

## **Q406 Conference Call Transcript**

### **Matt Ginter- Vice-President of Investor Relations and Financial Planning and Analysis**

Good morning everybody, I'm Matt Ginter, head of investor relations for 3M, and I would like to welcome all investors and analysts to our fourth quarter 2006 business review. Allow me to make a few brief announcements before we begin today.

As usual, today's discussion will follow a series of PowerPoint slides, which are currently available on our investor relations website at 3M.com. These slides will remain on our website, along with an audio replay of today's call, for an extended period of time.

During today's conference call, we will make certain predictive statements that reflect our current views and estimates about our future performance and financial results.

These statements are based on certain assumptions and expectations of future events that are subject to risks and uncertainties.

Item 1A of our most recent form 10-Q lists some of the most important risk factors that could cause actual results to differ from our predictions.

Both Pat Campbell, our CFO, and George Buckley, our CEO, will make formal comments about fourth quarter and full year results, along with our 2007 outlook, and then we will open it up for Q&A.

So now please go to slide number two, and I'd like to turn the program over to Pat.

### **Pat Campbell- Chief Financial Officer**

Thanks Matt and good morning everyone. As you can tell from the complexity of our press release, we have several items to cover with you this morning so let's begin.

Our calendar year and fourth quarter earnings include a fair number of adjustments, so I would like to take a moment and level-set our results so you can clearly understand the underlying profit performance. I will also explain our forward guidance on a comparable basis, which George will expand upon during his comments.

Our 2006 reported earnings per share were \$5.06. Our strong underlying operating performance drove these earnings, and I will describe this in detail in a moment, but earnings were also impacted by a number of special items.

First, in December of 2006, we sold our branded pharmaceuticals businesses in the United States, Canada, Latin America region and the Asia Pacific region, including

Australia and South Africa, which resulted in an after-tax gain of \$674 million, or \$0.88 cents per share.

In addition, we incurred employee-related severance and asset impairment charges during the year pertaining to the pharma sale itself, which in total reduced net income by \$114 million, or \$0.15 per share.

At the same time, we incurred restructuring costs in a number of our worldwide staff functions in order to lower overhead costs in response to the sale of the pharmaceuticals business. One-time costs associated with these actions totaled \$73 million after-tax, or \$0.10 per share. By the end of 2007, we expect to have eliminated the entire amount of overhead that had been allocated to the pharmaceuticals business.

We also restructured a number of our other businesses in the fourth quarter. These actions took the form of asset write-downs, headcount reductions, or in some cases we simply exited businesses that lacked strategic fit. One-time costs associated with these actions totaled \$78 million after-tax, or \$0.10 per share.

Next, in October of 2006, we acquired Brontes Technologies Inc., a developer of proprietary 3-D imaging technology for dental and orthodontic applications. This transaction resulted in a pre-tax and after-tax charge of \$95 million, or \$0.13 per share, reflecting the one-time write-off of acquired in-process R&D.

Moving along, in the second quarter of 2006, and as previously disclosed, we recognized an after-tax expense of \$25 million, or \$0.03 per share, to resolve the antitrust class action involving direct purchasers of branded transparent tape.

Finally, in the second, third and now fourth quarter of 2006, we recorded net after-tax benefits of \$149 million, or \$0.20 per share, from certain income tax adjustments.

It's important to note that approximately \$160 million of the total pre-tax charges, or \$0.15 per share are non-cash charges. Our first half 2007 cash flows will be negatively impacted by approximately \$600 million related to the other fourth quarter actions, including the taxes on the pharma gain..

After adjusting for these items, earnings were \$4.49 a share.

Generally accepted accounting principles prevent us from classifying the pharmaceuticals business as a discontinued operation, due to the extent of our projected continuing cash flows from our contractual supply relationship with the new buyers. Therefore it will create a comparability issue beginning with our Q107 results. Annual sales in 2007 for pharma were \$774 million, and operating income was \$257 million, excluding special items, or \$0.23 per share.

Many of our operational metrics will look quite different in 2007 as a result of selling the pharmaceuticals business. Gross margins will be lower by approximately one point, and

SG&A will be about 50 basis points lower than in prior years. R&D as a percent of sales will be approximately 30 basis points lower and operating margins will be diluted by about a half of a percentage point in 2007.

Total company earnings excluding special items and pharma earnings in 2006 were \$4.26 per share.

For 2007, we expect earnings to be in the range of 5.20 and \$5.45 per share, which includes an estimated \$0.60 to \$0.70 cent gain related to the January sale of the European pharma business, net of other anticipated restructuring costs. Earnings per share in 2007, on an apples-to-apples basis of \$4.60 to \$4.75, are expected to increase between 8% and 12% versus 2006.

Again, George will address our 2007 outlook in more detail in just a few moments. Please turn to slide number 3.

Here you see a similar reconciliation for the fourth quarter standalone. It compares this quarter's reported earnings of \$1.57 per share versus the 97 cents earned in the fourth quarter of 2005. Again, my objective here is to explain our results on a comparable basis.

The first five adjustments that you see here are the same as those that I described on the last chart, although there are slight variations in EPS values in certain categories, largely due to accounting differences in average shares outstanding between the full year 2006 and the fourth quarter.

In addition, reported earnings were boosted by net benefits from certain income tax adjustments which added \$25 million to net income, or \$0.03 per share.

As you may recall, in the fourth quarter of 2005, 3M adopted FASB Interpretation Number 47, "Accounting for Conditional Asset Retirement Obligations". We recorded a non-cash charge of \$35 million after-tax, or \$0.04 per share, as a cumulative effect of change in accounting principle.

Taking all these items into consideration, fourth quarter 2006 earnings were \$1.10 per share, a 9% year-on-year increase.

I know this was a long-winded introduction to this quarter's call, but we felt it was important to provide some context around our fourth-quarter and full-year 2006 results, as well as our 2007 guidance, before we went any further.

Please turn to slide number 4, where we will examine our 2006 full-year performance.

Record sales in 2006 were just shy of \$23 billion, up 8.3% over 2005. Sales increased 7.7% in local currencies, including just over 2 points from acquisitions. All businesses made positive contributions to growth in 2006, and have done so for three consecutive years.

Reported operating income was \$5.7 billion, an increase of 17.3% year on year, or 7.3% when adjusted for special items and stock option expense in both years. Operating margins were 22.6% for the year, which includes a negative 20 basis point impact from year-on-year differences in stock option expense.

Option costs were higher primarily due to additional vesting of our 2005 grant, along with accelerated expense related to the retirement-eligible portion of stock option expense. Recall that, beginning in 2005, we changed to a 3-year vesting from one year vesting in prior years.

We are making even further changes to many of our compensation programs to better align them with our strategic direction.

Importantly, we maintained our strong operating margins in 2006, which was a concern that many of you expressed to both George and me since we first articulated our growth strategy at our investor meeting in May of last year. Our objective here is unchanged – that is, to accelerate the long-term growth rate of the company, and to maintain premium operating margins and return on invested capital.

Reported earnings per share increased 27%, to \$5.06. Excluding special items in both periods, earnings per share increased 9%.

As I mentioned earlier, in December we sold two tranches of our branded pharmaceuticals business. We closed the sale of our business in the United States, Canada and Latin America regions effective on December 31<sup>st</sup>, and we closed the sale of our Asia Pacific pharma business, including Australia and South Africa, on December 1<sup>st</sup>, almost a full month earlier than we anticipated.

This obviously reduced our sales and profits slightly for the quarter, but of course on the whole we were pleased to get this done so quickly.

The sale of these businesses resulted in an after-tax gain of \$674 million, or \$0.88 cents per share. Also, in early January, we sold our European pharma business as well. Many of you know how challenging it is to execute a transaction of this magnitude, yet alone with three different buyers, and believe me, our team did one heck of a job closing the deal while keeping the business running to generate maximum shareholder value.

Full-year free cash flow was \$2.7 billion, down \$600 million versus 2005, due primarily to higher capital expenditures aimed at driving accelerated top-line growth, along with our higher tax payments.

And finally, return-on-invested-capital was 22.5% for the year, which was in-line versus 2005. This is easily more than twice our cost of capital and is a testament to the strength of our business model. We remain highly focused on accelerating investments to drive future growth, while simultaneously maintaining a sustainable and premium ROIC.

Now let's dig a little deeper into the full-year P&L, found on slide number five.

From this point forward, the numbers I will discuss exclude special items in all periods.

Sales once again were a record \$22.9 billion, up over 8%, and we leveraged this growth into earnings per share growth of 9%. Differences in stock option expense between years hurt earnings per share growth by 40 basis points.

Gross margins declined by about a point, impacted by higher raw material costs, slightly lower selling prices and higher costs associated with scaling up additional manufacturing capacity. We also had some inefficiencies in many of our supply chains that were capacity-constrained during the year.

Finally, we accelerated the pace of acquisitions in 2006, which muted gross margins just slightly for the year. Once these deals are integrated and begin meaningfully contributing to growth, we fully expect positive impacts sooner rather than later.

We increased SG&A expense just over 4%, gaining some leverage in the process. Importantly, sales and marketing costs increased faster than sales, while administrative costs remained relatively flat in dollars. As I mentioned to many of you back in May meeting, we are pushing even harder on the accelerator in driving additional leverage on administrative expenses.

We will use this leverage to continue feeding our businesses with focused investments in the front end, clearly aimed at customers, programs, new products and growth.

We invested \$1.4 billion in research and development in 2006, an increase of over 6% versus 2005.

Operating margins for the year were a healthy 22.6%, virtually equal to 2005 levels after you equalized for stock options.

All in all, 2006 was a very good year for 3M. We generated record sales, and local-currency growth was the highest we have seen since the year 2000. Profits were also at record levels, and we accelerated growth investments in many businesses while maintaining our top-tier operating margins.

Please turn to slide 6 for a discussion of our fourth quarter results.

Sales in the fourth quarter were up 8.6% versus the fourth quarter of 2005. Operating income was \$1.2 billion, up over 4% after adjusting for year-on-year differences in stock option expense. Both sales and operating income were the highest of any fourth quarter in our history.

Gross margins were down three points year-on-year, impacted by higher raw material costs, a weaker US dollar, selling price declines and to a lesser extent, early-stage acquisitions. But one of the bigger impacts this quarter was highly situation-specific, as the dramatic slowdown in the US housing and automotive had a significant negative impact on sales and gross margins in a handful of our divisions that sell into these industries.

Operating margins were 21.2% in the quarter, which is down 90 basis points versus last year's fourth quarter after adjusting for stock options.

SG&A expense in the quarter was \$1.2 billion, about flat versus last year's comparable quarter. Again, investments in front-end sales and marketing programs continue to increase about in line with sales, while administrative costs as a percent to sales continued to decline in the fourth quarter.

R&D expense increased 6.2% year-on-year.

Fourth-quarter net interest expense increased to \$22 million versus \$12 million last year, primarily driven by increased debt levels resulting from our stepped up share repurchase activity in the second half of the year.

The fourth quarter tax rate was 30.3%, down just over 2 points versus fourth quarter of 2005, largely due to the US government's long-anticipated reinstatement of the R&D tax credit, along with normal year-end adjustments that we encounter as we finalize our annual results.

When I say 'normal' it sounds like a simple effort, but in fact taxes are quite complicated for a global company of our size and diversity, and our team does a great job of optimizing our current tax situation, but we must continue to reduce our overall rate.

Average shares outstanding were down 3% year-on-year, largely driven by the step up in our buyback step-up in the second half of this year.

Earnings per share increased 9%, with year-on-year increases in stock option expense hurting the growth rate by 70 basis points.

Please turn to slide 7, where I will detail our sales performance for the fourth quarter.

As I mentioned, worldwide sales increased 8.6% versus last year's fourth quarter. Volumes increased 6.8%, with organic volumes up 4.9% and acquisitions kicking in an additional two percentage points of growth. Selling prices declined 1.0%, and currency translation added 2.8% to fourth quarter sales.

We posted strong growth in our international operations, which now represent 63% of global sales and are continuing to grow. Sales were up 12% in U.S.-dollar terms, with

growth in local currencies increasing 7.4%, led by Europe at 10.5% and Latin America at 10.2%.

Five points of growth in Europe came via acquisitions, with the largest being our August 2006 acquisition of Security Printing Systems Limited, a leading provider of finished, personalized passports and secure cards, based in the UK. SPSL gives us important technologies that will allow us to deliver a full range of border and civil security solution products.

China and India also posted solid local currency growth, with rates in excess of 20%; although we did see some slowing in Korea as the stronger Won appears to be hindering exports.

In the United States, sales expanded by 3.3% vs. last year's fourth quarter, including 1.8% of growth via acquisitions. US growth was held back due to significant slowing in both the housing and automotive industries, which we estimate hurt US growth by as much as 3 points.

The most dramatic impact here was in our roofing granules business, as the shingle manufacturers virtually shut off orders in the quarter, a direct result of slower home sales and housing starts, along with excess inventories. Other related areas of softness included retail do-it-yourself, appliances and automotive OEM.

Please turn to slide eight where I will recap our fourth quarter business segment results.

Industrial and Transportation business posted local-currency growth of 4.8%, led by the industrial adhesives and tapes business and our automotive aftermarket division, which is a leading global supplier of solutions to body shops for vehicle repairs. On a geographic basis, growth was strongest in Europe and Asia Pacific.

During the fourth quarter, we made two small but strategic acquisitions in this business. First, in November we acquired Global Beverage Group Inc., a provider of delivery management software solutions for the consumer packaged goods industry. This deal tucks in nicely with our existing High Jump Software business. We also acquired North Star Chemicals, which will strengthen our core adhesives platform.

Operating income in the fourth-quarter was \$316 million, up 6.1 percent versus last year's comparable quarter.

In Health Care, fourth-quarter local-currency sales increased 8.9%, including 1.2 percentage points from acquisitions. Growth was led by our medical supplies business, a leading supplier of technologies and solutions for hospitals and medical clinics, focusing on infection prevention and acute wound care. We also drove outstanding top-line growth in our dental and orthodontic businesses. Our latest innovation in this business is called 'Lava,' a digital dentistry system for producing crowns and bridges.

Health Care was also busy on the acquisition front, closing three deals in the fourth quarter. In addition to Brontes Technologies, we also acquired Biotrace International PLC, a UK-based manufacturer and supplier of industrial microbiology products used in food processing safety, health care, industrial hygiene and defense applications.

Finally, in December we acquired SoftMed Systems Inc., a provider of health information systems software and services that improve the workflow and efficiency for health care organizations.

And as I mentioned earlier, our Health Care team successfully completed the sale of the pharmaceuticals business in the Americas and in APACA during the fourth quarter, followed by the European leg in early 2007. It goes without saying that this team had a very busy fourth quarter in positioning their portfolio for accelerated growth into the future.

Health Care operating income increased 6.7% to \$304 million. Looking ahead, operating margins in 2007 in Health Care will be negatively impacted by the sale of our branded pharmaceutical business by almost 2 percentage points year-on-year.

Moving on to Display and Graphics, local-currency sales growth was 3.6% in the fourth quarter and profits declined 7.7% to \$264 million. Year-on-year differences in stock options expense hurt profit growth by 1% for the quarter.

Top-line growth in this business was led by the Commercial Graphics division, a leading global supplier of large-format graphic solutions that cut across a broad range of industries. If you are not familiar with this business, pay attention next time you see a large graphic image on the side of a semi-trailer, bus, train or the side of a building for that matter – chances are you will be looking at 3M materials. We also posted solid mid-single-digit growth in our Traffic Safety Systems business.

Optical film delivered record fourth-quarter sales as unit volumes increased at double digit rates, driven by continued exploding consumer demand for LCD TV's. As anticipated, we are seeing more seasonal fluctuations in this business, and in fact demand for our proprietary optical films and components began to moderate towards the end of December.

Selling price declines were in line with our expectations, and margins were similar to recent quarters. Margins are down, however, versus year-ago levels, consistent with what we have described on recent quarterly conference calls, driven by the significant mix shift to large-format LCD TVs, which now constitutes about 40% of total LCD film sales.

Margins have stabilized in LCD films, production yields are improving, and we are aggressively working to further capitalize on the expanded capabilities of our new film capacity. This multi-layer optical film equipment is designed for double the width and faster speeds than its predecessors, which is yet another critical competitive advantage for 3M in this high-growth industry.

One other item of note on pricing – we saw increased pricing pressure in our Traffic Safety Systems business as one of our competitors attempted to grab additional market share in Asia. This occasionally happens in that industry, but as the low-cost producer we have the ultimate advantage.

Fourth quarter sales in Consumer and Office were \$824 million, a 5.6% increase in local-currency terms. Holiday seasonal demand for our power brands, such as Scotch tape, Post-It notes and O-Cello sponges, was strong in the mass retail and wholesale channels.

Perhaps the most notable change in sales trajectory in Consumer and Office occurred in our Construction and Home Improvement division, which sells a broad line of consumable products into the retail DIY channel. After posting outstanding double-digit top-line growth for many of the past several quarters, growth moderated to a mid-single pace in Q4, and of course the business wasn't nearly as profitable as a result. There is no doubt the housing slowdown is affecting sales in this channel, and we certainly expect this situation to improve as 2007 unfolds, but the precise timing of when this happens is difficult to forecast.

Our Visual Systems business, which traditionally has offered analog overhead and electronic projectors and film, posted a sales decline, which hurt the overall Consumer and Office sales growth by over 1 point. Our team here has done a miraculous job of reinventing themselves by introducing a number of digital projection solutions that are just beginning to reach the market. There are no guarantees in this challenging space, but we have some outstanding technology that we believe is worth a shot.

Operating income in Consumer and Office was \$141 million, or flat with last year's fourth quarter, including a 1.2% year-on-year penalty from higher stock option expense.

Sales in our Safety, Security and Protection Services business were \$655 million, up 12.2% in local currencies, ten points of which was due to our August 2006 acquisition of Security Printing and Systems, Ltd., the UK-based security technology company that I mentioned earlier. Fourth-quarter operating income grew 1% versus last year's comparable quarter, including a negative 1.5% impact due to higher stock option expense.

As has been the case for some time, our occupational health and environmental safety business continued to be a stalwart in our portfolio, growing at double-digit rates in the fourth quarter. Organic growth in this business was driven once again by strong global demand for personal safety products, particularly in respiratory protection.

We also posted outstanding growth in our corrosion protection business – in excess of 50%, in fact. This is a truly great business that supplies coatings for all types of commercial and industrial applications across a broad spectrum of industries, including oil refining.

However, the story of this quarter in SSPS was our roofing granules business. The shingle manufacturers completely missed their forecasts in the fourth quarter. As a result, we went from producing all-out and incurring premium costs to meet excess demand early in the year to being virtually shut down in Q4. And as a result, sales in this business declined almost 50% year-on-year.

Excluding the impact of this slowdown, operating profit in Safety, Security and Protection Services would have expanded by approximately 20%. And the top line rate would have improved by about 7%.

In Electro and Communications, local-currency growth was 2.6% versus last year, including 2.2% from acquisitions. We generated good top-line growth in our electrical markets division, which sells a number of insulating, testing, and connecting products and solutions to both power utilities and manufacturing OEMs. Tempering growth in the fourth-quarter was softness in our flexible circuit business due to a number of applications that went end-of-life.

Operating income was \$110 million, or down 2.4% year-on-year. Year-on-year differences in stock option expense hurt profit growth by 1.5%.

For some time, E&C has been absorbing some large yet underutilized facilities, and we took action in the fourth quarter to get them behind us. In fact, of the business unit-specific restructuring actions that we took in Q4, two significant items were in the E & C business. These actions will make them much more competitive as we move through 2007.

Please turn to slide number nine, where I will review a few balance sheet and cash flow metrics.

Net working capital turns were 5.4, up 0.3 turns versus the third quarter, and down 0.3 turns versus the fourth quarter of 2005.

Capital expenditures totaled \$405 million, an increase of \$122MM year-on-year and \$93MM sequentially. Total capital expenditures for 2006 were just under \$1.2 billion, up \$225 million versus 2005 as we invested in a number of growing and highly profitable businesses such as medical, respiratory protection, blue masking tape, filtrete filters, LCD films and others.

Free cash flow in the quarter was a solid \$917 million.

Dividend payments to our shareholders were \$339MM, up 6.6% versus the fourth quarter of last year, and we repurchased \$330 million of our own stock during the quarter. Weighted average shares outstanding were down about 3% year-on-year, both for the fourth quarter stand alone and for the year in total. At the end of the fourth quarter, we had approximately \$750 million available of our existing authorization that expires on February 28.

During 2006, we contributed approximately \$350 million to our worldwide pension plans and had another solid year of double-digit asset returns in our U.S. plan. On the liability side, our discount rate increased by 25 basis points, thus reducing our projected benefit obligation. Our U.S. funded status now stands at 99%, up from 92% in 2005, and on a global basis we are 96% funded.

Our return-on-asset assumption remains 8.75%, and as I mentioned we are increasing our discount rate 25 basis points to 5.75%.

In September 2006, the Financial Accounting Standards Board issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans". This standard requires employers to recognize the under funded or over funded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position. As a result of the implementation of 158, the Company recognized an after-tax decrease in accumulated other comprehensive income, which is part of stockholders' equity, of approximately \$1.9 billion.

This decrease in the fourth quarter of 2006 is primarily due to the pre-funding of our U.S. plan. The adjustment impacts the balance sheet only, with no impact to net income or cash flows. For complete details, please refer to this morning's press release.

Finally, our debt to capital ratio was 26% at the end of the fourth-quarter.

This concludes my review of our fourth quarter and full year financial performance. Now I would like to turn the microphone over to George.

**George Buckley- Chairman, President and CEO**

Thank you very much Pat and good morning everybody.

In May of last year, we outlined a four-pronged strategy to reinvent 3M and change it into a faster-growing, faster-moving and more competitive global company. While we still have a great deal yet to do, and it's not an easy challenge, I'm personally very pleased, very pleased indeed with the progress we made in 2006 toward the goal of sustainable higher growth.

Sales in local currencies were up 7.7% in 2006 vs. 2005, which is the highest growth rate we've seen at 3M this decade and the highest mid-cycle growth we've seen in many years. The people of 3M are responding to the growth challenge that we've set.

We achieved this growth rate by confronting some realities about our portfolio and our historical investment patterns, by formulating a straightforward strategy for growth – which we shared with you in May – and by taking sensible steps in rekindling our investment in the future. I can say that our employees have wholeheartedly embraced our new focus on growth.

The issues that have to be addressed in any company driving growth are both cultural and financial. And we've been addressing both. One of the two or three most significant financial steps we took in '06 was an increase in R&D expenditures, by over 6%, to position our existing portfolio for accelerated growth. This increase is over 8% in the core, considering that we simultaneously reduced spending in Pharmaceuticals.

We made significant technology moves for the future, notably:

The acquisition of Brontes, Inc. –which is the premier technology solution in digital dentistry and a key bridge between accurate and fast digital data gathering and chair side production of bridges and crowns. This acquisition was the most important platform we have built since purchasing ESPE many years ago.

Secondly, we launched five new emerging business opportunities, or EBO's as we call them.

We achieved great traction on our Track and Trace initiative, where we merged a number of formerly disparate efforts into one single growth engine for the future. Significantly, we have made important inroads in applications for medical, food and aerospace industries in 2006.

Our global mining EBO, where 3M is now bringing its vast array of technologies and solutions to an absolutely massive industry.

Food Safety - which we boosted by one or two small acquisitions

Filtration - headlined by CUNO

Energy - where we've realigned several units to focus on this great market.

As many of you know, a major impediment to both long-term and short-term growth for 3M had been capacity constraints in some of our businesses. When we began this growth journey in 2006, we began by vigorously addressing those capacity constraints – for example, in medical tapes and drapes, respirators, optical films, industrial tapes and in roofing granules.

We had numerous product lines totally out of capacity, some working 7 X 24 shifts in an attempt, often forlorn, to keep up. Simply put, we've been putting our money where our mouth is, as demonstrated by an increase in cap ex of 25% in 2005. When factories get beyond about 95% capacity utilization, overtime costs, expediting freight and emergency repairs generally drive margins down on incremental volume, not up. And when demand is overseas, and your plant is in the US, it just makes the situation more difficult.

This higher level of capital investment will address two objectives: first, meeting the immediate need for capacity in businesses that are constrained and providing a platform

for greater organic growth, and second, to begin addressing the longer-term necessity to simplify and streamline our supply chains – better for our customers and better for us.

A streamlined supply chain will ultimately help drive growth at lower cost and at much lower working capital. So we are using these capacity expansions to simultaneously straighten out our convoluted supply chains. Along with G&A leverage and growth, a more efficient supply chain is the big nugget of opportunity for our company.

A great early example of this kind of investment is in our mask respirators business. We expect to open a new manufacturing plant in mid-year 2007 in Korea that will supply the rapidly growing Asian respiratory protection market. It will be the fastest we have ever built and opened a new plant of this scale in our history. We also made a large complimentary investment in an existing plant in the United States.

Please remember that we have not yet seen the benefit of these investments in our sales or our earnings, though we are now bearing the investment costs. While the first new plant in this sequence of investments has yet to come on stream, we will begin to see some of these churning out product beginning in the 3rd quarter of 2007.

We are planning these meticulously to make sure we do not suffer any serious start up challenges, though as a practical matter, there are always unabsorbed costs and issues in any plant start up, it is the nature of the beast.

In 2006, we continued to build our capabilities in many of the world's fastest-growing emerging economies. We began construction of three new plants in China, one in Russia, one in Poland, one in India and have been working on acquisitions in Turkey. By the end of 2007 we will have 10 or more plants open or under construction in China.

We also drove outstanding growth in more developed economies. For example, European sales growth was about 10% in US dollars, and 8.3% in local currencies.

I'm especially proud of the fire we lit under acquisitions in 2006, closing 19 deals during the year, versus four last year, all contributing to growth in different ways. Acquisitions are rarely only about volume. In our cases they were product additions and gap-fillers, to expand our offerings and become more important to our customers – both Biotrace, and SPSL in the UK fitted that mold.

Capacity additions were another factor in our line up of acquisitions. We did one of these to instantaneously expand manufacturing capability and meet surging demand – Nylonge was an example of this kind. We would do more of these if we could, because this is a very efficient way of getting good growth.

Getting access to local markets via local brands was another. Locals most often want to buy local brands – and we did this through acquiring POMP, a Brazilian maker of industrial ear plugs and hearing protection products. It is also a good low cost source of product worldwide. There are several others like this we are working on.

Technology additions were also part of our acquisition strategy in 2006, to augment our existing base with those of the future – and doing so in considerably less time than it would take to develop on our own technology. The previously mentioned Brontes is a prime example of this.

So all in all, I'm very pleased with our progress on the growth front.

Every journey that we take meets the occasional bump in the road and we met some to in 2006. So we had our share of challenges. Some of them were self-imposed, while others were caused by market forces beyond our control. But we learned the hard lessons and are making the necessary course corrections.

Take our Q2 experiences with the LCD film business as an example. This was clearly the toughest challenge in the year. Our experience in that quarter reinforced the need not only to understand better the pipeline and pricing dynamics of the sometimes volatile consumer electronics industry, but also more importantly, longer term, to develop significantly broader growth opportunities across all of our portfolio and to aggressively develop a new growth platforms for the future. We are working on that issue vigorously. A company like ours cannot be reliant on a single growth engine.

In the fourth quarter, sales growth was toward the lower end of our forecast, but this was not at all like Q2, as all the reasons were market-driven and caused mainly by a slow housing market, where we are at the back end of the production line supply chain. Roofing granules was a major factor here and significantly affected our sales growth and income. This one manufacturing unit alone cost us \$0.05 per share in earnings in the second half. Automotive has also become noticeably slower as the quarter went on.

Though it impacted three of our reporting segments, none of this housing slowdown related to the fundamentals of our business, or was self imposed. It was all externally market-driven. We gained share, but it was not enough to overcome contraction in volume.

But we absorbed this economic movement and more besides and still delivered reasonably good earnings growth for the quarter. Once again it underscored our resiliency, but it also emphasized the need to reinvent ourselves and shift some of our portfolio toward higher growth markets.

We got a tremendous amount of things done in 2006, and I'd like to list just a few. We got a new strategic plan figured out, communicated and accepted by our colleagues, we got our Pharmaceuticals business sold, which in my mind was a monumental task, we got the 3M growth engine growing again, we got much needed capital applied to lubricate our capacity and supply chain problems in many areas around the world, we invested heavily in R&D, we got a new compensation and option system in place and we got a well oiled acquisition machine underway. Quite a set of achievements I would say.

This, and much more besides, were all done from a standing start in 2006. These are only a few of the huge amount of things we got done and I think everyone who contributed to them at 3M should feel justly pleased with our progress.

It is important to understand how 2006 unfolded but it is more important now to articulate again where we are going in 2007 and beyond.

As I told you at our investor meeting in May of last year, we are absolutely committed to growing 3M at a faster pace, using a four-pronged approach – reinvesting in the core, developing adjacent EBOs, expanding on our already world-class capabilities outside the United States, and by acquiring companies in faster growing industries. And as I explained previously, we are charging ahead on all these fronts.

Transforming 3M into a faster growing company will, of course, require changes to the way we manage the company. And while it is our clear intention to invest in the future, we expect to do so while maintaining operating margins at or near current levels. During the transition period, investments will not always be synchronous with margin improvements. But ultimately, capacity, a fast supply chain and more R&D are the key bridges to a future of sustainable growth and superior margins for 3M.

Please turn to slide 11 entitled “2007 Full Year Guidance.”

As for our formal outlook for 2007, I see a year with plenty of challenges, some internal and some external, but none that will steer us off of our long-term course.

Taking pharmaceuticals out of the sales base since it has now been sold, we expect to generate local-currency sales in the range of 6% to 10% in 2007, including the carryover of acquisitions we did in 2006. New acquisitions in 2007 will be an unknown additive, perhaps adding another couple of points or so. Having pharmaceutical sales in the 2006 base will create about 3.5% to 4% of drag on our growth rate throughout 2007.

2007 earnings are expected to be in the range of \$5.20 to \$5.45 per share, including an estimated \$0.60 to \$0.70 per share gain due to the sale of our pharmaceuticals business in Europe, net of known one-time charges. Excluding these one-time items, we expect earnings to be in the range of \$4.60 to \$4.75 per share, and as Pat mentioned on his first chart today, this translates to approximately 8% to 12% earnings growth on an apples-to-apples basis.

We also plan to purchase our shares at least at a level that avoids dilution from option grants. In the broader context, recent history should be a guide.

By now I'm sure you've noticed that we are providing annual guidance only. There are several reasons behind this decision, which was arrived at after a lot of consideration over a long period of time. It was under consideration well before I arrived at 3M.

First and foremost, we manage 3M to create long-term, sustainable value.

Second, 3M businesses tend to be short-cycle in nature, and we sell a fair amount through distribution, both of which can, at times, make it challenging to precisely predict sales. When you combine this with our outstanding profit margins, the math will tell you that our earnings can easily move randomly by a penny or two, not due to any fundamental reason, just perhaps a key customer or two deciding to accelerate purchases in the current quarter or delay them into the next.

A third reason is the volatility of quarter over quarter tax rates, a recent phenomenon for most US businesses. It will probably be made harder by FIN 47. They make it even more difficult to predict the outcome within a penny or two of EPS in one quarter.

And finally, many of you have told us, in some cases with a fair amount of passion, that providing quarterly guidance creates unnecessary volatility in your holdings, and is, frankly, inconsistent with your own investment objectives, which are generally are longer-term in nature. So we listened to you.

We will still be setting tough quarterly internal targets and we will still give you general indications of how we expect a quarter to go. So nothing has changed on what we expect of ourselves. As Pat and I continually remind our team, if you want to be rewarded in the market, you have to be highly profitable, and you have to grow. Investors expect us to maximize the return on the capital invested in 3M, and we expect nothing less from our team – plain and simple.

Looking at our anticipated earnings trajectory in 2007, the first quarter will be the most challenging of the year for several reasons. First, we expect the economy will grow more slowly than it did in the first quarter of 2006, and 3M participates in the global economy too, we are not immune.

Second, the LCD TV industry was running flat out in last year's first quarter at production levels far in excess of market needs. We saw the back side of this in Q2. The industry now appears to be more stable and likely to continue solid in 2007; however it does create a difficult year-on-year comparison for us in Q1.

And finally, while we aggressively restructured many areas of 3M in parallel with divesting the pharmaceuticals business, the great majority of those costs will not go away until late in the first quarter or early in the second.

So our plans call for earnings growth to be the slowest in Q1, to pick up speed somewhat in the second quarter and to accelerate even further into the second half of the year. Overall, we are pretty optimistic about the year in full at 3M.

Operating margins are forecast to be in the range of 22% to 22.5% which, if you adjust for the divestiture of the accretive margin Pharma business and for stock option expense increases in 2007, this would be about the same as the premier margins we achieved in 2006.

The effective tax rate for 2007 is expected to be between 32.75% and 33.75%, which is higher than 2006 due primarily to the United States government's repeal of the Extraterritorial Income Exclusion, also known as the FSC, which was previously granted to US exporters. As a leading US exporter, the loss of the FSC legislation has a fairly significant impact on the company's tax rate. The government is replacing the FSC with a new manufacturers' credit, which will phase in over the next several years.

In addition, the company will implement FIN 48 in the first quarter of 2007. We expect that the impact of this new accounting standard will put upward pressure on the Company's tax rate in 2007 and, as I mentioned, will cause more volatility in the tax rate over time.

Our internal plan, however, is to reduce the effective tax rate by approximately 1% each year beginning in 2008 through investments and structure. Like our competitors, we expect to give tax planning much more emphasis going forward than it has been given at 3M in the past.

Capital expenditures are expected to increase from this year's \$1.2 billion to something in the range of \$1.4 to \$1.5 billion in 2007, with the majority aimed directly at accelerating top-line growth in many of our core businesses. In fact we have in the neighborhood of 15 significant plant construction efforts underway as we speak, some adding to existing facilities and a few of the greenfield variety.

Overseas, we are building respiratory protection capacity in Russia and Korea, medical products plant capacity in China, an LCD film plant in Poland, abrasives and tapes capacity in China and India and chemical facilities in China, and a new oil pipeline coating plant in Russia just to name a few. This is backed up by similar investments in the US.

Most investors know that we are revamping our compensation programs at 3M to align employee and shareholder interests more closely. The principal effect here is a reduction from 1.5% equity issuance to about 1% each year, which now brings us in line with the rest of US industry. But associated with that change was a "buyout" which will result in one more year of increased stock option expense in 2007.

This cost will flatten out in 2008, and then begin to decline in 2009 as we issue fewer stock options in the future and amortization gradually falls off.

So that about wraps up our formal comments for today. Let me conclude by reminding you that our mission remains the same as I've spoken about many times before: namely, to accelerate growth at 3M, it seems like we're doing that, and to do it by stimulating innovation and to support it by driving continued productivity. And of course, to focus on building great fundamentals and to execute well in what we think will be a good 2007.

Now we would be happy to take your questions.

