Alfa Laval
Q1 Earnings Conference Call
April 28th, 2014

Lars Renström:
Good afternoon and most welcome to the presentation. I will start by giving you my three highlights.

Marine & Diesel grew significantly year on year and increased somewhat from the high level established in the fourth quarter and the number of exhaust gas cleaning systems booked were at a record level.

The second highlight is that Asia grew slightly as the positive development for the base business compensated for fewer large orders. Also in China the positive trend for base business continued.

And finally, on April 7 we communicated that Alfa Laval had signed an agreement to acquire the Norwegian Company, Frank Mohn AS, a leader in pumping systems for marine and offshore. We expect to close the transaction during May after approval from competition authorities.

And now we move over to the key figures.

Orders received rose 5 percent to SEK7.5 billion. Net sales increased 1 percent to SEK6.6 billion. Adjusted EBITA was unchanged at SEK1.1 billion and the adjusted EBITA margin was at 16.1 percent versus 16.4 percent a year ago.

Now we move over to orders received and margins.

Orders received on rolling 12 months reached SEK30.6 billion. The increase year on year was 5 percent. Sequentially orders declined, mainly due to an exceptional order intake of large orders in the fourth quarter.

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From the order analysis you find that, year on year, acquisitions contributed 1.2 percentage units and organic growth was up 3.8 percent. Negative currency effects was 0.2 percent, giving a total of 4.8 percent.

Sequentially organic growth was minus 8.1 percent, mainly due to non-repeat large orders.

On the next slide we see that the EBITA margin reached 16.1 percent and the operating result was SEK1.1 billion, which is the same as one year ago.

Now we move over to highlights in the quarter.

Process Technology booked large orders for SEK280 million; the largest being for an offshore platform in the North Sea. The rest were for refineries of crude oil and vegetable oil.

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Marine & Diesel booked 17 open loop exhaust gas cleaning systems from both existing and new customers, giving a total of 40 systems since the product was commercially launched. The open loop systems will be prepared for closed loop and we expect a continued positive development.

On April 7 we communicated that we had signed an agreement to acquire Frank Mohn AS. We expect to close the transaction during May, after approval from competition authorities. And on the next slide we take a closer look at the company.

The marine pumping systems made up 50 percent of sales in 2013. Frank Mohn AS is a global market leader for cargo pumping systems for product and chemical tankers. The company also supplies cargo heaters and coolers.

Oil and gas offshore pumping contributed with 23 percent. Here they supply water injection pumps, fire water pumps and submersible seawater lift pumps.

Frank Mohn also has an interesting environmental business, supplying oil recovery systems. It is both equipment that collects oil spills from the surface of the sea and equipment for emergency offloading, also from sunken ships.

And finally, 21 percent came from service, where Frank Mohn has 50 percent of the installed base covered by service contracts.

And now we move over to the development per segment.

We had 4 percent organic growth year on year in the quarter and you see that seven segments grew, two were unchanged and two declined. Let's take a look at the development per division and now all comments are sequential.

In Equipment, Sanitary declined, due to the non-repeat of larger orders despite that pharma performed well. Industrial Equipment was affected by non-repeats, a cold winter in the US and political uncertainty in Russia. OEM, as well as service, was unchanged.

Next slide.

In Marine & Diesel Equipment saw overall higher demand following the ship contracting growth in 2013. Marine & Offshore Systems declined somewhat from a very strong fourth quarter. Demand for exhaust gas cleaning systems was very good. Service grew, favored by improved freight rates that increased demand for parts and repair work.

Next slide.

In Process Technology Division, the base business was stable while large orders declined from extraordinary levels. Food Technology was down, due to non-repeats by market unit Food Solutions, and Vegetable oil had strong growth. Process Industry was virtually unchanged with substantial growth in refinery, while life science and petrochemicals declined. It is also worth mentioning that oil and gas remains on a high level, even if there were fewer large projects.

Now we move on to the geographical developments and there you see that, year on year, Asia has grown 17 percent, boosted by the recovery in the marine industry. Then follows Latin America with 11 percent and we see a positive trend in Western Europe and Nordic and a modest decline in North America. The decline of 21 percent in Central and Eastern Europe is caused by Russia and Turkey that have been affected by political uncertainty.

Let's take a look at the regions and now all comments are sequential.

In Asia, base business continued to develop well, while the project business was more mixed, reflecting a cautious approach from some customers. Marine & Diesel Equipment continued to benefit from higher yard contracting. Refinery, petrochemicals and vegetable oil also did well.

In China, base business had a continued good development, while non-repeats made total China decline.

Now we move over to Europe and, when we combine Western Europe and Nordic, both total and base business was unchanged. In Central and Eastern Europe we had a significant drop as the record in large orders was not repeated. Base business declined as Russia and Turkey were affected by political uncertainty.

Moving over to Americas, in North America, we declined as we had fewer large orders. Positive was that base business remained unchanged. Energy and environment and OEM did particularly well, while others declined due to less of larger orders. In Latin America, fewer large orders in Brazil caused the region to decline. However, we are very pleased that we had a broad-based growth in service.

Moving on to the next slide you see our top 10 markets and the green bar is full-year 2013 and yellow bar is last 12 months. And you can see that most countries are virtually unchanged. Changes of significance are China, driven by the marine industry and that also applies for South Korea, where also offshore industry contributes. Russia had a very slow start, due to political uncertainty triggered by Ukraine.

And now I hand over to Thomas for the financials.

Thomas Thuresson:

Thank you, Lars.

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Good afternoon, all of you. So let's move on to the slide on highlights and let me jump right into sales, as Lars has covered orders received in quite some depth.

In the quarter we realized sales of SEK6.6 billion; an increase of 1.4 percent year on year, of which the organic element was 1.1 percent. Even if we report growth in sales, the number was some SEK200 million to SEK300 million below our own expectations. However, given that we have the orders, expected to have been shipped, in our order backlog, we expect to recover the shortfall in the coming couple of quarters.

In comparison with quarter 4 of 2013, sales were down quite a bit. This was a regular seasonal difference, as I'm sure you recognize, and totally in accordance with our prediction from February.

Let me also point out that service represented 29.2 percent of total revenues in the quarter compared with 28.1 percent in quarter 1 of 2013.

Let me then give you the first forward-looking statement. Not surprising, we expect sales to come in higher in quarter 2 than what was achieved in quarter 1.

Let's then move on to gross profit margin. Gross profit margin ended 39.4 percent in the quarter; an increase of 1.2 percent year on year and 3 percent sequentially.

Let me remind you that with quarter 4 report I said: In the near term we expect a positive mix effect, mainly from the reduction in capital sales. FX transaction effects are expected to be negative. The actuals for quarter 1 came out slightly better than anticipated. This is mainly thanks to a better mix within capital sales, but also factory results and mix between aftermarket and capital equipment contributed.

With that, let me then give you the second forward-looking statement. In the near term we do not expect product mix to be as favorable as in quarter 1. We expect very limited positive price effects, no material change to factory results and FX transaction effects are expected to continue to be slightly negative.

With that, let's move on further on into the P&L account. Looking at the overhead costs we can report the following. R&D ended at SEK188 million in the quarter, which is an increase year on year like for like of 11.4 percent; the explanation being phasing of project-related individual cost items and also a certain increase in resources.

Moving on to sales and admin, they amounted to SEK1.27 billion in the quarter, representing a like-for-like year-on-year increase of 5.6 percent. Explanations are a salary inflation combined with selective increases of resources to improve presence and also increased activity to catch the contracting in Marine & Diesel.

Then other costs and income. Please let me point out that this includes a non-recurring charge of SEK60 million related to the acquisition of [Frank Mohn]. So a non-recurring charge of SEK60 million in other costs.

EBITA margin 16.1 percent, as Lars pointed out before.

Moving on down the P&L, profit before tax was SEK794 million in the quarter; a reduction of 14 percent over last year. And this includes a difference in financial net due to exchange differences being some SEK43 million worse than last year.

Before leaving the P&L, taxes ended with a charge of SEK230 million; slightly above our guidance of 28 percent of profit before tax.

As far as EPS is concerned, the quarter ended SEK1.34 and SEK1.57 excluding amortization on step-up. This is a decline compared to quarter 1 of 2013 with approximately 20 percent. Let me then point out again that this decline is almost in its entirety explained by acquisition-related non-recurring costs and the FX differences in financial net.

Return on capital employed and return on equity ended exactly on the same level as per year end; that is 26.4 percent and 20.4 percent respectively.

Let me then give you a few comments on divisional performance on the next slide.

Equipment came out above quarter 1, mainly thanks to increased sales volume and a better mix and part of factory results. These improvements were somewhat reduced through increased R&D efforts but, all in all, an increase in operating profit and an improvement in operating margin.

Process Technology division was benefiting from a positive mix effect year on year. Sales and admin increased somewhat, giving a slight adverse impact, but still the net was a positive impact on operating margin with 0.4 percent.

Marine was adversely impacted by increased sales and admin costs and that is entirely explained by the high level of activity giving a buildup in order backlog. The increased contracting to the yards, of course, is an opportunity that is captured through increased activity in the sales area. The development in gross profit margin, I should mention, from marine was slightly positive thanks to mix, though.

If we then move on to cash flow, I think we can summarize the cash flow statement for the quarter as follows. Cash flow from operations amounted to just under SEK600 million and then some SEK370 million, SEK380 million below quarter 1 of 2013; the main reasons being an increase in inventories on the back of the increased backlog and somewhat higher receivables due to a more, among other things, volume.

The free cash flow ended SEK567 million compared to SEK933 million a year ago. The main reason, of course, for this deviation is the working capital, as I just commented. And let me point out, then, this variation in working capital is not to be considered anything but ordinary fluctuations in working capital due to volume.

Moving on to FX, we had an adverse effect in the quarter of SEK10 million and, of course, we've updated our full-year forecast. And we've concluded, on the back of the rates on the slide as well as applying closing rates as per end of March for calculating the expected translation effect, we believe we'll come in a negative SEK50 million for the full year. And, as you see from the slide as well, a very small positive in 2015 if everything remains the same.

Moving on to the backlog, then, we had a total order backlog as per end of March of just over SEK15.3 billion. That represents just over six months of LTM sales.

On a like-for-like basis the order backlog to be shipped in 2014 is some SEK700 million above the end of March 2013. In monetary terms, as seen from the slide, the backlog for shipment is about SEK900 million above the status a year ago.

Having said that, let's move on to the bridge for whole-year sales 2013 to 2014.

As we typically do, let's look at the known and the unknown parameters. Let me, to begin with, point out that full-year sales 2013 is about SEK100 million lower than what was reported in the P&L for 2013. And that is, of course, to do with the changes due to changes in IFRS 11 in accounting for joint ventures. Order backlog like for like, some SEK200 million lower at the beginning of the year; closing exchange rates as per end of March as end of December; an adverse effect of SEK100 million; acquisitions, that is Niagara Blower, assumed to give a boost to sales of about SEK100 million additional in 2014. That gives a subtotal of the known parameters of SEK29.6 billion. Of course, it's up to you to form an opinion about demand in 2014.

As for prices, let me just point out that we made some small adjustments to prices for standard products at the beginning of the year and that is expected to give only limited effects to the total of sales.

With that, I hand back to Lars for the outlook and closing remarks.

Lars Renström:

Thank you. The outlook is as follows: We expect that demand during the second quarter will be on about the same level as in the first quarter.

And for each division our demand expectations for the second quarter are as follows:

Process Technology unchanged. We have continued high tendering activity. Marine & Diesel unchanged. Equipment Division somewhat higher, due to seasonality.

And that completes our presentation and now I hand over to the operator for the Q&A session.

Q
Now it seems like we are closing in on the consolidation of Frank Mohn. Is it possible to share some light on the deliveries this year on a full-year basis? That's my first question.

My second question relates to the scrubber orders. Could you please remind us on the deliveries here 2013, 2014 and beyond that on the, in total, 40 systems?

A
Well when it comes to Mohn and its impact on deliveries, i.e., sales in 2014, please we would like to come back only once we've closed. And with the second quarter report we will certainly do our best to give you a very good sense of what the implications of Frank Mohn will be. But we are not prepared to provide any detail at this juncture.

A
And when it comes to the deliveries of the exhaust gas cleaning systems, it's some in 2014 but most of them will be delivered in 2015.

Q
Just two related sales questions, if I may. I think, or you've been quoted saying, that sales in Q1 were perhaps SEK200 million to SEK300 million below expectation and you were talking about a recovery in the next couple of quarters.

I presume that's more likely to be in Process Technology and Marine as some of these larger orders that were booked in Q4 start to be delivered. So I'm just checking which divisions have the catch up.

And then also, given your guidance Q2 on Q1 that you think Process Tech and Marine are fairly unchanged, I'm just trying to work that out, given the sales catch up that you've implied from that comment.

A
Well, to begin with, yes, the delay in revenue recognition has to do mainly with PTD but, to some extent, Marine & Diesel, so yes. Then the qualification on the outlook was relating to the demand, i.e., orders as far as we're concerned and not related to sales.

Q
A couple of questions, please. First of all, you mentioned the slowdown in Equipment orders, at least in part due to the weather in North America. If that's the case, can you then confirm that

you saw a pickup in orders in March compared to January and February?

I think most companies that experienced weather disruption in North America saw a better March than January and February so I'm just wondering whether you also saw that.

And then secondly, I have to ask, since we last spoke, GEA's HX division has been, as expected, sold to a PE buyer. What reaction do you see in the marketplace from that? And do you anticipate any impact on your business? Thank you.

A
Well, first of all, when it comes to the US and order intake, we do not comment on individual months when it comes to order intake for Alfa Laval.

And the second one, it's too early to tell, let's say, what the impact will be from the acquisition of GEA's heat exchanger division. But from Alfa Laval's perspective we do not expect any material impact from the sale of that division.

Q
Just firstly on the gross margin, even with the comments you make it seems like a fairly big sequential step-up, especially given currency didn't move too much.

Can you give us any more color on the different favorable mix effects that you saw in the quarter, either by region or product line, the new products coming in that are helping it, just so perhaps we can understand the sustainability of that?

And then secondly, I guess against it, you mentioned higher costs in the quarter for SG&A and R&D. Are there any one-off effects in there when you look at it year on year? Or is this a sustainable step-up in the kind of rate of spending that we should see for the rest of 2014? Thank you.

A
If we start with gross margin, I think it's important to stress then what I said before on the outcome of quarter 1; the mix within capital sales was better. And a good part of that has to do with the mix within Process Technology where, with a lower revenue recognition, i.e., with less of larger, wider scope contracts, with revenue recognition you get a positive impact on gross profit margin.

So this was more an impact in the quarter and, as I stated in the second forward-looking statement, in the near term we do not expect product mix to be as favorable as in quarter 1. I think that is quite explicit. It is relating to the lower-than-expected sales figure.

Then moving on to the overheads, in SG&A, no doubt Marine & Diesel had higher sales and admin costs partly due to the increased level of activity towards yards and ship owners on the back of the uptick in contracting. Underneath, of course, there is the salary inflation, but particularly in Marine & Diesel you have an impact for the higher activity level in the market.

For R&D, 11.4 percent certainly is not what we're looking for, for the full year. This is due to individual cost items. For instance, in specific projects we're buying tooling; the first set of tools for testing the new product. That is something that, in Alfa Laval terms, is an R&D spend and that is expensed immediately. And they kick in to quarters randomly so that is not an ongoing 11 percent.

Q
Got it, thank you. So to summarize, then, the improvement in the gross margin is more Process Technology driven and the step-up in SG&A is more Marine & Diesel driven. Is that a fair assumption?

A
That's a fair conclusion but all of the three divisions had an improvement in gross profit margin, but it was particularly strong in Process Technology for the reason I mentioned, yes.

Q
Thank you. And if you -- a very brief follow up. In terms of the more cautious comments you made around Russia and Turkey, just how do you expect those markets to develop in the second quarter?

And in your flat guidance what have you assumed; that those markets deteriorate further or they're fairly flat or maybe orders missed in Q1 come back a bit? Thank you.

A
We believe that we will see a recovery in Turkey since the elections have been completed and Mr. Erdogan has been a clear winner so then people know who's in charge.

And when it comes to Russia, we do not see any significant change to what we saw in the first -- you can say, what we saw in the first quarter we believe will continue in the second quarter as well since this is linked to the situation in Ukraine.

Q
If you could just firstly on the overall Marine & Diesel market trends, if you could just give us an idea whether there's any update on what you're seeing relative to the pre-close call that you did.

And I think a second question on the exhaust gas cleaning orders that you've received this quarter. Have those mostly been retrofits? Or I assume most of those have been on new ship orders. Thank you.

A
Well, when it comes to the Marine & Diesel and the demand situation, we maintain our view that we will see slightly lower contracting at the yards 2014 compared to a very strong 2013.

And when it comes to the exhaust gas cleaning equipment, it is mostly retrofits and we had orders both from existing and new customers.

Q
Thank you. And maybe just a very quick follow up. On the Process Technology, obviously there was a lack of large orders this quarter and it was exceptionally strong in the fourth quarter of last year. Are there any orders that have been pushed out from this quarter that may be signed next quarter? Or would you say just we've seen most of the large orders in Q4 and we haven't seen them in this quarter but there hasn't been any push out?

A
Well, we saw in the first quarter that there were some customers that postponed their decisions and whether that will materialize in the second quarter or not, that remains to be seen.

A
And please remember that we commented with the full-year report that we had -- some of the large contracts pushed forward into quarter 4 so there was an element of things reported already before yearend that impacted quarter 1 as well.

I think it's important, Lars' qualification to demand that we see a high level of tendering and quotation in PTD, still.

Q
Can I just ask you two questions? And firstly on exhaust gas system orders, the value per order, has that been coming down compared to what you delivered last year in terms of order per value?

And secondly, what should we expect in terms of the impacts on margin from partly SOx being executed and also service orders picking up? And what's going to be the net out of that going forward for the Marine & Diesel division?

A
If we start with the value on the orders landed in the quarter, they were open loop systems but still prepared for closed loop. But, being open loop systems, that means without separation equipment, so a lower value in average. It's clearly lower than the average SEK2 million we mentioned for closed loop. They are more like SEK1 million each on the scrubbers.

And then when it comes to impact on gross margin, the EGC orders, they are comparable to other capital equipment in Marine. So no impact as far as, say, the capital equipment is concerned.

And then, yes, we've seen an uptick in service. And, of course, that is beneficial for gross margin. But then, enjoying an uptick in orders will eventually mean an uptick in sales. So then you will have an adverse mix with more capital equipment eventually.

Q
Most of my questions have been answered. I was just -- if you look at the Energy & Environment piece, it came down sequentially quite a bit and you still say it's on a high level. What do you see specifically on the oil and gas side there in terms of tendering activity?

A
Well, we see that we have a good tendering backlog and we see still good activity in the North Sea. And the only thing that differs compared to a couple of quarters ago is that there are less of the very large orders. And we continue to believe that, going forward, there will also be a good activity level. And we should remember, the absolute level is quite good.

Q
Yes. And then perhaps just a few small items. The SEK60 million charge that you take in this quarter for the Frank Mohn acquisition, is that all of -- is that the total of extraordinary costs that you will book?

And then, I would also ask you, just the tax rate's a little bit higher this quarter than last quarter. What should we expect for the year there?

A
As far as the SEK60 million are concerned, that relates to the cost for the acquisition, for actually making the due diligence, set up the SPA and get to closing. And, as far as any costs for integration are concerned, that is work in progress. And to the extent we see any material cost for integration, we will come back on that subject.

Then, as far as the tax rate is concerned, nothing else than the overall guidance of 28 percent of profit before tax.

Q
I just wanted to ask, Lars, order activities so far. We heard your guidance. In particular, are the parts and service order activities so far in the quarter have continued to increase sequentially?

And could you please tell us a bit about the tendering on large orders? We have seen the press releases, or the lack of press releases, but could you share some words regarding the activity?

A
Yes, the tendering activity is still on a high level. Whether they will materialize into orders in the second quarter, that remains to be seen.

And you can see that fluctuations are quite big. We had all-time high in the fourth quarter; SEK900 million. And in the first quarter we had the lowest in nine quarters; SEK280 million. So it is hard to predict the behavior.

And then when it comes to service, we continue to believe that we will grow our service business at a steady pace. And more specific than that, I cannot be.

Lars Renström: Thank you very much and goodbye.

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