



Annual Report 2005

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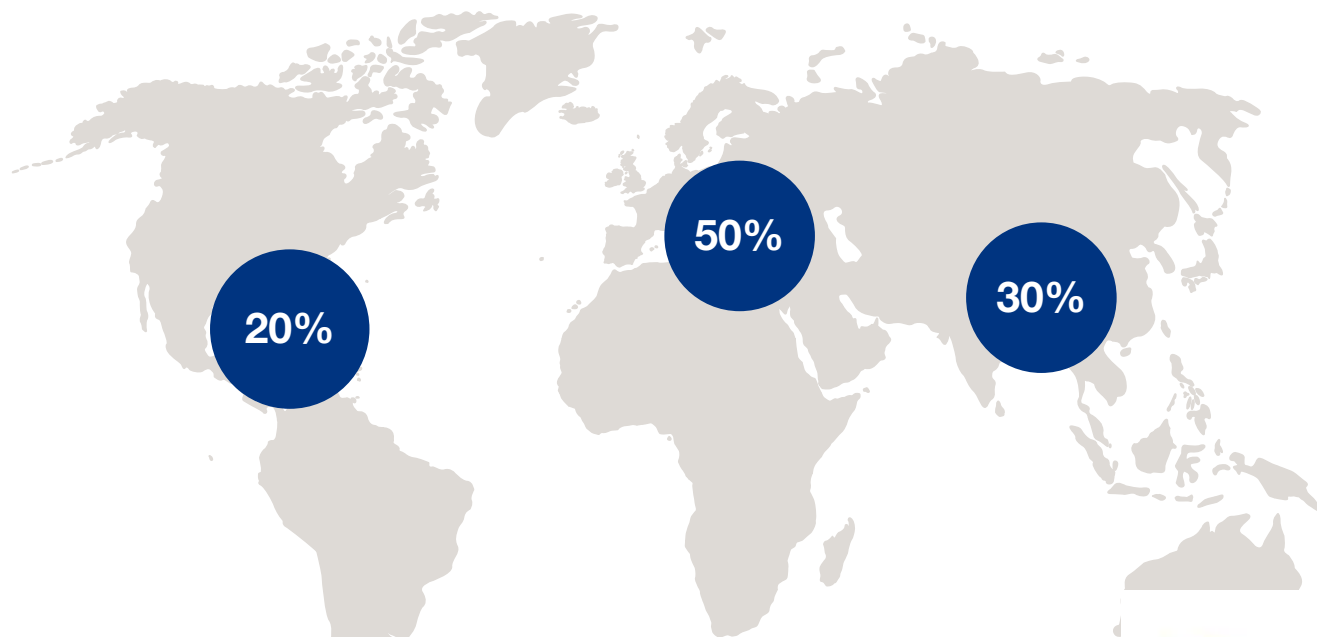
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Cover:

Turning dark into light

A drop of oil. Containing enough energy to keep a lamp lit for several minutes. At Alfa Laval we know this because we are involved at almost every stage of the long process from the extraction of raw materials through production to its ultimate use as energy. And not just with oil. Gas, steam and nuclear energy as well. Our equipment and systems undertake the vital tasks of heating, cooling and cleaning in these complex, often difficult processes. They offer unsurpassed efficiency, require minimal floor space and have extremely low maintenance costs.

Alfa Laval in two minutes



Global sales and production

One of Alfa Laval's greatest strengths is its global coverage. The company sells its products in approximately 100 countries, of which 55 through its own sales organizations. About 50 percent of sales are in Europe, 30 percent in Asia and 20 percent in North and South America. The company has 20 large production units (12 in Europe, six in Asia and two in the US), and 70 service centers. Alfa Laval has approximately 9,500 employees (9,400). The largest numbers of employees are in Sweden (1,938), Denmark (1,113), India (1,063), the US (799) and France (717).

Profitable growth

Alfa Laval's growth strategy means that the company shall grow faster than the competition. Growth shall be achieved with favorable profitability. The aim is an annual average growth rate of at least five percent over a business cycle.

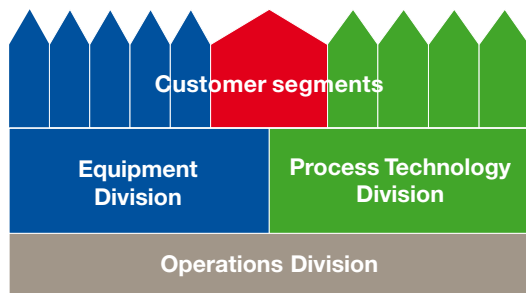


Market-leading positions that are developed continuously

Alfa Laval's operations are based on leading global positions within the three key technologies: heat transfer, separation and fluid handling. Continuous development of products is required to strengthen competitiveness. Annually, between 2.5 and 3.0 percent of sales is invested in research and development, which results in 25-30 new products each year. During 2005, specific product centers were established to shorten the time to market of new products.



ates



An organization near the customers

The market strategy at Alfa Laval is based on a sales organization that works close to the customers. The company's organization is based on a number of customer segments and to gain a distinct customer focus the segments are divided into two divisions. The Process Technology Division and the Equipment Division market and sell the company's products, with different offerings aimed at different customer segments. The Operations Division is responsible for production procurement, manufacturing and logistics.

Strengthened market positions through acquisition

To further strengthen its position in selected markets, Alfa Laval continuously searches for companies with which to cooperate or to acquire. Alfa Laval seeks companies that:

- strengthen the existing core technologies
- supply new key products
- complement current products and strengthen the offering made to the customer

The Group has the management capacity as well as the financial strength to achieve this. In 2005, Alfa Laval conducted two major acquisitions – Packinox and Tranter, which combined have annual sales of about SEK 1.4 billion.

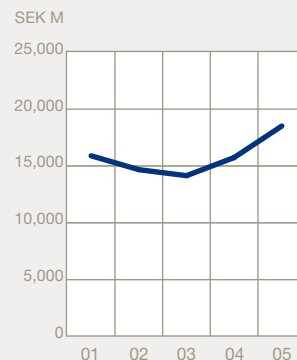
Industrial traditions from the 19th Century



Gustaf de Laval was a great engineering genius whose inventions include the centrifugal separator and the first functional steam turbine. During his lifetime, he registered 92 patents and started 37 companies. In 1883, he and his partner, Oscar Lamm Jr., established the company AB Separator, the forerunner of today's Alfa Laval.

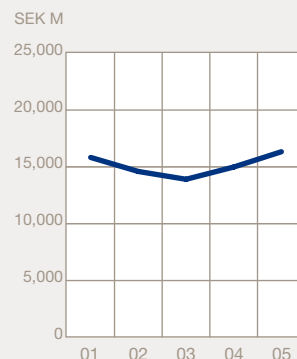
Order intake

Order intake during the year rose by 18 percent to SEK 18.5 billion (15.7).



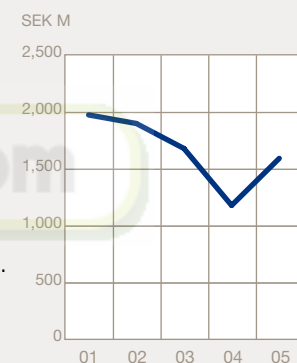
Sales

In 2005, Alfa Laval had sales of SEK 16.3 billion (15.0), an increase of nine percent.



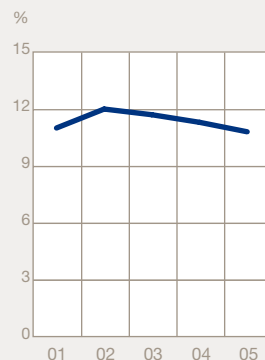
Operating cash flow

During 2005, Alfa Laval generated an operating cash flow of SEK 1,617 M, corresponding to ten percent of consolidated sales.



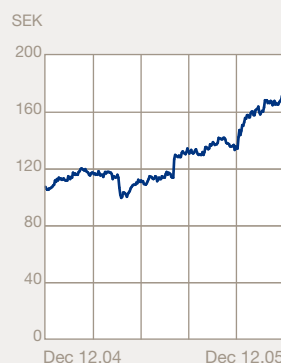
Operating margin

During 2005, the operating margin was 10.8 percent (11.3). The target is a margin of 10–13 percent.



Share up 60%

The Alfa Laval share rose during the year by 60 percent, closing at SEK 171(107).



Highlights

- Acquisition of Tranter from Dover Corporation in the US. This company is an established brand within both gasketed and welded heat-exchanger products for a range of applications. Tranter has annual sales of about SEK 900 M, with 470 employees.
- Acquisition of French company Packinox. This company is a world leader in the field of large, welded plate heat exchangers for use in refineries and other oil and gas applications. Packinox had annual sales in 2005 of about SEK 500 M, with approximately 150 employees.
- Several major orders* secured within the energy and process industry and marine fields totaling approximately SEK 800 M. The majority will be delivered in 2007 and 2008.
- Development and delivery contracts signed with the Volvo Group for the Alfdex system produced within Alfdex AB, a joint-venture company owned by Alfa Laval and Haldex. The order value is approximately SEK 400 M over a five-year period, with the first delivery at the end of 2005.
- Program to enhance efficiency of the Group's global production structure, including the closure of units in Madrid, Toronto and Tuusula (Finland). The measures will result in annual savings of at least SEK 50 M as of mid-year 2006 and generated a total non-recurring expense of SEK 125 M for 2005.
- The repurchase of the high-yield bond loan is expected to improve net interest expense by approximately SEK 80 M per year as of 2006. The transaction generated a non-recurring expense of approximately SEK 85 M in 2005.
- The Board proposes a dividend of SEK 5.10 (4.75) per share for 2005.

* "Major orders" refers to orders with a value in excess of SEK 50 M.

Amounts in SEK M unless otherwise stated	2005	+/- % ⁶⁾	2004 ⁷⁾	2003	2002	2001
Order intake	18,516	+18	15,740	14,145	14,675	15,894
Net sales	16,330	+9	14,986	13,909	14,595	15,830
Adjusted EBITDA ¹⁾	2,030	+4	1,956	1,920	2,087	2,138
Adjusted EBITA ²⁾	1,766	+4	1,695	1,627	1,755	1,738
Operating margin (adjusted EBITA ²⁾), %	10.8	-4	11.3	11.7	12.0	11.0
Profit/loss after financial items	1,099	-13	1,262	817	372	42
Return on capital employed, %	22.7	-4	23.7	21.3	20.2	18.5
Return on shareholders' equity, %	16.0	+1	15.9	13.2	2.7	2.5
Earnings per share, SEK	7.92	+11	7.12	5.78	1.41	0.96
Dividend per share, SEK	5.10 ³⁾	+7	4.75	4.00	2.00	–
Equity per share, SEK	52.0	+10	47.2	43.8	40.4	38.5
Free cash flow per share ⁴⁾	8.52	-23	11.10	10.71	16.10	56.37
Equity ratio, %	35.9	-4	37.4	33.3	29.2	8.2
Debt/equity ratio, multiple	0.35	-3	0.36	0.49	0.78	5.38
Number of employees ⁵⁾	9,429	-1	9,527	9,358	9,125	9,259

1) Adjusted EBITA – Earnings before depreciation and amortization of goodwill and consolidated surplus values, and adjusted for items affecting comparability.

2) Adjusted EBITA – Earnings before amortization of goodwill and consolidated surplus values, and adjusted for items affecting comparability.

3) Board proposal to Annual General Meeting.

4) Free cash flow is the sum of cash flow from operating and investing activities.

5) Number of employees at the end of the period.

6) Percentage change between 2004 and 2005.

7) Restated to IFRS.



Focus on profitability, acquisitions and production structure

ORDER INTAKE DURING 2005 exceeded Alfa Laval's expectations and rose by 18 percent. The strongest growth was achieved in Latin America and Asia. In the latter region, order intake rose by about 25 percent and accounted for 30 percent of the Group's total order intake. In China, growth amounted to 12 percent. Japan exceeded expectations by reporting growth of 43 percent in a solid and broadly based upturn.

Order intake from the aftermarket increased by 8 percent. The maturing installed base in the rapidly expanding markets of China, India and Russia developed particularly favorably.

During the year, Alfa Laval strengthened its positions through a number of activities, with special focus on profitability, acquisitions and an improved production structure.

Higher profitability

The focus on profitability took the form of two main activities. The first was based on obtaining compensation from customers over the short term for increased raw materials prices. This was successful in the vast majority of cases, due to our strong market positions and the added value we create for our customers.

In the second round of activities, price and profitability per customer and product were analyzed. A number of measures were implemented to further develop our ability to improve the customer and product mix, the effects of which are gradually being seen.

Taken as a whole, Alfa Laval has demonstrated that the company has "pricing power", which led to a recovery in margins during the second half of the year.

Acquired growth

Our acquisitions shall primarily consist of companies that complement Alfa Laval's existing business in terms of products, geography or new sales channels. This will reduce risk, ensure the rapid integration of operations into Alfa Laval and assure that an early contribution is made to profitable growth. The acquisition of a fourth pro-

duct area should not be excluded, but has low priority. Industrial logic must also be present if a fourth product area is to be viable.

During the year, priority was given to consolidating the sectors in which we hold leading positions.

Through the acquisition of Tranter in the US from Dover Corporation, Alfa Laval strengthens its position in the market for heat transfer within fluid applications. In 2005, this company had sales of approximately SEK 900 M, with around 470 employees worldwide. Its operating margins exceed the average for Alfa Laval and the acquisition will make a contribution to earnings per share in 2006. Tranter will remain a separate market channel and continue to offer its product range under the Tranter brand via an independent distribution network in full competition with the Alfa Laval brand. The company will also retain its own R&D and production units, which are based in the US, Sweden and India. Tranter's sales are equally distributed between North America, Europe and the rest of the world. Tranter was consolidated in the Alfa Laval Group from March 1, 2006.

The French company Packinox has been part of the Alfa Laval Group since January 1, 2005. Packinox's customers are found within the refinery and petrochemicals industries. The company is known globally for its niche applications within the large, high-performance welded plate heat exchangers segment. Packinox is a good example of a complementary acquisition. The acquisition of Packinox broadens our product range and will generate favorable synergies. In 2005, this company had sales of approximately SEK 500 M and contributed to earnings per share. Its operating margins exceed the average for the Alfa Laval Group. Demand from the refinery industry and Packinox's performance during 2005 exceeded Alfa Laval's expectations.

Combined, Packinox and Tranter add 8-9 percent to profitable growth.

We have the financial strength and management resources to continue to grow through acquisitions.

Improved production structure

During the first quarter of 2005, Alfa Laval's earnings were charged with SEK 125 M in restructuring costs. The

"We have
resources
for conti-
nued acqui-
sitions"

“Expansion of local production in India and China is continuing at a rapid rate”



effects of the restructuring will generate at least SEK 50 M per year in cost savings, commencing in mid-2006. Three units are being closed and production at two of them is being transferred to existing facilities. These measures affect a total of 250 employees.

Expansion of local production in India and China is continuing at a rapid rate, both to establish a closer presence to these fast-expanding markets and to utilize these countries as a base for global supply. A new factory was started up in India for the production of decanters and work was commenced on the expansion of another plant for the production of high-speed separators. In China, new investments were made in tank-cleaning equipment and the assembly of decanters.

Strong demand from energy industry

High demand for energy and the resultant high energy prices throughout the world led to strong demand from the energy industry and related sectors. These are areas in which Alfa Laval holds a strong position and nearly 40 percent of order intake in 2005 derived from these industries. A number of substantial orders with a combined value of about SEK 800 M have been booked for delivery in 2006 and 2007. Most of the deliveries are for installation in the Middle East oil, gas and petrochemical industries. The orders are for the delivery of products manufactured exclusively within the company, which has a positive effect on profitability.

The strong growth in China and India has led to high raw material prices and also limited access to certain commodities. During 2005, we were able to offset most of the price hikes for materials, albeit with a certain time lag.

Higher proportion of new products

To strengthen our leading market positions, we must develop our products on a continuous basis. Today, we invest close to 3 percent of our total sales in research and development. That is a sustainable level.

Alfa Laval's aim is to increase the proportion of sales that derive from new products by speeding up the process from feasibility study to when the product is introduced to the customer. That will create a firm base for

profitable growth and stable prices.

An important step to speed up this process was taken during the year through the creation of product centers to secure product dimensions internally. Expertise is being assembled in a center for each product area, which will create a larger critical mass and higher efficiency. This is the largest organizational change undertaken within the Group in recent years.

The new T50 heat exchanger introduced during 2005 is a brilliant example of the importance of new products. This product is used for the central cooling of industrial processes and a number of the large orders secured during the year are based on this product.

Share performance

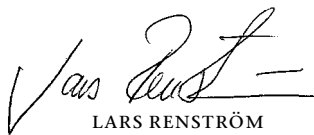
During 2005, the Alfa Laval share rose by 60 percent, at the same time as the Stockholm Stock Exchange as a whole rose by 33 percent and the SX20 Industrials index, against which Alfa Laval is measured, rose by 44 percent. Since the listing on May 17, 2002, the Alfa Laval share has risen by 90 percent, compared with 71 percent for the Stockholm Stock Exchange as a whole and 58 percent for the SX20 Industrial index.

Outlook for the near future

(included in the year-end report published on February 9, 2006). “In most of the markets, geographical as well as customer segments, that Alfa Laval serves a continued very strong demand is expected.”

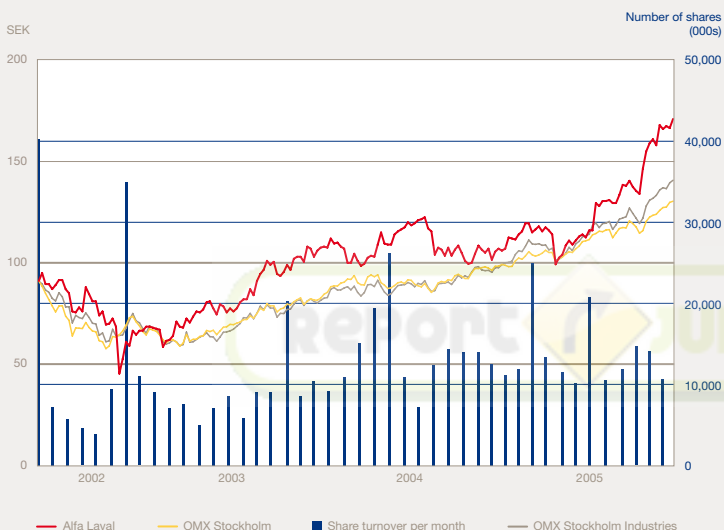
Finally, I would like to extend my appreciation to all employees within the Alfa Laval Group for their excellent contribution during 2005.

Lund, March 2006

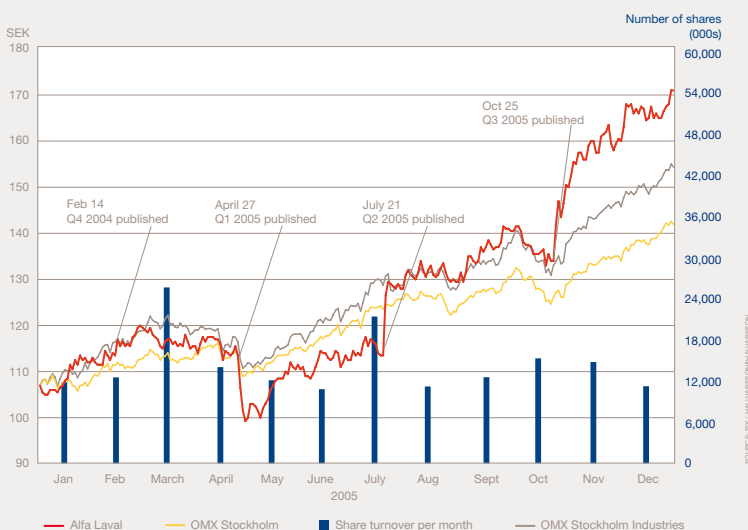

LARS RENSTRÖM
President and CEO

The share

Price trend, May 17, 2002 – December 31, 2005



Price trend, January 1, 2005 – December 31, 2005



THE ALFA LAVAL SHARE was first listed on the Stockholm Stock Exchange in 1901. After having been acquired privately in 1991, Alfa Laval was reintroduced on the stock market on May 17, 2002.

The Alfa Laval share is traded on the O-list and is part of the Attract 40 group of most-traded O-listed companies. Alfa Laval is also included in the OMX 30 index, which comprises the 30 most heavily traded shares on the Stockholm Stock Exchange by value. The shares listed on the Stockholm Stock Exchange are divided into different industrial sectors. Alfa Laval is listed under OMX Stockholm Industrials. Other companies in this sector include Atlas Copco, Sandvik, SKF and Volvo.

Share price rose 60 percent

The price trend for the Alfa Laval share was good in 2005 and rose by 60 (-2) percent from SEK 107 to SEK 171. Accordingly, Alfa Laval's total market capitalization at year-end was SEK 18.4 billion (12.0). The stock market as a whole (OMX Stockholm) rose 33 percent during the year, while the OMX Industrials index was up 44 percent. The highest and lowest quotations for the Alfa Laval shares during the year were SEK 172.50 and SEK 98.50.

Since the listing in May 2002, and up to December 31, 2005, the total return for the Alfa Laval share has been 109 percent. The total return includes reinvested dividends. For the stock market as a whole, the total return (measured by SIX Return) was 57 percent during the same period.

During the year, a total of 165.8 million (166) shares were traded at a value of SEK 20.9 billion (17.9). This means that 148 percent (149) of the total number of shares outstanding in Alfa Laval were traded during the year. The corresponding figure for the stock market as a whole was 124 (134) and for the O-list 87 (82) percent. During the year, an average of 326 (300) Alfa Laval share transactions were completed each day. Each transaction averaged slightly more than 2,000 shares (2,190). A trading lot in Alfa Laval corresponds to 100 shares.

Share capital

Alfa Laval has a total of 111.7 million shares with a par value of SEK 10 per share. This corresponds to a total par value of SEK 1,117 M. All shares carry equal voting rights and equal rights to the company's assets. Alfa Laval has

Ten largest owners, as at December 31, 2005

	Number of shares	Capital, %	Change in 2005
Tetra Laval B.V.	19,744,014	17.68	+/- 0
AMF Pension	8,838,200	7.92	+ 5,484,800
Fidelity	6,030,023	5.40	+ 6,030,023
Robur Funds	4,293,791	3.85	- 888,472
Fourth AP-fund	3,945,000	3.53	- 859,200
SEB Funds	3,676,680	3.29	- 321,320
State Street Bank & Trust	3,028,836	2.71	+ 940,468
Afa Insurance	2,830,413	2.53	+ 833,613
Handelsbanken Funds	2,774,210	2.28	+ 218,855
Lannebo Funds	2,417,895	2.38	+ 243,600
Others	54,092,931	48.44	
Total	111,671,993	100.00	

Data per share

	2005	2004	2003	2002 ¹⁾
Market price at year-end, SEK	171	107	109	77
Highest paid, SEK	172.50	125.50	110	98.50
Lowest paid, SEK	98.50	96	58	43.10
Price change during year, %	+ 60	-1.8	+40.3	- 15.4
Shareholders' equity, SEK	52.0	47.2	43.8	40.4
Market price/shareholders' equity, %	3.6	2.4	2.5	1.9
Dividend, SEK	5.10 ³⁾	4.75	4	2
Dividend as % of EPS, %	64.4	88.0	69.2	141.8
Direct return, %	3.0	4.4	3.7	2.6
Earnings per share, SEK	7.92	7.12	5.78	1.41
Unrestricted cash flow, SEK ²⁾	8.52	11.10	10.71	16.10
P/E ratio	22	20	19	55
No. of shareholders	10,964	11,758	7,254	5,746

¹⁾ Share listed on May 17, 2002.

²⁾ Unrestricted cash flow is the sum of cash flow from operations and investing activities.

³⁾ Board proposal to AGM.

Ownership distribution by size, as at December 31, 2005

Holdings	No. of shareholders	No. of shares	Holdings, %
1-500	7,396 (7,743)	1,478,380	1.32
501-1000	1,628 (1,771)	1,420,109	1.27
1001-5000	1,258 (1,490)	3,005,405	2.69
5001-10000	230 (297)	1,771,958	1.59
10001-15000	79 (87)	1,020,490	0.91
15001-20000	49 (54)	895,227	0.80
20001-	324 (316)	102,080,424	91.42
Total	10,964 (11,758)	111,671,993	100.00



Ownership categories (including Tetra Laval (the Netherlands))

	Capital, (%)	No. of owners
Institutions and funds*	92.73 (91.74)	1,993 (2,320)
Private individuals	7.27 (8.26)	8,971 (9,438)
Total		10,964 (11,758)

* Includes other legal entities

Geographic division

	Capital, (%)	No. of owners
Swedish owners	55.80 (55.65)	10,204 (10,986)
Non-swedish owners	44.20 (44.35)	760 (772)
Total		10,964 (11,758)

Geographic division of free float*

Capital, (%)	
Sweden	67.7 (75.4)
US	11.4 (8.3)
UK	11.1 (5.1)
Luxembourg	3.2 (4.2)
France	1.2 (2.1)
Others	5.4 (4.9)

* excluding Tetra Laval (17.68 percent)

no outstanding options or other instruments that could create a dilution effect for shareholders. Furthermore, the Board has not been given a mandate to acquire the company's own shares.

Dividend policy

The Board of Directors' goal is to regularly propose a dividend that reflects the performance, financial status and the current and expected capital requirements of the Alfa Laval Group. Taking into account the Group's cash-generating capacity, the goal is to pay a dividend of 40-50 percent of net profit over a business cycle,

adjusted for surplus value. For 2005, the Board has proposed to the Annual General Meeting that a dividend of SEK 5.10 per share (4.75) be paid.

Alfa Laval's shareholders

At year-end 2005, the company had a total of 10,964 shareholders (11,758). Tetra Laval BV is the largest owner with 17.68 percent (17.68) of the shares. The former second-largest shareholder, Industri Kapital, sold its holding during the year. Combined, the ten largest shareholders owned approximately 51 percent (55) of the shares at year-end 2005.

An energy-filled year – worldwide

Alfa Laval noted very strong order intake during 2005, up 18 percent in total compared with 2004. The energy, process and marine industry market areas were particularly strong. During the year, the main focus was on the energy area and Alfa Laval estimates that about 35 percent of the Group's total order intake in 2005 derived from the energy industry, or from energy-related sectors. The acquisition of the French company Packinox, which produces and sells plate heat exchangers to primarily refineries, consolidated Alfa Laval's position within the oil and gas industries.

Acquisition of Tranter

Tranter is well known for its gasketed plate and welded heat-transfer products for a variety of applications. In 2004, Tranter had annual sales of about SEK 900 M, with 470 employees.

SEK 900 M

DaimlerChrysler chooses Alfdex for its new engine platform

Development and delivery contracts signed for the Alfdex system. Series deliveries expected to start toward the end of 2006.

SEK 250 M

Strengthened position within oil and gas – acquisition of Packinox

Acquisition of French company Packinox, the world's leading producer of large, welded plate heat exchangers for oil and gas applications. Sales in 2005 totaled approximately SEK 500 M, with about 150 employees.

SEK 500 M

Environmentally compatible marine solution for Fincantieri

Order secured from Italian shipbuilding group Fincantieri for a complete fuel-treatment system for five cruise vessels and two RoRo vessels. Delivery in 2005 and 2006

SEK 75 M

Equipment for offshore oil platform in Brazil

End-customer is Petrobras, government-owned oil and gas company in Brazil. Order comprises some 20 large heat exchangers as core part of process for cleaning crude oil on Petrobras' floating platform off the coast of Brazil. Delivery in 2007.

SEK 75 M