Vision, business concept, goals and strategy

Vision and drivers

To “help create better everyday conditions for people” by offering efficient and environmentally responsible products and solutions in the areas of heat transfer, separation and fluid handling.

Business concept

The vision is at the core of the company’s efforts to realize its business concept: “To optimize the performance of our customers’ processes, time and time again.” This is achieved by helping customers to become more productive and competitive through the delivery of high-quality products and solutions in the three key technologies.

Goals and benchmark values

Financial goals

Alfa Laval’s operations are governed to realize its business concept, while at the same time meeting the financial goals established with regard to growth, profitability and return.

Growth

8% Alfa Laval’s sales are to grow an average of at least 8 percent annually measured over a business cycle, with organic growth accounting for 4 to 5 percentage points and acquisitions for 3 to 4 percentage points. This goal was established based on the results achieved over a longer period of time, as well as on the Board’s assessment of the company’s future prospects.

Profitability

15% Alfa Laval is to achieve an operating margin (adjusted EBITA) of 15 percent measured over a business cycle. This goal was established based on historical margins, while also taking the company’s sales growth ambitions into consideration.

Capital utilization

20% The goal is to have a return on capital employed of at least 20 percent, a level that Alfa Laval considers realistic from a medium-term perspective given the major acquisitions carried out in recent years.

Financial benchmark values

In addition to the Group’s financial goals, the Board has established benchmark values for three key financial ratios, which further specify the framework and goals for the operation of the company.

Net debt in relation to EBITDA

2x In the long term, net debt in relation to EBITDA, meaning operating profit before depreciation and amortization of step-up values, is not to be more than 2. Although the ratio may exceed the goal in connection with major acquisitions, this should be viewed as a temporary situation, since the company’s cash flow is expected to offset this effect.

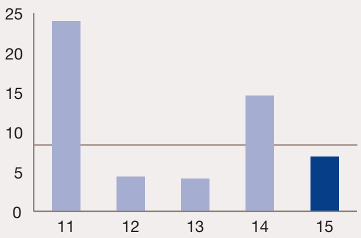
Investments

2% The benchmark value states that 2 percent of sales should go to investments. Given the investments and capacity expansion carried out in recent years, this investment level is deemed sufficient to create the scope for replacement investments and an expansion of capacity that matches the organic growth of the Group’s core products.

Cash flow from operating activities

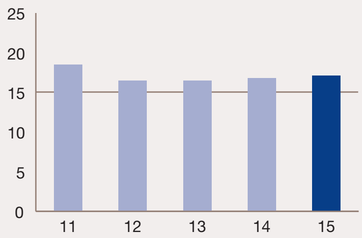
10% Cash flow from operating activities is to amount to 10 percent of sales, including investments in fixed assets. This value is lower than the goal for the operating margin, since organic growth normally requires an increase in working capital. In addition, taxes are paid in an amount corresponding to approximately 28 percent of earnings before tax.

Growth, %



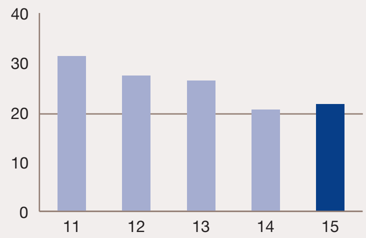
In 2015, invoicing increased 6.9 percent*, with organic growth accounting for -1.2 percent and acquisitions for 8.1 percent.

Profitability, %



The operating margin for 2015 was 17.1 percent, compared with 16.8 percent for full-year 2014.

Return on capital employed, %



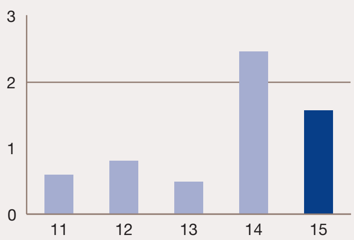
The return on capital employed for 2015 was 21.6 percent.

*Excluding exchange-rate variations

Sustainability goals

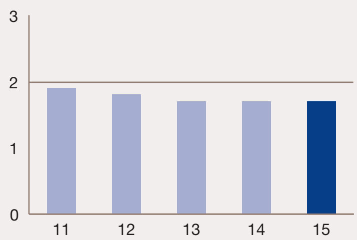
In addition to its financial goals, Alfa Laval also has a number of non-financial target parameters. These reflect the company's ambition of creating a safe workplace and a business that is as clean and energy efficient as possible. Among other areas, these key ratios encompass: a reduction in water consumption, increased energy efficiency, a reduction in the use of restricted "gray list" chemicals and a reduction in greenhouse gas emissions from freight transportation and travel. For more information about these goals and the company's various sustainability initiatives, visit: **www.alfalaval.com/about-us/sustainability**

Net debt/EBITDA



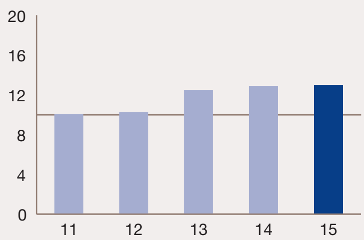
The net debt/EBITDA at year-end 2015 was 1.56.

Investments, %*



Investments in 2015 amounted to 1.7 percent.

Cash flow from operating activities, %*



In 2015, cash flow from operating activities amounted to 13 percent.**

* As a percentage of sales. ** Including investments in fixed assets

Strategy

To achieve its vision, implement its business concept and attain its growth, profitability and capital utilization goals, Alfa Laval has established various strategic priorities that include detailed Group-wide key initiatives. These strategic priorities encompass products, market presence and the continuous improvement work being performed in all areas of the company.

Products

Alfa Laval's offering in the areas of heat transfer, separation and fluid handling serve as the foundation for achieving the company's goal for profitable growth. The high quality and energy efficiency of the products are considered important for customers who want to improve their competitiveness while also reducing their environmental impact. Every year, the company invests between 2 and 2.5 percent of its sales in research and development in order to ensure that its offering is able to meet future customer needs. This may include not only brand new products, but also improved and even more efficient versions of existing products.

Identifying new areas of application for existing products and key technologies is another important strategic approach. At the same time, the product offering is also continuously being strengthened and expanded through acquisitions of both supplementary products in the three key areas and products that are new to the company and complement the offering in application areas where Alfa Laval is already represented.

Examples of product strategy:

– Alfa Laval continuously seeks out new, groundbreaking products and solutions. Among other developments, this has resulted in a unique heat exchanger made from tantalum – an exceptionally durable metal that reacts to only a small number of chemical compounds. However, tantalum is also very expensive, so a heat exchanger made entirely from tantalum would not be financially viable. Many customers use heat exchangers made from zirconium or high-grade alloys instead. However, these heat exchangers are less durable and must therefore be replaced regularly, resulting in production stoppages and high costs. Glass is another alternative – but glass is a delicate material with a low heat transfer capacity, which means that a bigger heat exchanger is needed. Accordingly, Alfa Laval has developed a unique solution – a heat exchanger with an extremely thin layer of tantalum, metallurgically bonded to the surfaces that may come into contact with corrosive liquids. The layer of tantalum is thick enough to do the job, but thin enough to offer a cost-efficient solution. The heat exchanger requires minimal cleaning and is extremely durable, yet very cost efficient. For one customer, a tantalum heat exchanger measuring only 30 centimeters tall could replace a three-meter graphite heat exchanger.

Market presence

Having a local presence is extremely important for Alfa Laval. This includes everything from production and new sales to the aftermarket. Accordingly, the company continuously makes decisions regarding the selective expansion and/or strengthening of its presence in certain geographic areas. Expansion should primarily occur organically – either in terms of breadth by entering new geographic areas or in terms of depth by further expanding the Group's presence in countries and regions where Alfa Laval is already established. Acquisitions may also be used as a secondary means of expansion – providing an efficient way of quickly strengthening the company's local presence. Another way to expand is to add new sales channels.

Examples of market presence strategy:

– In order to identify and meet various needs and business opportunities in West Africa, Alfa Laval opened a sales office in Accra, Ghana, during the year. The office focuses on the markets in Ghana, Nigeria, Cameroon, the Ivory Coast and Senegal. West Africa has grown at a faster rate than the rest of Africa in recent years. The region also includes a number of markets that are attractive to Alfa Laval, such as oil and gas, food, marine and diesel power.

– The Group's multibrand strategy, which has been established for several years, has resulted in the acquisition of prominent competitors in order to add new channels in specific geographic and industry-based markets. A niche company specializing in separation technology was acquired during the year. The company, which will offer a complementary market channel, will remain independent and offer products under its own brand.

Profitability and return

A number of basic questions must be answered in order to ensure profitability and a favorable return. One such question, concerning procurement and production, is where Alfa Laval should conduct its production operations, which products it should produce itself and which products should be purchased from suppliers. Another question, pertaining to logistics, is how Alfa Laval can meet its customers' requirements in terms of service level, while at the same time ensuring an efficient allocation of capital. The third question pertains to the business models to be applied in the company's divisions and the breadth that Alfa Laval should have in its offering.

Examples of profitability strategy:

– Alfa Laval's geographic footprint is reviewed continuously, including the distribution of production between the various units. The need for this type of overview has been accentuated by the addition of a number of plants through acquisitions in recent years. As part of a previously announced cost-cutting program, several structural changes were made during the year. Among other changes, LHE, a South Korean company within the group, discontinued its production operations in Qingdao, China, in order to relocate its heat exchanger manufacturing to an existing unit in Busan, South Korea. The Alfa Laval company Tranter also relocated its production of welded heat exchangers from Artern, Germany, to another production unit in Schopfheim. The facility in Artern was closed during the year.

Acquisitions

Between 2011 and 2015, Alfa Laval acquired ten companies with combined sales of SEK 8,540 million, corresponding to average annual growth of SEK 1,708 million.

2011

ACQUISITIONS	REASON	SALES, SEK MILLION*
P&S Multibrand	Channel	100
Aalborg Industries A/S, Denmark	Product	3,300

DIVESTMENTS	REASON	SALES, SEK MILLION*
–	–	–

2012

ACQUISITIONS	REASON	SALES, SEK MILLION*
Additional 8.5 percent of the share capital in Alfa Laval India. (Total holding 97.5 percent)	Geography	Did not affect sales
Vortex Systems, USA	Product	100
Ashbrook Simon-Hartley, USA	Product	500
Gamajet Cleaning Systems, USA	Product/geography	75
Air Cooled Exchangers, LLC, USA	Product/geography	350**

DIVESTMENTS	REASON	SALES, SEK MILLION*
–	–	–

2013

ACQUISITIONS	REASON	SALES, SEK MILLION*
Gas combustion unit	Product	40***
Niagara Blower Company	Product	425

DIVESTMENTS	REASON	SALES, SEK MILLION*
–	–	–

2014

ACQUISITIONS	REASON	SALES, SEK MILLION*
Frank Mohn AS	Product	3,600

DIVESTMENTS	REASON	SALES, SEK MILLION*
–	–	–

2015

ACQUISITIONS	REASON	SALES, SEK MILLION*
Service Multibrand	Channel	50****

DIVESTMENTS	REASON	SALES, SEK MILLION*
–	–	–

* Refers to sales for the year preceding the acquisition or divestment.

** Sales for 2012.

*** Expected sales for 2013 on the acquisition date.

**** Expected sales for 2015 on the acquisition date.