AUTOLIV INC
Form ARS
March 11, 2004

Autoliv Annual Report 2003

OUR VISION is to substantially reduce traffic accidents, fatalities and injuries.

OUR MISSION is to create, manufacture and sell state-of-the-art automotive safety systems.

OUR STRATEGY is to be vehicle manufacturers' first-choice supplier through:

- Technological leadership
- Complete system capabilities
- Highest-value safety system solutions
- Cost efficiency
- Quality excellence
- Global presence
- Highest level of service and commitment
- Dedicated and motivated employees

OUR VALUES ARE:

Life	- We have a passion for saving lives.
Customers	- We are dedicated to creating satisfaction for our customers and value for the driving public.
Employees	- We are committed to the development of people's skills, knowledge and creative potential.
Innovation	- We are driven for innovation and continuous improvement.
Ethics	- We adhere to the highest level of ethical and social behavior.
Culture	- We are founded on global thinking and local actions.

SEC AND NYSE FILINGS
The CEO/CFO Section 302 Certifications have been filed as an exhibit to Autoliv's 10-K report. The filings with the -Securities & Exchange Commission (SEC) and the New York Stock -Exchange (NYSE) of Autoliv's annual report, 10-K report, quarterly reports in the form of 10-Q reports, proxy statements, section 16 insider filings, Sarbanes-Oxley Certifications, CEO Certification to the NYSE and other documents can be obtained free of charge from the Company at the addresses stated on page 51. These filings and documents are also available on Autoliv's corporate website (http://www.autoliv.com under Financial Info/Filings) and SEC's website (http://www.sec.gov).

Autoliv Saves Lives

According to the World Health Organization (WHO), more than one million people are killed each year in traffic accidents. If the current trend continues, the number of annual deaths will double by 2020. While human suffering cannot be measured, monetary costs to society are estimated in the hundreds of billions of dollars each year for health care, rehabilitation and loss of income.

Autoliv is the world's largest automotive safety supplier with sales to all the leading car manufacturers in the world. We develop, market and manufacture airbags, seat belts, safety electronics, steering wheels, anti-whiplash systems, seat components and child seats. Our global market share exceeds 30 percent.

Autoliv Inc., is a Fortune 500 company, incorporated in the state of Delaware, resulting from a merger in 1997 between the Swedish company Autoliv AB and the American company Morton ASP. Headquartered in Stockholm, the Company has 80 subsidiaries and joint ventures in 30 vehicle-producing countries with 37,000 employees. In addition, Autoliv has established, in nine countries, technical centers with 20 crash test tracks - more than any other automotive safety supplier.

The Company's shares are listed on the New York Stock Exchange (under the symbol ALV) and its Swedish Depository Receipts (SDR) are listed on the Stockholm Stock Exchange (under the symbol ALIV).

Sales By Region The European market accounts for over 50% of Autoliv's sales, the North American market for nearly 30%, while Japan and the Rest of the World (RoW) account for almost 20%. Fluctuations in the split between Autoliv's traditional markets in North America and Europe mainly reflect currency rate swings, while increases in Japan and RoW result from Autoliv's dedicated investments in these markets during the last few years. The most important individual markets are the United States, Germany, France, Japan, Spain, Great Britain and Korea. Sweden accounts for 4% of revenues. **Sales By Customer** Ford and its companies (e.g. Volvo Cars with 8%) accounted for 24% of Autoliv's revenues in 2003 (23% in 2002). Renault/Nissan accounted for 14%

(13% in 2002) and GM companies for 12% (15% in 2002). However, no individual supply contract accounts for more than 4% of consolidated sales. Each contract typically involves one vehicle platform, and is usually valid as long as that platform is produced (approximately 4-5 years). Contracts are typically awarded approximately three years before production starts. **Sales By Product** During the last five years, Autoliv's sales have grown for all products, except for frontal airbags which have been flat. As a consequence, side airbags accounted for 17% of sales in 2003, compared to 10% in 1999, and electronics for 9% compared to 6% in 1999. The seat belt share has also increased, from 26% to 29%, as a result of market share gains in Europe and North America, and expansion in Asia. Autoliv's dependance on frontal airbags has decreased from 44% to 30%.

State-of-the-Art Safety Systems

Autoliv has accounted for almost all major technological breakthroughs in automotive safety over the last 20 years and continues to be in the forefront of development. The new BMW 5-and 6- series are examples of new vehicles with many state-of-the-art safety products from Autoliv. (Both models are under the same contract).

1. KNEE AIRBAG
Today, when people's lives are saved by airbags and advanced seat belts, it is becoming increasingly important to also reduce knee and leg injuries so people not only survive but can walk and lead normal lives after a crash. Knee airbags protect both the knees and the upper legs. If the occupant is unbelted, the knee airbag enhances the protection effect of the frontal airbag. The knee airbags are standard in the BMW 6-series in the U.S. market where seat belt usage is lower than in many other markets. Knee airbags were originally introduced by Autoliv in 1996.

2. STEERING WHEEL
Most driver airbags are snapped into the steering wheels. Autoliv introduced this concept in 1995, which eliminates screwing operations at the vehicle assembly line and reduces material use and weight in the wheel. For the BMW 5-series, Autoliv delivers both the standard steering wheel and a special sports wheel. This sports wheel is standard in the BMW 6-series.

3. DRIVER AIRBAG
Is estimated to reduce driver fatalities in frontal crashes by approximately 25% (for belted drivers) and serious head injuries by over 60%. The driver airbag in both the new BMW 5- and 6-series utilizes a dual-stage inflator. Both stages are used in very severe crashes.

4. PASSENGER AIRBAG
Is estimated to reduce fatalities in frontal crashes by approximately 20% (for belted occupants). The passenger airbag in the new BMW 5- and 6-series has a dual-stage inflator that enables the airbag to absorb more crash energy if the crash is very violent.

5. THORAX SIDEBAG
Introduced by Autoliv in 1994 and estimated to reduce the risk of serious chest injuries in side-impact crashes by approximately 20%. In the new BMW 5- and 6- series, these bags are standard for both front-seat occupants and optional in the rear seat.

6. FRONTAL SEAT BELT SYSTEM
Is estimated to reduce the overall risk for serious injuries in crashes by 60-70%. Autoliv has produced seat belts for the car industry since 1956.

Load Limiters
The seat belt retractors have load limiters which pay out some webbing to reduce the seat belt load on the occupant's chest causing the excessive crash energy to be absorbed more uniformly by the frontal airbag. This reduces, in combination with pretensioners, the risk for life-threatening chest injuries by approximately 75% in frontal crashes. Introduced by Autoliv in 1995.

Buckle Pretensioners
The seat belts also have pretensioners that tighten the belt at the onset of a crash, using a small pyrotechnic charge that pulls the buckle downwards by up to 3 inches (8 centimeters). Introduced to the world market in 1989 by Autoliv.

Summary 2003

As an American company, Autoliv follows Generally Accepted Accounting Principles in the United States (U.S. GAAP). This annual report also contains some non-GAAP measures. Some of them are required by Autoliv creditors. Management believes that these non-GAAP measures may assist investors in analyzing trends in the Company's business. Investors should consider these non-GAAP measures in addition to rather than as a substitute for financial reporting measures prepared in accordance with U.S. GAAP.

- Record sales, earnings and cash flow
- Strong growth for side airbags, electronics and seat belts
- Rapid expansion in Asia

- Dividend raised twice and continued share buy-backs
- New authorization for additional share buy-backs

U.S.$	**2003**	**2002**	**Change**
Sales (in millions)	5,301	4,443	+19%
Operating income (in millions)	427	323	+32%
Net income (in millions)	268	176	+53%
Earnings per share	2.81	1.79	+57%
Cash from operations (in millions)	530	509	+4%
Return on shareholder's equity (%)	12.2	8.9	+37%
Dividends paid (in millions)	51	43	+20%

Net Sales In 2003, Autoliv's sales continued to outgrow the light vehicle production in Europe and North America. Consolidated sales rose by 19% to $5,301 million and organic sales by 5%, compared to a 2% decline in the vehicle production. Over the last five years, Autoliv's reported sales (i.e. including acquisitions) have grown by almost 40%, compared to a 4% decline in the North American and European light vehicle production. **Earnings Per Share** The turnaround in 2002 continued during 2003 when earnings per share improved by 57%, hitting a record high of $2.81, including a one-time license income and currency effects that boosted earnings per share by 26%. In 2001, earnings were hit by a drop in vehicle production, peaking raw material prices and negative currency effects. Pro forma numbers show earnings using the same accounting principles for all years (see Note 1 to the Consolidated Financial Statements included herein.) **Cash Flow** In 2003, operations continued to generate over one-half billion dollars in cash before capital expenditures, and over one-quarter billion after these investments. Although cash flow dropped in 2000 and 2001, the internal cash generation has always been enough to cover capital expenditures.

Another Successful Year - President's Letter

"Return on equity is now back to the levels of the late 1990s. These improvements reflect the combined effects of strong top-line growth and our never-ending cost- cutting efforts."

Dear Shareholder,
Despite a 2% decline in light vehicle production in our major markets, 2003 became the best year ever for Autoliv and demonstrated the strength of our Company and its strategies.
We are now taking the next steps in these strategies by:
- increasing investments in Asia and other new markets,
- expanding capacity for side curtain airbags, electronics and other new products,
- moving even more production to low-labor-cost countries,
- consolidating our supplier base and taking other cost-savings initiatives and
- exploring the potential in active safety and other exciting R&D-areas.

This should generate sustainable profit growth which could enable us to raise dividends and/or buy back stock, thereby continuing to create value for you as a shareholder.

In 2003, Autoliv continued its strong performance from 2002. Sales rose by 19%, reaching a record-breaking $5.3 billion. Net income improved by 53% to $268 million - also a record high - and cash flow hit $253 million after acquisitions and capital expenditures.

Organically (i.e. excluding acquisitions and currency effects), sales were up 5%, mainly driven by a strong performance in side airbags, electronics and seat belts, and by rapid expansion in Asia. Since light vehicle production declined, Autoliv's growth was entirely self-generated.

In creating shareholder value, we focus on increasing earnings and returns on shareholders' equity. Reported earnings per share rose by 57% (partly due to a one-time license income and currency effects that boosted earnings per share by 26%.) The return on equity, in excess of 12%, is now back to the levels of the late 1990s. These improvements mainly reflect the combined effects of strong top-line growth and our never-ending cost-cutting efforts.

Over the last five years, we have closed or sold a dozen plants. We have moved production to low-labor-cost countries. Currently, we have 35% of our employees in these countries, compared to less than 10% five years ago. We have redesigned our products and reduced direct material costs by more than 3% per year, i.e. faster than the price decline of our products.

As a result, we have bucked the falling margin trend since the "airbag boom" in the 1990s and have improved our operating margin for two consecutive years. During these two years, Autoliv has generated a quarter of a billion dollars in free cash each year. This free cash has enabled us to pay $51 million in dividends during 2003, to return another $43 million in 2003 to shareholders by buying back shares, and to raise the dividend by 82% in 14 months in three steps, including the dividend declared in February 2004.

Now the challenge is to keep this momentum.

Planting the Seeds for Future Growth

- To maintain our *technological leadership*, net spending in R,D&E increased by 33% to 5.8% of sales. At the leading scientific conference of our industry, we introduced a new concept consisting of a new airbag and a new seat belt system (see page 11). We have developed a special airbag for convertibles, and we have laid the foundation for expansion into *Active Safety* by landing the first order for our *Night Vision* system. In Active Safety, we have also made significant technological progress in *Pre-Crash Radar* and *Pre-Crash Dipping Nose* (see page 11).
- We have also strengthened Autoliv's *system capabilities*. In 2003, this was evidenced by rapidly rising sales of steering wheels (up 20% organically) and electronics (up 15% organically). In these segments, Autoliv has had much lower market shares than in airbags and seat belts. This is now changing as customers increasingly buy all safety systems from a single supplier as a package for a vehicle platform.
- In line with our *cost-saving* strategy, we introduced a program that will, in a few years, reduce the number of suppliers from over 2,000 to less than 500. We also introduced another program to reduce the number of product versions (by more than 50% in seat belts) and introduced a global, web-based purchasing system to take full advantage of global purchasing synergies. Furthermore, we have expanded in low-labor-cost countries and consolidated production into fewer facilities.
- *Quality excellence* was evidenced by several awards, such as a *Global Supplier Award* from DaimlerChrysler, the *Component Award* and the *Gold Award* from Chrysler, and Toyota's *Award for Excellent Value Improvements*.
- *Global presence* is a competitive edge for Autoliv that becomes increasingly important as vehicle manufacturers merge and form global alliances. In 2003, we acquired the remaining shares in our Japanese seat belt joint venture and started construction of a new airbag plant with a technical center in China. In Korea, we acquired more land in order to expand a plant that we opened less than two years ago. As a result of last years' investments in Asia, we are increasingly awarded global contracts by Asian vehicle manufacturers. In 2004, this will cause our average supply value to Asian vehicles produced in North America to surpass our supply value to a typical vehicle from our traditional U.S. customers (i.e. Ford, General Motors and Chrysler). In addition, we expect to double our consolidated sales in Asia within three years and exceed one billion dollars by 2005.
- Our *dedicated and motivated employees* have achieved these results. They have done a tremendous job over many years, for which I am both proud and grateful. We are committed to continually developing their skills, knowledge and potential - to the benefit of both the employee and our Company.

Outlook

Our belief in the bright prospects for Autoliv, communicated in previous annual reports, has been validated by some significant announcements during 2003.

- The Alliance of Automobile Manufacturers in the U.S. announced "a new voluntary industry safety commitment for enhanced side-impact protection through the use of features such as side airbags and airbag curtains ." The commitment requires all new vehicles offered in the U.S. by participating manufacturers to meet the new front-to-side crash protection criteria by September 2009. Two years prior to this deadline, 50% of these vehicles are to meet the self commitment.
- In June, a committee of the U.S. Senate introduced draft legislation for rollover protection "based on the combined ejection-mitigation capabilities of safety technologies, including advanced side glazing, side curtains, and side impact air bags." If approved, the proposed regulation would become effective at the end of 2008 for all new light vehicles.
- The EU Commission announced a new directive introducing a new pedestrian protection test for all new vehicle models by 2005, leading up to an even more stringent test in 2010.

These announcements - in combination with a steady increase in consumers' demand for safer vehicles - should give Autoliv solid long-term growth opportunities. Long-term, our increasing presence in Asia and our global contracts with Asian manufacturers should provide additional growth opportunities.

In 2004, we expect light vehicle production rates to be almost flat. We expect to continue to increase R,D&E expenditures faster than sales due to the strong order intake. This means that, for yet another year, all improvements in Autoliv's earnings and cash flow must result from our own programs and actions.

These efforts should enable us to deliver a third record- breaking year in a row, although it is not realistic to expect such sharp improvements as in 2002 and 2003.

Lars Westerberg

Profitability Returns on equity and capital employed are now, at 12% and 14%, respectively, back to the levels of the 1990s. **Employee Allocation** Over the past five years, the number of employees in low-labor-cost countries has increased from 1,500 to over 11,000 employees. The number of employees in these countries corresponds to 35% of total employees compared to less than 10% in 1999. **Supply value in North America** In 2004, Autoliv's average supply value to Asian vehicles produced in North

America will surpass our supply value to a typical vehicle from Ford, General Motors or Chrysler. However, a recent OEM self commitment for side-impact protection should start to increase the supply value to these customers as well.

Maximizing Long-Term Cash Flow

Our value-creating process focuses on long-term cash flow to provide funds for competitive compensation to shareholders, in addition to funds for an adequate financial position and maintaining earnings momentum. We therefore focus on growing earnings per share, while minimizing the capital required to take full advantage of Autoliv's growth potential.

TOPLINE GROWTH

One of Autoliv's targets is to outperform the global occupant restraint market and to grow topline revenues faster than costs.

As with all companies, Autoliv's revenues are determined by the size of the market and the company's share of that market. In Autoliv's case, the growth of our market has added just over 4% annually to sales since the new Autoliv company was launched in 1997. During the same period, market share gains (including acquisitions) have added nearly 5% per year, on average, to Autoliv's sales.

The Market

Our market, the automotive safety systems market, exceeded $14 billion in 2003. It primarily consists of frontal airbags (36%), side airbags (14%), seat belts (29%) and related electronics (21%).

Adjusted for currency effects, the market grew by $0.5 billion in 2003. The size of the market also depends on global vehicle production and the safety content per vehicle. Since 1997, these drivers have caused the market to rise at annual average rates of 1.5% and nearly 3%, respectively.

Vehicle production is driven by GNP growth, and fluctuates with the business cycles in individual markets. The age of the vehicle fleet influences demand less than GNP growth.

The safety content per vehicle is driven by introduction and higher penetration rates of new airbags and other new technologies. Equally important are new regulations and crash test programs. The average supply value per vehicle exceeded $245 in 2003. However, the gap between the low-end cars and the best safety-equipped vehicles was more than ten times - providing great potential for improvements among less well-equipped vehicles while the best equipped ones strive to defend their superiority. As a result, the safety content per vehicle is expected to continue to rise.

In the regulatory field, 2003 was a particularly eventful year. Vehicle manufacturers in the United States announced a self commitment for enhanced side-impact protection to be phased in by September 2009. In Europe, the EU commission signed a new directive that will phase in stricter pedestrian protection requirements on new vehicles in 2005 and in 2010. Japan is considering following Europe's move.

Market Share Growth

Since 1997, Autoliv has grown its sales at an average rate of nearly 9% per year. In 1998, we became the industry sales leader. Currently, we have approximately one-third of the global market, followed by the Japanese family- owned company Takata and the American public company TRW Automotive. Both have nearly one-quarter of the global occupant restraint market.

Organic growth - based on technical leadership and geographical expansion - has, as an average, contributed over 5 percentage points annually to Autoliv's sales growth since 1997. Acquisitions have contributed just over 3 points.

It is our goal to continue to outgrow the total market. Autoliv is better positioned than our competitors in the market's growth areas (such as side airbags), and we have developed a more significant global presence. This is a tremendous asset as Asian vehicle manufacturers continue to increase their share of global vehicle production. With Autoliv's system capabilities we are also helped by the fact that many vehicle manufacturers prefer to purchase airbags, seat belts and other safety products as one combined system.

COST CONTROL

Approximately 50% of Autoliv's revenues are spent on components and other direct materials from external suppliers. Almost 30% of revenues are used for salaries and other costs for employees; most of this (nearly 20%) is in manufacturing.

R,D&E (Research, Development and Engineering) takes currently almost 6%, and S,G&A (Sales, General and Administration) about 5% of sales. Both R,D&E and S,G&A expenditures are mainly for salaries.

Direct Material

Our target is to annually reduce direct material costs by at least 3% - i.e. faster than the decline in market prices for our safety systems.

The most efficient cost-reduction method is redesigning and replacing existing designs and components with new, more cost-efficient ones.

We have reduced, for instance, the material content in our traditional seat belt pretensioner by more than 70% since the introduction of the first product generation 15 years ago. Having to use fewer components also speeds up the manufacturing process, thereby reducing costs even more.

Another cost-reduction method is the current supplier consolidation program, which should reduce our global supplier base from over 2,000 suppliers to less than 500 in a few years.

Labor Costs

Our target is to improve labor productivity by at least 5% per year to offset higher labor costs. For this we rely on Kaizen, Six-Sigma, Autoliv's own production system (APS) and many other manufacturing principles and methods.

In addition, we have set a target to move at least 1,000 jobs per year to low-labor-cost countries, and to establish at least 35% of total headcount in these countries. This target is based on the current cost and product mix. Today, we have 31% of headcount in these countries.

SHORT-TERM CASH FLOW

Since roughly one-third of Autoliv's costs are relatively fixed, short-term earnings are highly dependent on capacity utilization in our plants and are therefore sales dependent. Cash-flow also depends short-term on the timing of payments from customers (primarily the ten largest vehicle manufacturers.) Short-term cash flow could therefore swing substantially from month to month.

Total production levels in our major markets are good overall indicators of Autoliv's capacity utilization, but the production levels of individual vehicle models are most critical, since many under-utilized production lines cannot be used to supply another car model.

CASH REQUIREMENTS

During the next few years, cash needed for working capital is targeted to remain at 10% of sales (although it may fluctuate somewhat between quarters).

It is also Autoliv's policy to maintain net debt significantly below three times EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) and an interest coverage ratio significantly above 2.75 times. Since these ratios were 1.2 and 10.2, respectively, at the end of 2003, there is substantial borrowing capacity.

We believe that foreseeable capital expenditures during the next few years will not significantly exceed depreciation (including amortization.)

The need for additional manufacturing capacity could, however, be affected by the new self commitment for enhancing side-impact protection in the United States.

Capital Employed

We have a number of initiatives for better utilization of capital employed, such as plant consolidations, outsourcing and moving to low-labor-cost countries (where less capital-intensive manufacturing processes can be used.)

Currently, 54% of Autoliv's capital employed consists of goodwill and other intangible assets (mainly from the acquisition of Morton ASP in 1997). Since this fixed amount does not increase as long as growth in revenues is generated organically, we could grow our sales and earnings at a higher rate than capital employed.

Furthermore, we do not presently foresee any major acquisitions.

Returning Funds

In summary, Autoliv has the potential to generate strong free cash flow for its shareholders. At the end of 2003, we had bought back 8.1 million shares for $176 million (at an average cost of $21.66). In addition, we have raised the quarterly dividend by 82% in three steps during the last 14 months.

We are continously evaluating the best ways to compensate shareholders. For this evaluation, the Board uses internal forecasts, external advice from an investment banker as well as analysts' target prices for the Autoliv stock. In addition, the Board takes tax effects into account to make sure that funds are returned to shareholders in the most efficient way, thereby creating the highest possible shareholder value out of all available market and business conditions.

Market By Product Since 1993, the global safety systems market has grown by 9% per year, on average, to over $14 billion. In 2003, the growth was almost 12% when the strong Euro and Yen boosted growth by 8%. The market was primarily driven by side airbags and smart frontal airbags, which mainly drove the electronics segment. The stagnation in 2000 and 2001 reflects the weaker Euro and lower vehicle production. **Market Growth Drivers** Since 1993, new airbags and other new technologies have increased the safety- system supply value at an annual average rate of 6%. Currently, the value exceeds $245 per vehicle. The safety content in high-end vehicles is often twice as high as this average. The other growth driver for Autoliv's market - global light vehicle production - has increased at an average rate of less than 3% during the same period. **Market By Company** Autoliv accounts for one-third of the global automotive safety market. Takata and TRW account for nearly one-quarter each, and Key Automotive for less than 10% of the market. Autoliv's competitive edge is technological leadership, superior global presence and system capabilities with in-house expertise in all key competence areas. Takata is a Japanese family-owned company. TRW Automotive is an American company that was acquired in 2003 by the Blackstone equity fund. In 2004, TRW made a public offering and its shares were re-listed. Key Automotive entered the safety market in 2002 by acquiring the American company Breed. The owner of Key Automotive is the Carlyle equity fund.

Research & Development - A Key to our Leadership Position

Autoliv has accounted for virtually all of the major technological breakthroughs in our industry over the last twenty years. This has contributed to establishing Autoliv as the industry's global sales leader. Now the pursuit of new cost-efficient safety technologies promises to secure Autoliv's leadership position and superior profitability.

Autoliv's research, development and customer application engineering (R,D&E) focuses both on inventing completely new technologies and on implementing further improvements and cost-savings in existing products.

Despite the advent of airbags, safer vehicles and safer roads, there still remains a compelling need for improved automobile safety. According to estimates by the World Heath Organization, over one million people are killed in traffic accidents every year throughout the world. By 2020, twice as many will perish if nothing is done, and road traffic accidents will become the third leading cause of death - compared to the ninth position today.

In addition to human suffering, traffic accidents cost societies hundreds of billions of dollars annually for care, rehabilitation and lost income.

Global Resources

To identify the types of traffic accidents to which we might apply Autoliv's safety expertise, we research accident databases (such as CCIS in the U.K, and NASS-CDS in the U.S). Our research and development also draws on Autoliv's internal tests and trials, as well as on the vast expertise that our specialists have gathered over many years. Autoliv's research is also conducted in consultation with the vehicle manufacturers and the *Autoliv Technical Advisory Board*, which consists of four world-leading professors in safety and biodynamics from Europe, Japan and North America.

With 3,800 people in R,D&E and 20 crash tracks in nine countries, Autoliv has more technical resources in automotive safety than any competitor. We crash test hundreds of new vehicles every year, perform several thousand sled tests and do tens of thousands of crash simulations on computers. All of these tests give us unique insight into the way vehicles and car occupants behave during crashes, enabling us to develop new ideas for products and product improvements. It also enables us to become better advisors to our customers and to design better software for our electronic airbag controllers. Some of the crash tests are funded externally by vehicle manufacturers or other external customers.

Corporate research is conducted by some 30 dedicated specialists at our Swedish Safety Center. Corporate development projects are assigned to Autoliv's leading tech centers in France, Germany, Japan, Sweden and the United States. Application engineering projects are completed locally in each major subsidiary.

In total, Autoliv currently has more than 2,000 R,D&E projects. The vast majority of these projects (and associated costs) relate to application engineering on existing products based on supply contracts from customers. No single project accounts for more than 1% of Autoliv's total R,D&E spending.

Total Safety Concept

Our R,D&E stretches all the way from pre-crash projects to in-crash and post-crash projects.

Post-crash systems include, for instance, "mayday systems" such as Autoliv's On-Call System, which automatically calls an emergency center after a crash. New in-crash systems are Autoliv's *Pedestrian Protection Airbag* (PPA) and our *Active Hood*, which deploys upward to provide a flexible surface when the pedestrian's head hits the vehicle hood.

Pre-crash systems include Autoliv's *Active Seat Belt*, which pulls in a few inches of webbing when sensors indicate that a crash is likely. It also releases the webbing if the driver manages to avoid the impact.

In addition to these projects and products in passive safety that are aimed at injury prevention, Autoliv is developing a series of active safety systems aimed at accident prevention. These systems intervene before the pre-crash phase when the crash is still potentially avoidable. In this area, which is relatively new to our industry, Autoliv is developing such systems as an infrared-based *Night Vision System* and a *Pre-Crash Radar* that could be used in combination with the *Active Seat Belt* and/or frontal airbags. Even if this pre-crash system gives just a few more milliseconds to inflate the airbags, it could open the possibility to make the airbags "softer" during deployment without compromising their protection capability.

Patents and Trademarks

The number of patent applications from Autoliv has increased by 50% over the past few years, partly as a result of a new policy to obtain stronger and broader patent protection. Patent applications increased in all product and component areas.

Autoliv holds over 3,000 patents covering a large number of innovations, such as the *Inflatable Curtain*, rollover sensing, the one-piece-weaving technology for airbags, the buckle pretensioner principle, the seat-mounted thorax side airbag, the anti-whiplash seat principle and a vast number of other systems and technologies. The patents expire on varying dates through the year 2023. The expiration of any single patent is not expected to have any material adverse effect on Autoliv's financial position.

Autoliv also holds some trademarks, but trademarks are typically not as important as patents in Autoliv's industry, since the products are not sold directly to consumers.

During 2003, total gross expenditures for R,D&E (research, development and customer application engineering) rose by 25% to $417 million, corresponding to 7.9% of sales. Since 1999, this R,D&E ratio has increased from 6.6% with a low of 6.4% in 2000.

Of the 2003 amount, $112 million was related to customer-funded engineering projects and crash tests. Net of this income, Autoliv spent $305 million corresponding to 5.8% of sales. During the last five years, this net ratio has increased from 5.2% with a low of 4.8% in 2000.

R,D & E Projects - Exciting Project Portfolio

The introduction of seat belts and airbags has contributed significantly to a substantial reduction in traffic fatalities and injuries in Western countries over the past 30 years despite an increase in vehicles on the roads and more crashes. We are committed to driving this reduction even further by investing in R&D projects, both in passive and active safety systems.

Side-Support Airbag (SSA)

To provide additional protection in far-side collisions (i.e. the side opposite the occupant), Autoliv has designed a new airbag. It is mounted on the inner-side of the backrest and inflates to three liters at the height of the occupant's upper arm to hold the occupant in an upright position. This reduces significantly the risk that the occupant's head will hit the intruding car side, which can be fatal.

The SSA can be combined with Autoliv's new 3+2-point seat belt system, which consists of a two-point belt running diagonally across the regular three-point belt.

In severe frontal crashes, the additional belt could reduce the risk for life-threatening injuries by 30% compared to a regular three-point system.

In far-side collisions, the two systems have - in laboratory tests - eliminated completely the risk of fatalities, and reduced the risk in rollovers by almost 100%, provided that the roof of the vehicle does not collapse.

Pre-Crash Dipping Nose

High-profile light-duty trucks, such as pick-ups and other Sport Utility Vehicles (SUVs), could be especially dangerous for occupants in passenger cars, because these vehicles hit the passenger car above the door sill and other parts of the car's energy-absorbing structure. As a consequence, the risk of fatality to an occupant in a passenger car is four times greater if the striking vehicle is a pick-up or a SUV rather than another passenger car.

To address this problem, Autoliv is developing a *Pre-Crash Dipping Nose* that employs our *Pre-Crash Radar* to detect an inevitable crash three-tenths of a second before the crash. This short time is enough to release the air of the frontal suspension bellows in order to lower the SUV's front end by approximately 6 inches (15 centimeters) to make the vehicles geometrically compatible with each other. This does not affect the steering, braking or traction of the SUV.

After the crash, the valves of the air suspension bellows are closed again and the SUV automatically resumes its original height in less than 20 seconds.

The Pre-Crash Radar could also be used to trigger passive systems such as Autoliv's pre-pretensioning system the *Active Seat Belt* to mitigate the consequences of the crash.

In addition, the radar has the potential to be used for active safety functions such as automatic triggering of brake-assistance systems or even emergency braking of the vehicle.

New Airbag and Seat Belt Her Royal Highness Crown Princess Victoria of Sweden listens intently to a description of Autoliv's new Side-Support Airbag (SSA) and new 3+2-point belt system during her visit to Autoliv's main facilities in Sweden in 2003.
Pre-Crash Dipping Nose By using radar and controlling the suspension systems of high-profile vehicles, the front end of SUV's can be lowered to the level of a passenger car in the event of a crash, giving the occupants in the passenger car a four-times better chance of surviving. The SUV then automatically resumes its original height in less than 20 seconds.

Human Resources - Investing in People

Autoliv's Human Resources (HR) activities support the Company's overriding profitability target by making sure that Autoliv has enough skilled, talented and motivated people to maintain its growth momentum. For continued growth, it is also necessary to provide a steady flow of new managers. HR also supports and develops Autoliv's global culture.

We invest in people. We offer our associates a wide range of training and development programs, such as on-the-job training, job-rotation, courses and international assignments. We identify associates with high potential and offer them special leadership training and expatriate positions.

Currently, we have identified 50 such key employees with significantly high potential. The list is continuously expanded as the identification process proceeds. This reflects our new target, established in 2003, that 70% of all newly appointed managers in the future should be internal candidates. In 2003, we also decided to double the average time invested in employee training programs from the current four to eight days.

The Autoliv Culture

To take full advantage of Autoliv's superior global reach, we strive for a profit-oriented, team-building, global culture. Therefore in 2002, we established in writing the vision and mission that unite and lead us all in Autoliv (see www. autoliv.com under "Social Responsibilities"). We also agreed upon six core values (see page 2) and ten leadership behaviors that set the standard for Autoliv's managers and leaders worldwide. During 2003, we have incorporated these core values and standards throughout Autoliv's global organization. Additionally, a new global leadership-training program has been introduced based on these core values and leadership behaviors.

In 2003, we also replaced our traditional country-based organization and introduced a new organization based on regions and global product areas to strengthen global cooperation within Autoliv.

For this reason, we have also changed the bonus structure for many key employees, basing their annual bonuses - partly or entirely - on Autoliv's corporate performance instead of solely on earnings in their local Autoliv branch.

The increasing number of international assignments also contributes to more global cooperation. These assignments have tripled and are targeted to reach 200 annually in two years.

Social Policy

We have a social policy as part of Autoliv's Code of Business Conduct and Ethics that draws on the principles of the United Nations' "Global Compact" and the Global Sullivan "Principles of Social Responsibilities."

This code can be found at Autoliv´s website www.autoliv.com under "Governance".

Employee Facts

Of the total headcount of 37,000 at the end of 2003, 65% were direct workers and another 20% were other employees in manufacturing. Just over 10% were employed in R,D&E, while just under 5% worked in Sales and Administration.

Of the headcount, 13% are temporary hourly workers and 87% fixed employees. Nearly 50% of the headcount are women.

Work hours lost due to employee illness totaled 2.5% in North America, compared to over 6% in Europe. The differencies are primarily due to the public health care compensation systems. Health & Safety Programs in the plants adress this issue. The turnover rate among employees is less than 5%, in line with Autoliv's target.

LEADERSHIP BEHAVIORS

- Grow People
- Exhibit Integrity
- Promote Teamwork
- Encourage Innovation
- Be Results-Oriented
- Provide Clarity & Direction
- Support Diversity
- Demonstrate Accountability
- Support Global Strategies
- Create Enthusiasm

Productivity Improvement During the past five years, value added per employee has increased to nearly $68,600 from $63,300 in 1999. The increase is due to productivity improvements but also, in 2003, due to the stronger Euro and Yen. The decline in 2001 and 2002 reflects currency effects and lower vehicle production. Total Autoliv headcount (employees incl. temporary, hourly workers) has increased to 37,000 from 29,900 in 1999. **Headcount by Region** Autoliv maintains 50% of its headcount in Europe, where 82% of the headcount are in high-labor-cost countries (HLCC) and 18% in low-labor-cost countries (LLCC). Headcount in North America represents 29% of total headcount, and headcount in Asia and other countries 21%. Of the headcount in North America, 66% are in HLCC and 34% in LLCC (Mexico). In the Rest of the World (RoW), 41% of headcount is in HLCC (mainly Japan, Korea and Australia) and 59% in LLCC. The regional split of headcount could be compared with the corresponding split of sales, which is Europe over 50%, North America just under 30% and Rest of the World nearly 20%. **Training Days** The number of days invested in employee training has increased from 1.5 days on average in 2000 and 2001 to four days in 2003 and is expected to exceed five days in 2004.

Environment - Focusing on the Essentials

The main purpose of Autoliv's environmental management is to fulfill all legal and customer requirements. Environmental management also contributes to Autoliv's profitability by reducing material use. Recyclable products with minimal environmental impact also help drive sales and revenues.

The most essential contributions our company can make in environmental management are:

- to reduce product weight
- to improve capability to recycle products and
- to control Autoliv's facilities.

Weight Reduction

All companies in the automotive industry are under strong pressure to reduce carbon dioxide emissions.

For vehicle manufacturers, this means significant efforts to reduce gasoline consumption, not least by finding ways to reduce the weight of vehicles. Even small contributions are welcomed in these continuing efforts.

This is one of the reasons we have made product material use a priority.

In addition, reductions in material use lead to less environmental impact from steel works and other suppliers in the supply chain.

It is this phase (i.e. material use prior to arriving at an Autoliv plant) that causes most of the environmental impact of our products - not our own manufacturing processes.

In fact, the environmental impact of a typical Autoliv plant is - in relation to sales - not higher than the impact of a bank or an office, because most Autoliv facilities - unlike many typical plants - do only assembly work from pre-fabricated (mainly steel and plastics) components.

Recycling Capabilities

Although the European Parliament in 2000 adopted the directive End of Life of Vehicle ("ELV"), we started our program for recyclable products and elimination of hazardous materials many years ago.

The new ELV-directive, which will be phased in between 2003 and 2015, requires 95% of the material in all new vehicle models to be recoverable. The directive also bans the use of hazardous substances and restricts the use of other substances of concern.

To meet these requirements, the vehicle manufacturers have created one common database (IMDS) to which all automotive suppliers report all substances in their products. We have had such a database for many years, which now enables us to make leading contributions to the new industry- wide database.

We are committed to maintaining that lead by continuing to optimize the design and recyclability of our products and improving our manufacturing processes. The ELV requirements will also be applied to our operations outside Europe.

Our Facilities

Every Autoliv facility has an environmental management system, and most facilities are certified according to the international environmental management standard ISO-14001. At the end of 2003, our environmentally-certified plants accounted for 95% of Autoliv's revenues.

As part of the environmental management systems, each plant measures and monitors all relevant environmental factors, such as energy and water consumption, and emissions of various kinds, as well as the use of chemicals, freight and packaging materials and staff training.

For instance, to reduce freight and packaging materials, Autoliv has introduced foldable, reusable shipping boxes to minimize the space needed for returning boxes for reuse.

Recently, we implemented a cross-dock, logistical system in the United States. Using this system, trucks are loaded in the Midwest with components before returning to the Autoliv plants in Utah, after having delivered Autoliv's products to that region's vehicle plants.

Customers and Suppliers

Autoliv works closely with its suppliers on environmental matters and expects them to have environmental policies and management systems that are based on the principles that are laid down in the Autoliv Environmental Policy (see www. autoliv.com under "Social-Responsibilities").

Autoliv actively supports its customers in their environmental programs. Autoliv is, for instance, represented in the Ford Supplier Environmental Forum together with ten other leading Ford suppliers which have a track record of being in the forefront of environmental management.

Redesign of Airbag One of the most efficient ways to improve the environment is to redesign products. Autoliv's passenger airbag in 1998 (below left) weighed 3.3 kg. The current generation launched in 2002 (below right) weighs less than 2 kg and has fewer parts (which reduces assembly costs). This 40% savings in material reduces the impact that steel works and other suppliers in Autoliv's supply chain have on the environment. It also reduces vehicle emissions during the entire vehicle life. **Environmental Certifications** At the end of 2003, more than 65% of Autoliv's facilities had been certified according to ISO 14001, an international environmental management standard. These facilities accounted for approximately 95% of consolidated sales. The certification work began in 1997. The operations not yet certified are mainly companies that have been started or acquired recently.

Quality - A Key to Profitability

Lifesaving automotive products never get a second chance. They have to work flawlessly, even after many years in tough and varying environments. Continuous focus on quality is therefore key to maintaining Autoliv's competitive edge.

To reach the excellent quality standards required for safety products, we have - for many years - applied a proactive, "zero defect" quality policy. This pursuit of excellence stretches all the way from the initial development of a new product to the disposal of the product after many years in a vehicle.

To ensure that a new product is robust and has no hidden weaknesses that could appear after several years, we apply a stringent process called APDS (Autoliv Product Development System). It consists of four tollgates, wherein each development project is checked before it is allowed to proceed to the next step. All data is registered in a database that follows the product as it goes into production to create a complete file on each product.

To drive global standardization, product improvements and cost savings, we have appointed a corporate design authority with global responsibility for each product group. In this way, quality is assured - and improved - whenever a product is modified.

Supply-Base Management

We have developed a base of some of the best suppliers in the industry. This supplier selection and development process is continuously becoming more competitive since lower cost and further quality improvements are expected in our supplier consolidation program. This consolidation program calls for a reduction from over 2,000 Autoliv suppliers to less than 500 within the next few years.

To support this selection process, we rate our suppliers, and the suppliers can continuously track their score in the rating system on the Autoliv Partner Portal on the web. On the portal, the suppliers can also track orders and production forecasts.

We require suppliers to be certified according to QS 9000 or ISO/TS16949.

Internal Quality

All of Autoliv's own facilities are certified to QS 9000, a special automotive quality standard. In addition, over 50% of the Autoliv plants together representing 85% of sales are also certified to the new ISO/TS 16949, which was adopted in 1999. The target is to have virtually all plants certified to the new ISO/TS edition before the end of 2004.

In manufacturing, Autoliv's "zero defect policy" means that no defective materials should enter production lines and no nonconforming intermediate products or finished products should be passed to the next stage. Weight sensors, cameras, X-ray systems and other checkpoints for error detection are therefore installed at critical stations throughout the manufacturing process.

In addition, we have a global "Lessons Learned Database" to share experiences and spread best practices among all Autoliv plants. Intercompany quality audits also contributes to this process as our plants audit each other. Customer and other independent quality audits provide additional input.

The performance of every Autoliv plant is published quarterly in an internal global database. Plants can then be benchmarked and work to continuously improve quality. Quality performance is measured in the number of non-conforming parts per million (ppm) produced. The requirement is to meet the customers' new tougher target of less than 10 ppm, which an increasing number of Autoliv plants already meet. Previously, some customers accepted 50 ppm.

We use Kaizen, Six-Sigma and other tools for continuous quality improvements. All of our main facilities have Six-Sigma mentors who have been trained to employ various methods for finding root causes to complex problems and to take corrective action. Since the start in 2001, over 170 Six-Sigma projects have been completed, yielding significant quality improvements and cost reductions.

Customer Support
Our customers demand perfect products, flawless labels, comprehensive and correct documentation, clean and damage-free packaging, 100% on-time deliveries and smooth launching of new products. Vehicle manufacturers also require suppliers to be flexible in order to respond to variations in the demand for their increasing multitude of vehicle models.

We also need to be able to respond to design and process changes in connection with model shifts without halting shipments. Autoliv has therefore developed quality, responsiveness and delivery precision as competitive tools.

To strengthen our already strong position and further improve quality and service to customers, we have appointed "Customer Quality Windows." Each C.Q.W. specializes in a particular customer's individual quality requirements and is dedicated to ensure that the customer's requirements are met.

To meet our customers' continuously tougher requirements, we have implemented five new global key initiatives during 2003, including verifying process controls, standardizing work, error-proofing, change control and enhancing control of purchased components.

In this way, our comprehensive quality management not only ensures that our products meet customer specifications and legal requirements, but also contributes to Autoliv's profitability by servicing customers, promoting sales and continuously reducing costs.

Quality Certifications At the end of 2003, 55% of Autoliv's facilities were certified to the new automotive standard ISO/TS-16949. Combined sales of these companies represents 85% of consolidated sales. In 2004, virtually all plants (together representing 95% of sales) are expected to have this certification.

Management's Discussion and Analysis

TRENDS AND RISKS ANALYSIS

Key Financial Data Years ended December 31, (Dollars in millions)	**2003**		**2002**		**2001**	
Sales of airbag products (incl. steering wheels)	$3,608	68%	$3,160	71%	$2,817	71%
Sales of seat belts (incl. seat components)	1,693	32%	1,283	29%	1,174	29%
Total sales	**$5,301**	**100%**	**$4,443**	**100%**	**$3,991**	**100%**

Years ended December 31, (Dollars in millions)	**2003**	**2002[1)]**	**2001[1)]**	**2001[1)2)]**
Gross profit	$1,003	$803	$663	$663
Gross margin	18.9%	18.1%	16.6%	16.6%
Operating income	$427	$323	$182	$233
Operating margin	8.1%	7.3%	4.5%	5.8%
Net income	$268	$176	$53	$105
Net margin	5.1%	3.9%	1.3%	2.6%
Earnings per share	$2.81	$1.79	$.54	$1.07
Return on equity	12%	9%	3%	6%

1) As more fully described in note 20 to the Consolidated Financial Statements, the Company has restated the 2002 and 2001 financial statements.
2) Adjusted to show the effects of FAS-142 "Goodwill and Other Intangible Assets", as if the non-amortization of goodwill provisions had been applied in 2001.

Overview

Autoliv, Inc. (the "Company") provides advanced technology products for the automotive market. Airbag modules, seat belts and inflators for airbags are supplied to all major European, U.S. and Asian automobile manufacturers.

Seat belts and airbags are considered integrated safety systems that function together under common electronic control systems for the protection of occupants in motor vehicles.

The Company manufactures its products in several countries and, for the most part, sells the products in those

countries or other countries in the same geographic region.
Although the Company has no customer accounting for more than 24% of sales (See Note 18 to the Consolidated Financial Statements included herein) and no single contract accounting for more than 4% of sales, the Company is dependent on a relatively small number of customers with strong purchasing power.
The loss of all of the business of a single customer could have a material adverse effect on the Company. In addition, a significant disruption in the industry, a significant decline in demand or pricing or a dramatic change in technology could have a material adverse effect.
The Company carries product liability and product recall insurance with limits that management believes are sufficient to cover the risks. Such insurance may not always be available in appropriate amounts and a substantial recall, or liability in excess of coverage levels, could also have a material adverse effect on the Company.
A number of trends have influenced Autoliv's operations in the years 2001, 2002 and 2003. The most significant have been the changes in light vehicle production along with changes in vehicle model and customer mix, the growing safety content per vehicle, raw materials and components costs, pricing pressure from customers, and foreign exchange rates, especially between the U.S. dollar and the Euro.
The level of interest rates, activity in the Company's share repurchase program and increases in the rate of dividend payments have also had an impact on the cost of financing the Company's operations.
From their low point in 2001 there has been a turnaround in the Company's results. Since 2001, the impact of the various factors influencing the Company's reported results has been steadily increasing margins and cash generation.

Light Vehicle Production

The level of light vehicle production is an important factor influencing Autoliv's business. Historically, it has been light vehicle production in the Triad (i.e. Europe, North America and Japan) that has been most significant. In these markets, light vehicle production has declined in recent years. However, light vehicle production is increasing rapidly in the rest of Asia. The Company, having positioned itself to benefit from these emerging markets through both consolidated subsidiaries and joint ventures, is already benefiting from the growth in this region.
The level of light vehicle production is influenced by global economic activity, with variations in regional activity being especially important. In the short-term, production levels can be somewhat erratic within regions and over the course of a year. Although broadly speaking the Company's sales are positively correlated to light vehicle production, vehicle model and customer mix is more important.
Since roughly one-third of the Company's costs are relatively fixed, should there be a dramatic reduction in the level of production of vehicles supplied by the Company in any of its major markets, there would be a short-term negative impact on margins. The Company's initial response would be to reduce the number of temporary employees and to reduce its component purchases.
However, it would take considerable time to reduce the level of permanent employees, and to reduce fixed production capacity.

Safety Content per Vehicle

The most important long-term trend is that Autoliv's market continues to be driven by the growing safety content per vehicle. This enables Autoliv to increase its sales above the 2% long-term growth rate of global light vehicle production.
A specific major driver of this trend is the *Inflatable Curtain* for side-impact and rollover protection. The market for this airbag is expected to grow to approximately 30 million in annual unit sales by 2005, from less than 10 million in 2001.

Consolidation and Restructuring

The Company had experienced sustained growth, both organic and acquisition driven, for several years, but following a drop in vehicle production in the major markets that started in late 2000, the Company entered a consolidation phase.
Since late 2000, the Company has been more active in restructuring to reduce costs, has increased focus on control of working capital and has reduced levels of capital expenditure.
At the same time, the Company has continued to make strategic acquisitions and has disposed of certain small, non-core component manufacturing operations. Acquisitions, however, have been at a fairly modest level. Furthermore, the Company has continued to invest in the development of new products and in capacity to support growth.

Component Costs

The Company, at each stage of production, relies on internal or external suppliers in order to meet its delivery commitments. The Company may be dependent, in certain instances, on a single supplier for certain components.
In addition, the Company's customers, in many cases, require that the Company's suppliers are qualified and approved by them. Disruptions in the supply chain could lead to extra costs in order to meet delivery commitments.
The cost of materials is approximately 50% of sales. Direct materials are comprised of approximately 25% raw materials and 75% value added by the supply chain. Changes in raw material prices typically feed through in six to twelve months. Approximately 35% of the raw materials cost is based on steel prices, 30% on oil prices (i.e. nylon polyester and engineering plastics) and 15% on circuit boards and other electronic components. The remaining raw materials costs are based primarily on aluminum, magnesium and copper prices.
Prices of materials fluctuate and are influenced by regional economic conditions and currency fluctuations. The Company´s strategy is to offset price pressure on costs of materials by taking an increasingly global approach and by taking actions such as consolidating volumes to fewer suppliers and moving components sources from high to low-cost

countries.

Pricing Pressure

Pricing pressure from customers is an inherent part of the automotive components business. The extent of reductions varies from year-to-year, and is increasingly taking the form of reductions in reimbursements for engineering work rather than direct sales price reductions. In response, the Company is continuously engaged in efforts to reduce costs, including shifting production to low-labor-cost countries, product redesigns, product standardization, efficiencies from global purchasing activities and improvements in manufacturing productivity. The Company also works to give customers added value by developing new products and through its world-class engineering organization and test facilities.

The Company's various cost-reduction programs are, to a considerable extent, interrelated. This interrelationship makes it extremely difficult to isolate the impact of any single program on costs and management does not generally attempt to do so. Instead, management monitors key measures such as costs as a percentage of sales, margins and geographical employee mix.

Foreign Exchange Rates

The Euro is the largest currency to which the Company is exposed and net sales denominated in Euros comprised around half of 2003 sales. Approximately one-third of net sales were denominated in U.S. dollars. The second quarter of 2002 reflected a major reversal in the U.S. dollar/Euro exchange rate trend. For the first time in many years, reported sales were increased by currency effects. This also affected equity as the stronger Euro began to generate positive Cumulative Translation Adjustments ("CTA").

Since the spring of 2002, the dollar has weakened by around 40% against the Euro. Since the beginning of 2002, CTA has added $228 million to the Company's reported equity.

Interest Costs

Interest rates peaked in late 2000 and, in the past three years, have more or less continuously trended downwards. Autoliv benefited, but only partially, from this trend, having locked in fixed rates on a portion of its borrowings in accordance with Corporate policy.

Autoliv's weighted average funding cost peaked at 6.2% in December 2000, dropped to 4.9% at the end of 2002 and was 4.5% at December 31, 2003.

Share Buy-backs and Dividends

In order to increase shareholder value and to return funds to shareholders the Company initiated a share repurchase program in 2000. In addition, between December 2002 and February 2004, the Company has raised the quarterly dividend three times by a total of 82%.

SELECTED DATA IN SEK

	2003	**2002 1)**	**Change 2003/2002**	**2001 1)**	**Change 2002/2001**
Net sales (million)	42,936	43,279	(1)%	41,187	5%
Income before income taxes (million)	3,216	2,719	18%	1,286	111%
Net income(million)	2,174	1,709	27%	547	212%
Earnings per share	22.76	17.43	31%	5.57	213%

(Average exchange rates: 1$ = SEK 8,10 for 2003, 1$ = SEK 9,74 for 2002, 1$ = SEK 10,32 for 2001)

1) Restated. For further details see Note 20.

Exchange Rates for Key Currencies vs. U.S. dollar

	2003 Average	**2003 Year end**	**2002 Average**	**2002 Year end**	**2001 Average**	**2001 Year end**
EUR	1.127	1.250	0.941	1.042	0.896	0.883
AUD	0.648	0.747	0.542	0.564	0.518	0.509
GBP	1.631	1.775	1.498	1.603	1.441	1.451
SEK	0.123	0.137	0.103	0.113	0.097	0.094
JPY/1000	8.620	9.347	7.972	8.380	8.238	7.617

ITEMS AFFECTING COMPARABILITY

One-time License Revenue

Operating income in the fourth quarter of 2003 was increased by license revenue of $31 million. The license revenue was included in other income and is a result of the fact that Autoliv's wholly-owned subsidiary OEA, Inc. received a one-time consideration for past and future use of certain initiator and inflator technologies.

Due to the availability of tax credits in the U.S., the license revenue increased Net income by $26 million.

Goodwill Amortization

Effective January 1, 2002, the Company adopted Financial Accounting Standards Board ("FASB") Statement on Financial Accounting Standards ("FAS")-142 "Goodwill and Other Intangible Assets".

The application of FAS-142 resulted in a reduction of approximately $50 million of annual amortization of goodwill. The provisions of FAS-142 do not permit restatement in the primary financial statements of periods prior to January 2002. Had FAS-142 been applied in prior periods, goodwill amortization would have been lower by $52 million in 2001.

Unusual Items

During October 2001, a restructuring package was introduced to improve profitability and offset the effects of an expected downturn in light vehicle production. The costs and provisions for this package, totaling $65 million, were charged to the third quarter 2001 results and are referred to in this report as "Unusual Items". The Unusual Items included provisions for contractual, warranty and liability issues totaling approximately $29 million. Of the total, approximately $7 million related to contractual, $10 million to warranty and $12 million to liability issues.

The restructuring package mainly included restructuring costs and asset write-offs of the Seat Sub-System division, severance costs related to the U.S. and the Swedish textile operations and additional costs incurred for the partial integration of a former OEA plant into the main U.S. inflator operations. These restructuring activities accelerated the Company's efforts to reduce costs by shifting production to low-labor-cost countries and improve manufacturing productivity by consolidating manufacturing activities. See Note 10 to the Consolidated Financial Statements included herein for information related to the Unusual Item, including a roll-forward of balance sheet reserves.

Non-GAAP Measures

Some of the discussions below refer to non-GAAP measures. Management believes that these non-GAAP measures may assist investors in analyzing trends in the Company's business. Certain other non-GAAP measures discussed below are required by Autoliv creditors. Investors should consider these non-GAAP measures in addition to, rather than as a substitute for financial reporting measures prepared in accordance with U.S. GAAP.

Restatement

The Company has reviewed the historical accounting for one of its insurance arrangements covering potential recalls. Management determined that, based on the existing contractual terms, it was more appropriate to account for the insurance arrangement under the deposit method of accounting rather than as a traditional insurance contract.

After discussions with the accounting staff of the Securities and Exchange Commission, the Company has concluded that the most appropriate manner to correct this accounting is to restate 2001 and 2002 annual financial statements and 2001, 2002 and 2003 quarterly operating results. See Note 19 to the Consolidated Financial Statements included herein.

The positive cumulative net effect totaling $13.2 million of applying the deposit method of accounting on a retroactive basis, has been recorded as an adjustment of beginning 2001 retained earnings. See Note 20 to the Consolidated Financial Statements included herein and the Consolidated Statements of Shareholders' Equity for further information.

Debt related Derivatives

The Company has as from the third quarter 2003, reclassified the fair market value adjustments associated with debt related derivatives from the debt caption. See Financial Instruments section of Note 1 to the Consolidated Financial Statements included herein for further details.

OUTLOOK FOR 2004

During the first quarter of 2004, light vehicle production in the Triad is expected to be almost flat with a small decline in Europe. Currency effects are expected to add 11% to revenues (provided that the mid-January exchange rates prevail), and acquisitions another 3%. Based on these assumptions, sales would grow in the region of 15% in the first quarter, a level which Autoliv expects to exceed slightly.

Mainly due to the expected sales performance and Autoliv's continued cost-savings program, the Company expects its operating margin in the first quarter this year to slightly exceed the level recorded in the first quarter of 2003.

The Company expects Autoliv's effective tax rate to be approximately 32% with the potential of being somewhat lower in 2004.

However, the U.S. Congress is continuing to assess alternatives for a replacement of the controversial U.S. Extraterritorial Income ("ETI") regime and is expected to enact legislation in 2004. If ETI is repealed and replacement legislation is not enacted, the annual effect on the Company's effective rate would be an increase of between one and two percentage points.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Statements in this report that are not statements of historical fact may be forward-looking statements, which involve risks and uncertainties, including - but not limited to - the economic outlook for the Company's markets, fluctuation of foreign currencies, fluctuation in vehicle production schedules for which the company is a supplier, continued uncertainty in program awards and performance, the financial results of companies in which Autoliv has made technology investments, and other factors discussed in Autoliv's filings with the Securities and Exchange Commission.

YEAR ENDED DECEMBER 31, 2003 VERSUS YEAR ENDED DECEMBER 31, 2002

Net sales

Components of net sales increase in 2003	**Airbag products**	**Seat belt products**	**Total**
Organic sales growth	3%	8%	5%
Impact of acquisitions	1%	9%	3%
Effect of exchange rates	10%	15%	11%
Reported net sales increase	**14%**	**32%**	**19%**

Net Sales

Net sales for 2003 increased by 19%. In reported dollars, the increase was $857 million. The weakening of the U.S. dollar increased reported sales by approximately 11%. Acquisitions made during 2002 and 2003 added incremental sales of $165 million or just over 3%.

Organic sales increased by slightly under 5%. At the same time, production of light vehicles in the Triad is estimated to have declined by about 2%. Organic sales increased in every quarter compared to the corresponding quarter in 2002. Organic sales grew by 5% in the first quarter, 2% in the second and third quarters and then accelerated to 9% in the fourth quarter. A 3% organic increase in sales of airbag products was principally due to the continuing rollout of Autoliv's *Inflatable Curtain*, as well as gains in market share in steering wheels and electronics in Europe and North America. An 8% organic growth in sales of seat belt products was primarily due to continued gains in market share, especially in Europe and Korea. The market share gains in Europe were mainly due to a favorable sales mix.

Sales in North America declined by 3%, while acquisitions added 2% to revenues. Therefore, organic sales decreased by 5% compared to a 3% decline in light vehicle production. Production by the "Big 3" (i.e. GM, Ford and Chrysler), which accounts for most of Autoliv's sales, decreased by 6%, while the North American production of the Asian and European manufacturers rose by 7%. Therefore, the customer mix was unfavorable. Organic sales of airbag products decreased by 6%, partly as a result of the continued phase-out of low-margin inflators. Organic sales of seat belt products increased by 3%. Organic sales of seat belts declined in 2002 due to contracts having expired during the autumn. However, these contracts were replaced by new seat belt orders, starting in 2003.

Sales in Europe rose by 26%. Organic growth added 6% compared to a 2% decline in European light vehicle production. Currency effects added 19% and acquisitions 1%. Autoliv's market share gains were mainly driven by a favorable vehicle mix.

Sales growth in the rest of the world, led by Japan (where light vehicle production was flat) and Korea, accelerated throughout the year. Organic sales from companies in these countries rose by 32%. Currency effects increased reported sales by 10%. Strong demand for the *Inflatable Curtain* was the biggest growth driver. The acquisition of NSK in April 2003 increased reported sales in this region by 26%.

Gross Margin

The pressure on sales prices continued, but was more than offset by higher volumes and the beneficial effect of ongoing cost reduction programs which reduced per unit product costs. The gross margin improved in 2003 to 18.9% from 18.1%. The cost reduction programs include the shifting of production to low-labor-cost countries, product redesigns, product standardization, efficiencies from global purchasing activities and improvements in manufacturing productivity. Some of the productivity improvements are the result of the consolidation of production into fewer facilities.

Operating Income

Operating income was $427 million or 8.1% of sales. This compares with operating income of $323 million in 2002, which was 7.3% of sales. The operating margin was boosted in 2003 by 0.6% due to the $31 million one-time license revenue. Selling, General & Administrative expense ("SG&A")was 5.2% of sales in 2003 compared to 4.9% of sales in 2002. Amortization of intangibles, at 0.4% of sales, was unchanged. Research, Development & Engineering ("RD&E") increased to 5.8% of sales from 5.2% in 2002. RD&E is expected to continue to increase, as it is necessary to incur engineering expense to support the growth of order intake. It is also expected that the level of customer reinbursements for engineering work will decrease. These reductions will be partially offset by piece price amortization in sale prices.

Other income (expense), net was approximately $24 million of income, or 0.4% of sales, compared to approximately $12 million of expense, or 0.3% of sales, in 2002. The one-time license revenue of $31 million was partially offset by expenses of $7 million, primarily due to provisions for contractual issues.

The expense in 2002 was principally related to severance costs associated with plant consolidations.

Interest Expense, Net

Interest expense, net was $44 million compared to $49 million in 2002. Net debt at December 31, 2003, decreased by $79 million to $785 million from $864 million at December 31, 2002. Average net debt decreased by $67 million during 2003. Strong cash flows from the Company´s operations reduced borrowing requirements. This cash generation was partially offset by higher spending on capital expenditures, acquisitions and the cost of the Company's share repurchase program. The weighted average interest rate, net was 5.0% compared to 5.2% in 2002. Lower interest rates, therefore, along with the lower borrowing requirement contributed to the reduction in interest expense, net.

Income Taxes

The effective tax rate was 30.3% versus 33% in 2002. The decrease in the effective tax rate is primarily the result of a reduced level of losses being generated without any tax benefit, recognition of tax benefits associated with prior years' losses and of tax credits available in the U.S. These benefits were partially offset by increases in reserves for taxes that may become payable in future years as a result of tax audits.

Net Income and Earnings per Share

As a result of the higher operating profit and the lower interest cost, net income was $268 million compared to $176 million in 2002. Net income as a percentage of sales increased to 5.1% from 3.9% in 2002. Earnings per share were $2.81 compared to $1.79 during 2002. The one-time license revenue added 0.5% to the net margin and contributed 27 cents to earnings per share. Currency effects (including both translation and transaction effects) added 19 cents to per share earnings. The Company's share repurchase program improved earnings per share by seven cents. The reduction in the effective tax rate improved earnings per share by 11 cents.

YEAR ENDED DECEMBER 31, 2002 VERSUS YEAR ENDED DECEMBER 31, 2001

Net sales

Components of net sales increase in 2002	**Airbag products**	**Seat belt products**	**Total**
Organic sales growth	6%	7%	6%
Impact of acquisitions, net of divestitures	4%	0%	3%
Effect of exchange rates	2%	2%	2%
Reported net sales increase	**12%**	**9%**	**11%**

Net Sales

Net sales for 2002 increased by 11%. In reported dollars, the increase was $452 million. The weakening of the U.S. dollar increased reported sales by approximately 2%. Acquisitions made during 2002 added incremental sales of $122 million or 3%. Virtually all of the impact from acquisitions was generated by the acquisition of Visteon Restraint Electronics ("VRE") on April 1, 2002. The effect of the acquisitions was entirely in the airbag products group. The disposition of non-core operations reduced sales by $3 million. Consequently, organic sales increased by approximately 6%, while production of light vehicles in the Triad is estimated to have increased by just over 2%. After an organic sales decrease in the first quarter of 1%, organic sales grew by 7% in the second and third quarters and then accelerated to 12% in the fourth quarter.

The 6% organic increase in sales of airbag products was principally due to the continuing roll-out of new products, such as side-impact airbags (including Autoliv's *Inflatable Curtain*), as well as gains in market share in steering wheels in Europe and North America.

The 7% organic growth in sales of seat belt products was primarily due to continued gains in market share, especially in Europe and Korea. The market share gains in Europe were mainly due to a favorable sales mix.

Sales in North America grew by 8% compared to a 6% increase in North American light vehicle production. Production of light trucks rose by 10%, while the production of passenger cars increased by only 1%. Historically, Autoliv has had a higher percent of its North American sales in the passenger car segment. Autoliv has been improving its position and, following the acquisition of VRE, the two vehicle segments are equally important for Autoliv. VRE added 6% to revenues and organic sales grew by 2%. Organic sales of airbag products increased by 4%, while seat belt sales dropped by 5% as a result of contracts having expired during the autumn of 2002. However, these contracts started to be replaced during 2003 by new orders.

Sales in Europe rose by 11%. Organic growth added 4%, currency effects 5% and the VRE acquisition 2%. The organic growth could be compared with the 2% decline in the region's light vehicle production. Autoliv's market share gains were mainly driven by program launches and a favorable vehicle mix.

Sales growth in the rest of the world, led by Japan (where light vehicle production increased by 4%) and Korea, accelerated throughout the year. Organic sales from companies in these countries rose by 38%. Currency effects reduced reported sales by 3%. Strong demand for the *Inflatable Curtain* was the biggest growth driver, but the other product areas also outperformed the increase in light vehicle production.

Gross Margin

The pressure on sales prices continued, but was more than offset by higher volumes and the beneficial effect of ongoing cost reduction programs. The gross margin improved in 2002 to 18.1% from 16.6%. Excluding the Unusual Items, the gross margin was 17.8% in 2001. Of the improvement, 0.3 percentage points were due to costs that in 2002 are reported as RD&E or SG&A and not as Cost of sales as in 2001. For details of the cost reduction programs see above under "Gross margin" in the 2003 vs. 2002 discussion.

Operating Income

Operating income was $323 million or 7.3% of sales compared with reported operating income of $182 million in 2001, which was 4.5% of sales. However, after adjusting for goodwill amortization and the Unusual Items, the operating income in 2001 would have been $298 million or 7.5% of sales. SG&A was 4.9% of sales in both years. On a comparable basis, Amortization of intangibles, at 0.4% of sales, was also unchanged. RD&E increased to 5.2% of sales from 5.0% in 2001. RD&E is expected to continue to increase, as it is necessary to incur engineering expense to support the growth of order intake. Orders, on average, go into production approximately three years after they are received.

Other income (expense), net was approximately $12 million of expense, or 0.3% of sales, in 2002 compared to approximately $3 million of income, or 0.1% of sales, in 2001 excluding the Unusual Items. The expense in 2002 is principally related to severance costs associated with plant consolidations in the U.S. The income in 2001 was generated by a gain from the sale of a building, net of several small expense items.

Interest Expense, Net

Interest expense, net was $49 million compared to $60 million in 2001. Net debt at December 31, 2002, decreased by $159 million to $864 million from $1,023 million at December 31, 2001. Average net debt decreased by $92 million. A lower requirement for working capital contributed to a $243 million increase in cash provided by operations. Lower capital expenditure was more than offset by higher spending on acquisitions and the cost of the Company's share repurchase program. The weighted average interest rate, net was 5.2% compared to 5.8% in 2001. Lower interest rates, therefore, along with the lower borrowing requirement contributed to the reduction in interest expense, net.

Income Taxes

The effective tax rate was 33% versus 50.2% in 2001. Excluding the effect of goodwill amortization and Unusual Items in 2001, the effective rate was 33.5%.

Net Income and Earnings per Share

As a result of the higher operating profit and the lower interest cost, net income was $176 million compared to $53 million in 2001. Net income as a percentage of sales increased to 3.9% from 1.3% in 2001. Earnings per share were $1.79 compared to $.54 during 2001. Excluding goodwill amortization, earnings per share were $1.07 in 2001. The Unusual Items decreased earnings per share by 48 cents. Currency effects (including both translation and transaction effects) added two cents to per share earnings. The Company's share repurchase program improved earnings per share by less than one cent.

LIQUIDITY, RESOURCES AND FINANCIAL POSITION

Cash From Operations

For the foreseeable future, cash flow from operations, together with available financial resources, are expected to be adequate to fund Autoliv's anticipated working capital requirements, capital expenditures, acquisition program, share repurchase program and dividend payments.

Cash provided by operating activities was $530 million in 2003, $509 million in 2002 and $266 million in 2001.

Working capital requirements increased during 2003, mainly reflecting higher sales, acquisitions and foreign exchange rate effects. Working capital was $528 million (10.0% of sales) at December 31, 2003 compared to $385 million (8.7% of sales) at December 31, 2002. The Company has set a target that working capital should not exceed 10% of sales.

Days receivables outstanding were 77 at December 31, 2003 compared to 78 at December 31, 2002. Days inventory outstanding were 31 at both December 31, 2003 and 2002.

Of the $65 million total of Unusual Items recorded in the third quarter of 2001, approximately $24 million related to non-cash write-offs of assets (including goodwill) and approximately $39 million to provisions that did not have any immediate effect on cash-flow.

By December 31, 2002, approximately $17 million in cash payments had been made against various accruals, and a further $3 million was paid in 2003, leaving approximately $19 million to be incurred. See Note 10 to the Consolidated Financial Statements included herein.

Capital Expenditures

Cash generated by operating activities continues to be more than adequate to cover capital expenditures. These expenditures, gross, for property, plant and equipment were $258 million in 2003, $228 million in 2002, and $248 million in 2001. Capital expenditures as a percentage of sales were 4.9% in 2003, 5.1% in 2002, and 6.2% in 2001.

Capital expenditures including currency effects for 2004 are expected to range from $290 million to $320 million.

Driven by demand for the *Inflatable Curtain*, major capital expenditures in 2003, 2002 and 2001 were made for additional manufacturing capacity.

Acquisitions

The Company has continued to make strategic acquisitions. Cash (net of cash acquired) paid for acquisitions was $29 million in 2003, $22 million in 2002, and $13 million in 2001. Goodwill of $15 million, $7 million and $9 million, respectively, was associated with these acquisitions. Prior to 2002, such goodwill was being amortized over 5 to 40 years.

In 2003, the most significant transactions were the purchase of the remaining 17% of the Livbag operations and the acquisition of the remaining 60% interest in NSK's Asian seat belt operations in April. Both operations are now wholly-owned. The Company accounted for its initial 40% investment in the NSK operations under the equity method. Following the acquisition of the remaining 60%, these operations were then consolidated. The NSK operations had annual sales of approximately $150 million.

In April 2002, the Company acquired the Restraint Electronics business of Visteon Corporation. The acquired operations had $150 million in annual sales.

Effective January 1, 2001, the Company exercised its option to purchase, for approximately $12 million, an additional 17% of the Livbag inflator operations in France. This purchase increased the Company's ownership interest to 83%.

In addition, throughout the three years ended December 31, 2003, the Company was involved in several other relatively small acquisition/disposition transactions. See Note 2 to the Consolidated Financial Statements included herein for additional details concerning these transactions.

Financing Activities

Cash generated after operating and investing activities was $253 million in 2003. Cash and cash equivalents decreased by $8 million. Cash used in financing activities was $273 million. The Company's net debt (i.e. short and long-term debt and debt related derivatives less cash and cash equivalents.) decreased by $79 million during 2003 to $785 million.

The net-debt-to-capitalization ratio was 24% at December 31, 2003, compared to 29% at December 31, 2002.

The weighted average interest rate on the $878 million of debt outstanding (including debt related derivatives) at December 31, 2003, was approximately 4.5%. See "Treasury Activities" below for details concerning the Company's credit facilities.

Income Taxes

The Company has reserves for taxes that may become payable in future periods as a result of tax audits. See Note 4 to the Consolidated Financial Statements included herein for additional information.

At any given time, the Company is undergoing tax audits in several tax jurisdictions and covering multiple years. Ultimate outcomes are uncertain, but unfavorable outcomes could, in a future period, have a significant impact on the Company's cash flows.

Pension Arrangements

The Company has large non-contributory defined benefit pension plans covering most U.S. employees, although the Company has frozen participation in the Autoliv ASP, Inc., Pension Plan for all employees hired after December 31, 2003. See Note 17 to the Consolidated Financial Statements included herein for further information about retirement plans.

The Company's balance sheet liability for its U.S. plans was $29.5 million at December 31, 2003. At December 31, 2003, the U.S. plans had an unrecognized net actuarial loss of $17.2 million. The amortization of this loss is expected to increase pension expense by $0.6 million per year over the ten year service lives of the plan participants estimated to remain.

Pension expense associated with these plans was $15.0 million in 2003 and is expected to be around $15 million in 2004.

The Company expects to contribute approximately $14 million to the plans in 2004 and is currently projecting a funding level of around $14 million in the years thereafter.

Dividend Payments

Autoliv pays regular quarterly dividends. The latest dividend declared (payable in the first quarter of 2004) is 15 cents per share. In the past year, the quarterly dividend was raised from 11 to 13 cents and then to 15 cents. The dividend of 13 cents was paid for the first time in March 2003. Total cash dividends of $51 million were paid in 2003 and $43 million were paid in 2002.

Equity

During 2003, equity increased by $342 million, partly due to a $147 million positive effect from translating local currencies into U.S. dollars. Net income contributed $268 million. Equity also increased by $15 million due to the change in the market value of cash flow hedges and by $10 million for the issuance of shares in connection with Autoliv's Stock Incentive Plan. Equity was reduced by repurchases of shares for $43 million and by the payment of dividends of $51 million.

Impact of Inflation

Inflation generally has not had a significant impact upon the Company's financial position or results of operations. Inflation is currently expected to remain low in all of the major countries in which the Company operates.

Personnel

Total headcount (employees plus temporary hourly workers) increased by approximately 2,800 during 2003 to 37,000. This 8% increase in headcount during the year could be compared with the production volume output for the major products that rose by 4% for airbags and 13% for seat belts.

Of the headcount increase during the year, 1,700 was the result of acquisitions and 1,200 was concentrated in low-labor-cost countries. Headcount in high-labor-cost countries decreased by 100.

Compensation paid to Directors and executive officers is reported, as for all public U.S. companies, in the Company's proxy statement which is distributed to the Company's shareholders.

Off-balance Sheet Arrangements

The Company does not have guarantees related to unconsolidated entities which have, or are reasonably likely to have, a material current or future effect on its financial position, results of operations or cash flows.

Significant Litigation

In December 2003, a U.S. Federal District Court awarded a supplier of Autoliv ASP, Inc. approximately $27 million plus interest in connection with a commercial dispute. Autoliv intends to appeal the verdict as soon as possible. While legal proceedings are subject to inherent uncertainty, Autoliv believes that it has valid grounds for appeal which would result in a new trial and that it is possible that the judgement could be eliminated or substantially altered. Consequently, in the opinion of the Company's management, it is not possible to determine the final outcome of this litigation at this time. It cannot be assured that the final outcome of this litigation will not result in a loss that will have to be recorded by the Company.

Contractual Obligations and Commitments

The table below is intended to give an overview of known contractual obligations, aggregated and including agreements or other contractual arrangements involving an external party (other than contingent liabilities arising from litigation, arbitration or regulatory actions).

Contractual obligations include lease and purchase obligations that are enforceable and legally binding on the Company. Pensions and minority interests are not included in this table.

Long-term debt obligations:

For material contractual provisions, see Note 11 to the Consolidated Financial Statements included herein. Interest on debt and credit agreements relating to periods after December 31, 2003, are not included in the table.

Capital lease obligations:

These obligations are included in long-term debt obligations in this table and refer to property, plant and equipment in Europe.

Operating lease obligations:

The Company leases certain offices, manufacturing and research buildings, machinery, automobiles and data processing and other equipment. Such operating leases, some of which are non-cancelable and include renewals, expire at various dates through 2024. Also see Note 16 to the Consolidated Financial Statements included herein.

Unconditional Purchase Obligations:

There are no unconditional purchase obligations other than short-term obligations related to inventory, services, tooling and property, plant and equipment purchased in the ordinary course of business.

The purchase agreements with suppliers entered into in the ordinary course of business do not generally include fixed quantities. Quantities and delivery dates are established in "call off plans" accessible electronically for all customers and suppliers involved. Communicated "call off plans" for production material from suppliers are normally reflected in equivalent commitments from Autoliv customers.

Current liabilities:

The table excludes total current liabilities of $1,366.9 million, which are reflected in the balance sheet.

All employee obligations as a result of restructuring are reflected in Current liabilities and the major ones are disclosed in Note 10 to the Consolidated Financial Statements icluded herein.

Other non-current liabilities in the balance sheet:

These consist mainly of deferred tax liabilities, which are not included in this table. The remaining non-current liabilities reflected in this table consist mainly of non-pension post-retirement benefit obligations (see Note 17 to the Consolidated Financial Statements included herein.)

The impact of revaluation to fair value of debt related derivatives is included in long-term debt-obligations in this table.

Aggregate Contractual Obligations

(2) The pension plan in which the Company s executive officers participate is a defined benefit plan covering substantially all employees of the Company and Patterson Pump Company; and the amounts of contributions or accruals applicable to the individual participants therein cannot be readily calculated. The aggregate contributions made to such plan for the benefit of the Company s executive officers amount to approximately 2.1% of the total contributions made on behalf of all participants covered by the plan.

In general, a participant s monthly benefit under the pension plan is determined by multiplying 1.1% of his final average monthly compensation by the number of his credited years and months of service. A participant s final average monthly compensation is one-twelfth of the average annual compensation of the participant for the last 10 years of the participant s employment with the Company (or Patterson Pump Company) or, if less than 10, for his actual years of such employment. The compensation covered by the pension plan for 2005 is identical to the compensation set forth in the table, except that the plan does not cover profit-sharing bonuses or amounts labeled other in the table received by any executive officer, as well as any compensation in excess of $210,000, effective November 1, 2005. However, compensation covered by the pension plan does include any before-tax contributions made by the participant to the 401(k) Plan. The benefit amounts applicable to each individual participant are not subject to any deduction for Social Security benefits or other offset amounts.

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As of November 1, 2005, the Named Officers had the following number of credited full years of service under the Company s pension plan: Mr. J.S. Gorman 27; Mr. Kirkendall 27; Mr. Danuloff 34; Ms. Sovine 26; and Mr. J.C. Gorman 56. As of November 1, 2005, the estimated annual benefits payable at age 65 upon retirement to Messrs. Gorman, Kirkendall, Danuloff, Ms. Sovine and Mr. Gorman are $51,282, $32,449, $36,183, $25,803 and $71,388, respectively. Mr. J.C. Gorman is age 81 and remains active as an officer of the Company. In accordance with the terms of the pension plan, because Mr. J.C. Gorman is over age 70 1/2, he received payments from the pension plan which totaled $73,219 in 2005.

(3) Amounts include taxable life insurance, and Company contributions to Christmas Savings Plan and Employee Stock Purchase Plan.

(4) Amounts contributed by the Company on behalf of the Named Officers to the 401(k) Plan.

PENSION AND RETIREMENT BENEFITS

The following table shows the estimated annual benefits under the Company s pension plan which would have been payable to employees in various compensation classifications upon retirement in 2005 at age 65 after selected periods of service.

Final Average Annual Pay at Age 65*	10 Years	20 Years	30 Years	40 Years
$ 25,000	$ 2,750	$ 5,500	$ 8,250	$11,000
50,000	5,500	11,000	16,500	22,000
75,000	8,250	16,500	24,750	33,000
100,000	11,000	22,000	33,000	44,000
125,000	13,750	27,500	41,250	55,000
150,000	16,500	33,000	49,500	66,000
175,000	19,250	38,500	57,750	77,000
200,000	22,000	44,000	66,000	88,000

* Compensation in excess of $210,000 is not taken into account under the pension plan.

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SALARY COMMITTEE REPORT ON EXECUTIVE COMPENSATION

Under the supervision of the Salary Committee of the Board of Directors, the Company has developed compensation policies which seek to enhance the profitability of the Company, and thus shareholder value, by aligning closely the financial interests of the Company s corporate officers and other key employees with those of its shareholders. As a starting point, annual base salaries are generally set somewhat below competitive levels so that the Company relies to a large degree on annual incentive compensation to retain corporate officers and other key employees of outstanding abilities and to motivate them to perform to the full extent of their abilities. The incentive compensation is then closely tied to corporate and individual performances in a manner that encourages a long and continuing focus on building profitability and shareholder value.

Based on an evaluation of these factors, the Committee believes that the corporate officers and other key employees of the Company are dedicated to achieving improvements in long-term financial performance and that the compensation policies the Committee administers have contributed to achieving this management focus.

Compensation for each of the Named Officers, as well as other executive officers and certain senior executives, consists of a base salary and annual incentive compensation or profit sharing. The base salaries are fixed at levels somewhat below the competitive amounts paid to senior managers with comparable qualifications, experience and responsibilities at other companies engaged in the same or similar businesses as the Company. The annual incentive compensation is more closely tied to the Company s success in achieving significant financial and non-financial performance goals. The Committee considers the total compensation of each of the Named Officers and the other executive officers and certain senior executives in establishing the elements of compensation.

In the early part of each fiscal year, the Committee reviews with the Chief Executive Officer and approves, with modifications considered appropriate, an annual salary for the Company s executive officers and certain senior executives (other than the Chief Executive Officer). Salaries are developed based upon industry and national surveys and performance judgments as to the past and expected future contributions of the individual executive officers and certain senior executives. The Committee independently reviews and fixes the base salary of the Chief Executive Officer based on similar competitive compensation data and the Committee s assessment of his past performance and its expectation as to his future contributions in leading the Company.

At the beginning of each year, performance objectives for purposes of determining annual profit sharing are also established based upon operating earnings. At the end of each year, performance against these objectives is determined by an arithmetic calculation. In determining the profit sharing in 2005 for eligible employees, including the Named Officers, the Committee reviews management s recommendations with the Chief Executive Officer based on individual performance. The results of

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these evaluations are considered by the Salary Committee and the Board of Directors when determining the amounts to be awarded as profit sharing (which appear as Bonus in the Summary Compensation Table on page 14).

The Committee believes that its compensation policies have successfully focused the Company s senior management on building continued profitability and shareholder value.

The foregoing report has been furnished by members of the Salary Committee.

/s/ THOMAS E. HOAGLIN	/s/ W. WAYNE WALSTON	/s/ CHRISTOPHER H. LAKE
Thomas E. Hoaglin	W. Wayne Walston Chairman	Christopher H. Lake

SHAREHOLDER RETURN PERFORMANCE PRESENTATION

Set forth below is a line graph comparing the yearly percentage change in the cumulative total shareholder return on the Company s Common Shares against the cumulative total return of the American Stock Exchange Market Value Index and a Peer Group Index for the period of five fiscal years commencing January 1, 2001 and ending December 31, 2005. The issuers in the Peer Group Index were selected on a line-of-business basis by reference to SIC Code 3561 Pumps and Pumping Equipment. The Peer Group Index is composed of the following issuers: Ampco-Pittsburgh Corp., Dyneco Corporation, Flowserve Corp., Graco Inc., Idex Corp., Met-Pro Corp., Robbins & Myers Inc. and Roper Industries Inc., in addition to the Company.

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COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN

**AMONG THE GORMAN-RUPP COMPANY,
AMEX MARKET INDEX AND PEER GROUP INDEX**

	The Gorman-Rupp Co.	Peer Group Index	AMEX Market Index
2000	100.00	100.00	100.00
2001	153.84	128.82	95.39
2002	137.92	109.05	91.58
2003	159.77	146.37	124.66
2004	178.53	198.29	142.75
2005	175.99	228.64	157.43

ASSUMES $100 INVESTED ON JAN. 1, 2001

**ASSUMES DIVIDEND REINVESTED
FISCAL YEAR ENDING DEC. 31, 2005**

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APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

(Proposal No. 2)

A proposal will be presented at the Meeting to ratify the appointment by the Audit Review Committee of the Board of Directors of Ernst & Young LLP as independent public accountants for the Company during the year ending December 31, 2006. Representatives of Ernst & Young LLP are expected to be present at the Meeting, will have an opportunity to make a statement if they so desire, and are expected to be available to respond to appropriate questions.

The Company paid Ernst & Young LLP the following fees in connection with the Company s fiscal years ending December 31, 2005 and 2004:

Audit Fees $795,000 (2005); $865,000 (2004). Audit fees consist of the aggregate fees billed for professional services rendered for the audit of the Company s annual financial statements and the reviews of the Company s interim financial statements included in its quarterly reports on Form 10-Q, or services that are normally provided by the accounting firm in connection with statutory and regulatory filings or engagements for those fiscal years. The fees paid in 2004 and 2005 also cover services performed in connection with the Sarbanes-Oxley Section 404 attestation and other Sarbanes-Oxley requirements.

Audit-Related Fees $30,000 (2005); $30,000 (2004). Audit-related fees consist of the aggregate fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company s financial statements and are not reported under the caption Audit Fees. The audit-related fees were paid for the following services: benefit plan audits.

Tax Fees $48,000 (2005); $205,000 (2004). Tax fees consist of the aggregate fees billed for professional services rendered for tax compliance, tax advice and tax planning. The tax fees were paid for the following services: federal and international tax planning and advice; federal, state, local and international tax compliance; state and local tax consulting; form 5500 compliance issues; Canadian compliance issues; and other tax advice and assistance regarding statutory and regulatory matters.

All Other Fees $0 (2005); $0 (2004). The all other fees category consists of the aggregate fees billed for products and services provided, other than the services reported in the foregoing three paragraphs.

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Under its Charter, the Audit Review Committee of the Company s Board of Directors is directly responsible for the oversight of the work of Ernst & Young LLP and has the sole authority to (i) appoint, retain and terminate Ernst & Young LLP, (ii) pre-approve all audit engagement fees, terms and services, and (iii) pre-approve scope and fees for any non-audit engagements with Ernst & Young LLP. The Committee exercises this authority in a manner consistent with applicable law and the rules of the Securities and Exchange Commission and the American Stock Exchange, and Ernst & Young LLP reports directly to Committee. In addition, the Committee has determined to delegate its authority to grant any pre-approvals to its Chairman, subject to the report of any such pre-approvals to the Committee at its next scheduled meeting. With respect to certain of the services categorized above, the following percentage of services were rendered by Ernst & Young LLP in accordance with the annual *de minimus* exception to the pre-approval requirement: Audit-Related Fees 0%; Tax Fees 0%; All Other Fees 0%.

Ratification by the shareholders of the appointment of Ernst & Young LLP is not required by law. However, the Board of Directors believes that shareholders should be given this opportunity to express their views on the subject. While not binding on the Audit Review Committee of the Board of Directors, the failure of the shareholders to ratify the appointment of Ernst & Young LLP as the Company s independent public accountants would be considered by the Audit Review Committee in determining whether to continue the engagement of Ernst & Young LLP. Even if the appointment is ratified, the Audit Review Committee of the Board of Directors may, in its discretion, select a different firm of independent public accountants for the Company at any time during the year if it determines that such a change would be in the best interests of the Company and its shareholders.

The Directors recommend a vote FOR Proposal No. 2 to ratify the appointment of Ernst & Young LLP as the Company s independent public accountants.

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GENERAL INFORMATION

The Company s 2005 annual report to shareholders, including financial statements, is being mailed concurrently with this Proxy Statement to all shareholders of the Company.

The cost of soliciting proxies will be paid by the Company. In addition to the use of the mails, proxies may be solicited personally or by telephone, telecopy or other means of communication by a few officers or regular employees of the Company. No separate compensation will be paid for the solicitation of proxies, although the Company may reimburse brokers and other persons holding Common Shares in their names or in the names of nominees for their expenses in sending proxy material to the beneficial owners of such Common Shares.

Any proposal by a shareholder intended to be presented at the 2007 annual meeting of shareholders must be received by the Company for inclusion in the proxy statement and form of proxy of the Company relating to such meeting on or before November 29, 2006. If a shareholder proposal is received after February 27, 2007, it will be considered untimely and the proxy holders may use their discretionary voting authority if and when the proposal is raised at such annual meeting, without any discussion of the matter in the proxy statement. The Board of Directors proxy for the 2007 annual meeting of shareholders will grant discretionary voting authority to the proxy holders with respect to any such proposal received after February 27, 2007.

Any shareholder wishing to communicate with the Board of Directors may send a written statement or inquiry to the Company s Corporate Secretary. All writings will be acknowledged by the Corporate Secretary and presented for consideration and response at the next scheduled Board meeting.

OTHER BUSINESS

Financial and other reports will be submitted to the Meeting, but it is not intended that any action will be taken in respect thereof. The Company did not receive notice by February 28, 2006 of, and the Board of Directors is not aware of, any matters other than those referred to in this Proxy Statement which might be brought before the Meeting for action. Therefore, if any such other matters should arise, it is intended that the persons appointed as proxy holders will vote or act thereon in accordance with their own judgment.

You are urged to date, sign and return your proxy promptly. For your convenience, enclosed is a self-addressed return envelope requiring no postage if mailed in the United States.

By Order of the Board of Directors

DAVID P. EMMENS
Corporate Secretary

March 29, 2006

APPENDIX

THE GORMAN-RUPP COMPANY

AUDIT REVIEW COMMITTEE CHARTER

Purposes

The purposes of the Committee are to (a) assist the Board of Directors in fulfilling the Board of Directors oversight responsibilities with respect to (i) the integrity of the Company s financial statements, (ii) the Company s compliance with legal and regulatory requirements, (iii) the independent auditors qualifications and independence, and (iv) the performance of the independent auditors and the Company s internal audit function; and (b) prepare the Committee s report to be included in the Company s annual proxy statement (the Audit Review Committee Report).

Authority of the Committee

The Committee has the sole authority to (a) appoint, retain and terminate the Company s independent auditors, (b) pre-approve all audit engagement fees, terms and services, and (c) pre-approve any non-audit engagements with the Company s independent auditors. The independent auditors shall report directly to the Committee. The Committee shall exercise this authority in a manner consistent with applicable law and the rules of the Securities and Exchange Commission (SEC) and the American Stock Exchange, LLC (AMEX). The Committee may delegate the authority to grant any pre-approvals required by applicable law or rules to one or more members of the Committee as it designates, subject to the delegated member or members reporting any such pre-approvals to the Committee at its next scheduled meeting.

The Committee shall have the resources and authority necessary to discharge its responsibilities as required by law, including the authority to engage independent counsel and other advisors as the Committee deems necessary to carry out its duties, and the Company will provide appropriate funding as determined by the Committee.

The Committee is further empowered to:

Resolve any disagreements between management and independent auditors regarding financial reporting.

Conduct or authorize investigations into matters within its scope of responsibility.

Solicit information from or meet with Company officers, employees or agents, as necessary.

Set hiring policies for employees or former employees of the independent auditors.

Composition of the Committee

The Committee shall consist of at least three members. The Board of Directors will appoint the members and the Chairman of the Committee. Committee members shall serve at the pleasure of the Board of Directors and for such term or terms as the Board of Directors may determine.

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Each Committee member shall (a) meet the independence criteria of the rules of the SEC and the AMEX, and (b) be financially literate or become financially literate within a reasonable period of time after his or her appointment to the Committee. Additionally, at least one member of the Committee shall have accounting or related financial management expertise sufficient to meet the criteria of a financial expert within the meaning of the SEC rules.

Each Committee member shall serve on no more than three audit committees of public companies (including the Company).

Meetings of the Committee

The Committee shall meet in person or telephonically at least quarterly, or more frequently as it may determine necessary. The Chairman of the Committee shall, in consultation with the other members of the Committee, the Company s independent auditors and the appropriate officers of the Company, be responsible for calling meetings of the Committee, establishing agenda therefor and supervising the conduct thereof. The Committee may also take any action permitted hereunder by unanimous written consent.

The Committee may invite any officer or employee of the Company or the Company s outside legal counsel or independent auditors or others to attend a meeting of the Committee. The Committee shall meet quarterly with the Company s management, and as needed with the internal audit staff and/or the independent auditors to discuss any matter that the Committee, management, the independent auditors or such other persons believe should be discussed.

Duties and Responsibilities of the Committee

The Committee is responsible for overseeing the Company s financial reporting process on behalf of the Board of Directors.

The Committee shall carry out the following responsibilities:

Financial Statements

Review and discuss with appropriate officers of the Company and the independent auditors the annual audited and quarterly financial statements of the Company, including (a) the Company s disclosure of significant accounting policies under Management s Discussion and Analysis of Financial Condition and Results of Operations, and (b) the disclosures regarding internal controls and other matters required by applicable law and SEC rules.

Review and discuss earnings and other financial press releases (including any use of pro forma or adjusted non-GAAP information), as well as financial information and earnings guidance provided to analysts and rating agencies (which review may occur after issuance and may be done generally as a review of the types of information to be disclosed and the form of presentation to be made).

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Review disclosures made by the Company s CEO and CFO in connection with the Forms 10-K and 10-Q certification process concerning significant deficiencies in the design or operation of internal controls or any fraud that involves management or other employees who have a significant role in the Company s internal controls.

Review significant accounting, legal and reporting issues, and understand their impact on the financial statement presentations.

Internal Audit

The Audit Committee should approve the appointment and replacement of the internal auditor or outsourced internal audit service provider. At least annually, the Audit Committee should evaluate the effectiveness of the internal audit function and consider the need to make changes to ensure that internal audit objectives are being met.

Review and discuss with the internal audit staff the Internal Audit Charter and plans for and the scope of ongoing audit activities.

Review and discuss with the internal audit staff risk assessment issues, the annual report of audit activities, and examinations and results thereof performed by the internal audit staff.

Understand the scope of internal and independent auditors review of internal controls, and obtain reports on significant findings and recommendations, together with management s responses.

Review the effectiveness of the Company s internal control system, including information technology security.

Meet separately with management to discuss any matters that the Committee or internal audit staff believes should be discussed privately.

Independent Audit

Review the performance of the independent auditors. In performing this review, the Committee shall:

At least annually, obtain and review a report by the independent auditors describing (a) the audit firm s internal quality-control procedures, and (b) any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, with respect to one or more independent audits carried out by the firm, and any steps taken to deal with any such issues raised.

In connection with the retention of the Company s independent auditors, at least annually, review and discuss the information provided by management and the auditors relating to the independence of the audit firm, including, among other things, information related to the non-audit services provided and expected to be provided by the auditors.

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Review and discuss with the independent auditors the plans for, and the scope of, the annual audit and other examinations, including the adequacy of staffing and compensation.

Review and discuss with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61 relating to the conduct of the audit, as well as any audit problems or difficulties and management s response.

Review and discuss with the independent auditors (a) the report of their annual audit, or proposed report of their annual audit, (b) the accompanying management letter, if any, (c) their reviews of the Company s interim financial statements conducted in accordance with Statement on Auditing Standards No. 100, and (d) the reports of the results of such other examinations outside of the course of the independent auditors normal audit procedures that the independent auditors may from time to time undertake.

Confirm the rotation of the independent audit partner every five years and other audit partners every seven years.

Review and discuss with the internal audit staff recommendations made by the independent auditors.

Compliance

Periodically obtain reports from management that the Company and its subsidiary/foreign affiliated entities are in conformity with applicable legal requirements and the Company s Code of Ethics.

Establish procedures for (a) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal controls or auditing matters; and (b) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters as required by applicable law and the SEC and AMEX rules and (c) the confidential receipt, retention and consideration of any report of evidence of a material violation (within the meaning of Rule 205 of the Rules of Practice of the SEC).

Discuss with the Company s Corporate Counsel legal matters that may have a material impact on the financial statements or the Company s compliance policies.

Reporting Responsibility

Report its activities regularly to the Board of Directors in such manner and at such times as the Committee and the Board of Directors deem appropriate, but in no event less than once a year.

Other Responsibilities

Obtain assurance from the independent auditors that in the course of conducting the audit, there have been no acts detected or that have otherwise come to the attention of the audit firm

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that require disclosure to the Committee under Section 10A(b) of the Securities Exchange Act of 1934.

Discuss guidelines and policies with respect to risk assessment and risk management to assess and manage the Company s exposure to risk. The Committee shall discuss the Company s major financial risk exposures and the steps management has taken to monitor and control these exposures.

Review and discuss any filing with the Securities and Exchange Commission in which the independent auditor has been involved with respect to preparation or review.

Review and discuss such other matters that relate to the accounting, auditing and financial reporting practices and procedures of the Company as the Committee may, in its own discretion, deem desirable in connection with the review functions described above.

The Committee shall have the authority to establish other rules and operating procedures in order to fulfill its obligation under this Charter and applicable rules or regulations.

Audit Review Committee Report

The Committee will prepare, with the assistance of management, the independent auditors and outside legal counsel, the Audit Review Committee Report.

Annual Review of Charter

The Committee will conduct and review with the Board of Directors annually an evaluation of this Charter and recommend any changes to the Board of Directors. The Committee may conduct this charter evaluation in such manner as the Committee, in its business judgment, deems appropriate. In addition, the Committee will assure that the Charter will be attached as an appendix to the Company s proxy statement at least once every three years.

Annual Performance Evaluation

The Committee Will conduct and review with the Board of Directors annually an evaluation of the Committee s performance with respect to the requirements of this Charter. This evaluation will also set forth the goals and objectives of the Committee for the upcoming year. The Committee may conduct this performance evaluation in such manner as the Committee, in its business judgment, deems appropriate.

Adopted by the Audit Review Committee October 23, 2003.

Reviewed and approved by the Audit Review Committee without change July 22, 2004.

Reviewed by Audit Review Committee October 27, 2005. Internal Audit Section amended. Amendment approved by Board of Directors January 26, 2006.

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The Gorman-Rupp Company
c/o National City Bank
Corporate Trust Operations
Locator 5352
P.O. Box 92301
Cleveland, OH 44101-4301

PLEASE MARK, DATE AND SIGN THIS PROXY CARD AND
RETURN IT IN THE ENCLOSED POSTAGE-PAID ENVELOPE TO:
Corporate Election Services
PO Box 3230
Pittsburgh, PA 15230
ê **Please fold and detach card at perforation before mailing** ê

P R O X Y
COMMON
SHARES

Nominees For Directors:
James C. Gorman
Jeffrey S. Gorman
Thomas E. Hoaglin
Christopher H. Lake
Dr. Peter B. Lake
Rick R. Taylor
W. Wayne Walston
John A. Walter

The Gorman-Rupp Company
305 Bowman Street Mansfield, Ohio 44903

This proxy is solicited on behalf of the Board of Directors

The undersigned hereby appoints James C. Gorman, Jeffrey S. Gorman and David P. Emmens as Proxies, each with the power to appoint his substitute, and hereby authorizes them to represent and to vote all of The Gorman-Rupp Company Common Shares held of record on March 15, 2006 by the undersigned at the Annual Meeting of the shareholders to be held on April 27, 2006, or at any adjournment thereof, as follows:

The Board of Directors recommend a vote FOR Proposal No. 1.	**FOR**	**WITHHOLD AUTHORITY to vote for all nominees listed**
1. ELECTION OF DIRECTORS Fixing the number of Directors at 8 and electing all nominees listed *(except as marked to the contrary below)* ***(INSTRUCTION: To withhold authority to vote for any individual nominee, write his name below)***	o	o

The Board of Directors recommend a vote FOR Proposal No. 2	**FOR**	**AGAINST**	**ABSTAIN**
2. RATIFICATION OF THE APPOINTMENT OF ERNST & YOUNG LLP as independent public accountants	o	o	o

3. In their discretion, the Proxies are authorized to vote upon such other business as may properly come before the Meeting.

When properly executed, this proxy will be voted in the manner directed by the undersigned shareholder; if no direction is made, this proxy will be voted FOR proposals 1 and 2.

Please sign exactly as your name appears below. If signing as attorney, executor, administrator, trustee or guardian, please give full title as such; and if signing for a corporation, please give your title. When shares are in the names of more than one person, each should sign.

Dated: , 2006

Signature of Shareholder(s)

o Please check this box if you plan to attend the Meeting.