

## **Matt Ginter – Introduction and Safe Harbor**

Good morning, this is Matt Ginter, head of investor relations for 3M. I would like to extend a sincere welcome to all investors and analysts to our second quarter 2008 business review.

You will find this morning's presentation on our investor relations website at 3M.com. These slides will remain on the site, along with an audio replay of today's call, for an extended period of time.

Please take a moment to read the forward looking statements on slide 2. 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 10K lists some of the most important risk factors that could cause actual results to differ from our predictions.

Also, allow me to put in a brief plug for our upcoming investor meeting, in St. Paul, on September 9th. You should have received an email last week with a link to our registration site. If you received the invite, please take a moment and reply as to whether or not you plan to attend. If for some reason you did not receive an invitation, either drop us a note or give us a phone call and we will get it out to you. Registration will close on August 29th.

As per usual, today is a busy day in that many companies are reporting earnings. We will do our best to keep the call to about one hour. Again, you can help us during the Q&A by limiting yourself to one question and one follow-up, so that all questions can be fully addressed.

George Buckley, our CEO, and Pat Campbell, our CFO, will both make some formal comments today, and then we will get to your questions. So now please go to slide number three, and I'd like to turn the program over to George.

## **George W. Buckley – Q2 Overview**

Thanks, Matt, and thank you all for joining us this morning.

Today I'll make some brief opening comments, Pat will take you through the detail of the quarter, and then I'll return to address some of the key issues, including the state of our optical films business and our outlook going forward. After that, we're happy to address your questions and comments.

So to get started, our second quarter is perhaps best characterized as a repeat of the first quarter – a good quarter, especially when you look at the core of the company. Where there was any negative color, it was mostly provided by the secular change taking place in optical films. But on balance, it was a quarter in which we fought our way to a good overall result.

Over the past two and a half years, we have spent most of our time investing in and strengthening the core businesses of 3M, driving international growth and fixing our supply chains. 3M has owned and operated these core businesses for many years, in fact one of them, Abrasives, we've owned for over 100 years. It is primarily this strategy of investment in our core and in international that has made the current results possible. Despite all the headwinds that optical and the US economy threw at us, the fact is that we still met our numbers and delivered the

bacon. I'm pleased to report that at the operational level, 3M is performing superbly, with our largest three businesses posting double-digit increases in sales in the second quarter.

So after that brief introduction, let me turn it over to Pat for an in-depth discussion of our strong second-quarter.

Pat...

### **Patrick D. Campbell – Q2 Overview**

Thanks George, and good morning everyone.

Please turn to slide number 4.

Indeed this was a very good quarter for 3M and the positives far outweighed our challenges.

We posted record sales for the sixth consecutive quarter and 5 of our 6 six businesses achieved strong growth in sales and profits – including double-digit profit growth in our three largest businesses.

We were pleased that margins were 20% or better across the board.

We converted nearly 100% of net income to free cash flow in the quarter, which enabled us to return nearly \$1 billion to our shareholders via a combination of dividends and share repurchases.

On the other side, the challenges we faced will not surprise you. The US economy remained difficult, particularly in those areas that touch the consumer.

George will update you on our Optical Systems later.

And finally, commodity input prices continued to rise, which pressured our raw materials somewhat, but we have good pricing story here which I will address in a few minutes.

### **Patrick D. Campbell – Sales & EPS**

Please turn to slide number 5.

All information that I will present today will exclude special items, so allow me to summarize our special items quickly to get them out of the way. Last year's second quarter results included a net gain of 2 cents per share from special items. The second quarter of 2008 reported earnings-per-share of \$1.33 included a net charge of 6 cents per-share related to a loss on the divestiture of HighJump Software along with charges for exit activities at a Industrial and Transportation manufacturing facility located in the UK. Excluding these special items, Q2 2008 earnings per share were \$1.39 as compared to \$1.23 per-share in last year's second quarter. Please refer to the attachment in today's press release for a more in depth discussion of special items.

Second-quarter sales grew almost 10 percent to \$6.7 billion, which represents the sixth consecutive quarter of record sales. In our three largest global businesses, namely Industrial and Transportation, Health Care and Safety, Security and Protection Services, revenues expanded at a double-digit clip. On a local-currency basis, sales were up 4.6 percent versus last year.

Looking at the business geographically, sales growth was once again strongest in our international operations. Sales grew at a double-digit pace in Latin America, Europe and in Canada, and at one percent in Asia Pacific. Importantly, if you adjust Asia Pacific results for Optical Systems, sales growth was nearly 17% during the quarter.

Operating income was up 8.5 percent to \$1.5 billion, as four of our six business segments delivered double-digit operating income percent increases.

Operating margins topped 22 percent for the quarter with all six of our business segments achieving 20 percent plus operating margins. For several years in succession, we have continued to maintain best-of-breed margins regardless of the business environment. The strength of our broad business portfolio overcame a tough U.S. economic environment, all time high raw material prices for many key materials and a secular transition in our optical film business. I applaud the efforts of 3Mers everywhere for pulling off what many deem impossible ... that is, maintaining superior operating margins while simultaneously investing in growth programs for the future

Earnings per share in the second-quarter were \$1.39, up 13 percent year-on-year.

### **Patrick D. Campbell – P&L Comparison Vs. Last Year**

Please turn to slide 6 for an in-depth review of the second quarter performance versus the same quarter last year.

We have again isolated the impact of optical films in order to help you better understand our results.

The strength of our global portfolio was again evident in the second quarter as sales increased almost 10 percent, or 14% ex-Optical. This 14% growth was a combination of organic growth, acquisitions and, of course, positive currency impacts. This marks the sixth consecutive quarter of record sales.

Gross margins were down slightly from last year's comparable quarter. It was no surprise to us that raw material costs rose year-on-year, in the range of 3 to 4 percent. Excluding the optical business, we were able to offset this inflation with selling price increases along with relentless process improvements and cost reductions of our own, so once again we are effectively managing through a challenging commodity price environment.

Operating profit grew by 8.5%, or 18-plus percent ex-Optical, and our premium margins continued at 22.1%. And finally, our tax rate improved by almost 2 points to just under 31%, consistent with our tax reduction strategy.

Earnings per share rose 13% to \$1.39 a share. Excluding optical films, earnings-per-share would have improved by nearly 24% year on year.

### **Patrick D. Campbell – Sales Recap**

Let's now shift our focus to breaking down our second-quarter sales growth performance. Please turn to slide number 7.

Worldwide sales growth in U.S. dollar terms increased 9.7 percent led by our international operations with sales growth of 11.9 percent. U.S. sales growth was up 6 percent in the quarter. Second quarter local-currency growth was 4.6 percent with organic up 40 basis points, price up 10 basis points and acquisitions, primarily Aearo Technologies, adding 4.1 percent. Excluding the impact of the optical business, local-currency sales increased 8.1 percent as organic volumes increased 2.5 percent, selling prices increased 1.1% and acquired volume was up 4.5 percent.

International sales on a local-currency basis increased 3.4 percent in the second quarter. Organic volumes increased 1.8 percent with 5 of 6 businesses posting positive organic volume growth. Selling prices declined 1.1 percent including a 12 percent price decline in optical. Acquisitions added 2.7 percent to international local-currency growth in the quarter. Ex. optical international local-currency sales growth was 9.1 percent including 5.5 percent from organic growth, 3.1 percent from acquisitions and 0.5 percent from selling prices. On a regional basis international local-currency sales growth was led by Latin America at 21 percent followed by Canada at 7 percent and Europe with local-currency sales growth of 6 percent. Local-currency sales declined 4 percent in Asia Pacific due to a 37 percent local-currency decline in optical. Excluding optical, Asia Pacific sales in local-currencies increased 10 percent over same quarter last year.

Economic conditions in the U.S. continue to remain challenging especially in the retail, housing and automotive OEM markets. Second-quarter local currency sales increased 6.6 percent driven by a 6.5 percent impact from acquisitions. Selling prices increased 2 percent in the quarter with all businesses delivering price increases as we try to offset the continued high price of commodities while organic volumes were down 1.9 percent. Four of our six business segments delivered sales growth in the U.S. during the quarter.

### **Patrick D. Campbell – Year-to-date Highlights**

Please turn to slide eight, where I will briefly comment on our year-to-date progress.

At the end of the second quarter, year-to-date sales were up 9.3 percent, with operating income up 6.0 percent and earnings per share were up 10.8 percent. Excluding optical, year-to-date sales are up 12.4 percent while profits increased 15.2 percent. And finally, free cash flow was up 4.7 percent year-to-date versus the first half of last year.

### **Patrick D. Campbell – Balance Sheet & Cash Flow Metrics**

Please turn to slide 9 for a review of the balance sheet and cash flow metrics for the second-quarter.

Free cash flow for the quarter was \$909 million versus \$866 million last year. Free cash flow conversion for the quarter was nearly 100 percent.

Working capital turns were 4.9 turns, down slightly year-on-year and in-line sequentially. Foreign currency translation increased accounts receivable and inventories by \$243 million and \$167 million year-on-year while reducing them sequentially by \$36 million and \$13 million, respectively.

Second-quarter capital expenditures were \$334 million, down \$14 million versus same quarter last year and up sequentially by \$36 million. Through six months we have spent \$632 million on capital expenditures and expect full year cap-ex to be in the range of \$1.3 to \$1.4 billion.

Dividends to our shareholders were \$351 million during the quarter, consistent with past quarters. Share repurchases totaled \$572 million in the second-quarter which is up slightly from recent quarters. Weighted average shares outstanding were 712 million, down nearly 3 percent year-on-year and 1 percent sequentially.

And lastly, our debt-to-capital ratio was 32 percent at the end of the quarter.

## Patrick D. Campbell – Business Results

Now let's delve into our performance for each of our segments for the second-quarter. Please turn to slide ten for a summary of our results for our largest segment **Industrial & Transportation**, a business where our innovative solutions help manufacturers improve their businesses. With broad-based revenue growth across the portfolio, Industrial and Transportation delivered an outstanding quarter, with sales of \$2.1 billion, up 15.5 percent and operating income up 18 percent.

Sales growth in the business was led by our industrial adhesives and tapes business, followed by our automotive aftermarket, abrasives and closure systems for personal hygiene products. Local currency sales increased 8.7 percent, including 4.2 percent from acquisitions. Year-to-date sales are up 16.3 percent, with operating income also up 16.3 percent as operating margins held steady at 21.5 percent.

All geographic regions saw sales growth in the quarter, including the US. Strong market penetration continued in emerging economies, especially BRICP countries, where the business drove strong double digit organic local currency growth. Elsewhere around the globe, we saw double-digit growth in Europe, Asia Pacific and Latin America.

Some of the products driving growth in the second quarter were abrasives used in autobody shops; laminating adhesives providing attachment solutions in industrial applications; diaper closure systems; and packaging, masking and specialty tapes.

Continued investment in new technology has brought some very innovative new products such as new glass bubble filler that can reduce the weight of automobiles and clean sanding discs that can significantly reduce dust throughout various finishing processes in industrial market and automotive refinishing applications.

Industrial and Transportation Business continues to bring 3M technologies and solutions to high growth market space such as Oil and Gas, Renewable Energy and aerospace market.

Now please turn to slide 11, for a look at the second quarter highlights for our **Health Care** business, where we provide the health care community with innovative solutions based on 3M technology platforms to improve patient lives and the productivity of health care providers.

Health Care continued its exceptional performance for 2008 with broad based sales growth of 13.1 percent. Profits rose nearly 12 percent, to \$310 million. Local currency growth was 7.7 percent, nearly all organic. Year-to-date, sales have increased 12.5 percent, with profits up 15.5 percent and margins increasing 80 basis points from 2007 levels to 28.8 percent. Three divisions drove strong double-digit sales growth in the quarter—namely orthodontics, dental, and medical with orthodontics and dental, or our oral care business, showing outstanding strength and leading the way.

The US market had mid single digit growth, while international sales growth was outstanding, as all regions drove both double-digit growth for sales and profits. Some of the products that drove sales include advanced wound care and surgical tapes, dental restorative materials and equipment for crown and bridge procedures and self-ligating brackets for orthodontics.

In our medical business, we closed the Solumed acquisition, further solidifying our position as a provider of leading-edge medical products designed to prevent infections. Also, we were awarded top honors by the International Association for Food Protection for our contributions to food safety technology.

3M's dental business, where we saw double-digit sales growth and profits, closed in July a deal for IMTEC, a manufacturer of dental implants and scanning equipment primarily known for their mini dental implants, which importantly patients can be treated by their regular dentist versus seeing a specialist. We also marked the first sales of our chair-side oral scanner, a digital impression system that enables the motion capture of accurate and precise dental impressions.

In orthodontics, we continued to deliver strong double-digit results, and we announced a deal to acquire the German sister-company of US-based Lingualcare, expanding our offering for digital orthodontic products into Europe and Asia and helping to meet the surging demand for this invisible orthodontic solution.

Please turn to slide 12 for a recap of second quarter performance by **Safety, Security and Protection Services**, where our products increase the safety, security, and productivity of workers, facilities, and systems around the world.

Led by acquisitions, primarily Aearo, along with organic growth in personal protection, window films, cleaning solutions for commercial buildings and corrosion protection, Safety, Security and Protection Services delivered sales of \$1 billion for the first time ever, up 30.2 percent from last year. Growth in local currency was 25.6 percent, including 19.8 percent from acquisitions. Acquired growth was primarily from Aearo Technologies, an Indianapolis-based but global manufacturer of personal protection and energy absorbing products that adds hearing protection and fall protection lines to 3M's existing full-line of respiratory products.

Operating income for the quarter rose 30 percent, while margins remained steady at 21.2 percent, as compared with last year. Year-to-date, sales have increased 22 percent, with profits up 21 percent and margins holding steady at or above 22 percent. Included in these operating income results are approximately \$20 million of one-time Aearo acquisition related costs negatively impacting Q2 and year-to-date operating margins by almost 2 percent and one percent, respectively.

Driven by the Aearo acquisition sales were strong across the globe, led by double-digit sales increases in Europe, the US and Latin America.

In personal protection, we continue to see strong demand for our maintenance free and elastomeric respirators as well as reflective materials. And with the Aearo acquisition, we now offer a more complete personal protection solution that spans the industrial, military and construction markets. Our Speedglas™ auto-darkening filters and helmet product development team has been awarded Business Week's gold IDEA award for design excellence.

In building and commercial services, we saw strong demand for our floor maintenance products, due to an increase in commercial construction in many parts of the world. Also, we have continued to see steady growth in our corrosion protection products, where we provide pipe coating solutions that extend the life of both the underground and above ground pipelines.

In our track and trace business, we refined our strategic direction for the tracking of high value assets, asset utilization, and safety and security applications. In connection with these strategy refinements, we sold off our HighJump Software business.

Now please turn to slide 13, for details about our **Consumer and Office** business, home to some of our best known brands and enduring franchises.

Our Consumer and Office business improved from Q1 as sales increased 7.8 percent to \$899 million in the second quarter. Local currency sales were up 3.5 percent, including 0.7 percent from acquisitions. Profits were up 9.1

percent with operating income margins of 20 percent. Year-to-date sales are up 5.2 percent and operating profits are up a percent which we feel is an outstanding result in the current business climate.

We saw positive growth in all divisions, with do-it-yourself and home care leading the way. Overall sales growth was tempered by weakness in the office mass retail channel in the U.S. Geographically, 3M's international subsidiaries continued to drive growth again this quarter, with double digit sales growth in all regions led by Europe and Asia Pacific.

Through expanded distribution, brand presence and merchandising programs our Consumer and Office business drove outstanding growth of our Filtrete™ air filtration products for residential HVAC systems. Working with key accounts such as Wal-Mart, Target, Home Depot and Lowes the Filtrete™ team delivered sales growth of 75 percent in the second quarter versus last year.

In our Home Care division, we recently launched the Scotch-Brite™ Ultra Nail Saver as well as Fur Fighter™ pet hair remover that has taken off with customers, and which has been recently endorsed by Martha Stewart as well as gaining the *Good Housekeeping* magazine's "seal of approval." In addition, Consumer Reports just listed our Ultrathon insect repellent as an "everyday best buy" for 2008. We also launched our Nexcare™ cold-sore treatment product, leveraging our experience in manufacturing products focused on skin wellness to provide consumers with lasting, permanent relief from cold-sores.

Other products driving growth in the second quarter were Scotchbrite™ scouring products, along with Scotch™ blue masking tapes and Command™ mounting and fastening products.

Please turn to slide 14, where I'll provide an overview of results for our **Electro and Communications** business, where we are a leading supplier to the electrical, electronics and telecommunications industries.

Sales for the quarter increased nearly 8 percent versus the same quarter last year. Profits rose 11.4 percent, driven by outstanding cost discipline producing margins of 20.1 percent. Sales in local currency increased 2.2 percent, mostly from organic growth. Year-to-date, sales have increased 8.5 percent, with profits up 12.5 percent and margins growing by 70 basis points to 20.1 percent.

Overall, Electro and Communications saw strong double-digit growth in three of its businesses: Electrical Markets, Electronic Markets Materials and Communications Markets. International sales growth was strongest, led by double-digit growth in Asia Pacific and Europe.

Some of the products driving growth in the second quarter were outside plant and central office equipment used in the telecommunications industry, insulating and protecting products used in electrical applications, and electrical and power grid solutions used in the energy and electric power industry. We continued to see our volumes for inkjet printer circuits decline, which adversely affected sales by 1 percent and operating income by nearly 3 percent.

To date, our Aluminum Conductor Composite Reinforced, or ACCR product, which allows energy suppliers to transmit more than two times the capacity without the risks and delays of major construction projects, has had 25 installations, with the most recent installs being announced for Shanghai, British Columbia, Brazil and Silicon Valley.

Please turn to slide 15 for a review of second quarter results for our **Display and Graphics** segment, where we make the films that brighten the displays on electronic products, such as flat-panel computer monitors, cell phones, PDAs, and LCD televisions along with reflective sheeting for transportation safety, commercial graphics systems and projectors and projection systems.

During the second quarter we saw positive double-digit sales growth in Commercial Graphics and single-digit growth in Traffic Safety Systems where we were recognized by the American Road & Transportation Builders Association with a first place award for environmental protection and mitigation. And if you watch closely during the upcoming Beijing Olympics, you'll see our commercial graphics specialty films at work all around the sports venues.

Overall, second quarter sales for Display and Graphics was down nearly 16 percent with profits down 36 percent driven by the sales and profit declines of 36 and 54 percent respectively in our optical film business. Operating margins held constant at 21.7 percent. Excluding the optical film business and divestitures, Display and Graphics sales increased 5.3 percent and profits were flat.

Display and Graphics saw the effects of a slowdown US-driven markets for Traffic Safety Solutions and Commercial Graphics. Highway construction and commercial graphics for the trucking industry have both slowed as a result of sequential U.S. macroeconomic softness during the course of Q2. Despite the headwinds in the U.S, geographically we saw good performance in these businesses led by Europe, Latin America and Asia Pacific.

3M's Mobile Projection Technology, an ultra compact, LED-based projection engine for personal devices, is now in production. We are continuing to see interest in this new technology across a range of personal electronics options, including cell phones, laptops and PDAs.

That concludes my formal comments so now I will turn the program back over to George to give you color on the optical film business as well as our thoughts on the rest of the year. George.....

### **George W. Buckley – Optical Discussion and Guidance**

Thank you very much, Pat.

I'd like to first give you an update on the transition of our optical film business. There are still many investors who don't know the background or the challenges of this business, so let me give you a précis.

First, of the four optical film sub-segments we serve, three of them plus the polarized films are relatively stable and strong for us. The issue, of course, is in the supply of films to LCD TV.

Fundamentally, the rapid rise of Vizio as a club brand was the catalyst for this secular change. Beginning about two years ago, they rose from 8<sup>th</sup> place to 1<sup>st</sup> place in the US market in less than nine months. They were able to do what they did by reducing brightness and off-angle viewing standards, vigorously driving out other costs to hit key price points and getting a great distribution channel. As new and lower price points were hit, the consequent explosion of volume in the market at the bottom of the pyramid surprised us all. As the market commoditized, it rattled the large branded set manufacturers. They responded by following Vizio's decontenting example and worked to compete better.

The net result was that by lowering specifications, TV manufacturers were able to design out some of the high performance films and 3M did not have the product at the bottom of the market available for sale. We needed that low-cost film product available three years or even four year ago. So for 3M, the impact was that we suffered loss of volume from decontenting as well as huge price pressure, leading ultimately to the results and financial transition that we are experiencing today.

You'll recall that in April we said that we expected the balance of 08 to follow the same pattern for Optical that we saw in Q1 and also that it would be the toughest year of transition for that business. So the pattern that played out in Q2 was pretty much as we expected. Optical margins for the quarter actually came in a little better than our expectations; though sales were a little bit lower than we thought.

To give you an idea of the scale of the change, year-on-year sales of optical film for LCD TV applications declined by two-thirds while profits dropped nearly 80 percent. So after dealing with a tough transition here, I think we can see bottom, even if we haven't quite reached it yet. I don't expect this sub-segment to completely disappear, since there is always a small percentage of consumers who want high-performance and some films will be retained for that purpose.

So what are we doing to manage through this transition period?

First, the new management team has been in place in Asia for a few months now... and I am impressed with their quick understanding of current realities – the realities of both market dynamics and the value proposition we bring to our customers. Their quick uptake is helped by their knowledge of the consumer electronics business in their background.

To strengthen our competitive position, we are taking additional action to get our cost structure in line with these new market realities.

- Today we announced the elimination of 300 jobs in optical systems, all across the business, mostly in the US, but some overseas too: these are in SG&A, Mfg., R&D and other areas. This represents a 20 percent staff reduction in that business.
- We are also improving manufacturing efficiency by consolidating several film converting sites in the Asia region. Collectively, these actions will save around \$30 million dollars annually.
- Additionally, our former film converting plant in Poland has been taken out of the division and is being transformed into a multi-use, multi-divisional facility for other 3M businesses.
- We also have intense manufacturing cost reduction activities under way and they are making an impact.
  - As we said, margins in Optical improved by over a point sequentially compared to last quarter as some of the cost reductions took hold.
- At the same time, we are actively addressing the market situation by simplifying our product portfolio and making it more relevant to our customers.

Our optical products will continue to add value to our customers through technology, even in TVs. This is especially so as energy reduction is now becoming more important to set, monitor and notebook manufacturers. Our technologies contribute to and even enable the trend toward thinner TVs. I have said this before, but 3M optical films allow a reduction of 50 to 70% in energy over typical configurations and consumers can have that reduction today. You can imagine that we are working this issue very hard and it provides one of the upside opportunities in LCD TVs as does continued unit growth.

So to summarize optical, the bottom appears to be in sight, if not quite here yet and we have a new team in place close to our customers, we're aggressively taking cost out, and we're working hard to maintain margins and protect the bottom line. We're expecting to be complete with this transition in 2008, with the possibility of some bleed over into 2009, but if so, its impact should be small.

Of course, we're working hard to maintain margin and protect the bottom line all across the company as we continue to drive our growth agenda – even as we fight our way through these not too favorable U.S. economic conditions. As Pat described, it's tough out there, particularly in retail, housing and automotive OEM markets, no surprises there for

anybody. And we will continue to see blips in some of our short cycle businesses where impact is realized quickly... and, fortunately, where that impact stabilizes quickly also.

I'll remind you that our approach to growth investment is more practical than ideological. Like all public companies we must always keep one eye on the short term and one eye on the long-term. We are most certainly determined to drive growth for the long term and we will do so prudently and with attention to maintaining optimal flexibility in the timing of our investments. And as always, you'll see constant attention to operational discipline as it accompanies and enhances our drive toward growth.

Let me quickly update our guidance for 2008. Please turn to slide 16.

For the reasons Pat and I have outlined today, we remain committed to deliver 10 percent plus earnings-per-share growth for 2008.

With year-to-date operating income margins of 22.7 percent, we continue to expect full year operating margins to be in the range of 22.5 percent to 23.5 percent.

Our tax expectations for the year are also in the band 31.5 percent to 32 percent.

And finally, our 2008 full-year capital-expenditures range between \$1.3 billion to \$1.4 billion and this remains unchanged from previous guidance.

That concludes our formal comments and we are happy to take your questions.