

ALFA LAVL AB

Moderator: Tom Erixon
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OPERATOR: This is Conference #: 7459933

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Alfa Laval Q4 Earnings Conference Call. (Operator Instructions)

I must advise you that this conference is being recorded today, 4th of February 2020.

I would now like to hand the conference over to your first speaker today, Tom Erixon. Thank you. Please go ahead.

Tom Erixon: Good morning. Welcome to the Q4 earnings call. We'll follow normal procedure. I will start, Jan will follow with some further details and then we'll take the Q&As. Let me start as always with a couple of introductory comments to the report before moving into the presentation.

First, it's clear that it was a very strong quarter for us in terms of invoicing. And after a significant period of building the order book, we converted SEK 13 billion into sales, representing 15 percent growth compared to last year. So that went very well in the quarter.

In terms of demand, most end markets remain positive in line with the sequential guidance that we gave after Q3. So all in all, order intake in line with the guidance.

We have then also, as you well know, since some time been aware and planning for a possible macroeconomic slowdown in 2020. And although, in many aspects, perhaps those risks are somewhat decreased, we have remained very focused on our cost program and productivity programs.

And consequently, as a result, we also saw fixed costs coming down somewhat in the quarter compared to last year. And in fact, we are also a little bit lighter in terms of staffing in our production units, related to some efficiency measures have been taken during the year. So that's all right in terms of being ready for 2020, whichever way it goes.

Finally, as perhaps a side comment, we have now completed all transactions related to the Greenhouse. So as of now, the Greenhouse is closed and the divestment process and the objectives related to the Greenhouse have all been achieved now in a good way. So that is the final closure of that program.

With that, let me move on to the key figures. As I indicated to you, and as you well know, we saw a strong order book buildup in the later part of 2018 and early part of 2019. And all in all, for the Q4 and for the full year, we had a record conversion of that order book into record sales in the year and in the quarter. On the back of strong invoicing, profit margins continue to improve, closing the quarter at 17.4 percent and the year at 17.2 percent.

In terms of orders received, as you well remember, we had a shortfall of orders in Q2 2019. And that shortfall was entirely related to the situation in PureSOx and for Pumping Systems. Since then, we have guided for sequential growth and also achieved that growth, reflecting the fact that we had a positive sentiment and a positive development in most end markets.

And in fact, after the Q2 shortfall, also the Pumping Systems has gradually recovered to a more normalized level. In Q4, in addition, we saw a very good conversion of large orders, especially in the Energy segment.

In terms of the order intake, it may be useful for you to reflect on the order intake, excluding the effects from the marine environmental business. So on

this chart, you see the bars, excluding the marine environmental applications and the 12-month rolling curve, also excluding the marine environmental.

And the picture that you clearly see and which represent what we've been communicating for a period of time is that leaving aside the volatility on that part of the business, the underlying demand situation for most of our businesses throughout '18 and '19 has been stable and positive.

And in fact, the organic growth, although the growth, including currency effects, is 3 percent positive versus the fourth quarter last year. So we've been well balanced and in line in terms of the underlying market demand for essentially turn out of our 12 business units during the year.

Now we do not expect that we are going to move into a repeat of the rather strong PureSOx development that we had in 2018/2019, partly. But we do, at this point in time, based on the stronger quotation pipeline, expect somewhat of a returning level of new orders in the PureSOx business in the coming quarters.

Let me turn to Service. It has been a record year, and in fact, a record quarter when it comes to our Service business in terms of order intake. We have growth rates that we barely seen before, 10 percent organic in the quarter and for the full year 7 percent.

It is, to a degree, driven by strong performance in the Marine division, but it's also been a very good year in the Service business for the Energy division, whereas, the Food & Water business has been more of a stable and flattish type of performance.

Good market conditions and hopefully some results of the many good development initiatives that the service organization has performed during the last 2 years has resulted in a very favorable outcome in 2019.

If you want to take a geographical look at our order intake situation, let me give you just some brief summary comments. Eastern Europe has been very

strong in the quarter and good in the year, supported certainly by good performance in Russia.

Western Europe overall has been stable to positive. Asia has been good, including China, but the numbers for Asia are impacted by the variation in the marine environmental and to some degree Pumping Systems, and consequently, excluding that, we've seen a positive development, especially in China.

North America has been flattish for the year. And I must say that our expectations coming into 2019 were higher than that. We've seen, if anywhere in the world, sort of standoffish attitude to larger investments, some project cancellations. The business climate in the U.S., from our point of view, has been a little bit of a disappointment.

And with that said, still the business in terms of order intake has been about stable and on the same level as 2018. So – and you might see that better on the slide covering our top 10 markets, where the picture of U.S. approximately on the level as last year; China still looking good, but you should remember that there's a mix change there, slightly less on the marine environmental and more in the rest of the business mix; and the 2 markets affected by Marine, to a degree, is Japan and Korea; and other than that, it's been a fairly stable and stable-to-positive development in the rest of our core business.

Let me turn to the profit margin. We've seen solid earnings growth in the quarter. In fact, we are 26 percent up in the quarter versus last year. We are 90 percent up for the full year. So the drop-through into our bottom line has been good throughout the year. The margin at 17.4 percent in the quarter was supported by good improvements in all 3 divisions.

Lower fixed costs compared to Q4 '18 contributed to the drop through, and certainly, the invoicing growth was also supporting the margin improvement we've seen in the year and in the quarter.

Let me reflect briefly on the 3 divisions individually, starting with the Energy division. They really had a very solid performance and solid numbers across

the board. Demand for energy efficiency in many areas and in many parts of the world continue to be strong.

The oil and gas downstream investments continue, as we've been guiding you during a number of quarters to be very strong outside of the U.S. So we see the effects of Chinese independence and growth in petrochem and refinery sector in some other parts of the world to drive the oil and gas side, whereas the U.S., specifically on the upstream remains very soft for us in the quarter.

Service grew very well in the quarter and in the year for the Energy division, which posted good numbers in a number of markets in a number of areas for the Service.

Together with strong invoicing growth, the earnings growth in the quarter was 35 percent compared to last year. So it is a rather substantial increase of the underlying earnings for the division in the quarter.

Turning to the Food & Water division. In terms of end market, wastewater and, to a degree, edible oil has been 2 positive end segments for the business. But generally, it's been rather stable in most of the end markets of the Food & Water division.

All in all, 2019 is a bit of a flattish year for us, with somewhat lower project, large projects order intake and slightly higher component sale during the year. But strong invoicing in the end of Q4, together with a similar margin development as we had Q4 last year, resulted in a fairly good finishing of the year for the Food & Water division.

Finally, the Marine division. Certainly, the invoicing in the Marine division at SEK 5 billion is a significant all-time high based on the very strong order book that has been developed in '18/'19.

And I have to say that in this type of growth situation, there are significant challenges on the supply chain to manage that type of growth and that type of volatility in the invoicing, but the execution of that order book has been successful and resulted in a solid margin development in the quarter of almost 20 percent.

Contracting of ships at the yards remains on the low level similar as to 2019 and order intake for most of the businesses in the Marine division was fairly stable.

Pump systems, I indicated before, have been seeing a slight recovery from the very weak numbers in Q2. So we are back to a more normal level there. And we do expect that the PureSOx business will move into a slightly higher pace compared to the very low situation we had in Q2, Q3 and Q4.

Service continued to grow in essentially all parts of our Service business, driven by environmental products, driven by the IMO implementation of new rules and driven by solid organic growth in our traditional service areas in the Marine business. So all in all, for the Marine and for the Service side, a good quarter.

And with that, I'd like to hand over to Jan for some further financial comments.

Jan Allde: Thank you, Tom. So I will move directly into the presentation, starting with the sales. So we expect an invoicing to be somewhat higher than the same quarter last year, considering also the short number of working days in December. However, we realized sales of SEK 13 billion in Q4, which is an all-time high for the group.

And as you can see from the slide, we ended up stronger than we expected due to the strong sales in all divisions, but especially in the Marine division. Regards to Q1 sales, my outlook is as follows: we expect invoicing to be on the same level as in Q1 2019 on a comparable basis.

Then moving to the gross margin. So the gross margin came in 40 basis points below Q4 of 2018. And some comments on the year-to-year performance.

Due to the strong service growth in Q4 in pace with capital sales, we did not see a negative capital sales service mix in the quarter. However, we did see a

negative product mix between capital sales as we recognized a larger share of project sales in the quarter.

The load volume impact ended up somewhat negative year-on-year. However, this was fully offset by a positive impact from PPV metals as a larger procurement volumes with volume discounts and successful cost reduction actions could compensate the increased metal prices we saw after the summer. There was no significant impact on gross margin from changes in FX rates in the quarter.

Now over to my outlook for Q1. Starting point is 38 percent gross margin we reported in Q1 last year. We anticipate the neutral capital sales after sales mix in the quarter. However, we expect a slightly negative mix impact within the service sales as we see a larger share of service work versus spare parts sales.

We expect also the load and PPV methods impact to be neutral versus last year. And finally, we don't expect FX to have any significant positive or negative impact on the gross margin in the quarter.

And looking at some of the key figures, the development of sales and gross profit was covered in the previous slides. So on S&A, expenses were flat in Q4 versus last year, excluding FX and structural changes and up 3.8 percent for the full year. Considering the strong sales growth during the year, it means that S&A in percent of sales decreased from 16 percent in 2018 to 14.8 percent in 2019 with a direct impact on the overall profitability.

R&D expenses decreased by 16 percent in the quarter, but were up close to 7 percent for the full year 2019 versus last year on a comparable basis.

Other cost and income showed an increase of SEK 144 million versus last year. This increase is explained by an increase in royalties paid to our ballast water joint venture footprint-related costs and some downsizing activities in various locations as we are preparing for a more uncertain economic outlook. This means that improvement in operating income and operating margin in Q4 and also for full year 2019 was driven by a successful execution of our order backlog and good cost control.

Financial net excluding FX impact was minus SEK 32 million in Q4 and minus SEK 172 million for the full year 2019. The tax rate was 23.4 percent in the quarter and 23.7 percent for the full year. EPS increased by 10 percent in Q4 and 21 percent for the full year.

Now over to our cash flow. Cash flow from operating activities increased by approximately SEK 900 million versus last year, driven by the strong operating result and a slight reduction in working capital. The decrease in working capital was a result of a significant reduction in inventory, as we are executing our order backlog.

On a total year basis, our working capital and cash flow are still suffering from a reduction in customer advances due to lower order intake in PureSOx and Pumping System business in 2019. Investing activities included CapEx investment of SEK 499 million in Q4 and for the full year at SEK 1.3 billion as per our guidance.

Financial net paid, excluding FX impact, was minus SEK 12 million. The net realized FX losses amounted to SEK 592 million in the quarter. This was mainly related to an FX loss that occurred in relation to the repayment of the EUR 300 million EMTN loan that matured in September. This means that our pro forma cash flow for Q4 came in at SEK 1,289 million versus SEK 893 million last year.

Our net debt-to-EBITDA now stands at 0.88, and excluding the lease liabilities at 0.6. On the FX side, the FX impact in EBITDA in the quarter was a positive SEK 155 million, mainly due to a positive transaction impact of SEK 105 million. Looking at the projection for 2020, we expect a positive transaction impact of approximately SEK 380 million, slightly lower than the previously guided.

So then looking at the order backlog. At the end of December, we had a total order back of SEK 21.6 billion, a decrease of approximately 9 percent since year-end 2018 due to the very strong sales volume in '19 and especially in Q4.

The order backlog now represents 5.6 months of LTM sales. For shipments in 2020, the backlog amounts to SEK 16.4 billion, a reduction of SEK 1.3 billion

compared to the same time last year. Approximately SEK 300 million of this reduction is caused by the sale of Greenhouse divisions and the remaining reduction is related to the Marine division.

Let's then move over to the bridge for 2020 sales. Starting with the full year sales in 2019 of SEK 46.5 billion. As stated in the previous slide, the backlog for shipment in 2020 is SEK 1 billion lower than the same time last year on a comparable basis. The divestiture of the Greenhouse business will take out the sales of approximately SEK 0.4 billion in 2020 versus 2019, and this adds up then to a total of SEK 45.1 billion.

On top of that, you will need to make your estimate on change in-for-out orders and FX translation impact. For your reference, the level of in-for-out orders in 2019 was SEK 28.7 billion, excluding the businesses divested out of our Greenhouse division.

And lastly, please remember what we stated at the Capital Markets Day in November regarding the order backlog for 2020. The product mix and the order backlog for delivery in 2020 is less favorable, especially in the Marine division, as the order intake and new Pumping System and BU Gas System was lower in 2019, while the order intake in our PureBallast business, where we have the joint venture structure, was stronger.

And then finally, the Board will propose a dividend of SEK 5.50 per share for 2019 to the AGM in April, which is an increase from last year's dividend of SEK 5 per share.

And by that, I hand back to Tom for his outlook statement.

Tom Erixon: Jan, thank you. Finally, then, the outlook for Q1 sequentially versus Q4. All in all, as we indicated, we see a stable situation and expect demand overall for Alfa Laval to remain on about the same level as in Q4.

In terms of the divisional outlooks, we expect the Marine division to see somewhat higher demand. We expect the Food & Water division to remain on about the same level, and we do expect a lower demand situation for the Energy division.

And I'd like to point out that, that outlook for any division is mainly driven by an assumed lower conversion of large orders compared to the relatively high Q4 number, whereas the underlying demand situation for most of the applications, including the energy efficiency solutions that we are working with are remaining favorable.

So with that, we are through with the presentation and open for questions.

Operator: (Operator Instructions) And the first question comes from the line of Klas Bergelind.

Klas Bergelind: Yes, Tom and Jan, it's Klas from Citi. Can I start by asking on the backlog duration in Marine. The total SEK 1 billion reduction in the backlog, Jan, how much this is in Marine?

Last time, we had weaker Pumping Systems orders year-over-year, the backlog was still quite healthy with longer delivery times and sales never really came down that hard initially. I'm interested in Pumping Systems sales relative to scrubbers in 2020?I'll start here.

Jan Allde: Yes. I mean I think the way to look at this, Klas, is if you look – as Tom was mentioning, if you look throughout '19, we really had 1 quarter that stands out, which was the Q2, where the orders on the Pumping System was low. And since then, we have seen in Q3 and Q4, a normalization of the order intake on the Pumping System.

So yes, it will have an impact and that's what we sort of, say, highlighting here. But I think it's mainly the lower intake that we saw in Q2, that kind of stands out. But yes, 2018 was, of course, a strong year, so the comparison from a backlog execution is visible, and that's what we are highlighting.

Klas Bergelind: And we're still looking at a very favorable margin in Pumping Systems. Could you say anything on what is the level now relative to when you bought the company? Are we still at roughly the same level without quantifying it?

- Jan Allde: Yes. And it's still a very healthy business, but I don't want to go into any comments on the specific margins, if that's OK, Klas?
- Klas Bergelind: OK. Then another question on Marine, you're talking about improving tanker demand, Tom, but obviously, Pumping Systems orders are still down against the tough comp from last year. So you're improving it sequentially. When you now guide for demand to improve somewhat in Marine, is that mainly the tanker side? Or do you expect scrubber demand to also improve into the first quarter as well?
- Tom Erixon: As you well know, the more detail the guidance is the more wrong it's going to be. So we prefer to stay on the guidance level on a divisional as opposed to a business unit level.
- Klas Bergelind: OK. That's right. And then on the Service growth. There is a large order there on the Service side in Energy, could you get some steer on how big that was? And to what extent is the Service growth in Energy now improving on an underlying basis, Tom?
- Or should we expect lumpiness here going forward? We know, obviously, all the great stuff you've done, particularly in Marine, but I'm interested in – but this is an underlying improvement also in Energy?
- Tom Erixon: Yes. I think we've seen a continuous improvement on the Energy service business. So I wouldn't – we occasionally have some larger orders coming through, some are visible to you, some are not. So it's not something that happens every third year. They tend to come with some level of regularity.
- They do impact on the margin a little bit the numbers. But all in all, when we look at the number of plates that we work with in terms of reconditioning at the service centers and if we look on a lot of aspects of our Service business, the demand situation has been very favorable in 2019.
- Klas Bergelind: But is it a 3-digit number that the large order on the Service side? Or can you help us a little bit on the magnitude?

Tom Erixon: You're just going to confuse yourself on it. So let's leave it. Because there's order mixes all the time from a very small numbers to millions of euros and some are visible to you and some not. So I think you should not assume that there is anything that is major deviations when it comes to the normal progression of the Service business.

Operator: And the next question comes from the line of Johan Eliason.

Johan Eliason: Yes. This is Johan Eliason, Kepler Cheuvreux. I have some questions on this net other costs that you mentioned were going up because of royalties and then some preparatory restructuring charges, how was the split between the sort of restructuring and the royalties of that increase, which was the most important one?

Jan Alde: Yes. I think the royalties, we can give you some guidance there. I think the increase in the royalties, of course, following the increase that we've seen on – is in the range, let's say, of SEK 30 million to SEK 40 million. Then we also have slightly higher footprint-related costs.

So we ended the full year footprint costs around the guidance that we gave, meaning around SEK 170 million. That means that it was, let's say, SEK 10 million to SEK 15 million higher than the same quarter last year. And I think the remaining difference then are related to the actions we have taken to downsize some of activities and sharpen our cost base in the current situation.

Johan Eliason: Excellent. Then just to remind me on the Marine exposure, which segments are really the most important for you? We mentioned tankers here for the Pumping System. I assume offshore is also important for the high-margin Pumping System. But overall, would you see any specific segment that is key for you in 2020?

Tom Erixon: Yes. I think it's pretty clear what is the main focal area and the sweet spot for us when it comes to our new equipment sales, and that is tankers, product tankers, container, cruise. And whereas the areas of, let's call it, ferries near coastal and dry bulk has lower significance for us. So when you look at the

overall contracting numbers, it may be helpful for you to watch the individual segments a little bit and not just their total numbers.

Operator: And the next question comes from the line of Andreas Koski.

Andreas Koski: My first question is on your backlog delivery. You said when you reported Q3 numbers that you had the backlog for delivery in Q4 of SEK 8.1 billion, how much of your backlog did actually come out in the fourth quarter?

Jan Allde: Well, I think you can do that calculation, so to say, fairly easily. I mean you saw that we had a stronger-than-expected invoicing in Q4. And if you look at that, I think you will end up with – we executed, let's say, close to SEK 1 billion more than expected.

Andreas Koski: But was that coming from the backlog or from in-for-out orders? It's difficult for me to see.

Jan Allde: Yes. I think you can assume that the majority of that came through backlog execution.

Andreas Koski: OK. So around SEK 9 billion of your backlog was delivered. And my second question is on your service business in Marine. It looks like you had service orders of slightly more than SEK 1.4 billion, and in the past 8 quarters, the order intake for Marine service has been between SEK 1 billion and SEK 1.2 billion, so a significant step up, it looks like. Is that mainly driven by IMO 2020 and your ballast water treatment systems? Or is that step up relating to the, yes, let's say, conventional marine business?

Tom Erixon: The answer is that it's both.

Andreas Koski: OK. And the part that relates to IMO 2020 and ballast water treatment systems, should we expect that to be a sustainable increase? Or will that come down when scrubbers have been installed and the scrubber market comes down?

Tom Erixon: Well, that is slightly more complex question to answer. Obviously, as we are running in new product groups onto the ships in a fairly broad-based

installation, they will start to generate normal for the – representing those products, service needs, normal service revenues and service agreement revenues over the long term.

So as a result of increased environmental activities and implementation of new equipments on board, the scope structurally for our Service business will grow somewhat compared to our historic.

So whatever is, let's say, a certain retrofit or reconditioning process at the moment, is having some sort of lasting effect. The area which is temporary is a certain amount of reconditioning going on right now in order to handle more of a multifuel type of situation.

That will, obviously, from a reconditioning point of view, soften out eventually. On the other hand, we might experience changes on the new build side, which goes in the same direction. So there are many communicating parts in this. But all in all, we are probably on a slightly elevated level on the Service business, specifically in 2019 carrying into 2020.

Operator: And your next question comes from the line of Sebastian Kuenne.

Sebastian Kuenne: Also, a question regarding Services. So Services used to be a business where you get a call for equipment that is not working anymore, and you book the order and the sales basically in the same quarter. But it's just now that you create order income for services that are going into revenues in the longer time period.

Could you maybe explain what the average, like, backlog period is for Services currently in the company? And if that is stretching out a little bit? That would be question number one.

Then on the scrubber revival that you mentioned. Do you think that the order intake in scrubbers could be higher in 2020 than it was in 2019, so that we actually see a proper like a slight bounce back in the orders?

And then final big question would be the dairy sector in Foods & Water, I would like to hear a little bit what you see there?

Tom Erixon: Sorry, what was the last question?

Sebastian Kuenne: Dairy – the dairy market.

Tom Erixon: Dairy, OK. Yes, let's start there. Dairy for us has been fairly stable in the year, somewhat of a pickup towards the end of 2019. So a stronger finish than the beginning. The dairy market is, in some parts of the world, a little bit volatile, specifically in the U.S., there's been some difficulties for large end customers and – but nevertheless, all in all, it has progressed fairly well on our side.

Regarding the PureSOx business, as you well know, we don't guide full year on a product level for anything in our business and certainly not on the PureSOx.

I'll comment to the PureSOx business remains, what I mentioned before, after 3 quarters of close to 0 order bookings in the PureSOx and based on the fact that our quotation pipeline has been gradually improving during the later half of 2019 and considering the fact that the pricing delta for low-sulfur, high-sulfur fuel has increased rather sharply over the last few months.

We expect that the scrubber pipeline will start to convert to some sort of level. However, our expectation is not that we will return to the elevated levels of PureSOx order intake that we saw end 2018, beginning 2019. Where that will take us specifically in 2020 versus last year, that remains to be seen.

The first question was service conversion. Now I will not try to nail a specific effect there. I think what you've – let's talk about what's happening with the Service business short term in 2019 going forward and a little bit long term.

The short-term thing is that if there is a change in our Service business, to a degree that is related to reconditioning work. And reconditioning work is not about sending a spare part, getting an order and sending a spare part, that is actually planned service activity.

And that part of the service orders is taking a little bit more time from order booking to order execution. And you may see some impact of larger orders that are placed well in advance and are executing over a slightly longer period of time. So they come and go without being necessarily changing compared to our historic numbers.

So you're correct in your observation that the buildup of the order book for service has meant that there is a little bit of extension on the lag, but I think that you will see that's disappearing as we continue to – assuming that our mix continues to be on about the same, then we have sort of gone through the period of certain order book buildup, and I don't expect that to remain unless we have a significant additional volume coming in on top of what we are already running, specifically on the reconditioning side.

So not a big structural change, but there is certainly a certain mix change compared to the traditional spare parts deliveries that we've been doing.

Now I would add for the long term that we, as well as many other equipment makers, are going increasingly into service agreements and preventive maintenance and all of that. So you should expect that there are some changes to the composition of our Service business going forward.

I'm not sure that will in terms of recognizing orders and delivering the services is dramatically changing the way we book orders and execute on them, but nevertheless, it is a rather important long-term trend that we see in our business, certainly, on the Marine side, but also in terms of the – not least rotating equipment in the Food & Water division.

Sebastian Kuenne: If you get an order now – if you get the service order now for a 5-year contract, do you book it now as you receive 5-year revenues?

Tom Erixon: Certainly not. Certainly not. Certainly not.

Sebastian Kuenne: You book the first year? Or what would you book exactly?

Tom Erixon: Yes. I'm not going to go into a detailed accounting review on revenue recognition here and order recognition. But we are not – that's what I was saying that you should not assume that our order backlog will grow to a couple of years just because we have service agreements, that would be complete nonsense from an accounting point of view, and you can terminate the service agreement at any point in time. So we are very – as you know, very conservative in how we recognize orders and how we recognize revenue.

Sebastian Kuenne: Understood. Finally, a very brief question. When you say flat development, flat demand in Q1, I'm still new to the story, is that sales or is that order intake? And is it FX neutral?

Jan Allde: Sorry, we didn't understand your question.

Sebastian Kuenne: Yes. Sorry, in your outlook for Q1, you mentioned flat demand, does it refer to flat sales, flat orders...

Tom Erixon: Sorry, that's orders. That's orders. It's market – it is our assumption on how the end-market demands will develop. And you may choose to equate that with the demand specifically for Alfa Laval products or not, that's up to you.

But our outlook is really a market outlook statement, and we respect the fact that most of you consider that to be relatively a reasonable prediction for where will Alfa Laval go in those markets, but there may be some differences on that as well.

Operator: And your next question comes from the line of Sven Weier.

Sven Weier: The first question is on the M&A side. I mean you've rightly said the Greenhouse has now been closed, but on the other hand, you haven't done a larger acquisition for a number of years now.

And the question is, is it just hard to find anything suitable? Are the targets too expensive or both? And what's standing in the way of doing something more transformational or something bigger? That's the first one.

Tom Erixon: Yes. I think you're right, it's both.

Sven Weier: It's both. OK. So it's – the pipeline hasn't become more active or less active. It's just the same reason that it has been in the last couple of years already, yes?

Tom Erixon: Yes. I mean you're not really interested in the pipeline, you're interested in the transaction, right? And you haven't seen any yet. And to the degree, it will happen. We are not very likely to confirm it beforehand. So obviously, there has been work performed in the M&A over the last 3 years.

To a degree, I have to say, the effort has maybe been increased over the last year or 1.5 years due to the fact that the reorganization, the restructuring, the refocusing on the group and the divestment processes as such have consumed a fair amount of energy and a bit of rethink in terms of where we are and where we want to go. So that's part of the answer.

I think the second part of the answer, which we dwelled on with – in some depth at the Capital Markets Day, was the fact that in some areas like energy efficiency, renewable energy, energy storage and part of the, let's say, protein production in Food & Water and some other areas, we see a lot of emerging technologies that are not really suited for large-scales M&A, but more into partnership, coinvestments, technology collaborations and maybe some smaller M&A transactions.

So it may not be catching the interest of the analyst community from a transformation point of view, but for the long-term growth into our long-term strategic objectives in the new economy, those are as important to deploying our balance sheet into major M&A activities. So we'll see where we go. We remain active.

And you may think that 3, 4 years is a long period of time, but where we were in 2015 after the acquisition of Framo, we didn't have the balance sheet for doing any major M&A at the time. We are still building strength in our balance sheet. And as you well know, for EUR 500 million to EUR 1 billion today, we're not going to do a transformational M&A.

So in one sense, it's been taking some time to regain our strength. And well, we are getting there. So let's see what – we're not going to feel pressurized to do anything we don't believe in, for sure. And the people who work with us would call us at least disciplined, and we will remain that way. So whether that allows for a transaction in the future or not, we will see.

Sven Weier: Yes, maybe you just also simply don't see any big gaps, right? So that's maybe another reason why there's...

Tom Erixon: We don't like ideas, don't think that for a second. Don't think for a second we like ideas.

Sven Weier: OK. No, that's understood. And sorry, the second question is just a quick follow-up, sorry to bother you again on Service. But my understanding about scrubbers ballast water was always that it's not a very intensive wear and tear business so that the service with the spare parts would actually be below average, let's say. So is the strengths you saw in Q4 really more related to the multifueling service business and not directly related to scrubbers and ballast water?

Tom Erixon: Well, first of all, I think it's absolutely wonderful that we're talking so much about service today, so no apology for the question. I think this is the best earnings call for 4 years. So thank you for that. The question of where the Marine service is going is, I think, at the moment, driven by a number of things.

First of all, the hesitation for placing new orders, given some uncertainties in the market in terms of future fuel and the combination of high freight rates at the moment is, I think, driving to a degree the service intensity in our traditional products.

So we see right now favorite – leaving IMO and environmental products and everything aside, we see a positive development in our traditional base business as is, which is not insignificant. And I think the scrapping off of the old ships right now is also remaining on a very low level. So there is an

attempt to keep the merchant fleet up and running at the moment as the entry of new ships is relatively low.

Secondly, I think you're right in terms of traditional spare parts consumption on the environmental side. So we don't expect perhaps the same level as we have in – certainly on the rotating equipment and some more service-intensive products.

But nevertheless, as those are being installed, many with service contracts very important products when it comes to compliance and other things. So failure is not an option on this type of equipment. So we still think that we'll make a contribution and a meaningful contribution to the long term.

But you're right in saying, today, short term, with most of those installed, some still under warranties, I mean, the scrubber business has barely been around for 1 year up and running in terms of actually utilizing those pieces of equipment on board, we – they don't have a major impact in terms of revenue generation for Service. Right now, it is more the reconditioning and to some degree, the commissioning part of some of those retrofit installations.

Operator: And your next question comes from the line of Jack O'Brien.

Jack O'Brien: Tom and Jan, first question is on Marine. If we exclude scrubbers and the Pumping Systems, for the remainder, do you see any sort of optimism returning in terms of contracting rates?

Obviously, 2019 was a pretty challenged year on the tanker's side, less so on cruise. But are you seeing the sort of high freight rates that we currently see translating into a bit more optimism in terms of contracting? That's my first question.

Tom Erixon: I think the – without taking Alfa Laval view on the contracting market for next year or this year, as we are speaking about 2020, as such, I think the forecast are not indicating any major growth in contracting. But keep in mind that when it happens, it tends to go quickly. So a forecast is a forecast.

What is pretty clear is when you look at the forecast that they stand today, it tends to indicate that the ship mix is slightly more attractive than what we had in 2019. So I would say we are neutral to positive when it comes to the underlying contracting mix for 2020 versus 2019. The implications of that, I still have to advise you, is not huge for 2020.

First of all, new shipment contracting in terms of orders for us is less than 1/3 of our business in the Marine side. And secondly, the contracting volumes at the shipyards, 2020 will only in part be recognized in terms of order intake for us in Alfa Laval.

So it's partly 2020 issue and partly 2021 issue when it comes to the order intake. So that's why we've been saying for a couple of quarters going back and also into Q1, that our basic Marine business in terms of contracting looks rather stable.

Jack O'Brien: And just a second question. 2019 saw margins at, I think, the highest level they've been since 2011. Clearly, you've done a phenomenal job there in terms of service and also cost management. I guess, as we look into the future, 2020 and beyond, would you rather say that perhaps margins are unlikely to move materially higher from here?

I guess, I know we could see more service and more sort of scrubbers, which are good margin. But similarly, the return of more capital equipment would presumably dampen that and perhaps you have to, at some stage, add some more cost back. So do you think rather margins could be at somewhat flattish level as we look forward?

Tom Erixon: We are not – we are very careful to start to guide on margins. So you have to make your own judgment on that side. What we have indicated to you and you should keep that in mind is that the – Jan was on to it earlier in the call that we've seen a very favorable invoicing mix when it comes to the capital equipment side of our firmer base of PureSOx orders and a very good invoicing of the Pumping Systems 2018 elevated order intake numbers.

So those are not necessarily a full repeat in 2020. And if you think in terms of the mix, where we do know that we are ramping and have continued to ramp during 2019 is on the PureBallast side and due to the sharing on the profitability of that business with our JV partner, there is a mix issue in the Marine business that is a bit less favorable in 2019.

Now that doesn't necessarily tell you everything about what's going to happen in the market, but everything else being equal and while the changes happening, that would put some downward pressure.

Operator: And your next question comes from the line of Aurelio Calderon.

Aurelio Calderon: I guess, I wanted to ask on the energy outlook and whether you've seen anything from – any impact from global refining margins basically rolling over in the fourth quarter? And basically, if that's embedded into your guidance for a softer, let's say, project outlook in 1Q?

And also, if you could comment a little bit on your upstream exposure, what you're seeing there?

Tom Erixon: Well, all in all, the – so let's be clear. When we look at the Energy division, the lion's share and the most important part of our business is outside of the hydrocarbon chain. And we see a fairly steady and positive development in areas of energy efficiency and energy – in areas of HVAC, in areas of data centers today to just take a few.

So we see, in broad terms, a fairly stable situation, including the service side for the energy business moving into Q1. If we look at the hydrocarbon chain, specifically, we are not so far away from numbers that's been around all-time high in the hydrocarbon chain all in all for the group including the offshore side in – which is accounted for in the Marine division.

We are oscillating somewhere around SEK 7 billion per quarter and – sorry, per year. And I think our all-time high has been around SEK 8 billion. Within that mix, the downstream is stronger and upstream is weaker. And the upstream weakness is entirely related to the North American, mainly U.S.

market. And the downstream, I would say, have shifted a little bit in terms of its geographical mix going east.

I don't think the investment process for the downstream side is completed in Q4, but it was notably a strong quarter. So for an individual quarter, I don't think we should over-interpret. It's long order books.

Let's not over-interpret the trend curves on a given quarter. I think what we see when we look back the last 6 quarters or so, all in all, actually, year-on-year, quarter-on-quarter, a fairly stable volume of a couple of billion a quarter. And the trend shift is not dramatic into Q1.

Aurelio Calderon: And just a follow-up. And in terms of the U.S. upstream exposure, we've seen some of the other players saying that CapEx could be down 10 percent. Is that the basis in which you are forecasting more, let's say, planning ahead for 2020?

Tom Erixon: I don't have any further comments to our guidance for Q1.

Operator: We have 3 more questions on the line. And the next one comes from the line of Malte Schulz.

Malte Schulz: First of all, maybe also on China and maybe the virus. Even just – can you point us on your exposure there? And do you see any – or any impact on your production line? Or any kind of cancellations or heavily delays out of Chinese projects?

And maybe give us an indication of what you expect for the first half or the entire year of 2020 in China? And maybe also on the U.S., on a broader sense, I mean, looking into this year into 2020, what do you expect for the year going forward? I mean we see some more kind of political crisis as well, which might further indicate that U.S. will increase CapEx maybe in their own country.

Is it something where you already see, like at least a conditional asking from clients? Or would you still see, especially, as you just said that the upstream exposure remains quite weak regardless of any kind of political movement?

Tom Erixon: Well, thanks. We're not going to start guiding exercise for the full year 2020, certainly not in China nor in the U.S. The – I think we are – the Alfa Laval is not all that different from the rest of the engineering industry in the world when it comes to where we are in China and our exposure.

Short term, we are under the same conditions as everybody else. We have a standstill in our own manufacturing units for – including this week, which is an extra week compared to the last week, which anyhow normally is planned for being on shutdown. So it is a week delay.

A week delay can happen and that can be regained if we have a very extended period on the restrictions in terms of how we can and are allowed to operate, then obviously, it will affect us. And down the road, there's no point for us to operate very different from the rest of the market.

We are dependent on our Chinese suppliers and logistics supply chain that needs to work in and out of China. So we are right now taking – not taking any particular prediction view on what's going to happen.

We follow and monitor in the situation. But as we see it right now, it's a week shutdown and a week shutdown can be managed. And if it's going to change dramatically, then assume that we will have the same effect on us as the rest of the engineering in the industry will.

For U.S., we are not – I think – I don't know that it is a political problem. The – in the U.S., when it concerns our Energy business, by and large, I would say, the current administration has been very supportive for the development of the U.S. energy business.

So I wouldn't consider it to be a political problem, per se. We are not sure why general economic positive development and growth situation in the U.S.

is translating itself to hesitation when it comes to large CapEx, but that nevertheless has been the situation.

And I remind you and ourselves that, OK, we had higher expectations, but it's – we are still conducting a year on the same level as last year in a fairly decent level. So I don't want to create a bigger problem concerning our U.S. market and market situation than it really is.

But certainly, there was a lot of expectations in the U.S. and about a year ago in terms of how we would see the demand situation develop, and that hasn't quite materialized with the way we expected. So we'll take it from here and see where we go. We are prepared for both cases.

But upstream, there is no expectations in Q1 that we will see any sort of major return to upstream investment in the U.S. I think we have some time away from that.

Malte Schulz: Maybe one follow-up on China, have you received already any cancellations related to the virus?

Tom Erixon: Well, I have 2 answers: one is, I don't know; and two, I don't think we really want to go into a detailed review on China beyond the comments that I made.

Operator: And the next question comes from the line of Lars Brorson.

Tom Erixon: That would be the last one. Thank you.

Lars Brorson: That's fine, Tom. I'll keep it short. But actually, just following up on that prior question, sorry, about the return to China, but you're guiding to lower in energy sequentially not somewhat lower, obviously, on a very tough comparison. I'm not sure exactly how you define that, but I assume that's down double digit. We haven't seen that for what a handful of years.

It doesn't sound like you're baking in a lot at this point around coronavirus in China, you're talking about a 1-week shutdown. I would have thought there is

a risk of sort of broader closures among your customers. But can I just be clear that, that is what you're baking in.

So what you're really saying is, particularly around the oil and gas business, which delivered close to SEK 2 billion of order intake, there is just a sequential slowdown there. You aren't baking in a more material adverse impact at this point from China, just to be clear?

Tom Erixon: We have not in any way reflected, considered any impact from the Chinese virus situation into our forecast. That would have been the same with or without.

All right. With that, again, thank you. And if we don't meet each other beforehand, then we will meet after Q1 and see where we are. So thanks a lot for joining us today.

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

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