

Letter to Shareholders



Research & Development: Driving innovation and serving customers



Henri Lachmann
*Chairman and Chief
Executive Officer*

Dear Shareholder,

More than ever, your Company is committed to **pushing back the limits of its markets and stepping up growth**. This means broadening our lineup and enhancing the quality of our service, day after day. Because innovation is critical in achieving these objectives, our R&D strategy must focus actively on our customers' expectations so that we can meet their needs as closely as possible.

We have 4,500 researchers and developers in 25 countries and work with some 50 private university laboratories worldwide. Our R&D budget exceeds 5% of our revenues. All this goes to show that innovation is our priority. Being close to customers is also of key importance. That's why we've been **internationalizing our R&D resources**, notably in fast-growing emerging markets, with the opening of three centers in India, China and Mexico.

For historical reasons, nearly half of our resources are concentrated in France, which forms the core of our R&D skills base. One of the major 2006 events will be the inauguration of **Electropôle**, our global development center for protection and power control in Grenoble, France. With 1,000 team members, this center will be the largest in the world.

Our strategy of **selective acquisitions** in activities close to our core business, but with higher growth potential, also fuels innovation. A recent example is **BEI Technologies**, which makes leading-edge sensors for use in navigation systems and application monitoring in the automotive, aeronautic and manufacturing industries. One of BEI's strengths is its advanced expertise in the development of electronic microtechnologies. This acquisition, along with others, like **PMI** in energy management systems, perfectly illustrates our commitment to expanding our portfolio of products and services while bringing in new technological competencies that should benefit all of our businesses.

By making R&D a **priority** and by continuously striving to innovate faster and better, we are actively helping to build the New Electric World, and that's a source of pride for all of us here at Schneider Electric.

Third-quarter 2005

sales up 14.3%

Sales for the third quarter of 2005 totaled €3,017 million, up a strong 14.3% on a current structure and exchange rate basis from the year-earlier period. Like-for-like sales growth was particularly high at 10.3%.

All regions enjoyed robust growth during the quarter:

- Growth plans amplified the impact of very favorable market conditions in North America.
- Western Europe saw a gradual upswing in demand in most countries, although the situation remains mixed.
- The Company's very positive momentum continued in the emerging markets, with yet another excellent performance in a buoyant environment.

Assuming current economic conditions and exchange rates continue, Schneider Electric has again revised its full-year targets upwards, to 7% for organic sales growth and 15%-20% for operating income.

Breakdown by region

(€ million and percent change like-for-like)

Europe: 1,396

+ 7.9 %

North America: 820

+ 11.0 %

Asia-Pacific: 554

+ 12.0 %

Rest of the World: 247

+ 18.5 %



Strong growth in first-half 2005 results

Sales: +9%

Operating income: +17%

Net income: +15%

"Thanks to its active repositioning in emerging markets and new specialties, Schneider Electric continues to generate high sales growth," commented Mr. Lachmann on July 29, 2005. "This growth, combined with stepped-up implementation of our efficiency plans, has driven a new, strong increase in our financial results, building on an already remarkable performance in 2004. The successful launch of the new Company Program and the active involvement of all our team members give us confidence in Schneider Electric's ability to deliver growth and create wealth."

Research, Develop



"Schneider Electric's R&D strategy is fully focused on market and customer expectations."

Alain Marbach

Executive Vice-President, Products & Technology

How much does Schneider Electric devote to R&D?

"Schneider Electric invests more than €500 million each year in research and development. Upstream, we are involved in fundamental research into the basic physical phenomena of electricity, such as arc breaking in circuit breakers. Next comes new product development. Then we come to maintenance, which ensures a product's continuous quality and competitiveness, and adjustments required to address new geographic markets or applications."

Schneider Electric's motto is "pushing back our limits". Does that mean internationalizing R&D?

"It's true that we have considerably internationalized our R&D resources over the past few years. Although France still represents 50% in people terms, international skills centers have been created or restructured. R&D centers should be located close to our most demanding customers.

This is the case for us in Japan, Germany and the US—three countries where we've got around 1,500 high-quality R&D team members. At the same time, we need to move nearer the major customers of tomorrow. That's why we recently opened a research center in Bangalore, India and have concentrated heavily on developing our small unit in Shanghai, China. By the end of the year, we'll have 500 people at these two sites."

Evolis 24 kV

Latest addition to our range of medium voltage vacuum circuit breakers

Our innovation strategy is designed to offer the very best of a given technology so that customers benefit from equipment that is easier to integrate, install and maintain. Taking things a step further, we use other electronic, digital or IT features to enhance this technology. Take circuit breakers, for example, which play a critical role in ensuring the safety of people and equipment and in controlling energy distribution and use. In 2005 Schneider Electric presented Evolis 24 kV, the latest addition to its Merlin Gerin family of medium voltage vacuum circuit breakers. Evolis is intended for all electrical network applications, either new or renovation, for utility companies, infrastructure, manufacturers and commercial buildings. Thanks to our expertise in circuit breaker design, we've consistently been ahead of the technological curve in our market, developing solutions that support the changing needs of our user and contractor customers. An example is Pilot, the first supervision module integrated in a medium voltage circuit breaker. Pilot guarantees top long-term performance while making Evolis products easier to integrate and operate.

ment and Innovation

How do R&D and innovation contribute to the Company's growth?

"Our customers appreciate our products' quality, which is why they are willing to pay a substantial premium for our brands. We devote around a third of our R&D budget to maintaining our ranges, enhancing quality, replacing obsolete components and finding ways to use less expensive raw materials. The other two-thirds go to fundamental research and new products. In a nutshell, we want R&D and new products to make an even larger contribution to growth than in the past. This is the focus of our new2 program, through which we hope to leverage lineup improvements faster than ever before. Our main strategic objectives for innovation are to optimize ease of deployment and use, safety and upgradeability."

Could you give us an example of a recent innovation?



Alvaïs light switch

"One of our innovations was developed with hospitals in mind, to help in the critical fight against residual bacteria. When you think about it, light switches can play an unsuspected role in spreading bacteria because numerous people touch them every day. We've developed a special plastic formula for hospitals and medical offices to ensure optimum sanitary conditions. The underlying technique, which uses silver ions in the material to kill microorganisms,

significantly reduces the surface bacteria population. It's used on the Alombard brand's Alvaïs range."

How do the new Technopôle research center and Electropôle development center fit into your strategy?

"The scientific and technological challenges facing us have grown immensely over the past few years due to a combination of factors. Skills have become increasingly high tech and our customers' security requirements have risen sharply. More and more, we want to use thinner materials and integrate electronics into mechanical components. That's why we built a more functional research center in Grenoble, called Technopôle. More important, we've set up a new development center with a staff of nearly 1,000 in less than 18 months, in the Grenoble suburb of Eybens. Our electromechanical research resources from all over France have been concentrated in this new skills center. With Electropôle and Technopôle, we're giving our researchers the tools they need to enhance their technological capabilities and work on future-oriented projects."

R&D facts and figures

- > **4,500** people
- > **25** countries
- > **5%** of revenues
- > **50** partnerships with private university laboratories



Electropôle in Eybens.



Evolis 24 kV



Altivar 71

Altivar 71

A broad, aligned range of speed drives for high-performance applications

Without a speed drive, a motor either operates at full throttle or stops whenever a movement is required. This puts heavy wear and tear on the motor's mechanical components. Speed drives protect these components, reduce electrical consumption and provide greater performance and ease of use. They also make it possible to meet increasingly stringent standards, notably in the food industry.

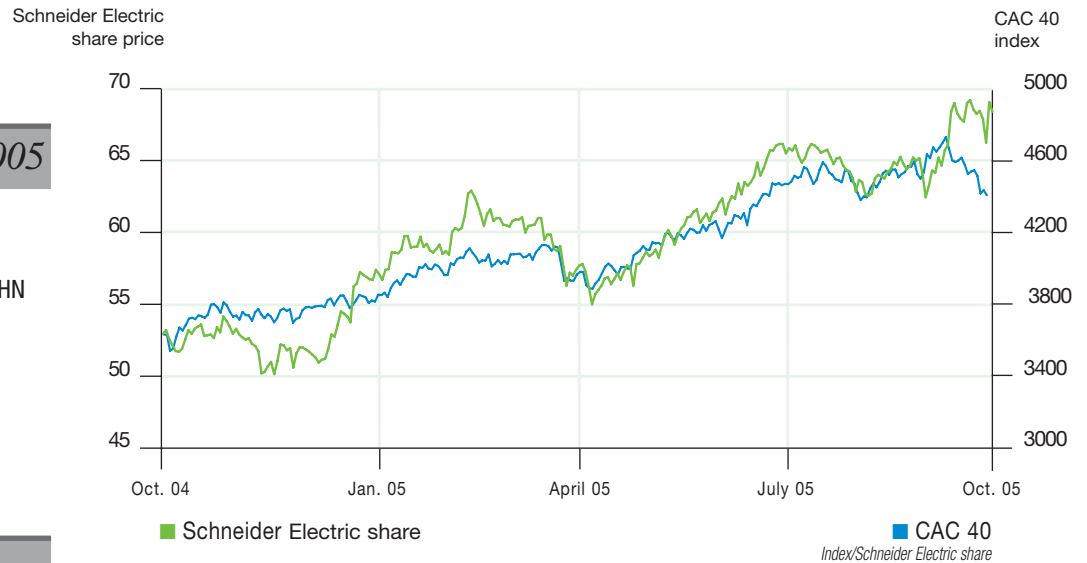
Our new generation Altivar 71 drive stands out for its broad power range, advanced functionalities and exceptional performance. Thanks to these qualities, it is perfectly suited to the needs of simple and complex machines of all power ratings and able to work in all types of automation solutions, from lifting and handling to woodworking to packaging. Above all, Altivar 71 is easy to use, with a highly ergonomic graphic terminal on the front facing. It can provide protection and safety in all locations. What's more, configurations and viewing screens can be personalized in relation to users' needs.

Looking to the future, we built this new drive to be recycled. Fully 88% of its components can be recycled at the end of their useful lives, compared with the current requirement of 70% set by the European Directive on Waste from Electrical and Electronic Equipment.

Schneider Electric Share/CAC 40 Index

Over one year

Oct. 21, 2004 – Oct. 21, 2005



Share data-October 2005

- Shares outstanding: 226,196,677
- ISIN code: FR0000121972
- Stock market site codes: SU or SCHN
- Traded on the Euronext Paris First Market; eligible for the deferred settlement service
- Par value: €8.00
- Market capitalization: €15.4 billion

Investor calendar

December 15, 2005 at 6:00 p.m.
Palais des Congrès de Marseille
 Shareholders' meeting

February 16, 2006
 2005 annual results and fourth-quarter sales

April 28, 2006
 2006 first-quarter sales

May 3, 2006 at 3:00 p.m.
Palais des Congrès de Paris
 Annual Shareholders' Meeting

May 9, 2006
 Dividend payment

July 28, 2006
 2006 interim results and second-quarter sales

October 24, 2006
 2006 third-quarter sales

For further information, shareholders in France may call the following toll-free number:

N° Vert 0 800 20 55 14



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Incorporated in France with limited liability and issued capital of €1,865,553,416
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Schneider Electric wins European Enterprise Grand Prize

The European Enterprise Awards, created by Enjeux-Les Echos, HEC and Roland Berger Strategy Consultants, are designed to promote the European corporate model and highlight winning strategies. They provide an opportunity to take the temperature of European companies and identify, each year, their new stakes, challenges and success stories.

Schneider Electric fulfilled the Awards' five main criteria: growth and improved performance, value creation for shareholders, innovation through R&D, a solid European base and initiatives to take advantage of the European Union's eastward expansion. As a vibrant, bold and assertive company that knows where it's going, Schneider Electric has successfully expanded in Europe and the international market.