

ALFA LAVAL

Moderator: Tom Erixon
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OPERATOR: This is Conference #: 4686502.

Operator: Good day, and thank you for standing by. Welcome to today's Alfa Laval Q3 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

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

Tom Erixon: Good morning, and welcome to the Alfa Laval earnings call. As always, let me start with a few intro comments before moving on into the presentation. As you've seen from the quarter report, global demand remained steady and firm. It was a continuation of a synchronized global recovery and we see especially favorable environments, both in our core markets of U.S. and China. We are as a company now with about the 2019 level as well and in many areas, significantly above the 2019 level.

The margin improved somewhat in the quarter. There was a lot of factors affecting the margin development, both in a positive and in a negative way. But if I would single out a specific factor, we have, over a period of time, improved underlying profitability of our engineering and product business, which is now in a stable performance level impacting specifically the margins of Food & Water positively.

Now finally, we've seen an intense period of organic growth for a number of years, not least in this quarter. We see a need to increase our – an opportunity

to increase our CapEx program into our existing technology platforms and growth opportunities in profitable businesses that we are already heavily involved in. In addition to that, as you know, we have been developing a number of new application opportunities primarily related to the rebuilding of Energy Systems and the Marine industry.

And those 2 together has triggered us to increase our expectations for the CapEx programs going forward. And we are now guiding you towards a CapEx in the region of SEK 7 billion, SEK 8 billion over the next 3 years. All in all, that's about the doubling compared to our previous footprint programs levels, and it's actually a quadrupling of the level of CapEx we used to have back in 2015 and prior to that.

So with that, if we go to the key figures. We came in, in terms of orders, about 30 percent above last year. It was more or less in line with our expectations. Our order book, it was continuing to strengthen significantly in the quarter and in the year-to-date. And invoicing remain pretty much as expected. So with the growth of 5 percent to 6 percent, we are obviously still building the order book for invoicing 2022 and forward.

The margin on 18 percent was satisfactory from the point of view that we see, obviously, a lot of inflationary pressure in the supply chain in our operations. And with a relatively slow emerging growth, the volume effects were limited. So from that point of view, we felt good about the margin improvement driven by the restructuring program that was launched in last year, driven by reduction of quality costs and driven by good productivity development across all parts of the organization.

Now moving on to the divisional levels. First, the Food & Water division, which came off a record pace in Q2 in terms of ordering. And although the quarterly order intake sequentially was a little bit down. It is still a very strong Q3 number for the division, compared to 2020 and 2019, those numbers are significantly above where we were. And I remind you that 2020 was a rather stable year from Food & Water division, not so much affected by the pandemic at the time, versus 2019, order intake was up 19 percent as referenced – sorry '21.

We see basically a strong demand growth across all geographies, including, as I said, U.S. and China, but we also – that as happens quite rarely, see good growth in essentially all of the end markets and end applications of the Food & Water supported by a number of areas, including veg oil, including brewery, including biotech, to just mention a few.

Volume effects were present in Food & Water as well as productivity and that compensated for somewhat of a negative mix and somewhat for an inflationary pressure and somewhat from a return of sales and admin cost to a more normal level after the big reductions in 2020.

Moving on to the Energy division. We had an all-time high in terms of order intake in the Energy division. It was many factors, but obviously, we see a continuous strong demand growth in sustainability-related applications with special focus on the energy efficiency solutions. We also see somewhat of a return to CapEx projects in the division. We see it in the Process industry. And to some degree, we see it also in the oil and gas.

So the oil and gas order intake as we guided to you in the last quarter, we had a bit of an uptick in the oil and gas service related business as a lead indicator. And in fact, in this quarter, we saw a modest return on CapEx project in the oil and gas sector.

Our expectations for the oil and gas order intake remains relatively modest compared to historic level, but it confirms the view we've been holding for a couple of quarters that we passed the bottom. And at this point in time, there may be a small upside as we move into a next up cycle in the oil and gas sector.

Service for the Energy division grew substantially across all applications and all geographies. It was a really strong service quarter, and it was supported by larger service projects as well, which came in unusually strong in the quarter, probably a little bit of a pent-up demand situation where those projects were not present in the order book during 2020.

The margin remained stable despite the negative PPV development. It is the division that is mostly affected by the material price increase and those were largely compensated by operational improvements and quality cost reductions.

Then on to the Marine division. We believe that the division is now returning to growth in terms of order intake, clearly, and that means that from an invoicing point of view, we feel we probably have passed the bottom of the cycle in this sector.

The contracting of new vessels and ships in the shipyard remains on a positive trend. The expectations have been upgraded somewhat, and most people would believe that we probably end the year at somewhat above 1,500 ships, 11 where we haven't been for many years.

Now I'll remind you that so far, the order intake as a result of increased ship contracting has had a limited impact on the order intake for the division so far in the quarter, whereas we expect some effect from this moving into 2022 and perhaps to a degree even in Q4.

With the absence of order intake growth on the new ships, what we do see is a growth in environmental applications, and we also see a strong return of the service business including all of the different service scopes for the Marine industry. At this point in time, we have the ability to do onboard services on the level that we were not able to do with last year. And that, together with increased utilization of their fleet, drives spare parts business and service business alike.

The margins remained stable in the quarter with some positive effects from mix and from the restructuring program, which was largely addressing overcapacities in the division, whereas volume and inflation had a negative impact on the mix. All in all, stable.

Let me finally say that the StormGeo acquisition is, as you know, well completed. The company is operating as a business unit in the Marine division. It's operating well in line with our expectations and well in line with our financial plans, and we feel good and positive about the development opportunities relating to this acquisition going forward.

Then a couple of comments on service overall. In fact, StormGeo is providing an increased share of service revenue in the Marine division and in the company as a whole. The whole development of digital services is ongoing on a broad-based level in the group and the investment that we've done into digital service, remote service and so forth in other parts of our Alfa Laval service portfolio is playing a role in the growth rate we currently see.

We have firm demand across all divisions an element of catch-up, as I mentioned before, but also a positive trend that we have returned to, which should, to some degree, remain stable and continuous in the years to come.

In terms of the growth, it was unusually strong, as I said, in the quarter, we were 21 percent up year-on-year, and we were 12 percent up sequentially to an all-time high number from the service business as a whole. A few comments on the overall order intake take graph.

As you can see, our base business was very strong in Q3. So recognizing we normally have and do have some seasonal negative effects in the Q3 period for our transactional business. The base business development in the quarter was very strong. So we had relatively speaking, a few large order announcement and, relatively speaking, a very strong underlying demand for our transactional business.

Now if you look at the last 2 quarters, quarter 2 and quarter 3, those together are our 2 strongest order intake quarters ever. And I would like you just to take note that our previous peak in late '18, early '19, was strongly supported by a scrubber business.

And if you compare the level of activity from the scrubber business now compared to them, we have compensated the drop of order on an annual run rate level of about SEK 3 billion with driving the mix in other areas of our portfolio to the same level.

So not only is there a pretty good growth rate overall for the group, but it also is a growth that is compensated and adjusted for the mix in the group in a very good level. Those, of course, the volume as such, but also the mix change are

contributing to the fact that we see capacity constraints and the need to continue to invest in our manufacturing system to keep those product groups that are growing aggressively on good footing.

Finally, a couple of questions on – and reflections on geography. When you look at the regional chart, the numbers are really strong, and it's almost difficult to comment. Of course, in some regions, we are comparing with relatively weak year. But all in all, of course, it is super strong numbers. I'd point out that the numbers in Asia, including China, they are, of course, strong as they are.

But if you take into account that the order intake growth in the Marine industry is relatively slow, the underlying growth in both Energy division and Food & Water division in Asia is stronger than it appears on the chart. So with U.S. and China being our 2 biggest markets, 20 percent each, we feel we have good momentum and good support of our core markets in our growth going forward.

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

Jan Allde: Thank you, Tom. And we would – I will jump direct into sales. So we expect the invoice in Q3 to be somewhat higher than the same quarter last year. We realized sales of SEK 10.3 billion, which is 6 percent higher than last year and broadly in line with our expectations. We did see some impact from the supply chain challenges on invoicing in the quarter and we estimate this impact to be approximately EUR 15 million.

With regard to sales in Q4, my outlook is as follows: considering the increased order backlog during 2021, especially in Food & Water and the Energy division, I expect invoicing in Q4 to be somewhat higher than the same quarter last year.

Then looking at our gross margin. So it came in at 37.3 percent in Q3 compared to 36.1 percent, which is an increase of 120 basis points. Excluding the acquisition of StormGeo capital sales service mix was unchanged versus last year. We had a continued good load and capacity utilization bolster our

factory during Q3. We also had a positive impact on the ongoing restructuring program, primarily impacting the Marine division.

As expected, the PPV metals impact was negative in the quarter due to the increased material and freight costs which mainly impacted the Energy division. Most of this impact could be offset by ongoing price increases and material price hedges in place. The FX impact was neutral in the quarter. Finally, the acquisition of StormGeo had a positive impact on the gross profit margin, but was neutral on an EBITDA margin.

Now over to my outlook for Q4. The starting point is 36.6 percent reported in Q4 last year. And we expect a slightly positive capital sales service mix on a comparable basis. We expect a continued good load and capacity utilization of factories but also that the negative PPV methods impact will continue due to the elevated material freight costs. We expect it to be partly offset by price increases and material price hedges. Finally, we expect a slightly positive FX impact on the gross profit margin in Q4.

Then looking at our S&A expenses. So on a comparable basis, S&A was up 10 percent in Q3 and 6 percent year-to-date. This reflects that we are returning to a more normal activity level in the company and that we are comparing with the period where the short-term working programs on last year were in full effect. If we compare to 2019, our S&A expenses are 5 percent lower in Q3 and 6 percent lower year-to-date on a comparable basis, which primarily reflects lower travel spend, and the more digital way of working following the COVID pandemic.

With regards to the restructuring program announced in December of last year, the program is progressing as planned, and we have reduced approximately 400 employees so far, which represents about 2/3 of the total planned employee reduction. As communicated earlier, the final restructuring costs related to this program was booked in Q2 '21 and the savings will primarily impact cost of goods sold.

The – as you have seen, our EBITDA margin came in at 18 percent, up from 17.6 percent last year despite higher overhead costs and elevated materials and

freight costs. This was possible due to a strong operational performance with high load in our factories, active price management, generally lower quality cost as well as a positive impact from the ongoing restructuring program.

Let's comment on some of the other key figures. We talked about sales. We talked about gross profit margin. Then on the S&A and R&D on a comparable basis, S&A, as I said, was up 10 percent and R&D expenses were up 13 percent versus last year.

As we stated earlier, this reflects 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 comparison distortion items, net other cost and income was SEK 61 million lower in Q3. This reduction is primarily related to lower one-off costs incurred last year.

Finance net, excluding FX impact was minus SEK 41 million. The FX gain losses in Q3 was minus SEK 47 million, giving a total finance net of minus SEK 88 million. The main reason for the FX impact in Q3 was revaluation of cash positions in local currencies. Tax rate was at 22 percent in the quarter and also 22 percent year-to-date. And the reason for the lower tax rate is due to the tax incentives and tax refunds in various jurisdictions.

Net income and EPS increased by 18 percent in Q3 versus last year due to the higher operating income and the lower tax rate. Cash flow. Cash flow from operating activities was SEK 1,469 million in Q3 versus SEK 1,256 million last year. The increase was due to higher EBITDA level and lower taxes paid, compensating for the increase in working capital. The increase in working capital was partly due to the volume growth in the quarter and partly due to global supply challenges i.e., some buildup of safety stocks to safeguard our delivery performance.

Investing activities, including CapEx – included CapEx investment of SEK 317 million and totaled SEK 325 million. Financial net paid, excluding FX impact, was minus SEK 90 million in the quarter, same level as last year. Realized FX gains losses in the quarter amounted to negative SEK 56 million, giving a total finance net paid of minus SEK 146 million.

This means our total cash flow in Q3 came in at about SEK 1 billion, up some SEK 136 million versus last year. Please note that we have bought back some 1.5 million of shares in the company during Q3 and a total of 2.7 million shares during 2021. This represents 0.63 percent of total number of offsetting shares at a value of SEK 840 million year-to-date.

Our FX impact on EBITDA in the quarter. So the transaction effect was slightly positive at SEK 20 million and the translation impact was negative SEK 20 million, giving a total net impact of pretty much 0. Looking at the projection for full year 2021, we expect a slight net negative impact of SEK 35 million, driven by negative FX translation impact caused primarily by the stronger Swedish kroner.

Then moving over to the order backlog. So at end of September, the total order backlog was SEK 22.9 billion, which is 18 percent higher than the same time last year and 27 percent higher than the year-end 2020 on a comparable basis. The order backlog now represents close to 7 months of LTM sales. For shipment in the remaining part of '21, the backlog amounted to SEK 8.1 billion, which is 0.4 percent higher than the same time last year.

And that leads me then to the sales bridge. So the year-to-date, our sales has been SEK 29.2 billion. The backlog for delivery as just stated, is – for this year, SEK 8.1 billion, which gives a total of SEK 37.3 billion.

On top of that, of course, you need to make your estimates on change in-for-out orders, FX impact and so forth. For your reference, the level in-for-out orders during Q4 2020 was SEK 3 billion. Secondly, regards to acquisitions, StormGeo had sales of SEK 700 million in 2020. And as the deal was closed on June 1, means that we will have 7 months of sales attributable to Alfa Laval during 2021.

Finally, the expected FX impact is, of course, very uncertain. However, we're using the closing rate end of September, the estimated FX impact on the full year '21 would be approximately negative 4 percent versus 2020.

And by that, I hand back to Tom for the outlook segment.

Tom Erixon: Thank you, Jan. And you've seen the overall outlook statement from us that we all in all, expect an order intake on about the same level as in Q4, we see in general, stable demand picture across industries, as I described earlier.

And our specific outlook for the various division is about the same level for Marine, about the same level for Food & Water and respecting the fact that we hit the real all-time high level on the Energy division, a somewhat lower expectation in Q4 compared to Q3.

And with that, we hand over for questions.

Operator: (Operator Instructions). We now have your first question sir, it's from the line of Max Yates of Credit Suisse.

Max Yates: Just my first question was on the Food & Water division, which has obviously had another very strong performance on the orders. I guess could you maybe help us understand what is really driving the growth here? If there's any sort of specific smaller businesses, which are kind of materially different to how they looked in 2019? So maybe any kind of if there's 2 percent or 3 percent of sales that may have doubled in that time?

And just to understand, are there also – when you look at the pipeline, any areas of that Food & Water business that look a bit peaky in terms of the pipeline of orders? Or do you see kind of no reason why this level of orders is a sort of base? And I mean annual orders is a base that we can't continue to grow off? That would be my first question.

Tom Erixon: Yes, it's a good question. I don't know I have a fantastic answer, but I tried to provide a couple of pieces of the puzzle at least. I think if you look at the situation for the division over a couple of years, you'll find that towards end '19 and '20, we've flattened out a bit.

We have some end markets that weren't too strong. And I think during the pandemic period, we had – while the division was stable overall in order intake, it was service and more importantly, the transactional business that kept pace, whereas CapEx projects slowed considerably.

And so I think what we see in the order intake side right now is partly return to normal and partly CapEx project that perhaps would have booked to a degree a year earlier, that is to a larger degree being booked now in Q2, Q3. So I think there is an element of catch up from delayed projects, and we see that tendency also return to CapEx projects in the Energy division, as I mentioned earlier. So that was 1 part of the puzzle.

The second part is, as you know, that we've spent 4, 5 years of investing in product technology footprint competitiveness, sales force training, and I always told you guys that those investments, they are not really paying off during the period of implementation.

They are operating the basis for growth going forward. And I think we see some effects in strengthening our market position based on a very strong product program and a very tight and well-organized sales and service organization. So I think there is a little bit of our own making in this.

And then the final and third piece of the puzzle is that it's very unusual that we see all our end markets going in a positive direction, and that's actually what is happening right now. And I don't think that necessarily is a 1-quarter effect.

We've seen a return to Benzoin investment that was slow for a period of time. We see a return on the ethanol business after a weak period, specifically in the U.S. We see very strong development in biotech. We see good development on the brewery side despite some of the challenges that the brewery sector has gone through the new proteins are making a dent and the mark.

So I don't see it as an exceptional high level that is unsustainable. But of course, we are aware that in a period where everything is pointing in a good direction, we will face different headwinds in the future. But as I indicate, our outlook short term remains quite positive, and we don't see a dramatic change to the demand situation in a negative way in the short term.

Max Yates:

OK. That's helpful. And maybe just a very quick follow-up. Just moving to margins. I think kind of 1 area where you've continued to surprise positively is on the Food & Water margin. And I guess now thinking about the Energy division where kind of orders are accelerating revenue growth should

accelerate next year. I think kind of when we think about Food & Water, you've talked a lot about sort of improved project execution, sort of high factory loads.

I guess I'm just looking at the Energy division now where the mix coming out of this downturn will be sort of quite different to the past. You've done some work on the cost base.

So I'm just wondering sort of how we should think about sort of where the margins coming out of this downturn in the same way that sort of Food & Water did after there were some improvements made could look, I guess, different to what we had seen different to what we had seen in the run-up to COVID. Could it be quite a different outcome as we come out of this downturn given the cost base and the mix of the business?

Tom Erixon: Well, I'd be cautious to guide you on margin development going forward. But I think your description on Food & Water is correct. And I don't think it's necessarily transferable to the Energy division. We are – and there are some structural changes that you should be aware of in your calculation. And 1 is the fact that we have a lower value add and a higher share of material content in the supply chain on the Energy division.

And so we are a little bit more PPV affected in any division as we already referred to in the Q3 results. So the inflationary pressure is a bit tougher in the Energy division when it comes to the cost side. I leave out for the moment any reflections on pricing and the net-net of all of the effects. But we will have to deal with that in a good way going forward.

I think the other outstanding question for the Energy division is that we are still in a situation with low capacity utilization in what used to be the high profit items in upstream oil and gas.

And I don't expect that to change dramatically or even come back to the 2015 level where it was a big part of the margin story for the Energy division. So what I would say is that with that out of the equation for a number of years,

the division has done a fairly good job in compensating in other areas and growing other businesses in a good way and with a good mix.

And I think I would leave some of the development in the oil and gas side. As I said for some time, the downside, we've already taken on that. We could potentially see some upside utilization and margins in oil and gas recovery, which may be in the last or the second last of the cycles before we see upstream oil and gas disappear as part of the revenue mix of Alfa Laval.

Operator: And we have your next question from the line of Sebastian Kuenne of RBC.

Sebastian Kuenne: Three questions from my side. One is there's a noticeable lack of comments on shortage of components. Many other industrial companies have already released Q3 and everyone speaks of shortage and production disruptions. And in your report, that's kind of missing. Can you maybe elaborate a little bit whether you see short or if you just see inflationary pressure? That would be my first question.

Tom Erixon: Yes. I think to a degree, our situation is from an operational point of view, not dramatically different from a lot of other companies. I think our tonality may be where I think to some degree, we have challenges to handle, and we try to handle it the best we can. And there are always difficulties in supply chain for various reasons.

I think the level of focus on it when it comes to the engineering industry is a little bit too much covered by the situation in the automotive industry and some other industries with high volume items with very complex and broad-based supplier base that needs to be in place in order to deliver a finished product. So I think our situation is somewhat easier. And we've indicated to you last quarter, a delay in shipping of about EUR 10 million. And our expectations is that, that number was possibly around EUR 15 million in Q3, so a slight increase.

But again, it's not unusual that we have deviations, both positives and negatives in shipment levels. So we are trying not to make too much of a big deal about it. We have good understanding of where our delivery position is. We have a good understanding of our lead times to deliver our.

And those KPIs are not exactly where we want them to be, but they are still – they are not in the crisis situation, they are in an intense operational scrutiny level and I must say that still, if I compare the situation to the beginning of 2020 when we were in a complete unknown territory as to integrity of supply chain. The situation today is on a much better level despite the problems and challenges we see.

Sebastian Kuenne: Understood. My second question is on preorders. Again, a lot of company mentioning it and beating expectations by 20 percent, 30 percent in Q3. This did not happen for Alfa. Do you think this is a structural – also a structural difference to other industries that maybe your dealers are not restocking in the same way as you would maybe see for automotive or other engineering companies. Would you confirm that, that there's low restocking and low preorder levels included in your orders.

Tom Erixon: Well, that's the feeling we have. I answer with some respect that we're not doing stock count at the customer. So we feel – but we had the same question up in Q2. And although we didn't share the July numbers with you at that point in time, we didn't have the feeling that after closing the quarter that the July numbers were weakening significantly. There were discussions about ordering before price increases and a number of other things.

So we didn't see any immediate decrease in the activity level as we had closed Q2. So the jury is still out in terms of where we are in Q4 and – but all in all, we – I think – the recovery of the CapEx projects that were delayed during 2020 is a much bigger factor in understanding our order intake than preordering.

Sebastian Kuenne: Understood. My last question is on capacity increases. For some reason, I would have thought it's the heat exchanges where you have the tightest capacity, but it seems that you have there the biggest unused capacity. Can you elaborate a little bit where – what type of products, what type of plant factories you want to – or you need to increase capacity?

Tom Erixon: I'll be a little bit talking about this partly with our competitive reasons. So I'm not too comfortable to go into it. What I can say is a lot of our profitable

growth areas in both Energy and Food & Water is and they should be at – as they continue to grow on capacity limits. And as I said, we are in many areas well ahead of 2019 levels. So it's not just recapture of lost ground last year. It is a structural long-term growth trend that we see.

And I think more importantly, the announcement that we made was, I guess, also to a degree a need for us to come clear in terms of how you see the structural demand growth in the years to come. And we feel we are well positioned in a lot of our existing profitable businesses and will continue to invest and drive growth in those as we go forward. And we hope we'll on some good level, and share some clarity on our thinking around that at the Capital Markets Day in end November.

Sebastian Kuenne: Yes. But there's big unclarity at the moment or confused. In heat exchanges, are you nearing the capacity? Or do you have a lot of spare capacities there? I'm a bit confused.

Tom Erixon: Be it our world and our supply chain is much more complex than that. Unfortunately, heat exchange is not a heat exchanger. And consequently, there are areas of heat exchanges that have been widely driven by, let's say, the upstream oil and gas and to the degree the refinery sector where we have a different capacity utilization than in the areas related to energy efficiency solutions in other parts.

So it's a much worth more and more. The answer is it depends in which area you look and consequently, that takes us into a level of detail that I stay away from, but it's – there are any answers to your questions, even as we stay in the heat exchanger and Energy.

Operator: Your next question comes from the line of Andrew Wilson of JPMorgan.

Andrew Wilson: I just wanted to start with the increased investment, which you've described this morning in Alfa Laval this one, I should say. Is it fair to assume that we're going to see that spend across the 3 divisions? Or would you sort of steer us in terms of it being particularly targeted on 1 or 2 divisions specifically?

Tom Erixon: Yes. As we said in the report, we will provide more details at the Capital Markets Day. So I hope you can bear with us and then we have something to talk to you in more detail at that point.

Andrew Wilson: No, understood. I can be questioned. Maybe switching across to Food & Water. I thought I was interested in your comments around what's obviously been a lot of work of a large number of years in terms of position in that business. And you can kind of see that obviously going through in the outperformance.

I guess I'm interested if you're sort of where you stand now, if you're seeing similar activities being undertaken by your competitors or whether you think you've been able to sort of drive a sustainable gap in terms of competitive position in some of these attractive markets that you've talked about in Food & Water.

Tom Erixon: Yes. I can't comment my competitors in any detail. But of course, I always say the job we are doing and have to do is to stay upfront. And it doesn't end and we are not done by end of. I guess we signal a certain shift because we have things in the plan now that is different from 5 years ago, but it is a daily – our job to stay competitive in the market where we have all kinds of – as you know, all kinds of competitors. So yes, it's a battle, and it will remain so.

Andrew Wilson: OK. And then the third 1 was possibly just a clarification question just on the S&A and the helpful kind of detail you've given in terms of development, both against 2020, but perhaps more interestingly against 2019. I think that you're still running a little bit below 2019 levels. I was wondering, I know there's been various sort of cost programs been going on as well.

But how should we think about where those S&A costs eventually get to? Should we expect them being back at sort of 2019 levels? Or do you think there are some sustainable savings? I know you mentioned travel is 1 of the areas which is still to come back. But just trying to get a sense of sort of where S&A potentially gets to versus that 2019 level?

Tom Erixon: It's – Jan do you want to take it.

Jan Allde: Well, as I said, we are running now here in 2021, around 5 percent to 6 percent below the level of 2019. And that's primarily, as you correctly said, on the traveling side. And that I think it's a little bit too early to say, but this will land, but certainly, there are some productivity improvements in the way we work now more digitally, both in terms of – towards the customers, on sales, on the service side and so forth. Will we see that difference continue?

At the time partly, yes, but we are running the company now at the high activity level, and we see the strong market that we have. We will continue to invest in sales activities and so forth. So – but there is a product – underlying productivity development. And we will have to, I think, mention and see how that the size of that as we continue here. So I can't give you a number, but certainly, there is some underlying productivity improvement.

Andrew Wilson: That makes sense. Appreciate the commentary around it.

Operator: Your next question comes from the line of Karl Bokvist of ABG Sundal Collier.

Karl Bokvist: Yes. I'm just a bit interested in the HVAC side. In the Energy business here, you mentioned a couple of end markets here, such as heat pumps, refrigeration, data centers. Just to understand, I think it's quite clear the way we can read about it at least that heat pump demand is accelerating in many parts of the world. But just a bit curious on the refrigeration side and standard air conditioning and also if you feel that the data center business is currently in a significant CapEx program that will level off in a year or 2?

Tom Erixon: No, we don't feel that there is a leveling off in these end markets in a year or 2. We think there is a structural growth period that will continue in air conditioning alone. It's not only related to the efficiency side. It's also related to the environmental impact of refrigerants and so it's becoming more demanding applications there in the years to come.

The data center side, I think, is there to stay in terms of growth, and it may be that part of the installed base was not optimized from the very beginning. So I think it is a sector which we still expect to be supportive of our growth journey in certainly in the longer period than a few years.

Karl Bokvist: All right. And my second question relates to Ballast, if you could just give us an update on what you feel about the orders, maybe some insight into Ballast as a share of your environmental portfolio this quarter, but mostly in terms of just what you feel – what you received kind of indications from customers given the deadline that is approaching and when you feel – if you still believe that the kind of peak in Ballast will come 2 years prior to the deadline?

Tom Erixon: Yes. If we cover that question, as I indicated in my earlier comments a little bit, a few years back. When we peaked on the retrofit implementation of scrubbers and PureBallast, we were at the level of almost SEK 6 billion in running rate SEK 4 billion in scrubbers, SEK 2 billion in Ballast. Now the implementation schedule for PureBallast has always been more predictable because it was a 5-year implementation plan.

So we've been on and that around the level of SEK 2 billion running rate in PureBallast and we still are, whereas the scrubbers side went up, then it went to almost 0 and now it's running maybe at some level of around SEK 1 billion or so. So that is our environmental running rates.

The PureBallast will go into its last year of the scheduled 5-year implementation cycle next year. And so – and after that, I think the – we may have some delays due to repair yards capacities and difficulties to get the job done, related to the pandemic last year. But all in all, next year is the last year and we expect to see a major impact from the retrofit program.

Operator: And we have 1 more question. It's a follow-up question from Sebastian Kuenne of RBC.

Sebastian Kuenne: A follow-up on the price and cost matching or the passing on of cost, new prices. And you have a component business, no project business. So would you confirm that you can pass on cost increases for alloys and so on within weeks, within a month, within a quarter, how quickly does that happen for the price list? And how willing are customers accepting those prices?

Tom Erixon: Well, I will not confirm you of us as a component supplier. We have a significant engineering and project activity, and we have long order books,

especially in the Marine. So we – all in all, I think our order book stands at about 6 months full delivery pace, but of course, that is not full delivery in the next 6 months.

Part of that order book is for all of 2022, and part of it moves into 2023. So it is a more complex analysis and reflection to do when it comes to orders and higher priced than what would the actual cost base be on those as we move into next year.

Then – but what I guess you could say is that over a cycle, over a pricing cycle, we will meet some headwinds or meeting some headwinds on cost increases versus the price increases that are happening in the market when raw material prices goes up, then the opposite will happen when the raw material prices go down, that is we mean create a bigger positive deviation on our book versus post cap.

So that's just the way it is. We are in that process at the moment. You see it to a degree in the Energy division already and is visible to some degree in the Marine division already. So that's what it is.

Of course, we are working with pricing. It's not as easy to say that it has an appeal, we don't sell most of our products that's cost plus. We don't sell material and add a little bit of margin on it. We sell a value-added solution to customers. And so while, of course, we need to make sure that we stay on top of our overall cost base and our pricing strategies than we are. Our pricing is not solely determined by how we feel about the raw material prices.

Sebastian Kuenne: Maybe I have to specify them. For the products you sell to the dealerships, how quickly can you pass on the cost increases? And then for the long-running orders and projects, do you have price clauses or cost clauses baked into these contracts where you can basically change the pricing in those 6 months that you have to have time to deliver?

Tom Erixon: I understand your objective with cost – with your questions, but I'm not willing to meet you in the details on how we run the numbers. I'll just stay with the fact that, of course, we're doing price adjustments as we go.

And of course, we have projects that are outstanding where we have a commitment and we will deliver on that and that includes a fixed price and a fixed delivery date and it doesn't take into account any shortage on material, any price increases or whatever. That's part of our business responsibility to our customers, and we think it fully – you see some effects of that already, and you can expect that there are some effects going forward on that.

Operator: We have 1 more question sir, it's from the line of Klas Bergelind of Citi Research.

Klas Bergelind: Yes. Thank you. Tom and Jan, it's Klas at Citi. So first, on the greener opportunities. I was just wondering, Tom, what you can comment on the potential size in the division in Food & Water. I think you have alluded before that this could be a USD 500 million business in a couple of years.

You've also said that you're more confident in your growth targets than before. So things are obviously looking quite positive. But it would be interesting to hear about current size of heat pumps, biodiesel, carbon capture, hydrogen and so forth. So we can bridge the upside a little bit.

Tom Erixon: Yes, let me say that I think it's a broad-based question. It's difficult. And this will – for everybody is not the last question we take. We are on schedule that forces us to finish here a few minutes before the hour. But of course, our commitment when it comes to our investment plan and our belief that we are well positioned into the growth drivers of the energy transition and the green economy is – I mean that is clear.

We will spend some time at the Capital Markets Day and given our view on the impact of hydrogen and the impact of other environmental trends and energy system changes that it has on us. But it's clear that if society goes through with the rebuilding on our global energy system over the next 10, 20 years, it is clearly adding a structural growth element to Alfa Laval that wasn't there historically.

And I think I communicated to you during a number of years that the question of our oil and gas exposure shouldn't be overemphasized from the point of view that it's reasonable to believe that over time, we will see a gradual

decrease of that as the CapEx spending is going towards the 0, perhaps in the 2030 perspective, but compared to the growth opportunities we see in the green economy those are substantially more important to us than residual exposure in the oil and gas sector.

So that gives you sort of some weighing of the factors, but I leave I think a big question to the Capital Markets Day where we will have the divisional presidents having an opportunity to give a little bit more respect I would not have a full Capital Markets Day. We do digital to our thing, but it will still be a little bit of opportunity to shed some light in terms of how we gain the opportunities.

Klas Bergelind: It sounds good. I'm aware, but I think some people out there still think that Alfa Laval is just in oil and gas and Marine stocks. So it's good to do that.

Tom Erixon: Thank you so much we discussed the Food & Water business today. It's a wonderful day for us here at the management team. We'll argue that from time and now we are here.

Klas Bergelind: A very quick final follow-up. On the investment side, you're obviously ramping CapEx, and I think that, that was expected out there in the market, given the growth opportunities. Am I right to assume, Tom, that you don't have to invest much more in R&D given that you're already market leading in the heat exchangers and most of your flow technologies. So these new growth opportunities is more a CapEx increase rather than R&D run, I'll finish there?

Tom Erixon: Yes, that's correct. And we take that as a last question. We haven't redone our targets and guidance when it comes to the R&D. We are at a higher level than we were as we grow in revenue even with the same percentage of investments into R&D, we will still have some headways. So that's not someone to change our guidance at this point in time, whereas the CapEx clearly is.

And as a final note on that, I may just say that, of course, we haven't committed SEK 8 billion over 3 years in 1 go decision. We will, of course, monitor the development in all areas and take those sequentially as needed in the time that we need to do it.

But that we will see an acceleration in terms of our CapEx decisions in this year and then during next year for execution next year and beyond, that is already clear. So – but of course, we will make those decisions stepwise to the best of our ability as we go forward.

With that, thank you very much, everybody, and I hope that you all will dial in on our Capital Markets Day in November, we decided to do it digitally after a lot of consideration. We will reflect on whether that is the solution for the future or whether we will have the opportunity to come physically together in 2022. So thank you very much.

Operator: Thank you very much. That does conclude our conference for today. Thank you for participating. You may all disconnect. And speakers, please stand by.

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