ALFA LAVAL

Presenters: Tom Erixon, President & CEO and Jan Allde, CFO
27 April 2021
2:00 p.m. GMT

OPERATOR: This is Conference #: 3048356.

Operator: Good day and thank you for standing by. Welcome to the Alfa Laval quarter one earnings call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question and answer session.

To ask a question during the session, you will need to press "star," "1" on your telephone. Please be advised that today's conference is being recoded, Tuesday, the 27 April, 2021. If you require any further assistance, please press "star," "0."

I would now like to hand the conference over to your speaker today, Tom Erixon, President and CEO; and Jan Allde, CFO (inaudible). Please go ahead.

Tom Erixon: Thank you, and welcome to the earnings call. I appreciate you guys have a busy day today, just as we do, in fact. But anyhow, welcome to Alfa Laval's call. A few introductory comments initially.

First, from a macroeconomic point of view, the quarter developed and improved a bit better and a bit faster than we expected a quarter or 2 ago, and that was true across most of the geographies and most of the Alfa Laval end markets.

Clearly, this was reflected in Alfa Laval's order intake in the quarter overall. It was stable with a clear sequential growth. And in fact, net of all of the currency effects compared to first quarter last year, in fact, we are a few

percent ahead of the pre-pandemic level of Q1 2020. I'll come back with some details on that.

Despite some headwinds, in terms of lower invoicing compared to last year and selected cost increases in various parts of the supply chain, margins strengthened somewhat to 17.1 percent in the quarter. Clearly, supported by good productivity, by some effects of the restructuring program that is now underway and with some continuous effects from last year's cost savings program in Sales and Admin.

In all, in terms of demand trends, we expect that we are at the lower end of the cycle at this point in time. We are bottoming up in the Q1 and to a degree, Q2. And if the macroeconomic tailwinds continues as they are right now, we expect to see a strengthening of demand as the year progresses.

Back with the forward-looking comments later. Let me then go to the key figures. In general, we have rather big currency effects on all of the numbers. So let me just comment that the volumes are a bit stronger than they look in the numbers net of the currency effect. Invoicing was a bit lower than expected, but within normal quarterly variations. Delivery on time continues on a high targeted level of 96 percent, 97 percent. So there are no operational issues that are causing delay in the invoicing per se.

In fact, we had a very strong productivity development with high run rates in a lot of our factories, especially in the transactional business and a decrease in overall FTEs in the supply chain supported by the restructuring programs. So that helped push the margin upwards despite the lower volumes and some challenges. We have some uneven loads in part of our factories related to areas under restructuring, and that is obviously pulling in the other direction.

The EBITDA as a dollar number versus last year was driven by lower volume. But be aware that the nonoperational factors below the EBITDA result pushed in a positive direction and overall net profit and earnings per share improved a fair amount as a result of that.

In terms of the divisional comments, let me start with the Food & Water division. We had a new strong quarter regarding order intake for the division.

It was a new all-time high, and it was high in most of the end segments while large projects in general continue to be slow in converting to firm orders.

So it was completely driven by transactional business. The pipeline, in terms of larger projects, especially in vegetable oil, to a degree, supported by the biofuel developments is ongoing and is clear, and we had the first conversion of one of our veg oil projects, larger projects in the quarter. Otherwise, as I indicated last quarter, the pipeline is fair and solid.

Profitability was stable overall compared to last year with positive volumes but also some selective negative mix effects in the quarter. Overall, plus and minus is pretty much balancing out.

The Energy Division continued with clear sustainability trends driving demand at a very high level in most of the transactional businesses. The project activity remained on a low level in the Energy division, just as it did in the Food & Water division in the quarter. But the first projects were converted to orders in the refinery and petrochemical segments during Q1. And that did degree drive the sequential growth of the Energy Division compared to Q4.

Invoicing was on the low side in the quarter. But as mentioned, mostly normal variations and to a degree, some lower loads in specific factories related to the energy sector. Sustainability continues to drive investments into new technologies in this division.

This quarter, we announced an investment into Liquid Wind, a consortium developing commercial scale solutions for converting captured CO2 to e-methanol, green methanol or, if you like, the equivalent of green LNG. As you've seen in the quarter, the number of announcements on the sustainability area has been substantial. And you have the press releases, I will not revert to the whole list here at this time.

Instead, I'd like to move over to the Marine Division, where ship contracting at the yards saw a sharp increase in the quarter. The data in terms of totally booking at the shipyards, they are back – updated throughout the preceding quarters. So today, the final numbers are not in.

But if we compare quarter 1 last year with the numbers reported in mid-April compared to the reported mid-April for the quarter 1 this year, last year had a contracting level that was very low of around 100 vessels. This year, that equivalent number was 360. So it's more than 3x to 300 percent increase in contracting and driven by several ship classes, but in particular containerships.

Partly, we believe the increase in contracting is driven by shipowners converting earlier options into firm orders. It is, at this point in time, options that typically are favorable in terms of cost, favorably in terms of short delivery cycles and they would perhaps otherwise expire.

So the conversion of options may be a significant factor of the quarterly intake. Whether that is fully repeatable or not in the rest of the year remains to be seen, but we perceive that the marine market as a whole with positive freight rates, and ship owners becoming more comfortable in the multifuel options available that the contracting level may remain somewhat on a higher level this year certainly compared to last year.

The short-term order intake in Q1 was supported by clear sequential growth in environmental applications in general and certainly in the recovery in the service business, indicating that the marine industry is returning to a more normal operating mode.

The increase in contracts say will have a limited impact on order intake for 2021. As you know, there are typical lead times between yard contracting and firm orders booked at Alfa Laval, and we expect that to remain that way also in this cycle upturn.

Some general comments regarding service. Overall, we saw a strong service quarter with sequential growth of approximately 8 percent. Spare parts remained fairly stable during 2020 and the pandemic. But now, in fact, all service products are growing, especially reconditioning in those areas that were negatively affected by the regulations in place during last year. To a degree, of course, this is a pent-up demand, but to a degree, it is also a return to more normal.

At this time, there are still pockets of low service activity in the market, but it is mainly related to upstream oil and gas, whereas in many areas right now, we see a fast growth and return to normal pandemic levels or above.

So summary comments on the order intake side. From a currency perspective, it is a bit of a complicated comparison. I just want to remind you that last year, in the first quarter, we had a positive backlog revaluation amounting to around SEK 800 million of most of it belonging to the Marine Division.

So if you adjust for that, and you compare in fixed currency rates, in fact, the volumes are about 2 percent higher than in the first quarter 2020. Normally, we don't consider comments on the backlog revaluations, but since the amount was so large last year, we made an explicit comment then, and I remind you of it now.

So considering the mix change with fewer large engineering projects in the mix coming in, in the orders right now towards a more transactional component business, we are seeing high factory loads in a lot of our component factories at the moment. In fact, we are at all-time high in several areas. We are in full load in several areas. And you may expect some further actions to address capacity and bottlenecks as we continue to grow into the next cycle.

In terms of the geographical trends, although it's not necessarily fully obvious on the chart, in fact, both U.S. and especially China had a strong quarter. We are 7 percent, 8 percent up in both markets compared to Q1 last year and the sequential growth, especially in China, is exceptionally high. It's a very healthy business condition in both markets, and both of those happen to represent our 2 individually biggest markets.

Leaving the lower level of marine activity in many of the other Asian markets, in fact, Asia as a whole is OK. It looks a little bit weaker than it is all in all, given the – among other things, the currency effects from the Marine side affecting the numbers comparability.

In general, Western Europe was relatively weak compared to the rest of the world. But even in Western Europe, there were variations between countries and there were clear variations between end markets.

So also in Western Europe, it was a mixed picture. Latin America, I think, stronger than you would expect given the situation in Latin America at the moment. And Eastern Europe, which typically growing strongly, except for certain quarters last year, we saw a return to solid growth also there.

So all in all, the picture was a good rebound, a return to normality and pretty strong growth in many parts and in some of our core geographical areas. I will come back with some comments regarding the outlook later. But for now, I hand over to Jan with some further financial comments.

Jan Allde: Thank you, Tom. I'm going to start commenting on our invoicing level. So we expected invoicing in Q1 to be lower than the same quarter last year. And we realized sales of SEK 9 billion in Q1, which is 15 percent lower than last year. Please note that we did have a large negative FX translation impact on sales. And excluding this, sales were down 7 percent versus last year, a bit lower than we expected, but as commented by Tom, no real operational issues behind that.

With regard to sales for Q2, my outlook is as follows: I expect invoicing in Q2 to be lower than the same quarter last year, primarily driven by the reduced backlog in the Marine Division and a continued negative FX translation impact. In fixed FX rate, I expect underlying invoicing volumes to be about the same as last year. Stronger invoicing volumes in Energy and Food & Water, offsetting lower volumes in the Marine Division.

Then looking at the gross margin. So the gross margin came in at 38.2 percent in Q1, which is an increase of about 0.5 percent versus last year. We have a positive capital sales service mix due to the relative strong service invoicing in the quarter. However, this was offset by an overall negative product mix.

The load volume impact was positive despite lower invoicing as our factories have adapted their cost structure to the lower invoicing volumes, including the

positive impact on the restructuring program primarily impacting the Marine Division in Q1.

Hence, we saw a strong productivity development in the quarter. As expected, the PPV metals impact was negative in the quarter. And finally, we did see a positive FX impact on the gross profit margin in the quarter.

Now over to my outlook for Q2. The starting point is the 35.4 percent gross profit margin reported in Q2 of last year. We expect a continued positive capital sales service mix in Q2, but also that the negative product mix in Marine will continue into Q2. We expect a neutral load volume effect in Q2, but a negative PPV metals impact due to the increased material and freight cost. We do expect a positive FX impact on the gross margin to continue into Q2.

Now looking at the S&A expenses. So the impact from the continued lockdown situation in many countries continued into Q1, which means there are traveling costs, but also to some extent, our general S&A expenses stayed on a level in the quarter. Excluding FX effects, our S&A expenses were down 6 percent versus last year.

We expect the S&A expenses that they will gradually start to increase during the year as countries start to open up again. However, we also expect that a new way of working, including the accelerated digitalization of our workplace, is likely to continue to have a positive impact during the year. However, it's too early to quantify this impact.

Regards to the restructuring program announced in December last year, the program is progressing as planned. It reduced approximately (300 MB) so far, which represents about 50 percent of the totally planned employee reduction in the plan. Please note that this program is primarily reducing cost of goods sold, and was set up to offset the lower invoicing volumes in Marine and the upstream oil and gas part of the Energy Division.

Finally, as communicated earlier, we expect to book another SEK 160 million of restructuring costs in Q2, which brings the total cost of the program to approximately SEK 900 million, slightly higher than the SEK 850 million

announced originally. Our adjusted EBITDA margin came in at 17.1 percent, up from 16.5 percent and the margin improvement was primarily driven by the higher gross profit margin and a continued low overhead costs.

Then looking at the key figures. Excluding FX effect, S&A expenses were down 6 percent and R&D expenses were down 2 percent versus last year. Net other cost and income was down SEK 102 million, excluding nonrecurring items, primarily driven by lower royalty payments to our PureBallast joint venture partner, lower external commissions and lower overhead costs in general.

Financial net, excluding FX impact, was minus SEK 48 million in Q1, slightly lower than last year. The FX gains losses in Q1 was a positive SEK (119) million giving a total positive financial net of SEK 143 million in Q1 versus a negative finance net of SEK 271 million last year.

The main reason for the FX gains and also the FX losses last year are due to revision of cash positions in local currencies. Tax rate was 25 percent in the quarter, hence, very close to our tax guidance of 26 percent. The higher EPS in Q1 was primarily explained by the positive swing in finance net year-over-year.

Then looking at our cash flow. Cash flow from operating activities was SEK 963 million in Q1, which is about the same as last year. Working capital was stable during the quarter and finished on about the same level as last year. Investing activities included CapEx of SEK 266 million in Q1, slightly higher than last year.

Financial net paid, excluding FX impact, was minus SEK 26 million in Q1. Realized FX gains losses in the quarter amounted to a positive SEK 160 million, giving a total finance net paid of positive SEK 90 million. This means that our cash flow came in at about SEK 800 million in Q1, slightly higher than last year, which is on a good level considering that we had a very strong cash flow in Q4.

Please note that we have refinanced our RCF in April with EUR 700 million credit facility. This facility has a maturity of 5 years and is the first of its kind

to be launched in the Nordic region since March of last year. Then looking at CapEx. The transaction FX on EBITDA in the quarter was a positive SEK 20 million. And the translation impact was a negative SEK 102 90 million, giving a total net negative FX impact on EBITDA of SEK 70 million in the quarter.

Looking at the projection for full year 2021, we expect a slight net positive FX impact of SEK 20 million, driven by a positive transaction FX impact. The order backlog at the end of March was at SEK 19.3 billion, which is 3 percent lower than the same time of last year on a comparable basis.

However, compared to year-end 2020, the order backlog is now 7 percent higher expressed in fixed rates due to a positive book-to-bill ratio of (1 14) in the quarter. The order backlog now represents 5.8 months of LYM sales. For shipment in the remaining part of 2021, the backlog amounts to SEK 14.5 billion, reduction of SEK 1 billion compared to the same time last year.

And that brings us to the sales bridge for 2021. Starting with sales of SEK 9 billion. As stated in the previous slide, the backlog for shipment in the remaining part of 2021 is 14.5, and this adds up to a total of SEK 23.5 billion. On top of that, you will need to make your estimate on change in in-for-out orders and FX translation impact. For your reference, the total of in-for-out orders during Q2 through Q4 2020 was SEK 102 15.4 billion.

With regards to the FX impact, it's of course very uncertain. However, using the closing rate at end of March, the estimated FX impact in 2021 would be approximately SEK 1 billion negative. And that brings us to the outlook statement then, and back to you, Tom.

Tom Erixon: Thank you, Jan. In terms of the market situation, I alluded to before, I think we probably are at the bottoming of this cycle. If we look at it divisionally going forward into the second quarter, sequentially, we expect the water demand to be somewhat higher on the basis of a firmer large order project pipeline.

And we expect Energy Division and the Marine Division to be on about the same level. All in all, that gives a fairly stable outlook into the quarter when it comes to orders on about the same level, perhaps with some positive

deviations given the situation of the Food & Water Division. And I think with that, I hand over for questions.

Operator: Thank you very much, sir. Ladies and gentlemen, as a reminder, is you wish to ask a question, please press "star," "1" on your telephone keypad and wait for your name to be announced. Our first question for today is from the line of Max Yates from Credit Suisse.

Max Yates: Just my first question was around the Marine Services business. So you talked about sort of sequential improvement, but obviously, it is still, on a year-over-year basis, lower.

Could you talk about what the sort of remaining challenges are in this business from the pandemic and sort of what it will take for those to be fully removed. Is it travel? Is it the shipping companies themselves hesitating? Just a bit of context around what the sort of remaining challenges are in marine service would be helpful.

Tom Erixon: Yes. I'm not sure I have a sharp answer to your question. I think the way we looked at it is, this is a rather normal (inaudible) I don't feel that the taps goes on at a certain – let's put it like this. The issue was not – was probably less in the quarter, what are the remaining hurdles and more a question of when did we see the rebound happening in the quarter.

And we normally don't talk too much about variations within an individual quarter. But certainly, the trend was stronger towards the end of the quarter as opposed to the beginning.

So I think there is probably a degree of a bridge, whether that is a trend that is sustainable into Q2 or whether it's a bit of a pent-up, I leave that open. So I don't want to predict marine service specifically in Q2. But if you look at the delta versus last year, the delta was certainly bigger in January than it was in March.

Max Yates: OK. And just a quick follow-up on the different shipping segments. I mean, you called out sort of container ships as a particularly strong part of the

Clarkson data. So I was wondering if you could just firstly help us with how significant a business that is for you of your marine exposure.

That would be helpful to sort of get a feel of that. And then I also wondered, as we see this sort of recovery in shipping markets, I think you've talked quite a lot about some of the sort of new technologies, some of the waste oil recovery sort of products that you have on ship.

So I just wanted to get a feel of if you think that your sort of content per vessel as we go into this sort of shipping up cycle could actually be larger this time around than maybe what we had seen in previous cycles, i.e., your kind of orders for a similar amount of ships could be larger this recovery? Just any sense of that would be helpful.

Tom Erixon: Yes, it becomes (inaudible) if you're going to try to break down the share of container within all of – remember that new contracting is a good third of our Marine business overall and within the new contracting about 70 percent of that is our sweet spot, as we normally call it, ship classes, which includes container, tankers, product tankers, cruise and the LNG carriers to take the main one.

So we end up on a fairly low level when it comes to demand. And then I'll remind you that the effects from that is coming most likely early as 2022, right? So it is not – that, in itself, is not spiking the demand. It's a broader recovery required for the marine numbers to go up.

But with that said, we are – the ship mix, as it was predicted or anticipated and how it developed in Q1 overall, is favorable when it comes to our exposure all in all. Let me leave it at that. I think from a technology point of view, there is a lot of work going on in various directions. We will see how all of that plays out.

I think what is positive from our point of view right now is that at least on the basic questions of fuel options in terms of specifying ships, it tends to settle down short term on multifuel mix of LNG and heavy fuel oil. And that is technologies that are well known to us and that we are able to serve here and

now. It doesn't put a pie in the sky for the future. It is a term trend that is somewhat favorable to us.

I think for the long-term development, there are much – there's bigger uncertainties but also a lot of excitement in terms of what may develop in the areas of ammonia (inaudible) develop in fuel sales solutions in general.

I mean, we remain relatively alert when it comes to following and proactively investing in those areas. But they will – most of that will take some time to play out. These are not fast changes that require global infrastructures and an agreement to a degree or at least consensus to a degree. So I think here and now, the clear driver of change on the fuel side remains LNG and variations of them fuel,

Operator: Our next question is from Johan Eliason from Kepler Cheuvreux.

Johan Eliason: This is Johan Eliason while staying on the subject of Marine. I noticed you mentioned that ballast water orders are up. And I guess there were some issues last year during the pandemic that might have sort of impacted the order intake on that one.

While the regulatory demand is still there, I guess, sort of 5 years from 2019 also. Has there been any change to the regulatory demand for ballast water because of the pandemic? Or should we expect sort of a set up demand, I mean, for ships out there to comply with this regulation with the sort of the...

Tom Erixon: Yes, there's no change. If I remember correctly, there was a 1-year extension from 5 to 6 years. So I got echo here. So it's going to be quite second. OK. Here we go again. So maybe somebody should mute here because I get a lot of echo.

So – but we think that the fact that ballast orders were quite strong was probably a bit of a pent-up demand, a bit of delay in retrofit programs because of repair yards scheduling problems. So we fell a little bit short of our expectations last year as a matter of fact. Now we were a bit more back to normality, so I think you're right. I think there may have been some pandemic effects on the order intake numbers.

But I'll also point out that also the PureSOx orders were reasonable in the quarter, of course. Not back to the heydays, but it's still stabilizing and somewhat improved sequentially to a level of a bit of a normality in our product portfolio, and it contributed as well in the quarter.

Johan Eliason: On the license payment, was just that a reflection of lower sort of deliveries during the quarter? Or has there been any change to the agreement on that?

Tom Erixon: No change. We stand by our agreements always.

Johan Eliason: You could have negotiated with something else, obviously. Thank you. That were my questions for now.

Operator: Our next question for today is from the line of Mattias Holmberg.

Mattias Holmberg: In Q4, you guided for the energy demand to increase sequentially into Q1. And if I'm not mistaken, you mentioned that this would, to some extent, be driven by large orders. And from the sounds of your comment, it seems like these have not really materialized. I'm just wondering if you still see these large projects in the pipeline and what the phasing of those could be? Or maybe I misunderstood something here.

Tom Erixon: Well, for the Energy division specifically?

Mattias Holmberg: Yes.

Tom Erixon: I don't remember the guiding comments exactly. I think I don't think we were very surprised about the project pipeline and the conversion to orders in the quarter, we were – I think, if anything, rather positive to the fact that we did have some large order bookings in 3 areas. So that's where, in fact, most of the larger projects tend to go. The upstream is capital intensive, but normally more on the equipment side.

So there were clear delays among other places in China in some large projects during the pandemic. They are not fully restarted or at least not in our order books at this point in time. So I think we have some way to go. But we took the quarter as a sign of a return to the normal CapEx plans that sits in the

downstream area. It was cautious, but still positive. So that's a bit I think our take on it.

Operator: Our next question is from Sven Weier from UBS.

Sven Weier: The first one, Tom, is regarding you joining the Center for Zero Carbon shipping from Maersk. I was just curious what products, specifically expertise, specifically, do you bring to the table there? And I was just wondering, obviously, the pressure on shipping will be much harder to decarbonize quicker in the next few years.

So which products from you specifically would be in demand there if we exclude the zero carbon fuels? And what comes then on top later on once these fields are available?

Tom Erixon: We – if I take the question broadly, we have an ambition in the Marine Division to be developing a tool box for the ship owners in terms of how to address the climate impact. And I think as you alluded to in your question, there's not going to be one beautiful solution happening short term.

There will be transition solutions that altogether will drive fossil fuel consumption down. All of the toolbox is not announced yet, and you may expect that there are further things happening. But certainly, we have a role to play when it comes to the LNG. We announced the PureCool recently, which is a methane slip problem address.

We are definitely engaged in the ammonia as a carrier of hydrogen as a fuel for at least for the auxiliary power generation on board. And so the fuel cells area is another one where we will be engaged on the marine side.

And so I think we have a lot to bring to the party. And on top of that, of course, (inaudible) value and business ambitions that we have to – in the Energy Division as well as in the other areas, including Marine, to be a proactive player when it comes to combat the climate challenge.

Sven Weier: Thanks for that, Tom. And you sounded early, a bit cautious whether the container ordering now is going to be followed up later with a real cycle. Is

that also because you think the shipping companies are confused by these very changes and rather wait and see what happens before they order something? Or was that maybe the reason why you sounded still a bit maybe skeptical whether there is a follow-up afterwards?

Tom Erixon: Well, I don't like to overstate a quarter when it comes to looking into the future. I think, as I commented, there are some underlying positive trends, developments in the marine industry when it comes to booking. We have partly an aging fleet with high OpEx cost and as the oil price is returning to some sort of normality, OpEx costs are high for a number of our assets.

Scrapping has been at historical low during a longer period of time. The building prices, at least for those who already sit on the options, is very attractive given where the steel price is and where the raw material prices are going.

So very favorable right now to move in and utilize that as a valuable asset at this point in time. So I'm not so surprised at seeing the rebounds now. But of course, to go from our all-time low last year to a number that starts to look like stable, 2,000 ships per year, I think for me, that's a very big jump given that 3 months ago, I wouldn't subscribe to a major growth looking forward 3 months.

So I think we need to see another quarter and a bit of a more broad-based category growth before we can say that we are into the more stable historic average type of order pattern at somewhere 1,500, 2,000 ships per year. I'm not sure we are there. I'm not sure the quarter is corresponding to 12-month running rate of 1,600, 1,700 ships. I'm not so sure. But certainly, it is a bit more positive now than it was 6 months ago, 2 to 3 months ago.

Sven Weier: Understood. And maybe one follow-up for Jan. On your guidance on revenues and currency impact, maybe I misunderstood, but I think you said SEK 102 1 billion negative impact. Wasn't that SEK 102 2 billion actually? Translation impact on revenues this year?

Jan Allde: Yes. But of course, we keep updating that based on the most recent rates we have. Again, it's a bit of a guessing game point is that we should expect this

negative translation impact in 2021 exactly where that's going to land. But going to be north of SEK 1 billion that is the best estimate we have.

Sven Weier: North of SEK 1 billion. OK. Because I think you already had almost SEK 900 million in Q1, right? So – OK. Thank you.

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

Klas Bergelind: Yes. Tom and Jan, it's Klas from Citi. The first 1 is on marine. Orders are down against a very tough comp, 27 percent down year-over-year. I'm not sure you will answer this one, but I will give it a go. At the end of the quarter and into April, could you comment at all on that year-over-year? Is it markedly better or are we trending around that level through the quarter?

Tom Erixon: Are you asking about the second quarter?

Klas Bergelind: No, I'm asking about the end of the first quarter into the second quarter in terms of the year-over-year against the 27 percent you have in the cold first quarter.

Tom Erixon: Year-to-date, we...

Klas Bergelind: Either year-to-date and you can back it out or if you have the April and, yes, if you have the April number would be excellent.

Tom Erixon: You're a very optimistic person.

Klas Bergelind: OK. No comment?

Tom Erixon: That was my comment. Well, one comment. I mean if you consider this order backlog revalue you had last year, the big positive impact. If you back that out, the order intake in Marine Q1 is down 16 percent.

Klas Bergelind: No. That, I know. But I'm thinking about the underlying momentum into April, even – obviously, I know that that's the case, but also into April. But yes, I guess you leave it at that. The guidance is for unchanged demand quarter-on-quarter ex devaluation. OK. That is clear (inaudible) had to give it a go.

One for you, Jan, on the energy margin. It seems like there is some FX effects from hedges in there on energy. Obviously, you have had impact from the drop-through on lower revenues. But it seems like the underlying margin would have been better ex some hedges. And I can see that, that is offset in operations and other. Is that at all true? You didn't mention that during the presentation.

Tom Erixon: Yes. I would say when you look at the Energy margin in the quarter. I mean, I think there's 3 things negatively impacting that, and I think Tom can comment on them. I mean, it is the volume impact, which had impacted given some, let's say, uneven load in some of the factories. And I would say, in addition to that, some pressure on the material and freight side.

I think that (those the 3) really reason impact in the energy margins. On the operations and other, I would simply say there's – this was really the impact of lower general overhead cost in the quarter, but also that the footprint cost in Q1 was very, very low. The kind of below the normal level, we would expect the footprint cost to come in, considering the programs that we have running on the operational side.

Klas Bergelind: OK. I was under the impression from speaking with you earlier today that you had some FX effects in there as well. But OK. My final question is on green energy. You're offering on across energy storage, carbon capture, hydrogen, data centers and so forth.

It's a small business today, but still moving in the right direction. Where among those technologies do you see the biggest opportunity over the next 12 to 24 months? Obviously, in Food & Water, you have a vegetable oil, biofuel side that the see momentum, but I'm also keen to understand on the pure energy side better.

Tom Erixon: Yes. It's a good question. It's somewhat – we are talking – I appreciate you don't ask it as a quarterly question, but as an 18-month question. But it's still a very short period of time when we – when our products are still in the lab.

So – but I would feel that the commercial pipeline in terms of where customers are going is probably mostly here and now related to larger engines and fuel/heat exchange applications related to high-temperature fuel cells.

Those are clearly going to come and we are clearly going to be a player in that area. And so I'm not ready to start to sketch any numbers on it. But I think that is, in my mind, the most here and now related issue.

The second one is probably potentially the buildup of the hydrogen infrastructure that will require transportation and storage of low-temperature hydrogen and liquid state. And just as for LNG, some of our energy solutions are needed to manage those temperatures and energy demands in an efficient way.

So in my mind, those 2 seem to be very reasonably reliable development projects, if you like, with a time horizon, at least to start to see the pickup on the curve within the time period that you are mentioning.

Operator: Our next question is from the line of Madhvendra Singh from Bank of America.

Madhvendra Singh: A couple of questions. Firstly, on Food & Water division, 15 percent organic growth looks very strong. Is it to assume that all the various end markets within that, they have all come back to normal operational level right now?

Or was there any particular segment which actually performed much stronger? And secondly, on – just following up on the Marine Division number. You earlier expected the recovery to happen only somewhere around second half. So is that all still your view that Marine recovery generally expect only after second half of this year?

Tom Erixon: The food end market, I think it's fair to say that those numbers wouldn't happen without broad based recovery. So while we have variations in it, I'm not sure how helpful it is. The biotech side remains strong. The protein side remains strong. The ethanol starch business remains strong, and the veg oil was strong.

And that leaves more of our flattish businesses in brewery, which I think, given the circumstances that, that industry has been in, was a rather good number and dairy, which also remains, let's say, on a fairly stable level. So there we have about the end market situation in the Food and Water market.

The – I don't want to predict marine demand quarter-by-quarter. I think it's – came in perhaps a little bit better than what most people expected in the quarter. We expect to remain on approximately that level in Q2. Given the contracting levels we see and to some degree, our own product launches and development, we should estimate that, that is about the bottom level for this cycle if the trends continue.

But let's see where the contracting goes. And as I mentioned a couple of times, the lead times between contracting and firm orders to Alfa Laval would indicate that the impact from contracting is reasonably limited during 2021, and we should rather expect an effect if it comes in 2022.

Operator: Your next question is from Lars Brorson from Barclays.

Lars Brorson: Tom, Jan, 3 questions, if I can. One on your outlook, one on Marine margins and 1 back on Food & Water. Sorry, I missed it. If you said it, what was your divisional demand outlook, please? I heard flat in Marine. Just clarifying, it's flat for the other 2 divisions as well.

And to that, Tom, anything you can say regionally, you've got a big exposure in emerging markets outside of China. I wonder what you're seeing in places like India and Brazil with COVID research. Is there any real impact on your business there from the standpoint, I guess, partly on your food and water business?

Tom Erixon: The outlook statement was somewhat better in the food and water and stable for the 2 other divisions. I would – in terms of color and any uncertainty to those statements tends to be related a little bit to what happens with the larger orders.

As I indicated a number of times, it's not that the pipeline is empty, it's not that the pipeline has been slower to convert. We feel it's alive and healthy and some effects perhaps will be visible in the Food & Water division in the second quarter. That's the basis for our outlook.

So we are on a typical situation where the short cycle business picks up before the long-cycle business. That's exactly what we are seeing. And our judgment on how that will play out is the basis for the Q2 outlook statement. I think that's being as transparent as I can be in terms of our estimation.

When it comes to emerging markets, it is – I understand your question. And to some degree, I would say it is a bit of a surprising situation. If you look across those markets, both Latin America and India showed significant strength in the quarter.

And of course, both of those geographical regions tend to be strongly influenced by the Food & Water division. So there, no, we don't see the negative effect on the business on the contrary. I think after a year, last year, we start to see some pent-up demand that needs to be converted into orders, and I expect that's a little bit what we've seen in Q1.

Lars Brorson: To the answer on Food and Water, if I can just clarify, the better outlook for Q2 and indeed maybe just further out in 2021. Is that strength coming through in the end markets you flagged earlier, biotech, protein, ethanol, veg oil? Are we starting to see a bit of movement around brewery and dairy? I guess, brewery very depressed last year. Is that fine to show some signs of life?

Tom Erixon: Well, we actually had a healthy brewer business throughout within – it hasn't been a growth business, but have been stable on an OK level. So I'd be a bit cautious in terms of our predictive because it wasn't that – it was surprisingly strong. I think let's see where it goes.

I think larger side. And that's typically, as you know, sometimes when we have bigger announcements like we had in Mexico a couple of years ago, that influences heavily what happens in the brewery segment specifically.

But in general, the activity level is good in the division, and we see the large order pipeline firming up a little bit as time goes by. So in that sense, as I said, I think what we see is a business cycle upturn where short cycle comes first and the long cycle takes a little bit longer time.

And I think that goes across – if you look at ethanol protein and veg oil, they tend to be relatively influenced by large order as well. That's where we go in and do plant constructions and the like. So.

Lars Brorson: That's helpful. Tom, finally, if I just can, on marine margins for this year. I think your IR has done a pretty decent job in terms of resetting margin expectations for the first quarter.

But for the full year, I mean, I still see market expectations for your Marine Division sitting just shy of 17 percent, which I'm struggling a little bit with, I guess that would require a meaningful swing back over the next few quarters from the 15 percent in Q1.

I appreciate there's a bit of seasonality, but you've got an environmental mix that should be somewhat adverse. You've got some cost inflation coming back, wonder whether you can give a little bit of color around how you see marine margins at these levels.

Tom Erixon: Maybe Jan will comment on the margin development.

Jan Allde: Yes. I mean I think we've been pretty clear on the outlook for Marine. I mean the backlog contains less of scrubber volumes. It contained less of pumping volumes. So on the other hand, they have taken pretty quick and firm actions on the restructuring side over the last year, having some positive impact already here in Q1. So again, but at the end of the day, they are suffering from a different backlog than they had a year ago. So that will come through during the year. That's clear.

Lars Brorson: OK. This sounds like you feel comfortable that Q1 has marked the trough.

Tom Erixon: I don't think we give outlook statement for specific divisions here on the margin side. I'm just saying we did open the year with a different pack of mix

than we had earlier, and that will come through during the year just as we guided for Q1. So I don't want to give more specific comments about that, Lars.

We are starting reaching the end of an hour. Should we go with 2 more questions?

Operator: The next is from Robert Davies from Morgan Stanley.

Robert Davies: I'd just be interested in terms of kind of the ongoing restructuring program that you've announced. Just when you look forward over the next 1 to 2 years, is there more you can do in terms of footprint consolidation or further headcount reduction or movement in manufacturing capacity across your kind of footprint at the moment? Is there still more to do? Or do you feel pretty comfortable in terms of where you're at the moment?

Tom Erixon: Yes, the work never ends, of course. And there are some footprint programs moving into 2022 and, to a degree, 2023. I would say they are backed up to a degree by organic growth plans. And so they are not necessarily just a stand-alone shutdown or so forth.

But in that sense and in the sense of the ongoing work with automation, which is starting to become attractive to us on a different level, the modern robot technology offering a lot more opportunities in manufacturing than the traditional pick-and-place robots. And so we see a fairly interesting technology development ongoing.

So if you stretch this 2, 3 years from now, I think we may start to see some productivity gains in that area as well. So I don't think it's going to be a binary event restructuring thing. I think we were in a good position now to, in a fairly reasonable footprint, to drive volumes, productivity, automation and efficiency. So I think we laid the foundation. We are not necessarily completed.

Robert Davies: I see. And then my second question was just around the comment you made on Marine on the yard contracting increasing. How much visibility do you get on the different sort of vessel categories within that?

Do you just get a feedback that it's just broad-based activity that's picking up? Do you get to sort of tell whether it's the different categories are sort of stronger. I'd just be curious to know kind of how close you are in terms of that feedback loop in terms of seeing the different vessel categories get better or worse?

Tom Erixon: Well, we – the numbers for the different categories are disclosed at the end of the quarter. So you can see them in the statistics, if you use clocks or something like that. So in that sense, after the fact, those numbers becomes clear. We, of course, have a certain visibility on ongoing contracting at the yards independently from Clarkson or any other reports on the issue.

So it happens that we are ahead of the curve. Obviously, in this instance, we were not because 3 months ago in the earnings call, I didn't necessarily see the pickup coming. At least I didn't predict it, and it wasn't so long ago. So my capacity as forecasted is maybe put in a little bit of doubt at this moment in time.

But at least I preferred caution to over optimism. But you'll find the categories they are fairly clearly disclosed. And with the caveat that they will be updated another month or 2. So you will see the existing report on 361 ships will probably climb by above 400 for the first quarter by the time the updates are complete.

Robert Davies: I see. But in your discussions, there's nothing to indicate that you've seen an uptick outside of container ships more broadly?

Tom Erixon: No, there's been some growth in other areas, too. So I think it is not isolated in any shape or form. And the reason I have an element of optimism compared to the 30-year low, (inaudible) swimming around in for a period of time is the fact that the global trade has returned to a fairly significant growth. And of course, that growth is driving not only container freight, but it does drive freight in all areas, in all ship classes, except necessarily than cruise, which will be on its own recovery leg.

But I think there are some grounds for (an optimism), not on the level that we saw in Q1, but in terms of taking action. I think that is to be expected. And I think that's within the forecast right now that we will see a reasonable number coming in for the year.

Gabriella Grotte: OK. We'll go on the last.

Operator: Our final question today is from Karl Bokvist from ABG.

Karl Bokvist: Two questions. First, on HVAC and R, I was just interested in hearing is there any particular area where you're seeing stronger demand, such as any particular region or category? Air conditioning versus heat pumps, for example.

Tom Erixon: Yes. There are variations, but I think the heat pump market is very strong, I think. So if I would point to anything, that's probably the one. But overall, the whole HVAC area, including air conditioning is going well, driven by the same trends of refrigerants energy efficiency and all that. So I think we are in the middle of the process, where we also see element of regulatory change driving demand structurally in these areas.

Karl Bokvist: All right. And then just a broader question on your Marine product portfolio. I think you mentioned it before that you're quite structurally content with the portfolio that you have.

But just out of curiosity, anyway, do you see any kind of product category that you would find interesting that you might not feel would be the best way of developing internally, i.e., something you might build interesting looking at externally.

And also then – sorry, just a follow-up also on your outlook for Aalborg. I think with the product portfolio that it has, it should be quite favorable for kind of all products outside of the engine room, so to say?

Tom Erixon: Let me start with your last question. I think to a degree, you're right, both fuel options, LNG and other trends will favor, I think, the offering we have in the

marine boiler business. So I think structurally, they are reasonably positioned at this point in time.

And they also had, by the way, both sequentially and year-on-year, a rather solid order intake. So we're on a good track with that. It's difficult for me to be precise and transparent on extension on the product range.

But I think I indicated to you already earlier in the call that we are working on a toolbox for the ship owners in terms of how to come back climate impact from shipping. We are not there yet. I think part of that is development work. Part of that is partnerships with other firms.

And there may be some components of M&A in that as well. So we are certainly working in the pipeline in all 3 of those areas. And our job is not completed. I hope part of that will clarify during the year, and part of that may take a little bit longer time. But it is a dynamic situation for us in the marine industry.

Yes, there's been some risks and downside related to the reduced demand in environmental after the retrofit boom and maybe some concerns on heavy fuel oil as a main fuel on board.

But I think when we look long term on what we can do and will do in the future, fuel options and climate challenges, we see, I think, more upside than downside in terms of how we will develop the division going forward. But I will keep your question in the back of your head, and I hope that gradually, we can give some answers to it. That is a bit more crystal clear than what I'm saying right now.

And with that, thank you very much for your interest. I know you had a busy day. You ended up with the most interesting call, I'm sure. So thanks for your interest and speak to you in a quarter. Goodbye.

Operator: Thank you. That does conclude the conference for today. Thank you (for) joining. You may now disconnect.

END