Alfa Laval Q4 earnings call
January 30, 2018
8:30 a.m. CET

Tom Erixon: Thank you very much and good morning, everybody. Let me start the Q4 report by giving a couple of comments on 2017 as a whole. It has clearly for us been a year where the business climate improved significantly compared to 2016, and specifically we saw that both in the marine industry and the oil and gas sector accelerating in the second half.

We also had significant progress and some impact on the restructuring program that was decided and launched in the end of 2016 carrying in with some effect into the 2017 results. We established new product plans and marketing strategies in our business unit structures, and all in all these measures together with a good market gave us a good growth of 14 percent year-to-date, perhaps I would say better than we expected when we looked into 2017 about a year ago. We also feel we have established a good product platform and lots of more work to do during 2018.

And with that, some reflections, as usual, on Q4 specifically before we go into the presentation. We had about SEK 10 billion in order intake, somewhat ahead of the guidance that we gave at the Q3 report. And I would say that the deviation compared to the way we looked at it then was the effects from a stronger tanker market than we expected, a good ship mix in contracting, and short lead times between contracting at the yards and booked orders, especially in the Pumping Systems.

On a divisional level, we were stable in our margins, but I still would like to point out the fact that Food & Water not only had a stable growth throughout the year and in the Q4 and also a solid margin improvement in the fourth quarter related to a reasonable degree to efficiency measures taken.

Thirdly, while we progressed a lot in our restructuring programs, we have, as you know, in 2018 a big part of the implementation of the manufacturing footprint project left to do. This has some impact on the CapEx level guidance that Thomas will come back to and it also will weigh in on our results for 2018 with approximately SEK 150 million. Thomas will be back to the specificity of that later on.

With that, let me go to the key figures and perhaps somewhat surprisingly, despite an order intake of about SEK 10 billion, we actually had a slight negative book-to-bill. We had a very strong invoicing of just above SEK 10 billion. As per the result that our invoicing in Q3, as you might remember, was on the weak side also according to our expectations, and we had a full catch up of any delays or lags from Q3 into the Q4.

So invoicing came out strong. And again, the SEK 35 billion plus achieved on the full year, perhaps somewhat above our expectations looking back with where we were about a year ago.

In terms of large orders, it's been a reasonable quarter. We announced somewhat above SEK 300 million and it's been mainly in the energy sector and actually a small sign of recovery even for offshore with an order booked in Pumping Systems for the North Sea. In terms of the highlights in the quarter, perhaps the environmental products is the most positive aspect where we had a steady growth both for ballast water and for scrubbers and a total booking of just above SEK 500 million for the quarter at the running rate of just above SEK 2 billion on a yearly pace. And that compares to about the SEK 1.5 billion pace that we have after the third quarter. So it's been a gradual strengthening in these 2 important areas.

Going back to the order trend as such, at the just below SEK 10 billion level, we are actually just slightly below our all-time high in Q4 2014. So it is comparing to all historical quarters, a good strength. And as you can see, while we do have large orders booked, it's not dominated by that effect. It is actually a quarter that's been characterized from a very strong base business across a lot of areas.

In terms of the margin development, it is as usually stable. We remain at 15.9. However, the profit in absolute terms, given the strong invoicing, came out well. Factors affecting the margin as such -- certainly a negative effect from mix. We invoiced a lot of projects in the fourth quarter, so there was some negative mix effect and that counterbalanced by a very good productivity development, both in sales but certainly also in the factories.

With a strong quarter, obviously the year-on-year comparison on a business unit level is pretty much positive across the board. As we've indicated already in Q3, we have a pretty broad-based positive development across our businesses. There are a few negatives on the chart. The Greenhouse is slightly negative versus last year entirely due to restructuring in the U.S. and the closure and divestiture of one of our businesses there. Otherwise we are flat to positive.

We do have a negative on Food Systems, but we should remember that Food Systems as a whole full year has a very solid growth and a very good year. So it is not a trend this year as such. It's a quarterly issue with some volatility due to when we book large projects. And thirdly, the Energy Separation unit is a bit weak and it is maybe the one area where we feel a bit disappointed with the development given the strengthening of the oil and gas business as a whole. However, it is a relatively small negative in the totality of things.

Let me move on to some divisional comments in further detail, starting with energy. We had a good year, solid year for Energy. We are plus 10 percent in order intake and there are mainly positives in Energy. The one I'd like to highlight perhaps is in the Brazed & Fusion Bonded Heat Exchangers; that is an OEM-driven business that's been on a steady growth path for quite some time now. As you know, we're working with capacity expansions to meet the demands and that's going according to plan, so fourth quarter, again, stable organic growth from this unit.

Otherwise, perhaps the most interesting reflection on the Energy division is the oil and gas market and what it has implied during 2017. All in all for 2017, we booked slightly above SEK 5 billion in orders and that is an increase versus '16 of approximately 30 percent. So we've seen a relatively broad recovery in the oil and gas market and a clear effect of the increased oil price on our order bookings, not the least in the U.S.

We, as you know, when we highlighted it about a year ago when times were tough, we knew what we did when we invested into oil and gas. We've been sticking to all our structural and capabilities in the oil and gas market waiting for the comeback and certainly we see an element of payoff on that in the year and not the least in the fourth quarter. For your reference, at the peak, we were at approximately SEK 8 billion in order intake. For this year, we were at about SEK 5 billion. The pace in Q4 was at around SEK 6 billion. So the trend remains positive in oil and gas, and it's been -- all-in-all with some variations across segment a good year for oil and gas.

Let me turn to Food & Water. As indicated, we had a solid year in Food & Water. Basically, across all applications, we've been having a positive environment, the positive demand trends, and that together with a good margin improvement in fourth quarter makes for good year in Food & Water. The one area that is contributing specifically is a lot of the work that we've been doing related to project execution and project selectivity in the Food Systems area. And I indicated already earlier that we feel we are coming to grips with part of the costs in product execution from the past, and at least in Q4 we could realize a good gross margin on the projects that were closed at that point in time, so a good progress in that area.

On to Marine, the contracting of ships landed as a whole, pretty much were the forecasts were -- have been at least for the last 6 months, somewhere up at around 900 ships. We don't have the final numbers quite as of yet. That was not a particularly big surprise. What was a bit of a surprise to us was the strength in the tanker market in the second half of the year and certainly in Q4. And that, combined with the fact that the lead times between tanker contracting at the yards and booking predominantly in our Pumping Systems business was unusually short made the order intake effects in Marine for the quarter coming a bit higher than we expected. All in all for Pumping Systems that means that the year ended with a 70 percent growth in order intake compared to the weak 2016, a healthy recovery of an important business for us. And at this point, I just ask you to keep in mind that the lead times we have between order booking in Pumping System and actual deliveries tends to be a year or year plus. So the main effect of the strong order intake at the end of the year will not be seen in the invoicing until we hit 2019.

A quick review on the Service situation in a somewhat busy slide, but it gives you the overall situation in Service. This is an area where I have to say we are not entirely happy with the outcome of the year. All in all for the group, we are the odd percent up for the full year versus '16, but is not exactly where we'd like to be in terms of the long-term growth of our Service division. It did grow well in Food & Water where we met our objectives well, and we are up in both the year-on-year for the full year and on the quarter, the sequential (development) is marginal issue. So all in all we are happy with the outcome of that. As you know, we've been impacted by the marine sector problems in the Service business already last year. It is flat to positive sequentially, but we haven't seen a recovery in the service business in Marine. It stayed stable during these years, but we haven't seen the growth yet. And same holds true for Energy where we are pretty much flat on the year, but comparing with the quarter and looking at it sequentially, we are down. The numbers are affected by non-repeat. We at times have large service order bookings in the order of magnitude of EUR 6 million, EUR 7 million and we didn't have it this year, so there is a non-repeat. But nevertheless, even if we overlook that, the growth in our Service business as a whole for the group is a bit below our expectations. We are, obviously, working without question in management.

The Greenhouse, as indicated, we are on track. The business development side of that is stable. The underlying earnings for the Greenhouse is on the range of 4 percent, 5 percent, where we wanted it to be year-end, so we are on that target. We have some distorting items, so our shown numbers is marginally lower than that, but we are pleased with where we are in terms of executing our Greenhouse plans.

Let's turn to the regions for a few comments. Obviously, with the order intake we have, sequentially it looks pretty good across the board. We are positive essentially in all areas. We have a small negative in North America. It is actually a positive for the U.S. sequentially as well, but we did have a very, very strong order intake in Canada in Q3 that was not repeated. So that gives you the explanation for the minus 2 percent. Other than that, it's a very solid situation across the board.

We are perhaps not fully happy with the development in Latin America. It's a little bit below our expectations, and we haven't seen the pickup that we expect to happen there. So that is a bit of a weakness on that on Q4 and '17 as a whole. And then obviously, the big strength is coming from Asia, no surprise. And you may know that in fourth quarter 40 percent of our order intake came from Asia. Clearly, the ship side has contributed to that number. But it is not only the ship side. Energy has been having a great quarter in China and a great year in China, and we see generally a positive picture of our business and how it develops in Asia in the fourth quarter.

And with that let me turn to our top 10 markets. I think when you look at that picture, the first thing you got to observe and reflect on is Korea. Korea is back, is my comment. It used to be our number 3 market. We had a very difficult situation in Korea in 2016 on the back of a troublesome shipping market in Korea. So we lost 60 percent, 70 percent of the pace of our order intake within a 6-month period, and it's very nice to see that we are on a strong comeback in Korea in 2017 as a whole.

Then, of course, our two biggest markets are growing nicely, China and United States. And, again, I emphasize the Chinese growth is actually not primarily driven by the Marine side. It is impacted by other parts of the business, specifically the Energy side, also supported by couple of large project booking that happened in 2017. The only country on the top 10 that has a slight negative is Japan. We haven't seen the Marine effects in Japan yet to the extent that we have in Korea and all in all it was behind in the beginning of the year, so I think we are more or less or par towards the end of the year now, but that is the one small decline. Otherwise, all our markets are slightly positive and in a broad-based growth scenario.

So that is my review on the quarter, a few comments on the year. And with that, I'd like to hand over to Thomas for a financial review. Thomas?

Thomas Thuresson: Thank you, Tom. Good morning all of you. As we typically do, let's move on to a couple of comments about sales as Tom has covered orders. Let me start off by reminding you that after quarter 3, I commented that we believe that a higher invoicing should be expected in quarter 4 compared to quarter 4 a familiar seasonal pattern. As you have seen, we realized sales of SEK 10.1 billion in quarter 4. In comparison with quarter 3, that was an increase of 21 percent and an increase year-on-year of 5 percent. In terms of the invoicing, we clearly ended up somewhat above our own expectations. We actually delivered everything promised for 2017 in 2017, including the shortfall that we reported in quarter 3 due to delays in delivery and revenue recognition.

If we move onto Service, the service activities represented 28.7 percent of total revenues. This was a decline sequentially of 2.5 percent and a reduction year-on-year of 1.3 percent. So this alone of course is giving a negative mix effect sequentially as well year-on-year for the margin.

Let me then before leaving sales, deliver the first forward-looking statement. We believe that a lower invoicing should be expected in quarter 1 compared to quarter 4; again, what I would call a familiar seasonal pattern.

Then let's turn to gross profit margins. We reported 36.3 percent as gross profit margin in the quarter, an increase of 2 percent year-on-year and a decrease sequentially of 0.7 percent. Let me then come back again to what I said 3 months ago.

In the near term, we expect adverse effects from mix following expected higher capital sales revenues. We expect continued positive transaction effects from FX. Load is foreseen to at least remain on the current level on the back of the increased order levels with a caveat for the effects of Christmas and New Year.

I would say that the actual means that gross profit margin came out somewhat better than our own expectations. The main reason being, as Tom has already alluded to, a better project execution in Food & Water. For some further comments, let's move on to the next slide.

Year-on-year, we were benefiting from a better mix representing better project execution in Food & Water and also a good margin development in Marine given the mix that we've had. Better load in many of our factories than a year ago. We enjoyed positive FX transaction effects. However, the purchasing variances, they were turning marginally negative following the development of prices for certain metals.

Sequentially, we were suffering from negative mix effects between after sales and service and capital sales as well as in some areas within capital sales, and of course marginally negative purchase price variances as I just mentioned.

Before leaving margins, the second forward-looking statement. In the near term, we expect adverse effects from somewhat higher metal prices. We expect positive impact from increased after sales and service share of total revenues. We expect FX transaction effects to be very limited, and load is foreseen to remain on the levels from quarter 4.

Then let's move further down the P&L and look at the development of overhead cost. To begin with R&D, ended at SEK 256 million. This is an increase year-on-year like-for-like of almost exactly 10 percent and the usual increase in quarter 4 compared to earlier quarters as we predicted 3 months ago, of course, occurred as well.

In percent of sales, R&D represented 2.5 percent. If we look at the full year, we had an increase in R&D of 5.3 percent, again expected in order to support the increased efforts in certain product groups. Sales & admin, we ended in quarter 4 with SEK 1.552 billion, representing an increase like-for-like compared to '16 of 4.2 percent. This increase is more than explained by increased activity level and salary inflation. It must be noted at this juncture that the number of employees in S&A is flat from end of quarter 3. That is to say the underlying benefits from the change program are retained.

Let me then move onto other cost and income. We came out with a large negative net in the quarter, a negative SEK 245 million. This is partly explained by costs related to the changed program and partly due to an accounting flaw in Alfa Laval India. Going forward, as mentioned already at the Capital Market Day, you must anticipate an increase in other cost of income of some SEK 150 million in 2018, and this relates to revenue investments for the change program, mainly the footprint activities.

Then moving further down the P&L, profit before tax ended at SEK 1,358 million, an increase mainly explained of course by improved performance and somewhat reduced by FX differences in the financial net.

Taxes ended with a charge of SEK 297 million. This is a relatively low level. This is partly explained by a one-off effect of the U.S. tax reform of some SEK 29 million. If we look at taxes going forward, you can expect a lower average tax rate for the group to the tune of at least 1.5 percent, thanks to the just mentioned U.S. tax reform. EPS finally ended at SEK 2.52 against SEK 1.46 a year ago and of course the better performance this year and the non-repeat one-off charges last year are the explanations.

Finally, the returns on capital employed and return on equity continue to move in the right direction. They were ending 17.7 percent and 13.9 percent, respectively. We are getting closer to our return on capital employed target of at least 20 percent.

Then a few comments on reorganization and capacity adjustment program. Since the end of June 2016, we have reduced our headcount with 942 FTEs. Of this reduction, some 800 FTEs are attributed to the program and the balance of course has to do with regular adjustments of capacity and other ongoing changes. We are, to conclude, very well in line with our planning from the fall of 2016.

As for savings, we realized SEK 100 million in the quarter and we are now at the pace annualized of 80 percent in relation to the target of SEK 500 million, so again, very well in line with the plan. For S&A the program was completed already last quarter as commented. For footprint, part of the program have been implemented. We have delivered relatively limited savings in this part, but it is ramping up, again, as expected and planned. We maintain the target for completion of a reduction of 1,000 FTEs and savings of the SEK 500 million which will be reached in the early part of 2019.

Then a few words on divisional performance, remember the 2016 numbers. They are of course pro forma, so we are comparing with pro forma due to the reorganization from January 1, 2017. Having said that, Energy came in higher than '16 thanks to better volume and despite a worse mix and somewhat higher overhead costs.

Marine ended far above last year mainly due to good gross margin in general and of course the non-repeat of the one-off charge for certain product deliveries that we had in the end of 2016. Food & Water came in better, very much thanks to better project execution as we mentioned already earlier and despite a worst mix and slightly higher costs.

Now cash flow. Cash flow from operations ended just under SEK 1.6 billion, a decline of some SEK 350 million year-on-year in the quarter coming from more taxes paid and an increase in working capital. Of course, the increase in working capital is of course due to the increased level of activity in our company as a whole, so a negative because of something very positive underlying, the growth that we've enjoyed in terms of orders. And then, of course, we had a compensating factor, the higher profits we generated.

CapEx, slightly above last year at SEK 282 million, financial net slight positive. Free cash flow just over SEK 1.3 billion, about SEK 0.5 billion less than quarter 4, but largely for very positive reason as I just mentioned, the increased level of activity. As far as indebtedness is concerned, we ended the year at a debt-to-EBITDA of 1.31 compared to 1.81 a year ago, so a very good level of deleveraging. I think I'd like to say that now we have really absorbed the SEK 14 billion acquisition from 3.5 years ago.

Then before I end my comments on cash flow, let me give you 3 items that you need to consider when it comes to cash flow for 2018. Expect CapEx of somewhat above SEK 1 billion. This is in line with the data as I provided at the Capital Market Day.

There will also be a cash out due to repayment of the tax credit that we've enjoyed in Sweden. We are forced by law to release risk reserve in our captive insurance company, and that will mean a cash out of SEK 200 million in '18, one-third of the total tax credit that we've enjoyed. This will not have any P&L effect.

There will also finally be cash out from restructuring provisions related to the footprint projects of a couple of 100 million.

Let's then move onto FX. In the quarter, we had a positive SEK 33 million only of FX effects, an outcome slightly better than expected, and translation was negative in the quarter exactly as anticipated, is of course a reflection of the weakening dollar. Looking at the projection for 2018, it must be noted that we expect only very limited -- we expect a limited negative transaction effect, which is then a combination of favorable hedges that we have done and an adverse effect from the weakening U.S. dollar impacting the open exposures. We do not foresee any translation effects compared to '17 at this juncture.

Moving on to backlog, as per the end of '17, we ended with a backlog of SEK 18.3 billion representing 6.2 months of LTM sales, a slight reduction due to a book-to-bill below 1 in the quarter, due to the high invoicing -- we had a slight reduction over end of September. If we look at shipments in 2018, the backlog amounted to SEK 13.9 billion. This means an increase of SEK 1 billion compared to the starting point that we had going into 2017. Having said that, let's look at a bridge from whole year sales '17 to whole year sales '18.

We start off with the SEK 35.3 billion achieved in '17. Again, we have a better backlog, current backlog going into '18, so we're adding SEK 1 billion. We're not expecting any translation effects at this juncture. We are not having any acquisitions to consider at this point. That gives us a sub total of SEK 36.3 billion.

There are 2 unknowns as always to consider -- the level of in-for-out orders in 2018, how will that develop compared to what we actually achieve in 2017? We achieved in-for-out orders of SEK 22.4 billion in '17.

And then finally, of course, any price effects to be considered. We have, as we traditionally do, we have made small adjustments to prices for standard products at the beginning of 2018.

And then finally, dividends. The board proposes a dividend of SEK 4.25 a share, the same level as for the 2016 and entirely inside the guidance of 40 percent to 50 percent of adjusted EPS, to be more exact 48 percent of adjusted EPS.

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

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Tom Erixon: Thank you, Thomas. Let me then turn to the forward-looking statement. And before going to that, let me then say that in terms of -- to give you some context, we've experienced a favorable and positive business environment in 2017. We don't expect any change to that situation coming into the first quarter of 2018. We do recognize in our forward-looking statement that the strength of the tanker market where we saw a significant effect in Q4 on Alfa Laval's order intake will not likely repeat itself in the first quarter. Considering though – on top of that we see order intake that came in very high in Q4 all-in-all compared to historic level.

So given the context of that, our outlook statements are as follows -- for the Marine division, we expect a lower order intake than in Q4. For the Food & Water, we expect a higher order intake and for the Energy division a somewhat lower. So that all-in-all for the group gives an outlook for this first quarter of a somewhat lower intake compared to the Q4 of 2017. That was my first forward-looking statement.

I had a second forward-looking statement at this point in time. As you know, this is the last quarter that Thomas and I are closing together and Thomas will retire from Alfa Laval after 25 years as CFO. He is not only the longest-serving CFO in the Swedish Stock Exchange; he is also one of the most prominent and best CFOs that we've been having. He has a unique ability to put the company first always. He has always done so and he has had significant impact on how the company has developed. He's been a tremendous help for me during my first 2 years at Alfa Laval. Thanks very much.

Thomas Thuresson: Thank you.

Tom Erixon: And you owes him big thank you, you, as well, you guys.
OK, questions.

Q: Yes, hi, Tom and Thomas. It's Klas from Citi. First on the guidance, I appreciate that we're coming off a high level here in the quarter and we have some seasonality. But Separation & Heat Transfer in Marine is yet to improve, which has longer lag versus contracting. And then we're yet to see the impact from higher activity in upstream in oil and gas. So is the somewhat lower guide, is that entirely explained by the mix that you think will get worse from here in the short-term for the Pumping Systems coming from a high level, or is it something else, so yes could we get some more color on the guidance there?

Tom Erixon: I thought we were usually explicit on our forward-looking statements -- we don't have a crystal ball. We had a good outcome in Q4. We gave a sequential guidance, and so I've given the reasoning for the judgment that we're making in the various areas. As indicated, we are already quite high on the -- even if you take the oil and gas side, yes, sure, there's potentially some upside, but we are already at 75 percent -- Q4 on the 75 percent of the peak, and I think we have certainly not expected to bounce back to that historic level. I think we indicated all along that even in a recovery, we may not be at the full level that we were at the peak. So I would be somewhat cautious to change. I don't think we had a reason to change that viewpoint today. I think we made that comment all along. I think we've come a long way. There's still some to go. Whether we see that in Q1 or not, I think let's leave that as an open issue.

Q: Tom, the reason for asking is that obviously I appreciate how you guide in terms of Energy to be somewhat lower on the back of lower larger orders. But I'm thinking about Marine because we have the 12-month lag in Separation & Heat Transfer is that's a longer lag versus the Boilers and the Pumping Systems, but you don't expect that within Marine to basically start to impact positively in the first half?

Thomas Thuresson: But, to begin with, maybe talking about the year of lag is to extend it beyond what we normally say. We normally say 3 quarters for the traditional Alfa Laval product. But you have to remember that we had an extraordinary situation in Pumping Systems where we in fact had kind of a negative lead time for orders. We got the order before the hull had actually gotten a number, so an extraordinary situation in December and, of course, there is a lag. We had orders in the last month of 2017 over 100. So that's a very high level and, of course, that indicates a certain amount of lag. So, hopefully, we will enjoy some of that as we get further into 2018, but we've certainly seen a strong recovery in '17 from the increasing contracting already.

Q: My second one is also Marine, and just to understand what happened to the revenue recognition in the quarter and on the margin. Obviously very strong. And how much was this owing to the slower recognition coming back versus new invoicing if you like? Obviously Pumping Systems sees very strong growth in orders but those deliveries I thought would come through more in the second half of '18 and you also highlighted that a mix within Marine sending the margin to these levels. So, Thomas, could you explain a little bit what happened in terms of revenue plus the mix there as sending up the margin (here to) 19 percent?

Thomas Thuresson: Well, remember that we had a very big one-off in 2016. Compared to 2016 is not really relevant, but certainly a good level. And I think the Marine organization has done a good job in defending both their position as well as prices. We have to remember that we've seen a big increase in steel in China towards the latter part of 2017. I think our organization has done a good job when it comes to compensating, but we will see effects of the increased steel prices in the Chinese production going into 2018.

Q: OK. My final one is on Energy. I'm thinking about revenue recognition and mix for 2018. The mix was a bit weak now, and it was positive last quarter. So if you could explain a little bit the moving parts there and then for 2018 mix within capital sales, I think when we were speaking before, Thomas, you said that most of the larger orders in Energy in 2017 will be invoiced in '18 and that these orders carry a solid margin. Should we expect a mix in Energy to improve here going forward?

Thomas Thuresson: You will inevitably have variations between quarters because of differences between individual contracts and to some extent between different applications and different industries. And you will see variations also going forward. There is no definite trend in either direction as far as margin content in the backlog is concerned. But there will be variations between quarters also going forward.

Q: But the larger orders for invoicing here, particularly in oil and gas, still has the same gross margin, right? I mean there has been a mix effect down to the margin. So it should be a mix effect up to the margin; is that correct or ...?

Thomas Thuresson: We do have a margin that we are happy with and that we consider healthy in the backlog that we will have. And as I said, you will see variations between quarters. There is nothing specific to report as far as the margin going forward is concerned. Here we'll see 3 months from now, 6 months from now and so on.

Q: Very good. Thank you.

Q: Yes, good morning, from my side especially to Thomas. I have 3 questions. Maybe we can take them one by one. The first question relates to the other line, which was quite inflated in fourth quarter and you mentioned in the quarterly report there were increased activities within the change program. So does that mean there were extraordinary expenses booked into the other line that you obviously did not adjust? And you said also the kind of related to the SEK 150 million you're going to have then obviously in 2018. That's my first question please.

Thomas Thuresson: Yes, I mentioned 2 specific items in relation to other cost and income in my short presentation, 1 was costs due to the change program. So clearly things that you cannot take as a one-off charge according to IFRS. They are revenue investments. So that's part of the high level. The other one was an accounting flaw in Alfa Laval India that influenced with some SEK 40 million in the quarter. If we take a different perspective of other cost and income, we have over the years reported some SEK 450 million, SEK 500 million per annum, so an average per quarter of negative SEK 100 million plus. On that basis, you should expect an increase in net other cost and income for some SEK 150 million in '18 and that is due to revenue investments in the footprint program.

Q: Understood. Second question probably for Tom. Good morning. It's on the service side and your commentary from a divisional point of view, I was just wondering, especially on the Energy side, there is no pickup in the service activity, rather a small decline. Has that got to do with the fact that maybe during the oil price downturn there was more activity on the service and now that activity is picking up again, oil prices are picking up again, there is less time reserved for service or is that completely the wrong direction where I'm thinking here?

Tom Erixon: No, it's a good and relevant question. I would say the facts -- I know what the facts are when it comes to Q4. We did not see a specific pickup in the oil and gas service related business and that goes a little bit against perhaps what we expected because given that there was equipment out in the market when the downturn came, we -- I think our hypothesis was that we would perhaps pickup on service side and refurbishing reconditioning work prior to seeing any particular growth on the capital equipment. That's in fact not what happened in Q4. I'm not sure what conclusion to make out of it when it comes to let's say Q1 and 2018, but that's where we are. I think you have an interesting question. We ask ourselves the same thing. I might be able to shed some more light on that after Q1, but I'm not sure what the logic is behind this.

Q: OK, understood. And the third and last question is just with regard to the M&A, I think you said on Reuters that you have plenty of ammunition to carry out acquisitions. So I was just wondering where we currently stand on that and just maybe repeating my question from Q3 on that and also if you don't find anything big in the next 12 months, what's your view on using the cash would be?

Tom Erixon: For the time being, we still have a significant net debt. So I don't think while we do have also cash, we still have some debt that we can bring down to good level. In this situation, I would say like this. If I were you, I wouldn't panic in a situation where we strengthen our balance sheet, at the same time as multiples in the acquisition markets are on a record level. So in that sense, we are biding our times. We are working with the pipeline. We have dry powder and that's going to increase. So I think over the next 12 months, I don't see an issue around that. Of course, if we see this situation, over the next 3 to 4 years, I think the question at some point in time obviously will come on the table. I realize that too. But for now we are working with the pipeline. There are activities going on. I think we honestly have to say that the work that we've done on Greenhouse, on strategy, on restructuring has taken a little bit of focus off from the M&A pipeline and that is not by strategy; it's a consequence of what we're doing. We have to recognize that, but we are of the mindset that there are opportunities for us in all our 3 divisions and maybe with some emphasis towards the Food & Water side as we go forward.

Q: OK. Thank you, both.

Q: Yes, hi, Thomas, hi, Tom. First question was just on -- I guess for Thomas -- is just on FX. It was just when was that guidance set? Did you do that on end of December rates. That was question number 1.

And the question number 2, I guess more for Tom, you've done 19 percent margins in Marine now. We hear about, to peak, it’s – we’re still some far away, but next year you're kind of looking for invoicing it sounds more or less flat. How do you think about that business now? How do you think about that margin? Do you think that 19 percent reflects where we are in the cycle, or do you think that because of the mix with Framo, there’s uplift to that margin? Just your thoughts about that will be interesting going forward.

Thomas Thuresson: I didn't quite hear your question about the FX, but I think you asked when the guidance was given on the FX. And the most recent before today was, of course, the Capital Markets Day where we indicated numbers in the same ballpark as we actually came out. And obviously, with the weakening of the U.S. dollar, we do see a change and we're getting headwind from the FX going forward.

Tom Erixon: On the question 2, what we can share in terms of where we are is a couple of facts. Looking into 2018, we don't expect that the invoicing for Pumping Systems will change dramatically. I think that's an indication we've given before. So the pickup that we had specifically in the second half is more an ‘19 effect than an ‘18 effect. When it comes to the margin development in Q4, as Thomas was onto in Marine side, it was a result, leaving the one-off aside, of an effect of the good control in operations and their strengthening, and generally speaking, a slightly stronger gross margin than we had a year ago. Obviously, you could say that the product-by-product that is not likely to dramatically change. I don't have any prediction for change on that as such. In Q4 it was what it was. I think the one aspect that will affect the way you calculate your margin is the fact that as order intake increases in all parts of our capital sales business in the Marine side, obviously the share versus the service sales, even if service will see a better development, if it would in ‘18, you will see that part may be pushing downwards. So there are various factors at play here, but we don't see that we are structurally changing the underlying profitability per se in any particular part of the business.

Q: (I got that). Thank you, Thomas, Tom.

Q: Good morning. Thanks very much, gentlemen. Couple of quick ones. The margin development in Energy, we've obviously talked a lot about Marine at the moment. I wondered if you could just talk a little bit about how that develops through for Q4 and also into '18? I wondered if you could make -- just clarify your comments on pricing. I think I slightly missed, Thomas, your comments in the bridge. And then just on in-for-outs, am I right in thinking that that grew about 10 percent last year and would it be fair to assume that momentum continues in '18? Thank you.

Thomas Thuresson: When it comes to the Energy division and the margin generated, a decline of 0.5 percent year-on-year as you've seen. We of course enjoyed a positive volume effect but a negative mix effect having to do with what we actually recognized for revenues in the quarter and delivered. And then we had a cost increase in Energy year-on-year as you also saw for the company as a whole.

When it comes to pricing, we have adjusted prices for standard products and standard components at the beginning of this year as we normally do, and that is of course on the back of the uptick in prices, not least for certain alloys during the last several months. As far as in-for-out is concerned, we did enjoy an increase in in-for-out ‘17 over ‘16. I mentioned to you that we realized SEK 22.4 billion of in-for-outs in ‘17 and it's, of course, your judgment, will we see a continued strengthening of the demand. Will it again be positive for ‘18, will it be flat, or do you have a more cautious view and anticipate a decline. That's your call.

Q: OK. Thank you.

Q: Just first question for me is on the environmental businesses. So you said you did about SEK 500 million as I think orders in Q4. Could you just clarify, is that just the SOx and ballast water equipment, or is there also the sort of waste oil recovery in there when you talk about environmental? And could you give a little bit of color also on sort of to what extent the environmental business or environmental orders that you're getting is retrofit versus new build and how roughly that splits with that SEK 500 million?

Tom Erixon: The SEK 500 million plus, that is, as you indicate, only the business we do in PureBallast and SOx and scrubbers. There are, of course, other applications that you could label environmental products in a fairly broad application span, so let's not go into that. These 2, on the SOx side is SEK 300 million plus and on the PureBallast water is about the SEK 200 million plus. As you've noticed, given the concern in the market after the delay on the ballast implementation from ‘17 to ‘19, in fact the ballast water implementation has continued on a steady pace despite that. We see on ballast water a clear demand for Alfa Laval solutions for the new build, and we also see the retrofits coming in. On scrubber, I think the vast majority is certainly retrofit, but of course it's a mix of both. I don't know for a fact that we are going into the detailed splits here in how it goes, but both are in play, let's put it like that.

Q: And just secondly on this business. Obviously, I mean, we'd expect this to continue to grow sort of quite nicely given the regulation that's coming in. Could you give a little bit of commentary around how the margins work on this business, how they compare perhaps relative to the Marine division or the group? And maybe just talking specifically about just sort of SOx scrubbers because we've talked about the JV in ballast water which obviously makes it lower margin, but if we can talk about the margins on SOx scrubbers and how you think those compare versus group?

Thomas Thuresson: Well, the current level of gross profit margin for capital equipment for these 2 products is well in line with the average for capital equipment in the Alfa Laval group as a whole. So there is no adverse mix impact from these 2 products at this juncture if we look at capital sales. But there is, of course, an adverse impact on net operating margin, on EBITA margin as we are kind of in "giving away" half of the net to our joint venture partner. The way we operate this JV is that we are doing all of the sales in Alfa Laval, we’re handling the supply chain and the profit is shared with our joint venture partner. So there's a negative on one specific line just before EBITA in our P&L, as specified. So, no impact on gross margin, adverse impact on net margin from ballast water.

Q: Just the final questions more just a sort of confirmation. You mentioned the sort of accountancy issue in India costing SEK 40 million. Could you maybe just first for sort of our comfort give us a couple of lines on exactly what happened there? And how confident you are that you've sort of drawn a line under this issue, because obviously we've seen some other companies in the sector where some accountancy issues have dragged on a little.

Thomas Thuresson: Incorrect accounting treatment of revaluation of investments of surplus cash. So, it should have gone into other comprehensive income, but it was taken into the P&L above the line, so to speak, in quarter 3 and of course that had to be reversed in quarter 4. So, it was too good in quarter 3 and it's consequently now worse in quarter 4, but that's the end of it. Our Indian colleagues, they know where to account for revaluation of investments of the surplus cash now. So, we don't worry about it, not at least in the near-term future.

Q: OK, great. Thank you very much, Thomas.

Q: Thanks. I want to come back to raw material prices because you have mentioned several times now that the steel prices are up and that will impact you going forward. So maybe if you could elaborate a bit about the sensitivity you have to raw material prices and what kind of headwind we could expect in 2018 based on current price levels. Are we talking about billions or only couple of hundred millions or what are we talking about?

Thomas Thuresson: We are definitely in a range below the lower amount that you mentioned, at this juncture. And what I was particularly referring to before was the cost development we've seen in China over the second half of 2017. I think our colleagues in Marine, they've done a good job to reflect that in their work with quotations during the second half. But no doubt, we will see effects in cost of goods for the products that we manufacture, for instance, in our plant in Qingdao.

Q: And that was actually my follow-up question. Do you think that you will be able to offset headwinds through price increases -- selling price increases?

Thomas Thuresson: Well, we have a responsibility as a market leader and I think we have demonstrated it historically that we have such ambitions, and we also managed to push it through. So that's absolutely what we have in mind and what we believe we can do also in this situation.

Q: And then on the Energy division, orders grew organically by 1 percent in the quarter and looking at the 4 different product areas, it seems to be Energy Separation that is tracking down the organic growth for the whole division because all of the other are either flat or up in the quarter. So could you just elaborate a bit what area of Energy Separation goes …?

Tom Erixon: … I think you are going into the dilemma of the more you dissect the product lines and markets, you eventually will find a minus somewhere. And I think all-in-all for the division, the full year is a solid 10 percent growth. I think it's a very significant improvement of the order intake compared to '16, which is not only an oil and gas effect but in fact a pretty good performance across the board. A number of our businesses, specifically in Energy, is driven by large projects. And consequently the occurrence of those in various areas affect the order intake a lot. I would say on Energy Separation, we didn't see any large projects being booked in Q4. So that creates a negative number. But I wouldn't make the issue larger than that.

I think in terms of volatility and I've said that before, the one area where you may want to be focused on from that point of view is on the welded which is also very much driven by large orders. A big part of that was booked on the large Chinese project that we announced in the beginning of this year in a number of instances. And so the comparability of the numbers in some of the units in Energy -- I think there will be volatilities without us drawing huge strategic conclusions at every juncture.

Q: I'm sorry. But according to the report, it says that the decline is due to lower demand in the base business, so that's why I was asking. But maybe I misunderstood.

Thomas Thuresson: Base is up to EUR 0.5 million orders and EUR 0.5 million orders is pretty sizable for a business like Energy Separation.

Q: OK. But just Energy Separation, what does it go into? Is it separate oil from -- of the particles of what is the main end markets for energy separation?

Thomas Thuresson: It's cleaning of lubrication oils, it's preparation of fuel oils for engines as large applications, they're used in gas turbine plants -- energy power plants. There is a long variety of applications. Generally in manufacturing industry, as I just mentioned, for cleaning of lubrication oils, for cleaning of cooling liquids and other ones. So there is a large number of different industries where you actually apply these separators.

Q: I see. OK. Thank you very much. And thank you for all those years, Thomas.

Q: Thank you for taking my questions. I have 2 quick questions. First one would be on Marine. You mentioned already that there is -- was a significant change in the order pattern, so we had significantly shorter lead time. Should we expect this pattern to continue or do you expect the order pattern to reverse to the old pattern? And my second question is on Greenhouse and what we should expect there in 2018?

Tom Erixon: I think on the order pattern, we can't give you a -- in principle we would expect the order patterns to stick to the historic level. Of course, there might be some effect. The reason for high bookings towards the end of the year is partly that lead times are shorter at shipyards right now. They have a shorter order book. The prices that you can book at the shipyard with shorter order book have been favorable, so eventually a number of ship owners decide to make a move and that is what's happening in the end of this year. Maybe that had some effect also on the speed of booking some of the orders with Alfa Laval, but in principle we were a little bit surprised in Q4. And I think it would be too early to say that there has been some structural change on that side. I would stick to our normality when it comes to the order cycles.

Thomas Thuresson: You had a question about Greenhouse going forward as well, and we spelled out that we want to bring these activities up to kind of market standard, if you like, as far as operating margin is concerned. And then that is somewhere between 6 and 8 percent. So we still have some way to go to improve these activities. We gave ourselves 2 years. We are a bit more than half way into these 2 years. And eventually when we are happy with the work done, then we will conclude on how to take this forward.

Guys, I think we are running short of time because we have a further appointment very, very shortly. I think we have to stick to 1 more question. Who's next?

Q: Hi, guys. I’ll keep it short. Thomas, 25 years now as a CFO. Well done, very impressive. Thank you and good luck.

I would really just ask a quick follow up on Marine margins. I don't know that I got a lot out of the answer that you have provided. I mean we're looking at a 16 percent level we've been cruising at for a few quarters now. We're seeing a 300 basis point step up. Can you maybe try and give us a sense of the impact or the catch up you're seeing in invoicing from the Q3 and also give us a sense of what was it within mix specifically that drove margins?

Thomas Thuresson: Again, Marine, I said that Marine has no doubt done a very good job in defending not only their positions, but they've also done a good job looking at what we've seen of the cost development for metals in China. And as far as pricing is concerned in general, they have also initiated over the last couple of years a great number of cost down projects for individual products. And that is clearly carrying and giving benefits, and we see that -- we've started to see that in a meaningful way. So that is part of the positive development in marine.

Q: And just on the catch up on invoices in Q3, can you give us a sense for the order of magnitude of that?

Thomas Thuresson: The variations between quarters, we said that we have reached the trough and we will oscillate on a trough level. We do not foresee any sizeable recovery in sales until the second half of 2018 as far as revenues are concerned. There are variations between quarters. We do have a tendency that we complete deliveries because of CapEx programs among customers' not least that gives us our revenues in the fourth quarter. So it's a well-known pattern.

With that, I'm sorry, but we have to dash off to the next meeting. But before that, I would also like to say thank you so much for an enjoyable collaboration over, for some of you, a great many years. Thanks a lot and stay close to Alfa Laval. I'm sure that Tom and team will continue to develop Alfa Laval. Bye, guys.

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

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