Annual Report 2007

Sustainability Report • Corporate Governance Report

Leading in growing energy and environmental markets

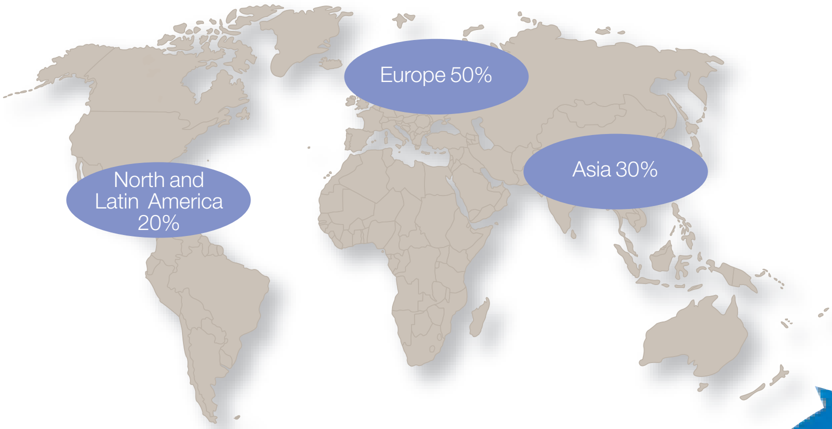
Contents

Cover:

From sewage to ecocycle

Waste water
Every second, thousands of cubic meters of this mixed slush are released around our planet. At present, only a fraction is treated. The least we can do for Mother Earth is to ensure that the cycle is closed in an efficient and environmentally-sound manner. The basic principle is clean in, clean out. In other words, a sound ecocycle approach. Alfa Laval has built up unique expertise within this important area. We can offer industries and municipalities customized solutions for the treatment of water and other substances. It concerns everything from individual products such as decanters, sludge thickeners and heat exchangers to entire wastewater treatment systems. Clean water is not only about appeasing your conscience. It is actually also an investment that is profitable in the long term. Water is a valuable commodity in short supply, which we must protect.

Alfa Laval in two minutes



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 goal is an average annual growth rate of at least 5 percent over a business cycle.

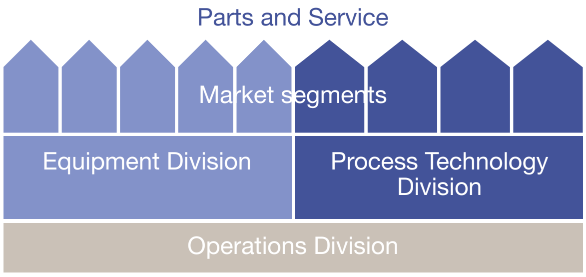
Sales in more that 100 countries

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, Oceania and the Middle East and 20 percent in North and South America. Some 26 large production units (16 in Europe, six in Asia, three in the US and one in Brazil), and 70 service centers are placed strategically around the world. Alfa Laval has approximately 11,500 (10,000) employees. The largest numbers of employees are in Sweden (2,275), India (1,265), Denmark (1,100), the US (950) and France (850).

Customer-driven business concept

"To optimize the performance of our customers' processes. Time and time again."

Creating a sustainable, profitable company requires that customers are continually provided added value. For shareholders, Alfa Laval shall be an attractive, long-term investment, which the company achieves through continuously improving its attractiveness – as a supplier, partner, employer and customer.



Three divisions and nine segments mean close relations with customers

Alfa Laval markets its products in nine different customer segments and to gain a distinct customer focus the segments are divided into two sales 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 at the right time and the right quality.

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. To achieve this, the Group has the management capacity and the financial strength. During 2007, four acquisitions were carried out adding 4 percent in growth.

Reduced environmental impact

In recent years, Alfa Laval has mapped the company's environmental impact, primarily emissions of carbon dioxide (CO_2). The goal is to reduce CO_2 emissions by 15 percent between 2007 and 2011.

At the same time, Alfa Laval's products and solutions contribute major environmental gains for customers, for example, approximately 5,000 Compabloc heat exchangers reduce customers' CO_2 emissions comparable to the emissions from all passenger cars in Sweden during one year.

Increased profitability goal – operating margin of 15 percent

The Board of Directors of Alfa Laval performed a review of the company's financial goals in the autumn of 2007. 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) to 15 percent over a business cycle and the goal for return on capital employed to at least 25 percent.

Three 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.

Heat transfer

Separation

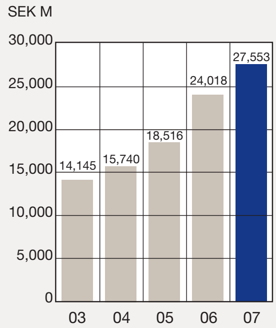
Fluid handling

35-40 new products each year

Continuous development of products is necessary to enhance competitiveness and maintain leading positions. Up to 3.0 percent of sales is invested yearly in research and development, resulting in 35-40 new products each year.

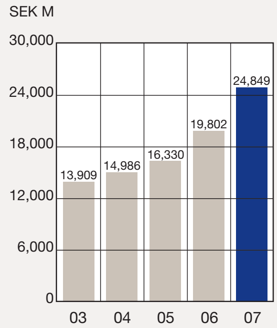
Order intake nearly doubled in five years

Since 2003, the order intake has increased from SEK 14,145 M to SEK 27,553 M. In 2007, order intake rose by slightly more than 18 percent.



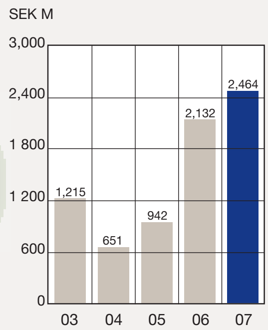
Continued strong rise in sales

During the past five years, sales rose from SEK 13,909 to SEK 24,849 M. In 2007, sales were up 29 percent.



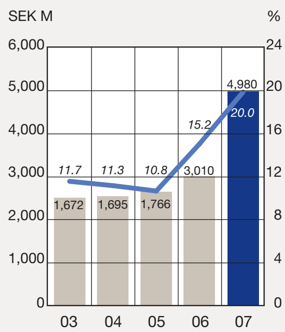
Free cash flow of about SEK 2.5 billion

Alfa Laval generated a free cash flow of SEK 2,464 M (2,132) in 2007.



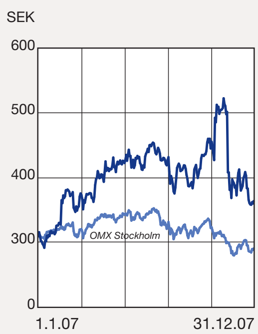
Focus on profitability increased operating margin by slightly more than 8 percentage points

Operating margin (adjusted EBITA) rose from 11.7 percent in 2003 to 20 percent in 2007. In 2007 alone, operating margin rose 4.8 percentage points.



Share rose 18% in 2007

During 2007, the Alfa Laval share rose 18 percent, compared with OMX Nordic Exchange Stockholm that declined 6 percent during the same period.



Highlights 2007

- Continued **very high demand** in most of the company's final markets – primarily the energy industry and energy-related sectors – contributed to the increase in order intake with 18 percent compared with 2006 by SEK 27.6 billion.
- **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.
- **Operating income[2] rose** to SEK 4,980 M (3,010).
- **The goal for operating margin was raised to 15 percent** over a business cycle. The goal for **return on capital employed was raised to at least 25 percent**. The growth target remains at an average of 5 percent annually over a business cycle.
- **Acquisitions of four companies** that combined add **about 4 percent growth**. Among others, Finnish Fincoil, with sales of SEK 375 M, and Netherlands-based Helpman, with sales of SEK 220 M, were acquired. Both sell industrial cooling products, with air heat exchangers as the largest product.
- Alfa Laval **acquired an additional 13 percent of Alfa Laval India (Ltd)** through a public offer and now holds an ownership interest of 77 percent.
- **3.2 percent of shares outstanding were repurchased.** Alfa Laval has a mandate to buy back up to 10 percent of shares outstanding through to the 2008 Annual General Meeting.
- The Board proposes a **dividend of SEK 9.00** (6.25) per share for 2007.

Amounts in SEK M unless otherwise stated	+/- %[6]	2007	2006	2005	2004 [7]	2003
Order intake	+15	27,553	24,018	18,516	15,740	14,145
Net sales	+25	24,849	19,802	16,330	14,986	13,909
Adjusted EBITDA [1]	+60	5,245	3,273	2,030	1,956	1,920
Adjusted EBITA [2]	+65	4,980	3,010	1,766	1,695	1,627
Operating marginal (adjusted EBITA [2]), %		20.0	15.2	10.8	11.3	11.7
Profit after financial items	+92	4,557	2,375	1,099	1,262	817
Return on capital employed, %		54.2	35.9	22.7	23.7	21.3
Return on shareholders' equity, %		44.1	25.3	16.0	15.9	13.2
Earnings per share, SEK	+89	28.48	15.10	7.92	7.12	5.78
Dividend per share, SEK	+44	9.00 [3]	6.25	5.10	4.75	4.00
Equity per share, SEK	+16	71.10	61.2	52.00	47.20	43.80
Free cash flow per share, SEK [4]	+55	14.42	9.32	8.52	11.10	10.71
Equity ratio, %		34.1	36.4	35.9	37.4	33.3
Debt/equity ratio, multiple,		30	22	35	36	49
Number of employees [5]	+13	11,395	10,115	9,429	9,527	9,358

1) Adjusted EBITDA – Operating income before depreciation and amortization of goodwill and impairment of 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 2006 and 2007.
7) Restated to IFRS.

Improved operating profit for the fourth consecutive year

In October 2007, the Board of Directors of Alfa Laval raised the goal for the operating margin (EBITA) to 15 percent over a business cycle. The target for return on capital employed was raised to at least 25 percent. The Board based these increases on the company's enhanced product mix, productivity improvements and the structural increase in demand from energy-related industries.

For the fourth consecutive year, we can report an improved operating profit, which amounted to nearly SEK 5 billion.

Sharply improved profitability

The operating margin has steadily improved in recent years and amounted to 20 percent for 2007.

The factors underlying the improvement were:

- An exceptionally favorable product mix. We delivered a large number of major orders containing a high proportion of Alfa Laval's core products.
- 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.
- 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 the customer and product mix.
- Higher efficiency in production, sales and administration.

Very strong order intake

Order intake in 2007 rose a full 18 percent to slightly more than SEK 27,5 billion. All geographic regions performed highly favorably. The sharpest growth was reported in Latin America and Asia. In Brazil, the order intake rose 49 percent in a solid, broad-based upturn and in China, the increase was 57 percent, primarily driven by strong demand from the shipbuilding industry.

During the year, Alfa Laval secured 15 orders worth more than EUR 5 M each, with a total value of SEK 1.2 billion. The orders are evenly divided between the various areas of application and countries, which suitably reflects the broad scope of Alfa Laval. Order intake from the key aftermarket sector rose approximately 20 percent. In particular, the maturing installed base in the rapidly expanding markets of China, India and Russia performed favorably.

"Order intake from the key aftermarket sector rose approximately 20 percent"

Higher number of new products

We continuously develop our products to strengthen our leading market positions. For 2007, Alfa Laval established the goal of increasing the percentage of sales from new products by 50 percent. At the same time, the period from concept to attained sales target shall be reduced by 25 percent. This is the foundation for profitability and a positive price trend.

We have increased our investments in research and development by 50 percent in the past three years. At the same time, we have improved organizational conditions to launch products on the market more rapidly and achieve established sales targets. The largest investments were made in energy and energy-related application areas. Already in 2008, 30 percent more products will be introduced compared with 2007.

Acquisitions strengthen our strategic positions and our growth

In 2007, we acquired companies that add 4 percent growth to our sales, which is also the average for Alfa Laval's acquired growth in the past three years.

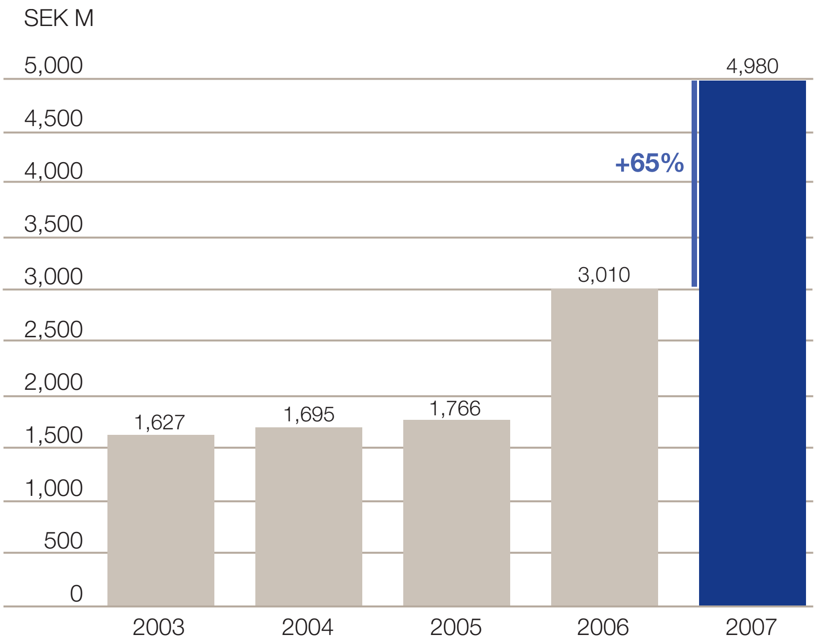
Acquisitions must primarily involve companies that supplement Alfa Laval's existing business in terms of products, geography or in the form of new sales channels.

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

The acquisitions of Helpman and Fincoil are two examples of product supplements in the area of industrial air heat exchangers. With these acquisitions, we have supplemented our Italian air heat exchanger unit and become one of the leaders in Europe. We now have a strong position in this area in terms of both products and geography, with total sales of SEK 1 billion.

The Dutch company Helpman was consolidated in Alfa Laval in March

Improved operating profit for the fourth consecutive year*



* Adjusted EBITA

2007. The acquisition broadens our range of products and the synergies with Alfa Laval's sales organization are clear. Helpman's customers are active in industrial cooling of agricultural products, fruit and meat. Sales in 2007 totaled SEK 220 M, with a workforce of 130. As early as 2007, Helpman contributed positively to earnings per share.

Finnish company Fincoil was acquired in November. The acquisition supplements the company's product range and synergies with Alfa Laval are considerable. We envisage major opportunities to further develop the company. Fincoil has a world-leading position in cooling diesel power plants, and its customers include Wärtsilä and MAN. Sales in 2007 amounted to SEK 375 M with 150 employees. Fincoil is expected to contribute positively to earnings per share in 2008.

Through the acquisition of DSO Fluid Handling and AGC Engineering, Alfa Laval will strengthen its position in the sanitary market in the U.S. These companies jointly generate sales of SEK 120 M and add new sales channels to the aftermarket for the dairy and food industries. The companies will market their products independently of Alfa Laval following a multi-brand strategy.

The acquisition of U.S.-company Tranter in 2006 is an excellent example of a new sales channel. As a result of the acquisition, Alfa Laval strengthens its leading position in heat transfer. In 2007, Tranter reported sales of approximately SEK 1.5 billion, with about 500 employees worldwide.

In January 2007, Tranter acquired its distributor in China. The distributor's sales amount to SEK 100 M, with 100 employees in assembly, sales and service. The acquisition is part of efforts to strengthen the company's presence in China.

"Structural changes continue to offer excellent growth opportunities"

Major orders* (number of orders/SEK M)

* Alfa Laval publishes press releases when the company receives an order exceeding EUR 5 M. In 2007, Alfa Laval received 15 such orders with a combined value of about SEK 1.2 billion.

Structural changes continue to offer excellent growth opportunities

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

Energy accounts for 40 percent of order intake

Demand from the energy and energy-related industries accounts for slightly more than 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 such areas 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 were very strong at the beginning of the year but since declined sharply due to the lower profitability of investing in new plants during the year. District cooling is growing rapidly as countries in warm latitudes quickly raise their standard of living. Generally, there is a major interest in reducing energy consumption, thereby raising the demand for plate heat exchangers.

Clean technologies spare the environment and reduces costs

Environmental issues are receiving widespread attention – landing on both politicians' tables and in conversations between people. Currently, the most important matter is the greenhouse effect and the continuously rising emissions of carbon dioxide. For decades, Alfa Laval's products have contributed to environmental gains and cost savings thanks to more efficient processes, and we see major opportunities for structural growth based on a more intense focus on environmental issues, particularly the increasing costs of environmentally harmful emissions.

Strong positions in rapidly developing BRIC countries

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 strengthen 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. In 2007, they accounted for a combined 23 percent of the Group's total order intake, compared with 13 percent in 2002.

Globalization creates the need for seaborne transport

Globalization is increasing the need for seaborne transport, which is favorable for our marine segment. The demand from the shipbuilding industry remained strong in 2007 for the fifth consecutive year and the order backlog now stretches all the way into 2010.

The Alfa Laval share

In a bid to improve the company's capital structure, the Board utilized its mandate to repurchase shares in Alfa Laval AB in 2007, with the intention of cancelling

"We acquired companies that add 4 percent growth"

them. A total of 3.2 percent of shares were repurchased at an amount of SEK 1,497 M and the average price was SEK 415 per share.

In 2007, Alfa Laval's share rose 18 percent, while the Stockholm Stock Exchange as a whole declined 6 percent and the SX20 Industrials – the industrial index against which Alfa Laval is gauged – rose 7 percent. Since its listing in May 2002, the share has climbed 360 percent, while the Stockholm Stock Exchange as a whole has risen by 95 percent.

Outlook for the near future

"We expect demand to remain on the current high level."

(Included in the year-end report for 2007 as published on February 6, 2008).

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 2008

Lars Renström
President and CEO

During 2007, Alfa Laval acquired four companies that added about 4 percent growth. The most recent acquisition, Fincoil in Finland, was also the year's largest with sales of some SEK 375 M. Combined with the earlier acquisition of Helpman in the Netherlands (sales of about SEK 220 M) and the existing operations in Italy, Alfa Laval has created a leading position in air heat exchangers for the cooling industry in Europe (read more on page 9). The application area for the product is broad, from cooling in diesel-driven power plants to keeping tulips from Amsterdam at the proper temperature.

Improved internal processes and market positions raise the financial goals

Financial goals

As a result of Alfa Laval's improved product mix and productivity, combined with a structural increase in demand from energy-related industries, the Board of Directors raised the goals for operating margin and return.

Invoicing growth, %

Goal: Minimum average of 5 percent annually over a business cycle.
The goal is to be attained through a combination of organic and acquired growth. The underlying organic growth of Alfa Laval's markets is expected to be on par with global GDP growth. To this is to be added technological substitution that is favorable for Alfa Laval, which increases growth.

Goal fulfillment in 2007: Growth in invoicing was about 29 percent. 25 percent was organic growth and 4 percent was growth derived acquisitions.

Operating margin**, % of sales

Goal*: 15 percent over a business cycle.
Goal fulfillment in 2007: The margin was 20 percent. The factors underlying the sharp growth of the operating margin are the company's enhanced product mix, productivity improvements and the high volume during the year.

**Goal raised from 10-13 percent to 12-15 percent in 2006. Goal raised to 15 percent in fourth quarter of 2007.*
***Adjusted EBITA.*

Return on capital employed, %

Goal*: at least 25 percent.
Despite the substantial goodwill and allocated surplus values, the goal for the return on capital employed is a minimum of 25 percent. The level has been set taking into account the low level of capital tied-up in current operations.

Goal fulfillment in 2007. The return was 54.2 percent. During the six past years, the return goal* has been exceeded as a result of continuous improvements in capital employed and higher operating earnings.

**Goal raised from at least 20 percent to at least 25 percent in fourth quarter of 2007.*

Delivering results

Alfa Laval's business concept is to optimize performance in customers' processes. Each person in the company must contribute with results so that Alfa Laval continually develops. This involves delivering results.

There is a strong desire within Alfa Laval to attain the established goals, both large and small. This is and must be a driving force for all employees. The attainment of financial goals is the final confirmation of the company's success.

Resources for successful operations

The basis for Alfa Laval's business model and the foundation for the company being able to achieve its financial goals is to continuously create added value for the customers.

Alfa Laval's global operations are based on three key technologies – heat transfer, separation and fluid handling – as well as technological know-how and expertise in a broad range of applications. The company is organized into three divisions. The Equipment and Process Technology divisions market the company's products and solutions. The Operations Division produces and delivers the company's products. To ensure the long-term functioning of the supplied equipment and to nurture and develop customer relations, Alfa Laval has a well-developed global service organization – Parts & Service.

Strategies for growth

Alfa Laval's strategies are based on leading positions in well-defined market segments. Alfa Laval has the financial as well as organizational expertise and the capacity to successfully manage and integrate operations that strengthen the company's offering.

Financial goals for dividends and development

Alfa Laval manages operations to achieve three financial goals for growth, operating margin and return. In recent years, the company has attained or surpassed these particular financial goals. This creates shareholder value through an annual dividend to the shareholders and increased value of the company.