



Annual Report 2006

Structural changes create  
continued profitable growth



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## Under the flap

Definitions

Cover:

### The natural force

C<sub>2</sub>H<sub>5</sub>OH.

Or ethanol, as it is more commonly known. It is produced from barley, wheat and other agricultural products. Used as an additive to the fuel you fill your car with. Converted to pure water and carbon dioxide in the combustion process. Provides plants with the perfect atmosphere to thrive. And closes in this way a cycle of nature. Alfa Laval plays a key role in this ongoing process. We are the world leader in heat exchangers, evaporators, condensers and separators for ethanol production. And we stand ready to meet the growing need for new plants.

# Alfa Laval in 2 minutes

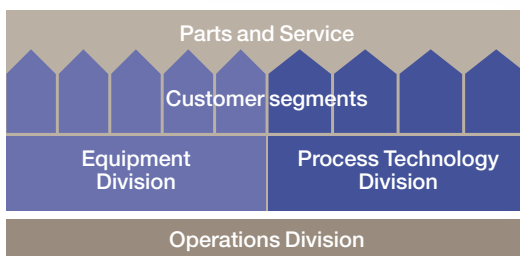


## 3 key technologies that play a decisive role

Alfa Laval's operations are based on three key technologies – heat transfer, separation and fluid handling. These technologies have been developed by the company over a long time and which today play a decisive role in many industrial processes within a number of industries. Alfa Laval holds leading global positions within all of these technology areas.

## 3 divisions and 9 segments mean close relations with customers

The market strategy at Alfa Laval is based on a sales organization that works close to the customers. The company markets its products in nine different customer segments and to gain a distinct customer focus the segments are divided into two divisions: the Process Technology Division and the Equipment Division. In addition, there is a special organization to serve the aftermarket, Parts and Service. The third division, the Operations Division, is responsible for production procurement, manufacturing and logistics to supply the sales units with products of the right quality at the right time.



## At least 5 percent growth per year

The principles for Alfa Laval's growth strategy is that the company should grow more quickly than its competitors and that growth should be achieved with favorable profitability. The aim is an average annual growth rate of at least 5 percent over a business cycle.

## Strengthened market positions through acquisition

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

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

The Group has the management capacity as well as the financial strength to achieve this. In 2006, Alfa Laval conducted one major acquisition – the American company Tranter, with annual sales of about SEK 1 billion.

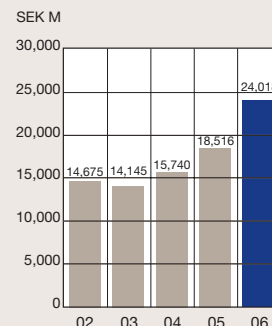


## 25-30 new products each year

Continuous development of products is necessary to enhance competitiveness and maintain the leading positions. Between 2.5 and 3.0 percent of sales is invested yearly in research and development, resulting in 25-30 new products each year.

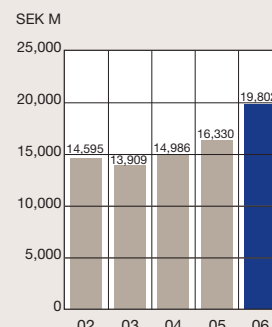
## 30 percent rise in order intake to SEK 24 billion

Order intake during 2006 rose by 30 percent to SEK 24 billion (18.5).



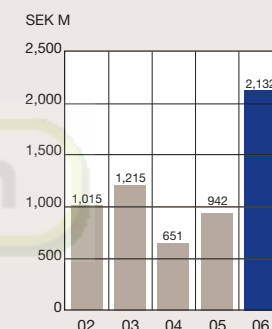
## Sales increased to SEK 19.8 billion

Sales increased to SEK 19.8 (16.3) billion during 2006, an increase of 21 percent. The goal is an annual average growth of at least 5 percent over a business cycle.



## Free cash flow of SEK 2.1 billion

Alfa Laval generated a free cash flow of SEK 2,132 M (942) in 2006.



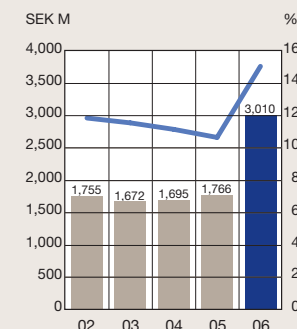
## Sales in more that 100 countries

Alfa Laval has broad geographic coverage and a strong local presence. The company sells its products in approximately 100 countries and in over half of these has its own sales organizations. About 50 percent of sales are in Europe, 30 percent in Asia and 20 percent in North and South America.

Some 25 large production units (16 in Europe, six in Asia and three in the US), and 70 service centers are placed strategically around the world. Alfa Laval has approximately 10,100 (9,500) employees. The largest numbers of employees are in Sweden (2,100), India (1,150), Denmark (1,100), the US (950) and France (750).

## Focus on profitability resulted in a 15.2 percent operating margin

The operating margin (adjusted EBITA) for 2006 was 15.2 (10.8). The Board of Directors raised the goal by two percentage points to between 12 and 15 percent.

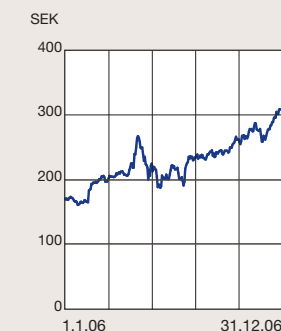


## Increased profitability goal – operating margin of 12-15 percent

The Board of Directors of Alfa Laval performed a review of the company's financial goals in the autumn of 2006. The company's improved product mix and productivity combined with a structural increase in demand from energy-related industries have prompted an increase in the goal for operating margin (EBITA) of two percentage points to 12-15 percent.

## Share up 80%

The Alfa Laval share rose during the year by 80 percent, closing at SEK 308.50 (171).



# Highlights

- The Board of Directors decided to raise the goal level for the operating margin (EBITA margin) by two percentage points to 12-15 percent. The factors underlying the increase are a superior product mix, productivity increases and the structural improvement in demand from energy-related industries.
- The operating margin for 2006 rose to 15.2 percent (10.8).
- The continuation of very high demand in most of the company's end markets – primarily the energy industry and energy-related sectors – contributed to the increase in order intake by 30 percent from 2005.
- Favorable growth in base business, meaning orders valued at less than EUR 0,5 M, which account for some 80 percent of total order intake.
- The acquisition of Tranter from U.S.-based Dover Corporation was completed. Tranter has sales of some SEK 1 billion, with about 450 employees. Tranter acquired its distributor in China, with sales of approximately SEK 100 M.
- Acquisition of the fruit concentrate unit from Tetra Pak, with sales of about SEK 45 M.
- Divestment of the biotechnology engineering activity, with sales of approximately SEK 100 M.
- Alfa Laval was dismissed as a defendant in the "Desert Storm" legal actions, referring to the claims surrounding injuries alleged to have occurred during the Gulf War (Desert Storm) in 1991.
- Closure of the Madrid production unit was completed. The measures entail savings of at least SEK 50 M annually from mid-2006.
- The Board proposes a dividend of SEK 6.25 (5.10) per share for 2006.
- The Board proposes a mandate for the buy-back of up to 10 percent of shares outstanding.
- Alfa Laval intends to acquire a further 26 percent of Alfa Laval (India) Ltd. through a public offer to achieve an ownership of 90 percent.

Amounts in SEK M unless otherwise stated	+/- % <sup>6)</sup>	2006	2005	2004 <sup>7)</sup>	2003	2002
Order intake	+30	24,018	18,516	15,740	14,145	14,675
Net sales	+21	19,802	16,330	14,986	13,909	14,595
Adjusted EBITDA <sup>1)</sup>	+61	3,273	2,030	1,956	1,920	2,087
Adjusted EBITA <sup>2)</sup>	+70	3,010	1,766	1,695	1,627	1,755
Operating margin (adjusted EBITA <sup>2)</sup> ), %	+41	15.2	10.8	11.3	11.7	12.0
Profit/loss after financial items	+116	2,375	1,099	1,262	817	372
Return on capital employed, %	+58	35.9	22.7	23.7	21.3	20.2
Return on shareholders' equity, %	+58	25.3	16.0	15.9	13.2	2.7
Earnings per share, SEK	+91	15.10	7.92	7.12	5.78	1.41
Dividend per share, SEK	+23	6.25 <sup>3)</sup>	5.10	4.75	4.00	2.00
Equity per share, SEK	+18	61.2	52.0	47.2	43.8	40.4
Free cash flow per share, SEK <sup>4)</sup>	+9	9.32	8.52	11.10	10.71	16.10
Equity ratio, %	+1	36.4	35.9	37.4	33.3	29.2
Debt/equity ratio, %	-37	22	35	36	49	78
Number of employees <sup>5)</sup>	+7	10,115	9,429	9,527	9,358	9,125

1) Adjusted EBITDA – Operating income before depreciation and amortization of goodwill and other surplus values, adjusted for items affecting comparability.

2) Adjusted EBITA – Operating income before amortization of goodwill and other surplus values, adjusted for items affecting comparability.

3) Board proposal for the 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 2005 and 2006.

7) Restated to IFRS.





# »Sharply improved profitability and very strong order intake«

IN OCTOBER 2006, the Board of Directors of Alfa Laval raised the goal level for the operating margin (EBITA) by two percentage points to 12-15 percent. The Board based the increase on the company's enhanced product mix, productivity increases and the structural improvement in demand from energy-related industries.

## Sharply improved profitability

The operating margin increased steadily during 2005 and 2006. The operating margin for 2006 was 15.2 percent. The factors underlying the improvement were:

- *Focus on profitability.* Thanks to our strong market positions and the added value we create for our customers, we have managed to offset higher raw material prices in most instances. Moreover, we are working on further developing our capacity to improve customer and product mix.
- *Highly satisfactory capacity utilization in our production facilities.* The favorable gearing effects on earnings confirm the efficient functioning of our production processes. Capacity is being expanded in those product areas in which we note a structural growth in demand.
- *Higher efficiency in production, sales and administration.*

## Very strong order intake

Order intake in 2006 rose a full 30 percent to SEK 24 billion. All geographic regions performed highly favorably. The sharpest growth was reported in Central and Eastern Europe, as well as in North America. In Russia, order intake rose 52 percent in a solid, broad-based upturn. In the U.S., the increase was 59 percent, driven by investments in bioethanol, the process industry and the acquisition of Tranter. The recovery in Western Europe that emerged in late 2005 accelerated in 2006.

During the year, Alfa Laval secured 15 orders worth more than EUR 5 M each, with a total value of SEK 1.4 billion. Most of the orders derive from the oil, gas and petrochemical industries and 50 percent are for installations in the Middle East.

Base business, meaning orders valued at less than EUR 0.5 M, progressed favorably in Western Europe and North America, attributable primarily to upgrades in the process industry and nationwide energy-saving programs. Base business is of fundamental significance for Alfa Laval, since it accounts for more than 80 percent of total order intake.

Order intake from the key aftermarket sector rose 14

percent. In particular, the maturing installed base in the rapidly expanding markets of China, India and Russia developed considerably

## Acquired growth

Acquisitions must primarily involve companies that supplement Alfa Laval's existing business in terms of products, geography or in the form of new sales channels.

Working with a number of brands offers opportunities for consolidation in industries in which we hold a leading position.

The acquisition of Packinox in 2005 is an excellent example of product enhancement in the refinery industry. Moreover, the acquisition resulted in higher sales of conventional Alfa Laval products. Between 2004 and 2006, order intake from the refinery industry rose from SEK 100 M to some SEK 1,000 M.

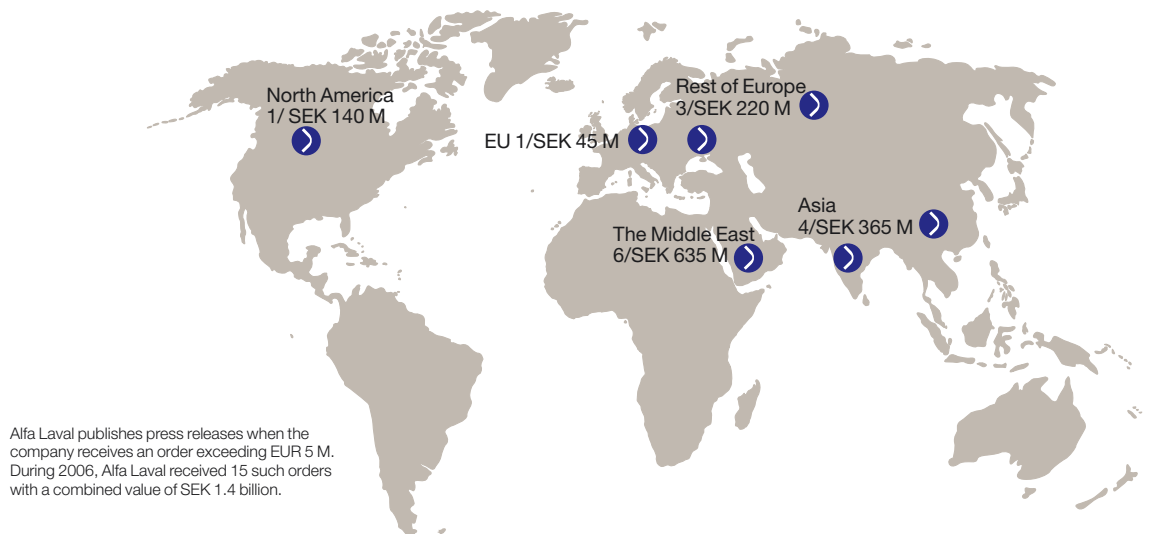
The acquisition of the U.S.-based company Tranter in 2006 is an example of a new sales channel. As a result of the acquisition, Alfa Laval consolidates its leading position in heat transfer. Tranter reported sales of SEK 1,000 M in 2006, with a workforce of almost 450 worldwide. Operating margin exceeded Alfa Laval's and the acquisition contributed to earnings per share in 2006. Tranter will remain a separate market channel and will offer its product range under the Tranter brand via an independent distribution network in full competition with Alfa Laval's brand. The company will retain its own R&D and manufacturing units.

At year-end, Tranter acquired its distributor in China. The distributor's sales amount to SEK 100 M, with 100 employees in assembly and service. The acquisition is part of efforts to strengthen the company's presence in China.

During 2006, Tetra Pak's fruit processing equipment unit was acquired. The unit brings with it valuable application expertise. Operations have sales of SEK 45 M and have been integrated into Alfa Laval.

In December 2006, Alfa Laval divested the project section of its biotechnology industry operations. Sales of the divested unit were more than SEK 100 M, with a workforce of 110. The project section has only a limited link with Alfa Laval's core products and does not have the prerequisites to meet Alfa Laval's financial goals. The sale resulted in a nonrecurring financial effect on the income statement of SEK 125 M, of which SEK 85 M represents a write-down of goodwill. The sale will have a

## Major orders in 2006 (number of orders/SEK M)



positive impact on earnings per share in 2007.

In March 2007 Alfa Laval signed an agreement to acquire the Dutch company Helpman. The acquisition will clearly broaden the product range and provide synergies with Alfa Laval's sales organization. Helpman's customers are active in industrial cooling of agricultural products, fruit and meat. The company has a strong position in Europe and will be Alfa Laval's product center for industrial cooling using air heat exchangers. The company will be integrated into Alfa Laval. Sales in 2006 totaled SEK 200 M, with a workforce of 100. During 2007, Helpman is expected to contribute positively to earnings per share.

### Structural growth

Alfa Laval sees continuing favorable opportunities for growth in a number of areas, based on structural changes in demand.

- Globalization is increasing the need for seaborne transport, which is favorable for our marine segment. The demand from the shipbuilding industry remained strong in 2006 for the fourth consecutive year and the order backlog now stretches all the way into 2009.
- Economic growth in China and the need for investment in China and India are creating a large, high-consumption middle class and a consequent need for investment, which favors global demand. China is Alfa Laval's second largest market after the U.S. and a number of activities are in progress to consolidate the Group's presence through organic growth as well as acquisitions. The term "BRIC countries" refers to Brazil, Russia, India and China – four large and rapidly growing economies whose GDP growth exceeds the global average. In 2006, they accounted for a combined 18 percent of the Group's total order intake, compared with 13 percent in 2002.
- The technology shift is opening up new opportunities, ranging all the way from the gradual replacement of shell-and-tube heat exchangers by plate heat exchangers to various pro-environmental applications such as ballast tank cleaning onboard vessels or the treatment of truck crankcase gases.

- Demand from the energy and energy-related industries accounts for some 40 percent of the Group's order intake. High-energy prices, environmental aspects and changes in the global energy policy map herald many opportunities for Alfa Laval. In areas such as oil and gas extraction, liquefied natural gas (LNG), refineries and petrochemicals there are extensive investments both in new facilities and upgrades of existing plants. Alfa Laval has a solid position in the production of bioethanol and biodiesel. Sales for these applications grew sharply during the year. District cooling is growing rapidly as countries in warm latitudes rapidly raise the standard of living. Generally, there is a major interest in reducing energy consumption, thereby raising the demand for plate heat exchangers.

### Share trend

During 2006, Alfa Laval's share rose 80 percent, while the Stockholm Stock Exchange as a whole advanced 24 percent and the SX20 Industrials – the industrial index against which Alfa Laval is gauged – rose 30 percent. Since its listing on May 17, 2002 the share has climbed 239 percent, while the Stockholm Stock Exchange as a whole has risen by 77 percent and the SX20 Industrials by 101 percent.


### Outlook for the near future

"In most of the markets, geographical as well as customer segments that Alfa Laval serves, a continued very strong demand is expected."

(included in the year-end report for 2006 as published on February 7, 2007.)

Finally, I would like to take this opportunity to offer my great appreciation to all employees of the Alfa Laval Group for yet another year of highly commendable work efforts.

Lund, March 2007

  
LARS RENSTRÖM  
President and CEO

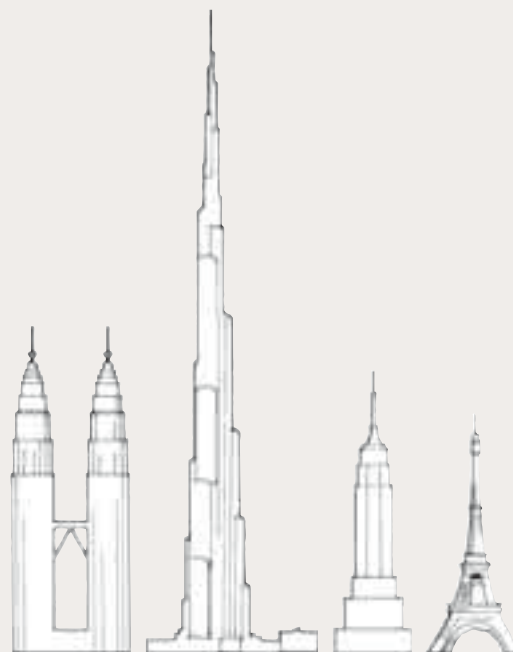




## Heavenly cool

The awesome Burj Dubai Tower in the United Arab Emirates – designed for exclusive offices and housing – will be some 800 meters high and thus the world's tallest structure. The building, which is moving up at a rate of one new floor every four days, is expected to be completed in 2008.

Since the temperature in Dubai can top 40°C, air conditioning of buildings is crucially important. Plate heat exchangers from Alfa Laval will be installed at various levels to split up the heating system into a number of smaller circuits. This reduces the static pressure on all equipment, thereby offering more reliable operation, superior operating economy and lower investments costs.



Petronas  
Towers 1&2 in  
Kuala Lumpur,  
452\* meters

Burj Dubai Tower  
in the United Arab  
Emirates,  
800\* meters

Empire State  
Building in  
New York,  
443\* meters

Eiffel Tower  
in Paris,  
324\* meters

\*including masts

# Continuing very good performance – up 80 percent

THE VALUE OF THE ALFA LAVAL SHARE rose steeply in 2006. The share price advanced from SEK 171 to SEK 308.50, or a rise of more than 80 percent (60). For the second consecutive year, Alfa Laval's share price trend substantially outperformed its industry index (Industrials) and the stock exchange as a whole (OMX Stockholm), which rose by 30 (44) and 24 (33) percent, respectively, during the year. Alfa-Laval's total market capitalization at year-end 2006 was SEK 34.5 billion (18.4). The highest and lowest prices paid for the Alfa Laval share during the year were SEK 312 and SEK 157, respectively.

The Alfa Laval share was listed on the Stockholm Stock Exchange for the first time as early as 1901. After

the company was acquired privately in 1991, Alfa Laval was reintroduced on the stock market on May 17, 2002.

Since its initial listing at SEK 91 in May 2002, the total return, which includes reinvested dividends, through year-end 2006 was 284 percent. This corresponds to an annual return of 30 percent. The average accumulated annual return on the stock exchange during the same period (via the SIX Return Index) was 15 percent.

## Trading volume remains high

During 2006, a total of 151.8 million (165.8) shares were traded at a value of SEK 35.0 billion (20.9). This means that 136 percent (148) of the total number of shares outstanding in Alfa Laval was traded during the year. The corresponding figure for the Stockholm Stock Exchange was 145 percent. During the year, an average of more than 650 share transactions (326) per day were completed in Alfa Laval's share. Each transaction averaged more than 900 shares (2,000). A trading lot in Alfa Laval corresponds to 100 shares.

With a market capitalization of SEK 34.5 billion, Alfa Laval is part of the Large Cap segment on the Nordic Exchange, OMX. The share is also among the most heavily traded on the Nordic Exchange in Stockholm and is included in the OMXS30 Index. According to the exchange industry categorization, Alfa Laval is part of the Industrials sector. Other major companies in the same sector are, for example, the Swedish companies Atlas Copco, Sandvik, SKF, Volvo and the Finnish company KONE.

The Alfa Laval share is exempt from estate tax for Swedish individuals.

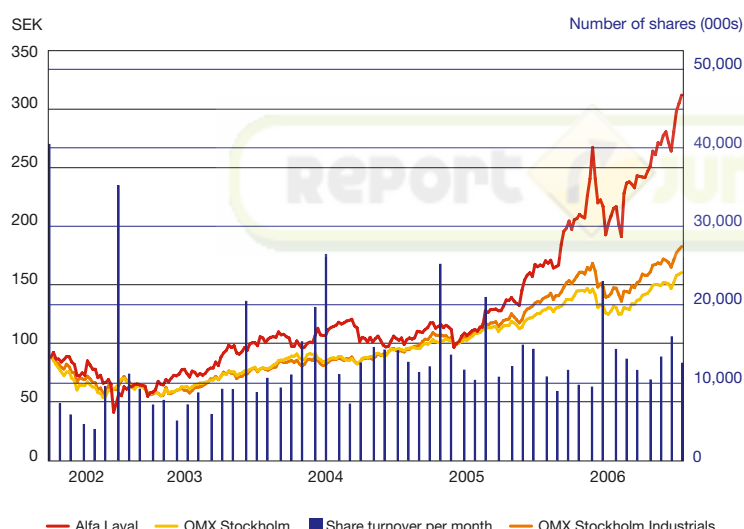
## Share capital

The share capital in Alfa Laval totals SEK 1,117 M. The number of shares totals 111.7 million with a par value of SEK 10 per share. All shares carry equal voting rights and equal right to the company's assets. Alfa Laval has no outstanding options that could create a dilution effect for shareholders. Also, the Board has not been given a mandate to acquire the company's own shares.

## Proposal on repurchase of shares

Alfa Laval's financial position is very strong. In order to adjust the Group's balance sheet to a more efficient structure while maintaining financial flexibility, the Board of Directors will propose the Annual General Meeting to mandate the Board to decide on repurchase of the company's shares – if the Board deems this appropriate – until the next Annual General Meeting. The mandate will refer to repurchase of up to 10 percent of the issued shares with the purpose to cancel the repurchased shares and reduce the share capital. The repurchase will be made through transactions on OMX Stockholm's Stock Exchange.

Price trend, May 17, 2002 – December 31, 2006



Price trend, January 1 – December 31, 2006

