

Alfa Laval AB
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Chaired by Lars Renström

Lars Renström President and CEO

Thank you very much. Good morning, and most welcome to the presentation of the second quarter report. I will start by giving you my three highlights. Demand remained on the same high level as in the first quarter, and order intake increased year on year by 6 percent to SEK 7.9 billion. Contributors to the growth year on year were the process industry segment, and the marine and diesel division, through the acquisition of Aalborg Industries. And all regions in Europe grew compared to 2011, thanks to several large orders.

My second highlight is that the operating margin year on year was negatively affected by lower capacity utilisation in some factories, lower margins in marine capital sales, and product mix. Sequentially, the operating margin was unchanged.

And finally, we expect demand in the third quarter to be on about the same level as in the second quarter.

And now we move over to the key figures. There you see that orders rose 6 percent to SEK 7.9 billion, and net sales increased 11 percent to 7.8 billion. Adjusted EBITA declined 3 percent to SEK 1.3 billion. And adjusted EBITA margin reached 16.5 percent compared to 19 percent one year ago.

For the first six months, orders received rose 14 percent to SEK 15.8 billion, and net sales increased 13 percent to 14.6 billion. Adjusted EBITA declined 2 percent to 2.4 billion and the adjusted EBITA margin reached 16.5 percent compared to 19.1 percent a year ago.

And now we move over to orders received and margins. Orders received on rolling 12 months rose to SEK 30.6 billion, and the increase in order intake was 3 percent, year on year, at constant exchange rates. And we are pleased to note that excluding large orders, order intake grew sequentially with 5 percent.

Next slide gives order analysis, and there you find that year on year, acquisitions contributed with four percentage units, and organic growth was minus 1.2 percent. We had positive currency effects of 3.6 percent. Sequentially, the organic growth

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was minus 1.2 percent, and we had 1.2 percent positive currency effect, resulting in unchanged order intake.

The EBITA margin declined to 16.5 percent, and the operating result was SEK 1.3 billion.

And now we move over to the development per segment. And here you see, for the first six months, that most of the segments were unchanged or declined, and we can see that the process industry stands out, and they had a positive development, and the same goes for parts and service in equipment division, and the marine and diesel division.

And now we move over to take a closer look into the divisions. And here, you should note that all comments are sequential. We start with the Equipment division. There, we see that Sanitary was up, driven by food and beverage, as well as pharma and personal care. Industrial Equipment was significantly higher, boosted by seasonal demand for [HVAC]. OEM and parts & service were unchanged.

Now we move over to the marine and diesel division, and there we enjoyed substantially higher demand for diesel power, and we also enjoyed continued growth for environmental solutions. Demand for Marine equipment, the traditional Alfa Laval product, was unchanged. Marine & Offshore systems was down significantly, due to non-repeat large order. More upgrading and repair works lifted parts and service.

Next slide, in the Process technology division, Food Technology grew, supported by the beverage and viscous food markets. Energy & Environment declined due to non-repeat large orders. Process Industry showed strong growth, driven by refinery in Asia and Middle East, and Parts & Service declined, due to non-repeat large orders.

You've heard non-repeats a few times in the sequential comparison, but remember that Q1 was all time high in large orders.

And now we move over to the next slide, the first six months, and there you see that year on year, and like for like, the aftermarkets for all divisions were stable or growing, whereas most capital sales segments declined.

Now we proceed with the geographical developments; there you see that in the quarter, all European regions had growth year on year, and the other regions showed modest decline. Let's take a closer look at this interesting fact by going deeper into the regions, starting with Asia. And please note that all comments are sequential. The decline of 7 percent in Asia was caused by non-repeat large marine order. It's positive that both Equipment and Process technology division reported growth. The best segments were Process Industry, Food, and Sanitary. Korea and India did well, and China had good sequential development if we exclude marine.

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Moving over to Europe, we see that in all European regions, we had double digit growth. In Western Europe including Nordic, orders rose, boosted by large projects. It's positive to note that despite negative macro-economic news, both the base business and Parts & Service were unchanged.

In Central and Eastern Europe, both Equipment and Process technology division contributed to the growth. Russia is the best performing BRIC country in 2012, and the base business continued to grow.

Now, we move over to the Americas. And there you see, in North America, we declined 25 percent, due to non-repeat large orders. We are pleased that the base business, particularly in the US, showed a continued good development. Industrial Equipment, Food, and Process Industry did the best, while Energy & Environment declined due to non-repeats. In Latin America, we had a good development for the base business, while large orders declined. Argentina and Chile reported good growth, and Brazil's base business grew, but the overall intake declined.

On the next slide, you see that the first six months, all regions delivered growth, with Central and Eastern Europe standing out. Here, Russia has been the main contributor.

On the next slide, we see the top ten ranking. The green bars are whole year 2011, and yellow bars are last 12 months. And we see that the US has had a positive development, and strengthened the number one position. China has declined due to slowdown in marine, and Nordic has grown and is challenging China for the number two position.

South Korea has grown substantially, thanks to Aalborg Industries and the success of Korean EPC contractors.

Mid Europe, consisting of Germany, Switzerland and Austria has declined, and is now challenged by Southeast Asia, where Indonesia and Singapore have grown significantly.

Adriatic has declined modestly, and now they are overtaken by Russia, where we have had a broad-based growth.

Brazil has grown, mainly due to Petrobras, and India's decline reflects the state of the Indian economy.

And now, I had over to Thomas for the financials.

Thomas Thuresson - CFO

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Thank you, Lars. Good morning, all of you. So let's, then, take a look into the data of the financials. As I think Lars has covered orders in some depth, let's move on to sales.

Sales was up organically 3.7 percent over quarter two of 2011. If we then include acquisitions adding a further 3.5 in positive and FX effects adding 3.9, we had an increase in absolute terms of just over 11 percent.

Also, sequentially, sales were up, to the tune of 13 percent on a like for like basis. This is explained mainly by the sizeable backlog from 2011, and seasonality, as we tend to have less of revenue recognition on contract based sales in quarter one every year, compared to the other quarters during the year.

Let's move on to gross profit margin. We ended the quarter at 37 percent flat, compared to 41.1 quarter two of 2011, and 38.5 in quarter one of 2012.

With the Q1 report, I gave the following forecast for gross profit margin. In the near term, we do not see conditions being different than those that prevailed in Q1, however, with the order levels of Q1, load is likely to improve somewhat, and mix deteriorate with the relative increase of capital sales revenues.

So let's look at the deviations and the actuals for Q2. Of course, we can see that the actual came out slightly below this forecast.

As projected, mix gave a negative effect sequentially, as well as year on year. So in line with the projection after the Q1 report. Currency was negative year on year, also as predicted. Impact from load was negative year on year, and sequentially, and of course, sequentially, that is a deviation to the forecast I gave three months ago. The main reason is that order inflow was lower in the beginning of the quarter than anticipated, and please remember Lars' comments about Sanitary and Industrial Equipment in the quarter. We saw a stronger inflow, a much stronger inflow in these two segments during the latter part of the quarter, and the effect of that was obviously, we did not have the anticipated load throughout the quarter.

Then let's get to the first forward-looking statement; in the near term, we expect conditions to be largely similar to those that prevailed in quarter two. However, order levels of quarter one and quarter two can support load somewhat, while gross profit margin is expected to be adversely affected by mix within capital sales.

And with that, let's move on to overhead costs, and the rest of the P&L. Starting in R&D, R&D ended at 180 million, in the second quarter, which is an increase with 7.9 percent, like for like. This is, of course, proof of continued investments in future products, and entirely in line with the established plans for product development. In terms of relation to sales, R&D represented 2.3 percent in the quarter.

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Sales and admin, then, amounted to SEK 1.26 billion in the quarter, and that meant a reduction like for like of 2.7 percent, year on year. So a trend shift, compared to quarter one, where, you remember, we still had an increase in sales and admin, year on year. This is, of course, evidence that the measures initiated at the back end of last year are having an impact in the organisation.

EBITA margin for the quarter ended at 16.5 percent, as Lars commented, which is on the same level as Q1, and in summary, of above comments, is explained by lower gross profit margins, compensated by higher sales volume, and lower overheads. Again, let me repeat. The implementation of the savings programme launched at the end of 2011 is progressing, and effects are realised.

Looking at profit before tax, this P&L line was influenced by negative exchange differences in the quarter, to an amount of 36 million. That is to be compared with a positive 58 in Q2 of 2011.

Profit before tax, following above, just exceeded SEK 1.1 billion, a reduction of some 6 percent over last year. EPS, then, for the first six months, is down about 5 percent, and if I exclude the amortisation of step-up, EPS is down just 2 percent for the first six months.

Before leaving the P&L, let me also comment on taxes. Taxes ended with a charge of 386 million in the quarter. This relatively high number is explained by negative results in a few countries, in this particular quarter, as well as some non-recovering items relating to Aalborg Industries' activities. Our guidance, however, remains 30 percent based on profit before tax.

Then moving on to cash flow, and cash flow from operations, this amounted to 640 million, compared to 669 last year. A slight reduction, mainly explained by an increase in taxes paid, and somewhat lower profits generated, also an influence, of course, from working capital.

With regard to returns, return on capital employed almost 28 percent, slightly lower than Q1. Of course, the capital coming from the acquisition of Aalborg having an impact on returns in comparison with last year. Return on equity, almost 22 percent, close to last year's level.

Coming back to cash flow, and looking a bit more into the details of the cash flow statement for the first six months, the following can be concluded; we are reporting an increase in cash flow from operations of 51 percent, and that is despite an increase in working capital of almost 300 million. Acquisitions, represented a cash out of SEK 1.25 billion, and is a result of the de-listing in India that is now involving a cash out of almost 800 millions. And then, in addition, cash out of SEK 460 million relating to the acquisition of Vortex Systems, as well as delayed payments on some other earlier acquisitions.

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Free cash flow, that is exclusive of acquisitions, divestments, and dividends. Free cash flow reached almost 1.4 billion for the first six months, which is about 200 million above what was generated same period last year. So I think it's fair to say that it's been another good quarter, and first six months, in terms of cash flow generation, despite an increase in sales volume, and the following increase in working capital.

Moving on to the FX effects; in the quarter, we had, for a change, a positive effect, with some SEK 12 million coming from positive translation effects, and a negative transaction effect. For 2012, and then assuming exchange rates of EUR/SEK 8:75, and EUR/USD of 1:26, we anticipate a net of negative 40 million for the full year, and that, of course, includes a negative transaction effect of some 130 million. An improvement compared to the projection after the Q1 report with some SEK 65 million, coming from an improvement in calculated translation effects. So SEK 40 million negative for the full year, and then for 2013, given current hedges and the exchange rates mentioned before, we anticipate a positive SEK 50 million for 2013, as far as transaction effects are concerned.

Let's then look at bit at the backlog, as per end of June; our total backlog amounted to SEK 15.1 billion, again representing about six months of LTM sales. If we look at the backlog development by division, you find an increase in Process Technology, a reduction in Marine & Diesel, and basically the same level of backlog for the Equipment Division compared to end of June last year. Looking at the backlog to be shipped during the rest of this year, it amounted to 9.8 billion, end of June. This also means an increase, compared to end of June 2011, with about 500 million. Please have that in mind, and then let's take a look at the next slide.

And that is to take a look at a summary of what I call the known and the unknown parameters for projecting full year sales for 2012. Again, as we just concluded, like for like, the backlog will give increased sales of 500 million during the last two quarters of 2012.

As we had Aalborg Industries only for eight months in 2011, we must add four months of sales from Aalborg. The actual addition, January to April, from Aalborg was SEK 900 million, so that comes on top. And then, based on our current exchange rate assumptions, and the rates applied end of Q2, we expect a positive translation effect of some hundred million. This gives a subtotal for the knowns, of 30.2 billion, an increase from the last reporting of the Q1, with some 700 million.

As always, it's of course up to you to form an opinion about demand for the full year 2012, which would give you a basis for estimating in-for-out orders for the rest of 2012. Remember, when you think about in-for-out orders and demand for the latter part of 2012, that 2011 was a year with a very strong demand situation for the first nine months, and we reported an all-time high in quarter three, with regard to orders received.

Commenting on prices, let me just repeat what I've commented already before. Prices for metal have been going down, compared to 2011. That is to be noted. We've adjusted prices, as we typically do, as per the beginning of the year. These adjustments have been very limited for standard products. This is, of course, to be kept in mind when you make your projection for sales, for full year 2012.

And with that, I give the word back to Lars for the outlook and closing remarks.

Lars Renström

The outlook for the third quarter is as follows; we expect the demand during the third quarter, 2012, will be on about the same level as in the second quarter.

I have two forward looking comments; the first is that we expect the lower level of capital sales to the shipyards to continue, given the contracting at the yards in 2011 and 12. This affects about 10 percent of Alfa Laval's total sales.

And the other comment is that we expect a high activity level in the Process Technology division to continue, especially within the Process Industry segment.

And by that, we have completed our presentation, and now I hand over to the operator for the Q&A session.

Questions and Answers

Q

Just a couple of questions, please. Firstly, the weaker...part of the explanation you gave for the weaker margin was lower capacity utilisation in some factories, can you just say which divisions that utilisation is lower, and should we read, from your comments on load, going forward, that you think the gross margin can stabilise at this level? That's the first question.

And then secondly, on marine, the margin is down quite a bit, year on year;;; can you just give us a bit more colour on what the main...the main driver of that is? Is it mix? Is it more [Alborg], less existing business, lower overhead recovery, etc?

And then, when I look at last year, the Q3 marine margin went up to almost 30%; would you expect a similar seasonal kind of spike in margins in marine and diesel this year? Thank you.

A

Okay. That was quite a few questions, and we'll do our best to deal with them all. Weaker gross margin, as I mentioned, we did have the projected negative mix effect, and of course, sequentially, the increase in revenue recognition in capital

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sales plays a big role, and that is all in line with what we expected, and in the right direction, as far as you should expect, as well.

When it comes to load, we did have a weaker load in quarter two than we anticipated, as I commented before. It has to do with how orders came in for the fast moving businesses in Sanitary and Industrial Equipment, so of course, that is having an impact on Equipment, but it does also affect standards products sold in the Process Technology division, as well as in Marine. So for instance, smaller, standard size...standard type heat exchangers.

Then marine down, year on year; well, yes. We did mention that we had a price mix effect negative year on year as well, and of course, looking at the EBIT margins reported for marine, quite a bit of that came out of the marine division, and that has to do with two things, mainly. Firstly, if we look at the Aalborg product range, we tend to have a longer order cycle than for the Alfa Laval products. And what we see is, say, a normalisation of the price level for the Aalborg range, something that we have commented upon for the Alfa Laval range, you know, post the peak and the adjustments in metal prices.

And secondly, we have an adjustment of the costing methods in Aalborg, meaning that we are increasing the overhead charges included in cost of goods, in Aalborg, sort of going on to Alfa Laval standards for product costing, so that's the second one.

Then, you were asking about a projection for marine for the third quarter, and of course, I'm sorry, we are not providing any divisional projections as far as margin is concerned. You have to remember what I said before about gross margin, that we expect possibly a bit support from load, and a continued negative year on year, on mix. That's as far as we go.

Q

Okay, thanks. I mean, if I can just follow up on that, I was...I was more trying to just understand whether there is any, you know, seasonality in this business, because we haven't...we haven't looked at, you know, Aalborg for very long, and it did a 30% margin in Q3 last year, and then it's fallen back to 17, marine and diesel. You know, how much of that is a reflection of the exceptional pricing that you just talked about, coming out of a backlog, and how much is it, you know, mix and seasonality, and things that, you know, (overtalking)?

A

Ben, I think my comment to that is, we have spent a big effort in bringing Aalborg onto the standards that we apply in Alfa Laval, and the recorded profits of the marine and diesel division as they are reported now, they well represent the standards and the way we account in Alfa Laval.

Q

Okay, got it. Thank you, Thomas.

Q

Yes, good morning, gentlemen. Also a couple of questions on the margin development, but more on the sequential basis. I think I understand what you mentioned on Sanitary, but on the other hand, the equipment margin improved sequentially from 12.8 to 15%, so you know, given what you've said, I wouldn't have expected an improvement in the margin, and that business.

And then also, on marine and diesel, I do understand what you said, year on year, makes total sense, but if I look at it sequentially, despite 10% higher sales, you had zero contribution margin, so I was just wondering what happened sequentially in that business.

And then, just finally, you know, also coming back to your sanitary comment, I think in Q4 last year, you saw that business slowing throughout the quarter, I think, Q3, did you...did you see something similar just, you know, on the kind of stocking behaviour, because of the Euro issues again, and then people kind of normalised that behaviour towards the end of the quarter?

A

When it comes to equipment, and the equipment margins, your comment is, of course, (unclear), but I did mention mix, I did not mention price. And I can report that equipment did achieve a positive price effect in the quarter.

Then your comment about sanitary, our assumption is that we have a restocking situation. We've seen somewhat of a restocking situation during the second quarter, and that sort of gave this pattern of increased demand towards the end of the quarter, in some of the segments.

Q

So it was not a destocking at the beginning of the quarter, followed by restocking at the end, or...?

A

Well, possibly we've seen somewhat of a destocking from earlier, even earlier in the year, and maybe the estimates of our channels, they were incorrect to begin with, in the early part of this year, so they have restocked.

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Q

And on the sequential marine margin development?

A

Well, again, we have elaborated quite extensively on the development of the margins, and you know, we are seeing a normalisation of the margins for Aalborg products. We are also adjusting the costing methods for the Aalborg range, and you know, those are the main elements of the explanation.

Q

But this does also have a sequential impact, not only year on year.

A

They do, yes.

Q

Good morning, A couple of questions, if I may. Thomas, you mentioned that savings are coming through, according to the plan, from the savings programme, by the end of the quarter; could you please try to help us with the profile of the savings? Have you reached sort of an on-going rate, now, that we could expect, or are we still on a climbing phase? And how much were those savings in the quarter? That's the first question.

The other question is to both of you gentlemen, regarding the outlook of demand, on about the same level; last quarter, given the very high activity of large orders, you excluded sort of the large orders in the outlook; when...now combining the outlook again, does this mean that an activity of around 600-plus million of large orders, is that what...is that what we see, currently? Is that a...the new normal? I mean, even that is a very high level, so please elaborate a bit about, maybe, the on-going activity for larger sized projects. That's it.

A

Yes, well, I can start with your final question, and we see a continued high activity level in the Process Technology division. High activity level, high quotation level, and that is...that is the main reason why we maintain, or why we have our outlook. And it's correct that we haven't made any comment on large orders. So this is the total we say that we will come in...demand will be on about the same level.

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Then on the savings and the achievements under the savings programme, we have realised between SEK 30 and 40 million on the sales & admin line, in the savings programme. Then, of course, we do have activities on-going, as far as manufacturing overhead is concerned, as well. You have not seen the full...the full impact yet. We will see a further increase in these savings effects during the second quarter. Remember, as far as total savings for the full year are concerned, we estimate that with the launch of the programme, savings of overheads to the tune of 200 million for the full year.

Q

Okay, that's very clear. Okay, that's fine. You mentioned prices, Thomas, that limited price changes for standard product, at the same time as input, in terms of metal is down, but I guess the price changes on standard products is slightly up, right?

A

We are adjusting our list prices up, but that is not to say that everybody accepts those, of course, unfortunately.

Q

Oh, that's fair. Okay, that's it from me. Thank you.

Q

Good morning, gentlemen. Two questions, please. The first one the strength we saw in orders in Europe and Nordic; were you surprised by the level of demand on the quarter, given the broader macro trend? And can you kind of expand a bit in terms of kind of where, kind of the strength was, you know, the strongest?

And then, the second question, in terms of your guidance, how important is the parts and service kind of order outlook there? Do you expect to see continued level of growth around the four and a half, 5% range that we saw in Q2?

A

Europe, where we saw growth year on year, and sequentially, it's...it was mainly driven by large orders since base business was unchanged. And when we look at the large orders that we have communicated in the press...in press releases, we had an order to offshore for Norway. We had, to a vodka distillery in Russia, we had to a chemical plant in Germany, and we also had an order for, let's say, half of the contract for the FLNG plant outside Australia, was booked in, in France through Technip. So there you see the large orders that have been visible to you, and we see that these sectors have been quite active in the second quarter, and that

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explains why we saw growth due to large orders. And we think it's quite positive, that despite the macro economic outlook, that we came in on this...on this level.

And then you have, the second question was...

A

It was about the parts and service impact on our outlook, and whether there was any reason to expect a change from sort of the growth pattern of four to 5% in parts and service, and I think there is nothing that, to us, proposes that we should see a change in that trend. We are continuously building our presence and resources as far as parts and service are concerned, so we're anticipating a continuation of the trend, yes.

Q

And just one follow up on that, in terms of marine, are you seeing any change in service...parts and service demand there, given kind of slow operating rates on ships, etc?

A

Yes, well, I would say, still global trade is growing this year. That is one thing we should remember. Global trade is projected to grow with about 3% in 2012, and what we saw was an increased activity level when it came to upgrades and repairs. So we have seen continued good level of activity in parts and service in the marine sector.

Q

Thank you.

Q

Oh, hi. Thank you for taking my questions. I just wanted to take a step back and look at your margins, say, versus the worst period we've seen of 2009, and we're trending at sort of broadly the same level, or slightly below. Should this trigger a reaction from you, at some point, in terms of an acceleration of cost cutting, or launching a further restructuring programme like you did in '08, '09?

A

We do not have any intentions of any further cost savings initiatives at this juncture, no. We continue to implement what we initiated at the back end of last year, and that's where we are. But of course, it's a continuous...in an engineering company, it's a continuous work to improve productivity, and look at all various cost elements.

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That's a continuous effort, to adjust, and that is regarding the operations side, and cost of goods sold, as well as in the overheads.

Q

Okay, that's clear. So thinking about the margins further, I think before, you cited to...there were a couple of relatively one-off reasons for margins to be under pressure, like abnormally high IT spend, and investment in SGNA; has this now been normalised, or are we still running at a high level?

A

Well, when it comes to certain IT projects related to distribution and channel sales, we are still, year on year, running at a higher rate in the second quarter.

Q

And would you expect this to normalise later in the year, or in 2013?

A

That is...that is absolutely our intention, yes.

Q

Great. And the last question is, we talked about stock levels in the sanitary segment, but I wonder if you could comment on, sort of a bit more broadly about the segments that are sort of more faster moving and shorter cycle for Alfa Laval; what are you seeing, in terms of customer stock levels? Are we up, compared to the beginning of the year? Have we now destocked?

A

Well, as we've elaborated a bit on...earlier on in the call, our take on the uptake in orders in sanitary and industrial equipment towards the back end of the quarter is evidence that quite a few of our channels, they are restocking, they probably went a bit too far in the early part of the year, and then they are restocking. That is our take on the order pattern we've seen, through the quarter.

Q

Right. And is this something you see continuing still in (overtalking)?

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A

We have no comments when it comes to order inflow in July, at this juncture.

Q

Fair enough. Great. Thank you very much for your time.

Lars Renström

Okay, no further questions, then I would like to thank the audience for your attention and your questions, and I'm wishing you a nice summer wherever you are. Thank you and goodbye.
