

ALFA LAVAL
Q3 Earnings Conference Call
October 25, 2016
08:30 a.m. CET

Tom Erixon:

Thank you very much and good morning everybody. Let me start before going through the presentation with a couple of overview comments as to the quarter and our restructuring program.

In terms of highlights, the development in our Equipment division was definitely the most positive part of the quarter. We had a number of record highs in the division, including sales in Asia; overall, a strong performance, good profitability. And the Equipment division is also reflecting a certain stability in our base business also in other parts of the Group.

The weakness in the capital investment market was definitely present, and as you noticed, we have not announced any large orders in the quarter; and in fact, large orders that are not announced but below EUR5 million were also relatively weak. And consequently that, together with some seasonal weakness after Q2 in the Equipment division, is affecting our overall order intake, ending lower sequentially.

We then also announced the second step in our strategic review. As you know, some time ago we announced a new organizational structure and we're obviously working with that full speed in terms of implementation. The second step was announced this morning including three initiatives. I will give you some few comments on that now, and Thomas Thuresson, our CFO, will give you some further detail on it later on during the call.

The first part, the first initiative, is the alignment of the organization into the new operating structure starting from January 1. That is ongoing now. It will result in cost savings on an annual basis in order of magnitude of SEK300 million. We expect to have that implemented end quarter 1, beginning quarter 2.

So it's a relatively short-term implementation going on in that area. It is to a large degree related to white collar, and to a small degree blue collar, whereas normally the blue collar efficiency programs are not announced in this manner.

The second part is separating out certain businesses and product groups that has not performed the way we expected over a longer period of time in the Alfa Laval operating structure. We don't see the perfect fit in the new structure either, and consequently, we want to take them outside of our normal operating structure.

We want the sales and marketing organizations to be fully focused on what we think are the profitable, long-term, important products for us. And these ones that have not developed accordingly in our structure, we put them on the side in what we call the

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Greenhouse. We will down the road make decisions as to what the next steps will be. We are not excluding keeping them; we're not excluding selling them, or any other appropriate action that might need to be taken.

Thirdly, we have announced a review of our production infrastructure, and at this point in time, we are not announcing the specific initiatives in that. It will happen over the next quarter. We still have some work to be done in union negotiations and other stakeholders' interaction. So we are not going public today with the individual initiatives on the production side, but we have, as you can see from the number, indicated that we will take one-time charges in the order of magnitude of a maximum of SEK400 million over the quarters to come as we present the individual initiatives on the manufacturing footprint.

That leaves us with about SEK1.1 billion of restructuring charge for quarter 3, and I will just remind you that about SEK600 million of those are related to a write-down of goodwill and other values which are non-cash affecting whereas the restructuring charge is in the order of magnitude of SEK500 million, resulting in yearly savings of SEK300 million on the white-collar side, sales and administration. But there will be effects on cost of goods sold as well. However, we are not specifying that at this point in time.

I would also like to remind you that we are working with other capacity measures. As you will see from our personnel numbers, we are down year on year already as we speak. We continue with other measures in Operations in areas where we feel we need to take actions. So I just want to remind you that what we are primarily looking at here are cost for sales and admin when it comes to the SEK300 million number.

So with that, let me go to the presentation with the key figures for the quarter.

As you can see, on most dimensions we are year on year affected by the downturn in Energy and Marine, and it's affecting essentially all the parameters on a year-on-year basis. Sequentially, our results are stable. The gross margin as well as the operating margin are in line with what we had in quarter 2. The invoicing is as expected. And as I indicated initially, we do see an absence of large projects and others affecting our order intake somewhat.

And that takes us to the next page on orders received. As you can see, the presence of large orders throughout this year so far has been very limited, and in fact, non-existent in the third quarter. There are some effects on our other businesses, as

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indicated in our forward-looking statement in the quarter 2 report, but by and large, it reflects the relative stability outside of the larger projects.

We have in our forward-looking statement indicated that our outlook is on the same level or slightly better for the next quarter, which indicates perhaps to you that we have some promise in the pipeline the way we look at it at this point in time.

The order analysis is showing you the structure of the order intake and how it was affected in the quarter. The minus 7 percent, again I think commented pretty much on the reasons and explanations for what they were.

Let's go to the operating margin. The operating margin is stable on 15.6 percent. It is affected by both positive and negative aspects. On the negative side, obviously, capacity utilization in our system; and some projects in PTD is affecting the operating margin in a negative way compared to previous quarters.

On the positive side, in general, our cost management has worked well, the service mix is increasing; we have some positive effects from currency. And I would say all in all, of course, the Equipment division is contributing to good stability in our earnings, and this holds true also for the gross margins.

Let me with that go to the divisional review and start with the Equipment division, and as you can see, especially on the year-on-year numbers, we are growing positively in all areas of that business. It's very solid numbers on that side. The fact that we are a little bit weak in some areas sequentially is related to the summer vacation period in Europe which typically affects the division somewhat. But all in all, we are certainly happy with the way we came in on the order side.

In some areas, like Sanitary, I would say we are even at the point where we've been capacity limited in our own operations and probably demand could have been even slightly stronger if we could deliver according to those schedules. So there are some variations that you can understand in our Group between different product groups where we have real capacity problems in both directions.

Let me go to the Marine & Diesel. When looking at it sequentially, we did have a good quarter in the equipment side, but I must say even with that positive note, we are clearly affected as you can see, year on year as well as sequentially of the downturn in the marine industry. You have probably seen that the market forecast for the number of

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contracted ships this year has been reduced further. At this point in time, it is believed to be in the area just south of 600, which is the third down revision this year. That is in line with how we see the market from a yard contact point of view. The expectations here is probably from the market that 2016 is the low point of the market and there is an expectation from a return to growth in 2017 from a very low level. And those are the market forecasts that are there. We will see. We obviously have some strong points in the marine market in any case at this point in time, both in terms of cruising ships and some other product tankers. The market is not that weak, but all in all, of course, that doesn't compensate for the weakness in the market.

And finally, in Process Technology, there are parts in the PTD that is going reasonably well. You will see that on the year-on-year numbers. We are pleased with the way our wastewater business is developing. We are also pleased with the way service has developed throughout this year. But on the energy side and food side, the larger projects have been limited, and obviously, this comes through on the overall order intake. That is probably the main explanation, if not the only explanation, in terms of the year-on-year comparison year to date.

And as you will see then if we just review the various customer segments overall, in terms of the year-to-date numbers for EQD, it by and large is positive. Industrial equipment is still negative after a weak beginning of the year, but that has certainly changed significantly in the later months.

In terms of PTD, you see the year-to-date numbers in both service and wastewater being positive. It has gone well for us in those areas. And we have some weaknesses in food and energy on the larger projects, as I indicated before.

And then the marine side, by and large for year-to-date numbers, we are clearly a bit behind, affected by the low contracting area. There is in marine a little bit of weakness in the service market as well based on longer service intervals for some of the ship owners, probably pushed by low freight rates in the market. It is more the larger renovation projects than the smaller spare parts and service initiatives that has declined a little bit in this year, but that's the situation on the marine.

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Let me then go to a quick review on where we are regionally, and I will start with the numbers in Asia. The good news in Asia is that China grew, including marine, in the quarter. We've been having overall a pretty good and solid development in China throughout this year exclusive of marine. And at this point in time when we're starting to hit the bottom in the marine market, it doesn't have a huge effect on China any more for the quarter, so that was all in all very good.

The big weakness in Asia was Korea. Korea is significantly impacted by the marine crisis, but it also spreads to areas outside of the marine industry. So Korea was a record low for us, and I think Korea will have industrially a difficult time and recovery process ahead of it. Japan was also affected by the marine side, but otherwise stable, and South East Asia was OK.

Going to Europe, we've been having a good recovery in the Nordic region. We started weak in the year in Nordic, partly affected by offshore industry in Norway, but also in some other areas. And all in all, Nordic has recovered nicely during this year. We had a strong third quarter in the Nordic area.

Western Europe has been a bit more neutral, stable to slightly weak in the quarter, and the difference is mainly related to some of the larger projects and some marine initiatives in certain market that is affecting the order intake.

Good development in some markets in Western Europe, including France and UK. Perhaps not intuitive for some of you, but the Brexit effects as we speak certainly not present in our order intake in our portfolio there.

Finally, Eastern Europe where Russia remains the engine of the region. We turned the page I think in Russia early this year. It has been clear that Russia has been developing from a very weak situation and coming into a lead, good quotation portfolio and good order intake. And you will see on today's numbers that although that the sequential numbers was a bit affected by individual projects, all in all we are very comfortable with where we are in Russia.

Then going to Latin America. We had a very strong start in Latin America, especially in Brazil in the beginning of the year. That has faded somewhat. But other than Brazil, we had a strong quarter in most geographies in Latin America. And all in all for the year, as you will see on the next page, we are OK with Latin America as a whole.

Going to North America, the year started weak in the United States where we've been doing better as we came into Q2, and to a degree, Q3. All in all, we are sequentially a little bit behind, but the year-on-year numbers is good. Canada remains

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affected by the oil and gas crisis which has been a big market for us in that segment, but sequentially, they were a little bit better than last quarter as well.

And that takes us the year-to-date numbers that will give you that feeling a little bit better. As you can see, in North America, we are 7 percent behind at this point in time. Last year, out of -- and we are 4 percent behind in the US, so that number is slightly better and has been improving as we've gone along this year.

Latin America remains ahead of last year after three quarters. In Nordic, you see the weak beginning that has turned now to a much stronger situation. Eastern Europe is clearly positive; somewhat negative in Western Europe. And the 28 percent negative in Asia is more than related to the decline in the shipping industry, whereas in other areas, we've been doing relatively well and seeing a stability, and in most areas an OK growth rate, not least in China.

So those are my comments to the market situation and the overall quarterly report, and I would now hand over to Thomas Thuresson for some further details on the financials.

Thank you.

Thomas Thuresson:

Thank you, Tom. Good morning all of you. So as Tom has covered orders in depth, let's then move on to some comments on sales.

Let me start off with the forward-looking statement that I gave in connection with the quarter 2 report. At that point, I said we believe it's reasonable to expect a somewhat lower invoicing in quarter 3 compared to quarter 2 because of the following main reasons: the phasing for delivery of the backlog; the demand development in certain sectors during the spring; and a certain seasonality when it comes to revenue recognition due to the vacation period in some regions. As you may have seen from the report, we realized sales of SEK8.58 billion in the past quarter. In comparison with quarter 2, sales was then consequently down 7 percent at constant rates, and compared to last year, we were down approximately 12 percent, again at constant exchange rates. I would say that in terms of revenues, we ended, as expected, in relation to our own view of quarter 3.

If we then move on to service, the service activities represented 30 percent of revenues in quarter 3. This is to be compared with just over 26 percent last year and

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some 28.7 percent in quarter 2 of this year. That is to say we have gotten a positive mix effect from an increasing share of aftermarket sales in total revenues.

Let me then deliver the first forward-looking statement, an indication of revenues for quarter 4. We believe it's reasonable to expect an invoicing in quarter 4 somewhat higher than that of quarter 3, mainly because of the phasing for delivery of the backlog, and then giving some due consideration to demand for short lead time items and services. With that, let's then move on to some comments on the gross profit margin.

Gross profit margin for the quarter ended at 35.7 percent. That is effectively an increase of 0.5 percent year on year and a reduction of also 0.5 percent sequentially. Let me then come back to what I said with the quarter 2 report. Then I said in the near term we expect adverse effects from volume/load to further increase. We expect slightly reinforced positive FX effects assuming a relatively weak SEK to provide some compensation. The actual outcome was influenced by the mentioned parameters I would say largely as expected.

For some further comments on the gross profit margin, let's move on to the next slide.

As I just said, quarter 3 came in somewhat better than last year and somewhat below quarter 2. We were suffering adverse effects from negative price/mix effect within capital sales year on year -- that is, of course, to do with declining oil and gas content in Process Technology; and a mix/price effect in marine and diesel as well as a weaker load in certain factories. Positive purchasing variances were supporting the gross profit margin. That is to say initiatives to further develop new suppliers has supported gross profit margin. Compensation was also provided by positive mix from relatively increased after-sales and service share, and of course, more so transaction, FX transaction effects.

Sequentially, we had again a weakening load which had a lot to do with the holiday season in Western Europe giving an adverse effect. Compensation then was provided by FX and the mentioned increase of after-sales in total revenues.

Let me then to finish off gross profit margin comments give you the second forward-looking statement. In the near term, we expect adverse effects from load and an increasing share of capital sales. We expect continued positive FX transaction effects and positive purchase price variances.

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Let's then move on to something that I believe most, if not all of you, have asked for and/or expected for some time, a program to address the decline in demand in certain sectors as well as the impact from the strategy review.

The program we launch today consists of three individual initiatives. We're looking at an initiative to adjust, as a consequence of the reorganization, adjust because of the decline in demand that we've seen in the oil and gas and most recently in marine. Secondly, we're looking at an initiative to adjust the manufacturing footprint. And thirdly, an initiative that we call the Greenhouse, an initiative where we are segregating three product groups out of the three new sales divisions in order to achieve improvement of performance through a focused effort for these three product groups. We are -- let me also say that this Greenhouse initiative concerns approximately SEK1.5 billion of sales, if we look at the revenues of the three product groups at this point.

For this program, we are expecting non-recurring charges to the tune of SEK1.5 billion totally. As you have seen from the report in quarter 3, we've taken a charge of SEK1.1 billion, and please note that there is a write-off of mainly goodwill and step-up values of some SEK600 million. This is obviously a non-cash item. Let me also say that this write-off of step-up and goodwill may have been a bit of a surprise to you; let me describe why this comes about.

By segregating these three product groups out of the ordinary structure with the three main cash-generating entities, the three sales divisions, we are effectively creating a further, a fourth cash-generating entity. And as we just commented, these entities, they have been financially underperforming for some time, and as a consequence, the step-up values and the goodwill related to these activities could not be justified and maintained. So that's why there is a write-off of these values.

The charges in quarter 3 are, of course, expected to generate substantial savings. We're looking at savings in the overhead area alone of some SEK300 million on an annualized basis. This charge, of course, involves redundancies, redundancies to the tune of some 700 employees, out of which some 250 relates to blue collar employees, and we believe it will involve redundancies in Sweden to the tune of some 100 employees.

We expect the initiatives related to the charge in quarter 3 to be implemented to a very large extent at least by the end of quarter 2, 2017.

If you look at the SEK1.5 billion and the charge in quarter 3 of SEK1.1 billion, that of course tells you that there will be more coming in the coming several quarters giving

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rise to further charges to the tune of SEK400 million but, of course, also savings corresponding to these charges.

With that, let's move on to some other elements of the P&L account.

To begin with, the R&D ended at just over SEK190 million in the quarter, a year-on-year increase of 5 percent. R&D is year to date representing 2.3 percent of revenues, an increase from 1.9 percent in 2015. In summary, this is really a conscious effect of decisions, or an effect of conscious decisions, to increase R&D efforts to support future sales, and that is despite that we have realized a decline in demand in some areas.

Moving on to sales and admin, we ended at SEK1.46 billion in the quarter, representing a like-for-like increase of 1.9 percent, and this is evidence that our efforts to reduce resources, to save, are starting to generate some effects. Year to date, the increase has been 2.7 percent, and 1.9 percent is clearly below the average salary inflation in this area for this year, so a real reduction in resources and costs on the S&A side. Sequentially, the quarter 3 number represented a reduction in absolute terms of approximately SEK100 million.

Then let's move on to the profit before tax line. We ended with only SEK93 million of profits before tax, and of course, that is almost entirely explained by the one-off charge of SEK1.1 billion; and then, some is recuperated by positive FX variances in the financial net. Before we leave the P&L, let me point out that the tax line gave rise to a charge of SEK199 million despite only SEK93 million before tax, and the explanation is largely that there is no tax credit against the write-off of goodwill. We maintain, of course, our underlying guidance of 28 percent tax charges on profits.

EPS ended at a negative SEK0.27, again to do with the one-off charge. Return on capital employed and return on equity, they are, of course, both very much influenced by the one-off charge as well, and they ended at 17 percent and 13.9 percent respectively.

Then a few comments on the performance by division, and my comments, of course, they mainly relate to the development of the operating, the EBIT margin for the three divisions.

As Tom has mentioned already earlier, Equipment came out very well, better than I would say ever before in this setup. Equipment came out obviously then higher than both last year and the previous quarter. This is thanks to slightly higher volume at better

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price mix, and then reduced somewhat through a lower load and marginally higher cost, not least in the R&D area.

Then Process Technology ended lower than both last year and last quarter due to very much lower volume, a decline in revenues of SEK500 million; but also, lower load from certain factories and slightly higher costs; and finally, a worse outcome for a few projects. To be more specific, really relating to three projects: two old, if you like, and one new bad-performing project.

Finally, Marine also came out lower than last year and previous quarter mainly because of the decline in volume, but also some adverse effects from price/mix and the mentioned load. With that, let's move onto cash flow.

Cash flow from operations amounted to just over SEK0.9 billion, a reduction of almost SEK0.4 billion compared to last year, and this reduction is really more than explained by the lower sales volume.

Regular CapEx ended at SEK134 million against SEK180 million a year ago. I would like to say here that for the full year 2016, you should not be expecting this year's CapEx to exceed last year's total level of CapEx. That is despite that we're running two large CapEx projects in Denmark and in India, and the reason is really mainly that we're facing delays in the relocation project in India because of delays with permits from authorities. And then, of course, we are also cautious when it comes to CapEx generally because of the decline that we've talked about and the lower load in certain factories.

Financial net paid was positive with some SEK20 million, an outcome of some SEK190 million better than last year, and it's really a combination of to some extent lower interest paid, but more favorable FX differences mainly.

Free cash flow, SEK800 million compared to just over SEK1 billion a year ago, again really to do with lower volumes compensated by a better net financial net paid. This cash flow has brought us to a debt to EBITDA of 1.9 times compared to 1.79 times a year ago, another key figure that of course has been influenced by the one-off charge as EBITDA was influenced by some SEK500 million of the one-off charges.

Then FX. FX on EBITA in the quarter SEK107 million, an outcome for quarter 3 somewhat below expectations for transaction effects. This is obviously explained by large variations in exchange rates during the course of the quarter having a less positive effect on open exposures than anticipated.

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The forecast for 2016 has been updated when it comes to some of the exchange rates applied for open exposures, as you can see specified on the slide. Translation effects have been calculated based on closing rates. The full-year effect gives then a positive SEK510 million, an increase from the SEK475 million after quarter 2. And of course, this is assuming that the Swedish krona remains on this relatively weak level throughout quarter 4.

Then a few words about our order backlog. We had an order backlog of totally SEK17.8 billion at the end of September, representing approximately 5.8 months of LTM sales, quite a reduction from end of quarter 2 where we had 6.6 months of LTM sales in our backlog. For shipments in 2016, the backlog amounted to some SEK6.9 billion, and that is a reduction of SEK1.1 billion compared to the end of September last year. Having said that, let's move on to the bridge for full-year sales.

To start off with, as you have seen earlier on, we have had year-to-date sales of SEK25.7 billion, and to that we can add two known parameters: backlog, as I just showed you, SEK6.9 billion for shipment before the end of the year; and then, to give you a sense of magnitude, orders coming in and shipped before end of quarter 4 amounted to SEK2.8 billion last year. And that gives a sub-total of SEK35.4 billion. I would to that -- I would like to that -- to add that when it comes to demand, of course, you've seen a decline for the last several quarters. And as you may have seen, we expect the same level of demand as in quarter 3 or somewhat higher for the coming quarter. And please remember that only businesses involving really short lead- time items and services are relevant for in-for-out business in quarter 4. I think that sets the scene for in-for-out. As far as price is concerned, no material variations.

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

Tom Erixon: Thank you very much, Thomas. So let's go straight to the outlook statement for the fourth quarter where we expect demand during the quarter to be in line with or somewhat higher than in the third quarter.

And on a divisional level, on the Equipment division, we believe it will be on the same level or somewhat lower for the quarter. On the Marine & Diesel division, we believe it will be on the same or somewhat higher level than in Q3. And on the PTD side, we expect it to be somewhat higher than in Q3.

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And I think this guidance reflects our earlier comments about some of the larger projects and our expectations on stability overall in the market.

I would also like to point out that after the ratification of the ballast water legislation then we are not expecting orders to be booked prior to Q1. So in our outlook, that is not an important figure.

And with that, thank you very much, and we turn over to questions.

Q: A couple of things from my side, first of all just on your Greenhouse project. Normally, we associate a greenhouse with creating conditions for things to grow. I think, Tom, you were saying actually it's not really a perfect fit and you're not excluding any action here. Can you just be clear about whether there is any footprint reduction associated with this?

And also, just on these operations, I'm particularly interested in your European heat exchanger business which obviously was partly restructured back in 2014. Are these loss-making operations currently? And also, just by segment or by division, where do these operations reside? I presume again European heat exchange are primarily within your industrial equipment segment.

Tom Erixon: All right. Let me make some comments first.

This is not -- when you say European heat exchange, our overall heat exchanger business obviously is core to us. It continues to sit, the majority of it obviously, within the existing product groups.

When we separate out certain activities, it is partly to create the right growth focus in our traditional sales channels for the -- Alfa Laval as in the three operating divisions. So that's one objective in getting focus and getting our core businesses back to a growth path that we have been discussing before.

The separation out of a number of units concerns approximately a turnover of SEK1.5 billion. There are obviously footprint consequences that will come as a result of this, but due to, as I think we indicated earlier, our footprint changes will need due consideration when it comes to internal dialogs and negotiations with unions, so we're not specific around that. But let me say that within the one-time charge and within the separation of these units, we have a clear ambition to turn units that has not been profitable to the degree we wish them to be into a more financially viable entity.

So clearly, they are impacted by this restructuring as well in terms of their restructuring charge, as well as in terms of the cost base that they will be provided with.

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And, Thomas, I don't know if you want to complement?

Thomas Thuresson: No. I think that's fair. It will have implications of footprint, but of course, we have to give consideration to the internal processes here. So, no.

Q: That's helpful. I just wondered whether to my point about whether you can give us any indication of where these 1.5 billion reside, is it primarily in your industrial equipment segment, or are you unable to say this at this point?

Thomas Thuresson: The greenhouse is representing only a share, a minority share of the SEK500 million charge. Let's take it here to make it as clear as possible to everyone. We've taken a charge of SEK1.1 billion in quarter 3. SEK600 million, roughly SEK600 million of that is to do with write-off, and that then mainly relating to goodwill and step-up values. That is to do with the Greenhouse and with the three entities, three product groups. Then, if we look at the remaining SEK500 million, that involves for instance redundancies, there we're looking at a minority of that charge to do with the Greenhouse. If we then take one step further, the balance between the charge of SEK1.1 billion and the total expected cost of SEK1.5 billion representing some SEK400 Million is really to do with the manufacturing footprint initiative, which has nothing to do with the Greenhouse.

Tom Erixon: But I think also the question was related to where the sales volumes are located, and I think you are correct in your assumption you will see the majority of that, especially on the air side with this, the biggest part, going into the EQD division and industrial equipment side. That's correct, absolutely.

Q: That's helpful, Tom. Thanks. And just, Thomas, on the SEK400 million charge relating to your manufacturing footprint, how should we think about the payback on that portion? And I know you're obviously holding back what you expect to deliver in terms of cost savings, but would you think that payback -- how would you think that payback compares, say, to your SG&A program?

Thomas Thuresson: Well, I think at this juncture you will have to expect that we're only going forward with sensible projects that have a good payoff. We will be specific

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about the expected effects of these initiatives once we communicate the charges and the implementation of these individual projects.

Q: And finally, if I can, can you say anything about the costs you expect to be associated with the part of your review which is related to rejuvenating organic growth? Can you try and quantify that? I didn't hear what you were saying earlier, Thomas, about R&D spend. Do you see a step-up there? Where else do you see a potential step-up in terms of spend in order to drive that part of your program forward?

Tom Erixon: Well, it's a good question. I think what we've done today is taking another step in the strategic planning and disclosing a fair amount of details in terms of where we're moving on a number of angles. There are other parts at work when it comes to the business planning of our new divisions and how we will focus resources and investments going forward. I don't -- and I don't want to go into the full detail of that. We have other opportunities to do that together later. But I would like to say that we're obviously not launching a huge initiative on cost savings at this point in time in order to balance it out with cost increases next year so you should not expect to see a neutralization of the tough work that we're doing right now on the cost side.

I think with the indications you had today from Thomas and where we are in R&D spend and other things we feel that we have included in the cost savings programs are already the announcement that has been made on increased R&D pace in the high-speed separator areas. We have taken [height] for the fact that we will continue to grow and develop the service business of our operations, and we want to make sure that we have feet on the street to drive the right product groups forward in our new organization. So you should not expect that we're announcing major cost increases prior to actually clearing out the cost challenges that we have. I think that's a fair statement. And then we'll come back with some further language in terms of what we think is key to this Group, and that is how we're going to develop our business going forward. But we'll take this step first, and that's why you have it today.

Thomas Thuresson: To be a bit quantitative related to your question, I think it's worthy of note that despite that we have seen a decline in orders received year to date of some 14 percent, we've actually allowed consciously an increase in R&D spend of some 6.5 percent year to date. I think that is really a strong commitment to development of the Company going forward.

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Q: A couple of questions, please; two questions on marine. I was just wondering in the order figure you had in Q3 if there was maybe a minor part related to some backlog adjustments, cancellations or currency adjustments. I guess if they were big you would have mentioned it, but maybe some minor impact here.

Then your comment on marine service, I guess we learn from Bureau Veritas that there was a delay in the mandatory reviews for some ships that where the ship owners tried to push that into Q4. Would you be also a bit impacted by that?

And then I think you obviously have an old margin target outstanding, old revenue midterm guidance. Is that's something we should be expecting you come up with an update on that at the Capital Markets Day, or how should we think about your 15 percent margin target in general?

And then the last question is just on operating leverage. I guess in the first half you were running well above 50 percent. Now, you're running below 40 percent. And if I take your comments for Q4 on gross margin development, I sense no major changes against the guidance that you gave for Q3. So should we basically expect the average operating leverage to be more the region of Q3 then? Thank you.

Thomas Thuresson: To start off with cancelations, they were at a very low level in quarter 3, so not really impacting the number. What I could mention though is, of course, an adverse effect from revaluation of backlog because of the strengthening of the Norwegian krone, and effectively, the backlog at Framo is very much denominated in US dollars. So there's certainly impact from that adversely on the marine order intake number.

For marine service, you're very specific in implications from a delay of reviews of certain ships. Well, to be quite honest, I don't know, we don't know whether we have a specific effect from these individual vessels. Our take on the development is simply that ship owners, they have -- they're struggling with their financial performance and they're pushing out their maintenance intervals at this point to safeguard cash.

When it comes to financial targets, whether there would be an update at the CMD, my only comment to that is, we hope to see you in Copenhagen in a few weeks and then you will certainly know.

Then finally on gross profit margin, well, I would like to refer back to the forward-looking statement that I gave a few minutes ago; with adverse effects from, for instance, an increase in share of capital sales of total revenues in the last quarter; and

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then, of course, some continued help from FX, continued help from purchase price variances.

Q: Maybe just one follow-up on the point of revaluation. I take it from your comments that the impacted total was below SEK100 million in the quarter.

Thomas Thuresson: Well, it's in that order. Yes.

Q: Just two questions I had, firstly, on the cost savings. Given broader wage inflation in your business, other internal costs, do you have a view on how much of these cost savings you should be able to retain at the profit line and how much will be eroded by normal course of business?

Tom Erixon: Well, let me take that first question. We expect the full impact as a running rate at some point in time during Q2, fully implemented end Q2. So I think we have taken height for whatever salary inflations we will have around the world on the S&A number. Obviously, if you move forward year by year, we do have a continuous inflationary pressure on our cost base so we will obviously as we move forward have to balance our sales development with productivity development to handle the cost inflation.

But we've set this program, let's say, in 2017 value. If we down the road are successful to grow our business based on a number of factors, or whether we need to take a closer look at the costs going forward if the cyclical downturn stays with us longer than we foresee, then obviously, we will do that.

Q: OK. Thank you. And just my second question was on the process technology margins. Could you help us give an -- well, help us understand how much of the margin decline in process was due to these problem projects that you had and how much was just due to the lower volumes?

Thomas Thuresson: We're looking at an effect from these three specific projects of well over 1 percentage unit in margin terms.

Q: OK. Thank you. And just the final question was that one of your competitors had some issues in the quarter revolving around customers slowing down deliveries in

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dairy processing, and given your focus on this market, I'm sure that some of your backlog -- have you seen any change in behavior among your dairy customers, particularly within dairy processing markets?

Tom Erixon: The answer is, no.

Q: On the Greenhouse, you mentioned the size of the business and that they're not performing according to expectations. So would it be fair to see that there is a zero earnings type of [entities to] SEK1.5 billion? That's the first question.

Secondly, you also mentioned, Tom, that you don't expect much orders in the ballast water treatment in the fourth quarter, so what's the magnitude of order intake for ballast this year? And given the ratification, what would be your expectations for 2017? And, of course, on the scrubber side, maybe the same quantification of the orders so far this year.

Tom Erixon: Let me start with the Greenhouse thing. Now you should be aware that the Greenhouse initiative includes a carve-out of businesses. The reason we are not comfortable with the situation is that they have not managed to perform within our operating structure the way we normally run it, and so we will recreate those and restate the earnings in those companies when they come to the Greenhouse.

I would say for that reason, it's a little bit difficult to discuss about it in absolute terms, in terms of whether it contributes or doesn't contribute to our earnings, but our overall picture is that they are not supporting our bottom line in the current structure and with the current cost allocations within the Group, and we are dealing with that now. We will see as we go into next year what effect we have on the measures we are taking. But I think our expectations is that we will down the road here in the next year see some positive signs of improved earnings for those units.

Regarding -- then going to the ballast water, I will not guide you on our long-term expectations. What we've said before is that there will be a big retrofit market taking place in the ballast water area over the coming six years, and as the ratification and then finally the expected approval from US Coastguard presumably coming relatively soon for a number of the suppliers, we believe that the market will open up. The orders will be booked based on the dry dock service intervals of the individual ships so we don't expect a huge inflow of orders over the next five -- covering the next couple

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of years. We believe that they will be booked for us as we service those ships on an ongoing basis.

The number that we've been giving you earlier is that the total global merchant fleet that we expect will go for ballast retrofit is somewhere north of 20,000 vessels, and the average value of an installation that we are looking at is probably somewhere in the neighborhood of EUR200,000. How much of that will go to us and what those numbers will mean we will have to see, but those are, let's say, the market parameters as they have been previously defined.

There has been ballast water installations for a number of years. There is an installed base, and I'm getting the number here. It's SEK180 million year to date on the ballast water. There is no trend numbers in those. It's not reflecting the ratification or any change of the market structure.

For the -- and then finally for the SOx, the number was low in the quarter. I think specifically it's very low indeed. You might call it a zero. Again, not a big trend number. We've been doing SOx installation for a period of time and we will continuously, but we're not impacted yet of the expected legislation in this area so you don't see that in the numbers. Nor is it included as a specific part of our guidance for the fourth quarter.

Q: That's very clear. So just a clarification. I think that the ballast water sales in last year were somewhere around SEK400 million/SEK440 million. Could you just clarify that?

Thomas Thuresson: Orders were SEK400 million last year, full year, to be compared with the SEK180 million for nine months. And remember, in the SEK400 million, that included orders connected to two so-called frame agreements with large ship owners where most of these frame agreements were called off during the course of last year. We have seen a bit of a wait-and-see mode among ship owners because of the questions around US Coastguard approval, I would say, throughout this year.

Q: Firstly, on the marine and diesel orders for Q4, the flat to better guidance that you've given, can you just maybe give some color around where within the market you see sequential improvement? And is that just the Framo SEK100 million that Sven mentioned dropping out, or do you see segments improving? That's the first question. Thank you.

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Tom Erixon: Well, if you want to frame this question a little bit, you have to consider that the order backlog at the shipyards as we speak is somewhere close to two years. It's unusually small compared to where it normally is, but there is a backlog of ships that are being delivered. And that is the reason why the contracting level is more volatile than our order intake or especially our invoicing in this area. So the contraction of the order books for the shipyards as they deliver the backlog is affecting the way we take orders. We obviously have visibility on a number of vessels that are already contracted and are in the pipeline for being sourced when it comes to component and equipment, and it's on that basis that we make our forecast every quarter. We look at the ongoing projects and negotiation and make a judgment on what we think will hit our books during the quarter. There is one parameter which is, I would agree, of successfully winning those offers, and I think we historically are pretty good at judging our expected market shares for the outstanding projects. And the more difficult part of it is to judging the timing of when are actually those orders booked and down-payment being made. And that is the more volatile part of how we judge our forecast or forward-looking statement in the marine business specifically. And I think that gives you the answer for how we consider the fourth quarter. It's not reflecting any dramatically changing business climate or order rates as such. It's just our best estimate of where we think we will be on the order intake side come the end of this quarter.

Q: So the commentary reflects what you see being built out of the backlog by the ship owners.

Tom Erixon: Indeed.

Q: So beyond that then, looking into 2017, we've obviously seen the Clarkson data weaken further. Do you think your marine and diesel orders have caught up with that downward trend? And I guess asking it another way, the backlog for the ship contractors are still falling. Should we assume further downward pressure on marine and diesel orders for next year as a result of that? Thank you.

Tom Erixon: Well, I hesitate to give you a forecast and forward-looking statement on the marine division for 2017, so I think I'll hold on that. Thomas, do you want to give any clarity?

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Thomas Thuresson: No. I think I definitely agree. And remember, we have a lag when in between orders are placed with yards and orders are placed with equipment suppliers for their equipment. And of course, that is giving uncertainty for you as well as for us, but I think we should not provide any longer-term forecasts at this juncture.

Q: Thank you. And then finally on the Greenhouse businesses, you described it in the last answer as a carve-out. I know you're looking to improve performance, but if that doesn't happen, then do these assets at some point become potentially non-core for Alfa? Thank you.

Tom Erixon: We are not excluding that we are successfully finding a recipe for running this in a good way and somehow keep it in the structure. We're not excluding that we are simply not the right owner for these assets. It's great businesses but they haven't developed as expected within our Group. So at this point in time, we are open for what the conclusions are, but I think for me, this carve-out, it's equally important -- and I think this is important for you to reflect on as well -- it's equally important for us to get our fantastic global sales and service organization focused on the right product going forward as well as getting these slightly more, let's say, entrepreneurial businesses into a structure where perhaps they are not burdened by the big corporate entities. They are somewhat more local in nature; they are not very big in terms of service and spare parts. And for those reasons they can be run in a slightly different fashion than perhaps most of the normal Alfa Laval type businesses, and that's why we do it.

Q: Two questions on the strategic review. Firstly, should we expect anything more to come out of the strategic review, or was this the final announcement from your side?

Tom Erixon: I think you should expect some clarity on how we see our long-term business development, our long-term plan. And I must say, with all the importance we give at today's announcement, this is not the answer for the long-term shareholder value of Alfa Laval. The long-term shareholder value for our company is to continue to develop technology, markets, sales service. So I think you can expect further clarity on the long-term business side.

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The actions we are taking today I think are correct; they are necessary. They are partly consequences of the organizational decisions we took as well as on what we think is a cyclical downturn that at some point in time will come back to us. But I think we have some other dialogs to be had, but what I think you can assume is that we don't have in the plan to launch a second restructuring program. That's not where we are in our thinking at this point.

Q: And I'm sorry if I missed it, but on the manufacturing footprint part, firstly on the remaining SEK400 million in restructuring costs, how large part of that will impact cash flows? And then secondly, did you or can you give any guidance, what kind of savings to expect from the manufacturing footprint part?

Tom Erixon: We will -- I think the question has been up before. We will come back with how we see the paybacks and the benefits of what we're doing. I must say, from the way I look at the program and where we are right now, I'm very comfortable that we are building a competitive supply structure in some areas. This is an investment and not just a shutdown process. So I'm very positive as to where we are heading in this and we will get a fully reasonable payback on it.

There will obviously be write-offs of some assets and non-cash item related issues in these restructurings as we walk away from leasing agreements and maybe have some [obsoletions] in both the working process and in equipment, but I don't have the split of non-cash versus cash. Thomas, would you?

Thomas Thuresson: No. I think we will give you the details of that as we present every individual project, but as Tom says rightly, there will be a split between cash and non-cash effects. There will be redundancies involved that will cause cash out, but there will also be write-offs, as Tom just said.

Q: And I think lastly, Tom, when you joined, I think you said now in the beginning will not focus on acquisitions. You would rather do this strategic review properly. Now you're done to some extent at least, are you focusing more on potential acquisitions now, or is that still on hold?

Tom Erixon: I am incredibly focused on getting our new structure, our new way of working, the implementation of what we said we're going to do. I'm incredibly

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conscious about the fact that when we are saying goodbye to 700 co-workers of which 500 are white collar, and many working very close to the head office indeed, we need to -- if I was focused on that when I started, it's even more so right now. So I think that's important for you to know that we are fully aware that this is a -- the program as a whole is a rather extensive exercise, and the key is in execution and not in the plans that we have presented today. So we have a lot of work to do. With that said, and I said that all along, we have not taken a full time out in terms of acquisitions. There was a pipeline of acquisitions when I arrived. We're obviously looking at that a little bit differently; perhaps in timing in terms of what we are pushing, and perhaps in terms of priority based on the changes that we are doing. But there are valid objects there, and to the degree that you don't control the timing of M&A because there is also a seller involved, we have [not just down] our M&A department.

Q: Can I just start by asking you --? You guided, Thomas, for invoicing to be slightly higher in Q4 versus Q3, and you've said before that Framo sales should start to be coming down on a year-on-year basis in Q4 or the latter part of this year. Does that mean that we'll see only a very small part of that downtick and more of it going into 2017? Is that going to be very close to the year-end loaded so to speak? I'll start with that one.

Thomas Thuresson: Well, the expectation of somewhat higher sales in quarter 4 compared to quarter 3 is obviously for the Group as a whole. I did not comment on Framo specifically. There is no change if we look at the profile of the order backlog in Framo. It is the same as we've commented earlier on. We're starting to see the adverse effects on the traditional vessel pumping systems now at the end of this year. Offshore, of course, there we've seen a decline already many months ago.

Q: And that meant, of course, that you still saw growth for Framo sales in Q3 then, or --?

Thomas Thuresson: No, it did not.

Q: OK. It started to come down already in Q3.

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Thomas Thuresson: Yes. And as I say, offshore we've seen a decline for many months already, but we're starting to see the effects for traditional vessel pumping systems now.

Q: Yes. Sorry. I meant the [latter part]. OK. Thank you. And then one for Tom maybe. I don't know if I missed it or not, but have you said anything about the length of any sort of evaluation period for the Greenhouse setup?

Tom Erixon: No, we have not. We will make an informed decision as we go along, but we will not put a deadline as such on the process.

Q: All right. And then lastly on the non-disclosed further savings from the manufacturing footprint, could you at least say anything about when -- even though it's not disclosed today, when that will be hitting full effect those savings that will come out of those SEK400 million in charges?

Tom Erixon: Yes. What we are clear about is that we have not included -- we will start -- we are well prepared and we have an understanding I think for the timing in terms of the announcement that will be done and then consequently the start of the implementation processes that go with it. We have for good order sake not calculated and assumed that we will have any bottom-line impact in 2017. However, by 2019, we will expect to have closed this project, so you should expect to see a gradual effect from beginning 2018 into -- towards the end of 2019. That's the timeline we are working with.

Q: I have just a few questions left. On the Greenhouse, I just wanted to be sure that the remaining part, that outside of the -- inside -- outside of the Greenhouse, that you see as the core. So that's just this SEK1.5 billion that's here today and for the future are not seeing as your core.

Tom Erixon: Well, at this point in time, I'm not really using the terminology of core. It has not fared well within our operating structure. We've tried for a long time to turn the tide, and let's say that the patience was up at this point in time. We need to find a different way to deal with it and this is what we're doing now. We will as we either reintegrate or divest, or whatever the actions are, come back and touch base on the core. They're obviously not -- they were acquired most of these assets originally for

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good reasons. They have certainly a relationship to the type of customers and activities and distribution channels that we are working on. So in that sense, the separation is not totally without complications. I'll be open and say that. But it is not a sign that they are way off in terms of the scope. It's just that we are not getting the performance out of them that we expect, and that's what we're tackling.

Q: That's perfect. Thank you.

And then on the equipment, you had a very positive and solid development in orders in equipment. Could you just help us understand the areas that are performing well? You mentioned Russia that has really turned the corner for you. Any other areas?

Tom Erixon: Yes. For equipment specifically, we were on all-time high. We had a number of all-time highs in equipment division. It's going well this year, as you can -- we are very pleased as you can hear from all our comments. But I think from a sales point of view, perhaps the two things that I would point out very strongly is that China was really an all-time high for the equipment, and as we reworked distribution channels and reworked our e-commerce platform and all of that, I think we are starting to see a little bit of traction on that. The second part I would say is for the year a very strong development in the sanitary equipment business. I indicated to that earlier in this call that to a degree we've been having longer lead times than normal for delivery based on the fact that we are now investing in production capacity to meet the market which we feel is stronger than it has been for a period of time. So within the food sector, the large projects that you sometimes see have been scarce this year but the ongoing work on the equipment side has certainly progressed, and we have a great year on the sanitary side.

Q: Thank you, Tom, and just the last questions.

You mention that your lower process technology margin was partly due to the projects, larger projects. When do you expect these projects to be completed?

Tom Erixon: Thomas, would you like to fill out on that?

Thomas Thuresson: Yes. Well, I have to admit that in really two of the cases, deliveries have been completed, but we are discussing the way in which they've been completed in one case, and we have an issue with the financial stability in another case.

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And then the third one (multiple speakers) the customer, there we are still in final stages of completing the project.

Q: Just three quick questions; first, just to follow up on that last question with regard to your answer on food. If you could maybe give some color on the absence of the large orders; if there's a sub-segment or geography where you've seen that and why you think that's lower. And also, in the comments on process technology, you talked about strength and orders up in mid-stream on energy. Just wondering if you think that that's a one-of or if you see that coming back. And then the last is just ask for an update on the application to the USCG on the blast water equipment approval. I think they came back to you and asked for more documentation. Just wondering how that's going.

Tom Erixon: OK. On the food side, I think the common wisdom is that we do see long-term investment cycles on the food sector. So although as a sector as such the mega trends are all positive and over time we expect that area to grow, you see investment cycles there. And I think we've been through some positive investment cycle right now. It's lower. There's been reasonable capacity in many areas. So with that said, I don't see any huge trend there. I just see a certain swing between higher and lower activity on the CapEx side. And I think the sanitary equipment provides the basis for saying that overall there is a good stability and a good situation on the food. So that's how I see the [product] side. On the PTD, it's correct that we had a very -- you could say a very --percentage-wise a very good number on up-stream energy. We have said in previous quarters that our feeling at this point in time is that we are oscillating around a low number. We bottomed out we said in -- after the second quarter, and it's been a little bit lower now, a little bit higher.

The percentage number I think in some of the slides indicate 88 percent growth for up-stream oil and gas; I think that's a wonderful number. But as you know now, we are so low on the oil and gas side that it really doesn't create a lot of attention on the top line for the Group. But we see rig count being modestly positive; we see stability on current levels. We have said and we still believe that it will take some time until the capital investments are pouring into the sector, but we will expect that on current level or current level plus, it's probably a reasonable scenario going forward from a low level.

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Finally on US coastguard, no, I think that process goes well. I think we expect that today as well as the market is in need of clarity. Soon, the clock is ticking for completing the whole installation basis for the existing merchant fleet, and the longer the US coastguard holds back, the more difficult will it be for ship owners to make their decisions and for suppliers to get the supply line ready. So we do not expect a long extension of this period of time. That would be putting the whole industry in a very difficult situation.

Tom Erixon: And I think with that, that was the last question. Thank you very much for a good Q&A session and for your taking the time for our quarterly review. So thank you very much.

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