ALFA LAVAL AB

Moderator: Tom Erixon
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OPERATOR: This is Conference #: 8308398

Operator: Ladies and gentlemen, thank you for standing by. Welcome to today's Alfa Laval update. (Operator Instructions) I also must advise that the call is being recorded today, Monday, the 13th of July 2020. And without any further delay, I would now like to hand over to your speaker today, Mr. Tom Erixon. Thank you. Please go ahead.

Tom Erixon: Good afternoon, and welcome to our call regarding the announcement of Neles today. I know that a fair amount of you were present at our press conference earlier today. So we're going to do the presentation relatively quick, Jan Allde and myself, and then we go to the Q&A session.

Let me just reiterate a few important points. And I do it, as I said, schematically. The announcement was made today earlier at 7:30, our time. We've made a public offer, cash, EUR 11.50 per share, representing a 33 percent premium on the trading price as the market closed on Friday. We have an irrevocable with Cevian supporting us.

We also have a recommendation from the Board of Directors of Neles for the offer, which, of course, was very important for us. As I indicated this morning, and as clear in the announcement, our ambition is to, of course, to have all shareholders, a minimum 90 percent accepting the offer. However, the conditionality is on 2/3. And if we get to 2/3, we will move forward, and then we will consider options for the various alternatives we may have in order to close the transaction fully.

I think by now, those of you who didn't follow Neles before, have done so during the day, I suppose, a newly established independent entity, I should say, as of July 1 in Finland. A leader in industrial flow, a market we've been looking at for a long period of time.

And those of you who have followed us in capital markets and others, I think, have been aware, I can see from many of your comments today that there is not a huge surprise that we are moving in this direction. That has been one of our core areas where we've been looking and scouting for business opportunities and growth for a long period of time.

And now that we are mainly with our Alfa Laval analysts, I expect you clearly know us since before most of you has a long-standing global company in a number of important areas of what we are normally describing as 3 technology platforms in heat transfer, separation and fluid handling.

And here, you have basically the matrix between our 3 division in Energy, Food & Water and Marine, and the 3 technology areas, where, in fact, the Energy division has not found its entry up until now into the fluid handling market whereas in the Food & Water division, specifically, we have a very strong business in valves and in pumps and in fluid handling. So this white spot is the one that we have as an objective to fill out. And obviously, the ambition is to be able to close a transaction with Neles towards the end of the year.

The business model with Neles, we think, will work very well in terms of integration. We have done so successfully with our large acquisitions over the last 10 years. We are now in a product-based business unit structure, which means we can easily plug in Neles as a strong product company within our group without doing a lot of changes to Neles' operational structure or span of control from the management team in Neles.

The way we've been running our transformation program over the last 3 years, those of you who followed us know well the emphasis we've been placing on investing into new products and new technologies, including process technologies in our manufacturing.

You also know the very strong focus we've been placing on developing our service business over time. And in a period where we have big changes in the Service business, how it's executed, including the connectivity and digitalization effects on the Service business, to some degree, I will say, even emphasized and reinforced by the pandemic problems where we are launching new products and services and remote ways of working in a pace that is higher than before.

This is also an area which obviously is very clearly adjacent to what Neles needs to develop and possibly can co-develop together with us going forward in the future.

You also know our transformation program in our supply chains, where we've been investing massively over the last 3 years in a competitive supply chain with state-of-the-art facilities and high level of investments and CapEx in order to drive productivity, a program which now is largely coming to an end, obviously, opening opportunities to direct our capital allocation stronger towards the industrial flow area as we will see what opportunities may arise around a possible Neles acquisition later this year then.

And finally, you'll follow us know well the emphasis we've been putting on the changes around sustainability over the last few years. The investments we are doing into green chemicals, processing, the investment we're doing to energy storage, new protein production and various environmental/climate initiatives that we are working with also on the Marine business.

Our experience and drive to ensure that we transit from the traditional oil and gas business that we partly have been carrying within Alfa Laval into the new green chemical and biofuels areas to just mention one example, is something that seems very appropriate to address also within Neles. We have a similar footprint when it comes to the hydrocarbon chain, and we can reinforce each other in those transition exercises as well. So we find this to be a very good fit with us going forward.

The rationale, I will not spend so much time on. Let me just point out that the financial profile and objectives that Neles set as an independent company, in connection with the Capital Markets Day recently is very close and similar to what we have put as the financial objectives of Alfa Laval. And I think this is a reflection that the businesses are, in terms of its business model and attractiveness, rather similar to each other. And I think that's a clear strength.

And then finally, in terms of the integration, as I was indicating before, the acquisition of Aalborg Industries in Denmark and Framo in Norway in recent years has proven that we can use a model of independence and respect in terms of our acquisitions, at the same time as those companies are able to grow into the Alfa Laval ecosystem and utilizes some of the platform capabilities that we can offer the operating companies under our umbrella.

So that is, I think, an important point that we have emphasized that in terms of integration, our objective in this sense is not to get the short-term payback in terms of cost reduction activities related to synergies. In fact, most of the operating structure of Neles will stand firm on its own given that it's complementary to us and not overlapping.

And so the main drive for us in terms of creating value, and this is enhancing the established business plan in Neles for growth and supporting Neles in the areas where we can in order to achieve the growth objectives and profitability objectives, better and faster than possibly they could do alone.

It is way too easy to discuss a business plan that is anchored within Alfa Laval. We are still looking at 2 independently listed companies, and we both have our operating agenda. But let me just reflect on a couple of areas where we obviously see the rationale for why we think there is a good collaboration opportunity between us.

The first one, up left, the fact that we have more than 2,000 service engineers in around 100 service centers around the globe is a platform and an infrastructure already paid for, already invested, already up and running. And obviously, there is an opportunity for Neles to link into that, considering that 70 percent of Neles sales is replacement or service sales or, at least, OpEx sales as opposed to the large capital investment, which both of us sometimes participate in.

The size of Neles product range fits well with the sizes of Alfa Laval's spare parts and parts distribution. And consequently, the global network of automated warehouses and infrastructure we have in place, in order to serve customers in a good and cost-efficient way when it comes to shipping and logistics is something which is available, should it be appropriate for kind of a plug-and-play solution.

Up, right. You see a picture from our valves business. I can assure you our valves are rather different from the valves that Neles is selling. Due to the fact that our valves is used exclusively in the pharmaceutical industry and in the beverage industry. And consequently, the specifications are rather different for our product range.

But with that said, we are dealing with valve controls, and we are dealing with a lot of technology issues that will overlap, and I can see a picture where we both have something to learn from each other and best practice from each other when it comes to how the valves technology and projects and connectivities and digital solutions are being formed and shaped around the valves businesses. So I think we have an interesting overlap there from a technology point of view.

And then finally, in the Energy division, you see the pie chart of the end market exposure that we have. And if you map that against the Neles' end market exposure, you will see a fair amount of overlap, which means that we are going to the same contractors, to the same end markets, to the same end customers, in many instances, and our installed base is, in many instances, in the same place.

The fact that both companies of Alfa Laval and Neles have a premium and technological profile towards the customers makes the fit quite well. I don't believe that the cross-selling is the main driver here, but I think our knowledge and understanding of where the products are, where their markets are, and our capability to reach the customers will support both of us in the sense of our presence in these important market segments.

So I will leave it at that. That's a bit of a background for how we've been looking at it, and I'll hand over to Jan for a few comments on the financial side.

Jan Allde: Thank you, Tom. Yes. So Tom was saying one of the key criteria that we looked, of course, is the financial profile of Neles. And in this slide, you see the strong growth the company has demonstrated over the last years with a CAGR of 5 percent growth since 2011 and more than 10 percent since 2016. And of course, what is attractive is a large share of recurring revenue stream coming from the MRO-type business.

Secondly, they have shown a good and resilient profitability, around 15 percent over the cycle, and also shown a strong cash conversion of around 90 percent, the last years.

If you then put these 2 companies Alfa Laval and Neles side-by-side, of course, you see the size or the scale of the company. Using 2019 pro forma figures would then end up around SEK 53.5 billion and employees around 20,400, with an EBITA margin at 16.8 percent. And finally, a good geographical balance with EMEA being 36 percent; Asia Pacific, 40 percent; and Americas at 24 percent.

Then this offer, the financing is a combination through – using our own funds and a fully committed debt facility from SEB. And if you then look at some of the gearing metrics in this instance, we're using net debt, including IFRS 16 lease liabilities, and how it would develop using end of March balance sheet. And of course, so you would see an increased gearing here, but we have, of course, the ambition to remain a solid investment-grade company.

Finally, if you look at Alfa Laval's capital structure over the last years, our strong cash flow has enabled us to deleverage the company significantly, and we are now down at leverage similar to one before the acquisition of Framo in 2014, to the point that we've also been claimed to have been overcapitalized. So we are not using that capacity for looking at this acquisition.

Finally, we believe that we remain confident of a high cash conversion of the combined entity going forward so that we can again show that we have and have the capability to deleverage the company going forward.

So by that, here are the indicative timetable. The estimated date for publication offer documents August 13 and also start of the offer acceptance period, being August 13 and expiration of the offer acceptance period then on 22nd October.

So by that, we hand over back to – or to open up for Q&A for today.

Operator: (Operator Instructions) So our first question is from the line of Klas Bergelind from Citi.

Klas Bergelind: Tom and Jan, it's Klas from Citi. A couple from me. The feedback from Investors today is the relatively high multiple against what seems to be mainly sales synergies not much on the cost side. Still, I want to dig deeper into that growth opportunity, Tom, which could be pretty big.

When you say that you want to use Neles as a platform for further growth, is this saying that you're supporting the SEK 1 billion sales ambition by 2025 at Neles? Or do you see further upside potential? It seems like that. And the reason we're asking is, obviously, the valves market is very fragmented. Neles only has a 2 percent market share. It's a top 10 player. Using your global scale, I would have thought that this could be much bigger, so I will start there.

Tom Erixon: Well, reflection number one, if we consider our M&A opportunities in various markets, as many of you know, we have market shares that – in areas outside of the valves business, they are so high that there are no major consolidation activities that can be made.

This doesn't exclude small add-ons here and there, but any meaningful acquisition program in our core technology areas are not really there, and that's why the industrial valves market provides potentially an area of significant long-term capital allocation opportunity. So in that sense, I wouldn't put a lid on what are the growth objectives here. I think it's an open playing field.

Now we are still in a situation where we are just making an offer. We are not really in any intense debate with Neles management and their planning and how they think about the future, obviously. So as an independent listed company, they can make publicly available information available to us, but not really more than that. So I think we're a little bit early to start to consider the planning after a successful completion of this, but there are clearly opportunities here.

I would add to that, that I don't think necessarily that in all of the years when Neles was Metso Flow that the core role of the unit was to drive growth. It was – the core business was probably more on the mineral side. So there may certainly be an opportunity just in the way that the management team wants to develop its business along its own plans presented at the Capital Markets Day.

So we are in general support of that plan. And then there will be, hopefully, a day where we can sit down together more intimately and discuss priorities and upside. But it should be a good area to continue to develop for many years to come.

Klas Bergelind: Very clear. Then my second one is coming back to oil and gas, Tom, and you talked about it. I think it moves up by 4 percentage points to 17 percent of pro forma sales. Obviously, not a huge uplift. But feedback today is this could be seen as a negative at first glance.

But at the same time, I think you're 2/3 into being carbon neutral by 2030. 50 percent of your sales is geared to clean take energy efficiency. So could you talk a little bit more about what it is that this can be a net positive against that absolute number in oil and gas going up?

Tom Erixon: Yes. I will reflect on it mainly from an Alfa Laval point of view. I have a difficulty to do an accurate assessment on how it looks on the Neles side. But my assumption is that there are at least some parallels that can be drawn. And when we look at our hydrocarbon chain exposure in Alfa Laval, we have approximately the following view, and we've talked about this, I think, at Capital Markets and other instances as well.

Number one, the upstream drilling side is already quite small with us. It's in the single-digit percentage of revenue just as it is with Neles, and it's not an area which we consider strategically, will grow in the future. There will always probably be a little bit, but it will, over time, not be a meaningful part of our business, although it may carry some presence even for the medium, long term.

The refinery business, if we move downstream, in our view, is in the latest – in the last phase of expansion, and that expansion is driven by regional priorities, China's energy independence and, to some degree, Saudi Arabia's 2030 strategy and a few other things, drives value-add strategies downstream from crude oil in those markets, and we see those projects coming through.

And – but once they are completed, our assumption is that we will not see so much activity on the refinery side, but remaining, of course, will be a long-term Service business or replacement business, if you like. And as you've noticed, in Neles' case, 70 percent of their business is MRO-type of business, replacement sales. So the new project's CapEx on the refinery side doesn't form any major part of our strategy in Alfa Laval, other than service and maintenance-type of job.

And then we come down to the petrochemical side, and I think that's where we have most of the dynamics in the future from our point of view. One is that the petrochemical side, for sure, will continue in many aspects. It's not a matter of plastic decreasing and the petrochemicals going down the drain. There will be a lot of petrochemical needs and development and value-add going forward.

But the other aspect of what will happen downstream is that there, we also have the projects that are driving towards green chemicals and driving towards biofuels. And those chemical processes are more equipment-intensive than the hydrocarbon traditional ones. So to the degree, we will see replacement of fuels and green jet fuels and vegetable oil going into the fuel mix of traditional hydrocarbon. We see that change process, net-net, as a positive for us.

So we don't see a big downside when we come very far down the chain. And I would sort of suspect that we will see a similar picture for Neles. And the conclusion of that is that as long as we are moving forward, investing, driving our presence and our product offering into those areas, and there, it's not trivial. It's similar equipment, of course, but new applications, new customers, new processes, needs to be handled. And the switch from hydrocarbon to green is something that is happening right now. And we are in it, and we will drive it.

And we think it's more of a mix change than a downside. So really, my view is that most of the downside in the oil and gas side, as far as Alfa Laval is concerned, is taken. We've indicated that we could see some percentage of our revenue go down over the next 10 years compared to what we do in energy storage and other areas, it seems like a relatively modest decrease in our overall portfolio.

And we are certainly investing for the next step. I think we will have a similar type of transition with Neles. So I think my net-net, when I look at the combination, is an increased stability in revenue and earnings as opposed to increased volatility because of the MRO OpEx type of structure of Neles rather than overplaying the volatility of certain end markets on the energy sector. That's the assessment we did.

Klas Bergelind: No. It's a good one. My very last one is on the synergies and maybe for you, Jan, through the aftermarket and through improved supply chain. Obviously, I get in terms of the ability to sell more through an improved supply chain that you have worked on for the last 3 to 4 years.

But also on the purchasing side, I mean, Neles is a smaller company than Alfa Laval and typically that means a lot of purchasing synergies that can be realized as well. So coming back to the cost side, aren't we going to expect something then on the purchasing side or is it only sales growth that we talk about here?

Jan Allde: Yes. I mean, I think important here, as Tom was saying, we are still early. These are 2 separately listed companies. We will have to go, of course, into close discussion with their management team to understand what opportunities there are. But I think at this point, it's probably a little bit too early to say. But for granted there will be some synergies that we will find and we will explore, but I don't think, at this moment, is good to make guess estimates away with that.

I think what Tom was saying, I think the way we look at this is that we are primarily now seeing a possibility to support the growth of Neles through the platform that we have on the service side and then we will explore these cost synergies and as we have a closer dialogue with the company going forward.

Operator: Next question is from the line of Max Yates from Credit Suisse.

Max Yates: Just my first question is for Jan. On the pro forma net debt that you showed sort of 2.6x, you said is sort of within keeping a strong investment-grade rating. Could you give us a little bit of help understanding kind of what the upper limits is that staying within that investment-grade rating that you see appropriate is? And also you don't list your explicit covenants in the annual report. But I was just wondering, could you give us what your current covenants are on debt that you have? That was my first question.

Jan Allde: No. I think a couple of comments here. I mean, those net debt view is, of course, as our balance sheet looked like at the end of March. So we'll see how this develops towards after Q2. We have, of course, the ambition to continue to be generating strong cash flow, and we have a track record of deleveraging fairly fast after an acquisition of this size. So that's the ambition that we have, to follow the same path and as we did in the Framo case or the same sequence, I would say.

I think from a covenant, I think there's – the covenant that we have today is such that we would have to first trigger event, which would be – that we would be a, noninvestment-grade company. And the second test would be that we would have to exceed a net debt-to-EBITDA of 3.5x. So – and that's actually excluding lease liabilities. So we feel confident that we will not be close to that, those covenants.

Max Yates: OK. And just my second question is just on return on capital. And you, obviously, at Alfa, have the ambition of a return of above 20 percent over the cycle. You talked about the deal being EPS accretive in year 1.

And I'll be quite blunt, when I look at the Framo deal, I can quite easily see a path to covering your cost of capital quite quickly. Could you give us a little bit about – a little bit of detail about how you think about the return on capital on this deal and also when you think you would be covering your cost of capital from this acquisition?

Jan Allde: Well, again, we are still early days to this, but I would say a couple of things. I mean, first, this is not an asset-intensive company in this end. If you look at the CapEx and it is – from a CapEx maintenance point of view, historically, it's not been very capital-intensive.

We see ambitions to continue to drive down working capital, both in Alfa Laval and as a combined company. And as I said, the cash flow conversion that we have seen, hence, has been good, both on Alfa Laval and Neles. So I don't – can't give you a specific time frame here, but I feel confident that we can work towards our return on capital target.

Operator: Next question is from the line of Mattias Holmberg from DNB Markets.

Mattias Holmberg: Could you elaborate a bit on the terms of the offer, considering the ownership structure and that there's been some news out today? Is the offer final? And if not, would you consider perhaps splitting up the company or a joint venture in order to sort of get to what we're looking for is what it is today?

Tom Erixon: We are not aiming for anything else than a full consolidation of Neles at the end of the period. Our hope is that as the process moves along, that all shareholders will agree that this is a good and fair offer, just as the Board of Neles has unanimously recommended. So that is our base case.

As we indicated in the announcement, we have made the offer conditional of 2/3 of acceptance of the shares, which gives an additional deal certainty to the shareholders to decide to accept offer, gives a deal certainty to the Board of Neles in the sense that certainty of completing the deal is an important aspect of a Board recommendation. So that has obviously, been a very important aspect.

Now the path to complete this deal, should we not reach the 90 percent, is a possibility to consider what in Finland is called a cross-border merger, which you can exercise with industrial logic should you choose to do so. Our assumption is that that's not a mechanism that is a priority mechanism for us and there are no decisions taken in that direction, but we are aware that there are more than one path towards completing this transaction. And so we consider our possibilities to be good in order to reach our objective down the road.

Mattias Holmberg: And one more question for me, if I may. Could you talk a bit about the timing of this deal, if there's anything in particular that's triggered it to happen at this point? And how long you've been working on it or if it's at all related to Neles becoming a stand-alone traded company recently?

Tom Erixon: Yes. We've been quite transparent with how we've seen the landscape in the industrial flow area before, and we continue to be so. We've been analyzing and looking at this space for years. I think we've been giving you, as analysts and our investor base, an indication that, that is one of the areas we're looking at.

We've also been looking at the water space in a couple of industrial areas where we feel we are well-positioned to add value as owners and where we believe there is a long-term growth potential for the company above and going where we are today. And so the – and we've been involved in a number of sales processes as a potential acquirer in valves-related or the industrial flow-related businesses.

Let me perhaps just point out in that context that while we discussed oil and gas exposure of Neles, it's very difficult to find any industrial flow company that doesn't have an oil and gas exposure. In fact, in our experience, the breadth of the end customer exposure of Neles is much broader and wider what is typical. It's not unusual that you find almost oil and gas or refinery or petrochemical-focused companies entirely in this area because the hydrocarbon fluids are such a big share of the overall industrial fluid market. So it's difficult to sort of get around.

So we found – when the announcement was made in July last year for demerger and the possibility to look at Neles as an independent unit as opposed to part of the Metso Group, then it was obvious that the aspects of the business portfolio, the market positioning, the next door Finnish markets, which we are very well used to, and so am I as a professional throughout the last 20 years, we thought immediately that this could be a potential interesting situation for us. So we've been working on that for a year.

Our expectation for the process was from the beginning that the appropriate – and we certainly have approached this from a friendly offer perspective. We have no interest whatsoever to move into the Finnish equity market with an elephant strategy here. So we've been cautiously moving forward in the process, expecting perhaps that the company needed to release quarterly report or 2 and establish itself, including its Board of Directors to be in a position to consider what is best for the company.

With the preemptive Valmet move, it was obviously that the time line had to be moved, and so we moved our time line significantly. And that's why we are here today. I think otherwise, the time line would have been delayed out of respect for Neles and the team and the Board of Directors there, but that was made impossible. And consequently, the option was to either leave this or to go quicker, and we decide it to go quicker. We think this is the right industrial logic.

We think it's the right solution for the employees of Neles and for the shareholders of Neles. And we think it will be a very good industrial combination, and that is reflected in the bid premium that we actually provided. So we feel comfortable that this is a good solution, and we will continue to build both the Finnish presence and the global presence within Alfa Laval.

Operator: Next question is from the line Sven Weier from UBS.

Sven Weier: The first one is coming back on your point regarding the exposure to the hydrocarbon chain. And I know that one of your value propositions in that market is really the energy efficiency part and how the plated heat exchanges are much more energy-efficient than the shell and tube, which, I guess, is part of your pitch. Is there something comparable with the valves and then something you can improve on that end?

Tom Erixon: I don't think we have a very clear answer on how to address the sustainability challenge in this from the industrial flow point of view. So I think it's a good question, but I'm a bit cautious to speculate as to how our answer will look. It will certainly be one of those things that we'll be eager to address in our long-term business planning, but I'm sorry to be vague at this point.

Sven Weier: OK. And then just with regards, obviously, you haven't been doing a deal the last 6 years. So you've been looking at M&A more cautiously. This has come up now, but I was just wondering what were the alternatives in the pipeline. Of course, you cannot talk about that specifically, but was there something similarly large but maybe with exposure to other industries? Or was this for now in terms of the size in terms of the impact, really no alternative to the deal?

Tom Erixon: Yes. It's difficult to be so very specific, but as you indicate, the fact that our – well, a couple of comments to the M&A strategy, if you like.

Number one, if we look at our acquisition history, although we did a couple of big deals, we tended to have a fair amount of smaller M&A transactions. And I think we may have concluded that to get any strategic change in Alfa Laval and a portfolio and our long-term trajectory, the smaller M&A deals tend to be somewhat status quo-oriented.

They are not moving the needle for us strategically, and therefore, we've been having less appetite for them. So on the small side, we'd rather gone towards, I wouldn't call it the start-up scene, but almost a start-up scene in terms of testing new technologies and engaging in part of the technology development for the future without necessarily committing a lot of capital into that but at least creating partnership networks and understanding and knowledge and to some degree, at times, a little bit of seed money in order to get verification on some of the business concepts. So on the small side, that's where we've been. On the small, we've gone smaller.

And then, of course, if we go back to 2015, we didn't have the balance sheet to do anything of substance in 2016. And since then, we've been in a number of the processes, although they have never materialized, so you saw them. We've been working through them.

I would make on the area of industrial flow, I think there have been 2 to 3 hurdles. Number one, one hurdle has been, as I indicated, a number of flow companies that have been very much focused on the oil and gas market. And consequently and typically, in these markets, are that they are focused, they are very strong, but it doesn't provide a platform from which to grow. And you end up more or less buying a bond – high-yield bond with low-risk, to put it that way.

Often profitable, but they are where they are. They are strong where they are and to move outside of that, they may not provide much leverage other than starting to buy other companies. So the breadth of the product platform and application platform for Neles was, in our experience, if not unique, at least, an attraction for us in order to see that we can go forward with the platform.

The other aspect is that I can assure you that the sales processes where a private equity company is trying to dispose of an asset are not necessarily attractive for Alfa Laval shareholders. And consequently, both in terms of pricing and in terms of contractual terms, and reps and warranties, and whatever you go through in these transactions, they've been very seller-friendly and very buyer-hostile.

So we backed out due to concerns about loading risks on to Alfa Laval and offloading them from the private equity owners. And that's not my job as CEO of Alfa Laval. So we said – discontinued a number of those processes. In that sense, you can look at this process and say, "Is the premium high? Is it low?" It is what it is. It is the market level. It is fair. We think we can defend sort of that price premium towards our Board and towards our shareholders, although you don't get full transparency right now.

History will show. But certainly, we feel that it is a company that is well-run. It has been running under the governance rules of the Finnish finished stock market. I personally know some of the managers who have been involved in running this business over the years, its individuals and professionals that I respect.

So we are very comfortable as to the status of the company, as to the integrity of the balance sheet, as to whatever exposures and risks that any industrial companies is involved with. So I think the risk-sharing between us and the seller, in this case, Neles shareholder, is much more appetizing than what we've seen in other sales processes.

Sven Weier: Understood, Tom. And the last question is just on what you said on cross-selling, right, because you said cross-selling is not the main driver. Also it would appear to me that maybe they can really benefit from you also and from some of your strong market positions outside their core industries.

But I was just wondering is there also regulatory hurdles for cross-selling the product, like, for example, in food? I know there's huge regulatory hurdles to get approval for the product. Is this also why you say it's not the main driver, at least initially?

Tom Erixon: Yes. I think the cross-selling – I think, the product specifications are very unique in different application areas. So I don't think we can move one product from one place to another.

When I say – when I talk about cross-selling and the issues around cross-selling, I think I'm back to the principle that we are applying here in Alfa Laval, which is we need specialized – as far as we can, a specialized dedicated sales force for a specific product area.

You cannot, in this world, go out and be a jack of all trades and think you can go to a petrochemical plant and sell all kinds of products. It doesn't work like that. So these sales engineers that Neles has, that know the product and the application, my expectations are that they are world-class in their areas, and they should be.

And so I don't expect to load them up with a lot of other products just as well as I don't expect to take the Alfa Laval sales engineers and load them up with that. But I think they will meet. I think they will know the same customers. We will tender in some of the same quotations.

We will know when projects are coming up. I think there is a lot of knowledge sharing as to what goes on in certain plants and where are things moving and where we can help each other out, but I think it is 2 parties that are helping each other out as opposed to broadening the product portfolio that each individual sales engineer will be responsible for. I don't see that as a prime driver.

We may find some areas. I always say, nobody can afford dedicated salespeople in Romania because the market is too small. So yes, there might be some areas where a representation is valid and feasible under the Alfa Laval brand work.

But if you think about the main markets in the U.S., in China and certain other areas, I think for sure that the dedicated Neles sales force will be intact and stay. And I think the contact can nurture business opportunities on both sides. That's where I see the overlap in practice.

Operator: The next question is from the line of Lars Brorson from Barclays.

Lars Brorson: Three questions, if I can. I guess we've had Valmet's CEO, Tom, come out and say, he's not accepting the offer. So I guess the base case is you're not going to hit your 90 percent. I just wonder what the implications might be in terms of the economics of the deal, a time line, et cetera, from a cross-border –

merger standpoint as you point out as being one of the alternatives you might be seeking should you not get to 90 percent.

Tom Erixon: Yes. I think, first comment is, I think we will have to wait and see how shareholders decide. I think it's too early to – for everybody to dig down. We have made a lot of (inaudible). It's a good one. If we find that, that opinion is shared by shareholders at large, let's see where we are then down the road. But of course, we were fully aware that there was a recent transaction of another industrial company that had a long-term view on this. So obviously, we have to live with the possibility that we have conflicting interest down the road.

Our – my only view, I will not evaluate that nor – their position. I fully respect it. But what has been important for us is that we have planned for long-term process to play out, and we will be patient.

And I think the issue with taking some time apart from that I'm sure that our shareholders would prefer to have this done quickly and move on is, I think the main issue is I don't think it will be necessarily beneficial for all the Finnish employees and all the Neles employees to sit in a long process that is for the wrong reason, creating uncertainty over a longer period of time. So there may be a time where responsible shareholders need to sit together and see if there's a solution that can be found.

Lars Brorson: Understood Tom. Secondly, can I just ask a little bit to the future of Neles within the context of Alfa Laval? I mean, you highlight Framo as a successful integration. And I guess I would argue that is perhaps one of the more separately run entities within Alfa Laval, separate footprint, separate brands, separate go-to market, separate service centers to a large extent. I wonder what is the ambition level here as far as the operational integration of Neles is concerned? And is that the kind of integration you are targeting or something quite different?

Tom Erixon: Well, I think you're right. We are very respectful of Framo. It was a hugely successful, enormously customer-oriented and customer service-oriented company with a very, very strong culture.

And I think we've been adapting to that and seeing that the main value of Framo was exactly what it brought to the table. It's so easy to start to integrate the left, right and center, and suddenly, the pride and the identity and the cultures start to erode, and you don't necessarily compensate those changes with increased sales or increased employee motivation.

So I think the way we look at Framo and each company is unique. But the way we look at Framo today is that from an integration perspective in Alfa Laval, it is a success.

If you ask, I'm a little bit cautious to state what Framo employees would say. I think maybe, at some point in time, you will have the opportunity to ask the question yourself. But the ambition we've been having is that as much as it is operating very much in a similar fashion as before, we hope that the Framo employees are proud of being a part of the Alfa Laval group and that they are leveraging on some of the platform a know-how that we have.

And if we look today, the number of collaboration areas when we are switching IT systems when we go into industry 4.0 – with CRO, when we go to purchasing contracts for new CNC machines, when we go to area after area, we found a professional mutual respect between the Framo team and the rest of the Alfa Laval, which is not an imposition on them, it's just colleagues get to know each other, and we see that actually we can leverage and learn from each other.

And with that said, what Alfa Laval has learned from Framo is how to drive customer excellence and service culture in a company where we have been having a lot to learn from Framo, and we still have some steps to go.

So it's been a really mutual constructive process where it's taking time, but have we pushed for the last cost synergy dollar in this merger, we would have lost much more than we would have gained. So we are happy where we are.

It could be that there are some further refining collaboration, things that could be done with Framo going forward, if they choose so, and if we decide to do so. But certainly, we still have that upside in the bag, whereas we still have a phenomenally round strong business that we have continued to invest in over the last 5 years. So we're very pleased where we are.

I think if we look at Neles, it has obviously a bit more of connection to our operating structure than Framo did. Remember that Framo has only about 30, 40 customers worldwide. They are all located in Korea and China. They deliver to certain spots. So it's a very consolidated structure. It's very lean on the front end side of global service organization and global sales representation because it is so consolidated in its market structure.

With Neles, we have a different situation, and we have a broader platform available in Alfa Laval to support that. So I think the structural benefits, both in terms of creating opportunities, but also perhaps of getting some cost efficiency out, I think those – the opportunity there is somewhat bigger.

And add to that the fact that Neles will need a balance sheet to continue to execute the M&A growth that I think they see, and certainly, we would be positive to support, that balance sheet can be put into use in a constructive way makes, for us, I think, the Neles acquisition a bit more intimate, if I use that word. But again, I – we will take exactly the Framo approach.

It will start with a discussion of where does the management team want to go, what do they see in Alfa Laval that they could leverage from and that they see useful, and I think we will, at the same time, look at Neles and say where are you good and what can we learn.

One area that I have pointed out in that context is the fact that Neles is really good at industrial distribution. And they built a good distributor network. It's something that we perhaps not always have been so commercially skilled at doing, and we've been more going back into the technical sales aspects and the commercial sales.

So – but it's too early to say, but we can certainly see areas where we can dialogue in and have mutual benefits from each other.

Lars Brorson: Finally, if I can, maybe more to Jan. When might we hear more from you around synergies, around value creation from the standpoint of return on capital? I guess, it's a little bit unusual as you would have understood from the questions, I guess, on this call, not on a deal of this size to get some more visibility on your calculations, particularly around synergies and return on capital. When might we get some more detail from you in that regard?

Jan Allde: Yes. I don't want to sit here and promise something. So I think when we are ready, we will provide that. Hopefully, won't be too long down the road. But I think, if and when we do that, we need to feel comfortable that we've had the dialogue and we know that we can provide substance to those. I think it's simply too early to sit here and make guess estimate. So, yes.

Tom Erixon: All right. I think we are maybe at the last question, and we're going to have to close for today. So is there any more?

Operator: Our next question is from the line of Johan Eliason from Kepler Cheuvreux.

Johan Eliason: This is Johan at Kepler Cheuvreux. Just a final question then on these potential outcomes between your acceptance level of 2/3, but to wish 90 percent level, obviously.

I guess the ultimate decision-maker on this is the Finnish government through Solidium. And in that perspective, would you consider sort of giving any sort of guarantees that Neles head office on R&D will stay in Finland or employment guarantees or anything similar like that? Do you think that's in their card of your negotiations going forward?

Tom Erixon: Well, as you know, it's different to – difficult to establish all positions prior to negotiations. So maybe not – that's not so advantageous. But I think we've been very sincere and honest and obviously, we dialogued with the Neles' Board on this, too.

I think Neles Board's consideration was, of course, to an important degree, financial, but I think there's also been a consideration for the company and its employees in the recommendation from the Board. And we have put outwards, clearly, forward on this topic, and you'll find it also when you read the announcement that we will – I cannot see that we will have Alfa Laval, as an owner, will have a negative impact on the Finnish footprint of Neles compared to where they are going themselves.

Now I want to be cautious in terms of what I would put down as a guarantee in the sense that I'm not sure exactly what plans Neles is running. I know how much change we have in Alfa Laval and how much we are moving and changing and adapting to market conditions and whatnot. So, of course, it's never status quo. But I cannot see anything.

I think the principal difference with us as an owner is that the listing is in Sweden as opposed to Helsinki. I don't think there is a footprint implication of us coming into an ownership situation. And in that sense, I have absolutely no problem in expressing that or let's see what – if there is needed anything more than a sincere comment.

But there is nothing in the way we see it. We see it rather as we will invest. And with investment, normally, you see growth also in terms of employment. So I'm not so worried about – that we should be a negative to the employment situation in Finland or the business leadership out of Finland or the technology development out of Finland.

I think there is another aspect on this, which is purely related to the ownership. And that is the fact that all of you who follow industry, especially a process industry, we are extremely tightly knit together between Finland and Sweden in paper, in pulp, in mining, in steel. In area after area, I myself have been leading companies with big operations on both sides.

So there is a long history of Swedish-Finnish mergers that has been happening. Some of them are owned and led out of Finland and some of them are owned and listed out of Stockholm, if you like, and I think this is not a very controversial issue nor in Finland or in Sweden. I think we found a very good way of operating together. So I should not see this as a big obstacle.

And in the landscape of Finnish-Swedish mergers, this is certainly on the smaller side compared to all of the others that has been done over the last 20 years. So I think this is a small step in the process that's been going on and probably will continue to go on for the years to come.

Johan Eliason: OK. Excellent. Let's hope for the best. It looks like a good deal for you.

Tom Erixon: Thank you. And thank you for your attention. I'm sure we will talk very shortly on a slightly different topic that is the Q2 report. So see you next week. Thank you very much.

Jan Allde: Thank you.

Operator: So that does conclude our conference for today. Thank you all for participating. You may all disconnect. Speakers, please stand by.

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