

How Höganäs is governed

Höganäs has adopted the applicable regulations of the Swedish Corporate Governance Code ('the Code'). Accordingly, the Company's Board of Directors has prepared this Corporate Governance Report. The Report has not been reviewed by the Company's auditors.

Election Committee

A resolution at the Annual General Meeting (AGM) in 2006 stipulated the appointment of an Election Committee, comprising representatives from each of the four largest shareholders in terms of the number of votes and the Chairman of the Board. There are rules on substitution if any member leaves the Election Committee before its work is complete.

The purpose of the Election Committee is to consider and submit proposals for: appointing a Chairman of the Meeting, electing the Chairman of the Board and other Board members, Directors' fees, selection of, and remuneration to, auditors and deputy auditors (where applicable) at the AGM and performing those tasks assigned to the Election Committee pursuant to the Code.

Since October 2006 the Election Committee is comprised of Chairman of the Board Per Molin, Ulf G Lindén (Lindéngruppen), Carl-Olof By (Industrivärden), Ramsay Brufer (Alecta) and Henrik Didner (Didner & Gerge Fonder). The Election Committee will prepare proposals for the AGM 2007 regarding the Chairman of the Meeting, composition of the Board, auditors and Directors' and auditors' fees. Since the AGM 2006, the Election Committee has held four meetings. No remuneration was payable to the Election Committee. To the extent it considers necessary, the Election Committee possesses the right to appoint external consultants within the framework of its assignment at the Company's expense. The Election Committee has not utilised this option.

The Board and its activities

The Board of Directors

Since the AGM 2006, the Board comprises AGM-elected members Per Molin (Chairman), Jenny Lindén Urnes, Bengt Kjell, Magnus Lindstam, Oystein Krogen, Bernt

Magnusson, Hans-Olov Olsson, Agnete Raaschou-Nielsen and Alrik Danielson (Chief Executive Officer). Additionally, the unions have appointed two regular Board members, and two deputies for them. A more detailed presentation of Board members is presented on page 88 of this Annual Report and the Company's website. All AGM elected members are independent of Höganäs and the Company's management team, apart from Alrik Danielson, Per Molin and Bernt Magnusson. Alrik Danielson is Höganäs' Chief Executive Officer (CEO); Per Molin and Bernt Magnusson have been Board members since 1994. Of the independent members, Hans-Olov Olsson and Agnete Raaschou-Nielsen are also independent of the Company's major shareholders.

Board member Magnus Lindstam, former CEO of Lindéngruppen, resigned from the Board in the beginning of 2007.

Directors' fees

Directors' fees totalling SEK 2 050 000 were payable, of which 400 000 to the Chairman of the Board, SEK 200 000 to each of the other AGM-elected Board members that are not employed by the group and SEK 250 000 as remuneration for committee work, of which SEK 50 000 to each of the external Board members on the company's Currency Committee and SEK 50 000 to each of the external Board members on the company's Audit Committee.

How the Board operates

Each year, the Board of Directors prepares written procedural rules regulating Board activities and its internal division of responsibility including its: committees, decision-making processes and agenda as well as the Chairman's tasks. The Board has also issued an instruction for the CEO and one for financial reporting to the Board. Additionally, the Board adopted several Policies for the Group's operations.

The Board of Directors monitors the CEO's activities through ongoing monitoring of operations in the year, being responsible for the organisation, management and guidelines for ensuring that the Company's affairs are expe-

diently designed, and that there are satisfactory internal controls. Additionally, the Board is responsible for developing and monitoring the Company's strategies through plans and objectives, decisions on operational acquisitions and divestments, major investments, appointments and replacements within the Group management. The Board of Directors presents the annual financial statement at the AGM.

Chairman

The Chairman of the Board, Per Molin, organizes and manages Board activities to ensure they are conducted pursuant to the Swedish Companies Act, other laws and ordinances, prevailing regulations for listed companies (including the Code) and the Board's internal control instruments. The Chairman monitors operations in dialogue with the CEO, and is responsible for other Board members receiving the necessary information for performing their tasks. The Chairman is responsible for the Board deepening its knowledge of the Company, that the Board's activities are evaluated and that the Election Committee receives these evaluations.

The Chairman also participates in evaluation and development issues regarding the Group's senior executives. The Chairman represents the Company on ownership issues.

Board members' attendance at Board meetings, 8 meetings total

| <i>Member</i> | <i>Scheduled meeting</i> | <i>Additional meeting</i> |
|-------------------------------|--------------------------|---------------------------|
| Ulf G. Lindén ¹ | 2 | – |
| Hans Mivér ¹ | 2 | – |
| Per Molin | 5 | 3 |
| Jenny Lindén Urnes | 5 | 3 |
| Bengt Kjell ² | 2 | 3 |
| Magnus Lindstam | 3 | 3 |
| Bernt Magnusson | 5 | 3 |
| Hans-Olov Olsson ² | 2 | 3 |
| Oystein Krogen ² | 3 | 3 |
| Agnete Raaschou-Nielsen | 4 | 3 |
| Alrik Danielson | 5 | 3 |

¹Resigned at AGM 2006

²Elected at AGM 2006

Board activities

Pursuant to the current procedural rules, the Board meets on at least four scheduled occasions, at one Board meeting following election each year, and additionally meets when a situation requires it to. In 2006, there were five scheduled Board meetings and three additional meetings. Apart from Board members, the Company's Chief Financial Officer participates in Board meetings, as does the Board secretary, Attorney-at-Law Ragnar Lindqvist. Other corporate executives participate in Board meetings to present information about specific issues, or when otherwise considered appropriate. In the year, Board activities focused on questions relating to strategy, structural issues, capital tied-up the development of metal prices and additional tax claims in Brazil.

Audit Committee

After the AGM 2006, the Board of Directors appointed an internal Audit Committee for the period until the end of the following AGM. The Committee comprises Chairman of the Board Per Molin, Bengt Kjell and Karl Henry Boo. The Chief Financial Officer, Group Accounting Manager and external auditors also participate at meetings when necessary. The purpose of the Committee is to consider issues relating to tendering for auditing and audit fees, monitoring auditors' activities and the Company's internal control systems, monitoring the current risk situation, monitoring external audits and the Company's financial information, as well as other issues the Board appoints the Committee to consider. The Committee's activities are formalized by a dedicated instruction adopted by the Board as part of its procedural rules. In 2006, the Committee met on three occasions when all of its members were present.

The Board of Directors held reviews with, and received reports from, the Company's external auditors, on two occasions in 2006, in contexts including adopting the annual financial statement for 2006. On two occasions, the Board of Directors held reviews with the auditors without the CEO or other members of the corporate management being in attendance.

Remuneration Committee

The Board of Directors has appointed an internal Remuneration Committee for the period until the end of the following AGM, comprising Chairman of the Board Per Molin, Jenny Lindén Urnes and Bengt Kjell. The Committee's task is to consider and prepare remuneration issues relating to the corporate management and will on assignment from the Board present proposals regarding the principles governing remuneration and other employment terms for the corporate management for resolution by the AGM. The Committee's activities are formalised through a dedicated instruction adopted by the Board as part of its procedural rules. In 2006, the Remuneration Committee met on three occasions when all of its members were present.

Currency Committee

The Board of Directors has appointed an internal Currency Committee for the period until the end of the following AGM. Since the AGM 2006, this Committee has consisted of Alrik Danielson, Agnete Raaschou-Nielsen and Bernt Magnusson. The Chief Financial Officer, Finance Manager and one external financial adviser also attend meetings. The Committee considers and resolves on currency hedging issues within the framework of the Company's Finance Policy. In 2006, the Currency Committee held four meetings, which were attended by all its members.

Policies

The Board has adopted, amongst others, the following policies for the Group's operations and its employees:

- *Ethical Policy*

The Group's Ethical Policy has been prepared with the aim of mapping the Group's fundamental standpoint on ethical issues, both within the Group and towards external customers, suppliers and other interest groups, as well as the general public.

- *Finance Policy*

The group's finance function works pursuant to instructions adopted by the Board, which create the framework for managing the group's financial issues, e.g. finance and currency risks.

- *Corporate Communication Policy*

The Group's Corporate Communication Policy is a document that states the Group's guidelines for external corporate communication.

- *Insider Policy*

The Group's Insider Policy formalises the Company's management of insider trading issues, responsibility for them and contains instructions for actions by insiders and other members of the organisation on insider-related issues.

- *Environmental Policy*

The Group's Environmental Policy provides guidelines and states the framework and standards applicable to the Group's environmental activities.

Corporate management

Pursuant to the Swedish Companies Act, and within the framework that the Board has established, the CEO leads operations. In consultation with the Chairman of the Board, the CEO prepares necessary communication and decision-support data for Board meetings, presents the issues and justifies proposed decisions. The CEO leads the group management's activities, taking decisions in consultation with the rest of the management. Apart from Alrik Danielson, this comprises Jari Aaltonen, Anders Andersson, Carl Eklund, Per Engdahl, Ulf Holmqvist, Avinash Gore, Annette Kumlien, Sten-Åke Kvist, Per Lagerlöf, Per Lindvall, Joon Park, Claudinei Reche, Hans Söderhjelm and BP Vaidya; currently a total of 15 people. The corporate management conducts regular operational reviews, led by the CEO. The CEO and members of the Group management team are presented in more detail on page 90.

Remuneration

No formal resolution regarding the principles for remunerating the corporate management and other employment terms was made at the AGM 2006. A proposal regarding these principles will be submitted to the AGM 2007. The current remuneration terms, including outstanding incentive schemes, are stated on page 79.

Auditors

The auditors are presented on page 91. The auditors observe an audit plan, incorporating the views of the Board, and report their observation to the Board partly during their audit process, and finally coincident with adopting the Annual Report. The auditors also participate in the AGM, reviewing and expressing an opinion on audit activities. During the year, the auditors were assigned to consult on Group audit issues and the investigation of tax claims in Brazil. The scope of these assignments is stated in

Note 6 on page 62. The auditors are appointed for the period until the end of the AGM 2007.

The structure of internal controls of financial reporting

The company has not established an internal audit function. The company does not consider that there is any need to create such a function because the company's group accounting function has responsibility for updating and monitoring internal control issues within the group, reporting back to the Audit Committee. The statement regarding internal controls has been prepared pursuant to the Code (items 3.7.2 and 3.7.3) and the Swedish Corporate Governance Board's supplementary instructions from September 2006 (Ref. 1-2006), and is thus confined to how internal controls regarding financial reporting are organised.

The Confederation of Swedish Enterprise's/FAR's (the Institute for the Accounting Profession in Sweden) guidance on Board reports on internal controls regarding financial reporting, identifies COSO particularly as the framework with the broadest proliferation and international acceptance, and which enjoys a unique position in terms of the definition of good internal controls. Accordingly, in December 2005, the Company resolved to introduce the COSO framework for internal controls of financial reporting. A review of the current structure of internal controls of financial reporting follows.

Control environment

Effective Board activities are the foundation for good internal controls. The Company's Board has formulated unequivocal working processes and procedural rules for its activities and the Board's committees. Resolving on the framework for internal controls to be applied within the Group, and to formulate and approve a number of fundamental policies, guidelines and frameworks related to financial reporting is an important part of Board activities. These include a Code of Conduct and Finance Policy.

The Board evaluates the performance and results of operating activities continuously through an expedient reporting package, including operational and profit figures, rolling forecasts, analyzing key indicators and other significant operational and financial information.

Risk assessment

In autumn 2006, the Company conducted a formal risk analysis for evaluating the risk of mis-statement in financial reporting, as previously stated. This process will be annual, which the Board will evaluate and adopt after consideration by the Audit Committee. A number of income statement and balance sheet items, subject to increased risk of material mis-statement, were identified coincident with the risk analysis. In the Company's operations, these risks mainly relate to the valuation of inventories, the valuation of fixed assets, revenue recognition, the valuation of accounts receivable, accrued liabilities and provisions, taxes and financial instruments. The Company has also established a number of risk management processes with a significant influence on the Company's capacity to ensure accurate financial reporting for some time, including:

- Risk assessments for purposes such as identifying events on the market or operations that can influence financial reporting.
- Processes to capture changes in accounting standards and recommendations to ensure that these changes are accurately reflected in the Company's financial reporting.

Control activities

Control structures are designed to manage those risks that the Board considers significant to the internal control of financial reporting. These control structures partly comprise an organisation with clearly defined roles enabling an effective division of responsibility that is suitable from an internal controls perspective, and partly of specific control activities intended to discover, or prevent the risks of, reporting mis-statement in time. Examples of control activities include unequivocal decision-making processes and decision paths for significant decisions (e.g. investments, contracts, divestments, provisions, etc.), profit analysis and other analytical updates, reconciliation, stock-taking and automated controls in IT systems significant to financial reporting.

Information and communication

The Company's control documents for financial reporting mainly comprise its policies, guidelines and manuals, which are kept continuously updated and communicated through relevant channels. A clear policy stating the guidelines for this communication is applied for communicating with external parties. The purpose of this policy is to ensure that all communication liabilities are fulfilled correctly and comprehensively.

Monitoring

As stated above, monitoring that internal controls are fit for purpose and function as intended will be achieved through a combination of self-assessment, independent testing and verification by external parties. The Audit Committee also conducts an annual process to ensure that appropriate measures are taken to rectify shortcomings and recommended measures resulting from the reviews conducted by the consolidated audit function and external auditors. After Audit Committee consideration, the Board receives and evaluates the routines for accounting and financial reporting, as well as monitors and evaluates the work, qualifications and independence of external auditors.

Höganäs' adoption of the Code

With reservations for divergences stated below, the Company has complied with all applicable rules of the Code.

- Until the AGM 2006, the composition of the Election Committee did not correspond completely to the stipulations of the Code (item 2.1.2) because the Chairman of the Board was also Chairman of the Election Committee. The reason for this was that this party represented the largest shareholder in terms of the number of votes, which pursuant to the principles governing the Election Committee at the time, should hold Chairmanship.
- Until the AGM 2006, the Board of Directors had not appointed a dedicated internal audit committee (item 3.8.2) because the Board had previously decided that these issues would be considered by the Board as a whole.
- The Board Of Directors did not present proposals regarding the principles governing remuneration and other employment terms of the corporate management for approval at the AGM 2006, nor did it present any proposal on the Company's website (item 4.2.2). The reason was that the Board considered that it was its task to bear ultimate responsibility for this cost item in the Company's operations.