

**ALFA LAVAL AB**

**Moderator: TOM ERIXON**  
**3 February 2021**  
**9:00 a.m. GMT**

OPERATOR: This is Conference #: 8775435.

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Alfa Laval Q4 earnings call. (Operator Instructions) I do have to advise you that the call is being recorded today on Wednesday, 3rd of February 2021.

And your speaker for today is Tom Erixon, President and CEO. Please go ahead, sir.

Tom Erixon: Good morning. Welcome to Alfa Laval's Earnings Call for full year 2020 and the fourth quarter.

As always, let me start with a few introductory comments. Financially, the year was relatively stable with an order intake of organic minus 6 percent, with a clear margin uptick during the year and especially during the fourth quarter, and overall, a strong cash flow.

Operationally, we had a good year with almost all operating indicators improving further during the year. Safety was improved. The cost of quality was reduced. The delivery position was kept high during a problematic year and the project execution improved. All in all, we had a meaningful contribution to the positive margin development through the operational improvements during the year.

Strategically, we accelerated the portfolio mix change towards the environmental solutions, and we increased investments into areas like thermal

energy storage and hydrogen to just name a few examples. In parallel, we announced the restructuring program, addressing some structural demand changes in our portfolio primarily related to the hydrocarbon chain. I think you all can see the emerging of the new direction we are heading in for Alfa Laval in this context.

Finally, based on a stable market outlook and a strong balance sheet, we intend to resume dividend payments for 2020, and we also intend to initiate a share buyback program starting from the AGM in 2021. The program is estimated to be of a level of approximately SEK 2 billion per year over the next 3-year period in size. I'm sure we're coming back to that later during the call.

With that, let me go to the presentation and start with the key figures. Financially, as I said, a relatively stable year and a modestly higher profit margin all in all through the year. The volume decline in sales has been mitigated by good cost control and a good performance on operational parameters. The Q4 specifically was sequentially better but fell short in comparison in terms of order intake with the all-time high level of Q4 2019.

Turning to the Food & Water Division. We had a very strong quarter and a strong year with solid sequential growth and clearly positive year-on-year order intake, excluding the currency effects. Most end markets saw demand growth, including important areas like protein and biotech. Even the brewery end market was relatively stable despite challenging end market conditions in the brewery sector.

The pipeline of large projects were slow in 2020, and it was compensated by a mix of smaller projects in terms of the order intake. To a degree, the smaller projects and the change of mix is reflected in a better margin for the full year and for the Q4, specifically in the Food & Water Division.

The Energy Division is in transition towards energy efficiency solutions, and that continued in Q4 with good demand growth in the HVAC sector and other end markets related to environmental solutions. The distribution channel

continued to grow, reflecting a clear strength in our product offering and our channel partners in the Energy Division, and in fact, in the group as a whole.

Large projects continued on a low level in Q4 also in the Energy Division, mainly related to limited CapEx into the refinery and petrochemicals end segments.

Finally, as expected, the oil and gas sector bottomed out probably around mid-2020. The CapEx spending in the sector has started to grow from a low level, reflecting a small increase in the orders sequentially for the Energy Division.

Then turning to the Marine Division. Overall, ship contracting market was very modest in 2020. Most likely, we will end up below about 1,000 ships when the final count is in, in a month's time or so.

There is no major change anticipated for the first half of 2021, although I would like to point out that there are certain ship classes, like container ships and LNG carriers, where there may be a somewhat more positive outlook when it comes to the medium term. And those are ship classes that typically are important for Alfa Laval and our order intake in the Marine Division.

Consequently for the quarter, order intake remained sequentially low. The existing environmental applications were flattish in Q4. But I'd also like to note that investments into new environmental solutions increased during 2020 with a number of product launches with the ambition to provide shipowners with a stronger toolbox to combat the environmental impact of the global merchant fleet.

Financially, Q4 was strong with a solid margin of 21 percent despite lower volumes. There were many contributing factors to the margin improvement, altogether perhaps somewhat overstating the underlying profitability of the division in the quarter.

Turning to Service. Sequentially, we were back to growth in Service in Q4, although still behind the 2019 numbers. Food & Water again had a very strong year, including in Service, in Q4 despite a weak start of the year in the service order intake.

The Marine Division is growing service in new applications from a low level, but it doesn't fully compensate the decline from idling ships and difficulties to perform onboard services and reconditioning work.

The Energy Division had a mixed portfolio with steady growth in many end markets but a larger decline in some idling customer plants and processes, especially related to the upstream oil and gas.

The digital transition in Service accelerated in 2020 with significant growth in remote services, connectivity solutions and long-term service agreements. The increased investment over the last years into our digital service offering is having a meaningful impact on Service sales overall towards the end of 2020.

Then finally, some reflections on the order intake trends. We had about, as expected, a 4 percent organic growth sequentially as we guided you during the last earnings call. We had that growth despite a very low level of large orders.

And as you can see on the graph, typically, we tend to be higher especially in Q4 on large orders. And as I indicated earlier, the large orders are there in the pipeline, but they are taking a longer time to convert. I will come back to the outlook overall, but in general, we believe the market demand will be stable in the short term.

In terms of regions, the largest regions, as always for us, is Asia with approximately 40 percent of the orders coming from there. Apart from some very specific weaknesses, we have a good underlying growth trend in most of the Asian markets, and that includes China.

North America, after a weaker period in our books, saw a good quarter, especially in the Food & Water Division. Latin America had a very strong quarter across the board, across the businesses and in most of the regions of Latin America.

Northern Europe and Southern Europe was trending a bit down both in the quarter and full year. But overall, we saw a quite stable business situation there during the second half. Finally, Eastern Europe, we had a long period of

substantial growth, and that ended with a weak Q4 in 2020. We believe the underlying demand in Eastern Europe is better than what we actually saw in the order intake in the fourth quarter. So with that, I'd like to hand over to Jan for some further financial comments.

Jan Allde: Thank you, Tom. And I will jump into the sales figures.

So we expected invoicing in Q4 2020 to be lower than the same quarter last year but sequentially higher as Q4 is normally a stronger invoicing quarter. We realized sales of SEK 10.7 billion in Q4, which is 18 percent lower than last year but 10 percent higher than Q3, hence, in line with our expectations.

Please note that we have a fairly large negative FX impact on sales in Q4, and excluding this, sales were down 11 percent versus last year.

With regards to the outlook for Q1, it is the following: considering the lower order backlog versus last year, especially in the Marine Division, I expect invoicing in Q1 2021 to be lower than the same quarter last year.

Then looking at the gross profit margin. It came in at 36.6 percent in Q4 compared to 35 percent in the same quarter last year. We had a positive capital sales service mix due to a relative strong service invoicing in the quarter, offsetting a negative product mix in the Marine Division. Service represented close to 30 percent of total sales in Q4 versus 27.4 percent last year.

The load volume impact was neutral in the quarter despite lower invoicing as our factories have adopted their cost structure to the lower sales volumes. Also, the PPV/metals impact was neutral in the quarter. However, we do expect higher metal prices in recent months to have a negative impact in Q1. We did see a positive FX impact on the gross profit margin in the quarter.

Finally, the gross profit margin improvement also reflects the overall strong project execution that we have seen during the year with some small onetime impact, especially in Marine and Food & Water Division in the quarter.

Now over to my outlook for Q1. The starting point is 37.6 percent gross profit margin reported in Q1 last year. We expect a continued positive capital service mix in Q1. However – but yes, but we also expect a negative product mix in Marine that will continue into Q1. We expect a neutral to positive load volume effect but a negative PPV/metals impact due to the increased metal prices mentioned earlier.

Then looking at the S&A expenses. So the impact from the cost reduction program continued well into Q4 and came out a bit stronger than we had expected. In fixed rates, the cost reduction program generated savings of approximately SEK 200 million in Q4, which supported the further reduction of S&A expenses by 12 percent versus last year on a comparable basis.

This means that the cost reduction program have generated savings of more than SEK 700 million that was launched in early 2020, and our S&A expenses are down 10 percent on the full year 2020 on a comparable basis.

As we have stated earlier, this program is temporary in nature. However, considering the current lockdown situation that we see in many countries, we expect that, for example, traveling costs to remain low in Q1. We also expect that the new way of working, including the accelerated digitalization of our workplace, is likely to continue to have a positive impact on our S&A expenses. However, it is too early to quantify this impact.

So considering the strong gross profit margin in Q4 and the continued positive impact from the cost reduction program, the adjusted EBITDA margin came at 18.4 percent, up from 17.4 percent in last year. As stated earlier, the strong margin also reflected good project execution with low-quality costs during the year with some onetime positive impacts, especially in the Marine and Food & Water Division in the quarter.

As you know, and as communicated in December, we are in the process of implementing a targeted restructuring program, which is mainly addressing structural imbalance in specific parts of the upstream oil and gas business as well as part of the Marine business. In addition, the program will further drive the competence shift required in light of the accelerated pace of digitalization.

In total, we expect the program to include restructuring costs of approximately SEK 850 million.

In Q4, we booked restructuring costs of SEK 741 million, of which SEK 360 million was related to goodwill write-downs in the oil and gas-related businesses. The remaining cost is expected booked – to be booked in the second quarter of 2021. The restructuring cost is booked as a nonrecurring item in our P&L. The program will impact approximately 600 employees, mainly in Europe and North America. The program will generate savings of around SEK 300 million with a full effect expected from mid-2022.

From a division point of view, about 1/3 of the employees affected are in the Energy Division, 50 percent in the Marine Division, and the remaining, of course, in the Food & Water side.

OK. Looking then at some of the key figures. As communicated earlier, S&A expenses in Q4 were reduced by 12 percent on a comparable basis as a result of the cost-saving program. Excluding FX effects, the R&D expenses were flat versus last year, and we continue to invest approximately 2.5 percent of sales into our product development.

Net other cost included restructuring cost of SEK 740 million booked to Q4. Excluding this, net added cost and income was down approximately SEK 50 million due to the lower royalty payment as well lower footprint-related costs.

Financial net, excluding FX impact, was minus SEK 47 million in Q4, slightly higher than last year. The FX gains, losses in Q4 was a negative SEK 63 million, giving a total net – total financial net of negative SEK 110 million in Q4 versus negative SEK 177 million last year.

The tax rate came in at 39 percent in the quarter. This high tax rate is primarily explained by the restructuring program, where the goodwill write-down of SEK 360 million was not tax-deductible.

EPS was also naturally impacted by the restructuring program.

Then looking at the cash flow statement. Cash flow from operating activities was roughly SEK 2.6 billion in the Q4, which is about SEK 300 million higher than last year, driven by a significant decrease in working capital. The decrease in working capital in Q4 was primarily related to lower inventories. And in fixed rate, we have reduced our operating working capital by approximately 1.5 percent of sales during 2020. Investing activities included CapEx investment of SEK 456 million in Q4 and SEK 1.2 billion on a full year basis.

Financial net paid, excluding FX impact, was minus SEK 28 million in Q4, and realized FX gains losses in the quarter amounted to a negative SEK 121 million. This means that total cash flow came in about EUR 2 billion in Q4 and about EUR 6 billion for the full year, which is well above last year and in the quarter.

So the strong cash flow generation in 2020 has reduced our net debt position from SEK 8.2 billion at the end of 2019 to SEK 3.6 billion at the end of 2020. Excluding the lease liabilities, our net debt position now stands at SEK 1.4 billion and – which equals a net debt-to-EBITDA ratio of 0.2.

Hence, we are now operationally moving into a very low gearing of the company. And based on this strong balance sheet and expected stable market conditions, we will resume dividends in 2020. In addition, we plan for a 3-year share buyback program, where the Board will propose to the AGM to purchase up to 5 percent of the issued shares per year starting in 2021.

From an FX point of view, the transaction FX effect on EBITDA in the quarter was a positive SEK 120 million and the translation impact was a negative SEK 100 million, giving a total net positive FX impact on EBITDA of SEK 20 million in the quarter. Looking at the projection for the full year 2021, we expect a positive transaction impact of approximately SEK 85 million.

Now looking at the order backlog at the end of December. We had a total order backlog of SEK 19 billion, which is 8 percent lower than year-end 2019 expressed in fixed rates. The book-to-bill ratio was 0.87 percent in the quarter.



The order backlog now represents approximately 5.5 months of LTM sales. For shipment in 2021, the backlog amounts to EUR 15.1 billion, a reduction of SEK 1.3 billion compared to the same time last year.

Let's then move over to the sales bridge for '21. So sales bridge starts, of course, with the sales for the full year 2020 of SEK 41.5 billion. As stated in the previous slide, the backlog for shipment in 2021 is SEK 1.3 billion, lower than the same time last year on a comparable basis. The acquisition and divestiture of businesses in 2020 will have really no impact on the sales bridge for '21, and that adds then up to SEK 40.2 billion.

On top of that, you will need to make your estimate on change for in-for-out orders and FX translation impact. For your reference, the total level of in-for-out orders in 2020 was SEK 25.1 billion. With regards to the FX impact, this, of course, is very uncertain. However, if we would use the closing rate at the end of 2020, the estimated FX impact in '21 for the full year would be approximately negative SEK 2 billion.

And finally, the Board will propose a dividend of SEK 5.50 per share for year 2020 to the AGM in April.

And by that, I hand over back to you, Tom.

Tom Erixon: Thank you, Jan. Let me just round off then with a bit of an outlook comment. And let me then restate that, in general, we see the market trends being rather stable, especially if we look at the transactional part of our businesses across segments. We are typically on level or on a growth path through 2020, moving into 2021.

To the degree we've seen volatility in the portfolio and uncertainty in the short-term demand trends, it tends to be related to larger projects that have been delayed. Although, as always, there is a pipeline of projects that may or may not be converted. So the degree of uncertainty that we may have in the Q1 outlook tends to be the timing of the larger projects that may or may not be converted in terms of down payment on those projects prior to being booked in the quarter.

Based on those comments, our estimation for Q1 demand trends is that we will be on about the same level for the group as a whole. We expect the Energy Division to be higher sequentially in Q1 compared to Q4, and we believe the Marine Division and the Food & Water Division to be somewhat lower, all in all, balancing the group's demand picture reasonably stable into Q1.

And with that, we open for questions.

Operator: (Operator Instructions) Our first question for today is from the line of Max Yates from Credit Suisse.

Max Yates: Just my first question is around capital allocation. And should we read the share buyback as now as a sort of shift in focus towards more bolt-on deals? Or are you still out there looking for some of these larger industrial automation deals?

I appreciate you've said up to 5 percent per year, which obviously depends on what happens elsewhere with M&A. But I just wanted to understand whether we should read this as a shift in strategy and maybe away from some of those larger industrial automation deals that you've talked about previously.

Tom Erixon: It's not a shift in our direction. It's a reflection of where we are. We – as you know, based on the dialogues and transaction discussions we had last year, we assess our M&A capability at the moment to be somewhere in the span of SEK 15 billion to SEK 20 billion.

Based on the cash generation that we have and the status that we have at the moment, including dividends and an estimated share buyback in order of magnitude of about SEK 2 billion per year, we will continue to maintain our gearing at the current level or even smaller levels.

So we are not deteriorating in any shape or form the gearing, our capability to conclude larger deals and our interest in doing so.

Max Yates: OK. And just my second question. If I look at the Marine Division, it looks like within there, you had about SEK 4 billion of orders from environmental. I

just wanted to understand, maybe without too precise numbers, but a little bit around the areas within environmental that you talked about as really helping customers with efficiencies.

So just trying to understand the parts that aren't SOX scrubbers, aren't ballast water, but some of those newer projects – products you talked about. How big is that today? And sort of how fast do you envisage that growing? Because I imagine that's kind of more of a retrofit market than link to new build. So just a bit of detail around that would be helpful.

Tom Erixon: Let me say that, that was a rather forward-looking comment in terms of what we are working with in our business development portfolio and our R&D portfolio. Although, of course, the product we launched and discussed at the capital markets related to reducing the methane slip in gas-driven engines is launched and is commercially available in the market.

So I think if you are eliminating at the moment the scrubber markets, which is still there, and the ballast water, which is continuing on a stable level, the particularly CO<sub>2</sub> reduction type of solutions are still relatively modest. There will be – but what we are sure is that we will see increased LNG as a fuel. We will see more multi-fuel type of solutions.

And we see some impact of that in our sales mix to ships already today. We see LNG carriers, at least, being right now equipped with LNG as a fuel as well, of course. But those trends in the multi-fuel side is creating opportunities in the engineering for us for existing type of applications in the future.

So I think the trend is going to be there. And I think you can expect to see in the years to come both product launches and business development activities that would further enhance our positioning when it comes to dealing with what – I mean, let me say if there is a change, the change is on the shipowners' consciousness and focus in dealing with the situation.

So I think this is a situation which is becoming much more real here and now. And with that said, we're starting from a small level.

Max Yates: OK. And maybe just one very quick housekeeping question. Could you help us with – kind of out of your Marine Division that's directly exposed to new shipbuilding, how much the containership segment makes up of that today? That would be helpful.

Tom Erixon: I don't have that specific number in my head. But what we typically say, just to give you perhaps a little bit of a better picture. If you take the ship classes that tends to be in our sweet spots, which includes cruise, which obviously is a bit limited right now, LNG, product tankers, tankers and containers, there, you tend to have approximately 70 percent of our order intake from the newbuild segment.

And then, of course, you have a fair – a large number of ships above and beyond those being contracted every year. They tend to have somewhat of a smaller impact on our order intake, and specifically, that tends to hold true for dry bulk.

Operator: Our next question is from L.W. Brorson from Barclays.

Lars Brorson: It's Lars here. If I can maybe stick for now, Tom, with the question earlier around the divisional outlook and then get on to Jan with a couple of quick questions.

First of all, can I just confirm you were saying Energy higher, not somewhat higher? Just to clarify the divisional outlook.

And on Marine somewhat lower, are you able to help us a little bit with what you see on the OE and also on the service side sequentially? I'm particularly interested in trying to understand the headwinds you're facing on services, how transient are those?

Not quite sure I understand why they're impacted by lockdown. I assume the engineers can travel around. Can they not access ships? Or maybe you can give a bit of color around what's going on in your services side?

Tom Erixon: Yes. The outlook statement for the Energy Division was higher, correct. And it was somewhat lower for the other 2, and that's how they balanced out, so to

say. So the service side, when it comes to the trend line has been, I must confess, somewhat difficult to follow. And I'm speaking about service in general now, just – not just the ships, because we have similar challenges on the land-based services as we have on the onboard services.

But you should be aware, if you stay with the merchant fleet, that there are substantial challenges building for crews on ships where you have crews who have not been able to change de-board for a year or so. There's still a huge problem in flying people in and out of harbors and having those planned. And as a consequence, our reconditioning work and services onboard remains challenging.

And with that said, I think we saw an immediate decline in the beginning of 2020. We've seen a stabilization. After that, we'll start to see sequential growth after that. We are less affected in the high profit areas of service compared to the low profit areas of service. So obviously, onboard services, reconditioning work doesn't tend to have the same margins as typical spare parts and replacement sales have.

So there are some impact there. I think we got it under control. And what is especially encouraging to see is, as I indicated in my introductory comment, the service is changing in nature, moving more towards service agreements, significant growth in new products, including in marine where we have increased service revenue in environmental applications, just to take an example.

So we – I think it's reasonable for us to expect some sequential growth on the service side overall. I don't think necessarily Marine will be much different than the rest of the divisions from that.

I think if you compare the service revenue in our 3 divisions, I think the Food & Water side is interesting from the point of view that we don't have the challenge of idling assets in the Food & Water Division. Assets producing beverages and food and the biotech products are running, and as a consequence, they are being serviced. And as we drive our Service business in

a better way, we've seen a good solid growth in the Food & Water Division, reflecting customer level of activities.

And I think the impact we have in certain of our end markets when it comes to either ship classes or to specific end customers in the Energy division, I think the decline we see is predominantly driven by idling assets and idling – or lower capacity utilization as opposed to any specific COVID type of related activity.

Lars Brorson: Can I briefly ask, Tom? You voiced some optimism around containers and energy within your slightly longer-term outlook for Marine this year. I think containers is understandable. Where is it that you see a slightly better outlook beyond Q1, presumably around the energy space for your Marine business? Specifically, I'm curious as to what you see for tankers this year.

Tom Erixon: I guess I've been less vocal about the tankers. But what I see from our own pipeline and our dialogues in – with our customers, I think there's reasons to have a certain amount of optimism when it comes to the LNG side.

I – given the amount of asset placed we see in placing orders with shipyards, I think the question for tankers and others is going to be, given the short delivery times that are available and the relatively low price levels that we're also offering at the moment, there will probably be a point where a number of shipowners find it opportune to actually place those orders. But whether that's going to happen this year or not, I will not speculate.

Lars Brorson: Understood. I mean, I guess, LNG sales to LNG carriers was about EUR 100 million business for you last year. That's 5 percent of the Marine Division. So it's going to take quite a lot on the energy side, I guess, to sort of swing the meter for you this year.

Tom Erixon: I will not disagree.

Lars Brorson: Can I quickly just ask, Jan, a couple of quick questions on both the lease of provisions in Marine and also the share buyback? Are you able to help me, Jan? I appreciate it was a good quarter from a project execution standpoint.

You did point to some onetime impacts in Q4, specifically around project execution. Can you help us with the release provision impact in the quarter?

And also, can you help me understand exactly what you mean with the bonus issue as far as the share buyback is concerned?

Jan Allde: Yes. Maybe we start with the share buyback. So the process is such that if we get the mandate to repurchase shares, we will do that during 2021. And then we will go to the – following AGM, to ask those shares to be canceled. As you cancel the shares, the equity gets lower. And to ensure that we can keep the equity intact, we will then do a corresponding bond issue to make sure that the equity is, so to say, is not changed.

And I think this is market practice. So I don't think there's anything, let's say, different that we are doing than market practice here.

On the provision, I don't think I want to go and give an amount. But certainly, we have executed well on an order backlog. And as you come to the end of the year, naturally, there is some of that you will have to release. So I don't think there's anything strange to that. I think it just reflects that we have managed project well. We haven't seen any quality issues. And so...

Operator: Our next question is from Klas Bergelind from Citi Research.

Klas Bergelind: Yes. It's Klas at Citi. So first, coming back to the Energy side, when you say that you're looking for higher demand, you're seeing high demand into the quarter. Can we talk a little bit more about the drivers? Is that the green shoot you see on the upstream side coming through? Is it larger orders versus underlying services stepping up? Is it environmental products? Just so we understand what you're guiding higher, Tom.

Tom Erixon: The guiding higher for the Energy Division is, I think, based on 2 factors. Number one, there are significant parts of the Energy Division and markets that's been growing all along, and that's related to our energy efficiency solutions in many areas.

There is strong demand in areas like heat pumps, air condition. And we have good development in areas – in general, in the HVAC area, you could say, including data centers and the whole host of end markets that were taken. So the situation for the Energy Division has been quite positive.

Then we also have project-related businesses that tend to be a bit volatile. And as you could see, the bookings were low in Q4 and have been reasonably low in the year due to a drag of those projects. So of course, when we look into the next quarter and the next half year, the question on how the pipeline will convert, it's always a little bit of a guessing game.

But we feel that the underlying market is there. It was maybe almost understated a bit in Q4. And our expectation is that we will not see any major change from the market sentiments. We just expect positive momentum to continue and some conversion of the product pipeline. That's where we are.

I don't see any big – there's no specific technology or energy price issues as such that is affecting us. The – with that said, the oil price is established back to \$55, \$60 level. It is a good level for CapEx investment. And we see a small return to CapEx decisions on onshore upstream, whereas offshore has been reasonably stable through 2020.

Klas Bergelind: That is good. Good to hear that the environmental side is a key driver, not only oil and gas. I just had a question on – a follow-up on Energy, and that's on the mix. So last quarter, in the third quarter, mix was quite positive, and that was that shift to environmental. And now it's negative. Is that just the timing thing out of the backlog? Just to understand that mix negative commentary on Energy in the fourth quarter.

Tom Erixon: Jan, do you want to take a crack on that?

Jan Allde: It's a little bit how the project got invoiced during the year. So normally in Q4, we have a tendency – if you look to Q4, we have a tendency to have, let's say, more projects invoiced in kind of base business. I don't think you should draw too many conclusions.



Klas Bergelind: OK. OK. My very final one is on Marine. And Tom, when you talk about your mix likely more positive than the market, you talk about containers and LNG, is that something that you're seeing in your own tendering right now? Or is that more what you're hearing from the likes of Clarkson?

Tom Erixon: Well, partly, you've got to monitor the freight rates in order to have some idea of where is demand trends and capacity utilizations and shipowners' interest in investing. Part of it is related to shipyards' lead times and contracting prices as well. So it just looks like the plan is not to be a bit better aligned compared to the relatively low levels that we've seen for a period of time in those areas.

So on the LNG service side, specifically, I would say for the year, certainly the pipeline looks reasonably promising for us. And I think there is no doubt that we will see a long-term demand increase in LNG, not only as a fuel. But in general, the LNG consumption around the world is expected to grow at the cost of other (carbohydron) products. So I think the demand trends are positive, and we do expect certain conversion of product leads during the year.

With that said, I don't think we have estimated to have a huge impact of that in Q1 specifically.

Operator: (Operator Instructions) Our next is from Sven Weier from UBS.

Sven Weier: Yes. The first one is on the Food & Water business and your comments around brewery being stable, surprisingly stable. I mean, has that got to do with the vaccination announcement and the breweries are planning ahead 6 to 9 months on their lead times for new CapEx? Does this make a difference to sentiment among your brewing clients? That's the first one.

Tom Erixon: No, I don't think so. Maybe they are a bit more resilient than we expected. We were certainly concerned that, not least, the craft brewers would be hit a bit worse than some of the large breweries that – doesn't have the retail distribution that the large brewers has.

And – but I just think we've seen some more resilience in the sector. We've seen a bigger mix of type of projects and upgrades. The underlying trends that's been in the market for increased product diversifications and

dealcoholization and all of these trends that you see in the brewery sector has carried us through 2020 in a good way.

And it's not a huge part of the – it's not what drives the volumes in the Food & Water Division, but I think if we expected some headwinds or some tailwinds, and all in all coming out positive, I think the headwinds were just a bit smaller in general. And certainly, the demand growth in areas like biotech was substantial in the quarter.

So if you want to see in that sense, you should not look at the biotech rather than the brewery.

Sven Weier: Right. And anything you could say on dairy? I mean, here, we've seen dairy prices going up quite nicely. Recently, demand from China being very strong. Do you see some positive effects on your dairy side as well?

Tom Erixon: I think we had a quite stable year. And as you know, there's been some volatility in the dairy both pointing downwards and upwards. And I think our value was relatively shallow, and I'm not sure we're at the peak exactly, but it's been running more smoothly in the year than we expected. So we are somewhat positive to where we think it's heading, but it hasn't been a huge volatility in the quarter.

Sven Weier: Understood. And then the last question is just again coming back to the engine room in Marine. We talked about LNG. I mean, what are your thoughts when we look a little bit more forward towards hydrogen, ammonia? I mean, does that change your content in the engine room at all? Do you need to make a lot of R&D development on that side? And what would be your exposure there on those 2 technologies?

Tom Erixon: Yes. The LNG specifically is, as expected, I think, somewhat slow to penetrate. If you are an LNG carrier, then your fuel option is almost a given, of course. But if not, if you're on a different ship class, you see relatively modest conversion to LNG for non-LNG carriers in terms of LNG as a fuel. It will probably continue to grow somewhat, but it's not going exponentially fast.

When it comes to new fuels, be it the methanol or ammonia or wherever you want to go, I think that has started and we are investing in technology for the engine room. We think it's exciting. We have broadened the capability of our R&D test center in Aalborg. I think we have the most advanced engine testing facility in the world for that. And we are doing a lot of customer testing on options and how things work in practice.

We are well in line to be able to handle transitions towards hydrogen, towards fuel cells and what it means for the engine room. We will be an integral part of making that capability visible in the engine room in the years to come.

Sven Weier: And would you see opportunities, specifically ammonia? Because it's so toxic, right, that you – I mean you have safety solutions on the LNG carrier side. I mean, is that something where you could see opportunities for you for the safer handling of ammonia? Or is it simply way too early, too?

Tom Erixon: I think yes, it's too early. And as I think we all learned through the years, we tend to get a lot of hype on the individual solutions to battle climate and environment. But I think we are just very prepared to play the full piano on this. I don't think there is a holy grail here. I think there are many contributing factors.

Certainly, the hostility of ammonia as a substance is creating somewhat of a challenge. And so we are prepared in all directions and we are participating. But we are not sure on how the shipowners will make their decisions down the road. I think there will be a lot of testing going on for a couple of years.

This year – I would say it like this, they want, I think, all of these developments in principle. If you look at our business, as they materialize, are positive. I mean, I'm not worried that we are nonrelevant or we don't have a business or that converting from one fuel to another is going to be problematic for our presence onboard. I'm not at all worried about that. On the contrary, I think it's a business opportunity as well as a climate opportunity.

The issue we have around the fuel selection right now is that if you order a new ship today, you are not quite clear how you want to have it equipped. And there's uncertainty around the future fuel options that, I think, makes

people hesitate somewhat as they place an order for an asset that's going to stay for the next 30 years.

So if you see a somewhat held back demand at the moment in 2020 and possibly in the beginning of 2021, I think one factor is the difficulty for the shipowners to decide on the fuel options.

Operator: Our next question is from Madhvendra Singh from BofA.

Madhvendra Singh: Just a couple of follow-ups. On Marine orders, if you could clarify if excluding scrubbers, orders are growing or not. And if you could quantify what is the performance actually, excluding scrubbers.

And another clarification on the margins within Marine segment. It is at quite a high level, thanks to the release of provisions. But should we use this as a base going forward? Or is it more of a one-off situation, and we should rather look at Q3 as the run rate?

Tom Erixon: Let me make a comment to margin. We – I mean, we are, of course, excited and happy, and I think we deserve a bit of credit for delivering 21 percent margin in the fourth quarter of the worst marine crisis in 30 years. So I think that's fine to reflect on that for a second. But it doesn't mean all that much in the bigger context of things.

What I think you should do as – what I would do if I were in your shoes is I would look at the longer-term trends on margin for the group and for the divisions. And I think our 3-year trend on margin is stable and slow and sure uptick in the margins over the period. Come better volumes or come worse volumes, we've shown that we could manage the margin development in the group.

It tends to be somewhat more volatile in Energy and Marine, and that has to do with project nature or part of that business. Whereas in the Food & Water Division, you tend to see a bit more of stability in the margin, both in the short-term and over the long-term trends. So that's what we are focused on as managers.

We don't give a forecast on the margin per se on the quarter. We just give the market demand forecast. I will refrain from guiding you in terms of what you want to assume for the future, but I would typically recommend you to look at the trend numbers a little bit more than the individual quarters. That's the quarterly comment.

And the other question was related to the order intake, excluding scrubbers. I think it's fair – well, the scrubbers are on a lower level now. I don't know, Jan, do you want to add a comment to it? It looks like you do. No? Yes?

Jan Allde: No, I'm just saying, the question was on the full year or the quarter on the Marine order intake?

Madhvendra Singh: For the quarter, but you could also talk about the full year. That's fine.

Jan Allde: I mean, the marine environment – the order intake on the marine environment was basically flat versus the same quarter last year. So with that, you can then sort of, say, calculate backwards what the rest of the portfolio was doing.

Madhvendra Singh: Sure. And if I could discuss a bit more in detail around the new trends within the Food & Water Division, especially around the sustainability trends, alternative protein processing, insect processing for proteins and all. Have you seen any changes in the underlying trends there in terms of take-up of these trends? Has the pandemic slowed down the adoption? Or has it accelerated it somewhat? Just wanted to understand these alternative protein trends specifically, yes.

Tom Erixon: I appreciate the question. And in the food – we've started to articulate a bit where our development as a company is going, and alternative proteins and some other areas is certainly part of that story. You'll find similar investments and development going on in the Energy Division as we look to fuel cells and hydrogen and all of that. I think it's a way to describe where we are aiming, going in the years to come, and I think it offers a good opportunity for us for long-term growth.

In the short term, these parts of the business portfolio does not have a major impact when it comes to the quarterly order intake. And that's also true in the

Food & Water Division. If you look at the growth numbers in the Food & Water Division, you find traditional well-established areas like biotech being very good. Our protein production in traditional ways is going very good.

And if you look at the lead pipeline, we have an issue when it comes to biofuels, where biofuels typically start with vegetable productions – or vegetable oil production or residual fat production. And that is the capability that we are dealing with in the Food & Water – the engineering part of our Food & Water Division.

So – and that's where we see right now a very strong growing pipeline when it comes to volume. I think the new areas in alternative protein sources and things like that will take some time to grow, but it forms part of our long-term growth forecast for sure.

Operator: And our last question for – apologies, we've had another come through. The next is from Andrew Wilson from JPMorgan.

Andrew Wilson: Just 2 probably quite quick ones, I think. Just going back on the Q4 Marine margin, which, I mean, clearly is outstanding in terms of the level that it's at. I guess in that context, particularly given that you're referencing again the negative mix on Marine side, can you give us an idea of how many more quarters you're expecting to see that negative mix or when that starts to roll off in terms of sort of bridge effect?

Tom Erixon: Jan?

Jan Allde: I would say it is sagely, so to say, of course, becoming smaller and smaller, the mix impact. But we do expect to have a negative overall impact in 2021. And I've highlighted that before. So I would say, yes, it will gradually reduce. But year-over-year, there still will be a negative product mix in Marine.

Andrew Wilson: OK. But I guess a lower impact '21 on '20 than '20 or '19, if we take the year as a whole?

Jan Allde: Yes, I think that's a fair assumption.

Tom Erixon: I think we struggle a little bit with the question because the question is how you will translate that into a meaningful conclusion. There are a number of factors affecting the Marine margin in the year to come. And I think what we have referred to in the Marine was a very strong pipeline of orders built up on the back of Marine pumping solutions and scrubber order backlog in the heydays of that business.

And as that being invoiced out, it's a question of how will that be replaced in terms of mix. And certainly, in 2020, we had a good invoicing number on those, and we expect to see less of that, of course, in 2021. So with that, there is uncertainty about how big will the service be compared to 2020, and there's a lot of outstanding issues in terms of looking at the overall mix and margin development. So it's only one component in your calculation.

But I think it's fair to say that the order book for 2020, when we started that year, was quite favorable when it came to part of the Marine invoicing business.

Andrew Wilson: No. That's very helpful. And then second, I guess, is just around working capital. Obviously, very, very good performance this year. Just thinking about – I guess, hoping to see some recovery at some point. But thinking specifically around 2021, what's the sort of expectation in terms of what you can do with working capital? Is this sort of something you have to give back given how strong this year has been? Or is this a sort of sustainably better level? Just interested in any kind of high-level thoughts on that.

Jan Allde: Well, if you remember, we've been through a strong volume growth period. We had launched a lot of new products. We have made a lot of footprint adjustment, and that was driving a higher working capital if you go back to 2019 and also partly into 2020.

Now we've been working to reduce that higher level of inventory. And so we have sort of, say, gradually taken down the working capital here during 2020, as I said, about a 1.5 percent down. I think there is – this is, of course, going to continue to be a high focus area for us and we will work to gradually – continue to reduce it. But I would say that, let's say, historical peak, we have

now worked down. So we are today more in line with, I would say, historical averages, if you go back.

Operator: And our final question for today is from Sebastian Kuenne from RBC.

Sebastian Kuenne: My question is on the hydrogen, let's say, economy. You currently do 37 percent of the Energy business in oil and gas, which is arguably a top-ish business probably declining in the next 20, 30 years.

But hydrogen is coming. And when I do the math, production of diesel and petrol, you lose about 5 percent of the energy in the processing. In the production of hydrogen and then transport compression and so on, you lose 50 percent of the energy content in – on the industrial side. So 5 percent versus 50 percent. So a lot of heat loss for the entire hydrogen economy. It's a lot of heat loss involved.

Isn't it a massive opportunity for you guys? And do you see this as more than compensating for the loss of business in oil and gas? That's one question.

And the second question would then be, of course, do you think hydrogen should be part of your end markets within Energy, that you basically split out also the – anything related to the hydrogen economy?

Tom Erixon: Thank you. It's a good question. I agree with some of your assumption and disagree with some. The way we look at the oil and gas market, we consider the Energy Division to have an exposure to the oil and gas side of approximately 10 percent of the group's turnover.

One can discuss exactly how to deal with the petrochemicals side, but one way or another, whether it's through biofuel or fossils or whatever, there is a chemical – a green chemical replacement needed. And we are obviously very much engaged in the production and processing of green chemicals.

So the downstream part of our oil and gas business, we tend to consider to be somewhat neutral to the original source of the ingredients. And that may be overstating it a little bit. But in principle, green chemical, for us, is a clear growth area. Biofuels is a clear growth area. Whereas we will see a certain



slowdown on the traditional refinery, traditional petrochem business, as we know it today.

So when we do our strategic plan for the next 10 years, we consider a possible volume drop of a few percent per year, exclude – we probably have another cycle of oil and gas ahead of us, something like that. But in a 10-year perspective, we're going to drop off a few percent per year. And the question is what's going to make up for that. And we think we have some really substantial investment opportunities and growth opportunities apart from that.

And that takes us to the hydrogen story. You're absolutely right in – well, I mainly not concur exactly with your yield and efficiency calculations on this. But you're absolutely right, that when it comes to hydrogen, there are 2 parts that we are looking at and engaging in.

One is what we always do when it comes to production, storage, transportation of hydrogen. We have exactly the same type of demands on heat exchanger solutions as we have, for example, for LNG. So there's no difference on that. It doesn't really create a lot of, let's say, R&D work. It just creates business opportunity for our existing range and applications that will probably generate a decent demand.

But on top of that, if you go to the fuel cells, you actually are right in your observation that there is a heat loss, or let's call it, a waste heat energy stream in these processes.

And it means that if you need a fuel cell, you most likely need a heat exchanger as well. So we will – even if we don't engage in the fuel cell business, there will be a demand growth on heat exchangers related to capturing the full energy out of a hydrogen conversion to electricity. So that is one part of what we're doing.

The other part of what we are investigating and looking into is if you think about the technologies that we are using, specifically for high-temperature fuel cells application, it tends to be very close to the technology we are

working with for thermal energy storage, and to some degree, in certain heat exchange applications.

And consequently, there is customer work, pilot work and R&D work done in terms of fuel stacks. And we will see where we go on that and how far we go on that. But certainly, this is an avenue for the Energy Division, which has a substantially bigger upside than whatever downside we may see in the upstream oil and gas business, which is anyhow being restructured at the moment as we speak.

Sebastian Kuenne: Very helpful.

Tom Erixon: I don't want to sound too blue-eyed and too skyrocketing here. I don't tend to get high on the occasion. But if you're asking where we are aiming in the next 5 years, certainly that is a sweet spot for us in terms of our capabilities, production processes and technologies.

Sebastian Kuenne: Understood.

Tom Erixon: OK. Thank you very much. I think that was a last question for today. I appreciate the time on a busy reporting day, and I look forward to speak to you in connection with the first quarter report in late April. Thank you very much.

Operator: Thank you very much, sir. Ladies and gentlemen, that does conclude the call. Thank you all for participating. You may now disconnect.

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