

ALFA LAVAL AB

Moderator: Tom Erixon
20 July 2021
10:00 a.m. CET

OPERATOR: This is Conference #: 3593903

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Alfa Laval Q2 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.

If you wish to ask a question, please press “star,” “1” on your telephone keypad. For your information, the conference is being recorded. And now I would like to hand the conference over to your speaker today. Please go ahead, sir.

Tom Erixon: Good morning, and welcome to the earnings call. I will start with a few intro comments before we move on to the presentation as always.

First, let me say that end markets across the board remained positive in the quarter across all our regions and across all our divisions. We are in a clear global recovery, and Alfa Laval is now passing the low point on this business cycle as we are rebuilding the order book going forward.

The operating margin improved somewhat despite the noticeable inflationary pressure and a somewhat low invoicing. Strong operational performance and the implementation of the early announced restructuring program compensated well for the cost escalations across the board.

The sustainability platform continues to grow organically at a good pace, as you noticed. On top of that, we have added a number of important business development initiatives in the quarter, specifically to the Marine division, and I will come back to that later on obviously.

Finally, let me say that end markets are expected to remain firm in the near future. But for Q3, we also expect perhaps some seasonal variation effects that we normally have for a weaker Q3, and there may have been some preordering taking place in Q2 ahead of anticipated price increases and others. So while end markets in nature remain firm and strong, we may see some effect on the order intake, specifically in Q3, and we'll return to that in the forward-looking statements.

And with that, let me go to the key figures. Being a long cyclical company, invoicing lags order intake, as always and as expected. Despite the lag, the operating margin improved a bit in Q2 year-on-year and sequentially.

The weaker marine invoicing and increased cost for managing inflation and bottlenecks in supply chain was compensated by a good operational performance and also to a degree with a positive mix in product and mix in service versus capital sales.

Remember that when the invoicing decreases, the share of large projects tend to decrease and the share of service tends to increase. So we have a natural hedge reducing the margin cyclicity. And remember that, that hedge goes in both directions, both when we are heading South and when we are heading North.

With that, let's go to the divisional reviews. For Food & Water, it was obviously a very strong Q2 in terms of margin and in terms of order intake. We saw clear return of large projects in the quarter, especially in sustainability-related application like biofuels. In addition, the demand was very strong with our channel partners, driving volumes to record levels for our transactional business.

Let me here point out an important fact regarding the structure of our order intake. The biofuel business, to a large extent, is booked in the Food & Water

division due to the technology platform we have in engineering solution for vegetable oils.

As we transit from fossil to biofuels, which is part of the energy transition, we are somewhat consequently understating the order intake in the Energy division and somewhat overstating the order intake in the Food & Water division from an end market perspective.

So strictly looking at end markets in Q2, if we adjust for this, you would find that both the Energy division and the Food & Water division was just above the 30 percent growth mark, both of them. So I hope you follow me in terms of the allocation of the order intake and how it's being booked for technology reasons. End market-wise, we saw equal strength between those 2 divisions.

Let me then move on to Energy division as such. We had, even in the positive numbers in the Energy division, strong growth in sustainability application, and it was more than compensating for the weak market sentiment that remained in the upstream oil and gas market, and to a degree, downstream as well.

From a supply chain point of view, we are in a challenging situation with bottlenecks becoming a limiting factor with extended lead times and some additional costs already present in the Q2 result. At the same time, we have under absorption in some units with primary focus on the oil and gas application.

This is, to a reasonable degree, addressed in the ongoing restructuring program, supporting a stable margin in the quarter. Service demand was high and grew also in the upstream oil and gas market which tend to be a leading indicator when it comes to market development for the quarters ahead.

Regarding the Marine division, the second quarter continued a clear improvement in yard contracting following a strong Q1. And it's now on a contracting pace at around the historic average level of (15) to 2,000 ships per year. We expect when the final count for ship contract is in for the first 6 months, we will be in the region of 800 to 900 ships for first half 2021 with a

reasonable expectations for a good contracting market looking into the second half as well.

Contracting included a good number of product tankers, with immediate effect on the order intake for Pumping Systems specifically. And they had a very solid order intake in Q2, affecting the overall order intake for the Marine Division positively.

Demand developed somewhat positive also across most of the product groups, but especially in sustainability-related applications. Despite the expected lower invoicing, margins were relatively stable on the back of a quick implementation of capacity adjustments, end last year beginning this year, and a good operational performance overall.

As you know, we have been working on the Marine sustainability platform for many years, starting with the PureBallast project over 10 years ago. Global environmental regulations will continue to drive innovation and investment into this area over the next 10 years as decarbonization becomes critical for the shipping industry.

In Q2, we added 3 important initiatives to the decarbonization toolbox available for the shipping industry. First, we announced the acquisition of StormGeo. StormGeo has multiple purposes in our portfolio, but one important aspect is the providing of a route advisory service to save fuel on the navigational arena.

Apart from that, StormGeo also has other aspects, as we discussed in an earlier call, supporting the digitalization and development of digital service business in the rest of Alfa Laval's portfolio. The second announcement we did in the quarter was the investment into a joint venture called Alfa Laval Oceanbird, which will develop a highly efficient wind propulsion system with significant fuel savings opportunities for a number of ship classes.

Third, we took a minority stake in a company called Marine Performance System which will commercialize the system to distribute air bubbles under the hull in order to reduce friction and save fuel. Together with the existing

portfolio of environmental applications, we're in a strong position to support the shipping industry to cut emissions by 50 percent going forward, and we have positioned our portfolio in the Marine division to become fuel independent in the time span of 2025-2030 range.

Let me then make some remarks on service specifically. Service has returned to growth in all divisions and end markets at this point in time. Although we do still see some limiting effects on travel restrictions in a number of geographical areas, not least for the marine industry.

The implementation of digital service tools and investment into modern technology to industrialize high-volume service items will continue and have a positive effect in building Alfa Laval as a service company and building the service culture in the group. I think we are on good track and the current order intake growth is signaling that as well.

A couple of geographical comments to round off before I hand over to Jan. The global recovery is clearly noticeable in our order intake numbers for Q2, and we see growth in all regions, with the perhaps small exceptions of the Nordics. And in all regions, we see a good, stable and, in fact, rather high growth numbers at the moment.

If you remember, just a few years back, China was first out in entering the growth phase and after that, came North America. What we saw this quarter was the rest to follow. It has been quite a few years since we have seen a synchronized business upturn across all important regions in the world, but that's where we are right now, and that is clearly supporting the order intake growth we've seen in the quarter.

And with that, I'd like to hand over to Jan for the financial details.

Jan Allde: Thank you, Tom. I'm going to start with looking at sales, as usual. So we expected invoicing in Q2 to be lower than the same quarter last year. We realized sales of SEK 10 billion, which is 5 percent lower than last year. Please note that we had a large negative FX translation impact on sales in Q2. And excluding this, sales were up 2 percent versus last year, so pretty much as expected.

With regard to sales in Q3, my outlook is as follows. I expect invoicing in Q3 to be somewhat higher than the same quarter last year, primarily driven by higher invoicing in the Food & Water and Energy divisions despite the continued expected negative FX translation impact versus last year.

Then looking at our gross profit margin. So the margin came in at 38.2 percent in Q2 compared to 35.4 percent last year. We had a positive capital sales service mix due to the relative strong service invoicing in the quarter. We had a good load and capacity utilization in most of our factories during Q2, and this benefit could more than compensate for the very low cost situation of last year when the short-term working programs went in full effect.

Secondly, we also had a positive impact from the ongoing restructuring program in the quarter, primarily impacting the Marine division. As expected, the PPV metals impact was slightly negative in the quarter due to increased material and freight costs, which mainly impacted the Energy division. Finally, we did see a positive FX impact on gross profit margin in the quarter.

Now over to my outlook for Q3. The starting point is 36.1 percent margin reported Q3 last year. We do expect a continued positive capital service mix. We expect a neutral load volume effect, but a continued negative PPV metals impact due to the increased material and freight costs. We expect this to be partly offset by price increases and material price hedges already in place. And finally, we do expect a positive FX impact on the gross profit margin also to continue into Q3.

Then looking at our S&A expenses. So on a comparable basis, the S&A expenses were up 15 percent in Q2 and 4 percent versus last year – year-to-date, sorry. This reflects that we are returning to a more normal activity level in the company and that we are comparing with the period again, where the short-term working programs of last year were in full effect.

With regards to the restructuring program announced in December last year, the program is progressing as planned, and we have reduced approximately 375 employees so far, which represents about 60 percent of the total planned employee reduction. We booked the remaining part of the restructuring costs

amounting to SEK 204 million in Q2, which brings the total cost of the program to SEK 945 million. Please note that this program is primarily reducing cost of goods sold and was set up to offset the lower invoicing volumes in the Marine division and the upstream oil and gas-related part of the Energy division.

With regards to our EBITA margin, as you have seen, it came in at 17.4 percent, slightly up versus last year despite a lower invoicing volume and higher overhead costs. This was possible due to a positive mix impact, both in terms of a high proportion of service but also a higher proportion of transactional business volumes, but also the ongoing restructuring program and the strong operational performance that Tom commented on earlier.

Then looking at some of the rest of the key figures. So again, excluding FX effect, S&A were up 15 percent and R&D expenses were up 16 percent. This reflects that we are returning to a more normal activity level in the company and that most of our end markets are recovering and business activity is strong.

Excluding the restructuring cost of SEK 204 million that was booked in Q2 as commented earlier, other cost and income was SEK 186 million, which is slightly lower than last year. Financial net excluding FX impact was minus SEK 22 million, and the FX gain losses in Q2 were minus SEK 91 million, giving a total finance net of SEK 113 million versus SEK 166 million last year.

The main reason for the FX impact in 2021 and also last year are due to revaluation of cash positions in local currencies. The tax rate came in at 20 percent in the quarter and 23 percent year-to-date. And the reason for this are lower – for the lower tax rate is due to tax incentives and tax refunds in various jurisdictions.

The lower EPS in Q2 – of course, it's primarily due to the restructuring cost that was booked in the quarter.

Now looking at the cash flow statement. Cash flow from operating activities were SEK 1.4 billion in the quarter. While the EBITDA was at about the same

level as last year, we did see a slight increase in working capital, primarily driven by the strong growth in orders received. Investing activities included CapEx investment of SEK 172 million and, of course, the acquisition of StormGeo at SEK 3.6 billion.

Financial net paid, excluding FX impact, was minus SEK 10 million. Realized FX gains losses in the quarter amounted to a positive SEK 7 million, giving a total net – finance net paid of minus EUR 3 million.

This means that our total cash flow came in at minus or negative SEK 2.3 billion, primarily due, of course, through the acquisition of StormGeo. Please note that we have bought back approximately 1.2 million of shares in the company during Q2, representing 0.3 percent of total number of outstanding shares at a value of SEK 330 million.

When it comes to the FX impact on EBITDA in the quarter, the transaction impact was a positive SEK 30 million and the translation impact was a negative SEK 60 million, giving a total net negative FX impact on EBITDA of SEK 30 million in the quarter.

Looking at the projection for the full year '21. We expect a slight net negative FX impact of SEK 50 million, driven by a negative FX translation impact caused primarily by the stronger Swedish krona. When it comes to the order backlog at the end of June, it totally amounts to SEK 21.5 billion, which is 7 percent higher than same time last year, but 19 percent higher when compared to the end of 2020 on a comparable basis. And this large increase in order backlog is, of course, due to the high book-and-bill ratio of 1.22 in the quarter.

The order backlog now represents 6.6 months of LTM sales and for shipment in the remaining part of '21 amounts to SEK 12 billion, which is about the same level at same time last year. And that brings me to the sales bridge for '21, starting, of course, with the sales achieved during the first half, which is SEK 18.9 billion.

And as stated in the previous slide, the backlog for shipment in the remaining part of '21 is SEK 12 billion, which adds up to a total of SEK 30.9 billion. On top of that, you will need to make your estimate on change in in-for-out

orders, FX translation impact and acquisitions. For your reference, the total of in-for-out orders during Q3, Q4 2020 was SEK 8.3 billion.

Secondly, in regards to acquisition, StormGeo had sales of approximately 700 million in 2020. And as the deal was closed on June 1, we will have 7 months of sales attributable to Alfa Laval during this year. Finally, the expected FX impact, of course, very uncertain. However, using the closing rate at the end of June, the estimated FX impact is a negative SEK 1.5 billion for the full year.

And by that, I hand back to Tom.

Tom Erixon: Thank you. And then let me repeat some comments on the outlook statement. As indicated, we believe that the end markets will remain on the current high level in Q3, but we also expect some seasonality effect, which are normal and some preordering perhaps, that took place in Q2 will possibly affect the order intake in Q3 somewhat.

So all in all, we expect a somewhat lower demand for the group, and we expect a somewhat lower demand across all 3 of the divisions. And with that, we open for questions.

Operator: Thank you. As a reminder, if you wish to ask a question, please press “star,” “1” and wait for your name to be announced. If you wish to cancel your request, press the “hash” key. Once again, “star,” “1” if you wish to ask a question. We are taking the first question from the line of Klas Bergelind at Citi Research.

Klas Bergelind: Klas at Citi. So the first one is on mix. It's already quite good. But I'm trying to understand the product mix ahead looking at the orders now coming in linked to the green agenda. We still have weak oil and gas orders, I think, moving through the backlog, and now we have the strong growth in the newer verticals, looking at orders.

Does this mean that the mix out of the backlog from a product point of view should start to turn more positive into the second half? Or is that more for

2022 i.e., is net pricing better on these newer greener products? That's my first question.

Tom Erixon: Well, it's difficult to describe it in terms of net pricing for various reasons. But I think it's a bit more complicated than that. We have a lot of welded products that go into the oil and gas side, and the demand is relatively low.

They are still and the utilization in those units is relatively low whereas what we sell into a lot of the other areas are products where we are in high capacity utilization, but also perhaps in some areas, starting to reach, let's say, some bottleneck challenges.

So it's not that we are shifting sales from product A from one area to the other. It certainly happens to a degree. But this also is a different mix. With that said, I would not predict that we have a negative mix effect from fossil to renewable, if you like.

Klas Bergelind: OK. And no, that's fine. My second one is on Marine. We know that product tankers are important for you and you get orders through very quickly after the contracting increases. Early in the year, contracting was more driven by containers, LNG, LPG and so forth, and that typically is a 9- to 12-month lag until you get an order in these segments.

But now we have bottlenecks out there. Do you think, Tom, that orders will take longer to come through outside of the tanker segments, i.e., those that are geared to more, sort of, conventional containers and so forth?

Tom Erixon: I think we – I think what's driving that in this cycle is that at least initially, I think we may have somewhat shorter times than normally just because the order books are relatively short at the yards and the delivery times for the first book ships, I think, will be relatively quick.

So we may have a somewhat accelerated order book build in Marine compared to normal cyclical uptown. But as we've said before, we don't expect any major impact this year, certainly not when it comes to invoicing. And I think, if anything, outside of Pumping System, maybe a bit gradual during the year.

Klas Bergelind: OK. My very final one is for you, Jan, on the cost savings. Great execution driven by both good load and the mix, but you had temporary savings reversing and then we had some structural cost savings. Can you please zoom in on those? How much did the temporary savings from last year, the SEK 300 million reverse?

And did you get any structural savings already this quarter because I thought that, that was more for the third quarter onwards. So I understand the moving parts there a little bit better.

Jan Allde: Yes, I would say the following, but a lot of the savings we saw last year came through the short-term working programs and such. And of course, those goes away. You also have some other elements related to traveling and such, which will be more gradually, of course, come back. So I think if you do the math, you probably have about 2/3 of, let's say, the costs that are coming back on that program or maybe even a little bit more.

Then on the restructuring programs, as I've said before, we expected to have that program fully up and running through – in 2022. We did see some of those savings come through absolutely, but they're coming through in a different line on the P&L. It's coming through primarily on the COGS side rather than on the S&A side. So it's a bit of a different, let's say, hitting the P&L from a little bit different points in the P&L.

Klas Bergelind: But you had progress – you had savings at the COGS line from the structural program this quarter already?

Jan Allde: Yes.

Operator: We are now taking our next question from the line of Max Yates at Credit Suisse.

Max Yates: Just my first question is about how you're thinking about this marine recovery. And I guess if I look back to, kind of, the last time we had a very good year in Marine, it was 2018, then you were doing around 5 billion of orders that were directly related to pure shipbuilding.

So I just wanted to understand, as we, sort of, think about this recovery, kind of, going in through this year and then in your own orders into 2022, should we think about a similar, sort of, level of order intake for your pure shipbuilding business?

Or is there anything kind of additional that you're doing content per ship for additional products that mean actually for, sort of, a similar amount of ships and mix? We may actually see a higher revenue – a higher order number for your own business in the pure shipbuilding component.

Tom Erixon: Yes, your question implies that the sky is a limit, but I think the reality is a bit more complex than that. The 2018 number, remember, was an enormous pumped up demand short term for scrubber.

And that invoicing has been going on up until let's say, beginning of this year when that part of the order book was more or less invoiced out. So main reason for the deviation in invoicing this quarter compared to last year is the decrease on the scrubber invoicing volume. It's not the only factor, but it's an important factor.

So the 2018 number was not really so supported by contracting market conditions as opposed to retrofit conditions. So if I would give you – if I would guide you on that, remember that at any given point over the last years, our order intake from new shipbuilding tends to be approximately 1/4 of the Marine order intake, about 1/4 is related to the service area, and about 1/4 is related to offshore and to a degree, environmental products that tend to go as much on a retrofit as a new build.

So if you're going to look at an escalation of order intake from Marine, you need to – you can't start from the full base of order intake. You have to take the 1/3 of it and do some math on that further. The service will have its own dynamics. The sustainability products will have their own dynamics as well. You rightly point out that there are new components and elements.

What I talked about earlier when it comes to StormGeo, obviously, is joining us on a monthly basis, a quarterly basis from now on with an annual revenue

of about SEK 700 million. First month of operation within our book has been stable and according to plan. So we are on good pace with that. Others like Oceanbird and the Marine Performance System, it will take years before we see an effect on invoicing.

But there's been another of other announced projects over the last year related to methane slip and other things where we certainly see opportunities for additional revenue going forward. So I'm just trying to describe the components for you a bit. And from there on, you have to think through the numbers.

Max Yates: OK. Maybe just a very quick follow-up question on that. I mean I think if I go back to 2018, the scrubbers business was about 4.3 billion. We know that's come down considerably.

But I just wondered if you could give us a feel of obviously, the scrubber, but the ballast water business is bigger since then. So just maybe any feel on, kind of, where the current ballast water business on a, sort of, annualized basis may sit just to try and get a feel relative to that, sort of, where the scrubbers were previously?

Tom Erixon: Yes. We are on a good level in ballast water. It's – as you know, we are starting to approach the final years of the retrofit programs. So we will have a decrease eventually. But right at this moment and in this year, the PureBallast business is strong and firm. Approximately, it's higher than – somewhat higher than 2018. It's not a huge factor, but it's a plus factor compared to 2018.

As you rightly point out, the scrubber side is significantly lower. We don't expect that it will come back anyway close to where we were in 2018. But from almost a collapse in that market last year, now we see a more normal and, what we think is, maybe somewhat of a sustainable order level. So it's a contributing factor for us. And in the quarter, it's somewhat positive compared to last year for sure, and it is also sequentially growing in the quarter.

Operator: We are now taking our next question from the line of Mattias Holmberg at DNB.

Mattias Holmberg: First, any particular area where you've seen these preorders that you mentioned earlier in the presentation? And just to be safe, I'm pretty sure you've said earlier that you also require down payments to book orders. But would you say that there is any risk of order cancellations because of this pre-buying that you've seen?

Tom Erixon: No, I don't think so at all. Let me divide it up for you a little bit. I mean what we've seen structurally in the quarter is a return on larger projects. They were not released during 2020 and the beginning of this year. And so they've been in the pipeline for a long period of time. And as expected, when the pandemic effects are starting to wither, then we see the release of some of those projects.

So I don't think – that is not a preordering or any quick fixes. Those have been – work where we've been doing a lot of engineering work already, sometimes invoiced and then eventually converted. So those projects are firm. Well, they're as firm as they've been any time in history. And we don't have any order cancellation situations of any meaningful substance in Q2, and we don't expect it going forward.

The area of preordering when we granulate the order intake is possibly in the area where we have strong channel partners. And we built a very strong channel partner network, not least in the Food & Water division, but to some degree in other areas as well.

And they performed exceptionally well in the quarter. And I think that's where we may have some preordering or early posting of orders in anticipation of price increases or anticipation on the fact that we may see some bottleneck and lead time extension in certain areas.

So from that point of view, I don't think it's a massive challenge. I don't think there's a risk that we have products returned, but it may affect the pace of order intake in Q3. That's how we see it.

Mattias Holmberg: That's very clear. One more question for me is, if you look at your organization today, you're doing some headcount reduction in marine and oil and gas, as you mentioned. But is there any part of the business where you see

the need to adjust either up or down in order to be able to have a right-sized organization going forward?

Tom Erixon: Yes. We – let me start with sizing up. I think we are on all-time high order intake in quite a few areas which are high value-add production areas. So we will need to take decision when it comes to CapEx and manning gradually in a number of areas. Going forward, we are cautious not to move too quickly because the future is always uncertain.

But we are clearly in a zone right now in a number of areas that if we continue on this level or higher, it will not be efficient for us to operate in the current size of the costume that we have. We are going up in shift. We're going up in temps. We're going up in a lot of ways to cope with the supply situation.

So I think we are standing in front of a number of areas where we may come back to do additional investments, additional manning. As of now, I have to say our productivity number looks very, very good. They've been doing that during 2020, and they've been doing that during 2021.

So we are cautious and considerate in making sure that – as you know, the footprint investments and CapEx levels for automation and other things has been higher the last few years than before. And what we're seeing now, I think, is some positive effects and outputs from those CapEx projects as well.

So before we add a lot of manning in operations, we will look carefully on optimization levels. So that's part of your question. The other part of your question is the possibility for downsizing. Well, with order intake pays this quarter of SEK 48 million, SEK 49 billion, of course, there's not a lot of areas where we are looking for restructuring.

But I still have to say that we believe that the actions we took to adjust capacities in oil and gas-related applications is what we see is needed right now. We are still a little bit in that program. In – I've communicated a number of times that we have foreseen that we probably have another cycle to go in the CapEx programs, upstream, downstream, oil and gas and expecting that, I think we will be relatively stable as to where we are.

If that is a miscalculation or there is a different scenario going forward, then obviously, we may have some portfolio reshuffling to do in the years to come. But it's nothing that I see as particularly urgent right now, we are in a reasonable position. We have taken a lot of actions to address the situation. And as long as we believe that we will see another cycle of investments, and that's where we are right now, then I think we are, sort of, well equipped to handle the uptick.

And I remind you guys that when we were 1 year, 1.5 years back and looking at a very uncertain situation, the actions we took were very much set in an order – in order for us to be able to scale up afterwards. And the scale-up is being done right now and it's working and we're going to do the same with oil and gas. We will remain with our full capabilities to follow the next cycle should it come. Sorry, long answer.

Operator: We are now taking our next question from the line of Andrew Wilson at JPMorgan.

Andrew Wilson: If I can start with just – I guess, it's a broader question. Clearly, the Q2 marine orders were significantly better than I think we talked about with the Q1 results and I guess, better than (obviously) consensus was expecting as well. Just interested in kind of what, I guess, happened that surprised you in the quarter.

Or was it just a case that it was a relatively cautious guide? I know you alluded in the Q1 to some potentially customers taking options up early or making sure that they could take options up and therefore, maybe it felt a little less sustainable.

I mean, you obviously again talked positively today on the outlook. So is it just that you just feel the whole underlying market, you just have more confidence that this is a sustainable level? Appreciate that's quite a long question, but maybe just to get a little bit more of a thought process how it's changed.

Tom Erixon: No, it's good, Andrew. I follow you. And let's see if I can wrap up a reasonable response. The – you're right. When we looked at the Q1, we thought it was a bit of a container-driven uptick with what it was rather options conversion related. We didn't necessarily feel confident in looking at it as a cyclical upturn.

We saw structural reasons for orders coming in I think with – after second quarter, we see this as a little bit more broad-based when it comes to ship classes. We see it a bit more broad-based when it comes to the shipping industry's optimism going forward. And it's supported by a return to growth in global trade and the underlying – and to some degree, capacity needed to manage bottlenecks in parts of the global trade system.

So I think we are a little bit more comfortable with where the contracted volumes are at the moment compared to Q1. So that's one aspect. Structurally, for us, when it comes to the order intake in Marine, I think the big difference compared to our guidance at the time and what we didn't necessarily nail to the decimal was the fact that the Pumping System orders came ahead of our expectations.

And I think we've been mentioning this a couple of times that we tend to – that tends to be the most short cyclical order book business compared to contracting sometimes and often, we see public system orders before the ships are registered in the statistics at Clarkson.

So it – and those came to a large degree in June and later part of June. So it was a little bit in advance of our expectation. It doesn't change perhaps too much our outlook for longer 3, 4 quarters. A lot of it came in Q2. But I think that moved the numbers significantly in the second quarter. You can call it a bit of a one-off. If there is something that is less of a one-off, I think the fact that the shipping industry is gradually moving to a multi-fuel solution type of situation.

And on top of that, we see an increasing pricing delta for low sulfur, high sulfur fuel. I think, in generally speaking, the demand situation with more ship contracting, more multi-fuel, higher-priced deltas, sort of, the underlying

situation was somewhat positively affected already in the Q2, and that is not a one-off. I think that may be, certainly in Q3, a trend that extends.

Andrew Wilson: That's helpful. Maybe if I can just follow up just quickly on that. I think in previous quarters, and I appreciate things have, sort of, moved quite quickly on the Marine side, but I think you talked about customers having been, sort of, hesitant to place orders, given obviously the uncertainty around, sort of, direction of fuel and fuel types. Do you – it sounds as if that is beginning to free up a little bit and you'd kind of expect that to continue to.

Tom Erixon: Yes. I think we were coming to a point where decisions needed to be made, and I think the decision-making process among a lot of the shipowners have been to not bet everything on one card. I mean we still see extension of the life cycle of older ships that may not be that efficient.

And so there's still a hesitation in the market even at the current contracting level. We see trade of secondhand ships being relatively active and high price despite the fact that perhaps the time to put that order in for new would make sense.

So the fuel story and the fuel challenge is still out there. But I think the underlying trend has been that this uncertainty will not disappear. We will get, as a consequence, more complex fuel solutions in the engine room, and we see that already in the mix of the ordered ships, and we see it to a degree in the order intake for a number of the Alfa Laval systems that go into the engine room.

Andrew Wilson: That's good. And if I can just ask one, I guess, unrelated, but just to cover it off. I guess, interested in any comments you can or are prepared to make regarding the situation with Neles.

Tom Erixon: Yes. I don't have a lot to add. We've obviously noticed the emerging proposal. I thought it would have been good if that came around when the actual bidding was on the table. It didn't. Now it's there. We haven't made a final decision yet, but obviously, we feel comfortable in the situation that we are well into the money.

Operator: We are now taking our next question from the line of Madhvendra Singh at Bank of America.

Madhvendra Singh: The first one is a quick follow up on your comments on temporary savings. I think you said more than 2/3 of the temp savings are coming back. I just wanted to understand whether you meant it for second quarter. Or you're expecting it for third quarter? And then I'll have a second question afterwards.

Jan Allde: Yes. What I said that a large part of the cost savings program of last year was related towards short-term working programs. And of course, that cost automatically comes back here during 2021 and was visible in the quarter.

What I also said is that part of that program were related to lower level of traveling and a lower activity level in general in the company. And of course, now, yes, the activity level is coming back in the company, but we haven't yet seen the full effect of a higher, let's say, more normalized traveling aspect.

So some elements has certainly come back and some of the activity level, particularly related to traveling is still low. So – but on the other hand, as I said, yes, the restructuring program is progressing well. A majority of that is cost of sales, but certainly, there is an element of S&A savings also there.

Madhvendra Singh: OK. And then just trying to understand your views on the oil and gas market. Because of our Energy division, you said that orders are mostly driven by the energy efficiency products, while trends in the, both upstream and downstream are still not great.

But at the same time, in the Marine division, your product tankers are seeing very good demand and take up and hence, you're seeing the good pumping system orders. So I just want to square off these comments on – with regard to 2 divisions where we are seeing different trends.

Tom Erixon: Well, I don't think I'm able to connect the dots between the marine market and the oil and gas market. It is what it is. I think you've got to figure out the links. I'm just trying to sell products.

Madhvendra Singh: So what I was trying to understand was that, when you say that oil upstream and downstream, both are weak, do you mean on a year-on-year basis? Or you haven't seen any sequential improvement either within oil and gas upstream and downstream side?

Tom Erixon: I think it's fair to say that it's fairly low. It can vary by individual projects and things like that, but there is not a clear release of funds into the refinery sector other than the biofuel side. And as I commented on, that's what you see to a degree then mainly booked in the Food & Water business that amounts to about SEK 600 million.

I made this comment to you, I think, at last quarter that in this – we booked about SEK 600 million on biofuels. Our upstream oil and gas business is about SEK 1 billion. So we are almost doubling the Energy business from a biofuel point of view, and that is becoming a more and more important part of the portfolio.

Operator: We're taking our next question from the line of Johan Eliason at Kepler Cheuvreux.

Johan Eliason: I was just wondering a little bit going back to the ESG and the ballast water. We had the regulations put in force in 2019, implying, sort of, a 5-year cycle where these installations needed to be done on the existing fleet.

Has the pandemic changed this in any way? The regulations or the availability for the ship owners to actually get access to shipyards and do the upgrades? Or is it sort of still until 2024, we should be expecting this cycle to continue and then drop off?

Tom Erixon: I have an answer to the comment. The – to my memory, I think we had a 1-year extension compared to the original implementation plan due to the difficulty of visiting repair yards. So that is my understanding.

The other comment is you guys are surprising. If we are throwing a 45 percent organic growth on the Food & Water division, and you're burring yourself in marine and oil and gas, I get a little bit puzzled as to the investor strategy here. OK. That was a bit of a noisy comment, but I had to make it. I apologize.

Johan Eliason: No, I understand. I think part of it is, it's more difficult to find good numbers about the edible oil business, basically. That's why we are relating to this area, which we know better. But thank you anyhow.

Operator: We are now taking our next question from the line of Robert Davies at Morgan Stanley.

Robert Davies: My first one was actually on Food & Water. I just – my first one is on food and water. Just be interested in I guess some of just the larger project activity, and it's always difficult to get a sense quarter-on-quarter when the, sort of, larger projects and where the investment cycles are. I just guess stepping back on a sort of 3- or 5-year view, where are we?

Do you have any sense of whether there's been any, sort of, catch-up or acceleration or build out or COVID, kind of, impacted the types of investment cycle? Some of these food and water, sort of, businesses that have made across those divisions? So I guess my question is really trying to sort of figure out are we expecting more, less or a similar amount of, sort of, large orders over the next 1 to 2 years, for example? That was my first question.

Tom Erixon: Yes. I can understand that it's a bit of a struggle for you. And in all honesty, it becomes a bit – sometimes a struggle for us as well when it comes to predicting the short-term order intake, given that whether you book or not book a SEK 400 million project in one division certainly affects the overall number.

I would say, in general, to a degree before the pandemic and certainly during the pandemic, we were, in the Food & Water side, a bit low on the larger projects. We got low in ethanol and part of the biofuel side because of the regulatory changes, not least in the U.S., and I think to a degree an overinvestment in capacity over a period of time, so it's been very slow for many years, and we see signs of recovery, specifically in that sector right now.

The veg oil side, sometimes we call it (inaudible) and sometimes we call it edible, but let's call it veg oil, was also over period a bit over invested, not least in Southeast Asia. And we see a good return on it now, not only for

consumables, but also for as feedstock for biofuel. So I think those are 2 areas where typically the projects are relatively large and visible to you guys.

But on a slightly smaller scale, of course, there are very healthy project pipeline driven by the growth in biotech, including the vaccine growth that we see at the moment. And in protein, it's quite OK. It may not be mega projects, but the project pipeline is good. So I would say it's pretty healthy. And that is, of course, a comment that is also affecting our outlook in Q3.

As you can understand, with the large projects announced to compensate for that in any – to get anywhere close, we need to continue to book a bit on the large order side. And so that's our best guess, short term, but the pipeline looks OK.

Robert Davies: Great. And then my only other question was I guess, kind of, joining up the dots across marine transport logistics, I mean we're hearing various stories of all these transport logistic headwinds and issues. Is that at all affecting the amount of service business in your kind of marine business?

Are you seeing people holding off through 2Q from doing service because they're making better money on higher freight rates or whatever it is and there could be some sort of catch up into 3Q?

Because I know you had, sort of, positive number on your slide marine service growth. So just wondered, I guess, were there any option or potential for that to accelerate into 3Q? Or is that not a meaningful impact quarter-on-quarter?

Tom Erixon: Well, I think there are 2 parts of the – on the service side in marine that remains weak. One is, of course, in cruise, where we still have idling fleet. It is – with that said, both in cruise and in upstream oil and gas, we see some small growth from a very low level.

So it's moving in a slow way in the right direction. And the other part is services on board, which require flying in personnel, sometimes in one port and flying them out from another port. And that logistics exercise is still very difficult to do in large parts of the Asian harbors, not least.

So there is still a couple of factors that is holding us back. But with that said, from what we see on the transactional side, I think we see a fairly full, fair reflection of the underlying market right now.

I don't think there's a lot of headwinds left when it comes to optimizing ships. (That even be) a little bit of pent-up ordering demand for spare parts that is happening right now. So I don't think we're overstating or understating the growth right now. We may be fairly balanced in where it is, when it comes to the marine.

Operator: We are taking our next question from the line of Sebastian Kuenne, RBC.

Sebastian Kuenne: A couple of questions. First, on the Food & Water, very briefly. You have mentioned ethanol and vegetable oil business coming back. What do you see for the milk – for the dairy business overall? Because I saw that the U.S. is producing significantly higher amount of milk at the moment.

Secondly, for Marine, I still don't quite understand the market positions for your new acquisitions. So where is StormGeo positioned? Oceanbirds? Marine Performance? Where are they compared to competitors or competitor technology? That would be the second question.

Thirdly, again on Marine, sorry to be insisting on that. We see the big boom of container vessels, of course, maybe growing fivefold this year. And we noticed that a lot of these ships now have dual fuel engines, so they need a lot of LNG technology.

If you were to look at the modern ship order now and ship orders, let's say, 3 years ago, how much more content or how does the content change for Alfa Laval, if you go from bunker fuel engine to a dual fuel engine with all the technology needed?

Tom Erixon: That was a broad question. The first question was easier. I'll take that one first. If we look at the Q2 order intake for the Food & Water division, 2 applications areas that were stable rather than growing was brewery and dairy. I think the outlook is reasonable, as you indicate, actually in both of those orders.

We've been somewhat surprised that the brewery, despite the shutdown of the pubs and restaurants, has stayed as healthy as it has to in the pandemic, but nevertheless, it has, and we may see some signs of further strengthening in that area.

Dairy has, for us, stayed flattish over a period of time. And I think the expectation is all of that typically there looking into Q3, we may see some signs of recovery. And I'm not making those comments to accelerate the growth path of the food division above and going what it was in Q2. We have many moving elements, but those 2 specifically, as your question indicates, have in plantation may be a reasonable outlook.

When it comes to StormGeo, the – I would just highlight there were – the 2 reasons why we acquired it. And if you want to go to fundamental, we're all clear about the impact of digitalization on industrial companies. And we are also clear that building organically, some of those capabilities is difficult.

It's difficult to retain people, it's difficult to develop the culture and the context for where some of these data scientists and big data analytics and AI competence sits. And therefore, we felt convinced that acquiring a platform from which we can continue to build our digital services in a broader way was an important place to start, as opposed to fiddle around in our mechanical engineering world and try to make us digital.

So it was a very long-term strategic option for us to use. And one of the key tasks in the coming 12 months is to explore and evaluate opportunities to drive digital acceleration in the Alfa Laval portfolio above and beyond what StormGeo does today. So there is one fundament.

The other question is around StormGeo's market position and what they do. And they clearly are doing more than route advisory, although I would say on route advisory, our perception is that it is the market leader and the best way to optimize the fleet, optimize performance or optimize navigation is by using data and know-how from StormGeo, which is not only weather data, mind you.

It is actually a significant database of performance from thousands of journeys being done historically, where the effects on fuel consumption can be clearly noted and learnings and lessons to be learned are there.

So I think it is an important knowledge base that we acquired. But of course, they do a lot of other things, too, when it comes to providing safety data to the offshore as well as onshore industries, and that the weather insight and very localized knowledge is a big part of the business portfolio going forward.

So StormGeo, as it is today, we will continue to support the development and know-how in AI, potentially further acquisitions to expand the portfolio. But clearly, the position within the marine industry indicates the tight link which we see between something like StormGeo and, of course, the possibilities down the road of Oceanbird when we start to use wind as propulsion system, weather insights will become massively more important.

And so consequently, we think we are in a good position to build a very, very relevant platform for 2025 onwards when sometimes we expect to start to see the initial installation going on ships.

Sebastian Kuenne: But do you see Oceanbird and Marine Performance as being the – also the leader in the market in terms of technology on wind propulsion and (air-lubrication)?

Tom Erixon: Yes, I understand your question. And I will remain a little bit humble. I mean, this is early investments into projects we believe a lot in. What I really, really like with Oceanbird is the fact that we are doing a joint venture with Wallenius, and one of the aspects, apart from the prototype technology development that already has been done, we also have ships ready to be equipped with sails.

So as long as we can develop the supply and technological challenges in the right way up until 2025, we have the pilot ships and – I shouldn't use pilot in this context because it means something else. But the initial installation already secured, and we have a very environmental conscious partner who will work with us side by side in making this penetrate into the ocean side.

So I think today, it's difficult to judge the various initiatives in terms of the quality of where they are. I think our route to success in this is putting the best people at work, working with one of the most environmental conscious ship owners in the world and to drive this very fast forward to proof of concept, and that's where the value is.

I don't think the drawing board of Alfa Laval is significantly better than any other smart company figuring our way to design the sales solution. So momentum, speed and capabilities are key.

I think the air bubble side is a different story. We believe that the patented solution that we are buying into is a very good platform to build on. But obviously, that is a much more straightforward industrial development to do. It's not technologically a very difficult challenge for us. It's more of a question of finding a market acceptance for the technology, and we're obviously very hopeful that this will play a role.

Sebastian Kuenne: And then on old versus new 2-stroke engines and large container vessels, the content that you have?

Tom Erixon: Sorry, can you repeat that one?

Sebastian Kuenne: Yes, yes. So my third question I had was, container vessels ordered 3 years ago compared to container vessels booked especially in the first half of the year, with most of them running on dual fuel engines, how does the content for Alfa Laval change in those?

Tom Erixon: Yes. Yes, you're right in your assumption. We add complexity in these situations, and there is – we have been guiding many years that depending on ship classes, we see total order intake potential varying between a few million euros to some EUR 12 million, EUR 14 million depending on ship class and equipment.

That was before we started to discuss multi-fuel solutions. So you could potentially add a couple of million euros into the theoretical potential of exhausting all of the equipment opportunities on board. So it's not a game changer, but it is an add-on possibility for any given ship, yes.

Sebastian Kuenne: OK. Very brief final question. In Energy, you have any orders relating to hydrogen yet? Heat exchanges for hydrogen production?

Tom Erixon: It is – I'm not sure I'm answering your question absolutely correct. But my feeling is that we are in a very early stage still when it comes to actual orders. We – I don't know, Jan, do you have a different perception on...

Jan Alde: There are some, but it's not sizable.

Operator: There are no further questions on the line. Please continue.

Tom Erixon: With that, thank you very much. And if nothing dramatic happens, we will all meet up again after the second quarter – after the third quarter, sorry. Thank you.

Operator: That concludes our call for today. Thank you for participating. You may all disconnect.

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