

Annual Report 2006



Every AC motor des



erves a Vacon drive

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Profitable growth and saving energy

The AC drive represents technology that boosts the performance of an electric motor and saves energy. AC drives enable more cost-effective production, reduce the greenhouse effect, and play a part in meeting emissions targets. Despite this, less than one in ten electric motor in the world is fitted with an AC drive. Financially it would be justified even now to install AC drives in at least one in three electric motors. Our business concept in fact is based on the idea that every electric motor deserves a Vacon AC drive.

For Vacon 2006 was a year of profitable growth. We built up our market position in all major market areas. The investments in Asia's growing market also began to produce results and our company's factory in China turned profitable at the beginning of the year. We succeeded in improving profitability despite the increase in copper and steel prices.

During the year the positive trends in revenues and profitability were reflected in a rise in the value of Vacon's shares. Vacon's market capitalization had risen to EUR 370 million at the end of 2006, when one year earlier it had stood at EUR 266 million. Vacon's earnings per share in 2006 was 1.04 EUR.

Close to the customer throughout the world

Our goal is to grow and become one of the leading AC drive manufacturers in the world. Our strategy activity in 2006 highlighted the ever increasing need to operate globally and to serve customers wherever they operate. During the next few years we will increase the level of

international expansion, aiming at coverage of the markets by region and by segment through our multichannel sales network.

AC drives are used everywhere in industry, in buildings and in municipal engineering. The high price of energy is at present the most important growth factor in the market. Increasing automation also brings AC drive control to an increasing number of electric motors.

During 2006 we strengthened our position especially in the marine industries and building automation, in cooperation with our strong partners. The agreement with Converteam signed in November opens up the market in the rapidly growing oil and gas industries.

Goal of profitable growth

Vacon's goals are profitable growth, improving profitability, and ensuring a good return on investment for the company's owners. We expect growth to take place mainly organically. These are high goals and require development with a long-term perspective, which will bring genuine, lasting value to our owners. Any weakening of the dollar from its present level may have an impact on how well we meet these goals. Based on these assumptions, we believe that revenues will increase during the current year by 15–20 per cent and that profitability will improve from 2006.

I would like to thank our customers for fruitful cooperation and our other partners for their efforts in developing Vacon. Vacon personnel deserve thanks for their work that has made possible the company's success in 2006. I also thank our shareholders for their confidence in us. We at Vacon will continue our efforts to grow and become one of the leading AC drive manufacturers in the world.

The positive trends **in revenues and profitability** were reflected in a rise in the value of Vacon's shares.

Vesa Laihi,
President and CEO
Vacon Group

Global AC drive supplier

Vacon's success is based on customer-orientation and the ambitious drive of its personnel.

Vacon is a global, full-service AC drive supplier that has focused entirely on producing, developing, selling and marketing AC drives.

The company was established in 1993. From the very start, it has been the passion of Vacon personnel to develop and produce AC drives for demanding needs.

Vacon's success is based on customer-orientation and the ambitious drive of its personnel. Vacon's products are easy to adapt for different applications and operating environments. Vacon provides AC drives in the power range 0.25 kW – 5 000 kW. Vacon's products are on sale in more than 100 countries. In addition to direct sales, Vacon also supplies products to distributors, system integrators and brand label customers. Vacon had revenues in 2006 of EUR 186 million.

Vacon's share (VAC1V) is quoted on the Helsinki Exchanges (OMX).

AC drives save energy

An AC drive is a power control unit for regulating the rotation speed of an electric motor to match the needs of the process at any particular time. Electric motors are commonly used in industry, buildings and municipal engineering.

Controlling the motor with an AC drive gives considerable energy savings, since the motors are seldom operated at maximum power. It also reduces the load on the electricity network and the mechanical stress on machinery when starting up the motor.

AC drives also make it possible to connect the motor to automation systems, when the motor speed can be regulated automatically.

AC drives can be used with almost any electric motor. Typical applications are pumps and fans, and these also give the biggest energy savings. Other places where AC drives are used include hoists and cranes, elevators, paper machines, air conditioning equipment, winders, compressors and winches.

There is an enormous global market for AC drives. At present less than 10 per cent of all electric motors are controlled by AC drives.

Mission

Every AC motor deserves a **Vacon drive**.

The principle underlying our business concept is that every electric motor deserves a Vacon AC drive.

Vacon's drives optimize the regulation and control of electric motors. They improve process control and save energy. AC drives make production more cost-effective and reduce the greenhouse effect. That is why every electric motor deserves a Vacon AC drive.

Vision

Vacon is a **global, customer driven and dynamic AC drives supplier** with a passionate attitude towards **product leadership and customer services**.

As the most dedicated AC drives supplier, Vacon is the best choice on the market for its customers all round the world. Vacon's superiority is based on its customer-driven, passionate and ambitious attitude and on outstanding expertise and product leadership. Vacon is an easy, open partner that is able to respond to its customers' needs quickly, reliably and effectively.

Values

Vacon's business culture is based on the values listed below. A statement of values is not enough. They are consistently practised in everyday life with customers, partners, suppliers and personnel.

Customer first

We start from the customer's needs. Our way of working is flexible, and we make sure that the customer is given the best possible service. We treat all our customers and partners, both internal and external, with the same respect.

People in focus

Our way of working is based on honesty and fair play. Respect for the individual, mutual trust and concern are a natural part of social relations.

Entrepreneurship and drive for achievement

Our way of working is based on internal entrepreneurship: we take the initiative, we have the courage, and we take the responsibility. We are committed to reaching the goals. At the same time, we are open to new challenges. Our operations are efficient and we constantly improve them.

Passion for excellence

We are devoted to the quality of our products, services and our way of working. We provide our best possible expertise to the customer. We create innovative solutions. Our products use the most appropriate technology.

Vacon's new **strategic choice** is stronger international expansion in the next few years.

Financial targets

- average annual growth in revenues of 15–20 per cent
- operating profit (EBIT) of more than 14 per cent
- return on equity (ROE) of at least 30 per cent
- to pay a dividend of about 50 per cent of the profit for the period

Vacon aims to grow and become one of the leading AC drive manufacturers in the world. The cornerstones of Vacon's business strategy are profitable growth and focusing one hundred per cent on AC drives. All other strategic choices support these goals.

Profitable growth

Vacon's revenues grew by 24.3 per cent in 2006, and the company will continue to aim at a growth rate of 15–20 per cent, but without putting profitability at risk. The goal is for business to grow as our customers grow. Business development is part of growth.

Focusing on AC drives

Vacon focuses one hundred per cent on AC drives. Focusing on AC drives enables Vacon to stay at the forefront in technology and maintain outstanding expertise. The company aims to be one of the leading AC drive suppliers in the world. At present the company holds 3.5 per cent of the global market, making it the largest of the companies that focus entirely on AC drives.

Product leadership

Vacon has achieved product leadership as a manufacturer of application-based AC drives. For Vacon product leadership means a broad product selection, outstanding AC drive expertise, customer relations management, the latest technology and mass customization.

Focusing and profitable growth

Multichannel sales

As well as having its own sales and customer service organization, Vacon expands its sales resources through a global sales and partner network. Vacon manufactures AC drives under its own name and also for distributors, system integrators and brand label customers. Vacon aims to cover the market by region and segment with its multichannel sales network.

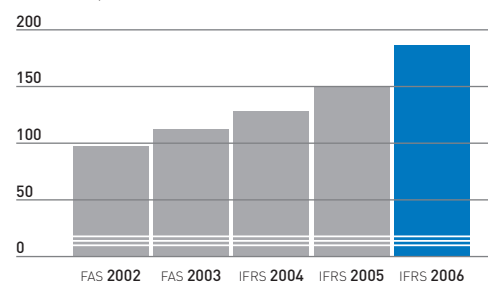
Efficiency, flexibility and independence

Vacon aims in all its activities at flexibility and efficiency. Its cost-effective production and logistics models and multichannel sales enable the company to provide a diverse, broad product offering and achieve a light and nimble way of operating. As an independent AC drive supplier Vacon supports open automation and international standards. Independence gives Vacon a clear competitive edge, since the company's products do not compete with those of its customers.

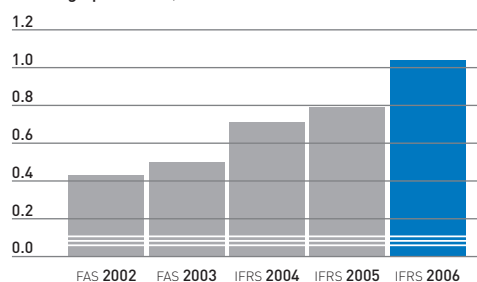
Close to the customer all round the world

Vacon is bringing its services and products ever closer to the customer. Vacon's new strategic choice is stronger international expansion in the next few years. Vacon wishes to serve customers where they operate. At present Vacon is present through its partners in more than 100 countries. Vacon currently has production in Finland and China. The company is systematically examining other options.

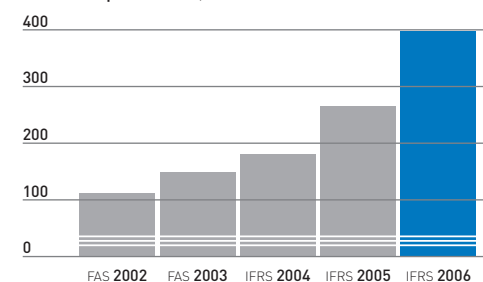
Revenues, MEUR



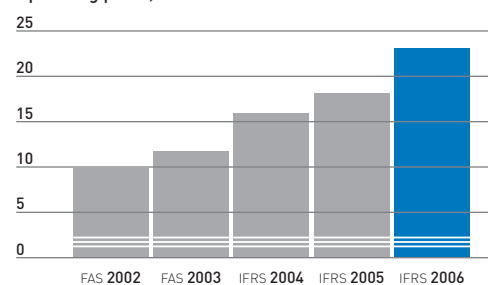
Earnings per share, EUR



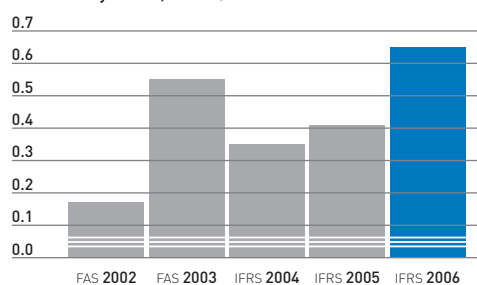
Market capitalization, MEUR



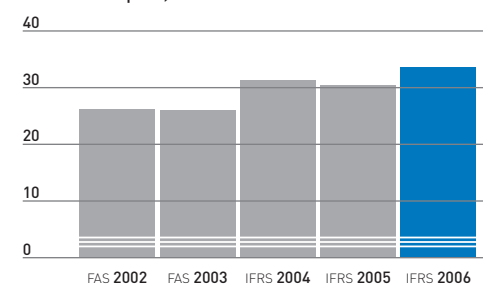
Operating profit, MEUR



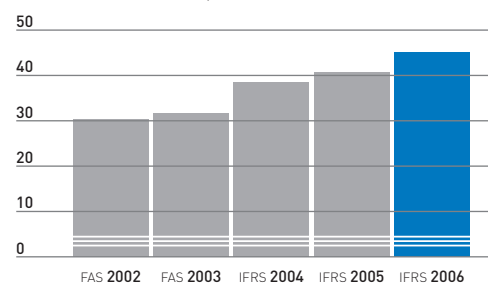
Dividend by share, EUR *)



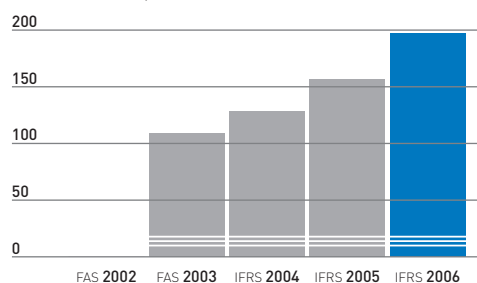
Return on equity, %



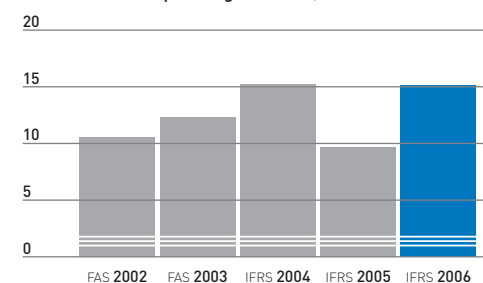
Return on investments, %



Orders received, MEUR**)



Cash flow from operating activities, MEUR



*) The 2006 dividend is the Board of Director's proposal to the Annual General Meeting.

**) The year 2002 figure is not available.

Highlights of the year



Converteam and Vacon sign global agreement

International system supplier Converteam and Vacon signed a global cooperation agreement in November 2006. Converteam is a major player in the marine and offshore, oil, gas and process industries and the renewable energy sector. The agreement is important for Vacon since it opens up the market for example in the rapidly growing oil and gas industries.

Representative office in Bangkok, sales companies in India and Australia

Vacon opened a representative office in Bangkok, Thailand in October and sales companies in India and Australia started operations in November. These investments are expected to improve customer service and boost Vacon's sales in Asia already in 2007. After these additions Vacon's own sales network comprises 14 sales companies and two representative offices.

Factory extensions commissioned in China and Finland

In January Vacon opened its Chinese factory in new premises with more than 5000 m² of floor space in Suzhou. The expansion of production capacity meets the growth in demand mainly in the Asia and Pacific region.

The extension to the Finnish factory in Vaasa was commissioned in June. It has a total floor area of about 7100 m².

Product range expanded, new features

Vacon expanded its product selection in the high power sector from 3 MW up to 5 MW. During the year the company launched the new Vacon NXL AC drive. The drives are some of the smallest on the market.



Frost & Sullivan award for Vacon's customer-driven approach

Frost & Sullivan, one of the world's most highly regarded growth consulting companies, named Vacon as recipient of its 2006 Global Excellence Award in Customer Value Leadership. The award is given each year to a company that has demonstrated its ability to expand its customer base, while maintaining its existing installed base, with more innovative value creation and enhancement strategies than competing vendors.

Scandinavian Electric Systems orders Vacon AC drives for 16 ships

In April Vacon signed several contracts to supply AC drives with its Norwegian partner Scandinavian Electric Systems AS. Vacon's liquid-cooled AC drives are an ideal solution for marine industry applications with their demanding conditions caused by salt water, humidity, dust and heat.

Trend Control Systems has sold more than 10 000 Vacon AC drives in Great Britain

European leader, British company Trend Control Systems, which supplies building automation systems to the global market, has supplied more than 10 000 Vacon NX AC drives to its customers. The Vacon NX series is rapidly becoming the most popular AC drive option in the building automation sector in Great Britain.

Vacon supports Finnish Alpine Ski Team

Vacon and Finnish men's, women's and junior alpine ski teams have signed a cooperation agreement for the season 2006–2007. Vacon will be the official sponsor of the Finnish Alpine Ski Team and the official main sponsor of the Finnish Junior Alpine Ski Team and young ladies' (Tehotytöt) team.

AC drive technology is playing an increasing role in **energy saving** and controlling **climate change**.

The AC drive market experienced a second successive year of rapid growth. Demand was boosted by developments in energy prices, which make purchasing an AC drive an attractive investment.

The pay-back period for an AC drive is on average less than two years, which makes it easy for industry to justify this expenditure. Increasing automation also brings more and more electric motors under AC drive control.

Investments by industry and the construction boom in Asia and the developing countries also contributed to positive growth. The market in Russia grew even faster than in China. High energy prices encourage Russia to make investments locally and safeguard its own energy supply.

Vacon is growing faster than the market

The global AC drive market is estimated at 6,3 billion US dollar (source: The Worldwide Market for AC & DC Motor Drives – 2006 Edition, IMS 2006). Vacon has a 3.5% share of the global AC drive market, which places it among the ten largest manufacturers. Vacon grew faster than the market and strengthened its position in all major market areas.

The AC drive market is highly fragmented. Vacon's main competitors are global conglomerates for which AC drives are just one product among many. Vacon is the largest company that focuses entirely on AC drives. There are numerous other small AC drive manufacturers on the market.

Demand continues to grow

The challenge facing the sector is to find cheaper manufacturing methods. Raw material costs have risen somewhat, especially for steel and copper. Product prices, however, remain unchanged. Vacon maintained its cost-efficiency by developing its own operations.

Positive prospects for the current year as well

The prospects for the current year in the sector are positive. In the long-term, energy prices are not expected to come down, which is forcing customers to consider ways to raise efficiency in energy usage. AC drive technology will play an increasing role in energy saving and controlling climate change. The sector is hoping for stricter regulations on monitoring energy consumption in industrial production, which would have a positive impact on demand for AC drives.

Vacon is expected to continue to grow strongly. During the current year Vacon will put much effort into building a global network and finding new, expert partners. In its customer acquisition Vacon will concentrate on large and medium size customers. Smaller customers are looked after more effectively and with greater expertise through the partner network.

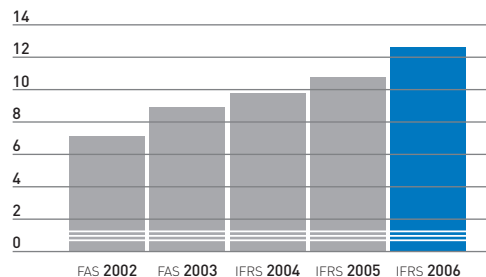
Vacon will also launch new, more competitive products in the near future that are expected to establish themselves quickly in the market.



AC drives save energy, for example by optimizing the functioning of air conditioning equipment.

Customer-driven product development

Research and development costs, MEUR



Personnel by function



The starting point for Vacon's R&D is product leadership. Vacon aims to be the most reliable and versatile AC drive manufacturer in the world.

Unlike many of its competitors Vacon concentrates entirely on AC drives, which also clarifies the focus for R&D. This can concentrate on making AC drives more application-driven, user friendly and cost-effective.

The past year was spent in Vacon's product development in putting the final touches to the successful Vacon NX product generation and expanding the product offering, for example in high power AC drives. Vacon launched powerful AC drives for the 5 MW power range. It also carried out more mass-customization of AC drives for individual customers. The range of Vacon's product offering is now broader than it has ever been.

Development work on new product generation has begun

During the year full-scale development started of the next generation product platform as well as development work on new products. The goal is to renew the product series over the next few years. The first new generation AC drives were delivered to customers during 2006.

Vacon's investments in R&D are among the highest in the sector. About one in seven Vacon employee works in research or product de-

velopment. Product leadership in the sector requires significant investments in R&D, since the best AC drives in the world are created only as the result of long-term systematic product development, of close, effective cooperation with customers, and innovation.

Product development has so far been concentrated in Finland, which will continue to be Vacon's most important product development country. Accord-

ing to Vacon's chosen strategy, product development must be carried out close to the customer, in order to serve each market area as quickly as possible with maximum customer input. In line with this policy, the decision was taken at the end of the year to establish a product development unit in conjunction with Vacon's factory in China.

Next year's focus in product development will be designing the next generation product platform and products. It is planned to phase the launching of the new products.

Concentrating on AC drives also focuses product development.

A PASSION FOR AC DRIVES

IT engineer Marko Koskela heads up a ten-person team that works at Vacon's R&D unit in Vaasa. Marko, who joined the company as an electronics designer in 2000, has moved upwards in his career at Vacon. For the past three years he has worked as project manager.

Developing products is long-term work. It all starts from customer requirements, and it is the task of the product development team to work out a practical solution to these requirements. After this a product concept is formed and then prototypes are built. Once the structure has been verified as practical and of high quality, the product moves into the piloting phase, to obtain broader field experience. After piloting the product is launched on the market.

"The best aspect of my work is being able to follow the progress of a project and see a new product being born. Shared successes give motivation for carrying on," explains Marko.

Vacon invests heavily in research and development. The company has a high regard for skilled employees and puts its confidence in them.

"Vacon is an expanding, international company that is able to offer challenging duties. I appreciate the independence I have in my work and the encouragement we receive to educate and develop ourselves."

Marko Koskela also has a good word to say for the Vacon team spirit.

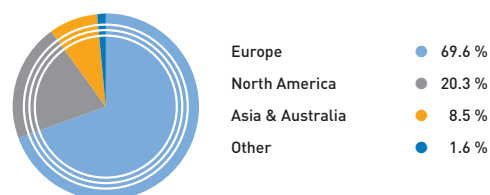
"When I joined the company, there were about 200 of us. Vacon now employs over 650 people, but we still have the same Vacon team spirit," he says, praising his agreeable workmates.



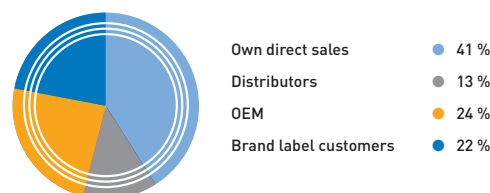
Vacon's investments in R&D are among the highest in the sector. Some 13 per cent of Vacon's personnel work in R&D.

Vacon looks to the developing markets

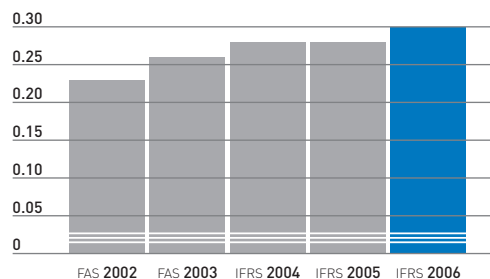
Revenues by market area 2006



Revenues by distribution channel 2006



Sales/personnel average, MEUR



Heikki Hiltunen is the Group's executive vice president with responsibility for sales, marketing, product marketing and customer service. He says that Vacon is known for its expertise, service and good price to quality ratio.

How does the AC drive market look at the moment?

AC drives are used everywhere in industry, buildings and municipal engineering. The market is active and prospects are good; automation is increasing and the use of AC drives is spreading. At the moment demand is strong in all industrial sectors.

What are Vacon's strengths?

Customers are looking for products that are easier to use. They also require products that can be adapted for different applications. We stand out as a customer-driven supplier that makes reliable products with a good price to quality ratio. At the same time we have succeeded in building up our services and paying closer attention to customer needs.

How has Vacon developed its product selection?

Our business as a product company is based on a broad product range. We invest some eight per cent of our revenues in product development and are currently launching the first of our next generation products on the market. Vacon has previously been a manufacturer of small and medium-size AC drives, but during the past few years Vacon has expanded its product family to cover the power range 0.25 kW–5000 kW. High energy prices have increased demand for high power drives.

Vacon has made a stronger presence in the international market one of its strategic focuses. What does this mean?

We want to be involved in the markets in which our existing and potential customers are building their own businesses. Being present also means that Vacon has motivated, skilled personnel and knowhow close to the customer.

Reliable products
with a good price
to quality ratio and
the “Driven by
drives” attitude.

Where is the focal point for Vacon's international expansion?

The Asian market is the fastest growing but it is also challenging. We have our factory in China, and last year we also established sales companies in India and Australia and representative offices in Thailand and Brazil. India and Russia are equally large and important markets for Vacon. Other developing markets such as South America also interest us.

What is the importance of Russia for Vacon?

We have been in Russia since 2001. The Russian market is growing strongly at an annual rate of about 25 per cent. We are working to raise our market share there in the next few years from its current level of five per cent to ten per cent. Vacon has a good reputation in Russia in water treatment, the paper industry and energy solutions, but compared to the major conglomerates Vacon is still in the position of a challenger in Russia.

What does the multichannel sales strategy mean?

One of the pillars of Vacon's strategy is multichannel sales. This means that as well as selling direct to the end customer, the company also sells drives to equipment manufacturers (OEM), distributors

and system integrators. As an independent supplier Vacon can also manufacture AC drives for brand label customers with their own brand label. Our multichannel sales help us to serve customers better and make us an easy to approach, customer-driven supplier. The comments we have received commend our expertise and good price to quality ratio.

How important are sales of services to Vacon?

Vacon is a product company, but there is also demand for sales of spare parts, replacement equipment, maintenance, energy saving and training services.

What progress has been made with the customer relationship management and development process (CRM)?

Initial experience indicates that it will make it easier to develop customer relationships and service. It is planned to integrate all the companies in the same CRM system during 2007.

What goals have been set for sales in 2007?

We are looking for growth in all market areas from existing and new customers and through new customer accounts. We aim to concentrate on larger customer accounts. We are also looking into ways to improve the effectiveness of marketing and the professional skills of sales personnel.

STRONG OPENING TO OIL AND GAS INDUSTRIES

In November Vacon signed a contract with multinational system supplier Converteam. Converteam supplies systems and tailored solutions for the conversion of electrical energy to the global market. Under the agreement Vacon will supply Converteam with low-voltage, air-cooled AC drives worldwide. Converteam strengthens Vacon's market channels, for example opening up the rapidly growing oil and gas industries.

Converteam Group is the world's leading engineering company that focuses on the conversion of electrical energy. More than 100 years old, the company is the globally recognized technology leader in the power conversion sector. Its core business areas are the marine and offshore industries, the oil, gas and process industries and renewable energy sources. In addition the company serves several specialized sectors. The company has 3,500 employees.





In ports and harbours AC drives enable highly efficient stevedoring operations in equipment such as various lifting and loading machines.

Moving production closer to the customer

Jari Koskinen, vice president responsible for production and logistics, was contacted in China, where he heads up Vacon's global production processes and Vacon's operations in China.

What are the principles on which Vacon bases its decisions relating to production and logistics?

Vacon's production and logistics model is based on networking and mass-customization. The factors guiding production and logistics decisions are quality, speed, flexibility, and cost-effectiveness in all operations.

What developments took place in Vacon's production processes during 2006?

We tested out the Minifactory concept, which is based on fast customer service. A logistics centre is located close to the customer and equipped with typical factory knowhow and capabilities. The cost-effective Minifactory concept enables a high level of customer service locally and at the same time provides fast delivery times.

How has the commissioning of the factory in China gone?

Running in a new factory is always a challenge. We have put much effort into recruiting personnel and building teams, and the work has been very successful. In terms of delivery reliability and quality Vacon's factory in China matches the best in the world and the team in China has met its targets in terms of these indicators.

How important is production in China for Vacon?

In 2006 we carried out factory extensions in Finland and China. Vacon's Chinese company will be given greater global responsibilities and as a result the standing of Vacon's factory in China will rise.

And what is the role of the Finnish factory?

The Finnish factory will in future concentrate on activities that demand high levels of AC drive knowhow and experience.

Manufacturing high power drives requires indepth AC drive knowhow in testing and assembly. The higher the power range, the more complex and demanding the drive.

In Finland we will focus more on Global Sourcing functions, which will also help us bring materials to the Finnish factory from outside Europe. The objective of the Global Sourcing function is to keep the costs of the Finnish factory competitive in future as well.

Will we continue to increase production outside Finland?

Vacon's business is growing extremely rapidly. It is natural to have production in several locations close to customer needs. We are looking into the possibility of starting production in Europe, Asia and elsewhere.

What happened on the logistics front during the year?

We piloted and introduced solutions based on the Demand Flow Technology (DFT) model. Our materials solution is based on pull control, the Just In Time (JIT) model. In this model, information flows upstream and materials and assemblies downstream during the production process. The pull control method releases capital tied up in stocks and ensures that the right amount of materials is in the right place at the right time.

What plans are there to further enhance production and logistics?

We will continue to develop the Minifactory concept and material control in our production. As Vacon expands internationally, the Global Sourcing functions will also take on greater importance.

Networking and mass-customization

Corporates **responsibility** drives all activities

Close attention is paid to environmental, occupational health and safety issues.

Responsible business operations consist of three interrelated areas: financial, social and environmental responsibility. A company that operates responsibly creates well-being for its customers, personnel, owners and other stakeholders.

Our activities are based on the company's mission, vision, strategy and values, as well as on the changing needs of our stakeholder groups and society.

Respecting people and the environment

The products manufactured by Vacon, AC drives, save energy. Saving energy helps the life of the present and future generations. We participate in preventing climatic change and rising energy consumption by developing more efficient and environmentally friendly AC drives. We use natural resources responsibly in manufacturing the drives.

We encourage the participation of employees and stakeholders in the continuous improvement of Vacon's responsible activities. We actively participate in the dialogue about saving energy.

Responsible business is part of our everyday work. We comply with laws and regulations in all our operations, we act ethically and honestly, we take responsibility for the environment and respect human rights principles with our business partners everywhere we operate.

THIS IS WHAT WE BELIEVE, THIS IS HOW WE WORK

Only a satisfied customer is a profitable customer

Customer needs are always our starting point when we develop, manufacture and deliver AC drives and related services all over the world.

People are our most valuable asset

We cherish high quality in environmental, occupational health and safety issues. In this way we create a healthy, safe and pleasant work-

ing environment where we feel good, are motivated in our work, and are able to serve our customers in the best possible way.

High quality provides our competitive edge

We deliver faultless product on time. Our goal is to provide the fastest and most flexible service in the market. We make sure that our products and services always meet customer requirements and expectations better than those of our competitors.

We also require high quality from our subcontractors

High quality is guaranteed by close, long-term cooperation with carefully chosen subcontractors. We require high quality and the same uncompromising attitude to the environment and occupational health and safety from our partners as we have.

We take care of the environment

We are committed to looking after our environment and to taking our environmental, occupational health and safety issues into consideration in all our operations. We produce energy-saving products that improve process performance and reduce environmental load.

All Vacon employees are committed to our common goals

We all at Vacon are committed to our common goals. Vacon's management makes decisions so that our business activities, operational processes and resources develop in accordance with predefined goals and objectives. Each Vacon's employee is familiar with the company's operational policy, participates in the continuous improvement of this, and is responsible for meeting agreed goals in their own area of work. In all our operations worldwide, we comply with legislation, regulations and accepted standards.



AC drives play a key role on ships. They are used to regulate the operations of winches, propellers and air conditioning equipment.

Values are reflected in practical work



Vacon is a motivating place to work where people can **develop and grow.**

Vacon's strength lies in its expert, enthusiastic personnel that are firmly committed to the company's goals.

Vacon's human resource strategy is updated in connection with the business strategy and is based on four priorities: being a leader, performance management, internal communications and total wellbeing. Areas of focus and operational plans are defined each year for each of these priorities.

In 2006 the focus in being a leader was on revising the values and incorporating them in practical work. For performance management the focus was on improving the development discussions and the internal training system. The main task in internal communications was renewing the intranet. The theme for total wellbeing during the past year was social wellbeing. This was expressed in various events aimed at bringing people together, including a day at an amusement park for employees and their families.

Common values create common rules

The values reveal how the company acts towards its customers, personnel and other stakeholders. During the past year Vacon spent much time in fine-tuning its values. The seven old values were compressed into four. Vacon's revised values are: customer first, people in focus, entrepreneurship and drive for achievement, and passion for excellence.

Personnel representatives were involved from the start in revising the values. The Board of Directors approved the new values in the spring, after which a campaign was started throughout the organization to help the values take root. Each team considered how the values show in their work. The values will also be used in future as a management and development tool.



Vacon is a motivating, reliable employer

Vacon's success is based on skilled, enthusiastic personnel. And the company also gives rewards for good performances, expertise, personal development and commitment to goals. The incentive scheme covers all personnel. In addition a quick bonus scheme has been created for supervisory staff to reward deserving subordinates throughout the year. Vacon also supports the free time activities of its personnel and for example provides low-cost holiday apartments for its employees.

Vacon's annual personnel survey measures satisfaction in the work place. According to the survey employees think that the working environment is good and that Vacon is a reliable employer. Employees also appreciate the way the company clearly communicates its goals and the opportunity for independent decision making.

Vacon has taken on many new employees during the past two years. Recruitment continues to grow rapidly in Finland and abroad.

International expansion also affects Vacon's human resources management. A knowledge of local legislation and culture is becoming increasingly important if Vacon's values and knowhow are to remain unchanged from one continent to another. The number of overseas placements has also increased with international expansion.

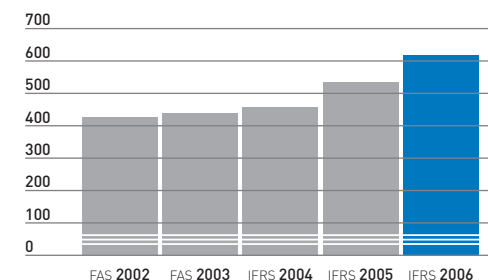
Work of instilling values continues

The focuses decided on for human resources management next year in the area of being a leader are strengthening Vacon's organizational culture and continuing to instill the values. The main goal for performance management is on increasing AC drive knowhow. In internal communications the focus is on developing supervisor communications and in total wellbeing the theme for the year is emotional wellbeing. Based on these areas of focus, each unit will draw up its own operational plans for meeting targets.

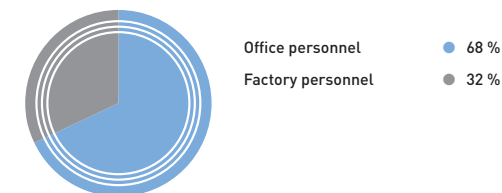
Personal in figures 2006

Number of employed on average	618
Average age	35.3 years
Average length of service	4.1 years
Percentage of women of personnel	27.2 %
Percentage of men of personnel	72.8 %

Personnel in average



Personnel



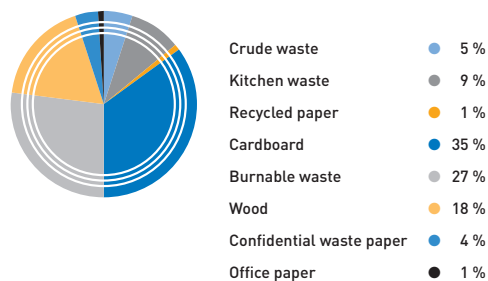
An AC drive is an environmentally friendly product

Key production environmental indicators 2006

Indicator	Amount	Unit
Energy consumption	9700	MWh
Water consumption	8600	m ³
Recycling of electronic waste*	13000	kg
Other recycled waste*	200000	kg

* Figures only for Finland

Other recycled waste



Vacon contributes to preventing climatic change and rising energy consumption by developing better and more environmentally friendly AC drives. An electric motor controlled by an AC drive saves energy since it operates optimally in all circumstances. In many applications even a small decrease in motor speed gives major savings.

An AC drive can be used with almost any electric motor. The biggest energy savings are made in various fan and pump applications, ie wherever liquid or air is moved from one place to another. AC drives take on increasing importance in saving energy as the standard of living rises and as climatic change progresses. Air conditioning and irrigation systems for example are expected to become more common in developing countries.

Expensive energy drive users to energy efficiency

Energy sufficiency and the resulting environmental load are one of the key problems of our time. More than half of the world's electricity is still generated with fossil fuels. The efficiency of power plants generating electricity is poor, however, and about half of the energy consumed is unused. Using an AC drive can raise the efficiency of coal- or oil-fired combustion. AC drives can then give a double benefit. First they raise the efficiency of coal- or oil-fired combustion in a power plant and after that they help to make optimal use of electricity in industry. The potential savings are considerable when it is borne in mind that half of the world's electricity is used by industry and that about 60 per cent of the electricity used by industry is consumed by electric motors.

The higher the price of energy rises, the greater the significance of even small savings. Saving energy is also of importance because it puts off the need for new investments and gives time for technology to develop. In many cases an AC drive gives further savings, since it enables a system to function more efficiently.

We take on responsibility for our environment

As well as making a product that is in itself environmentally friendly, Vacon also carries out its own environmental responsibilities. Vacon has a certified environmental management system that meets the requirements of the ISO 14001 standard. The company is committed to identifying and complying with environmental legislation and regulations and to continuously developing its operations.

The objective of Vacon's environmental activities is to improve the ecofriendliness of its operations and products throughout their lifecycle. Vacon aims to choose raw materials, working methods and processes that cause the minimum harm to the environment. Each year the company carries out an environmental assessment and identifies environmental impacts, and these form the basis for drawing up an action plan to minimize damage.

Production does not burden the environment

AC drive production does not place a special burden on the environment. During the past year the key environmental issues related to reducing impurities released in the air. These impurities are created mainly in the lacquering area in production, and greater efforts were made to isolate them. A ventilation system was also built in the testing area to remove flue gases.

Another issue was minimizing the environmental impact of electro-magnetic fields in the testing systems. Attention was also paid to sorting waste and to energy consumption. Through the ongoing planning and improving of waste processing Vacon has succeeded in significantly increasing the level of reuse and recycling.

During the past year no accidents were reported and no cases of exceeding permit limits in any phase of production.

Vacon requires its sub-contractors, suppliers and partners to have responsible operations and comply with environmental regulations. How they comply with these regulations is also monitored regularly in connection with supplier assessments. Vacon also trains its own personnel to recognize the impact of their work on the environment.



Increasing use is being made of AC drives to make irrigation systems more efficient.

Vacon Plc is a Finnish limited liability company which, in its decision-making and administration, complies with the Finnish Companies Act, other regulations concerning public companies and the Articles of Association of Vacon Plc.

In addition, Vacon Plc complies with the Guidelines for Insiders that came into force on 1 July 2005, approved by the Helsinki Exchanges, the Central Chamber of Commerce of Finland and the Confederation of Finnish Industry and Employers, and the Corporate Governance Recommendation for Listed Companies that came into force on 1 July 2004. The Articles of Association of Vacon Plc can be seen on the company's website at www.vacon.com >Investors under Corporate Governance.

General Meeting of Shareholders

The highest authority in Vacon Plc is exercised by the Company's shareholders at General Meetings, which are convened by the company's Board of Directors. The Annual General Meeting is held annually on a date determined by the Board of Directors but no later than the end of June. Extraordinary General Meetings are convened when necessary.

The main matters under the authority of General Meetings are:

- approving the financial statements
- distribution of profits
- discharging from liability the members of the Board of Directors and the President
- deciding on the number of Board members and auditors and their remuneration, and selecting them
- making any changes in the Company's Articles of Association
- increasing and decreasing the share capital

Advance information for shareholders

Notice of a General Meeting of Shareholders, stating the matters to be considered at the meeting, is either sent to shareholders by registered mail or is announced in at least one nationwide newspaper determined by the Board of Directors. The invitation and the proposals made by the Board of Directors to the General Meeting are also published in a stock exchange release and on the Company's Internet website.

The names of persons nominated for the Board of Directors are published in the invitation to the General Meeting or, if the invitation has already been published, in some other way before the General Meeting, provided they have given their written consent to be nominated and are supported by shareholders holding at least 10% of the votes carried by all the shares of the company. The proposal prepared by the Board of Directors concerning the company's auditor is published in a similar way before the meeting.

Attendance

Those wishing to attend the General Meeting must inform the Company by the deadline stated in the notice of meeting. Shareholders may attend the meeting themselves or through an authorised representative. Each shareholder or representative may also have one assistant at the meeting. Minutes are taken at the General Meeting and are made available to shareholders for inspection two weeks after the meeting. The decisions taken by the General Meeting are also published in a stock exchange release immediately after the meeting.

Attendance at General Meetings of Board members and President

It is the Company's aim that all Board members attend the Annual General Meeting. Persons nominated for the first time as Board Members shall attend the General Meeting that elects the Board members, unless they have very pressing grounds for being absent.

Decision-making

Vacon Plc has one class of shares and each share is entitled to one vote. When votes are taken at a General Meeting, proposals supported by more than half of the votes cast are the decisions of the General Meeting or, in the case of a tie, the chairman has the casting vote. Exceptions to this are certain matters mentioned in the Finnish Companies Act, such as an amendment to the Articles of Association or a decision on a rights offering, for which any decision requires a larger majority specified in the Act in relation to the number of shares and the votes to which they give entitlement.

According to the Articles of Association of Vacon Plc, a shareholder whose holding of all Company shares or of the voting rights con-

ferred by the shares – either individually or jointly with other shareholders as defined hereinafter – reaches or exceeds 33 1/3 per cent or 50 per cent (shareholder subject to redemption obligation), is obliged on demand by other shareholders (shareholders with rights of redemption) to redeem the shares of such shareholders and securities entitling them to shares as defined in the Finnish Companies Act in the manner prescribed in the relevant Article.

The Company is not aware of any shareholder agreements concerning the use of voting rights in the Company, or of any agreements limiting the surrender of Company shares.

Risk management

Vacon Group's risk management is part of the management process for the Company's business operations. Risk management aims to ensure that the risks relating to business operations have been thoroughly surveyed and are effectively controlled. The goal is to minimize any damage arising from the risks and to identify the risks in managing the business. Risk management activities aim to ensure profitable growth for the Company.

More details about risk management are given in the Financial Statements section.

Insider dealing

Vacon Plc observes the guidelines for insiders for listed companies approved by the Helsinki Exchanges. In addition, the Company has approved its own insider guidelines for the Group, which in some parts set stricter requirements for handling insider information than those of the Helsinki Exchanges. The Company keeps its register of insiders in the SIRE system maintained by the Finnish Central Securities Depository Ltd.

The Company's public permanent insiders, based on their position as stated in the Securities Market Act, comprise the Board of Directors, the President and CEO, and the auditor. In addition to these, under a decision of the Company's Board of Directors, other public permanent insiders are the Management Team, the secretary to the Board of Directors, as well as the spouse of the above or their registered partner, minors and other family members who have lived in the same household for at least one year.

Vacon's own company insiders include personnel in the treasury and communications departments and the secretaries to senior management. The Company also maintains insider registers for individual projects. Vacon's silent period lasts three weeks. The Company does not comment on market prospects and does not meet financial market or media representatives for three weeks before the publication of interim reports or the annual financial statements.

The silent period also applies to Vacon's permanent insiders, who may not trade in the Company's securities for 21 days before publication of the results for a reporting period. Vacon Plc also does not purchase its own shares during this period.

Shares, share capital, major shareholders, and flagging notifications during the past 12 months

Basic information about the Company's shares, share capital and major shareholders are given in the section Shares and Shareholders in the financial pages of this annual report.

The company has issued the following statutory notices of changes during the past 12 months:

- 8 June 2006: Threadneedle Asset Management Holdings Limited announced that the share capital and voting rights in Vacon Plc held by the company had risen above 5 %.
- 26 June 2006: Fidelity International Limited announced that the share capital and voting rights in Vacon Plc held by the company and its direct and indirect subsidiaries had risen above 5 %.

Audit

The auditors elected by the Annual General Meeting are the authorized public accountants KPMG Oy Ab and the principal auditor appointed by them is Pekka Pajamo, APA. In addition to the duties in accordance with current regulations, he also reports on his observations during auditing to Group management.

The scope and contents of the audit are defined so that they take into account the fact that the company does not have its own internal audit organization.

Vacon Plc paid the auditors fees of EUR 123,000 for the 2006 audit. In addition, the authorized public accountants were paid fees of EUR 19,000 for services not related to audit.



Board of Directors: Composition and term of office

According to the Articles of Association, Vacon's Board of Directors has at least three and at most seven members chosen by the General Meeting of Shareholders. The members of Vacon's Board are chosen by the Annual General Meeting of Shareholders for a term of one year at a time. The Articles of Association do not stipulate an upper age limit for Board members nor do they limit the number of terms of office. The Board elects from among its members a chairman and deputy chairman for one term of office.

The Annual General Meeting held on 6 April 2006 decided that the Board of Directors should have six members. Pekka Ahlqvist, Jari Eklund, Kalle Heikkinen, Mauri Holma, Jan Inborr and Veijo Karppinen were re-elected as Board members. Jan Inborr was re-elected Chairman and Veijo Karppinen was re-elected Vice Chairman of the Board of Directors at the organization meeting of the Board of Directors.

Duties of the Board of Directors

The tasks and duties of the Board of Directors are defined in the Finnish Companies Act, the Company's Articles of Association and in the Board of Directors' rules of procedure. The Vacon Plc Board of Directors has approved written rules of procedure for the duties of the Board, matters to be considered, and meeting and decision-making procedures. The Board revises its rules of procedure each year so that they conform to good principles of corporate governance at all times. The Company's President participates in the meetings of the Board of Directors and prepares and presents to the Board matters to be considered at the meetings.

According to the rules of procedure, Vacon's Board:

- confirms the Company's long-term goals and strategy
- approves the Group's operations plan, budget and financial plan, and monitors how these are implemented
- decides on individual major and strategically important investments and approves the investment programmes of Group companies
- monitors the Group's financial performance and how its goals are being met
- appoints the President, Executive Vice President and members of the Management Team, and decides on the composition of the boards of directors of Group companies
- decides on the principles for bonus and incentive schemes
- considers and approves interim reports, consolidated financial statements and the annual report

Evaluation of independence

Vacon's Board of Directors has evaluated the independence of Board members in relation to the company in accordance with recommendation 18 of the Corporate Governance Recommendation. The majority of Board members – Pekka Ahlqvist, Jari Eklund, Kalle Heikkinen,

Mauri Holma and Jan Inborr – are independent of the Company. Veijo Karppinen was CEO of Vacon Plc until July 2002 and so is not wholly independent of the Company. Pekka Ahlqvist, Jari Eklund, Kalle Heikinen, Mauri Holma and Veijo Karppinen are independent of major shareholders. Jan Inborr is not independent of major shareholders since he is CEO of Ahlström Capital Ltd.

Decision-making

The Board of Directors shall always act in the interest of the Company and in such a way that its operations are not liable to result in an unjustified advantage for any shareholder or other party at the expense of the Company or another shareholder. A Board member is disqualified from being present when the Board considers matters involving the Board member and the Company. The chairman of the Board of Directors is responsible for convening the Board meetings and for meeting procedures. When votes are taken, the majority opinion is the Board's decision and, in the case of a tie, the chairman has the casting vote. In an election, a tie is decided by drawing lots.

Meeting practice and self-assessment

The Board of Directors meets about 10 times a year. The Board of Directors has not allocated special areas of focus for its members to monitor business operations. Matters are presented at meetings by the President of Vacon Plc or, at his request, by another member of the Management Team. According to the Board of Directors' rules of procedure, the President ensures that the Board obtains sufficient information to assess the operations and financial situation of the Group. The President also supervises the implementation of Board decisions and reports to the Board on any deficiencies or problems in implementation. The secretary to the Board of Directors is Stefan Wikman, attorney from Attorneys Ltd. The Board of Directors regularly assesses its operations and working procedures by carrying out a self-assessment once a year.

The Board has had 10 full meetings during 2006. The average attendance percentage, a figure that illustrates the participation of Board members in the work of the Board, was about 97 per cent in 2006.

Board of Directors' fees and other benefits

The Annual General Meeting decides each year on the fees and principles for reimbursing expenses to the members of the Board of Directors. Fees to the Board members are paid in cash.

The 2006 Annual General Meeting decided that the fees paid to the Board members were as follows:

- monthly fee for the Chairman EUR 2,000
- monthly fee for each Board member EUR 1,000
- bonuses depending on the company's result, 1,450 EUR/month for Board members and 2,900 EUR/month for Chairman.

In addition, Board members are entitled to per diem allowances and travel expenses in accordance with the general travel rules of Vacon Plc.

Committees

Vacon Plc's Board of Directors has set up a combined Remuneration and Nomination committee, made up of three members of the Board. The committee is subordinate to the Board of Directors and makes recommendations for the Board to decide on.

The task of the committee is to create forms of remuneration that are felt to boost motivation and also take into account the special features of Vacon. The committee also prepares for the election of members to the Board of Directors so that the Board can make proposals to the General Meeting, prepares matters concerning compensation for the Board of Directors, and identifies successor candidates for the members of the Board. The committee members in 2006 were Jan Inborr, Veijo Karppinen and Pekka Ahlqvist.





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Board of Directors

1. Jan Inbarr, chairman

- Born 1948, B.Sc. (Econ.), President and CEO, Ahlström Capital Oy.
- Board member since 2002.
- Board member at: Enics AG (chair), Å&R Carton AB (vice chair), Ahlstrom Corporation, Nordkalk Corporation, Stiftelsen för Åbo Akademi.
- 31.12.2006: No Vacon Plc shares.

2. Veijo Karppinen, vice chairman

- Born 1950, M.Sc. (Eng.), President, VNT Management Ltd.
- Board member since 1993.
- Board member at: EpiCrystals Oy (chair), Optogan Oy (chair), The Switch Engineering Corporation (chair), Vaasa Engineering Oy (chair), Wapice Oy (chair).
- 31.12.2006: 209,349 Vacon Plc shares.

3. Pekka Ahlqvist, board member

- Born 1946, M.Sc. (Eng.), MBA. Vice President, Automation, Wärtsilä Corporation.
- Board member since 2004.
- Board member at: -
- 31.12.2006: No Vacon Plc shares.

4. Jari Eklund, board member

- Born 1963, M.Sc. (Econ.), Investment Director, Tapiola Insurance Group.
- Board member since 2001.
- Board member at: Seligson & Co Oyj, Ilkka-Yhtymä Oyj (member of supervisory board), Mortgage Society of Finland.
- 31.12.2006: No Vacon Plc shares.

5. Kalle Heikkinen, board member

- Born 1956, MBA, M.Sc. (social science), M.A. (Communications), Managing Partner, Nordic Adviser Group.
- Board member since 2004.
- Board member at: Longhorn Capital Oy (chair), Harvard Club ry. (chair). Delegation member at: Finnish Cultural Foundation, Harvard Fund (director of board).
- 31.12.2006: No Vacon Plc shares.

6. Mauri Holma, board member

- Born 1950, B.Sc. (eng.), President and CEO, Vaasa Engineering Ltd.
- Board member since 1993.
- Board member at: Btb Plaza Oy, Wapice Ltd.
- 31.12.2006: 347,171 Vacon Plc shares.

7. Stefan Wikman, secretary of the board

- Born 1956, LL.M. (Law). Partner of Roschier Attorneys Ltd.
- Delegation member at: Harry Schaumans Stiftelse, Stiftelsen för Åbo Akademi, Stiftelsen för Österbottens högskola.
- 31.12.2006: No Vacon Plc shares.



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The President and Management Team

The Board of Directors appoints the company's President and defines the terms of employment of the President in writing. The President prepares matters to be decided at the meetings of the Board of Directors and is responsible for seeing that the Board's decisions are carried out. The President is responsible for the Group's administration and is chairman of the Management Team. The retirement age for the President is 60 years. The Company will pay the President compensation equivalent to 18 months' salary if the Company terminates the contract of employment.

The Management Team prepares and guides the development of the Group's processes and business areas and the Group's joint functions. The Management Team consists of the President and representatives chosen from the Group's senior management. The Management Team is not an administrative body as stipulated by the Finnish Companies Act. Subsidiary companies report to the Group's Executive Vice President, Products and Markets.

Salaries and other benefits paid to the President and other senior management

The salaries and other benefits of the President and other senior management are approved by the Board of Directors. The Board of Directors confirms each year any management bonus and any bonus for all personnel. During 2006 personnel were paid a productivity bonus totalling EUR 1,895,000. Additionally the management was paid share bonus totalling EUR 764,000. The President & CEO's annual salary, which includes the monthly salary and bonuses, was EUR 457,000 in 2006.

Management Team

1. Vesa Laisi

- President and CEO
- Born 1957, M.Sc. (Eng.), M.Sc. (Econ.)
- Employed by the company since 2002.
- Board member at: Finnfacts (chair) and Teknoliigatollisuus ry.
- 31.12.2006: 3,016 Vacon Plc shares.

2. Heikki Hiltunen

- Executive Vice President, Products and Markets
- Born 1962, B.Sc. (Eng.).
- Employed by the company since 2002.
- 31.12.2006: 2,320 Vacon Plc shares.

3. Tuula Hautamäki

- Vice President, Human Resources, Information Technology and Process Development
- Born 1964, M. Sc. (Eng.), M.Sc. (Econ.).
- Employed by the company since 2000.
- 31.12.2006: 6,000 Vacon Plc shares.

4. Dan Isaksson

- Vice President, Corporate Development and Solution Customers business area
- Born 1965, M.Sc. (Eng.), MBA
- Employed by the company since 1999.
- 31.12.2006: 1,036 Vacon Plc shares.

5. Timo Kasi

- Vice President, R&D
- Born 1966, M.Sc. (Eng.)
- Employed by the company since 1999.
- 31.12.2006: 3,357 Vacon Plc shares.

6. Jari Koskinen

- Vice President, Production
- Born 1960, M.Sc. (Econ.), MBA.
- Employed by the company since 1994.
- 31.12.2006: 356,350 Vacon Plc shares.

7. Mika Leppänen

- Vice President, Finance and Control and CFO
- Born 1959, M.Sc. (Econ.)
- Employed by the company since 2003.
- 31.12.2006: 928 Vacon Plc shares.

Extended Management Team

8. Jukka Kasi

- Vice President, Technology, Vacon Suzhou Drives Co. Ltd.
- Born 1966, M.Sc. (Eng.)
- Employed by the company since 1997.
- 31.12.2006: 52,263 Vacon Plc shares.

9. Olavi Lehtonen

- Director, After Market Service
- Born 1957, M. Sc. (Eng.)
- Employed by the company since 2004.
- 31.12.2006: 600 Vacon Plc shares.

10. Jouko Liljeström

- Director, Global Accounts and Solution Support Unit and Brand Label and OEM Customers business area
- Born 1969, B.Sc. (Eng.)
- Employed by the company since 2004.
- 31.12.2006: No Vacon Plc shares.

11. Pertti Rajamäki

- Director, Component Customers business area
- Born 1952, B.Sc. (Eng.), MBA
- Employed by the company since 2005.
- 31.12.2006: 200 Vacon Plc shares.

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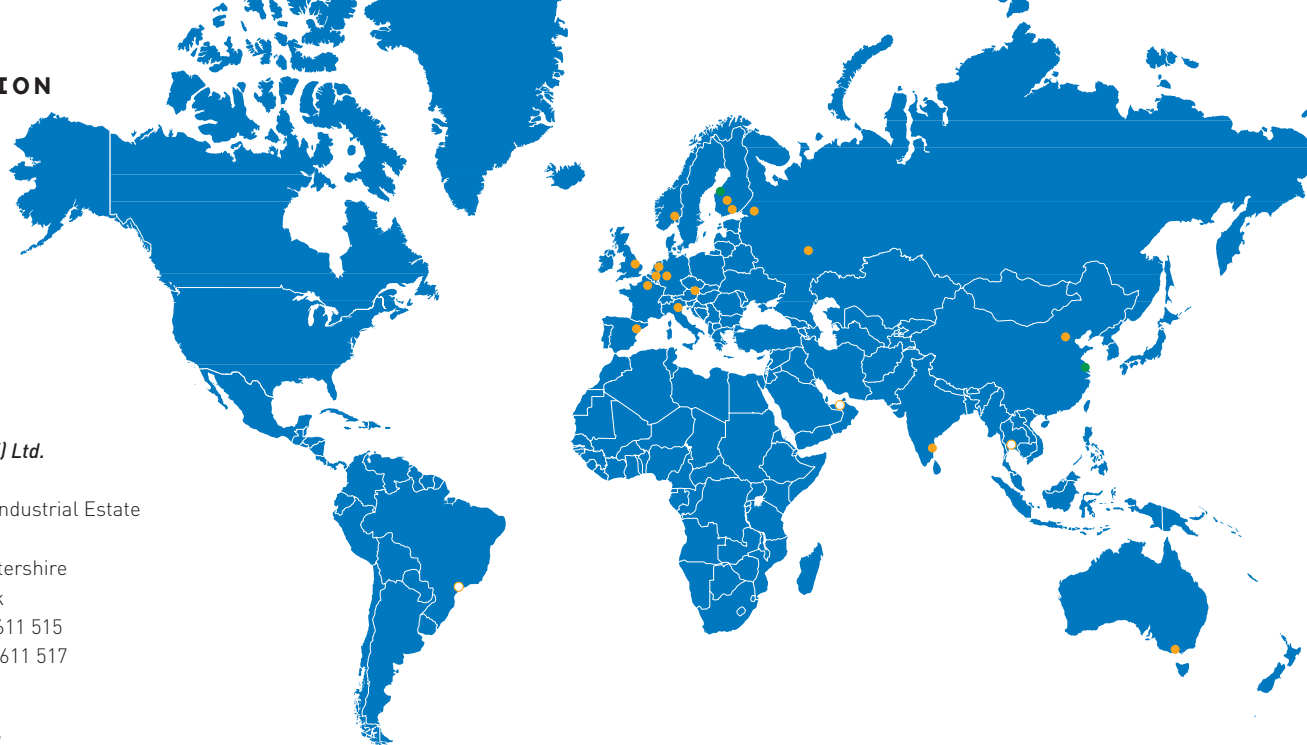
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