income and expenses:

(FIM millions)	Group 1997	Group 1998	Parent Company 1997	Parent Company 1998
Financial income:				
Dividends received	22	**44**	161	**211**
Interest income	103	**111**	93	**136**
Other financial income (*)	32	**67**	19	**–**
Net gains and losses from foreign exchange	62	**32**	49	**29**
Tax credit regarding dividends	7	**14**	62	**81**
	226	**268**	384	**457**
Financial expenses:				
Interest expenses	–128	**–150**	–94	**–138**
Other financial expenses	–32	**–32**	–17	**–164**
	–160	**–182**	–111	**–302**
	66	**86**	273	**155**

(*) Includes a gain of FIM 19 million in 1997 and FIM 54 million in 1998 from the sale of shares in listed companies.

(FIM millions)	Group 1997	Group 1998
Unrealized losses of short-term investments included in Group's interest income are	–25	**–9**

(4) INFORMATION ON ASSOCIATED COMPANIES

Information regarding the company's investments in associated companies is described below: A detailed specification of Valmet's long-term investments in associated companies is contained in Note 8.

(FIM millions)	Group 1997	Group 1998	Parent Company 1997	Parent Company 1998
Dividends received	7	**17**	7	**17**
Share of profits or losses	13	**19**	–	**–**
Equity value of investments in associated companies	250	**238**	199	**185**

(5) EXTRAORDINARY INCOME AND EXPENSES

Extraordinary income and expenses, including transactions considered outside the normal course of business, resulted from the following:

(FIM millions)	Group 1997	Group 1998	Parent Company 1997	Parent Company 1998
Extraordinary income:				
Net gains from the sale of shares and businesses (*)	200	**–**	247	**–**
	200	**–**	247	**–**
Extraordinary expenses:				
Compensation to Beloit regarding patent disputes	–81	**–**	–81	**–**
Settlements and other non-recurring costs	–	**–**	–9	**–**
	–81	**–**	–90	**–**

(*) In 1997 Valmet sold its 25.4 per cent holding in Oy Sisu Ab to Partek Corporation and recorded an extraordinary gain of FIM 200 million on the sale.

(6) INCOME TAXES

Income tax expense (benefit) consists of the following:

(FIM millions)	Group 1997	Group 1998
Total current income tax expense	239	**178**
Total deferred income tax expense (benefit)	14	**–2**
Total income taxes	253	**176**
Income taxes include tax expenses due to extraordinary items	44	**–**

The principal reasons for the difference between the "expected" income tax expense (benefit), computed by applying the statutory Finnish tax rate of 28 percent to income (loss) before income taxes, and the actual income tax expense (benefit) are as follows:

	1997	1998
"Expected" income tax expense	318	**242**
Taxes for prior years	–6	**2**
Temporary differences for which no deferred tax had been provided	–50	**–43**
Losses not currently utilized	13	**–**
Utilization of tax loss carry forwards for which no deferred tax had been provided	–63	**–37**
Non-taxable income	–4	**–9**
Expenses not deductible	51	**26**
Differences in foreign tax rates	5	**–5**
Deduction for write-down of investment in subsidiaries	–9	**–**
Other	–2	**–**
Income taxes	253	**176**

The Finnish tax authorities are currently auditing the Group's tax returns for the years 1992 through 1997. As a result of this inspection, the tax authorities may identify certain items on which they take a different view than Valmet.

Management believes that the Group has made adequate provision for income taxes and that the results of this audit will not have a material affect of the Group's financial position, results of operations or liquidity.

((7) FIXED ASSETS

Fixed assets of businesses sold during the year are not included in the fixed asset balances on January 1. Fixed assets of businesses acquired during the year are included in the fixed asset balances on January 1. Exchange rate differences arising from consolidation are included in the beginning balances in this specification.

	Group		Parent Company	
(FIM millions)	1997	**1998**	1997	**1998**
Consolidated goodwill:				
Acquisition cost, beginning of year	259	**636**	–	**–**
Additions	501	**15**	–	**–**
Disposals	–	**–**	–	**–**
Accumulated amortization	–241	**–172**	–	**–**
Book value, end of year	520	**479**	–	**–**
Other goodwill:				
Acquisition cost, beginning of year	17	**20**	10	**11**
Additions	4	**2**	–	**–**
Disposals	–	**–**	–	**–**
Accumulated amortization	–15	**–16**	–9	**–11**
Book value, end of year.	6	**6**	1	**–**
Other intangible assets:				
Acquisition cost, beginning of year	216	**279**	129	**182**
Additions	80	**58**	53	**41**
Disposals	–13	**–11**	–	**–2**
Accumulated depreciation	–122	**–158**	–66	**–88**
Book value, end of year	161	**168**	116	**133**
Land and water areas:				
Acquisition cost, beginning of year	227	**244**	130	**129**
Additions	24	**1**	1	**–**
Disposals	–3	**–18**	–2	**–15**
Book value, end of year	248	**227**	129	**114**
Buildings:				
Acquisition cost, beginning of year	1 338	**1 316**	577	**603**
Additions	110	**66**	61	**13**
Disposals	–27	**–14**	–11	**–**
Accumulated depreciation	–543	**–521**	–277	**–282**
Book value, end of year	878	**847**	350	**334**

(FIM millions)	Group 1997	Group **1998**	Parent Company 1997	Parent Company **1998**
Machinery and equipment:				
Acquisition cost, beginning of year	3 388	**3 574**	1 565	**1 678**
Additions	423	**288**	167	**88**
Disposals	–35	**–22**	–8	**–13**
Accumulated depreciation	–2 621	**– 2 777**	–1 237	**–1 310**
Book value, end of year	1 155	**1 063**	487	**443**
Other tangible assets:				
Acquisition cost, beginning of year	131	**140**	85	**90**
Additions	12	**14**	5	**7**
Disposals	–1	**–**	–	**–**
Accumulated depreciation	–117	**–122**	–72	**–77**
Book value, end of year	25	**32**	18	**20**
Assets in construction:				
Acquisition cost, beginning of year	148	**171**	86	**83**
Additions	207	**226**	104	**107**
Disposals and transfers	–188	**–153**	–107	**–63**
Book value, end of year	167	**244**	83	**127**
Property insurance values of tangible fixed assets	7 305	**7 250**	3 298	**3 213**
Taxation values				
Land and water areas	93	**85**	39	**42**
Buildings	734	**737**	369	**353**
Shareholdings, subsidiaries	–	**–**	1 944	**2 081**
Shareholdings, associated companies	171	**116**	170	**115**
Shareholdings, other companies	609	**496**	333	**97**
	1 607	**1 434**	2 855	**2 688**

(8) SHAREHOLDINGS AND OTHER SECURITIES

(The staggering of the names shows the chain of ownership)	Country	Number of shares	%	Nominal value		Parent company ownership Book value FIM millions	Ownership via subsid. Book value FIM millions
SUBSIDIARIES, DEC 31, 1998							
Valmet-Boustead Pty. Ltd.	Australia	4 000 000	100	AUD	1	43	
Valmet (ANZ) Pty Ltd	Australia	139 420	100	AUD	1	–	
Valmet Brasil Ltda.	Brazil	400 000	100	REAL	1	2	
Valmet Canada Inc.	Canada		100			95	
Valmet Chile Ltda.	Chile		100			–	–
Finbow Oy	Finland	10 200	60	FIM	50	3	
Valmet-Raisio Oy	Finland	204	51	FIM	10 000	13	
Valmet-Raisio GmbH	Germany		100				–
Oulun Kumitehdas Oy	Finland	900	100	FIM	1 000	6	
Oulun Norrcon Oy	Finland	8 500	100	FIM	100		
Comroll Oy	Finland	30	100	FIM	500		
UHAB Industrigummering AB	Sweden	4 860	81	SEK	100		
Pinaltek Oy	Finland	130	52	FIM	1 000	2	
Valmet Dura Inc.	Finland	1 200	60	FIM	10 000	12	
Valmet Flootek Ltd.	Finland	40 800	51	FIM	125	6	
Valmet Flootek AB	Sweden		100				15
Flootek International AB	Sweden		100				–
AVM Teknik AB	Sweden		100				1
Valmet Flootek Polska Sp z.o.o.	Poland		100				
Roval S.A.R.L.	France	10 000	100	FRF	1 000	7	
Valmet S.A.R.L.	France	98	98	FRF	500	–	
Valmet GmbH	Germany		100			17	
Valmet Ges.m.b.H.	Austria		100				–
GTU Ges. für Trocknungs- und Umwelttechnik mbH	Germany		100				3
Valmet Service GmbH	Germany		100				8
Valmet Vertrieb GmbH	Germany		100				1
Valmet-Como S.p.A.	Italy	10 000	100	ITL	1 000 000	120	
Valmet Gorizia S.p.A.	Italy	146 300	100	ITL	100 000	48	
Valmet Rotomec S.p.A.	Italy	6 999 362	100	ITL	1 000	69	–
Rotomec Frabelux S.A.R.L.	France	850	85	FRF	100		–
Rotomec Service GmbH	Germany	1 000	100	DEM	100		–
Rotomec Iberica S.A.	Spain	2 480	80	ESP	1 000		–
Rotomec America Inc.	USA	2 020	100	USD	100		–
Valmet Japan Co. Ltd.	Japan	100	100	JPY	100 000	–	
Valmet Korea Inc.	Korea	10 000	100	WON	10 000	1	
Valmet (SEA) Pte Ltd	Singapore	820 000	100	SGD	1	1	1
PT Valmet Indonesia	Indonesia	100 000	100	USD	1		–
Farros Blatter AG	Switzerland	1 000	100	CHF	1 000		
Von Roll Handling Systems Ltd.	Switzerland	5 000	100	CHF	1 000		
Valmet Technology (Thailand) Co. Ltd.	Thailand	999 993	100	THB	100	18	
Valmet (UK) Limited	UK	9 999	100	GBP	1	–	
Valmet Converting PLC	UK	40 000 000	100	GBP	1	354	
Atlas Converting Equipment plc	UK	10 576 839	100	GBP	0.05	–	730
Atlas Hurley Moate Ltd	UK	2	100	GBP	1		10
General Vacuum Equipment Ltd	UK	100	100	GBP	1		–
Titan Converting Equipment Ltd	UK	100	100	GBP	1		–
Atlas Group Americas Ltd	USA	5 000	100	GBP	1		–
Valmet Automation Inc.	Finland	3 000 000	100	FIM	60	230	
Valmet Automation (Australasia) Pty. Ltd.	Australia	502	100	AUD	1		2
Valmet Automation Ges.m.b.H.	Austria		100				–
Valmet Automation (Canada) Ltd.	Canada	11 186 391	100				112
CPS Elektroniikka Inc.	Finland	3 000	100	FIM	1 000		3
Sensodec Oy	Finland	800	100	FIM	1 000		8
Valmet Automation Kajaani Ltd.	Finland	1 500	100	FIM	10 000		21

(The staggering of the names shows the chain of ownership)	Country	Number of shares	%	Nominal value		Parent company ownership Book value FIM millions	Ownership via subsid. Book value FIM millions
Valmet Automation Projects Ltd.	Finland	3 000	100	FIM	1 000		3
Valmet Fisher-Rosemount Inc.	Finland	102	51	FIM	10 000		1
Valmet Automation France S.A.	France	19 816	99.1	FRF	1 000	–	–
Valmet Automation GmbH	Germany	3 500	100	DEM	1 000		10
Valmet Automation K.K.	Japan	300	100	JPY	50 000		–
Valmet Automation AS	Norway	50	100	NOK	1 000		–
Valmet Automation Polska spolka z.o.o.	Poland		100				–
Valmet Automation B.V.	The Netherlands	1 700	100	NLG	100		–
Valmet Automation Ltd.	UK	200 000	100	GBP	1		1
Valmet Automotive Inc.	Finland	63 200	100	FIM	1 000	363	
Euromotive Inc.	Finland	50	100	FIM	100 000		5
Valmet Power Transmission Inc.	Finland	6 000	100	FIM	5 000	49	
Valmet Hydraulics Oy	Finland	15 000	100	FIM	1 000		25
Statemet Insurance Company Limited	Guernsey	249 993	100	USD	1	1	
Valfin Ltd.	Finland	255	100	FIM	200 000	51	
Valmet Svenska AB	Sweden	800 000	100	SEK	100	107	
Valmet Automation (Sverige) AB	Sweden	46 000	100	SEK	100		4
Valmet-Karlstad AB	Sweden	70 000	100	SEK	1 000		43
Valmet Skandinavien AB	Sweden	200	100	SEK	1 000		–
Valmet NV Inc.	USA	515	100	USD	1	512	–
Valmet Inc.	USA		100				287
Valmet Automation (USA) Inc.	USA		100				161
Valfin Incorporated	USA		100				130
						2 132	1 586

SHAREHOLDINGS AND OTHER SECURITIES OF THE GROUP CONSIST OF THE FOLLOWING:

	Dec 31, 1997				**Dec 31, 1998**			
	Shares	% Held	Equity value FIM mill.		Shares	% Held	Equity value FIM mill.	
Investment in associated companies:								
Oy Scan-Auto Ab	350 000	50.0%	135		350 000	50.0%	132	
Sako Ltd.	40 000	50.0%	43		40 000	50.0%	44	
Other			72				62	
Total investment in associated companies			250				238	
	Shares	% Held	Book value FIM mill.	Fair value FIM mill.	Shares	% Held	Book value FIM mill.	Fair value FIM mill.
Investment in other securities:								
UPM Kymmene Corporation	2 954 396	1.1%	269	322	1 984 396	0.7%	174	288
Tamfelt Corporation	181 575	2.8%	26	36	242 100	2.7%	26	30
Merita Ltd	444 266	0.1%	7	13	440 000	0.1%	7	14
Sampo Insurance Company Limited	356 408	0.6%	7	63	356 408	0.6%	7	68
Sato Corporation	86 760	4.7%	21	21	86 760	3.9%	21	21
Patria Finavitec Oy	3 996	49.9%	71	71	–		–	–
Partek Corporation	4 126 039	8.5%	337	351	4 126 039	8.5%	337	192
Other			99	101			95	98
Total investment in other securities			837	978			667	711
Total shareholdings and other securities			1 087	1 228			905	949

Revaluations included in the Group's investments in associated companies were FIM 70 million at December 31, 1997 and 1998.

(9) GOODWILL

In July 1997 Valmet acquired a U.K. company, Atlas Converting Equipment plc and its subsidiaries for a net price of FIM 725 million. Goodwill amounting to FIM 496 million has been recorded on the acquisition and the goodwill will be amortized over 15 years, which represents its estimated economic life.

(10) UNFUNDED PENSIONS

Unfunded pension liability refers to that part of total pension liability which has not yet been accrued.

	Group, Dec 31		Parent Company, Dec 31	
(FIM millions)	1997	**1998**	1997	**1998**
Voluntary additional pension liability to Valmet's Pension Fund	44	**33**	44	**33**
Parent company's additional direct pension liability	64	**38**	64	**38**
	108	**71**	108	**71**

The unfunded pension liabilities are included in assets and long term accrued expenses in the Balance Sheet. The statutory pension liability was transferred from Valmet's Pension Fund to an insurance company at January 1, 1992. Valmet's Pension Fund has been closed to new employees since 1987. Due to the closing of the Pension Fund the unfunded pension liability will decrease in the future and the remaining part of the liability will be charged to income by the end of the year 2000.

(11) RECEIVABLES

The information regarding Valmet's receivables is as follows:

	Group, Dec 31		Parent Company, Dec 31	
(FIM millions)	1997	**1998**	1997	**1998**
Receivables due later than one year:				
Trade receivables, interest-bearing	41	**233**	–	**204**
Trade receivables, non-interest-bearing	25	**37**	31	**25**
Accrued income and prepaid expenses	22	**43**	1	**7**
Other receivables	11	**1**	–	**–**
	99	**314**	32	**236**
Interest-bearing receivables, total	182	**335**	75	**261**
The allowance for doubtful accounts	57	**49**	–	**1**

(12) COST AND EARNINGS OF PROJECTS UNDER CONSTRUCTION IN EXCESS OF BILLINGS/BILLINGS IN EXCESS OF COST AND EARNINGS OF PROJECTS UNDER CONSTRUCTION

Information on balance sheet items of uncompleted projects at December 31, 1998 (Group):

(FIM millions)	Cost and earnings of uncompleted projects	Billings of projects	Net
Projects, where Costs and earnings exceed Billings	2 574	1 506	1 068
Projects, where Billings exceed Costs and earnings	554	1 153	–599

Net sales from projects which were uncompleted at the year end were FIM 1,763 million in 1998.

(13) CASH AND SHORT TERM INVESTMENT

(FIM millions)	Group, Dec 31 1997	Group, Dec 31 **1998**	Parent Company, Dec 31 1997	Parent Company, Dec 31 **1998**
Cash	318	**505**	31	**43**
Short-term investments	1 263	**1 028**	962	**667**
	1 581	**1 533**	993	**710**

Short-term investments consist of time deposits, commercial papers, certificates of deposit, treasury bills, bonds and other securities.

(14) SHAREHOLDERS' EQUITY

Changes in consolidated shareholders' equity are as follows:

		Other shareholders' Equity			
(FIM millions)	Share capital	Restricted funds	Cumulative translation adjustment	Retained earnings	Total shareholders' equity
Balance at Jan 1, 1996	851	1 351	–149	1 013	3 066
Net income 1996	–	–	–	806	806
Dividends	–	–	–	–149	–149
Redemption and cancellation of shares	–	–	–	–494	–494
Translation differences	–	–	18	–	18
Balance at Dec 31, 1996	851	1 351	–131	1 176	3 247
Net income 1997	–	–	–	863	863
Dividends	–	–	–	–234	–234
Translation differences	–	–	17	–	17
Balance at Dec 31, 1997	851	1 351	–114	1 805	3 893
Net income 1998	–	–	–	675	675
Dividends	–	–	–	–273	–273
Translation differences	–	–	–73	–	–73
Balance at Dec 31, 1998	851	1 351	–187	2 207	4 222

Unrestricted shareholders' equity was FIM 1,644 million at December 31, 1997 and FIM 2,033 million at December 31, 1998. Unrestricted shareholders' equity includes untaxed reserves less deferred taxes FIM 67 million at December 31, 1997 and FIM 95 million at December 31, 1998. At December 31, 1998, FIM –13 million of the cumulative translation adjustment was considered as restricted funds and FIM –174 million as unrestricted funds. According to the Finnish Companies Act, the free distributable funds of the Group were FIM 1,578 million at December 31, 1997 and FIM 1,939 million at December 31, 1998. Dividends will be declared and paid in Finnish markkas.

Changes in the parent company's shareholders' equity are as follows:

		Other shareholders Equity		
(FIM millions)	Share capital	Restricted funds	Retained earnings	Total shareholders' equity
Balance at Jan 1, 1997	851	1 481	983	3 315
Net income 1997	–	–	589	589
Dividends	–	–	–234	–234
Balance at Dec 31, 1997	851	1 481	1 338	3 670
Net income 1998	–	–	379	379
Dividends	–	–	–273	–273
Balance at Dec 31, 1998	851	1 481	1 443	3 775

The unrestricted equity of the Parent Company at December 31, 1997 was FIM 1,338 million and FIM 1,443 million at December 31, 1998.

(15) LONG-TERM DEBT
Long-term debt of Valmet Group consists of the following:

	Group					
	Dec 31, 1997			**Dec 31, 1998**		
(FIM millions)	Total	Short-term portion	Long-term debt	Total	Short-term portion	Long-term debt
Bonds	1 446	1	1 445	1 360	1	1 359
Loans from financial institutions	449	99	350	488	128	360
Other long-term loans	274	119	155	172	57	115
Total	2 169	219	1 950	2 020	186	1 834

Bonds consist primarily of a 200 million USD bond, issued in the United States and registered with the Securities Exchange Commission (SEC). The Bond matures in 2007 and bears a fixed annual rate of 6.875 per cent. A part of that bond has been converted through a currency swap agreement into a fixed rate loan in British pounds sterling.

Another bond is a FIM 300 million bond with a fixed interest rate of ten percent. The bond matures between 2000 and 2002. This bond has been converted to USD and to different rates of interest through the use of currency and interest rate swaps.

Loans from financial institutions consist of international bank borrowings with varying maturities and either fixed or floating interest rates. The majority of the Group's loans from financial institutions are denominated in USD. Other bank loans are denominated in various currencies such as British pound sterling and Italian liras. The interest rates of the loans range from 2.123 percent to 10.25 percent at December 31, 1998 and they mature between 1999 and 2006.

Other long-term loans consist principally of government loans and loans from governmental agencies (e.g., for research and development support) and pension loans at interest rates ranging from 0.5 percent to 8.49 percent at December 31, 1998. The balance of pension loans included in other long-term loans at December 31, 1997 was FIM 24 million and FIM 22 million at December 31, 1998. "Pension loans", as permitted in Finland, consist mainly of relending of contributions paid for pensions.

For substantially all of their bank debt, the Group does not have any financial covenants.

As of December 31, 1998 the Group had FIM 408 million in long-term committed borrowing facilities that were unused and FIM 776 million unused credit facilities and similar lines of credit.

Long-term debt of Valmet Group at December 31, 1998 will be payable as follows:

(FIM millions)	Bonds	Loans from financial institutions	Other long-term loans	Total
1999	1	128	57	186
2000	101	48	15	164
2001	101	15	20	136
2002	140	9	11	160
2003	1	8	8	17
2004 and later	1 016	280	61	1 357
Total	1 360	488	172	2 020

Long-term debt of Parent Company consists of the following:

	Parent Company					
	31.12.1997			**31.12.1998**		
(FIM millions)	Total	Short-term portion	Long-term debt	Total	Short-term portion	Long-term debt
Bonds	1 439	–	1 439	1 354	–	1 354
Loans from financial institutions	278	3	275	258	1	257
Other long-term loans	79	7	72	79	13	66
Total	1 796	10	1 786	1 691	14	1 677

The long-term debt of the Parent Company at December 31, 1998 will be payable as follows:

(FIM millions)	Bonds	Loans from financial institutions	Other long-term loans	Total
1999	–	1	13	14
2000	100	1	11	112
2001	100	1	11	112
2002	140	–	6	146
2003	–	–	5	5
2004 and later	1 014	255	33	1 302
Total	1 354	258	79	1 691

(16) DEFERRED INCOME TAXES

The net deferred tax liability of the Group consists of the following:

(FIM millions)	Group Dec, 31 1997	**1998**
Deferred tax liabilities:		
Property and equipment	113	**119**
Untaxed reserves	1	**–**
Other	9	**57**
Total deferred tax liabilities	123	**176**
Deferred tax assets:		
Tax loss carryforwards	235	**179**
Property and equipment	90	**39**
Other	88	**115**
Less tax assets not recognized	–362	**–230**
Net deferred tax assets	51	**103**
Net deferred tax liabilities	72	**73**

Deferred taxes have not been provided on the unremitted earnings of subsidiaries and associated companies because such earnings are intended to be permanently reinvested or can be recovered in a tax-free manner and, in the case of associated companies, are not material.

Tax regulations in some countries permit tax deductions for allocations to special reserves with such amounts being accumulated in untaxed reserve accounts. In the Consolidated Balance Sheets, untaxed reserves in Group companies are allocated between shareholders' equity and deferred tax liabilities.

The Group's tax loss carryforwards were FIM 631 million and FIM 491 million at December 31, 1997 and 1998, respectively. FIM 184 million of the tax loss carryforwards at December 31, 1998 have no expiration date. Of the remaining tax loss carryforwards, FIM 38 million arises in Italy and expires during the years 1999 to 2002, FIM 82 million is from Canada and expires during the period 2000–2005, and FIM 187 million relates to the U.S. and expires during the period 2000 to 2007.

(17) ACCRUED EXPENSES, LONG-TERM

	Group, Dec 31		Parent Company, Dec 31	
(FIM millions)	1997	**1998**	1997	**1998**
Voluntary additional pension liabilities (Note 10)	137	**93**	115	**75**
Provisions for other claims and compensations	2	**1**	1	**1**
Other long-term provisions and accruals	52	**57**	–	**–**
	191	**151**	116	**76**

(18) OTHER INTEREST-BEARING SHORT-TERM LIABILITIES

Other interest-bearing short-term liabilities consist primarily of short-term borrowing under various credit lines, trade finance advances and deposits accepted from Personnel, Pension and Support Funds. The weighted average interest rates on short-term borrowings for the year ended December 31, 1998 was 4.43 percent.

(19) ACCRUED EXPENSES AND PREPAID INCOME, CURRENT LIABILITIES

A detailed specification of accrued expenses and prepaid income is as follows:

	Group, Dec 31		Parent Company, Dec 31	
(FIM millions)	1997	**1998**	1997	**1998**
Personnel costs	606	**438**	289	**209**
Interest expenses	30	**20**	14	**10**
Income taxes	175	**78**	71	**18**
Accrued expenses related to long-term contracts	821	**617**	580	**357**
Provisions for warranty claims	334	**371**	205	**237**
Other accruals	270	**213**	74	**74**
Provisions for losses on long-term contracts	31	**24**	18	**19**
Provisions related to reorganization of production operations	18	**20**	5	**12**
Other provisions	29	**2**	10	**1**
	2 314	**1 783**	1 266	**937**

(20) ASSETS PLEDGED AND CONTINGENT LIABILITIES

	Group, Dec 31		Parent Company, Dec 31	
(FIM millions)	1997	**1998**	1997	**1998**
Mortgages on corporate debt	80	**31**	–	**–**
Other pledges and contingencies				
Mortgages	35	**32**	–	**–**
Pledged shares	4	**3**	–	**–**
Other pledged assets	7	**6**	–	**–**
Guarantees on behalf of subsidiaries	–	**–**	788	**950**
Guarantees on behalf of associated companies	8	**4**	8	**4**
Other guarantees	11	**4**	8	**4**
Total	65	**49**	804	**958**
Leasing-repurchase commitments	19	**20**	19	**7**

The mortgage amount has been calculated as the amount of the corresponding loans. The nominal value of the mortgages at December, 1998 was FIM 23 million larger than the amount of the corresponding loans. The pledged shares amount has been calculated as the amount of the corresponding loans and other commitments.

(21) RELATED PARTY INFORMATION

Information regarding transactions with related parties is as follows:

(FIM millions)	Group 1997	Group **1998**	Parent Company 1997	Parent Company **1998**
Associated companies:				
Receivables – current				
Trade receivables, non-interest-bearing	1	**2**	1	**2**
Sales to associated companies	–	**1**	–	**1**
Members of the Board of Directors and the Chief Executive Officers:				
Loans receivable – long-term	1	**1**	1	**1**
Subsidiaries (regarding Parent Company only):				
Loans receivable – long-term	–	**–**	447	**860**
Receivables – current				
Trade receivables, non-interest bearing	–	**–**	155	**323**
Loans receivable	–	**–**	355	**55**
Accrued income and prepaid expenses	–	**–**	77	**175**
	–	**–**	587	**553**
Current liabilities				
Accounts payable	–	**–**	179	**120**
Advances received	–	**–**	4	**5**
Cash pool balance	–	**–**	445	**426**
	–	**–**	628	**551**
Financial income and expenses:				
Interest income	–	**–**	33	**62**
Interest expenses	–	**–**	–15	**–20**
	–	**–**	18	**42**

(22) OPERATING LEASE COMMITMENTS

The minimum lease payments under non-cancellable, operating lease agreements:

(FIM millions)	Group
1999	91
2000	100
2001	65
2002	51
2003	39
2004 and later	74
Total	420

Rental expense for operating leases was FIM 139 million in 1997 and FIM 148 million in 1998. Amounts under finance leases are not significant.

(23) FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Group's financial function must identify the financial risks connected with the business operations and minimize their impacts on the Group's financial result. To minimize financial risks, the Group uses different derivative instruments, such as forward contracts, currency and interest rate swaps and options. Derivatives are used only to support the underlying businesses.

Because the derivative instruments below are presented at their notional or contract amounts, they do not reflect the Group's risk position caused by the use of derivatives.

Foreign Currency and Interest Rate Risk

A substantial portion of the Group's turnover is generated outside Finland. The Group has also invested in the net assets of foreign subsidiaries. The Group's sales, marketing and financial activities are conducted in several countries and raw materials and components are purchased in several different currencies. International operations expose the Group to variations in exchange rates. Transactional risks relate to the risk that currency fluctuations will have a negative effect on the value of the Group's commercial cash flows. Translation risk relates to the risk of adverse currency fluctuations in the translation of foreign operations and foreign assets and liabilities into Finnish markkas for the Group's consolidated financial statements.

Variations in interest rates expose the Group to interest rate risk, which may cause changes in the values of such interest bearing liabilities and assets which are already in the balance sheet and also affect the amounts of future interest income or expenses.

At December 31, 1997 and 1998, the net assets of foreign subsidiaries denominated in currencies other than FIM amounted to FIM 948 million and FIM 1,088 million, respectively. The Group has partly hedged with loans and other financial instruments the net assets of its foreign subsidiaries.

The table below summarizes in FIM equivalent by major currency the contractual amounts of forward exchange contracts used primarily to hedge future firmly committed cash flows at December 31, 1997 and 1998. The "Buy" amounts represent the Finnish markka equivalent of commitments to purchase foreign currencies, and the "Sell" amounts represent the FIM equivalent of commitments to sell foreign currencies.

	Group			
	Dec 31, 1997		**Dec 31, 1998**	
(FIM millions)	Buy	Sell	Buy	Sell
United States dollar	–	1 649	34	170
Canadian dollar	7	455	–	41
British pound sterling		36	–	373
German Deutsche mark	2	69	–	1 051
French franc	1	27	–	244
Other	24	490	1	307
Total	34	2 726	35	2 186

The following table presents information regarding the contract amount in FIM equivalent amounts and the estimated fair value of all of the Group's forward exchange contracts with a positive fair value (assets) and a negative fair value (liabilities) as at December 31, 1997 and 1998:

	Group			
	Dec 31, 1997		**Dec 31, 1998**	
(FIM millions)	Contract amount	Fair value	Contract amount	Fair value
Forward exchange contracts:				
Assets	634	20	1 695	43
Liabilities	2 126	–115	526	–19

The Group utilizes interest rate and currency swaps to manage its exposure to interest rate and exchange rate movements. Interest rate swap agreements allow the Group to synthetically adjust floating rate receivables or borrowings into fixed rates or vice versa. Under interest rate swaps, an agreement is made with a counterparty to exchange, at specified intervals, the difference between fixed rate and floating rate interest payments calculated by reference to an agreed notional principal amount. All of the interest swap and currency swap agreements are designated to hedge specific loans. The maturities of the interest rate swap agreements do not exceed the maturities of the debt to which they relate. The Group accounts for interest rate swaps on an accrual basis.

The following is a summary of the interest rate swaps, interest/currency swaps and currency swaps of the Group. Swaps that have a positive fair value are listed as assets and swaps with a negative fair value are listed as liabilities.

	Group			
	Dec 31, 1997		**Dec 31, 1998**	
(FIM millions)	Contract amount	Fair value	Contract value	Fair value
Interest rate swaps:				
Assets	300	1	–	–
Liabilities	–	–	300	–7
Interest rate/currency swaps:				
Assets	300	21	300	40
Currency swaps:				
Liabilities	403	–4	379	–25

The interest rate and currency swap agreements at December 31, 1997 and at December 31, 1998 will mature over the period between 2000 and 2007. Under the terms of currency swap agreements a part of the Finnish markka denominated bond has been converted to USD, and a part of the USD denominated bond to British pound sterling. Under the terms of interest rate swap agreements the Group pays interest rates which range from 5.695 per cent to 7.51 per cent at December 31, 1997 and from 5.011 per cent to 7.51 per cent at December 31, 1998, respectively.

Credit Risk
Derivative contracts carry a risk of non-performance by the counterparty. In the opinion of the management, the counterparties of the Group's financial instruments are creditworthy and no significant losses are expected from existing contracts. In the normal course of business, no collateral is required by the Group. The credit exposure of the interest rate and foreign exchange swaps is represented by the positive fair value of those contracts which have a positive fair value.

The Group's sales receivables also contain a credit risk of non-payment. As of December 31, 1998, one larger receivable Valmet had from a single customer represented approximately 15 percent of total receivables.

(24) LAWSUITS AND CLAIMS

Product liability suits against Valmet Corporation are pending in the USA. However, they cannot be considered as constituting any overall material risk. The normal risks of legal disputes concerning deliveries and the taxation risks involved in export delivery projects cannot be regarded as material in terms of the Corporation's total business activities.

(25) BONDS WITH WARRANTS, STOCK WARRANTS AND AUTHORIZATIONS BY SHAREHOLDERS' MEETING

The 1994 Annual General Meeting approved an issue of bonds with warrants, valued at FIM 500,000, to the members of Valmet Corporation's senior management. The bonds are valid for five years, carrying an interest rate of 5 per cent and an issue price of 100 per cent. The warrants entitle the holders to subscribe to a maximum of 1,000,000 shares from December 1, 1998 to January 31, 2001, at a subscription price of FIM 60. The bonds with warrants have been completely subscribed. In connection with the approval of Valmet-Rauma's merger plan on November 17, 1998, the Board of Directors of Valmet determined that warrant holders would be eligible to subscribe for Valmet shares during the period from December 1, 1998 to May 31, 1999 and for Valmet-Rauma shares from the completion of the merger until January 31, 2001, at the original subscription price and in accordance with the original terms of the warrants. The subscription rights of the warrants had not been used by February 16, 1999.

The 1998 Annual General Meeting approved an issue of two series of warrants to persons belonging to the management of the Group and certain other key persons. The warrants entitle the holders to subscribe to an aggregate of 2,000,000 shares in the Company (1,000,000 shares in each series). The subscription period for the new shares will commence on April 1, 2001 for the first series, entitling holders to subscribe for new shares of Valmet at a price of FIM 108 per share, and on April 1, 2003 for the second series, entitling the holders to subscribe for new shares of Valmet at a price of FIM 113 per share. The subscription period for both series will close on March 31, 2005. The share subscription price for both series will be adjusted by dividends distributed after May 1, 1998 and before the date of subscription. In connection with the approval of Valmet-Rauma's merger plan on November 17, 1998, the Board of Directors of Valmet determined that warrant holders would also be eligible to subscribe for Valmet shares during the period from April 1, 1999, to May 31,1999. Following completion of the merger the options will entitle holders to subscribe for shares of Valmet-Rauma at the original subscription price and in accordance with the original terms of options.

No other bonds with warrants or convertible bonds were outstanding during 1998. Valmet Corporation does not currently have an authorization to issue shares or warrants, or to buy back its own shares.

(26) U.S.GAAP INFORMATION

The accompanying consolidated financial statements have been prepared in accordance with Finnish GAAP which differs in certain significant respects from U.S.GAAP. The following is a summary of the adjustments to net income and shareholders' equity that would have been required if U.S.GAAP had been applied instead of Finnish GAAP in the preparation of the consolidated financial statements.

	Group	
(FIM millions, except per share amounts)	1997	**1998**
Net income under Finnish GAAP	863	**675**
Adjustments to reconcile to U.S.GAAP:		
Pensions (a)	5	**–75**
Income taxes (b)	–28	**18**
Goodwill (c)	10	**11**
Investments (e)	25	**9**
Capitalization of interest (f)	–1	**4**
Equity method investees (g)	–9	**–**
Tax effect of U.S.GAAP adjustments	–8	**17**
Net income under U.S.GAAP	857	**659**
Basic earnings per share (h)	10.97	**8.44**

	Group	
	Dec 31, 1997	**Dec 31, 1998**
Shareholders' equity under Finnish GAAP	3 893	**4 222**
Pensions (a)	–190	**–294**
Income taxes (b)	71	**106**
Goodwill (c)	–82	**–71**
Revaluations (d)	–70	**–70**
Investments (e)	102	**32**
Capitalization of interest (f)	42	**46**
Shareholders' equity under U.S.GAAP	3 766	**3 971**

Those differences which have material effect on consolidated net income and shareholders' equity are as follows:

a) Pensions

The Group companies have various pension schemes in accordance with the local conditions and practices in the countries in which they operate. Most of these programs are defined benefit pension schemes with retirement, disability, death and termination income benefits. The retirement income benefits are generally a function of years of employment and final salary with the company and are generally coordinated with local national pensions. The schemes are generally funded through payments to insurance companies or to trustee-administrated funds as determined by periodic actuarial calculations. The Group's policy for funding its defined benefit plans is to satisfy local statutory funding requirement for tax deductible contributions. The Group contributes at least an amount equal to the minimum funding requirements for the countries in which it maintains pension schemes that are subject to such requirements. The Group also participates in some multi-employer pension arrangements and defined contribution pension arrangements.

Under U.S.GAAP, the determination of pension expense for defined pension plans is made pursuant to Statement of Financial Accounting Standard " Employers' Accounting for Pensions" (SFAS No 87). SFAS No 87 is more prescriptive than Finnish GAAP in that it requires the use of a specific actuarial method (the projected unit credit method). Also under SFAS No 87, under certain circumstances, a minimum liability is recorded with a corresponding intangible asset and/or reduction of shareholders' equity for plans that are underfunded.

For U.S.GAAP purposes, shareholders' equity has been reduced by FIM 284 million (net of deferred tax assets of FIM 110 million) at December

31, 1997, and by FIM 313 million (net of deferred tax assets of FIM 122 million) at December 31, 1998, for the effects of this additional minimum liability.

b) Income taxes

Under Finnish GAAP, the Group recorded deferred income taxes primarily on the amount of untaxed reserves and accelerated depreciation.

Under U.S.GAAP, deferred taxes are required to be recorded on differences between the book basis and the tax basis of all assets and liabilities. Deferred tax liabilities are recognized regardless of the likelihood of reversal of such amounts and deferred tax assets are reduced by a valuation allowance to the amount that is "more likely than not" to be realized.

c) Goodwill

Under Finnish GAAP, negative goodwill arising from the excess of the fair value of the net assets acquired over the purchase price of an acquired business is recorded directly to shareholders' equity.

Under U.S.GAAP, such negative goodwill is recorded as a reduction in the value of acquired long-lived assets, thus reducing future levels of depreciation expenses for those assets.

d) Revaluations

Under Finnish GAAP, certain fixed assets and investments in associated companies can be revalued with any resulting revaluation surplus recorded directly in shareholders' equity.

Under U.S.GAAP, no such increases in the carrying value of fixed assets and investments in associated companies are permitted.

e) Investments

Under Finnish GAAP, the Group records short-term investments at market value and changes in the market value are recorded as part of "Financial income and expense" in the Income Statement Under Finnish GAAP, the Group records long-term investments at cost.

For U.S.GAAP purposes, all of the Group's short-term and long-term investments in debt securities and equity securities with a readily determinable market value are classified as "available-for-sale" and are recorded at fair value with changes in unrealized appreciation or depreciation recorded directly to shareholders' equity, net of applicable deferred income taxes.

f) Capitalization of interest

Under Finnish GAAP, capitalization of interest is allowed, but not specifically required on projects that are constructed for an entity's own use. The Group presently does not capitalize interest on such self-constructed assets.

Under U.S.GAAP, capitalization of interest on assets constructed for an entity's own use is required based upon the weighted average capital expenditures on self-constructed assets.

g) Equity method investees

In the accompanying Consolidated Financial Statements, the Group has reduced its investment in the shares of an associated company as the result of the Group's share of the losses of that equity method investee company. The Group discontinues the use of the equity method when the investment is reduced to zero and when the Group has not guaranteed to provide further financing.

Under U.S.GAAP, a similar principle would be followed except that the investment in associated companies would also include the amount of any advances made. In addition, this adjustment includes the Group's proportionate share of U.S.GAAP adjustments to the earnings of associated companies.

h) Earnings per share

Earnings per share for Finnish GAAP purposes is based upon income before extraordinary items and taxes deducted with income taxes and minority interests divided by the weighted average number of shares outstanding and adjusted with the tax effect of extraordinary items.

Under U.S.GAAP, earnings per share would be based upon net income divided by the weighted average number of shares outstanding.

Key Figures and Financial Ratios 1994–1998

(FIM millions)	1994	1995	1996	1997	**1998**
Orders booked	8 928	12 131	10 486	10 609	**10 686**
Order backlog, Dec 31	6 381	9 699	8 086	7 126	**5 813**
Net sales	8 328	8 574	11 764	12 313	**11 649**
Net sales change, %	–22.0	2.9	37.2	4.7	**–5.4**
Operating profit	371	530	921	939	**761**
Operating profit, % of net sales	4.5	6.2	7.8	7.6	**6.5**
Income before extraordinary items and taxes	203	637	1 056	1 018	**866**
Income before extraordinary items and taxes, % of net sales	2.4	7.4	9.0	8.3	**7.4**
Income before taxes	178	719	1 020	1 137	**866**
Income before taxes, % of net sales	2.1	8.4	8.7	9.2	**7.4**
Net income for the year	173	656	806	863	**675**
Exports and international operations	6 753	7 208	7 891	9 799	**9 791**
Exports and international operations, % of net sales	81.1	84.1	67.1	79.6	**84.0**
Capital expenditures	266	461	632	1 376	**516**
Capital expenditures, % of net sales	3.2	5.4	5.4	11.2	**4.4**
Depreciation and amortization	449	383	437	432	**501**
Depreciation and amortization, % of net sales	5.4	4.5	3.7	3.5	**4.3**
Change in working capital	84	365	46	–793	**–592**
Net cash provided by operating activities	463	1 170	1 259	418	**430**
Research and development	300	374	493	498	**500**
Research and development, % of net sales	3.6	4.4	4.2	4.0	**4.3**
Research and development expenses in the income statement	298	306	404	472	**468**
Number of personnel, Dec 31	12 146	12 808	12 871	13 480	**12 680**
Shareholders' equity and minority interests	2 533	3 094	3 283	3 949	**4 278**
Balance sheet total	8 905	9 641	8 302	10 073	**9 886**
Net debt/equity, %	37.5	–3.2	–9.5	18.8	**6.8**
Equity ratio, %	33.3	40.6	42.8	40.3	**46.1**
Return on net assets, %	9.4	16.0	23.4	20.6	**15.8**
Return on equity, %	8.7	20.7	26.6	22.4	**16.8**
Earnings / share, FIM	2.50	6.74	10.26	10.08	**8.64**
Dividend / share, FIM	0.50	1.75	3.00	3.50	**3.50** [1)]
Dividend / earnings, %	20.0	26.0	29.2	34.7	**40.5**
Market value of shares, Dec 31, FIM million	3 830	4 638	6 326	5 873	**5 311**

[1)] Proposal by the Board of Directors

Accounting Principles

Valmet's Financial Statements have been prepared in accordance with the Finnish Accounting Act. The following accounting principles have been applied to all subsidiaries in the consolidated financial statements.

Basis of consolidation

Subsidiaries in which Valmet's holdings exceed 50 per cent are consolidated in the financial statements. The results of subsidiaries acquired or sold during the year are included in the consolidated income statement from the date of purchase or up to the date of sale. The acquisition of companies is accounted for using the purchase method. The excess of the purchase price over the estimated fair value of the net assets acquired is recorded as goodwill and is amortized on a straight-line basis over a five to fifteen year period. All inter-Group transactions and balances have been eliminated in the consolidation process.

Associated companies

The equity method of accounting is used for investments in associated companies in which the investment provides the Company with the ability to exercise significant influence over the operating and financial policies of the investee company. Such influence is presumed to exist for investments in companies in which the Group's direct ownership or indirect ownership is between 20 per cent and 50 per cent. Under the equity method, the Group's share of profits and losses of associated companies is included in the Con-solidated Income Statement. The Group's share of post-acquisition retained profits and losses of associated companies is reported as part of the investments in associated companies in the Consolidated Balance Sheet.

Foreign currencies

Foreign currency transactions are recorded at the exchange rate of the date of origin, or at a forward contract rate, if hedged through a related forward exchange contract. Realized and unrealized exchange rate gains and losses related to unhedged transactions are recorded in the Consolidated Income Statement as financial income and expenses.

Assets and liabilities denominated in foreign currencies are translated at year-end exchange rates unless a related or matching forward exchange contract or currency swap has been entered into, in which case the rate specified in the contract is used. Exchange rate differences on assets and liabilities denominated in a foreign currency that are not covered by a hedging arrangement are recorded in the Consolidated Income Statement.

Foreign subsidiaries

In the Consolidated Financial Statements, the income statements of foreign subsidiaries are translated into Finnish markka at the average rate of exchange prevailing during the year and the balance sheets are translated at the exchange rate at the balance sheet date. Exchange differences arising on the translation of financial statements of foreign subsidiaries are recorded in shareholders' equity. The Group hedges a portion of foreign subsidiaries shareholders' equity by designating the loans in foreign currencies and other financial instruments as a hedge of net assets. The exchange rate differences arising from these loans and other financial instruments are offset against the cumulative translation adjustment in shareholders' equity arising from consolidation. The currency of the loans and other financial instruments should correspond to the currency of the net assets in order to qualify for hedge accounting.

Derivative financial instruments

Forward exchange contracts and currency swaps

Gains and losses on forward exchange contracts and currency swaps that are designated and effective as hedges of firm foreign currency commitments are deferred and recognized in income or as adjustments of carrying amounts when the hedged transaction occurs.

Interest rate swaps

Interest rate swap agreements that are designated as a hedge of a debt obligation are accounted for on an accrual basis. That is, the interest payable and interest receivable under the swap terms are accrued and recorded as an adjustment to the interest expense of the designated liability.

Amounts due from and payable to the counter-parties of interest rate swaps are recorded on an accrual basis at each reporting date based on amounts computed by reference to the respective interest rate swap contract. Realized gains and losses that occur from the early termination or expiration of contracts are recorded in income over the remaining period of the original swap agreement.

Hedge Accounting

The Group considers its derivative financial instruments to be "hedges" (i.e. an offset of foreign exchange and interest rate risks) when certain criteria are met.

Foreign currency derivative instruments:
The Group's criteria to qualify for hedge accounting are:
– The instrument must be related to a foreign currency asset or liability or firm commitment whose characteristics have been identified;
– It must involve the same currency as the hedged item; and
– It must reduce the risk of foreign currency exchange movements on the Group's operations.

Interest rate derivative instruments:
The Group's criteria to qualify for hedge accounting are:
– The instrument must relate to an asset or a liability; and
– It must change the character of the interest rate by converting variable rate debt to a fixed rate or vice versa.

Revenue recognition
Commencing on January 1, 1996, revenue from long-term delivery contracts has been recognized using the percentage of completion method. Percentage of completion is determined by reference to the extent of contract performance based on achievement of milestones. Revenues from other goods and services sold is recognized when substantially all of the risks and obligations of ownership are transferred to the buyer, or when the service is performed.

Fixed assets and depreciation
Fixed assets are recorded at historical cost. Revaluations of long-term investments are made in certain cases. Tangible fixed assets are depreciated commencing on the date of acquisition and using the straight line method over the useful life of the asset or through the date of disposal. Typical useful lives of tangible fixed assets are as follows:

Buildings	15-20 years
Heavy machinery	10-12 years
Other machinery	8-10 years
Vehicles, office and EDP equipment	3-5 years

The Group evaluates the recoverability of long-lived assets not held for sale by measuring the carrying amount of the assets against the estimated undiscounted future cash flows associated with them. At the time such evaluations indicate that the future undiscounted cash flows of certain long-lived assets are not sufficient to recover the carrying value of such assets, the assets are adjusted to their fair values.

Rent expense on operating leases is recognized evenly over the terms of the lease.

Other intangible assets
Intangible assets consisting primarily of patents, licences and other similar items are amortized over their estimated useful lives, which are 3 to 10 years.

Inventories
Inventories are recorded at the lower of cost or market value calculated on an "average cost" basis. Historical costs include purchase costs as well as transportation and processing costs. The costs of finished goods include direct materials, wages and salaries plus social costs, subcontracting and other direct costs. In addition, production costs include an allocable portion of production and project administration overheads. Inventories are shown net of a reserve for obsolete and slow-moving inventories. A reserve is established and a corresponding charge is taken to income in the period in which loss occurs based upon an assessment of technological obsolescence, turnover and related factors.

Short-term investments
Short-term investments are recorded at market value and gains or losses arising from changes in market value are recognized in the Consolidated Income Statement.

Pensions and other retirement benefits
The cost of retirement benefits is accounted in the period during which the services are rendered by employees. The Group has various retirement plans in accordance with local regulations and practices. The cost of these plans is charged to income systematically and the amounts are based on actuarial calculations or on insurance companies' charges.

A portion of the voluntary additional pension liability incurred in previous years is not fully funded. It is recorded in assets as unfunded pensions and in liabilities as long-term accrued expenses. This pension liability will be charged to income by the end of the year 2000.

Research and development expenses
Research and development costs are generally charged to income as they are incurred except that such costs may be deferred in limited circumstances if such costs have alternative future use. If such costs are deferred, systematic amortization is made over periods not exceeding five years. Such deferrals have not had a material effect on the Group's results of operations.

Provision for warranty costs
An accrual is made for expected warranty costs in the period when the respective revenue recognition is made. Management reviews the adequacy of this accrual periodically based on historical analysis and anticipated product returns.

Income Taxes
Income taxes consist of direct taxes and the change in deferred taxes on untaxed reserves and accelerated depreciation. Direct taxes are calculated on the results of the consolidated companies and according to the local tax rules of each country. In the Consolidated Financial Statements, untaxed reserves have been divided between deferred tax liability and shareholders' equity.

Changes in Accounting Policies
In 1997 amendments to the Finnish Accounting Act were enacted. The Group expects to implement the changed accounting principles provided for in this legislation from the beginning of 1999. Management believes that the major changes effected by the amendments relate to accounting for deferred taxes.

Use of estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Definitions of Financial Ratios and Key Indicators

EQUITY RATIO, % [1,6] =

$$\frac{\text{Shareholders' equity + Minority interests}}{\text{Total assets – Billings in excess of cost and earnings}} \times 100$$

RETURN ON NET ASSETS % =

$$\frac{\text{Income before extraordinary items and taxes + Financial expenses}}{\text{Balance sheet total – Non-interest-bearing debt (average for the year)}} \times 100$$

RETURN ON EQUITY, % [1,5] =

$$\frac{\text{Income before extraordinary items and taxes – Taxes}}{\text{Shareholders' equity + Minority interests (average for the year)}} \times 100$$

NET DEBT / EQUITY, % [1] =

$$\frac{\text{Interest bearing debt – Interest-bearing receivables – Cash and short-term investments}}{\text{Shareholders' equity + Minoritys interest}} \times 100$$

DIVIDEND / SHARE, FIM [2,3] =

$$\frac{\text{Nominal dividend}}{\text{Issue-adjusted number of shares on Dec. 31.}}$$

DIVIDEND YIELD % [2,3] =

$$\frac{\text{Dividend/share}}{\text{Issue-adjusted share price on Dec. 31.}} \times 100$$

EARNINGS / SHARE, FIM [2,3,4,5] =

$$\frac{\text{Income before extraordinary items and taxes – Taxes – Minority interests}}{\text{Average number of shares adjusted for share issue}}$$

P/E-RATIO [2,3] =

$$\frac{\text{Issue-adjusted share price on Dec. 31.}}{\text{Earnings/share}}$$

CASH FLOW / SHARE, FIM [2,3,4,5] =

$$\frac{\text{Income before extraordinary items and taxes + Depreciation – Taxes}}{\text{Average number of shares adjusted for share issues}}$$

EQUITY / SHARE, FIM [1,2,3] =

$$\frac{\text{Shareholders' equity}}{\text{Issue-adjusted number of shares on Dec. 31.}}$$

DIVIDEND / EARNINGS, % =

$$\frac{\text{Dividend / Share}}{\text{Earnings / Share}} \times 100$$

(1) In the calculation of this ratio shareholders' equity includes untaxed reserves net of deferred taxes.

(2) In calculations of ratios related to shares the dilution effect of the FIM 500,000 bonds with warrants (maximum 1,000,000 shares) or the stock warrants of an aggregate of 2,000,000 shares has not been calculated.

(3) At March 25, 1996, the nominal value of the shares was changed from FIM 20 to FIM 10 per share and the number of shares was increased in a 2-for-1 share split. The ratios have been retroactively adjusted for all periods presented based on the 2-for-1 share split.

(4) The ratios of 1996 have been adjusted with the redemption and cancellation of those shares made at June 7, 1996.

	Number of shares, Dec. 31	Average number of shares
1994	85 101 430	79 079 512
1995	85 101 430	85 101 430
1996	78 100 000	81 130 756
1997	78 100 000	78 100 000
1998	78 100 000	78 100 000

(5) Taxes from 1996 and 1997 have been adjusted with the tax effects of extraordinary items.

(6) In calculating the equity ratios for the years 1994-1995, the amount of advances received was deducted from the Balance Sheet total. Since adopting the percentage of completion method of revenue recognition in 1996, the billings from the customer regarding long-term projects have been offset by cost and earnings of the projects in the balance sheet.

Auditors' Report

TO THE SHAREHOLDERS OF VALMET CORPORATION
We have audited the accounting records and the financial statements, as well as the administration by the Board of Directors and the Managing Director of Valmet Corporation for the year ended 31 December, 1998. The financial statements, which include the report of the Board of Directors, consolidated and parent company income statements, balance sheets and notes to the financial statements, have been prepared by the Board of Directors and the Managing Director. Based on our audit we express an opinion on these financial statements and the company's administration.

We have conducted our audit in accordance with Finnish Generally Accepted Auditing Standards. Those standards require that we plan and perform the audit in order to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statement presentation. The purpose of our audit of the administration has been to examine that the Board of Directors and the Managing Director have complied with the rules of the Finnish Companies Act.

In our opinion, the financial statements have been prepared in accordance with the Finnish Accounting Act and other rules and regulations governing the preparation of financial statements in Finland. The financial statements give a true and fair view, as defined in the Accounting Act, of both the consolidated and parent company result of operations, as well as of the financial position. The financial statements can be adopted and the members of the Board of Directors and the Managing Director of the parent company can be discharged from liability for the period audited by us. The proposal made by the Board of Directors on how to deal with the distributable funds is in compliance with the Finnish Companies Act.

We have acquainted ourselves with the interim financial statements made public by the company during the year. It is our understanding that the interim financial statements have been prepared in accordance with the rules and regulations governing the preparation of such statements in Finland.

Helsinki, February 16, 1999

KPMG Wideri Oy Ab
Eero Suomela
Authorized Public Accountant

Board of Directors and Auditors

Board of Directors

Elected at the Annual General Meeting on March 30, 1998.

Chairman	Paavo Rantanen (1934)	Ambassador (retired)	
Vice Chairman	Jaakko Rauramo (1941)	President, Sanoma Corporation	
Members	Teuvo Kinnunen (1937)	Municipal Counsel	
	Jarmo Leppiniemi (1948)	Professor, The Helsinki School of Economics and Business Administration	
	Markku Mäkinen (1945)	President, Finnvera plc	Resigned on August 24, 1998
	Matti Sundberg (1942)	President and CEO, Valmet Corporation	
	Juhani Yli-Paavola (1934)	Former President and COO, Oy Metsä-Botnia Ab	
Representatives of Personnel Groups on the Board	Martti Luhanko	Valmet Corporation	
	Lasse Saarnio	Valmet Automation Inc.	
Secretary	Harri Luoto (1946)	Senior Vice President, General Counsel, Valmet Corporation	

Auditor

KPMG Wideri Oy Ab Eero Suomela, Authorized Public Accountant


Paavo Rantanen


Jaakko Rauramo


Teuvo Kinnunen


Jarmo Leppiniemi


Matti Sundberg


Juhani Yli-Paavola

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The Annual General Meeting

The Annual General Meeting of Valmet Corporation will be held in Hall C1 of the Helsinki Fair Centre, at Rautatieläisenkatu 3, Helsinki, Finland, on March 31, 1999, starting at 12.00 noon.

Shareholders who have entered their shareholdings in the shareholders' register maintained by the Finnish Central Securities Depository Ltd. are eligible to participate if their shares are registered in their own name by March 26, 1999.

A shareholder, whose shares have not been transferred to the book entry system, shall also have the right to participate in the Annual General Meeting, provided that the shareholder has been entered in the Corporation's share register before May 28, 1993. In this case, the shareholder must present his or her share certificate, or some evidence that ownership of the shares has not yet been transferred to the book-entry system, at the Annual General Meeting.

Shareholders who intend to participate in the Annual General Meeting must register in advance, either at room 687 of the Corporate Head Office at Panuntie 6, 00620 Helsinki, Finland, by phone +358 9 7770 5607, by fax +358 9 7770 5586 or by mail. All such notifications, including written ones, must be received no later than 4.00 p.m. on Friday, March 26, 1999. Shareholders are kindly requested to forward authorizations, if applicable, so as to reach the Corporation before the above deadline.

Notice of the Annual General Meeting is given in the following newspapers: Helsingin Sanomat, Kauppalehti and Hufvudstadsbladet.

Dividend

The Board of Directors proposes to the Annual General Meeting that a dividend of FIM 3.50 per share be paid for the fiscal year ended December 31, 1998. The record date of this purpose will be April 7, 1999. The dividend will be paid to all shareholders who, on the record date, are recorded in Valmet Corporation's register of shareholders, which is held by the Finnish Central Securities Depository Ltd. The dividend will be paid on April 14, 1999.

Financial publications in 1999

In addition to its financial statements and annual report for 1998, Valmet Corporation will publish two interim reviews as follows:

Interim review for January-March
May 6, 1999
Interim review for January-June
August 10, 1999

The merger of Valmet and Rauma on July 1, 1999

Valmet-Rauma's pro forma figures will also be published at the same time as Valmet Corporation's and Rauma Corporation's Interim Reviews. The new company will publish an interim review as follows:

Interim review for January-September
November 10, 1999

To order financial publications

The financial publications will be published in English, Finnish and Swedish. They can be obtained from the following address:

Valmet Corporation, Corporate Head Office,
Panuntie 6, PO Box 27, FIN-00621 Helsinki,
Finland
Tel. +358 9 777 051
Telefax +358 9 7770 5580.

The financial reviews will also be published on Valmet Corporation's Internet pages at
http://www.valmet.com

Helsinki Exchanges	VAL.HSE
New York Stock Exchange	VA.NYSE

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