

ALFA LAVAL AB

Moderator: Tom Erixon
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OPERATOR: This is Conference # 4826907

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Alfa Laval Q1 earnings call.

At this time, all participants are on a listen-only mode. After the speaker presentation, there'll be a question and answer session. To ask a question during the session, you will need to press "star" and "1" on your telephone keypad.

I must advise you that this conference is being recorded today sorted the 23rd of April 2020.

And I would now like to hand the conference over to your speaker today Tom Erixon. Please go ahead, sir.

Tom Erixon: Thank you. Welcome to the call.

I understand you all have a busy day today. So thanks for joining us.

On this one, let me start with the normal introductory comments. First, financially, it was a stable quarter overall. We more or less repeated order intake sales and profits compared to the same quarter last year. Operationally, it was a different story. It was a very challenging quarter from a supply chain point of view. We were dealing with

several lockdowns, shutdowns of factories, shutdowns of supplier bases. And overall, we managed to keep our delivery service to customer up well. I will return to this topic later on.

In terms of the sales organization and general white-collar staff functions, a large part of our employees are now working from home. That's obviously also disruptions. But even so, we have to acknowledge that customer service interactions and work in general has worked a bit better than we expected perhaps from that point of view.

So lastly, looking forward, clearly, the big challenges are ahead. Demand is expected to slow in the short term. And obviously, that will affect Alfa Laval's end markets as well.

With that said, we feel we're entering a possible downturn from a strong position. As you well know, our big strategic investment programs, including footprints and product programs, were planned to slow down in 2020 regardless. We've come a long way in implementing those. We've gone through a period over the last 3, 4 years of significantly strengthening the balance sheet and it was accelerated in this quarter.

And lastly, as you know, we were relatively early out with our fixed cost reduction program of approximately SEK 1 billion in 12-month running rate. We are well underway on track with implementing that program, as we described earlier.

And with that, let me then move onto the presentation. In terms of the key figures, as I said, largely in line with last year, largely in line with the guidance we've been giving to the market. Clearly, we had an impact on the – from the pandemic, both operationally and in certain customer segments. But overall, we kept our act together and markets kept their demand situation together fairly well. The margin in that context was OK. There were clearly divisional variations on that. So we will return to the divisional margin discussion in just a little while.

In terms of orders received at almost SEK 12 billion, it was a good start to 2020. I would like to point out that there are 2 relatively big factors affecting the size and the way you should consider the order intake. Firstly, we had unusually big currency swing, especially relating to the Norwegian crown and U.S. dollar, and that resulted in a positive revaluation of the order backlog to the magnitude of SEK 800 million. And let me point out that we always have revaluation effects, positive and negative. We don't make a big fuss about it. We think it doesn't help you in interpreting the numbers. But this time, it was of a size and the magnitude and specifically in the pumping system business, we wanted to alert you to the fact.

Second and sort of working in the other direction, when we compare to last year, actually, the first quarter last year was the last quarter with large order intake for scrubbers. And the order intake difference between the first quarter last year and the first quarter this year was of approximately the same size, SEK 800 million. So if you do the math on that, and it's not so complicated, you will find that if we disregard the currency aspect and disregard the scrubber business for a moment, in fact, the rest of the portfolio was stable in terms of order intake. And consequently, our comment – it was a fairly stable comment from quarter from many points of views.

Let me go to – sorry, service. Clearly, in the quarter, service execution has been complex for many points of views. Customer admitting our service technicians, ability for our service technician to travel and the list goes on. In that context, we were happy to see that the service organization delivered another strong quarter after an already strong 2019. The organic growth year-on-year was approximately 10 percent. And sequentially, we were about 3 percent to 4 percent up. In fact, all 3 divisions contributed well to the growth. It was a solid service quarter for us.

As always, and I remind you, service tend to increase, not necessarily in absolute terms but also in relative terms in difficult times, providing a bit of a natural hedge to the margin development of the group. We

see right now, service growing faster than capital sales, something that we perhaps should expect at the moment. Let me finish the service discussion with a small little anecdote to give you a picture what happens out in the field. We had a situation down in Dubai, early March. Service technician boarded a ship in order to resolve a scrubber issue. He came on the ship in early March. He ended up being 5 weeks on that ship. He passed Singapore 3 times before finally being able to be allowed to get after ship, given all of the limitations in various harbors he saw most of the world before he actually managed to get home in time for Easter.

We had not planned him for 5 weeks duty on a single ship and I think this shows a little bit what happens when things go wild out there in the corona world. And again, with that said, I think the service organization under those circumstances managed to do a very good job. Let me move to orders by region. It was a very strong quarter for our Asian business. About 42 percent of the order intake came from Asia. I think we have been maxing out on 45 percent a couple of quarters ago. So Asia certainly is a very important core market for us now and going forward. It's especially noteworthy that China returned to solid year-on-year growth despite the complications we had in China in connection with the Chinese New years. In all – in fact, all 3 divisions were at or significantly better than last year, including the Marine division.

Let me move to the other parts of the world Going West, Eastern Europe was strong. Across most markets, that includes Russia and Turkey. We had good growth in the region as a whole. Western Europe was solid. We had growth in a number of core markets, including Germany and in fact, Italy in the quarter. Nordic had a tough comparison versus last year. But other than that, from some large orders, we had a stable development and a good track in most of our businesses, including in Sweden. Latin America despite some turmoil grew well, including Argentina. And then finally, North America, both Canada and the United States were clearly affected by the collapse of the oil market and oil price. And we saw some project delays, and we

saw some reduced activity in the market. And consequently, that impacted as a whole, the North American market to a negative comparison versus last year. If we move to the chart of the top 10 markets on the rolling 12-month basis, you can see that overall, in a large market, there is a fairly good stability on the rolling 12. And the 1 noteworthy thing on the picture is that China is getting very close to United States to become our biggest market. That has been constant development over the last 5 years or so, U.S. is still ahead. We will see where it goes in a couple of quarters, but China has been seeing good momentum as we speak.

Moving onto profits and margin. After a couple of strong invoicing quarters during the later half of 2019, a invoicing was as expected and guided a bit lower and ended up just slightly higher of the first quarter 2019. Margin developed slightly negative to a degree, reflecting negative currency effects in the marine divisions. I will come back to that. Let me comment on some supply chain issues at this point and give you some color to where we are on that. We obviously saw some downward pressure on margin related to lockdowns and everything else in the distribution and the logistics chain. Everything else being equal, of course, it would have been a better situation for us. Still, the operations team did a fantastic job in maintaining customer servicing deliveries in a very good way. We dealt with situations in France, Italy, China and to a degree, U.S. where we face complicated delivery and uptime situations. And at this point in time, we are basically able to operate at pretty much full capacity in all of those markets. So largely, at least for now, we have temporarily resolved the situation for us and to a large degree, our subsuppliers in those regions.

At the moment, those markets are reasonably stable from a supply point of view. The one remaining issue we are facing is the lockdown in India. It is our short-term concern. We are operating at partial capacity at this point in time in India, but it is a highly uncertain situation. And it does, among other things, affect our Indian business and on its own. It affects the under-absorption in our Indian operations. And our supply capability, both in India, but to a degree

also for export market to other Alfa Laval markets. And finally, we also have some Indian suppliers that may – that is delivering to Alfa Laval outside of India. And also here, we have some challenges. So as you can hear, there are a number of issues that are on the troubleshooting level at this point in time. I will not guide you any specifics on that. We've been facing similar situation in a number of other markets, and we solve them well. So let's see where we go. But the Indian situation is potentially a bit more complex just from the way the country is managed and the size of the issues, including logistical problems in India in itself.

So with that, let me run through the divisions quickly and start with the energy division. We had a solid quarter in energy with high invoicing. We had good capacity utilization in our manufacturing structure. And we also had a continued low-cost of quality in the quarter. That resulted in a record margin of 16.1 percent and then earnings growth of 25 percent year-on-year. The demand trends were a little bit mixed. There were some clear weaknesses in the oil and gas market excluding offshore. And I want to remind you that in our oil and gas market in energy, about 50 percent is petrochemical, so you can classify it more or less as the chemical side, about 10 percent of the order intake of the Energy Division is related to upstream oil and gas. So while it is, of course, a concern, most of the onshore upstream oil and gas business is not in our books today. We don't expect it to return, obviously, very quickly. It may go down, but of course, the impacts are somewhat limited, given the already low level.

In terms of the strength in the Energy Division, we clearly saw good growth in energy efficiency solutions across a number of end segments. So like HVAC, like refrigeration, and that includes applications like data centers and others. So in terms of the division's transition gradually into sustainability solution and energy efficiency solution, that was very visible in the order intake composition during Q1. We have been making good progress in the repositioning of the energy division for a period of time, it came very clear in Q1.

Going onto the Food & Water division. It was an overall stable performance and a good margin of 16 percent, although a little bit lower than last year. After the very high invoicing and capacity utilization in the second half of '19, we did see somewhat slowing production rates with a small negative effect on the margin development in the Food & Water division. Demand was decent, resulting in a positive book-to-bill of 1.08. And that was supported by a number of good end markets in the quarter. To mention a few of them, the biotech side, the dairy side and in fact, even brewery was quite good in the quarter in terms of end segments.

Going to Marine Division. The order intake was, in a sense, stable at SEK 5 billion overall, but below the SEK 5 billion top line, there were some aspects of the currency and others that I highlighted earlier. So in Q1 '19, with a strong order intake of scrubbers, we ended up with a delta on the scrubber intake this quarter versus last year of about 800. And about the same number came out of the revaluation of the backlog in positive terms. So most of the revaluation is that we have in our books was related to marine and was specifically related to Pumping Systems and Framo.

So again, on the Marine division, we have the same situation, excluding currency and excluding the scrubber business, the rest of the portfolio was stable compared to last year. The margin decreased 3 percentage points versus last year. It was affected by mix changes, including an increasing share of invoicing from a PureBallast Water applications. With the resulting dilution from sharing the profits with our joint venture partner, but the pure ballast business performed well, continued well in line with plans during the quarter. We then had about 2/3 of the negative effects on various currency-related issues. And I will leave it to Jan to go through the bridge between last quarter and this quarter when it comes to the currency issues per se.

Demand was good in offshore. It was good in pumping system. And overall, it was reasonably stable in most product categories other than the scrubber business related to a situation where the retrofit market is

expected to continue on a very weak level, giving the small price spread and the collapse of the crude oil prices, we don't see any recovery on the retrofit side, around the corner. We do, however, continue to expect some level of business on the new build side, also scrubbers. The demand forecast in the marine is reduced by external forecasters when it comes to the yard contracting for a number of ships. The external forecasting now indicates a return to the 2016 contracting level of around 800 ships or so. We will see where that forecast go, but if the forecast is correct, and we look at the ship classes that forms the basis for Alfa Laval's business in the Marine new-build segment, that would indicate over 2020 a possible reduction of the business opportunity for Alfa Laval in the Marine new-build sector of around 25 percent.

For your reference, the new-built order intake in the Marine Division is approximately 30 percent of the total. So again, if you do your math on that, it would correspond to a 10 percent opportunity reduction, everything else being equal for the Marine Division in connection to the new forecast presented in the market recently.

And with that, I will hand over to Jan for some further financial details to the quarter.

Jan Allde:

Thank you, Tom. As Tom has covered all intake, I will move directly to sales. We realized invoicing – sorry, we expected invoicing to be on the same level as Q1 2019, and we realized sales of SEK 10.6 billion in Q1 2020, which is a growth of about 4 percent. With regards to Q2 sales, my outlook is as follows – We expect invoicing to be supported by the good order backlog at hand. However, considering the market outlook for Q2 and potential supply disruptions caused by the COVID-19 situation, we expect the in for out orders to be lower than last year, and therefore, also the total invoicing level to be lower than Q2 of 2019. Looking at the gross margin. The gross profit margin came in about 40 basis points below our Q1 2019. And let me give you some year-on-year comments there.

We had a positive capital sales service mix in the quarter. However, a negative product mix both in capital sales and service, primarily related to marine division resulted in a small negative mix impact in the quarter. The load/volume impact ended up neutral as expected. However, we did see a positive impact from PPV metals in the quarter due to the lower metal prices. Finally, we did see a negative FX impact on the gross profit margin related to our marine operations in Norway due to the weakening of the NOK-U.S. dollar exchange rate. I will provide some additional comments on this later in the presentation. Now over to my outlook for Q2. The starting point is the 35.9 percent gross profit margin we reported in Q2 of last year, we expect a positive capital sales service mix, but also that the negative product mix in marine from Q1 to continue into Q2, giving an overall negative mix impact in the quarter. We anticipate a continued positive PPV metals impact in Q2. However, this will be more than offset by an expected negative load impact due to the reduced invoicing levels. And finally, we expect FX to continue to have a negative FX impact on the gross profit margin in Q2.

Now a summary on the divisional performance. So starting with the Energy division, as Tom was saying, good invoicing growth and favorable factory load resulted in an improved operating margin in the quarter. Food & Water reported stable margins, a positive mix impact from higher share of service could not fully compensate for the lower invoicing and load in some factories. The operating margin in Marine was negatively impacted by unfavorable product mix, a negative FX impact and higher royalty payments on the PureBallast business. The negative FX impact included both a negative FX revaluation impact and an FX dilution impact that reduced the operating margin by approximately 2 percent. The FX revaluation impact is more of a temporary effect coming from the revaluation of balance sheet items expressed in foreign currency caused by the weakened NOK-U.S. dollar exchange rate. Secondly, the weak NOK-U.S. dollar exchange rate also inflates the invoicing level in the Marine Division impacting the EBIT margin negatively as we recognize revenue at the prevailing rate, while our project gross profit levels are fixed in absolute value

through the currency hedging. It is expected that these negative effect or negative FX – negative effects will continue into the second quarter for the Marine division.

So let's look at some of the key figures in the quarter. Sales and admin expenses were flat in Q1 versus last year. And considering the sales growth, S&A in percent of sales decreased from 16.4 percent to 15.8 percent in Q1, with a direct impact on our overall profitability. R&D expenses increased by 11 percent versus last year on a comparable basis. However, it was on the same level as Q4 2019, reflecting all the ongoing product innovation programs. Net other cost and income increased by SEK 79 million versus last year, and this increase is explained by an increase in royalties paid to our ballast water joint venture partner in the Marine division. Financial net, excluding FX impact, was minus SEK 50 million in Q1. And the FX gains, losses amounted to a negative SEK 91 million, giving a total finance net of minus SEK 142 million versus a positive finance net of SEK 151 million last year. The FX losses were primarily related to the revaluation of cash positions in foreign currency.

The tax rate was 26.1 percent in the quarter as per our guidance. EPS was down 16 percent versus last year. The decrease was mainly due to the negative FX impact on finance net, as our operating result increased by 4 percent compared to last year.

Finally, with regards to the ongoing cost reduction program, we are progressing well with the actions to achieve cost savings of SEK 1 billion on a 12-month rolling basis with a gradual impact as of Q2 2020. This means that when fully up and running, the cost savings will amount to approximately SEK 80 million per month or approximately SEK 500 million to SEK 600 million for the full year 2020, depending on the length of the program, including work time reductions, reduced traveling, et cetera. This corresponds to savings of approximately 6 to 7 percent of the fixed cost versus 2019.

Now some comments on the cash flow statement. Cash flow from operating activities was SEK 959 million in Q1, on about the same level as last year, including a similar level of increase in working capital as last year. The increase in working capital was primarily driven by increase in inventory, partly offset by an increase in customer advances. Important for us at this point is to secure supply of material, considering the risk of supply and transportation disturbances caused by the COVID-19 situation.

Investing activities included CapEx investment of SEK 207 million in Q1 2020. Hence, a reduction of approximately 50 percent versus last year, as the wave one of the footprint program was completed at the end of last year. Considering the current situation, we are further prioritizing our CapEx decisions and a revised guidance for full year 2020 is now at SEK 1 billion.

As we also divested some fixed assets and received the remaining payments from our greenhouse divestments in the quarter, the total cash impact from investing activities amounted to minus SEK 83 million versus SEK 494 million negative last year. Financial net paid, excluding FX impact, was minus SEK 22 million, about the same level as last year. And the net realized FX gains and losses amounted to minus SEK 325 million in the quarter, giving a total finance net paid of minus SEK 347 million versus a positive financial net paid of SEK 167 million last year.

The FX losses in Q1 was related to the exchange loss that incurred in relation to the repayment of the EUR 115 million EIB loan in March as well as the revaluation of cash positions in foreign currencies mentioned in the previous slide. This means that our pro forma cash flow in Q1 came in at SEK 498 million versus SEK 709 million last year. However, our cash flows from operating and investing activities i.e., cash flow, excluding the impact on the FX losses amounted to SEK 876 million and well above last year.

Our net debt-to-EBITDA ratio now stands at 0.88 and excluding the lease liabilities at 0.59. And finally, last week, we successfully extended our SEK 900 million RCF program by one year to mid-2020, thereby securing our strong balance sheet and liquidity situation during the (22) – sorry, ('22), so (mid-'22). And thereby, associate, securing our balance sheet and liquidity situation during this uncertain economic situation.

Looking at the FX so the transaction FX effect on EBITDA in the quarter was positive SEK 60 million, and the translation impact was positive in giving a total positive FX impact on EBITDA of SEK 90 million in the quarter. Please note that this FX analysis does not include FX impact caused by revaluation of balance sheet items in foreign currency and the FX margin dilution effect that impacted the operating margin in the Marine Division in the quarter.

Looking at the projection for full year 2020, we expect a positive transaction impact of SEK 530 million and a smaller translation effect of SEK 20 million. In total, a positive FX effect SEK 550 million on EBITA. Please note, however, that these estimated impacts are based on the current FX rates, and does not necessarily have a positive impact on the EBIT margin as per my previous comment.

Now looking at the order backlog at the end of March. So we had a total order backlog of SEK 22.9 billion, an increase of 6 percent since year-end 2019, as we had a book – positive book-to-bill ratio of 1.12 in the quarter. The order backlog now represents 5.8 months of LTM sales. For shipment in 2020, the backlog amounts to SEK 15.5 billion, a reduction of SEK 1.1 billion compared to the same period last year. Approximately SEK 400 million of this reduction is caused by the sale of the Greenhouse businesses and the remaining reduction is primarily related to the Marine Division.

Let's move on then to the sales bridge for 2020. So starting with the sales of SEK 10.6 billion in Q1 2020. And as stated in the previous slide, the backlog for shipment in the remaining part of 2020 is SEK

15.5 billion. And this adds up to a total of – or sub total of SEK 26.1 billion. On top of that, you will need to make your estimate on price change in for out orders and FX translation impacts.

And by that, I hand back to Tom.

Tom Erixon: Thank you. And let me make some comments around the outlook statement. As indicated earlier, we do expect a weaker market situation at large in the next few quarters and in our scenario thinking, we will see a gradual recovery coming up. And that means that our strategy to deal with this situation at this moment is to use maximum short-term flexibility to adjust our cost structures to a lower temporary demand situation and be ready to scale up as the worst problems in our end markets are being overcome. We do this in a context when during the last 3 years, we felt – we built a strong and competent organization. Investments in product training and application training alone has been significant over these 3 years, and we are aiming to have that strong and well-trained team in place and ready to go as we come out of the dip.

Given that a large share of our white-collar organization in sales, R&D, IT and so forth, are working from home, we have decided to significantly slow all development programs in the group and just to focus on the essence of customer service of selling, producing and delivering goods to our customers. And take a little bit of a break in some of the development activities where, at large, we already come a long way in terms of completion.

That is the strategy behind the SEK 1 billion fixed cost reduction that Jan has described. And with that, we feel we have a good chance to keep stability on employment levels in place. As always, we may take structural actions in specific product areas or business areas where we see long-term market shifts. Some adjustments have already been made to the U.S. upstream oil and gas businesses. Over in the U.S., we will, obviously, in the quarter and looking forward, be ready to take

further actions in some areas if we feel we have a restructuring need that goes beyond what we see in the current COVID-19 scenario.

Then finally, given the increased uncertainty in the global economy, I will not give special divisional outlook statements today. For the group as a whole, we expect a lower demand in the second quarter compared to the first quarter. But I will waive the possibility to try to guide you into the specificity of all our different end markets. I fear the reliance on my comments will have limited value.

So with that, we open for questions.

Operator: Thank you. Ladies and gentlemen, as a reminder, if you wish to ask a question, please press "star" and "1" on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the "hash" key. Once again, that's "star" and "1" if you wish to ask a question.

Your first question comes from the line of Mattias Holmberg from DNB.

Mattias Holmberg: Looking at the Marine margin division, there are a few moving parts in Q1, and I'm simply trying to understand what's sticky and what's not essentially? So I understand the FX reevaluation, that's obviously more or less a one-off. And I guess that to about 100 basis points. However, when I look at the cost increase, which landed at SEK 118 million year-over-year, so roughly 270 basis points. You comment that it's largely driven by the royalty payments for PureBallast. So could you please help us in being a bit more specific perhaps in sort of how big share of that cost increase was related to these royalties? And also perhaps if you could elaborate on if you expect the ballast mix to remain the same going forward?

Jan Allde: Yes. But we – if we take the question around the royalty payments, they increased approximately with SEK 70 million versus the same quarter last year. So to answer your question, I mean, more fully, we – so you had a drop in margin around 3 percent. What we were showing

was that the FX impact was about 2 percent of that drop. And you had 2 FX impact, which represented roughly 50 percent each of that. And what I also said was that we expect those impacts to continue into the second quarter.

Mattias Holmberg: And in terms of environmental mix, it seems like you've had deliveries rather stable for marine environmental products over the past couple of quarters. So is it fair to assume that this should hold true also going forward? Or should we expect a pickup, say, in installments of scrubbers or ballast systems in the coming quarters?

Tom Erixon: I don't think you should expect any pickup in scrubbers. I think, as I indicated, clearly, the retrofit market in current market conditions are not likely to recover. We had some bookings for sure in Q1. So there has been a market. We expect there will be elements of it in the quarters to come. But currently, we are delivering the backlog on the scrubber business, and that will gradually face during the remainder of this year.

Operator: Next question comes from the line of Andreas Koski from Nordea.

Andreas Koski: It was actually about the royalty payments as well. So could you clarify how they were? Are you paying the royalties on a quarterly basis in line with what you are selling? Or how do you pay those or royalties?

Jan Allde: Well, well, we – I mean, we, of course, whether we pay them or not, but we certainly accrue for the cost on a quarterly basis.

Andreas Koski: OK. So the cost comes up in line with the volumes that have increased basically. So if the volumes remain unchanged in Q2 and Q3, you will still be on the same kind of cost level. As you run it?

Tom Erixon: No. They are calculated on profits, not on volume. Now you may assume that there's a correlation between the 2. It's a fair assumption, but we are certainly not paying any money if the business doesn't perform.

Andreas Koski: OK. So – but if you would make the same kind of profit then the cost would be the same one in the coming quarters.

Tom Erixon: Yes.

Andreas Koski: OK, great. And then on environmental products overall, I think you had sales of around SEK 1.7 billion. Related to environmental products in Q1, and it was the same in Q4 and Q3 last year. Could you just give us sort of a sense how much of that is related to scrubbers and ballast water treatment systems. I would get around 1 billion scrubbers of 700 million balloter treatment systems. But is that a fair assumption?

Tom Erixon: Yes. We don't want to jump to details on this matter, but I would rather call it a 50-50. And that's not an exact number, but good enough for you to work with.

Andreas Koski: Yes. And then lastly, just to understand how you view the future because you guide for lower demand now in your sort of guidance framework, do you have something you would call significantly lower demand as well? Or is this the lowest demand outlook that you can provide?

Tom Erixon: You're trying to attach a number to the wording. I was trying to phrase this in a way that we probably face the option of saying nothing or putting a word to it. The only thing I know is that it's going to go down. I'm not – my crystal ball does not give me the transparency to guide you much better than that.

Operator: Our next question comes from the line of Max Yates from Credit Suisse.

Max Yates: Just my first question is around the Marine business. I just wanted to understand, within your overall mix, how much of your business is related to cruise vessels? I know you don't give your kind of Marine exposure by segment, but I just wonder whether this probably has been

a growing business, given cruise deliveries over the past few years, but I just want to understand in either of OE or aftermarket?

Tom Erixon: I'm not going to break it down for you. We don't go into that detail. But if you look at the statistics on the contracting level, you will find that there is approximately 30 cruise vessels contracted every year. If you go back in history versus the overall ship market has been 1,300, 1,400 ships for the last couple of years. So I wouldn't get lost in cruise, if I were doing the analysis in your shoes.

Max Yates: OK. I mean just because for other companies, it can be (inaudible) ...

Tom Erixon: But I'm just telling you the story for Alfa Laval.

Max Yates: OK. And then just my follow-up was on ballast water systems. So you talk about kind of having a pretty healthy demand this quarter. I was just wondering, could you give us the level of order intake, either compared to so last year because you mentioned scrubbers were down around SEK 800 million or either absolute, it'd be very helpful?

Tom Erixon: I was given in the previous question to answer that you could consider the environmental products in Marine, that is in the quarterly report about a 50 / 50 split then you get pretty close to the number.

Operator: Your next question comes from the line of Madhvendra Singh from BofA.

Madhvendra Singh: Sorry, I was on mute. Just my question is on the Food & Water division, where – I mean understanding is that this segment is a lot more compared to the others. Could you talk about the trends there? Have you seen any impact on your customers' operations this time around and in second quarter specifically as well? And what kind of service trends are you seeing as well in the Food & Water division post-corona impact?

Tom Erixon: It's a little bit challenging to conclude fully on your question, we have to realize that although we all talk about corona right now, most of Q1

was not affected by this at large. We are talking about the time period that to a large degree, were pre corona affected. I would like to add in this context that March for us, including service, including Food & Water, essentially across the board, was a strong month. Typical for us, the order intake is good in the last month of the quarter, and that pattern repeated itself. So for the time period that we are talking about, we didn't really have any negative impacts and certainly not in service, which was well-performing across the board.

With that said, are there difficulties in service? Yes. Could it have been better even? Yes, we probably could have, but it was a couple of weeks of a quarter that was at least for Europe and the U.S. having any meaningful effect. So we didn't see any sharp change. However, with that said, I think for my comments, we are concerned across the board, including the Food & Water side. In terms of how demand will look. I don't think there is particularly much sweet spots in this economic crisis. So I wouldn't – I personally don't bet that service, Food & Water and everything else that we sometimes talk about is completely resilient to any economic scenario. I think we have to expect to see a broader effect, and that is the scenario from which we are working. I hope I'm wrong, and I will let you know in a quarter. But for now, we take a cautious view on the demand trends, including the Food & Water division.

Madhvendra Singh: And on Marine side, because of the low oil prices, we have seen a massive increase in the oil tanker demand for storage purposes. I'm not sure whether that relates or drives higher demand for servicing at all for your products and services generally. Can you talk about that?

Tom Erixon: Yes. The tanker market is a bit unusual at the moment due to the fact that there is a lot of tankers being used for storage. But it's absolutely true that the rates are good, profits in that segment for the moment are good. I don't think there's a lot of shipowners that would put too much money on being long-term storage keepers as opposed to transportation facilitators. So there are swings in this market. I don't think it has a huge effect on Marine when it comes to our service

business, spare parts business and so forth. But in general, when we look at the ship classes that are important for our business, and I was referring to the minus 25 percent versus you see a smaller decline in the ship classes we are working with then for the market as a whole. And that is a reflection of the fact that the tanker market is somewhat stronger than some of the, let's say, the bulk carrier, the dry bulk carrier and some other ship classes that tend to be big in number.

Madhvendra Singh: And finally, I want to just touch on the supply chain and logistics, how you manage it, given your global nature of operations. I'm just wondering how well aligned are your production factories versus your customers? And whether this current corona crisis and resultant disruption to the logistics and all is going to drive further localization or regionalization for your factories and service sales?

Tom Erixon: Yes. I think that's a question on many people's mind right now. My personal reflection on it is, moments of crisis or not moments for redoing strategy. I think sometimes we get a bit overexcited and we overdo the conclusions as to what this pandemic will have for a long term effect. I think at the moment, we are very focused on troubleshooting, working with what we have. And to some degree, by necessity having to shift some of our suppliers away from certain markets and into more safe havens in order to short-term create stability for the supply chain.

I think let it go half a year or a year, and we will have to think a little bit about whether the overall trends will be forced into a subscale localization strategy or not. I'm not there as a change. What I would say is that, of course, we and a lot of large industrials have for a long time, at least, worked with regional supply structure. So we don't do all products in all regions, but we have a reasonable balance between how much production we have located in the Americas and in Europe and in Asia versus how much our business is performing. And of course, you're never quite finished in that trend. So I expect we continue to see some of that balancing out going. But that really has been a matter of

long-term supply change strategy as opposed to any big disruptional force driving the decision.

Operator: Thank you. As a reminder, if anybody wishes to withdraw their question, it's the "hash" key.

Your next question comes from the line of Klas Bergelind from Citi.

Klas Bergelind: Tom and Jan, it's Klas from Citi. So first, I'm trying to understand the revaluation there in Marine and I'm not talking about the EBIT impact. I'm talking about order book. You talked about better demand in Pumping systems, both on cargo and on offshore on the pumping side. But then we have the revaluation effect. Tom, can you help us with our comments, as the revaluation is boosting the headline number? It's tricky for us to see what is underlying. What's a firm underlying improvement on the turnkey side, just so we understand the comment there?

Tom Erixon: No, I think even if you eliminate – and that's why we made it very explicit for you to be able to make the math yourself pretty much. There is – it's a good quarter, call it, a normal quarter for the pumping system business overall. So on the back on recent tanker contracting, that side has been OK. Of course, with another (SEK 800 million), that would be – well, I mean, SEK 800 million is real, right? So it's there. But as Jan said, since we are hedging in our gross profit level on those contracts, then it doesn't really create any more money for the shareholders. It's just a little bit of an inflated revenue number coming out of the pumping systems in the coming year.

Klas Bergelind: Yes. Good. I just want to confirm that the underlying was there. Then the – on my second 1 is on the scrubber side. Sorry, I know you don't like scrubbers, but quite at least (inaudible).

Tom Erixon: (Inaudible).

Klas Bergelind: Well, this thing that I'm going to ask about can be significant, and that is why I'm asking. And that is given the collapse in spreads, do you

also think we can see cancellation out of the existing backlog? Or should we just be concerned about low demand looking at orders?

Tom Erixon: I mean we are – in any crisis that you come into, and this is just a typical crisis with uncertainty and uncertainty among customers and financial markets. There is always a heightened risk for cancellations. I don't see a specific scrubber cancellation risk, particularly. I think there are – we have to be acutely aware that the order backlog needs to be monitored carefully. We have reviewed with some extra attention moving into the Q1 report in certain areas of where you could see and possibly think about an elevated risk. We don't see any of those trends at this moment in time. Are they there, possibly? Yes, they could be. But that's not what we've seen. We don't have any meaningful cancellations on our order book.

What I would say is – and this is not a specific comment, this is a general comment. In some areas, we've seen cancellations of signed orders that have not been entering the order book because we haven't received a down payment. So I would – for me, that means that there is some substance and stability in the agreed and down-paid projects because we don't see that moving pretty much at all. Whereas on – in the project pipeline, including when you move to ones that have been signed, the volatility has been a little bit higher. And with that said, it hasn't been dramatic there either, but just to put a fair valuation and color to the picture of the risk of how we see the cancellation side. So I would say for the moment, OK, but obviously, it's something we need to continue to monitor.

Klas Bergelind: My final one is on services. And you obviously have strong growth in the quarter, and that's good to see. Is that what you – is that what you're seeing now also in April? And the way I'm thinking about this, at least, is on Alfa Laval on heat exchangers is that you don't consume that much spare parts. The bottleneck risk, if you compare it with a compressor, for example, might not be there. And you managed to pull-through some good growth in the marine side, even if there were issues with technicians being stuck out on waters. I'm just trying to

gauge how sensitive Alfa Laval's service businesses against the current lockdowns? It doesn't really look like it so far. But obviously, it will be a problem. But if you could talk about spare parts and also a little bit what you've seen in April?

Tom Erixon: You will not get any comments on April, of course, because we are sticking to our quarter number and then take second quarter when we are there. It is a – I think we can say like this, for the time period we are talking about, the stability was probably a bit better than we expected. There are clearly areas where we can – we do not get access to sites the same way. It does affect – I want to say everything else being equal, it could have been a better quarter for sure. On the other hand, there are also some other aspects showing up. And one of them is that this is actually a good time when some processes are down at customers that it is a good opportunity to service some of the equipment. So I'm not going to balance those 2 factors out by any means. I don't think there's going to be a big flood of projects related to opportunistic service work when people are idling. But we do have various effects in the service business related to the current situation.

I said before, and I will repeat it again. I don't think it's reasonable to assume that there are any particular points in our business that is totally immune to a general economic downturn. We will see people who are not making money, who will cut down where they can, and that would probably also affect our service business. I do expect that the share of service still will increase as the share of total. I will assume that it is a natural hedge on a margin deterioration as it always is. So I don't see anything different in this downturn than in any historic downturn from that point of view. But let's see when we're in Q2, what the real effects are. As you can hear, I'm just taking a cautious attitude to all parts of our business at the moment. And we are happy that March finished well, but second quarter is a different story.

Operator: Your next question comes from the line of Denise Molina.

Denise Molina: It's Dennis Simone from Morningstar. And I just want to come back to energy and looking at the last downturn in the sector. And I appreciate that you're not really that exposed in terms of the small portion of the upstream exposure. But if you think about upstream, a lot of that affects the refiners because of the integrated. So if you look at 2016, you had a pretty steep drop-off in sales for Energy relative to 2014. So I'm just thinking that it's kind of a mid-cycle business for you and that there's a lot of contractual revenue associated with the CapEx that's probably already in the books for the energy or the integrated, but we've already talked about cutting CapEx pretty severely. So just wondering if you think there's going to be sort of another lag effect for you this turnaround in the cycle in terms of that business? And if that's an area where you're going to be cutting costs more than, say, minimally to invest?

Tom Erixon: Yes. It's a good question. I'm not sure I have seen that effect just around the corner. It is obviously a risk when you look at it. Our view on the mid downstream businesses for some time has been that for us in terms of capital sales, it's been migrating east for a period of time. We've seen limited upside or, call it, a certain downside in the North America and possibly European structure for a period of time. We do see continued investment activities, especially in China. We would in Saudi, Middle East as well, but we may see some disruptions of that due to the price collapse.

But certainly, and also, as you could see from this morning's press release, the investment activities in Asia in order to create a larger energy independence. They are ongoing. And we thought – obviously, the order was just down paid recently. So, but we thought it was a good color for this call as well, that you see that the refinery side of our business to recontinues. And we have a very strong order pipeline already for our project business in this area. So for the short period of time, over the next quarters, I don't see any immediate downturn when it comes to volumes, sales deliveries, percentage of completion or whatever in terms of the ongoing financial metrics that you will see on that business.

Operator: Our next question comes from the line of Malte Schulz from Commerzbank.

Malte Schulz: On if you maybe shed some light in the current crisis, I mean, you have a quite strong liquidity. Would there be any kind of opportunity or where you would think that you would do an active M&A action at this moment? Or are you clearly committed to keep all the cash to whether the crisis and to be ready to – for an even stronger downturn?

Tom Erixon: I think the whole point of being a disciplined buyer when prices or skyrocketing when M&A deals are not creating shareholder value. That period has been going on for a number of years. We walked out of those processes. We built our strength also from a balance sheet point of view. I think if market and valuations go the way, I expect right now, there will be opportunities in the M&A markets going forward. And that is the time when we are much more interested in taking action than overpaying with shareholders' money for assets that can never pay back their own investments.

So yes, I think this is exactly what we expect to see. With that said, as you know, when you come into a revaluation period, when you come into crisis period, it tends to take a little bit of time before buyer and seller agrees on a new price level, a new valuation level. So I don't foresee that there will be a lot of transaction going on in the market right now in a quarter or so. But give it a few quarters or a year going forward, and I think there will be opportunities that we're interested to look at.

Malte Schulz: And maybe another question on general energy efficiency on top. If we see particularly oil price energy price is quite low at the moment. Do you expect that it will be a generally lower investment demand from clients as you have less and less net savings?

Tom Erixon: No, I don't think so. I think the movement has started towards decarbonization. If we look at many of the customers we are working with in this area, be it heat pumps, be it more efficient air conditioning

solutions, be it data centers and the owners of data centers, who are acutely aware of the environmental impact on energy consumptions from data centers. I don't think they will take any short-term oil and gas price considerations into their decisions. There may be some optimization projects on the margin in process industry that where you potentially would look at payback analysis that delays such an investment. But for the large part of what's growing in our portfolio, I don't see the energy prices as such as a problem. I, of course, see the general end market problem of the crisis possibly affecting that. But as I said, so far, so good, March was strong from that point of view, and let's see where we go.

Malte Schulz: OK. Maybe a final question on what is you said that the overall level, there weren't a lot of cancellations, but this you had a lot of requests of delaying projects by year 2, maybe from some time? Anything to..

Tom Erixon: No, it has not – up until now, it has not been on any red alert level at all. It's – I mean, there's always changes in the portfolio. And normally, we don't talk about it in the earnings calls today. So it's part of a natural thing. Is it on somewhat of a higher level? Yes, that's probably reasonable to assume, but it's not on the level that we actually sit then and make any large adjustments to our delivery expectations for this year. And what you saw from Jan's presentation in terms of the backlog, I think, represent our current belief in terms of whatever in that number is already baked in whatever possible delays that we would expect at this point in time. We're not saying it could not happen, it may, but it hasn't been a big factor so far.

Operator: Our next question comes from the line of Robert Davies from Morgan Stanley.

Robert Davies: Actually, my questions have all been covered.

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

Andreas Koski: Thanks for taking my follow-up. I can see that the hour is out. But just quickly on the energy margin, which was very strong, and you are referring to a positive mix effect. I just want to understand what kind of mix effect that was and if this is sustainable and sticky for the coming quarters and years?

Tom Erixon: Well, let me make a few comments to the Energy division. That is a bit broader than your question. Number one, we have worked in Energy division as well as in the Food & Water division, a lot with project-focused applications, project execution in order to keep our cost of quality on a tighter range than in the past. And as you've seen, we have in our P&L over the last few quarters or even years, have very few quality costs that popped up in the P&L. We worked off the backlog of some project problems from the past. And the cost of quality has a positive impact on Energy division now. We obviously expect that to continue. And with that said, we can all have a quality mistake somewhere. So let's not be overly confident in that. But we've seen a long-term reduction very stable over a number of years now. So that gives us good confidence for the future, number one.

Number two, we worked with underlying profitability level and capacity utilization in our project business, specifically in business unit welded that tends to be larger projects, including to petrochem and refinery sector. And that work has paid off. So we see somewhat of a more stable profit margin in those businesses compared to a couple of years ago. Thirdly, the mix issue, I wouldn't go on a product level on that. But of course, the transactional business, including the service business put together carries a better margin than large projects. And we see a little bit of effect on that in the Q1. We saw a little bit of the opposite effect in Q4 when we typically have relatively large project invoicing coming through. So there are some mix effect of that nature. I think that covers the margin in Q4 Energy pretty full out, I think.

Thank you. We are ready to take a last question, and then we have a very limited here with relatively few participants. And so we're going to have to break after this question.

Operator: OK. Your final question comes from the line of Lars Brorson from Barclays.

Lars Brorson: Tom, hope you're well. I'll try my 3 questions. I'll try my love with 3 quick ones. Instead of 1 long one. Just on the marine service growth, I thought we be a gradual slowdown in Marine services after that should we say sort of super normal growth we saw in the second half of '19, particularly around reconditioning work, was actually taking another leg up here. Can you talk briefly about the sustainability of that? And whether we should think about marine services continuing that sort of sequential trajectory through 2020, notwithstanding some of the near term issues?

Tom Erixon: Yes. No, it's good. We have guided you already last year that we will see some IMO-related fuel regulatory-driven service works, driving up the Marine service temporarily. I think it's safe to assume that we will see that starting to wear off a little bit. With that said, and we also commented that over a period of time, all aspects of the Marine divisions service work has increased. So it hasn't been just an add-on of something that is temporary. We've seen a stable growth in all areas. And I think the work we've been doing with the international marine service organization and a couple of other things has helped us to support the volume growth. So there is an element of wearing off on the service work related to the IMO regulation.

Lars Brorson: Clear. I was late on the call, just on order cancellations time. Did you say that was all confined to you as onshore? Or was there more broad-based cancellations across the oil and gas business?

Tom Erixon: Well, they are not broadband calculations anywhere. The ones we saw on onshore was, in this case, signed but not down paid. Consequently, it was never in the order book since we don't book it formally. So the cancellations delay processes that we note are, yes, they are on the relatively small, but still the business on onshore in the U.S. Obviously, they are very visible in the product pipeline and to a degree the discussion of signed projects. But – so from adding to the order

book, I think our expectations are limited, obviously, but we don't see any lot of integrity problems in the current order book per se.

Lars Brorson: Clear. And just on the SEK 15.5 billion backlog for delivery for the rest of 2020, how much the scrubbers, are you able to quantify that 10 percent, 15 percent?

Tom Erixon: And I don't think we'll give that number. We'll return to you in that case

Thank you. And with that, we unfortunately have to close since the AGM is a little bit different this time. There will not be a speech from myself. Since the shareholders are essentially not present due to the corona problem. We have made the annual speech into a film that's going up on our homepage in an hour or so. It gives you a little bit of color for those of you once this whole frenzy of today's earnings calls and the reporting season is over. If you want to get a feel for what we were doing last year with some color on development projects and other things, I would recommend you to take a look at it when you have some time and piece of mind.

So thanks a lot for this time. And if not before, I speak to you in the quarter.

Operator: That does conclude our conference for today. Thank you for participating. You may now disconnect. Speaker, please standby.

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